87951

East Asia Pacific At Work

Employment, Enterprise, and Well-being

WORLD BANK EAST ASIA AND PACIFIC REGIONAL REPORT

THE WORLD BANK

East Asia Pacific At Work

WORLD BANK EAST ASIA AND PACIFIC REGIONAL REPORTS

Known for their economic success and dynamism, countries in the East Asia and Pacific region must tackle an increasingly complex set of challenges to continue on a path of sustainable development. Learning from others within the region and beyond can help identify what works, what doesn't, and why, in the search for practical solutions to these challenges. This regional flagship series presents analyses of issues relevant to the region, drawing on the global knowledge and experience of the World Bank and its partners. The series aims to inform public discussion, policy formulation, and development practitioners' actions to turn challenges into opportunities.

TITLES IN THE SERIES

East Asia Pacific At Work: Employment, Enterprise, and Well-being

Toward Gender Equality in East Asia and the Pacific: A Companion to the World Development Report

Putting Higher Education to Work: Skills and Research for Growth in East Asia

All books in this series are available for free at https://openknowledge.worldbank.org/handle/10986/2147

World Bank East Asia and Pacific Regional Report

East Asia Pacific At Work

Employment, Enterprise, and Well-being

Truman G. Packard
Trang Van Nguyen

THE WORLD BANK
Washington, D.C.

1 2 3 4 17 16 15 14

ISBN (paper): 978-1-4648-0004-7
ISBN (electronic): 978-1-4648-0005-4
DOI: 10.1596/978-1-4648-0004-7

Cover image: Bill Pragluski of Critical Stages
Cover design: Critical Stages

Library of Congress Cataloging-in-Publication Data has been applied for

Contents

Boxes

Figures

Tables

Foreword

There is no better way to lift people out of poverty than productive employment. For the majority of people, skills and the ability to work are their most valuable assets. In the past two decades, the East Asia Pacific region has brought people out of poverty and to middle-class status faster than any other region at any other time. From 1990 to 2011, the region's share of global economic output rose from 6.7 percent to 17.4 percent, and the share of people in extreme poverty dropped from 56 percent of the population to 12.5 percent.

East Asia Pacific At Work offers a systematic review of the employment landscape in the East Asia Pacific region. Many countries in East Asia Pacific enjoy a favorable environment for growth and employment creation: Price stability, low public debt, low taxation, and increased integration in the world economy have expanded job opportunities, while widespread access to basic health and education has nurtured the human capital people need to find work. These strong fundamentals have paid off: Labor force participation is high, and labor productivity rose faster than in other regions in the past two decades. Rising earnings from work were the main driver of poverty reduction in countries across the region. The strong fundamentals also helped many countries sustain high growth rates and protect jobs during the recent global financial crisis.

But challenges remain. Economic growth in the region is moderating. Labor's share of gross national output has declined in some countries. Further productivity gains have been handicapped by shortages in basic skills in Cambodia, Lao PDR, and several Pacific island countries, as well as gaps in advanced skills across the region's labor force. Inequality rose in countries such as Indonesia and Lao PDR. Some countries face high youth unemployment rates. Across the region, more than 30 percent of people ages 15–24 are not employed or receiving education or training. Meanwhile, a still pervasive informal economy constrains countries' productive potential and hurts household welfare.

To keep the region on the right track, this report recommends that countries look beyond the labor market and further improve the fundamentals. Clearly the region is not uniform, and specific policies will vary across countries. But some general conclusions can be drawn. Drawing on an extensive review of empirical evidence, the report observes that the most important policies are those that ensure price stability, encourage investment and innovation, and support a regulatory framework that enables small and medium-size enterprises, which employ most people in the region.

Further, governments should pay close attention to how labor policies affect workers on the ground. For example, several countries have established employment protection regulations on par with the southern European countries, which force many people into informal employment. In addition, labor regulation and social protection should not favor any particular sector, location, or profession. And finally, modest, noncontributory unemployment benefits financed by general revenues, for example, could help employers avoid costly severance schemes, lower labor taxes, and encourage businesses to become formal.

The recommendations proposed should appeal to policy makers, as many countries are formalizing their labor markets, and workers in the region are becoming more demanding. I hope this report will contribute to the debate on employment strategies and provide them with policy options that will boost productivity and people's living conditions.

Axel van Trotsenburg
Regional Vice President
East Asia Pacific Region
The World Bank

Acknowledgments

This report was prepared by a team drawn from the Poverty Reduction and Economic Management, Human Development, and Finance and Private Sector Development departments of the World Bank's East Asia Pacific Regional Office. The team was led by Truman Packard and Trang Van Nguyen and comprised Melissa Adelman, Thomas Bowen, Ximena del Carpio, Jennifer Golan, Tobias Haque, Alexander Krauss, and Ahmed Rostom. Mee Jung Kim, David Knight, Nataliya Mylenko, and Laura Pabon provided substantive inputs. Background papers for the report were written by Reena Badiani, Ximena del Carpio, Reno Dewina, Jennifer Golan, Marek Hanusch, Darian Naidoo, Laura Pabon, Maria-Antonia Remeyni, and Trang Van Nguyen. Mildred Gonsalvez, Sarah Harrison, and Kris Mcdonall provided invaluable research and production support.

The work was conducted under the guidance of Bert Hofman, Sudhir Shetty, and Xiaoqing Yu. The team is grateful for their ongoing support as well as for guidance provided by other members of the Bank's East Asia Pacific regional management, including Jehan Arulpragasam, Shubham Chaudhuri, and Philip O'Keefe.

We are thankful to our peer reviewers—Omar Arias, Martin Rama, and Carolina Sanchez-Paramo—for their detailed comments on early drafts and for their advice. The team benefited tremendously from extensive consultations with World Bank staff held in Bangkok in May 2012 and March 2013. Participants at these consultations included Vivi Alatas, Christian Bodewig, Karl Kendrick Tiu Chua, Gabriel Demombynes, Iene Muliati, Yuko Okamura, Cristobal Ridao-Cano, Frederico Gil Sanders, Lars Sondergaard, Rogier Van Den Brink, and Dewen Wang. During the preparation of the report, the team also received insightful comments and extensive technical advice from Ahmad Ahsan, Rita Almeida, Rosa Alonso, Xiaoyan Liang, Kevin Macdonald, Andrew Mason, Philip O'Keefe, Vivek Suri, Prateek Tandon, and Ekaterina Vostroknutova. Jesse Doyle and Stephen Howes provided extensive comments on the sections of the report covering the Pacific island countries. The World Bank team managing the International Income and Distribution Database (I2D2), Kathleen Beegle and Claudio Montenegro, provided critical access to data and support throughout the development of the report. Denise Bergeron, Susan Graham, and Patricia Katayama from the Publishing and Knowledge division of External and Corporate Relations provided valuable support in the design and publication of the report.

The team also gained from feedback on preliminary findings and messages through presentations at the Asian Development Bank's International Skills Forum in Manila in December 2012; the Employment-Centered Development Strategies Senior Policy Forum in Seoul in March 2013; the International Labour Organization's Experts Meeting on the challenges and opportunities for ASEAN employers in Bali in November 2013; the Club de Madrid Annual Conference Jobs for Inclusive Growth: A Call to the G-20 held at Coolum Beach in December 2013; the public discussion forum "Improving Well-Being for All" at the Center for Strategic and International Studies in Jakarta; and discussions with the International Labour Organization subregional office for East Asia and the Pacific in Bangkok in January 2014.

About the Authors

Truman Packard is a lead economist and sector coordinator for the World Bank's Human Development Program in the Pacific Islands, Papua New Guinea, and Timor-Leste. He co-led the report team. His work has focused primarily on the impact of social insurance—including pensions, unemployment insurance, disability benefits, and financial protection from adverse health events—on household labor supply decisions, saving behavior, and risk management. Since 1997 he has been a part of World Bank teams providing financial and analytical assistance to governments seeking to improve the coverage and efficiency of education, health, and social protection systems in Latin America and the Caribbean, in East Asia, and from 2006 to 2011 in Central and Eastern Europe. He also served as deputy director of the *World Development Report 2009: Reshaping Economic Geography* and is a member of the World Bank's Safety Nets Global Expert Team. He holds a PhD in economics from the University of Oxford.

Trang Van Nguyen is a senior economist in the Poverty Reduction and Equity Team in the East Asia and Pacific Regional Office of the World Bank. She co-led the report team. Her work focuses on the areas of poverty and inequality, labor, social protection, education, health, and gender and development. She is one of the lead authors of this report and is co-author of other World Bank regional publications, including on gender and migration. She holds a PhD in economics from the Massachusetts Institute of Technology.

Melissa Adelman is an economist in the Poverty Reduction and Economic Management Unit of the East Asia and Pacific Regional Office of the World Bank. She was lead author of chapter 5 of the report on human capital. Her work focuses on the analysis of poverty and its causes at the regional level and in the Pacific island countries. She earned her PhD in economics from Harvard University.

Thomas Bowen is a consultant in the East Asia and Pacific Human Development Department, focusing primarily on social protection and labor, poverty, and vulnerability. He was lead author of chapter 7 of the report, which identifies country-specific priority employment challenges. He was formerly a research analyst for the *World Development Report 2013: Jobs*. He holds an MA in international relations and economics from the Johns Hopkins University, School of Advanced International Studies.

Ximena del Carpio is a senior economist in the Human Development Department of the East Asia and Pacific Regional Office of the World Bank. She led the stock-taking of labor market institutions, regulations, and interventions in chapter 6. She has designed and led analytical and advisory assistance on social protection and labor issues in Latin America and the Caribbean and in East Asia Pacific countries, including recent reports on minimum wage policies in ASEAN countries and policy reports on minimum wages, migration, and skills in Malaysia. She holds a PhD in economics from the University of Southern California.

Jennifer Golan was an economist in the Poverty Reduction and Equity Team in the East Asia and Pacific Regional Office of the World Bank before recently becoming a lecturer in development economics at the University of Manchester. She led the analysis of employment and development transformations in chapter 3. Her work at the World Bank involved the analysis of microdata for the East Asia Pacific regional poverty monitoring system as well as analytical tasks related to gender and social protection. She holds a PhD in economics from the University of Manchester.

Tobias Haque is an economist in the Pacific Islands Country Management Unit of the World Bank and part of the Poverty Reduction and Economic Management Team. He wrote chapter 8 on the Pacific island countries. Based in Suva, Fiji, he works with governments across the Pacific advising on economic policy and public financial management reforms. He holds an MA in political economy from the University of Auckland.

Mee Jung Kim is an analyst in international economics and international relations in the Finance and Private Sector Development Department of the East Asia Pacific Regional Office of the World Bank. She provided analytical input on the demand for labor and human capital from the private sector, used throughout the report. She works mainly on monitoring financial sectors in countries of the East Asia Pacific region, covering a wide area of topics dealing with financial access and financial sector reform. She holds an MA from the Johns Hopkins University, School of Advanced International Studies.

Alexander Krauss is an economist and social scientist working in the Poverty Reduction and Economic Management Unit for the East Asia Pacific Regional Office of the World Bank. He wrote chapter 4 on policy fundamentals as well as the comparative analysis of labor unions in East Asia Pacific and other regions in chapter 6. He has spent the last seven years conducting analytical and policy work related to labor markets, human development, social safety nets, and poverty and social impact analysis. He holds a PhD in development economics from the University of Leipzig.

Ahmed Rostom is a financial sector specialist in the Finance and Private Sector Development Department of the East Asia Pacific Regional Office of the World Bank. He led the analysis of demand for labor and human capital from the private sector that features throughout the report. His duties included conducting analysis, post-implementation monitoring, and evaluation for financial sector projects as well as monitoring and surveillance of macrofinance trends and developments in the region. He also worked with the team on devising programs related to developing regulatory frameworks and reforming financial systems in the region. He holds a MS in economics from Cairo University and a MS in economics and social policy analysis from the University of York; he is in the final stages of his PhD in economics at George Washington University in the fields of quantitative economics, international trade, and finance.

Executive Summary

The contribution of work to growth and household well-being is a growing concern in East Asia Pacific. The labor share of gross domestic product (GDP) in several countries in the region has been declining. Specific problems include high youth inactivity and unemployment, rising inequality, and binding skills shortages. A key underlying issue is widespread economic informality, which increases household vulnerability to shocks, limits the tax base, and constrains innovation and the productivity of firms and the economy as a whole. Informality is both a consequence of relatively stringent labor regulations and a reason for their widespread evasion. Key components of the appropriate policy response include macroeconomic stability and a regulatory framework that encourages, in particular, the growth of small and medium enterprises where most people in East Asia Pacific work. It is also critical to "formalize" more work, in order to increase the coverage of essential work-risk and social protection and to sustain growth. To this end, policies should encourage mobility of labor and human capital and not favor some forms of employment (for instance, full-time wage employment in manufacturing) over others. East Asia Pacific is one of the most diverse regions in the world. The challenges to sustaining well-being from work are just as diverse. Countries that are still mainly agrarian should focus on raising agricultural productivity. Rapidly urbanizing countries should address the critical need for good urban planning. The Pacific island countries should provide young people with the human capital they need to succeed abroad as migrant workers.

The triumph of work for well-being

Economic development in East Asia Pacific is a triumph of working people. The region has experienced industrialization, urbanization, and economic diversification at historically unprecedented rates. In the last two decades, rapid changes boosted agricultural output and triggered large movements of people to towns and cities and into work in factories and firms, raising factor productivity in most of the region. The concentration of working people and enterprises boosted output in fast-growing cities. Countries that were low income a generation ago successfully integrated into the global value chain, exploiting their labor cost advantage.

In 1990, the region held about one-third of the world's labor force. Leveraging this comparative advantage, developing East Asia Pacific countries' share of global GDP grew from 7 percent during 1990–92 to 17 percent during 2009–11.

Sound policies and good economic institutions have encouraged private sector–led growth, stimulated demand for work, and enhanced resilience. Price stability, low public debt, and relatively light taxation in many parts of the region encouraged business and investment. Widespread access to adequate health and education ensured a strong foundation of human capital. Given these strong fundamentals and increasing integration with the global economy, East Asia Pacific was able to sustain high growth rates and maintain its resilience during the global financial crisis of 2008–10. Some East Asia Pacific countries continued to generate employment in 2009 and 2010, in contrast to the job losses experienced by most countries in Central and Eastern Europe and to the muted employment growth in other developing regions.

Sustained high rates of economic growth have been necessary, though not sufficient, to ensure well-being from work. Growth has improved employment outcomes, fueled gains in living standards, and mitigated social tensions. The rise in labor productivity in East Asia Pacific during the 1990s and 2000s was far greater than in Latin America, Eastern Europe, and the countries of the Organisation for Economic Co-operation and Development (OECD). China's threefold and Vietnam's almost twofold growth in labor productivity since 2000 are particularly impressive. Households reaped the benefits of greater productivity in higher earnings: rising labor income accounted for more than 40 percent of poverty reduction in the late 2000s in several East Asia Pacific countries (figure 1). The share of the region's population living in extreme poverty (that is, on less than US$1.25 a day) declined by more than half since 1990, from the highest level across all regions to among the lowest. Working people experienced stark changes in their lives within a generation, as work shifted from rural farms to urban factories, village institutions and community property rights broke down, and extended family structures weakened. But these changes neither created significant political debate nor catalyzed social tension because so many people were moving out of poverty and into the urban middle class, against a backdrop of fast growth. In that sense, as argued in the *World Development Report 2013: Jobs* (hereafter referred to as WDR 2013; World Bank 2012), work has been the conduit connecting and enabling three critical development transformations: *productivity gains*, *improvements in living standards*, and *greater social cohesion*—which are collectively referred to here as advances in "well-being." For much of their recent history, East Asia Pacific countries have managed to achieve these three development transformations in tandem.

Rising challenges to well-being from work

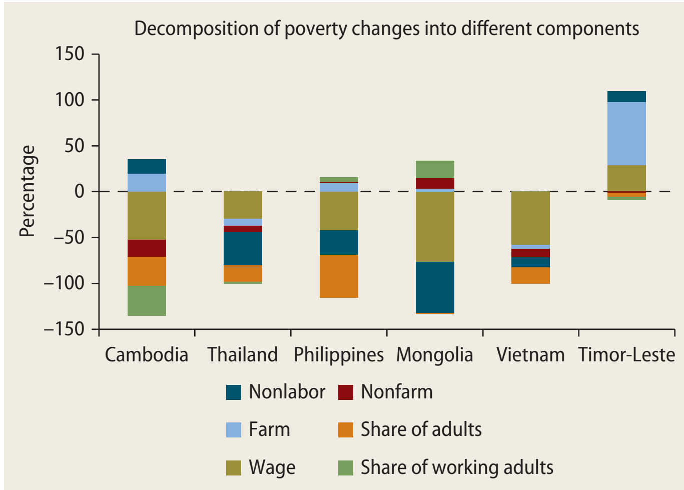
Against the backdrop of these impressive gains, the share of wages in GDP has declined in many East Asia Pacific countries, and expectations and aspirations of working people are shifting. In the last few years, the news headlines have started to change. Among the usual articles about growth, productivity, and poverty reduction are stories of a very different character. Since 2009, reports of discontent among Chinese factory workers protesting poor working conditions have become more frequent. There have been growing instances of strikes in Indonesia, a twofold increase of "wildcat" strikes in Vietnam during 2011, and frequent clashes between garment factory workers and police in Cambodia. These reports seem at odds with the widely accepted narrative of the region's rise, and they signal rising demand for government action to sustain household and social well-being from work.

Widespread economic *informality*—work and other transactions in unregulated and untaxed markets—is critical to understanding the growing concerns about work and well-being, despite the region's successes.

The exact dimensions of the informal economy are difficult to measure, because only proxies are available. As a region, East Asia Pacific has the second-highest share of the labor force working outside of wage and salaried employment, surpassed only by countries in Sub-Saharan Africa. A large portion of this activity in agrarian countries like the Lao People's Democratic Republic, Cambodia, and Papua New Guinea reflects "structural informality," since many people still work in subsistence or small-shareholder farming. This type of informal work typically decreases with structural changes that reduce employment in agriculture. However, in all middle-income countries, even those with large manufacturing and services sectors, a persistent share of the labor force continues to work beyond the reach of taxation, regulation, and protection. This informal work (whether measured as nonfarm self-employment, people working without a labor contract, people working in microenterprises with five or fewer workers, or the segment of the workforce that fails to contribute to social insurance) is higher in many East Asia Pacific countries than in other countries at similar income levels (figure 2).

High levels of informal work in East Asia Pacific are not harmful per se, but they may have undesirable side effects. The informal economy provides a living to many who would otherwise be destitute. And, across the region, many informal workers and enterprises are well integrated into domestic, regional, and international production chains. Often, the output of the informal economy is either consumed by formal sector factories and firms as an intermediate input or is consumed by people who themselves work in or provide services to the formal economy. The problem arises when the prevalence of informal economic activity constrains innovation and productivity, when the tax base is so small that governments find it difficult to provide public goods and services, and when working informally limits households' options for managing shocks to their well-being or makes it more difficult for them to seize opportunities.

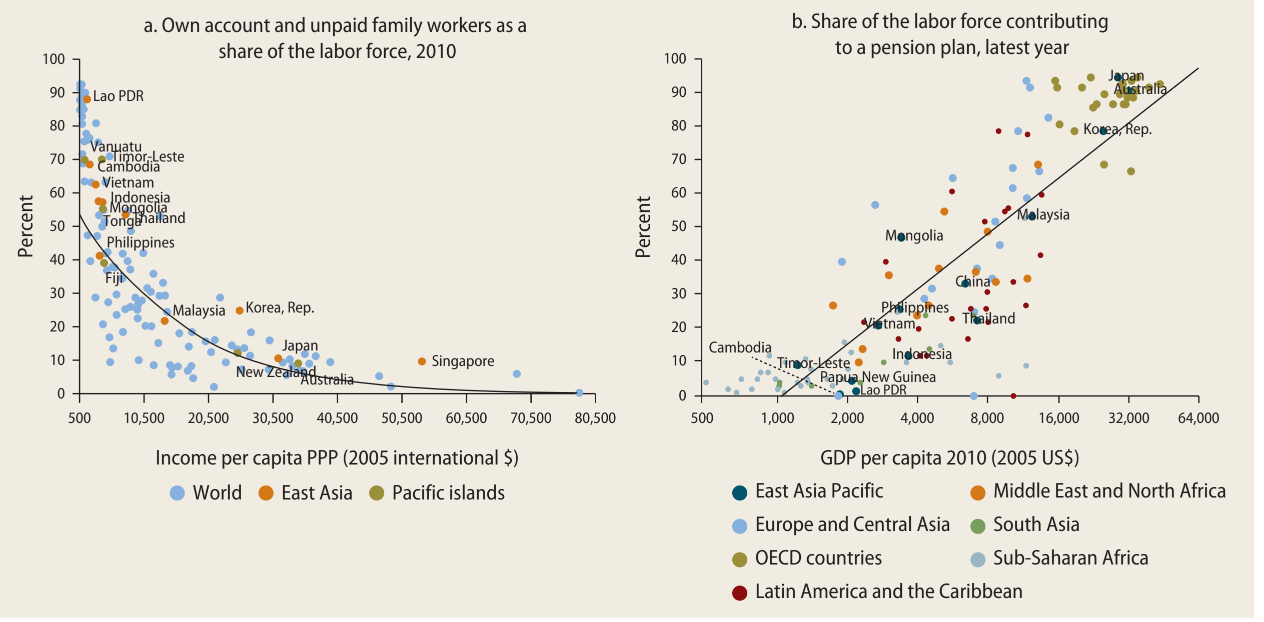
FIGURE 1 Income from work explains a large share of the reduction in poverty



Sources: Estimates based on the Cambodia Socio-Economic Survey (2007, 2010); Thailand Household Socio-Economic Survey (2006, 2009); Philippines Family Income and Expenditure Survey (2006, 2009); Vietnam Living Standards Measurement Survey (2004, 2010); Mongolia Household Socio-Economic Survey (2007/08, 2011); and Timor-Leste Survey of Living Standards (2001, 2007).

The high levels of informal work in East Asia Pacific are both a consequence of relatively stringent labor and social protection policies and a reason for their widespread evasion. Overall, the history of state intervention in labor and social protection policy in East Asia Pacific is modest relative to that of countries in other regions. Governments started regulating their labor market much later in East Asia Pacific than in Latin America and Central and Eastern Europe and provide fewer social programs. But several governments in emerging East Asia have recently stepped into this arena of policy making with levels of intervention similar to those found in Southern European countries (figure 3). For instance, formal employment protection legislation is highly restrictive in Indonesia, where workers whose employment is regulated enjoy more protection than workers in France, Greece, or Portugal, and only slightly less protection than workers in Spain. In China, workers in regulated employment are more difficult to dismiss than workers in Belgium and Italy. In the Philippines, as a result of labor regulation, the average statutory minimum wage, relative to the value

FIGURE 2 Informal forms of work are more common in East Asia Pacific than in other countries at similar levels of development



Sources: World Bank Pensions Database (2013) and World Development Indicators.
Note: PPP = purchasing power parity.

added per worker, exceeds the level in 90 percent of countries in the world.[1] Cambodia and Indonesia are not far behind.

Even labor regulations set at reasonable levels but poorly implemented can aggravate the market failures they were designed to overcome. Evidence is mixed on the impact of minimum wages and employment protection legislation on employment outcomes across countries. Set at reasonable levels, these regulations have been found to have a negligible impact in countries with strong institutions and higher administrative capacity. However, even where labor regulations have a limited impact on overall employment, unemployment, and wages, they have distributional consequences that favor prime-age men in full-time dependent, salaried employment at the expense of women, young people, and people in part-time work and self-employment. For instance, minimum wages in the Association of Southeast Asian Nations (ASEAN) member countries disproportionally reduce the employment opportunities of low-skilled people, women, youth, and recent entrants into the labor market.

The prejudicial impact of labor regulation on the forms of work that are prevalent in most East Asia Pacific countries is a growing problem that creates both segmentation and exclusion. The extent of informal activity is positively associated with levels of employment protection and labor taxation. In China, the 2008 Labor Contract Law attempted to expand social insurance coverage, financing it through increased payroll taxes. This was associated with a lower probability of local employed residents' being protected (Giles, Wang, and Park 2013).

Louder and more frequent calls for action

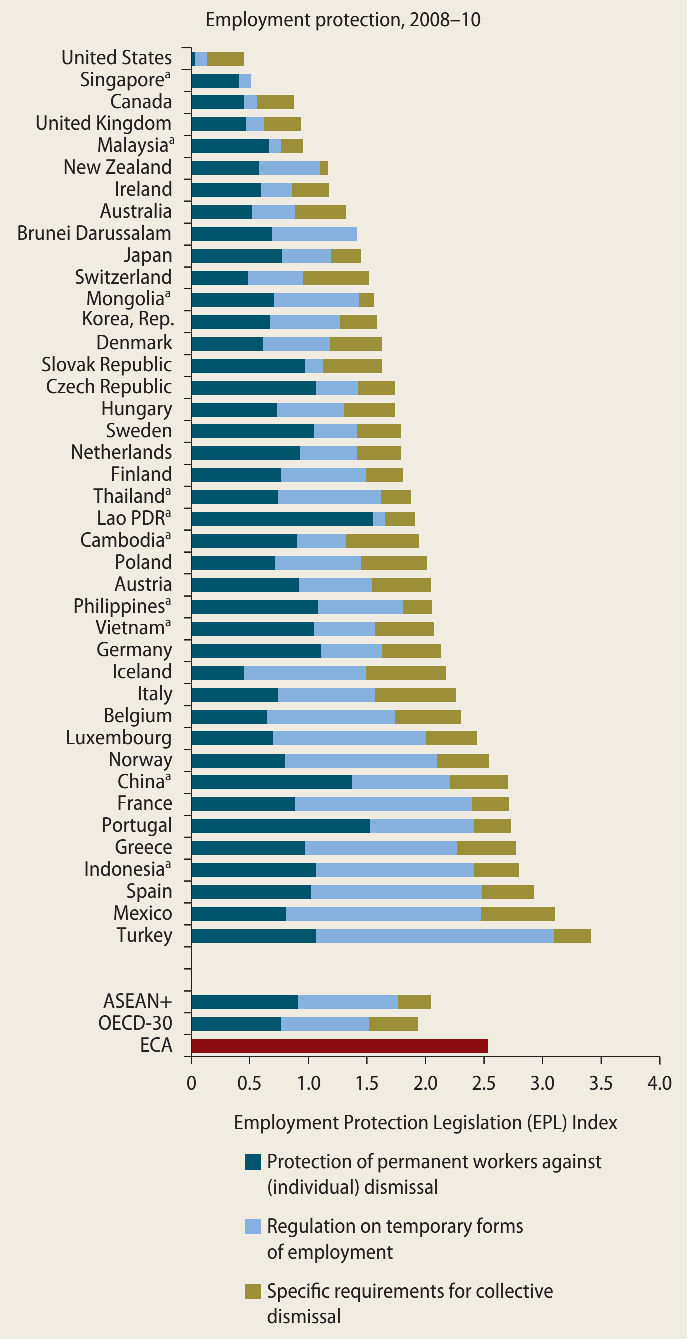
Questions about the links between work and well-being have begun to surface in East Asia Pacific with greater frequency and urgency. This is to be expected since most East Asia Pacific countries, including the most populous (China and Indonesia), are now at a development stage where the three transformations propelled by work (gains in productivity, living standards, and social cohesion) are no longer happening at similar rates. Some countries experience direct threats to social cohesion, specifically from high youth unemployment and inactivity, as well as high and rising income and consumption inequality.

For the region as a whole, more than 30 percent of people ages 15–24 are not in employment, education, or training. Fiji, Indonesia, the Philippines, Tuvalu, and Vanuatu have among the highest rates of youth inactivity in the world (figure 4). High levels of youth inactivity have been linked to violence and eroding social cohesion, providing a strong motivation for governments to pay closer attention to the opportunities for youth to work or build human capital. Even where violence is not yet a concern, high rates of disengagement among youth can have a lasting impact on their future economic prospects and ultimately limit the productive potential of a country as a whole.

While the region's economic success has been accompanied by gains in average living standards, growing skill premiums have led to rising inequality—for instance, in China, Indonesia, and Lao PDR.[2] Rising skill premiums in many parts of the region raise concerns among policy makers about widening income disparities and the risk of social polarization.

But the threats to well-being from work are wider ranging: The growing challenges to social cohesion are linked to a general slowing of economic growth in the region. The challenges are more pronounced in countries where productivity and living standards have been lagging for some time. For instance, despite recent economic growth, the Philippines has experienced much slower poverty reduction than its neighbors, reflecting the low productivity of most forms of employment created by the economy. Many economies, including Cambodia, Indonesia, Lao PDR, and the Philippines, need to find ways to create and sustain productive

FIGURE 3 Some countries in East Asia Pacific have restrictions on dismissal similar to those in countries in Southern Europe

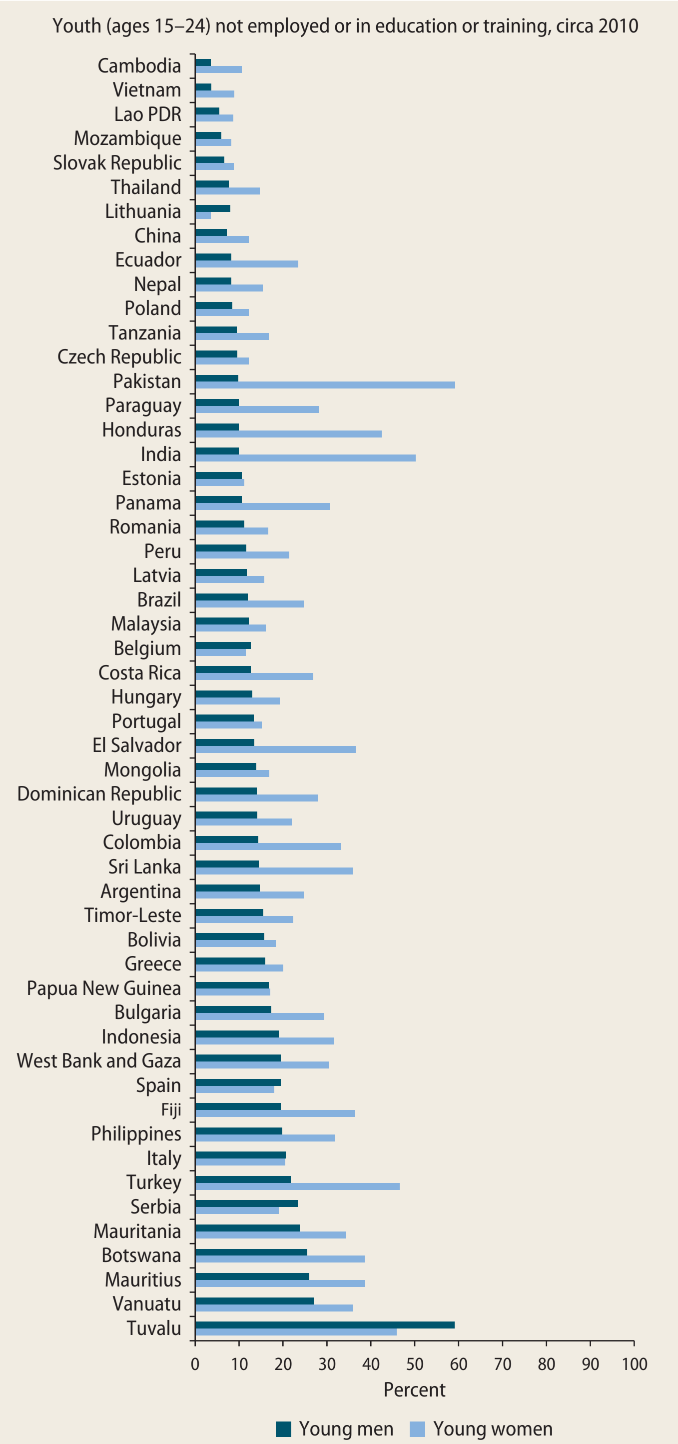


Sources: Estimates based on country labor codes and latest available for OECD countries from www.oecd.org.

Note: Scores range from 0 (least stringent) to 6 (most restrictive). OECD average includes a sample of 30 countries; values refer to 2010. Europe and Central Asia values are for 2007 and reflect only a total (with no breakdown by category).

a. ASEAN+ countries.

FIGURE 4 Youth inactivity is high in some of the Pacific island countries, Indonesia, and the Philippines



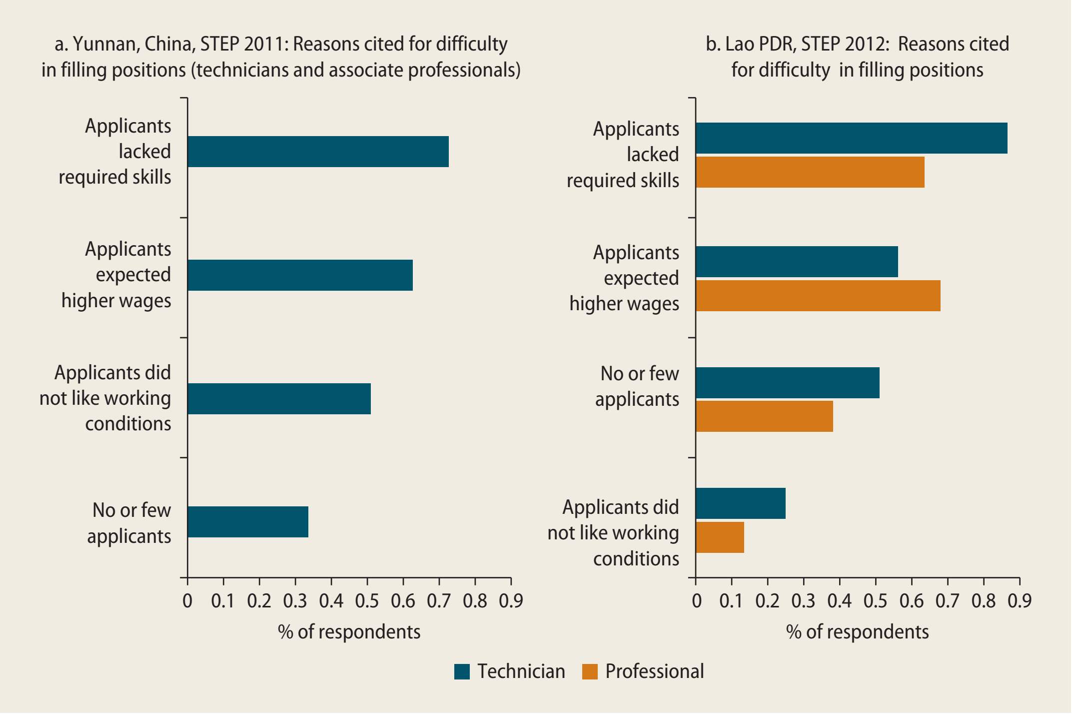
Source: World Bank 2012, Core Statistical Tables, based on the World Bank's International Income Distribution Database (I2D2).

work, amid more difficult global economic prospects and more intense competition. Countries can ill afford to ignore what appear to be increasingly restrictive business environments.[3]

In addition, skills shortages in the labor force in many East Asia Pacific countries are becoming a binding constraint. Skill gaps threaten growth when health and education systems and the existing labor force adjust too slowly to keep pace with fast-evolving demand, and when incentives for people to invest in skills, and firms to choose technologies are distorted by outdated policies. Shortages of basic skills in Cambodia, Lao PDR, and several Pacific island countries, as well as gaps in advanced skills across the region's labor force, are motivating governments to pay more attention to health, education, and training systems (figure 5). Moderating rates of economic growth and slower gains in living standards than many in the region have come to expect over the last two decades have led to louder and more frequent calls for governments to become more active to ensure sustained and more widespread well-being from work.

For these reasons, the discussion of well-being from work is pushing to the political forefront and, if ignored, could threaten the social contract. In contrast to the history of today's high-income countries, the rapid economic changes in emerging East Asia Pacific countries have not been accompanied by the development of social and civic institutions to accommodate the interest of different groups and classes. As a result, many countries now face the difficult challenges of slowing growth, increasing inequality, and an unprecedented pace of structural transformation without the support of strong formal civic, labor, and social welfare institutions. Households and governments in the region are beginning to question how policies can ensure that work continues to improve well-being through higher productivity, rising living standards, and greater social cohesion. The development trajectories of East Asia's high-income success stories also included periods when similar calls for "inclusive growth" and

FIGURE 5 Employers cite lack of skills among applicants as the top reason for persistent vacancies



Source: Liang and Chen 2013, based on the Skills Towards Employability and Productivity (STEP) employer survey.

"jobs strategies" were heard. But the answers that made sense for those countries at the time may not be viable today in a far more integrated, rules-based global economy.

How can policy sustain well-being from work in East Asia Pacific?

The most powerful policies to sustain well-being from work reach far beyond the labor market and aim to establish sound fundamentals. The most important are those that ensure price stability and maintain a fiscal stance that encourages investment and innovation and a regulatory framework for factor and product markets that encourages enterprise, particularly in the small and medium enterprises (SMEs), where most people in East Asia Pacific work. In setting the fundamentals of macroeconomic policy, the business environment, and human capital development, policy makers should take into account all forms of economic units (from farms to microenterprises, SMEs to corporations) as well as all forms of work (wage and nonwage, full time and part time) that exist in the region. Policy makers should be alert to laws and regulations that intentionally or unintentionally influence firms' decisions about how much capital or labor to employ or households' decisions about where and how much labor to supply. A policy stance that biases firms' and households' decisions will result in structural imbalances: too much capital and not enough labor in one part of the economy or vice versa. These imbalances can become embedded economically and politically and hinder countries' ability to adjust, evolve, and grow.

With sound fundamentals in place, as policy makers turn their attention to the market for labor and human capital and to social protection, they should pay closer attention to the many ways in which people in East Asia Pacific work to earn a living. Governments stepping into this still relatively new arena of policy making do not have to respond to increasing calls for intervention with policies that were designed and evolved in very different contexts. The prevailing models of labor regulation and social protection developed in countries where full-time salaried employment was the most common way to work and during periods in their history when men were by far the largest group in the work force. Indeed, the evidence, including from East Asia Pacific, shows that these models benefit prime-age men in full-time wage employment at the expense of other working people.

Policy makers should focus on measures that favor all working people, even if they work for themselves or hire others to work for them. In principle, labor regulation and social protection should benefit all working people and their dependents, and not favor any sector, location, or manner of economic engagement. For instance, the new emphasis in several Scandinavian countries on protecting people rather than jobs is a way of providing protection against labor market risks, without tying this protection to where or how a person works. A national system of modest, noncontributory unemployment benefits, financed by general revenues, could relieve employers of costly severance schemes, lower the distortionary impact of labor taxes, and provide some incentive for workers currently without any protection to register their work and businesses. In several countries, governments are already experimenting with delinking financial protection and risk pooling for health from where and how people work. Thailand's universal health coverage model is the most successful example of this approach and is credited with extending both coverage and usage.

Governments also have a role in making and sustaining investments in public goods and in capturing opportunities to increase well-being from work that would remain unexploited if left purely to market incentives. WDR 2013 offers a typology that policy makers can apply to identify their particular challenges in maximizing well-being from work and with which they can prioritize public investments. The typology takes account of countries' levels of development, demography, natural endowments, and political circumstances, and it helps policy makers to determine which of these factors are dominant in shaping the opportunities for and constraints on the demand for and supply of labor and human capital. The eight country types are agrarian, conflict-affected, formalizing, high youth unemployment, resource-rich, small island state, urbanizing, and aging (figure 6).

This typology of challenges to well-being from work offers new and useful insights. First, it demonstrates how diverse the region is, in that East Asia Pacific countries can be mapped to at least one of all eight types. There is no single dominant set of challenges, as there is in other emerging market regions.[4] Second, most countries can reasonably be mapped to more than one type, reflecting the dynamism of the region. Third, setting aside the types determined by natural endowments (such as the small Pacific island states and "resource-rich" economies), most East Asia Pacific countries are "agrarian" or "urbanizing." Indeed, given the stage of development of the region's population giants, most people in East Asia Pacific live and work in the "agrarian" or "urbanizing" contexts. This is important because, as stressed in the WDR 2013, when countries are (or are close to) urbanizing, all three development transformations tend to happen at a similar pace: productivity and wages are increasing, living standards are rising, and social cohesion is greater, as more people move out of poverty and closer to middle-class prosperity. But when countries have substantially urbanized, one or more of the transformations can start to lag. This story is unfolding in the region now, prompting demand for policy action.

Applying the typology to East Asia Pacific countries suggests the following guidance regarding the most salient policy challenges.

FIGURE 6 Countries can be classified into eight types by their specific challenges, although most countries in East Asia Pacific fall into more than one type

a. Types and defining characteristics

Agrarian	Majority of the population lives in rural areas
Conflict-affected	Livelihoods altered by war and violence
Urbanizing	Agricultural modernization and rural-urban migration rapidly taking place
Resource-rich	Extractive industries make a substantial contribution to exports
Small islands	Size of population doesn't support economies of scale or specialization
High youth unemployment	Youth unemployment rates and idleness rates at unusually high levels
Formalizing	An urban middle class and a large share of informal employment coexist
Aging	Rapidly increasing old-age dependency ratios

b. Plausible mapping of East Asia Pacific countries

Agrarian	Cambodia, Lao PDR, Myanmar, Papua New Guinea, Thailand, Timor-Leste, Vietnam
Conflict-affected	Timor-Leste, Solomon Islands
Urbanizing	China, Indonesia, Lao, PDR, Malaysia, Mongolia, Philippines, Vietnam
Resource-rich	Myanmar, Mongolia, Papua New Guinea, Lao PDR, Timor-Leste, Indonesia
Small islands	Fiji, Kiribati, Marshall Islands, Micronesia (Fed. Sts.), Palau, Samoa, Solomon Islands, Tonga, Tuvalu, Vanuatu
High youth unemployment	Indonesia, Mongolia, Philippines
Formalizing	China, Malaysia, Mongolia, Philippines
Aging	China, Indonesia, Thailand, Vietnam

Source: Based on World Bank 2012.

Small island countries

In small island countries, employment creation led by private enterprise is significantly constrained by small and dispersed populations. Outside of niche sectors, small size makes it almost impossible to achieve economies of scale. Moreover, the Pacific island countries are particularly constrained by great distances, which conspire against their gaining competitiveness even in activities where endowments would otherwise give them a comparative advantage. Given these constraints, policy makers have to focus on preparing young people with the human capital they will need to succeed abroad as migrant workers. In doing so, service provision itself can become a force for employment creation when populations are dispersed on difficult-to-reach islands. And while the Pacific island countries are too constrained by economic geography to compete in manufacturing, and find it difficult to process their natural resources for export, managing the exploitation of these resources and tourism nevertheless offers opportunities for work. Also, as improvements in information and communication technology bring the islands closer to distant markets, opportunities for work in call centers and other business services may become more readily available. Again, it would be wise to invest in human capital to prepare people to take advantage of these opportunities.

Agrarian economies

For countries that are still mainly agrarian (particularly Cambodia, Lao PDR, Myanmar, Papua New Guinea, and Timor-Leste), the policy priority to increase well-being from work is to raise agricultural productivity, in order to free labor and human capital to work in rural off-farm enterprises and eventually to migrate to towns and cities. The instruments to increase agricultural productivity and facilitate the structural transition are land reform, agricultural extension programs, price deregulation, rural infrastructure, and good-quality education and health services. Ignoring such measures will result in low productivity and persistently high poverty, as discussed in the *Philippines Development Report 2013: Creating More and Better Jobs* (World Bank 2013). To sustain well-being from work, governments should identify and remove policies and programs that create implicit or explicit restrictions that keep working people from moving off the farm and into rural nonfarm industry or urban manufacturing and services. The most notorious example in the region is China's *hukou*; whereas Vietnam's experience in the 1990s and the first decade of the twenty-first century is an often-cited example of success. The danger to be avoided is urbanization *despite* policy rather than *enabled by* policy, characterized by efforts to discourage people from moving, unproductive use of land, people migrating in search of better health and education services, cities unprepared for fast population growth, and rapid divergence in living standards between town and country.

Urbanizing economies

For countries that are rapidly urbanizing (particularly China, Indonesia, Mongolia, the Philippines, and Vietnam), the policy priority is to make cities work better. Somewhat counterintuitively in a discussion of well-being from work, the factor market that policy makers should pay the greatest attention to is the market for land. Since land is the least mobile factor of production, good urban planning becomes the key to increasing the flexibility and efficiency of land use. Urban planning becomes the area of policy with the greatest impact on the incentives of firms in towns and cities to form, to grow, to move up the value chain, and thus to create and sustain demand for labor and human capital. Also important are urban transportation infrastructure and service provision, to ensure that growing cities with plenty of skilled people foster economies from agglomeration rather than incur burdensome costs from congestion. The examples of both Japan and the Republic of Korea are instructive in this regard.

Formalizing economies

In several countries where urbanization is already well advanced (including China, Malaysia, Mongolia, and Vietnam), governments are also facing the challenges of "formalizing" more work, in part to increase the coverage of essential work-risk and social protection, but also to lift constraints on productivity. The key is to avoid forming or entrenching a policy and regulatory framework that creates labor market segmentation. Segmentation can be caused by differences in how income from different sources is taxed; by rules for providing credit that explicitly or implicitly exclude self-employed people and small businesses, as well as businesses owned by women; by differences in the types of work that are recognized in the labor code and the types that have no legal recognition or accommodation; and especially by how nonwage social protection benefits are designed and financed. Models of labor regulation and social protection that tie eligibility to certain places, industries, and forms of work and that are financed by mandatory contributions from employees and employers create segmentation. In most low- and middle-income countries, this segmentation is further aggravated by institutional and administrative weaknesses. The typical result is the exclusion and disenfranchisement of many working people from social protection and labor institutions. To avoid segmentation, policies in the areas of macroeconomics, business regulation, human capital development, and labor and social protection should take into account *all* forms of economic production and all forms of work in the region. Doing so will encourage factor mobility and efficient factor allocation, helping countries to make the difficult transition out of middle-income status.

"Business as usual" is not an option

East Asia Pacific faces a future of moderating rates of economic growth and pressure to respond to rising threats to well-being from work. Not taking action will increasingly threaten social cohesion, constrain productivity, and limit gains in living standards.

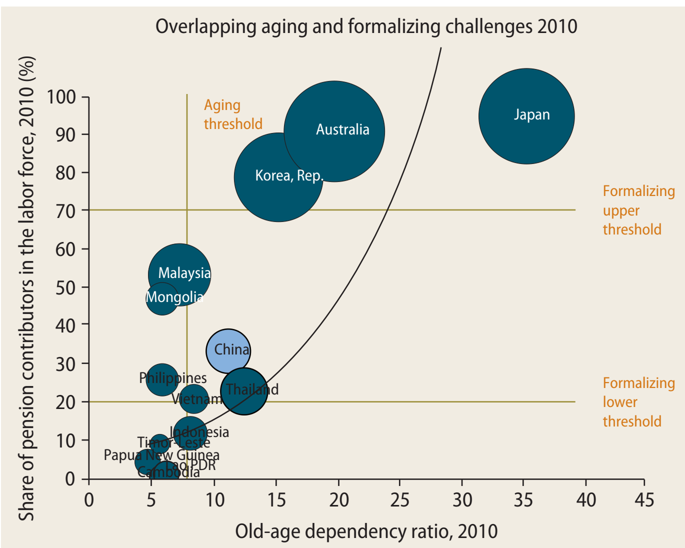
Policy makers in East Asia Pacific have greater opportunity to respond appropriately than their counterparts in other regions. The good news is that the history of policy interventions in East Asia Pacific, particularly in the arenas of labor and social protection, is short relative to that of countries in Latin America and Central Europe. As a result, the costs of transitioning from a biased stance (that favors certain factors of production, sectors of activity, or ways of working over others) to a policy stance that favors all working people are likely to be much lower in East Asia Pacific. For instance, while Latin American and Central European governments might find it appealing to provide "noncontributory" forms of social protection, instead of those financed by employer and worker contributions, the transition costs of such a shift may be hard to afford for already heavily indebted governments. In contrast, East Asia Pacific governments face limited "legacy costs," fiscally as well as politically: there are relatively fewer vested interests and social protection "sacred cows" in the region.

On the flip side, the risks of ignoring or aggravating biases in the current policy framework are higher for countries in East Asia Pacific due to their rapidly shifting demography. The pace of this demographic wave is likely to pick up in a couple of years and roll over the region faster than it has over any other. In China the statistics authorities reported the first ever contraction of the working-age population in 2012. Korea already has the lowest population replacement rates in the world. And if the average longevity of people in Japan is a suitable benchmark, many people in East Asia can expect to live very long lives. Yet at the margin, most policy models currently in place in the region are likely to discourage longer working lives, constrain the productivity of older people, deprive all working people of the foundational skills they need to easily re-skill throughout their lives, or discourage formal forms of work that appeal to the elderly (part-time, irregular hours). Structural discouragements of longer working lives in East Asia Pacific are nowhere near as bad as they are in Latin America or Southern and Central Europe, where it often pays to withdraw from the labor force at an early age. Today, people in East Asian countries work longer into old age because they do not have any other choice. But this is a poor, residual outcome rather than the intended consequence of a coherent employment strategy. Better policy fundamentals, labor and social protection institutions, and proactive measures targeted at older people could create stronger incentives for people to remain productive longer. Across the region—particularly in the Pacific island countries that, despite a "younger" demographic profile, face a health and financial burden of noncommunicable diseases similar to that of much "older" countries—greater emphasis on better nutrition and prevention is likely to lengthen productive working lives and ease the burden of health care costs.

While preparing for the onset of aging, several governments in the region are also facing the challenges of "formalizing" more work, in part to increase the coverage of social protection, but also to sustain productivity and increase the tax base for financing public goods (figure 7). As shown in chapter 7, in the region's most populous countries, the majority of people will soon live in towns and cities. The key principle for policy making in these countries is to avoid *segmentation*: cleavages in factor markets that impede competition, impair labor mobility, and limit the coverage of essential work risk and social protection. Segmentation is caused mainly by intended and unintended biases in countries' policy frameworks, including differences in how income from different sources is taxed, rules for providing credit that explicitly or implicitly exclude self-employed people, design and financing of nonwage social protection benefits, and recognition of only some types of work in the labor code.

Avoiding and eliminating biases and segmentation from factor markets are essential if the countries of East Asia Pacific are to grow in wealth before they have to face the far more difficult challenges of an aging economy. This is the current quandary of several middle-income countries in Central and Southern Europe and in the Southern Cone of Latin America that became old before they became rich. Their example should strike a note of caution for policy makers in East Asia Pacific countries, where the average age of the labor force and the share of elderly in the population are already rising quickly.

FIGURE 7 The constraints on growth from a large informal economy are a danger as countries age



Sources: World Bank Pension Database 2013; United Nations Population Division.

Notes

1. For instance, it is much higher than in Belgium and France, and than in high-income countries in the region, such as Australia and New Zealand.
2. The Gini coefficient of consumption inequality in China increased from approximately 35 percent in the mid-1990s to 42 percent in the mid-to-late 2000s. Among salaried workers in Indonesia, annual wage increases between 1999 and 2003 amounted to 9.3 percent for nonpoor employees, but only 6 percent for poor and near-poor employees.
3. In the World Bank's Ease of Doing Business ranking, Indonesia (ranked 120), the Philippines (108), and Cambodia (137) score poorly. China (96) and Vietnam (99) score moderately.
4. For instance, the dominant challenge in Europe and Central Asia is mostly aging; in Latin America and the Caribbean it is mostly formalizing; and in the Middle East and North Africa it is mostly high youth unemployment.

References

Giles, John, Dewen Wang, and Albert Park. 2013. "Expanding Social Insurance Coverage in Urban China." Policy Research Working Paper 6497, World Bank, Washington, DC.

Liang, Xiaoyan, and Shuang Chen. 2013. *Developing Skills for Economic Transformation and Social Harmony in Yunnan, China*. Directions in Development Series. Washington, DC: World Bank.

World Bank. 2012. *World Development Report 2013: Jobs*. Washington, DC: World Bank. http://hdl.handle.net/10986/11843.

———. 2013. *Philippines Development Report 2013: Creating More and Better Jobs*. Manila: World Bank.

Abbreviations

ASEAN	Association of Southeast Asian Nations
EPL	employment protection legislation
EU	European Union
GDP	gross national product
I2D2	International Income Distribution Database
ILO	International Labour Organization
NPA	New People's Army
OAD	old age dependency
OECD	Organisation for Economic Co-operation and Development
PIC	Pacific island country
PISA	Program for International Student Assessment
RSE	recognized seasonal employer
SABER-WfD	Systems Approach for Better Education Results–Workforce Development
SAR	Special Administrative Region
SEWA	Self Employed Women's Association
SME	small and medium enterprise
STEP	Skills Towards Employment and Productivity
TFP	total factor productivity
TVET	technical and vocational education training
UCS	Universal Coverage Scheme
UN	United Nations
WDR	World Development Report

ISO 3166 country or economy abbreviations

AUS	Australia
CHN	China
FJI	Fiji
FSM	Federated States of Micronesia
HKG	Hong Kong SAR, China
IDN	Indonesia

JPN	Japan
KHM	Cambodia
KIR	Kiribati
KOR	Republic of Korea
LAO	Lao People's Democratic Republic
MHL	Marshall Islands
MYS	Malaysia
NZL	New Zealand
PHL	Philippines
PICs	Pacific island countries
PLW	Palau
PNG	Papua New Guinea
PRK	Democratic Republic of Korea
PYF	French Polynesia
SGP	Singapore
SLB	Solomon Islands
THA	Thailand
TLS	Timor-Leste
TON	Tonga
TUV	Tuvalu
TWN	Taiwan, China
VNM	Vietnam
VUT	Vanuatu
WSM	Samoa

1 Introduction and Road Map

East Asia Pacific is like no other region in ways that strongly affect the supply of and demand for labor and human capital and the well-being that people gain from work.

Talent, skills, and the ability to work are people's most important assets. The majority of people realize the value of these assets in the labor market, whether they sell their time to others or pursue their own enterprise. Work is often the channel through which the benefits of economic growth spread and living standards improve. This has been especially evident since 1990, as the share of the world's population living in poverty has declined by half. The prospects of working people in East Asia Pacific are better than those of many living elsewhere. The flow of goods and services within the region, integration with the global economy, price stability, rule of law, and relatively unfettered markets all foster opportunities for advancement through work that people in other regions regard with envy. In East Asia Pacific, work has brought more people out of poverty and closer to middle-class prosperity faster during the past three decades than in any other place and at any other time.

Nevertheless, working people in many parts of the region feel some of the same pressures and face some of the same challenges as their peers elsewhere. The region has the second highest share of workers outside of wage and salaried employment and consequently beyond the reach of most forms of regulation and formal protection. In this regard, East Asia Pacific is surpassed only by Sub-Saharan Africa. In some East Asia Pacific economies, youth inactivity and unemployment are growing problems, most starkly apparent in Indonesia, the Philippines, and the Pacific island countries.

Economists are more familiar and comfortable with the term "welfare." Although "welfare" and "well-being" are synonyms, the latter is more typically associated with safety or psychological comfort than with the outcomes discussed in this report—economic development, material living standards, and social cohesion. In discussions of work, welfare is often used too narrowly in reference to social protection programs. Further, there is considerable evidence that individuals and communities draw benefits from their work that are neither strictly pecuniary nor a function of economic growth, many of which contribute to social cohesion and, in turn, to development.

As rising indexes of inequality in several East Asia Pacific economies show, these challenges are starting to threaten the viability of work as a means of advancement and a channel through which economic growth can be shared broadly. In addition, after more than two decades of rapid development, people in the region are beginning to experience moderating economic growth, often coupled with lagging productivity and slower gains in living standards than they have come to expect. As a result, governments across the region are beginning to hear louder and more frequent calls for action to sustain the well-being—that is, the individual and social gains—that people can expect from their work.

East Asia Pacific At Work examines the changing world of work in a diverse, dynamic region and proposes how policy can support inclusive growth by creating a more enabling environment for working people. The report is motivated by and benefits from the spotlight shone on work and development by the *World Development Report 2013: Jobs* (henceforth WDR 2013; World Bank 2012c). Like the WDR 2013, this report is about a much broader variety of forms of work than is typically understood by the word "jobs," including farm employment, unpaid family work in household market enterprises, self-employment, and casual labor. We use the more inclusive term "work" instead of "jobs" throughout this report to reflect a broader range of market activities than just full-time, salaried employment. We apply the conceptual and analytical tools presented in the WDR 2013 to East Asia Pacific economies in order to draw additional inferences and guidance for policy makers in the region.

This report adds value to the discussion initiated by the WDR 2013 in three specific ways. First, it grapples with issues that are of greatest urgency in East Asia Pacific. The economic and demographic changes in this region, as well as the nascent engagement of its governments in labor regulation and social protection, affect the demand for and supply of work in ways that are distinct from those in countries elsewhere.

Second, the report contributes to what is still a relatively small body of empirical evidence showing the impact of policies on employment in East Asia Pacific and proposing options for reform. With some notable exceptions (Betcherman and Islam 2001), there are still fewer policy reports on labor markets, work, and development with a regional scope in East Asia Pacific than in Europe, Latin America and the Caribbean, the Middle East and North Africa, or South Asia.

Third, in covering geography that extends from China to Tuvalu, the report takes closer account of the region's diversity. East Asia Pacific economies differ considerably in their size, natural endowments, demography, political institutions, and stage of economic development. In several, most people still live in rural areas and work in subsistence or small-scale agriculture; in others, rural-urban migration has been taking place rapidly. In several, urbanization is already well advanced, and an ever-growing concentration of working people in cities is creating pressure on governments to broaden social protection and bring more economic activity into the regulated "formal" economy. In many parts of the region, the labor force is aging, particularly in the most populous countries—China, Indonesia, Thailand, and Vietnam. In contrast, the labor force in most of the Pacific island countries is still very young, but the small size and remoteness of these countries present a host of unique challenges to work as an effective channel of development. Appreciating the exceptional diversity of East Asia Pacific is essential to understanding the challenges to sustaining the gains from work and to crafting policies to address these challenges.

In this chapter, we open the report by acknowledging how East Asia Pacific is like no other region in ways that strongly affect work. Those who have spent time reading and writing about the economies of East Asia Pacific in the past 30 years have grown used to superlatives, with good reason. The region's dynamic context of economic and social change has had undeniable impacts on the demand for and supply of labor and human capital. The first section of this chapter shows that several important factors set the region apart in shaping the context for work, including its sustained high growth and fast-rising prosperity.

Our discussion then turns to the question, Has growth in East Asia Pacific been "jobless"? With the highest rates of participation in market employment and the lowest rates of open unemployment, the question may seem odd. Nonetheless, evidence from our own analysis and that done by others shows that the relationship between employment and changes in output is not straightforward and cannot be taken for granted. But claims of so-called "jobless growth" are just as overblown and simplistic as complacency about what markets can achieve when left to their own devices. Although not sufficient, economic growth, as a derived demand, is necessary to sustain the demand for work. That conclusion allows us in the chapters that follow to examine the quality of work and whether and how it contributes to people's well-being.

Finally, this chapter closes with a "road map" of the report. We have divided the nine chapters into three parts. The first (chapters 1, 2, and 3) describes the context: what is unique about East Asia Pacific, how diverse are the profiles of households and firms within the region, and how is the contribution of work to well-being changing. The second part (chapters 4, 5, and 6) reviews policy and takes stock of the prevailing models in East Asia Pacific and how they affect the prospects of and outcomes for working people. The third part (chapters 7, 8, and 9) looks at the policies that governments in East Asia Pacific economies may wish to consider to sustain the transformative impact of work, even as growth in the region begins to moderate.

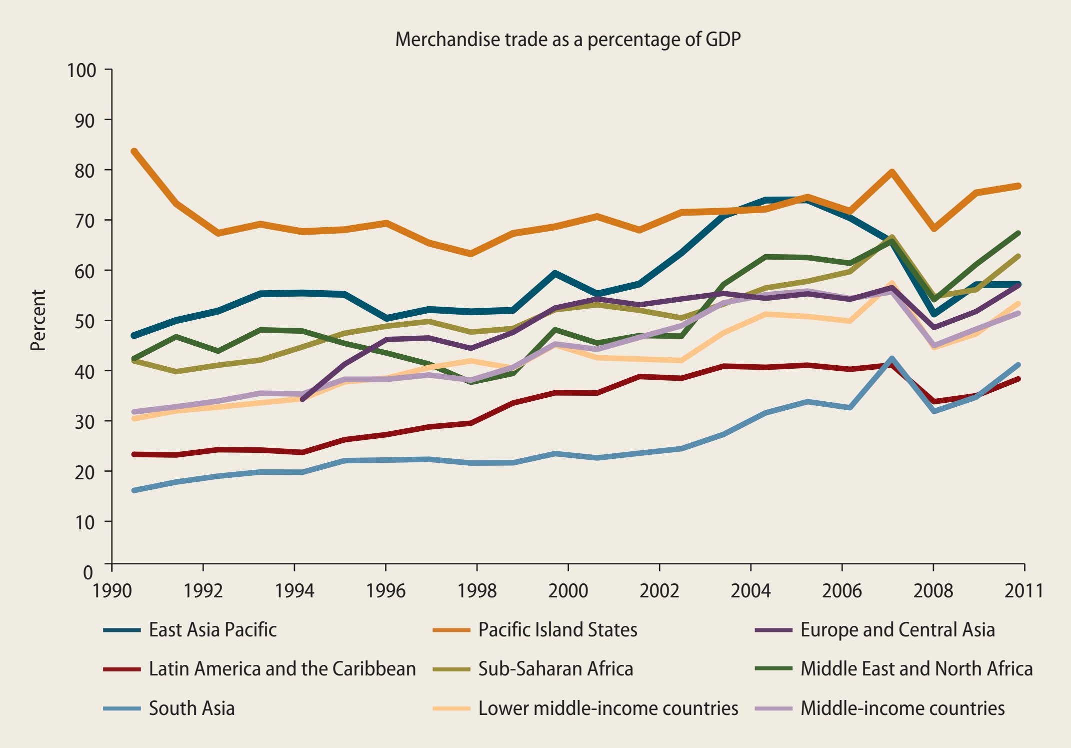
The context for work in East Asia Pacific

Several interrelated contextual factors differentiate the East Asia Pacific region, particularly East Asia, from other, mainly low- and middle-income-country, regions in setting the environment for work. These contextual factors have facilitated the fast pace of structural change and influenced the returns to labor and human capital. The first factor is deeper economic integration with the global economy. Another is sustained high growth that has accelerated the pace of development. The third is economic resilience through the period of global financial crisis and economic contraction of 2008–10. Finally, although growth in the region has not been especially volatile—with the exception of growth in the Pacific island countries—the entire region faces higher risks from natural disasters than countries elsewhere and has borne a heavier economic burden from these disasters. These contextual factors shape not only the speed of structural transformation and what most people do to earn a living, but also the relative returns to labor and human capital, the skills profile required to maintain productivity, and the vulnerability of working people to shocks. We turn to each of these contextual factors in turn.

Economic growth in the region is characterized by a greater degree of export orientation and openness to world trade than elsewhere. This has been true for so long that it is rarely questioned. Figure 1.1 shows how merchandise trade as a share of global gross domestic product (GDP) has been rising in almost every region of the world. But in East Asia Pacific, the levels of economic integration measured by this statistic have been higher, around 50–60 percent, than in other low-income and emerging-market regions. This level of global integration has remained high throughout the last two decades. And to a much greater extent than in other regions, integration with the global economy rests on integration between East Asian economies and the flow of trade in intermediate goods (Gill and Kharas 2007).

The East Asian economies have sustained higher rates of economic growth for much longer periods than other regions that have experienced spurts of high growth, resulting in fast-rising living standards. At average

FIGURE 1.1 Countries in East Asia Pacific have sustained higher levels of global integration longer than other developing regions



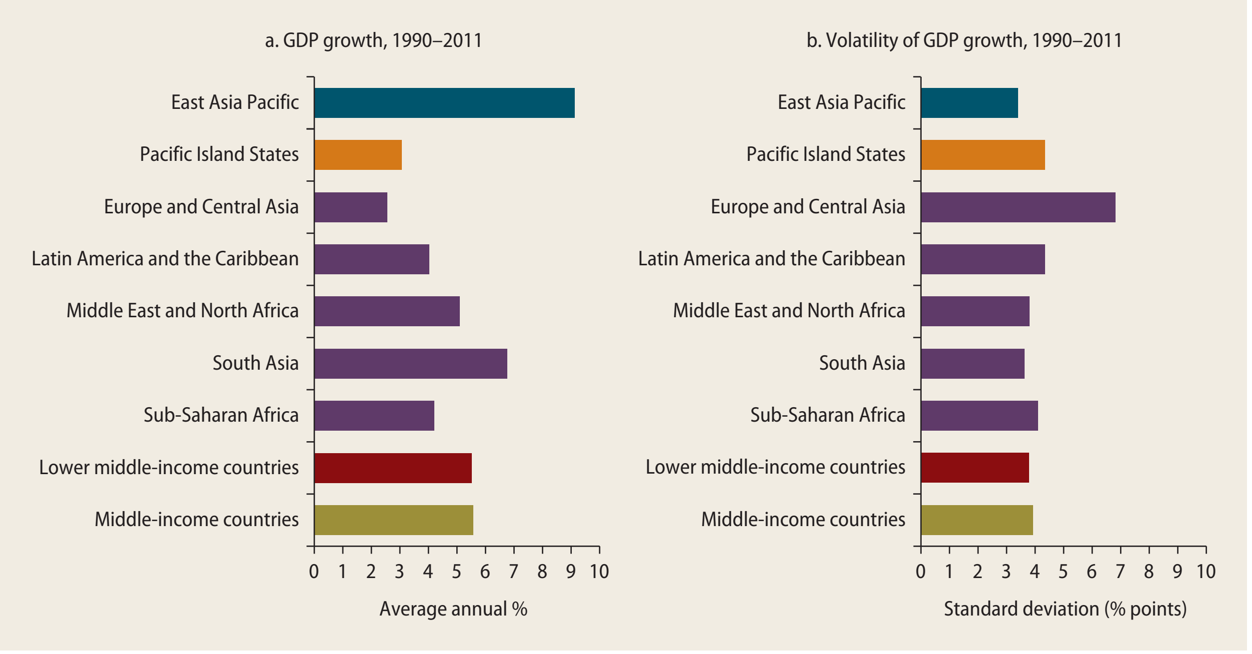
Source: World Bank 2013c.

annual GDP growth of more than 9 percent between 1990 and 2011, East Asia far surpassed other regions. Average annual growth was almost 4 percentage points higher than the averages for lower- and middle-income countries (figure 1.2). What is more, economic growth in the region outside the Pacific island countries was not particularly volatile: the volatility of GDP growth, measured by the standard deviation of average annual economic growth during 1990–2011, was lower than in any other developing-country group. As a result, the region's share of world output and its share of output growth both increased substantially (figure 1.3). East Asia Pacific's share of global GDP rose from 6.7 percent in 1990–92 to 17.4 percent in 2009–11.

But it is important to note the diversity of experience in East Asia Pacific, which has large differences in the rate of economic and social progress. For example, although average annual GDP growth during the first decade of the twenty-first century was close to 10 percent in China, it was close to zero in several small Pacific island countries. As shown in figure 1.2, the growth rate was much lower in the Pacific island small states, at 3 percent, than in East Asia. Furthermore, economic growth in the Pacific was significantly more volatile and, in this regard, was similar to growth in Latin America and the Caribbean and in Sub-Saharan Africa.

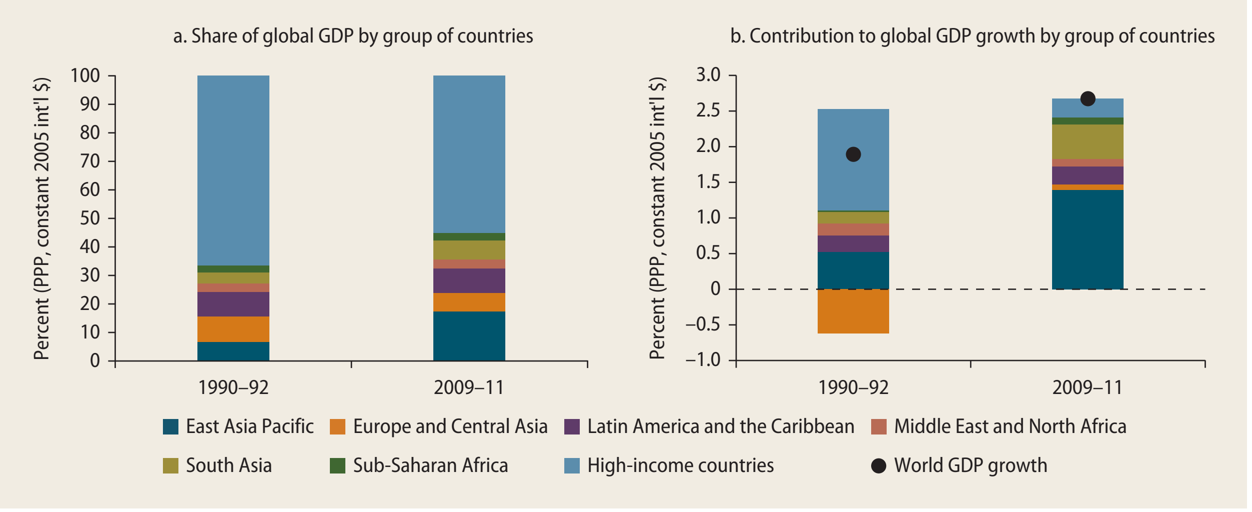
Economies in East Asia Pacific showed considerable economic resilience through the period of the global financial crisis and economic contraction of 2008–10. Perhaps reflecting hard-learned lessons during the region's crisis in the late 1990s, some economies in East Asia continued to generate employment even during the global economic slowdown and contraction of 2009 and 2010, although with a substantial

FIGURE 1.2 East Asia's high growth has been relatively stable



Source: World Bank 2013c.

FIGURE 1.3 East Asia Pacific's share in world output and growth has risen rapidly



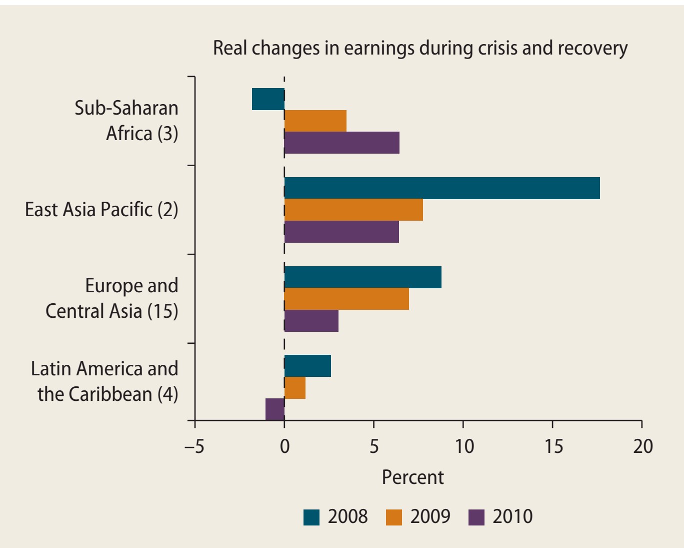
Source: World Bank 2013c.

downward adjustment in earnings (as shown in figures 1.4 and 1.5). This adjustment took place in part because working people shifted from registered, regulated work to unregistered, "informal" contracts, from full- to part-time work, and from jobs in firms and factories in cities to work on farms in rural areas. Amid the more recent slowdown in growth, unemployment has remained steady in East Asia Pacific economies, relative to the

FIGURE 1.4 East Asia Pacific did not experience large contractions in employment during the crisis

Source: World Bank 2011.
Note: Numbers in parentheses refer to the number of countries used to calculate the regional average.

FIGURE 1.5 Growth in earnings slowed down during the crisis



Source: World Bank 2011.
Note: Numbers in parentheses refer to the number of countries used to calculate the regional average.

rises seen elsewhere (figures 1.6 and 1.7). In the recovery period, East Asia Pacific continues to remain resilient despite a perilous global economic context: developing East Asia Pacific, excluding China, is expected to grow 5.7 percent in 2013, up from 4.6 percent in 2011 (World Bank 2013a).

Despite a positive outlook, the context in which firms demand and households supply labor and human capital is not without challenges. For example, in the wake of the global financial crisis and economic contraction, the external economic environment continues to be weak and will be so for the foreseeable future. Annual GDP growth in high-income and developing-country markets is expected to improve only slightly in the period to 2015. With slow recovery of demand from high-income countries, demand from domestic consumption is becoming more important to sustain growth in East Asia Pacific economies. Indeed, consumption and services replaced investment and manufacturing as the dominant drivers of growth in China for the first time in 2013. As shown in figure 1.8, the contribution of domestic demand to year-on-year output growth has increased since 2007 in four members of the Association of Southeast Asian Nations (ASEAN). In addition, with rising labor costs in China, some low-labor-cost production in the global production chain is on the move. For example, garment production is moving in greater volume to Bangladesh, Mexico, Morocco, and Turkey. The challenge for the rest of East Asia is to leverage their comparative advantage in intermediary and final goods trade and to integrate anew into the changing global supply chain.

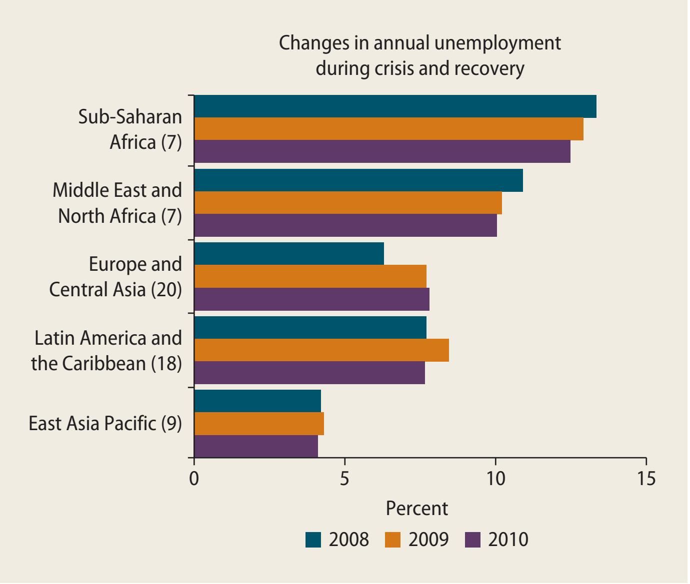
In the midst of these shifts in demand from consumers abroad to consumers at home, economies and working people in East Asia Pacific face risks that are hard to assess. Economies in the region face significantly higher and increasing disaster risks that impose substantial economic costs. Disasters have cost the economies of East Asia Pacific more than US$300 billion since 2000, almost three times the cost to countries in Latin America and the Caribbean (figure 1.9).

The region incurred 61 percent of global losses from disasters in the past 20 years and 40 percent of floods worldwide in the past 30 years. More than 1.6 billion people in the region have been affected by disasters since 2000, as detailed in a recent World Bank report (Jha and Stanton-Geddes 2013).

Natural disasters disrupt growth and demand for work and thus have a disproportionate impact on poor and lower-income people who rely on work the most. Natural disasters divert government budgets away from essential services and investment and thereby lower longer-term growth prospects. With rising numbers of people and economic assets located in places at risk, losses are likely to rise further. Indeed, with respect to natural disasters, 2011 was the costliest year on record: in the first nine months, losses in East Asia Pacific amounted to US$259 billion, which was 80 percent of the global total. In relative terms, the Pacific island countries are the most affected globally, with average annualized losses estimated for Vanuatu and Tonga at 6.6 and 4.4 percent of GDP, respectively (Jha and Stanton-Geddes 2013).

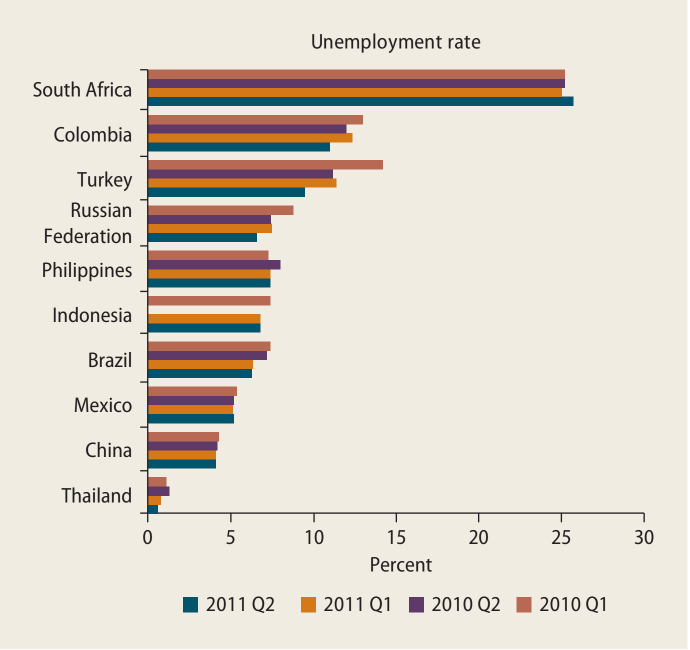
A final contextual factor worth mentioning is in many ways a combination and a culmination of the previous factors discussed in this section, setting aside natural disaster risks. In the past 60 years, many countries came into being as modern nation-states. Through a slow and painful process of trial and error, governments in these countries have attempted to improve the lot of their people, sometimes through direct measures aimed at spurring industry and employment. But there are still very few stories of successful economic development and many stories of failure and back-sliding. Of the few countries or economies making the difficult transition from low- to high-income status, most are in the East Asia Pacific region (figure 1.10). Why should this matter to working people today and to the governments that serve them? It matters that Japan; Hong Kong SAR, China; the Republic of Korea; Singapore; and Taiwan, China succeeded because their

FIGURE 1.6 Unemployment remained low during the crisis



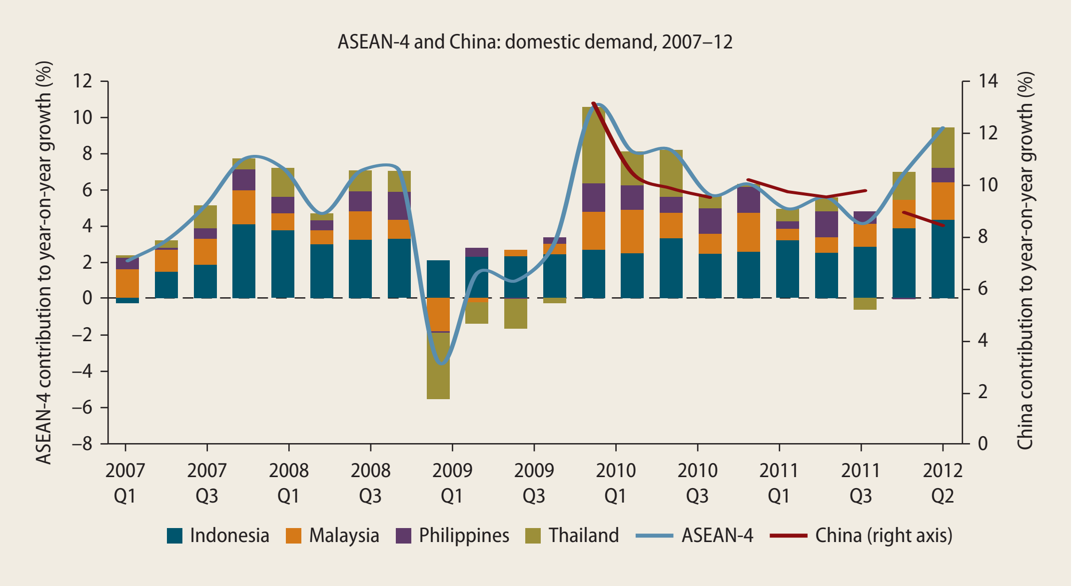
Source: World Bank 2011.
Note: Numbers in parentheses refer to the number of countries used to calculate the regional average.

FIGURE 1.7 Recovery has been slow



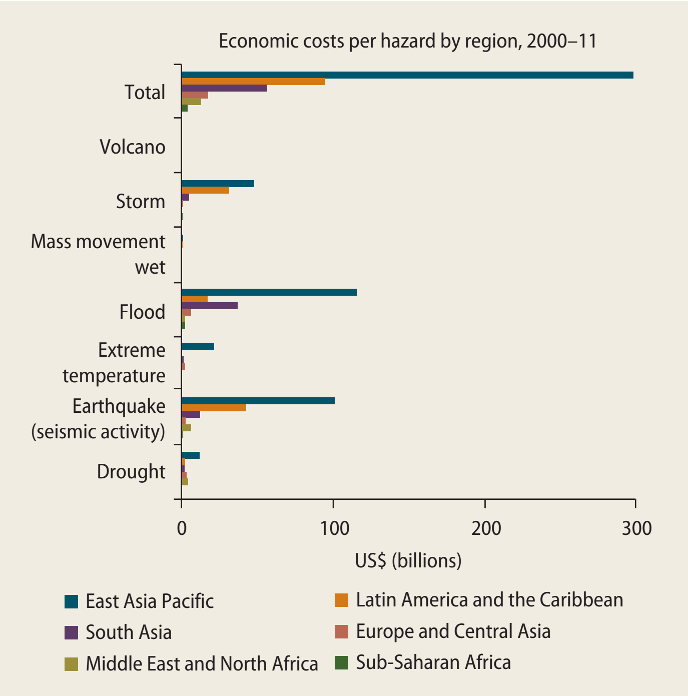
Source: World Bank 2011, 2012b.
Note: Q1 and Q2 refer to the first and second quarters, respectively.

FIGURE 1.8 Domestic demand is becoming more important to growth in East Asian economies



Sources: Haver Analytics 2013; China National Bureau of Statistics 2013.

FIGURE 1.9 East Asia Pacific faces much higher disaster risks than elsewhere, and it bears the largest share of global losses



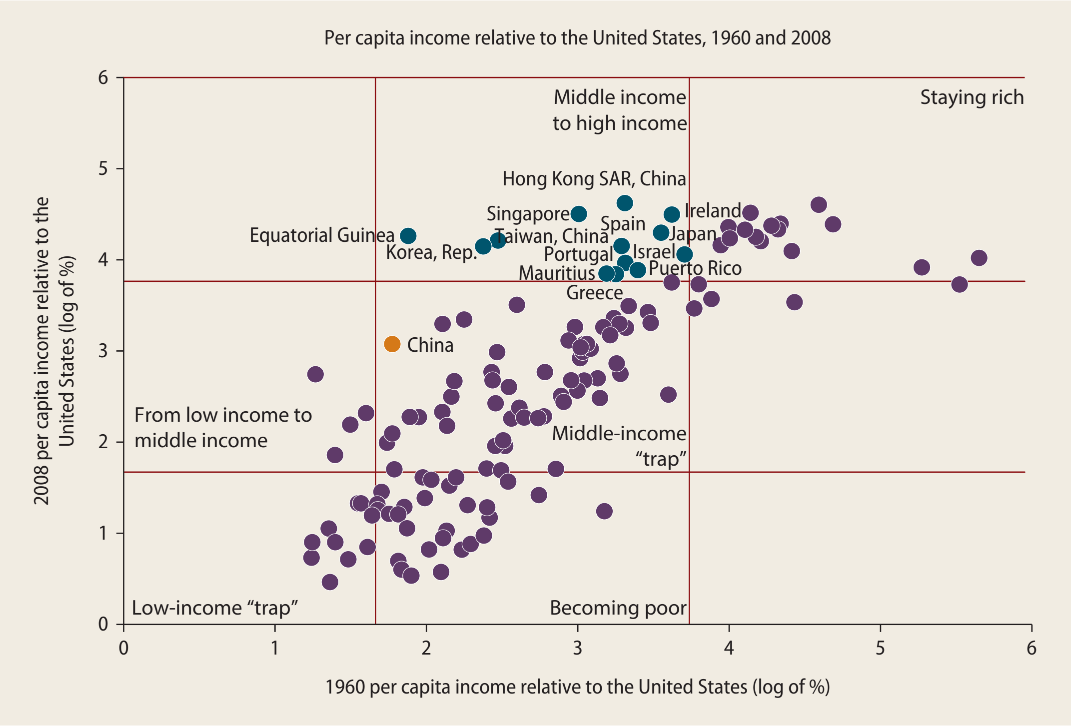
Source: CRED 2013.

success shapes the aspirations of people in the region regarding what they expect from themselves and from their governments.

Has growth in East Asia Pacific been "*jobless*"?

The sustained high levels of growth in recent decades that have set East Asia Pacific apart from other regions are expected to have tremendous impacts on work. Has growth indeed put more people to work? This section examines the empirical relationship between growth and employment and, by doing so, sheds light on whether East Asia Pacific has experienced "jobless growth." The demand for labor is derived from changes in output. Although economic growth can affect employment, it matters less in the medium and long term than demographic trends and changes in the population dependency ratio (World Bank 2012c). Changes in demography narrow the extent to which macroeconomic policies and outcomes can affect employment.

FIGURE 1.10 Few economies rose from low to high income, but among those that did, most are in East Asia Pacific



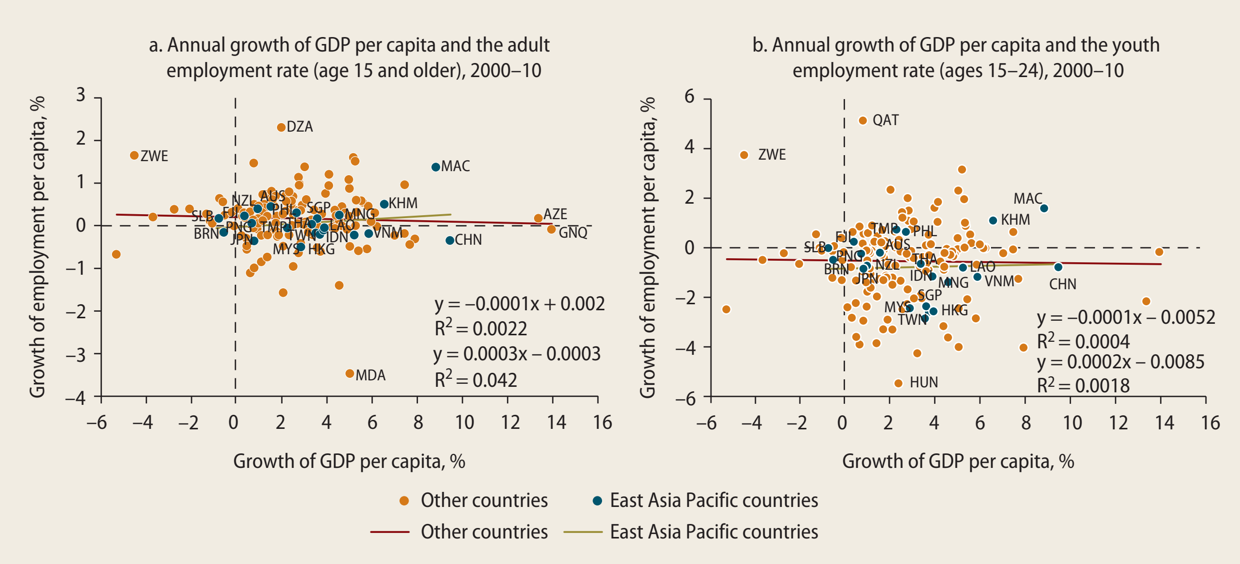
Source: World Bank and Development Research Center 2013.

In addition, for a region where large sectoral shifts in labor are a key part of economic success (discussed further in chapter 3), looking at growth and overall employment can give only a partial picture of the links between growth and work.

Following the WDR 2013, we examine the relationship between annual growth of GDP per capita and growth of employment per capita over the period 2000–10, but for a larger sample of countries. While there is a slight relationship between growth and employment creation in the region, it is statistically very weak (figure 1.11). As in most regions, the empirical relationship between economic growth and employment creation varies widely across the economies of East Asia Pacific. In the first decade of the twenty-first century, growth was clearly associated with a rise in employment more in some parts of the region than in others.

Among the 23 East Asia Pacific economies with available trend data, 11 experienced no growth or an actual contraction in employment per capita over the period 2000–10. While the employment rate increased strongly from 2000 to 2010 at an average of 0.5 percent or higher a year in Cambodia and Macao SAR, China, it dropped an average of –0.5 percent a year in Malaysia. While gross employment creation was positive in all economies in the region except Japan, employment growth kept pace with demographic forces in about half of the economies. For example, in spite of the contraction in economic output over the period 2000–10, the Solomon Islands experienced net employment growth. However, in China, about 74 million jobs were created over the 2000–10 period, but the average ratio of employment to population contracted over this period at –0.34 percent annually. The high

FIGURE 1.11 The simple correlation between growth and employment is weak



Source: Based on World Development Indicators data (World Bank 2013c).
Note: Growth of employment per capita reflects growth of the employment-to-population ratio (the proportion of a country's population that is employed).

productivity gains experienced in China combined with average annual population growth of 0.6 percent constrained net per capita job creation in the country.

Similarly, economic slowdown during the global financial crisis adversely affected employment in some economies but not others. Korea; Taiwan, China; Hong Kong SAR, China; and Timor-Leste did not experience a fall in employment during the period 2000–07, but they all experienced a decline in the wake of the global crisis. This could be explained by their relatively high integration with global markets and thus high vulnerability to the global contraction in demand. Other East Asian economies generally maintained low levels of unemployment, even in times of economic crisis. Disaggregated quarterly data at the national level indicate that in the Philippines, GDP growth fluctuated wildly over the 2008–10 period, while the unemployment rate remained very stable and even fell slightly. Similarly, Indonesia experienced a reduction in its unemployment rate, despite large fluctuations in GDP growth over the past decade. As economic growth contracted at the onset of the global financial crisis in late 2008, unemployment rates in the East Asia Pacific countries for which quarterly data are available (China, Indonesia, Republic of the Union of Myanmar, the Philippines, and Thailand) apparently were not affected. People did not stop working as a result of macroeconomic shocks; rather they turned to unregistered and unmonitored "informal" employment.

However, the elasticity of employment to changes in the size of the economy in East Asia Pacific economies shows a stronger positive relationship. Hanusch (2013) estimates the elasticity of employment to output in eight East Asian economies where employment trend data are collected with sufficiently high frequency. Table 1.1 presents the results based on a simple regression of the log of the employment rate on the log of real GDP, illustrating the percentage change in employment associated with a 1 percent change in output. For the eight economies in the 2001–11 sample, the effect of economic growth on the employment rate was about 0.3 percent (median: 0.32), ranging from 0.22 in the Philippines to 0.42 in Singapore. Employment creation in the

TABLE 1.1 Growth has had a positive impact on employment since 2001

Elasticities of employment to output, 2001–11

Economy	Elasticity
China	0.30
Hong Kong SAR, China	0.36
Korea, Rep.	0.24
Malaysia	0.39
Philippines	0.22
Singapore	0.42
Thailand	0.33
Taiwan, China	0.31

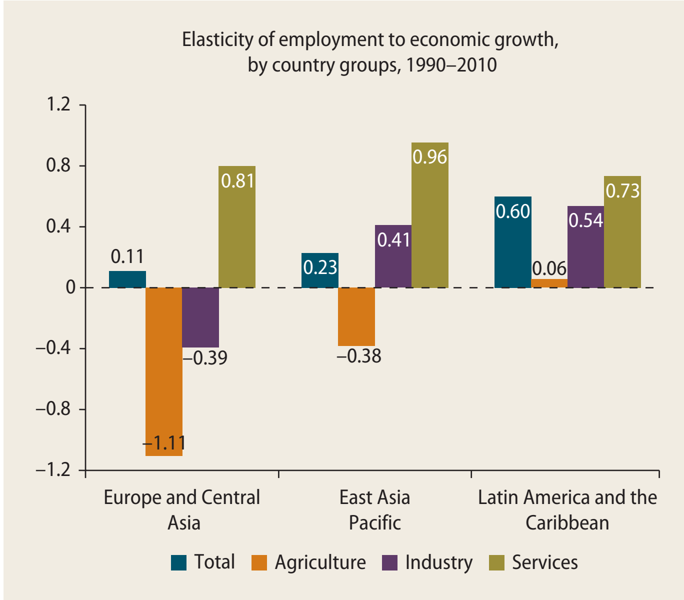
Source: Hanusch 2013.

wake of economic growth was fast in China, Malaysia, and Thailand from 2001 to 2011.[1] In addition, applying the same method as in Crivelli, Furceri, and Toujas-Bernate (2012) to estimate the employment-output elasticity, but to a larger panel of countries, and extending the period of analysis from 1990 to 2010, we find that in East Asia Pacific, the average long-run elasticity of employment to GDP growth was 0.23.

The elasticity of employment to output also varies considerably by sector. Figure 1.12 shows the results from a cross-country panel regression of the log of employment, total and by sector, on the log of GDP (in constant 2000 U.S. dollars), with employment defined as all forms of remunerative economic activity. As shown in figure 1.12, the services sector experienced the highest employment elasticity, and agriculture experienced negative elasticity in East Asia Pacific. Similar differences across sectors are found for Europe and Central Asia. With China's strong growth driving the East Asia Pacific average, the service sector, which is more labor-intensive than industry, surpassed industry in its contribution to overall GDP as of early 2013.

There are three important messages to take away from this section. First, the relationship between economic growth and employment should not be taken for granted. Second, the statistical evidence is mixed and can vary according to the tools applied to the data that are available. Third, and most important, analyses conducted by others and

FIGURE 1.12 Growth creates more employment in services than in other sectors



Source: Based on World Development Indicators data (World Bank 2013c).
Note: Data are disaggregated by sector for all regions with at least 17 observations out of the 21 years of data—that is, comparisons with other regions are not possible given the limited number of observations.

for this report reach the same conclusion: the demand for work is a derived demand. Thus while economic growth may not be sufficient for employment, East Asia Pacific's high rates of economic growth have certainly been necessary to sustain the improvement in employment outcomes.

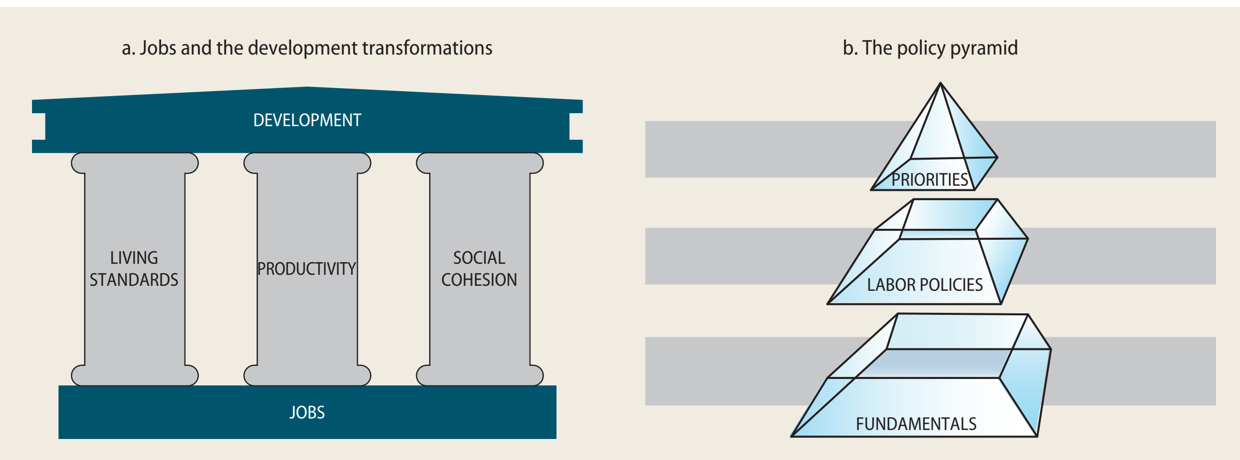
Road map to the report

This chapter has shown that East Asia Pacific is exceptional in many ways, particularly in ways that influence the supply of and demand for labor and human capital and thus the well-being that people derive from work. High rates of economic growth in most East Asia Pacific countries have been important. However, despite undeniable economic progress and favorable employment outcomes relative to countries elsewhere, policy makers in the region are concerned not only about the quantity but also about the quality of work available to people. Households and the governments that serve them are starting to question how policies can ensure that employment continues to improve well-being. Indonesia has experienced mounting pressure to increase earnings from work (World Bank 2012a). The government of the Philippines has sharpened its focus on creating "better" (higher-paying) jobs (World Bank 2013b). Governments in Vietnam, the Lao People's Democratic Republic, and Malaysia are paying particular attention to raising productivity and improving the skills of their workforce. In the island countries of the Pacific, which experience very different economic forces shaped by formidable geographic constraints, the substantial—even growing—share of youth in the population and the large number of these young people who are not working provide strong motivation for governments to pay increasing attention to employment.

The concerns and pressure on governments to focus on work and well-being are not surprising. The WDR 2013 argues that jobs are the channel of three critical transformations that drive development: higher productivity, rising living standards, and greater social cohesion. In the parlance of the WDR 2013, productivity gains happen through jobs. Jobs provide earning opportunities, lift people out of poverty, and contribute to life satisfaction. Lastly, jobs shape values and behavior and affect the distribution of outcomes in ways that influence social cohesion. The WDR also proposes a policy pyramid for governments to structure their thinking and responses to the challenges facing working people: starting at the base with policy "fundamentals" (monetary and fiscal policy, the investment climate, and human capital policies), then labor and social protection policies, and at the top, policy priorities that vary widely according to a country's particular "jobs challenges." Readers who are familiar with the WDR 2013 will recognize these tools in the structure of this report (figure 1.13).

In the remainder of part I of the report, chapter 2 presents a broad range of descriptive statistics to profile the region's demography, labor supply, and labor demand. It underscores the diversity in how and where people work. Wage and salaried employment is only a small segment of employment in emerging economies in the region. In chapter 3, we demonstrate the importance of work in bringing about all three development transformations—higher productivity, rising living standards, and greater social cohesion—in the countries of East Asia

FIGURE 1.13 The WDR 2013 presents conceptual tools used to structure the arguments of this report



Source: World Bank 2012c.

Pacific in recent decades. Chapter 3 also presents evidence that the contributions of work to well-being in East Asia Pacific are starting to change: one or more of those transformations is starting to lag. We argue that these lags explain the mounting pressure on governments to become more active in sustaining the well-being that people derive from work.

In part II of the report, we take account of current policies and examine evidence of their impact on employment. Reflecting the bottom two layers of the WDR policy pyramid, chapters 4, 5, and 6 examine monetary and fiscal policy and the investment climate, human capital policies, and labor market institutions, regulations, and interventions. These chapters take stock of current policies and determine whether, on balance, the framework that governments have put in place is "pro-employment." Where available, we have gathered evidence of the impact that these policies have on the demand for and supply of labor and human capital.

In part III of the report, we discuss policy directions. The three final chapters discuss whether governments in East Asia Pacific need "jobs strategies" and what these strategies might entail to foster a better environment for work in the region. Chapter 7 applies the WDR 2013 "jobs challenges" typology (agrarian, urbanizing, formalizing, aging, high youth unemployment, resource-rich, small islands, conflict-affected) by mapping the economies of East Asia Pacific to these types using several empirical measures and thresholds to categorize them. In doing so, the chapter highlights the relatively greater diversity in the East Asia Pacific region compared to other low- and middle-income-country regions. In East Asia Pacific, at least one country can be mapped to every type, and many countries are likely to be mapped to more than one type. Chapter 8 delves deeper into the economic geography of the Pacific island countries; how the challenges faced by working people in these countries are unique not only in the region, but also in the world and what governments concerned about employment and well-being in this corner of the region can do given these challenges.

Finally, chapter 9 closes this report with a call for action, arguing that "business as usual" is not an option. The chapter points out that whereas governments in East Asia Pacific have been slower to intervene in the past (than, for example, governments in Latin America and the Caribbean, South Asia, and emerging markets in Europe and Central Asia), the stage of development in which most countries in the region find themselves may make greater intervention necessary to surmount the challenges facing working people and to sustain well-being from work. The chapter argues, however, that intervention need not take the form of outdated, imported models from other regions, which tend to favor men in full-time, dependent employment in the manufacturing sector. Intervention can instead support all working people in East Asia Pacific, regardless of the location and sector or how they work, today and in years to come.

Note

1. A study by Ball, Leigh, and Loungani (2013), examining data for the United States since 1948 and for 20 advanced economies since 1980, finds that Okun's law has a strong as well as stable relationship in most countries, which did not vary significantly during the global economic recession. The authors argue that their estimate of Okun's law coefficient—that is, the effect of a change of 1 percent in output on the unemployment rate—differs largely between countries, in part explained by the characteristics of labor markets other than employment protection legislation.

References

Ball, Laurence, Daniel Leigh, and Prakash Loungani. 2013. "Okun's Law: Fit at 50?" Working Paper, International Monetary Fund, Research Department, Washington, DC, January.

Betcherman, G., and R. Islam, eds. 2001. *East Asian Labor Markets and the Economic Crisis: Impacts, Responses, and Lessons.* Washington, DC: World Bank; Geneva: International Labour Organization.

China National Bureau of Statistics. 2013. *China National Bureau of Statistics: Statistical Data*. Beijing: China National Bureau of Statistics. http://www.stats.gov.cn/english/.

CRED (Centre for Research on the Epidemiology of Disasters). 2013. The International Disaster Database (EM-DAT). Brussels: CRED. http://www.emdat.be/database.

Crivelli, Ernesto, Davide Furceri, and Joël Toujas-Bernate. 2012. "Can Policies Affect Employment Intensity of Growth? A Cross-Country Analysis." IMF Working Paper 12/218, International Monetary Fund, Washington, DC.

Gill, Indermit, and Homi Kharas. 2007. *An East Asian Renaissance: Ideas for Economic Growth*. Washington, DC: World Bank.

Hanusch, Marek. 2013. "Jobless Growth? Okun's Law in East Asia." *Journal of International Commerce, Economics, and Policy* 4 (3): 1–14.

Haver Analytics. 2013. Haver Analytics Database. New York: Haver Analytics.

Jha, Abhas, and Zuzana Stanton-Geddes. 2013. *Strong, Safe, and Resilient: A Strategic Policy Guide for Disaster Risk Management in East Asia and the Pacific*. Washington, DC: World Bank.

World Bank. 2011. *Job Trends* 1 (October).

———. 2012a. *Indonesia Economic Quarterly*. Washington, DC: World Bank, December.

———. 2012b. *Job Trends 5* (October).

———. 2012c. *World Development Report 2013: Jobs*. New York: Oxford University Press.

———. 2013a. *Global Economic Prospects*. Vol. 7. Washington, DC: World Bank, June.

———. 2013b. *Philippines Development Report*. Washington, DC: World Bank.

———. 2013c. World Development Indicators. Washington, DC: World Bank. http://ddp.worldbank.org/ddp/home.do.

World Bank and Development Research Center. 2013. *China 2030: Building a Modern, Harmonious, and Creative Society*. Washington, DC: World Bank; Beijing: Development Research Center of the State Council, People's Republic of China.

The Demand for and Supply of Labor and Human Capital 2

Economies in East Asia Pacific are especially diverse when it comes to where and how people work.

This chapter brings to bear available data to show the diverse profiles of firms demanding work and individuals and households supplying work in East Asia Pacific. Across and within economies of the region, we demonstrate the many places where people work, from micro and small firms to large corporations, and the many ways in which they work, from self-employment to wage dependence. Our description of demography and the supply of and demand for labor and human capital—including key characteristics and dynamic trends—also shows how East Asia Pacific differs from other regions and how the economies that make up East Asia Pacific vary substantially from one another.

On the demand side of work, the private sector accounts for the majority of employment created, as it does in other parts of the world. A key exception to this general observation is employment in the small Pacific island countries, where demand from the public sector is substantial. Small firms are an important segment of employment creation across the region, albeit with a substantial degree of churning. Only a few of these firms grow to sustain increased demand for work. On the supply side of work, the region's labor force has several distinct features: high rates of participation in markets, including the participation of women in market activities; substantial labor mobility within and between national borders; and adequate access to education. Many of those participating in the labor force work in the primary sector and outside of wage employment. More broadly, work in East Asia Pacific is characterized by a high degree of "informality" across several measures, explaining the growing concern of households and policy makers in the region not only about how much work is being created but also about where and how people are working.

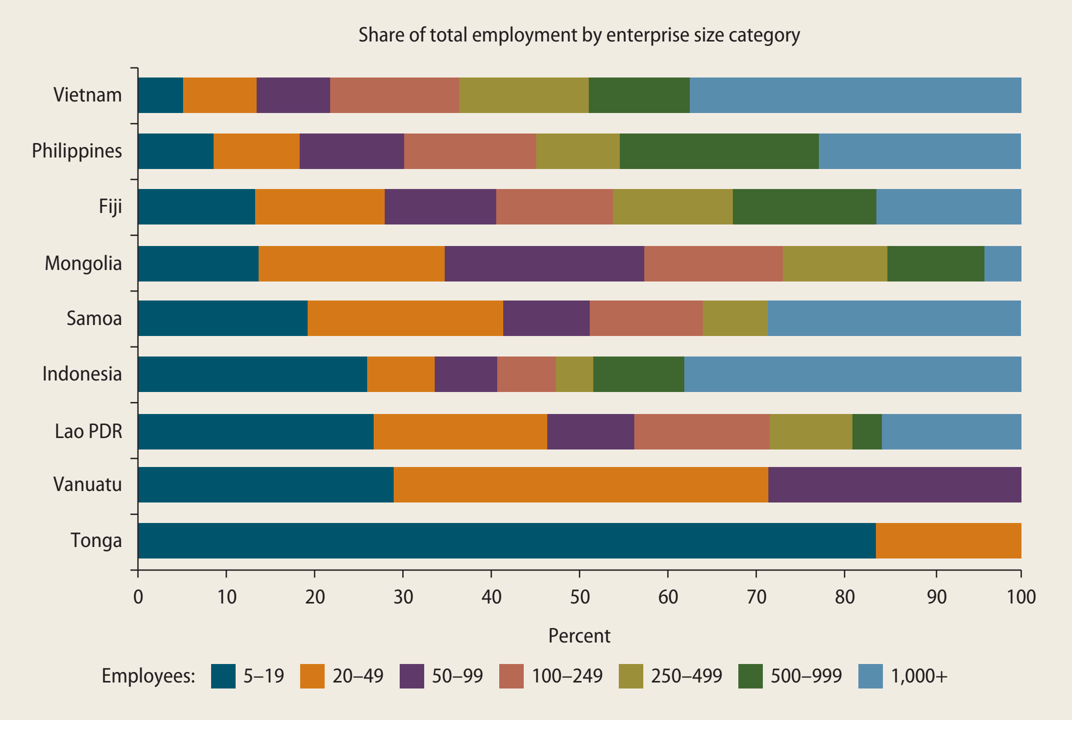
The basic profiles of demand and supply that are presented in this chapter provide the foundation for deeper analysis in chapter 3 of the development transformations propelled by work. These profiles are a result of many factors, including growth, changes in technology, productive assets, the investment climate, and labor policy. The policies that shape demand for and supply of labor and human capital are covered in part II of this report. The diverse ways and places in which people work will have important implications for policy to ensure that work continues to increase productivity, raise living standards, and strengthen social cohesion, a discussion taken up in part III.

The demand for work: A profile from firm surveys

The private sector is the main engine of employment creation, accounting for 90 percent of employment in the world (World Bank 2012b). The private sector has led employment growth in China, for example, by a remarkable margin. From the early 1980s to the early 2000s, China's private sector employment grew from 2.3 million workers to 74.7 million. In contrast, the volume of employment in state-owned enterprises dropped from 80 million to 74.6 million (Kanamori and Zhao 2004, cited in World Bank 2012b). Household survey data indicate that, for most economies in East Asia Pacific, the share of people working in the public sector is less than 5 percent. A significant exception to this pattern can be found in some of the small Pacific island countries, covered at length in chapter 8. Within the private sector, the potential for net employment creation varies substantially across firms, depending on the size and age of the firm as well as the gender of the owner.

Most working people in East Asia Pacific economies earn their living in micro, small, and medium enterprises.[1] Figure 2.1 shows the share of employment by firm size using

FIGURE 2.1 The share of employment in small and medium enterprises varies substantially across countries



Source: Ayyagari, Demirgüç-Kunt, and Maksimovic 2011, based on World Bank enterprise surveys for 2006–10.

the World Bank's enterprise surveys. These surveys include only registered firms with at least five employees. In the Lao People's Democratic Republic, Tonga, and Vanuatu, small enterprises are the major employers, while in Mongolia, small and medium enterprises (SMEs) with fewer than 100 employees employ the most people. In Fiji, Indonesia, the Philippines, and Vietnam, large firms account for the majority of employment. But even in those economies, total employment is still spread across all types and sizes of firms.

These data do not provide the full picture of demand. Given the frame from which their samples are drawn, enterprise surveys do not capture very small, unregistered family enterprises. Based on a more representative sample of firms from firm censuses, small businesses account for the bulk of employment (figure 2.2). In Indonesia, the Philippines, and Thailand, in particular, most people work in micro, small, and medium enterprises, defined as having fewer than 200 employees.

FIGURE 2.2 Micro, small, and medium enterprises employ a large fraction of the labor force

Source: ADB 2009.
Note: The categories are defined slightly differently for Thailand than for the other economies. In all economies except Thailand, micro and small enterprises employ 1–49 workers (in Thailand, 1–50 workers), medium enterprises employ 50–199 workers (in Thailand, 51–200 workers), and large enterprises employ 200 or more workers (in Thailand, more than 200 workers). For China, data are from the 2004 National Economic Census; for Indonesia, the 2006 Economic Census; for Malaysia, the 2005 Annual Survey of Manufacturing Industries; for the Philippines, the 2005 Annual Survey of Philippine Business and Industry; and for Thailand, the 2007 Industrial Census. Estimates for Malaysia, the Philippines, and Thailand impute the number of self-employed by looking at the differential between data from the labor force survey and data from the enterprise survey or census.

Employment also varies by firm age and whether the owner is a woman or a man. For example, firms headed by women in East Asia Pacific are, on average, smaller than firms headed by men. Around 33 percent of small enterprises in Indonesia are managed by women, while only 14 percent of large and 20 percent of medium firms, respectively, are run by women (World Bank 2012a). In addition, more mature firms account for most employment in East Asia Pacific economies. Figure 2.3 shows the share of employment by a firm's age. In most economies of the region, firms that are more than 10 years old have at least a 50 percent share of employment. Timor-Leste, where the largest employers are firms less than two years old, is a notable exception to this pattern.

The segments of SMEs and young firms together account for the majority of new employment created in East Asia Pacific. Based on the enterprise surveys collected between 2006 and 2010, more than 70 percent of employment creation in the economies of East Asia Pacific happens in small firms with fewer than 20 employees (Ayyagari, Demirgüç-Kunt, and Maksimovic 2011). SMEs account for the most employment creation in those economies with available data, while large firms account for the most employment destruction (figure 2.4). More than half of new employment is created by firms less than six years old. This pattern is particularly stark in Indonesia, Timor-Leste, and Vietnam. Lao PDR, Samoa, and Tonga have experienced a net loss of employment driven by the destruction of employment in relatively mature firms (figure 2.5).

FIGURE 2.3 Mature firms account for most employment in East Asia Pacific

Source: Ayyagari, Demirgüç-Kunt, and Maksimovic 2011, based on World Bank enterprise surveys 2006–10.

These observations need to be taken with an important caveat: the data collected by enterprise surveys generally do not follow the same firms over time. As a result, the data include surviving firms but miss firms that have gone out of existence and the employment lost in firms that were liquidated between survey years. This important selection bias in the data makes it difficult to separate the employment creation of existing SMEs from the employment creation of new entrants.

Yet many firms in the region start and remain small. The 2006–09 enterprise surveys show that most registered firms stay in the same size category after three years. Small firms rarely grow into medium and large firms. In East Asia Pacific economies, 1.5 percent of small firms, on average, grow to become medium firms, and 3.3 percent of medium firms grow to become large firms after three years. Firms in the Philippines and Vietnam appear exceptional in this regard: 23 and 24 percent, respectively, grow from the small to the medium size category. The Philippines also has an exceptional share of firms that grow from medium to large size: 27 percent. This performance is followed by Thailand and Vietnam, with 9 and 10 of medium firms, respectively, growing into large firms. Many of the firms that have moved from the small to medium category in Lao PDR and the Philippines are in retail and wholesale trade. The firms that have moved from the medium to large category are mostly in the garment industry in Lao PDR, retail and wholesale trade in the Philippines, and auto components in Thailand.

In fact, owners of small firms often have little intention to grow. Many started their business out of necessity and as a substitute for dependent wage employment rather than out of a desire or talent for entrepreneurship. The Global Entrepreneurship Monitor recently surveyed self-employed people in several countries, including China, Indonesia, the Republic of Korea, Malaysia, the Philippines, Singapore, and Thailand. The survey results show that the share of adults who started their own business is high in middle-income economies in East Asia Pacific compared with middle-income countries in other regions. The share of those who report that they started a business out of necessity is also high relative to countries elsewhere. In China in 2002, 52 percent of self-employed people and employers claimed to be involved in entrepreneurship out of necessity. That share dropped to 37 percent in 2012 (Global Entrepreneurship Research Association 2013). In Vanuatu in 2010, 38 percent of self-employed and employers claimed to have started their enterprise out of necessity, and only 4 percent expected to add more than five employees in the following five years (Global Entrepreneurship Research Association 2013). Similarly low shares of entrepreneurs in Indonesia, Malaysia, the Philippines, and Thailand expected to expand employment significantly (figure 2.6).

The lack of strong growth and further employment prospects among micro and small enterprises, despite being an important segment of the economy, is a reflection of the business climate (International Finance Corporation 2013). Chapter 4 discusses this topic at length. The most binding constraints on firm growth and demand for employment vary by country. But some commonly reported obstacles in East Asia Pacific economies stand out, including lack of access to finance, a shortage of people with the right skills, problems with electricity supply, and competition from the informal economy (International Finance Corporation 2013; World Bank 2013a).

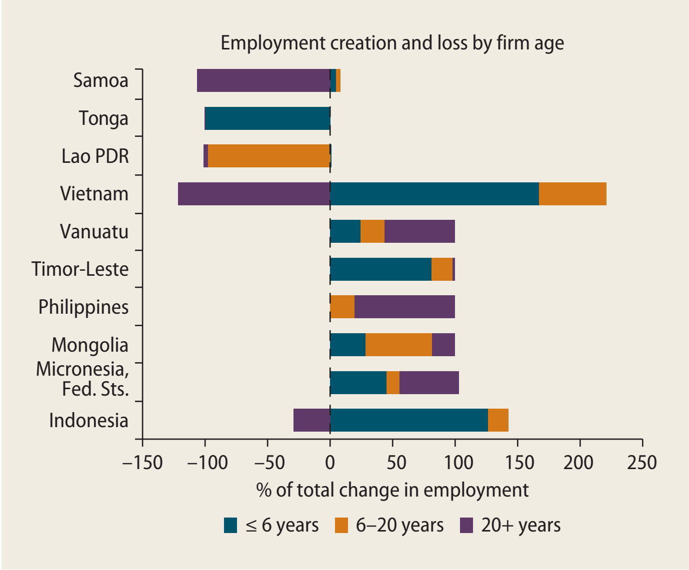
A profile of the labor force in East Asia Pacific: Who is working and where?

East Asia Pacific's demography is changing rapidly. Many East Asian economies will soon cease to benefit from the

FIGURE 2.4 Small and medium enterprises account for most employment creation in East Asia Pacific

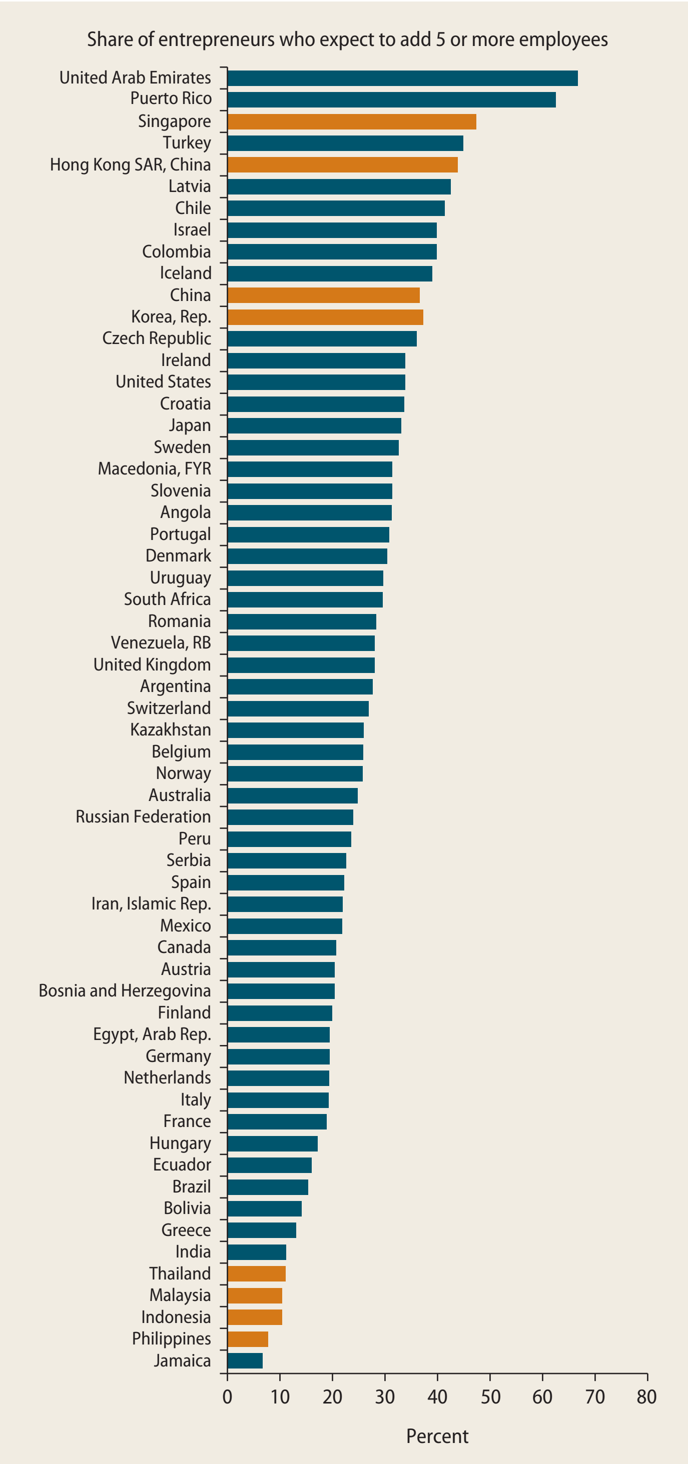
Source: Ayyagari, Demirgüç-Kunt, and Maksimovic 2011, based on World Bank enterprise surveys for 2006–10.

FIGURE 2.5 Young firms create more than half of new employment



Source: Ayyagari, Demirgüç-Kunt, and Maksimovic 2011, based on World Bank enterprise surveys for 2006–10.

FIGURE 2.6 Most new firms in middle-income East Asian economies do not expect to increase employment



Source: Global Entrepreneurship Research Association 2010.

"demographic dividend," a period in most countries' evolution when the share of dependent children and elderly relative to that of working-age adults is particularly low. Fertility rates in most of the economies making up the East Asia Pacific region have been falling rapidly, causing their populations to "age" quickly (figure 2.7). Middle-income economies in East Asia Pacific have the lowest average fertility rate among countries at this level of development. High-income Korea has the lowest fertility rate in the world, at 1.2 births per woman in 2011. China and Thailand are not far off.

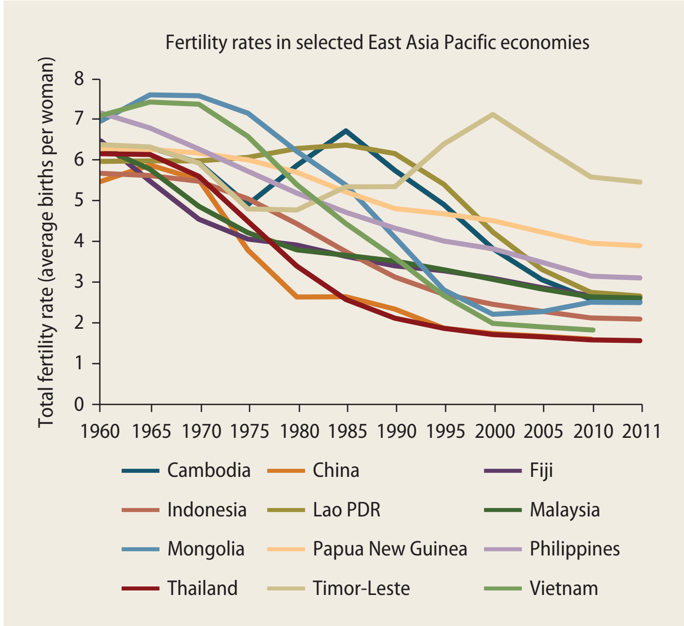
The old-age dependency ratio—the ratio of the population 65 and older to that of working age—has been rising steadily in the region, putting increasing pressure on the working-age population. In the past couple of decades, the share of elderly people in the population has grown faster than in any other low- and middle-income-country region (figure 2.8). High-income Japan, with the highest average life expectancy in the world, offers a preview of what many countries in the region can expect. These demographic factors shape the size and composition of the labor force and, in turn, influence employment and productivity in the economy. The rapid demographic shift is thus an important transition for the region, and we return to it several times in this report because it heavily influences the conclusions and messages for policy makers that are presented in chapter 9. Even in the Pacific island countries, many of which are still "young" and have yet to experience their demographic transition, governments are worried about rising dependency rates. Years of poor nutrition and bad habits have sparked an epidemic of noncommunicable "lifestyle" diseases that can have an impact similar to that of aging on the size and composition of the labor force.

Who is working in East Asia Pacific economies? Figure 2.9 presents a cross-section of key demographic and labor force participation data for two reasons: first, to show how East Asia Pacific economies as a group are different from other countries and, second, to show how different East Asian economies—particularly those in the Pacific—are from each other.

The first important characteristic to note is that most people in East Asia Pacific economies still live and work in rural areas. This is particularly apparent for Pacific island countries. The share of the population living in towns and cities—although growing faster in 1990–2011 than in any other region—remains lower than expected given levels of development (proxied by income per capita). The second important characteristic is that the share of the population participating in the labor force (working or seeking work) is higher in most economies of East Asia Pacific than in comparable countries elsewhere. Economies in East Asia Pacific have much lower rates of open unemployment than other countries at similar income levels. In the East Asian economies, young people (ages 16–25) are more likely to be economically active than elsewhere. So are older people (ages 56 and above). Inversely, Pacific island populations are younger and have lower youth participation rates. We take up the discussion of youth inactivity, unemployment, and the implications for productivity and social cohesion in chapter 3.

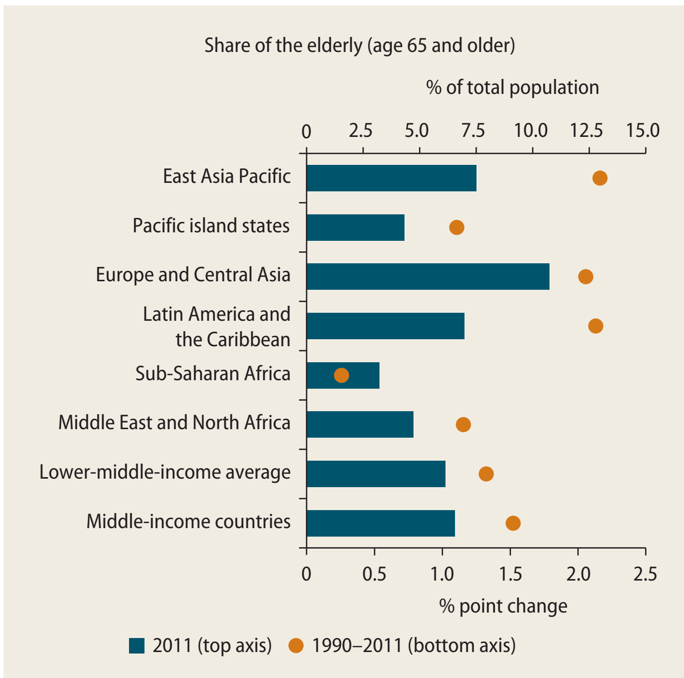
Another important distinction of labor supply in East Asia Pacific economies is that women represent a larger share of the labor force than in other parts of the world. Malaysia is the notable exception in East Asia and so are a few other countries in the Pacific. Among younger cohorts of the population, labor force participation of women has risen over time. Women are increasingly moving out of household work and family-owned enterprises and into nonagricultural employment, and they are migrating to cities for employment opportunities. Yet wage gaps between men and women persist and tend to widen with age. These gaps can reflect many factors, including women's lower average levels of experience caused by gender differences in endowments, career interruptions during childbearing years, and occupational and sector segregation (World Bank 2012a).

FIGURE 2.7 Falling fertility is driving rapid population aging in many East Asia Pacific economies



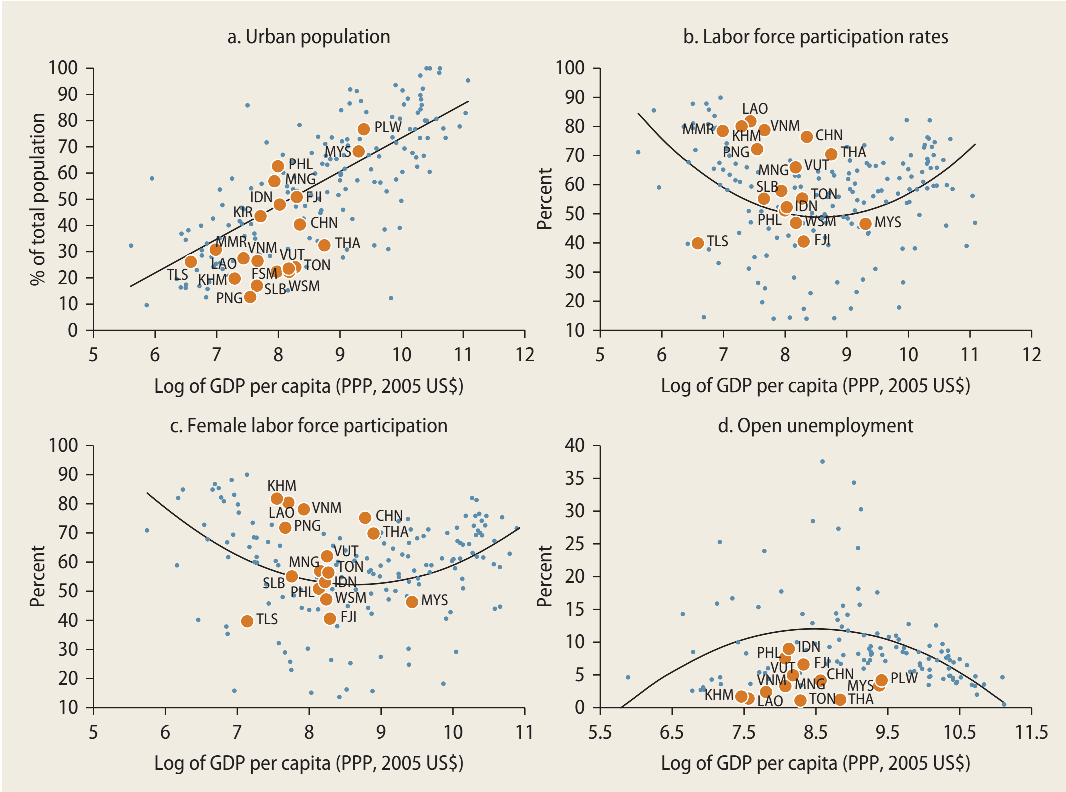
Source: World Bank 2013d.

FIGURE 2.8 The population is aging faster in East Asia Pacific than in other regions



Source: World Bank 2013d.

FIGURE 2.9 The labor force in East Asia Pacific relative to the rest of the world is still very rural, participation in labor markets is high, particularly of women, and open unemployment is low



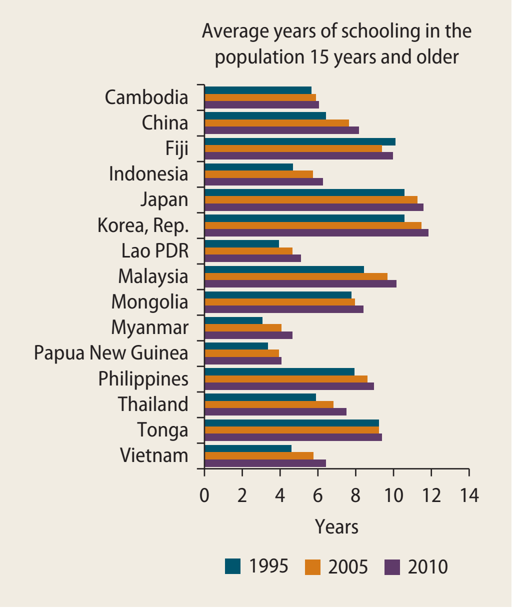
Source: World Bank 2013d.

The labor force in East Asia Pacific, both men and women, is relatively well schooled. Primary school completion rates are at least 80 percent for both girls and boys in most economies. The average years of schooling in the adult population have also increased in most economies (figure 2.10). These achievements are a result of favorable economic growth and good human development policy in many parts of the region. Expanding and deepening access to education, however, does not necessarily equate to an adequately skilled labor force. In chapter 5, we present evidence of important “gaps” in the abilities on offer and what employers say they need. In chapter 5, we also discuss how human capital policies can help to shape the optimal investment in skills and the supply of skills in the labor force.

Where are people working? The composition of the labor force is certainly diverse both within economies, spanning various types of economic engagement, and across economies in East Asia Pacific. A large share of the labor force still works in the primary sectors, specifically agriculture. This ranges from about 34 percent in the Philippines to 70 percent in Lao PDR (figure 2.11, panel a). Wage and salaried employment is a minority share of work: less than 40 percent of working people in low- and lower-middle-income East Asia Pacific today are in wage employment (figure 2.11, panel b). This share remains around 50 percent for the higher-middle-income economies of East Asia and surpasses 70 percent only in Malaysia.

Within countries, the forms of work engagement also vary by income. In all of

FIGURE 2.10 Access to schooling and educational attainment have increased substantially in most East Asia Pacific economies

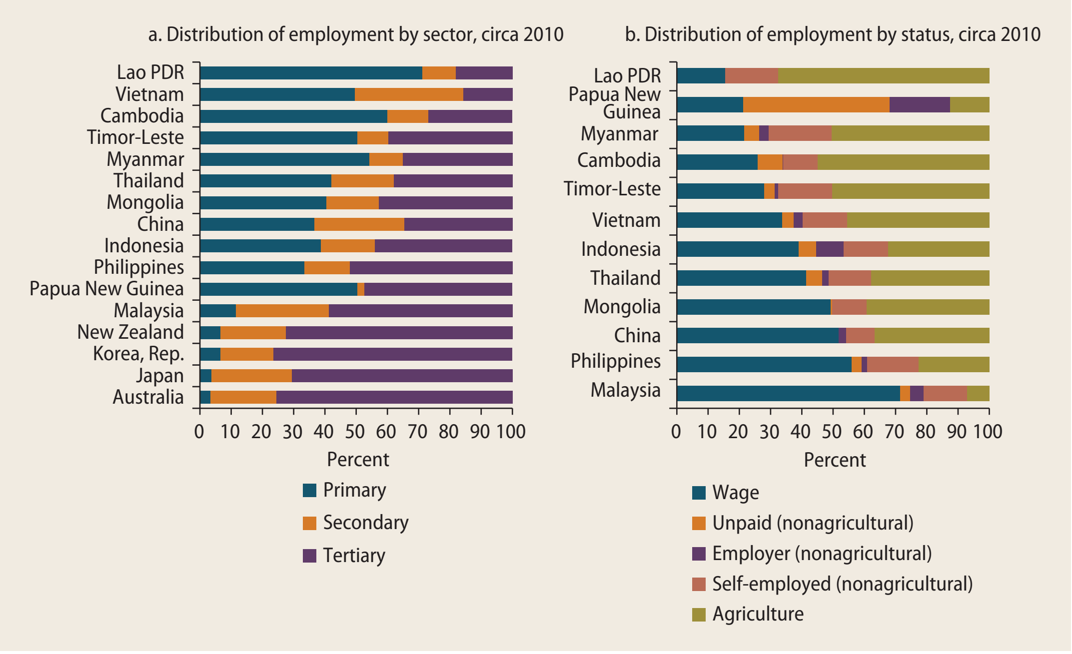


Source: World Bank 2012b.

the East Asia Pacific economies with available data, those in lower income quintiles are more likely to be engaged in agriculture and less likely to be engaged in dependent wage employment (figure 2.12). For example, the share in dependent wage employment among people in the top income quintile is more than twice that among people in the bottom quintile in Cambodia, Lao PDR, Thailand, and Solomon Islands. But even among people in the top income quintile, there are still diverse forms of work engagement, with the exception of Mongolia.

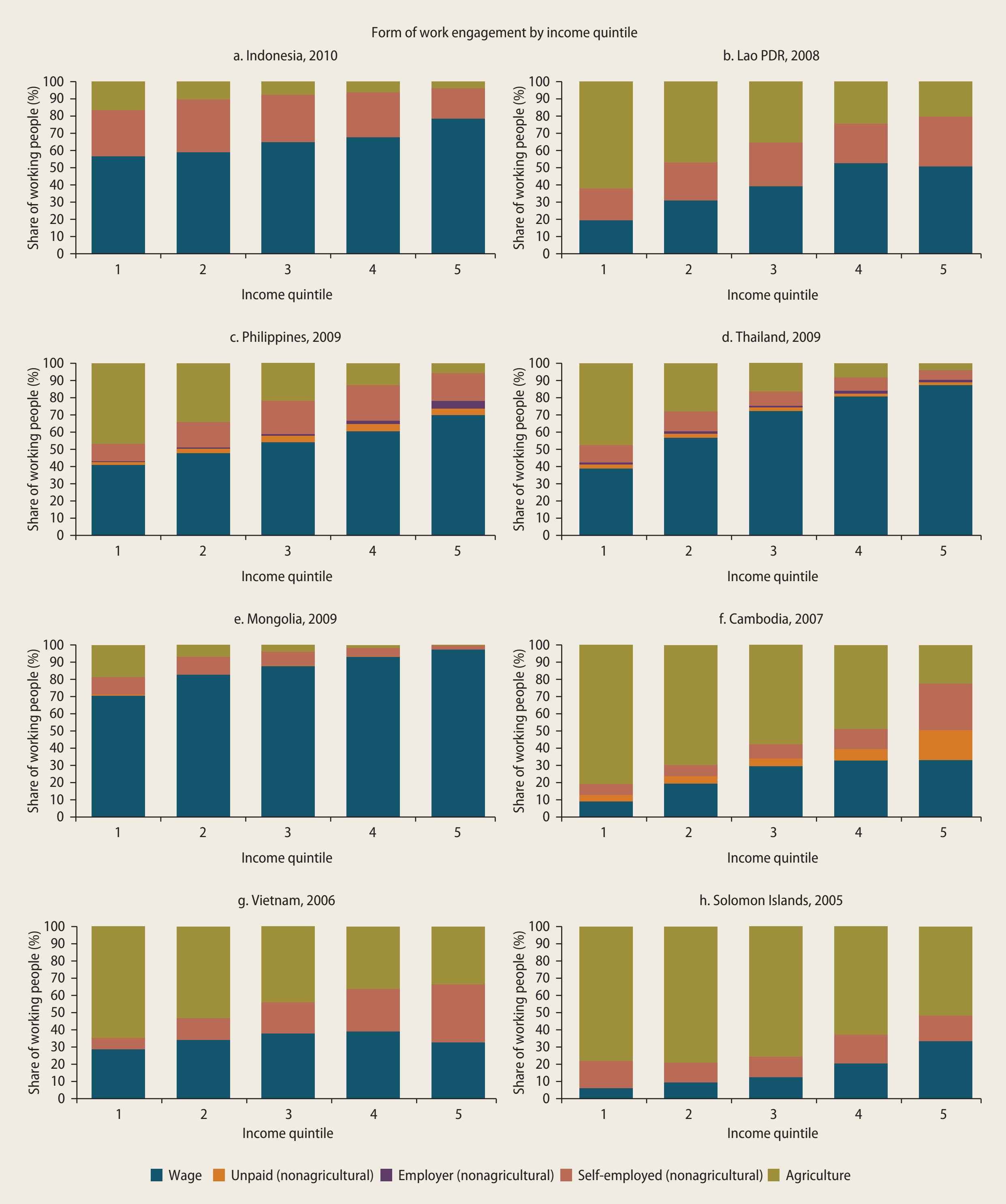
Agriculture's share in employment has been declining over the past half century, but the speed of change varies across countries. The fraction of the region's workforce in agriculture fell from approximately 60 percent in 1991 to just above 40 percent in 2008. But in the countries where available survey data allow us to track changes, the profile of the labor force by type of economic engagement has remained fairly stable. In East Asia, only Indonesia and the Philippines offer an adequately long time series of comparable

FIGURE 2.11 Many people are working in the primary sector and are not dependent on wage employment



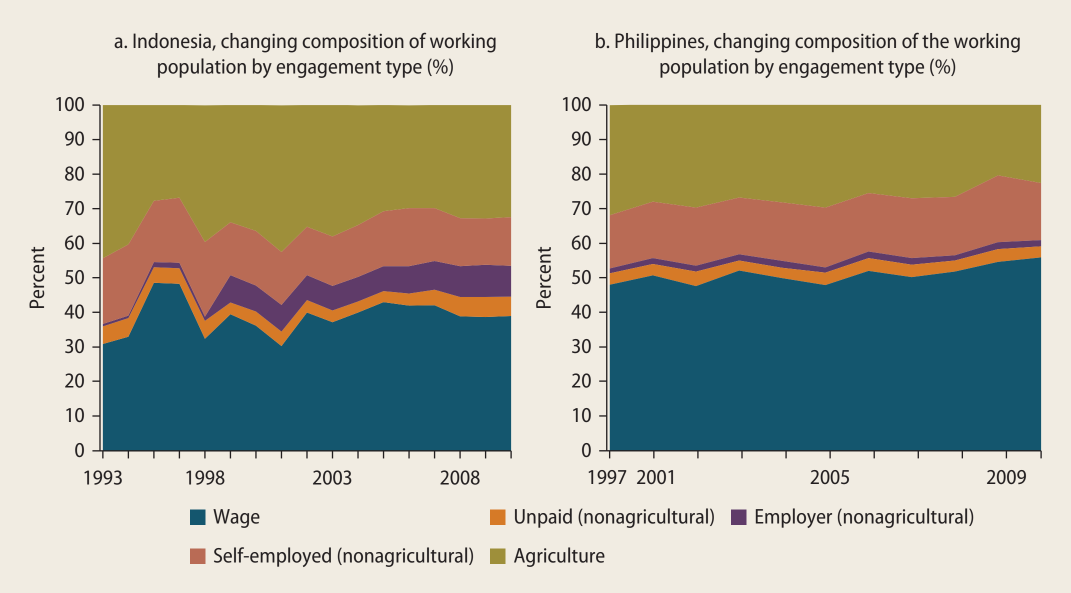
Sources: World Bank 2013b; National Bureau of Statistics of China 2012.

FIGURE 2.12 Dependent wage employment is not the dominant form of economic engagement in East Asia Pacific



Source: World Bank 2013b.

FIGURE 2.13 **The distribution of working people by type of engagement has been fairly stable over time in Indonesia and the Philippines**



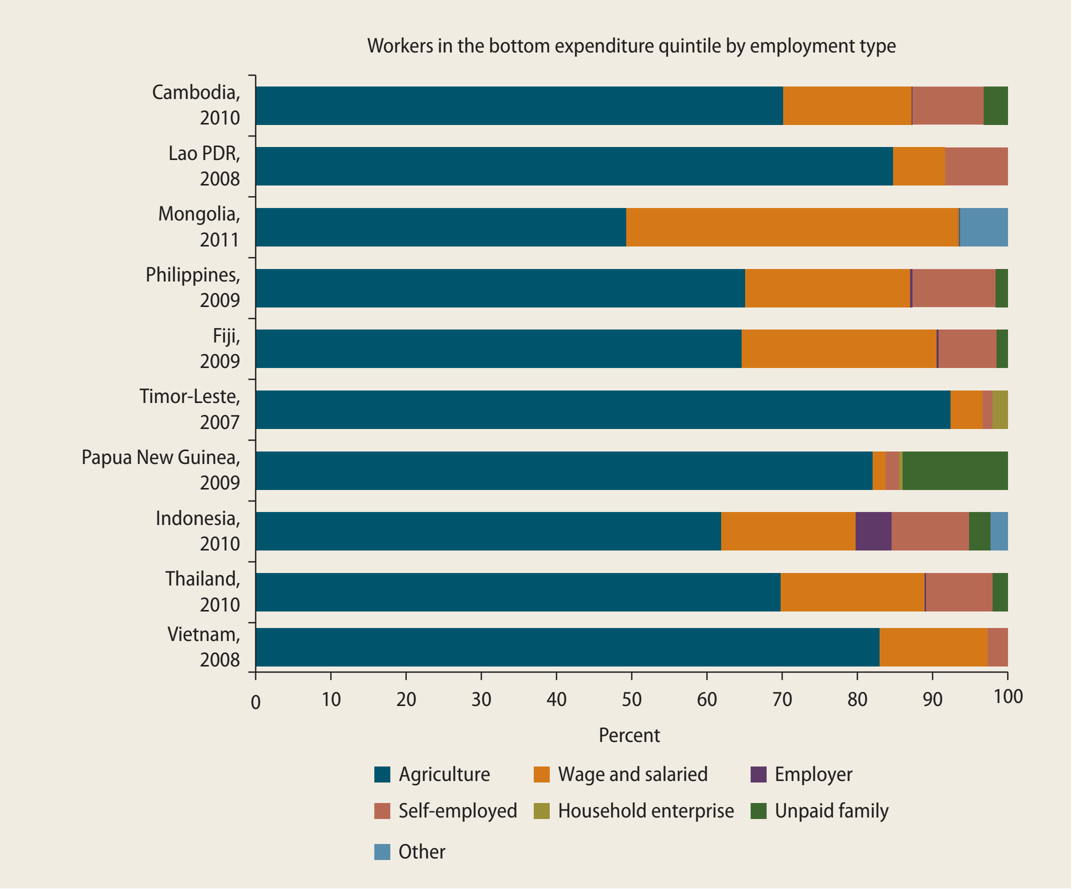
Source: World Bank 2013b.

labor force survey data to shed light on workforce dynamics. Figure 2.13 suggests only small increases in the share working in wage employment and correspondingly small decreases in the share working in agriculture in Indonesia and the Philippines from the 1990s to 2010.

A closer look at people living in poverty and ethnic minorities, in particular, shows that the majority are still engaged in agricultural production. The share of people working in agriculture from households in the bottom quintile is particularly high, more than 80 percent in Lao PDR, Papua New Guinea, Timor-Leste, and Vietnam (figure 2.14). Only a very small share of the poorest population works in dependent wage employment. The largest share is in Mongolia. Other than in Indonesia, few people in the bottom quintile of consumption are self-employed and employers. In addition, people from ethnic minorities in Vietnam are more likely to be in the bottom consumption quintile, and their livelihoods depend almost exclusively on agriculture and forestry. Among poor people, ethnic-majority poor are more diversified in how they work than ethnic-minority poor; they engage in low-skill, low-paid, off-farm employment in rural areas to supplement farm income (Badiani et al. 2012). In Lao PDR, the Lao-Tai are more likely to work outside agriculture, especially when residing in urban areas. All other ethnic groups work mainly in agriculture, independent of the area of residence.

The labor force is also notably more mobile in East Asia Pacific than in other parts of the world. There has been substantial labor mobility within economies in the region. With the process of structural transformation, large numbers of people have moved from rural areas to towns and cities. This movement is reflected in the high urbanization rates in several East Asian economies in the past decades. Even today, internal migrants account for a substantial share of the population in most East Asian economies. Good and comparable data on

FIGURE 2.14 Most people in the poorest households work in agriculture



Source: Estimates based on household surveys.

internal migration are scarce since most of the available measures, such as many in table 2.1, only show interprovince migration and underestimate the extent of people's movements. These measures are hard to compare across countries due to differences in the definition of what constitutes "internal migration."

The movement of working people within national borders is as important as their movement across international borders. East Asia Pacific is both a host to a large number of immigrants as well as a major exporter of labor to markets elsewhere. This characteristic reflects one of the contextual factors discussed in chapter 1: the relatively greater degree of regional and global integration of East Asia Pacific economies when compared to countries in other parts of the world. As of 2010, East Asia Pacific economies hosted approximately 7 million immigrants and received US$90 billion in remittances from up to 21 million emigrants (World Bank 2013c). Pacific island countries like Samoa and Tonga lead in sending emigrants as a share of their small populations (figure 2.15). The Philippines is probably the best-known country for exporting labor. The wide disparities in wealth and earnings across low- and middle-income economies in East Asia Pacific as well as the impacts of aging and labor shortages in high-income East Asian economies are strong forces pulling intraregional migration. Cross-border labor

TABLE 2.1 Internal migration has been a defining force of employment in East Asia Pacific

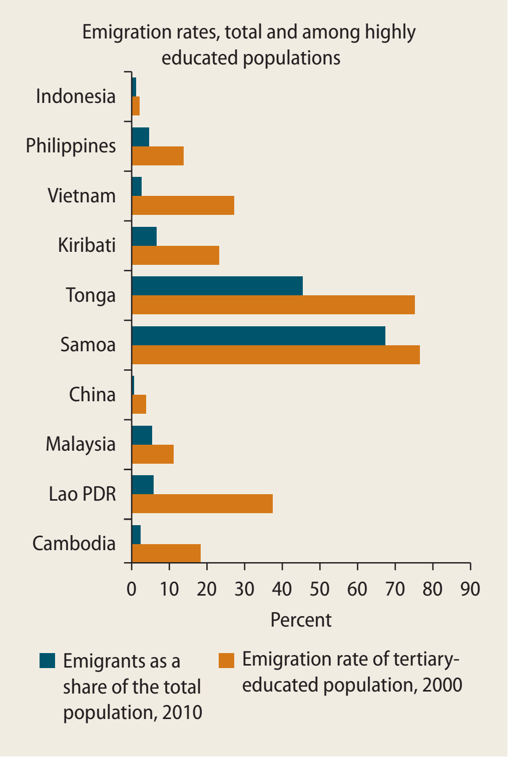
Country	Internal migrants as % of the population	Year	Definition	Source
China	19.6	2011	Total migration rate: population that is registered (with *hukou*) in a town or district other than the one in which they live	China Statistical Yearbook 2012 (National Bureau of Statistics of China 2012)
Indonesia	2.3	2010	Population that is living in a province different from where they lived five years ago	Indonesia Statistical Yearbook 2012 (BPS 2012)
Vietnam	9.7	2010	Interprovince migration: all moves across provinces in the calendar year	Statistical Yearbook of Vietnam 2012 (General Statistics Office of Vietnam 2012)
Thailand	2.0	2009	Interprovince migration: in last two years, population that was away for at least one month at a time or permanently away	2009 Migration Survey (National Statistical Office 2009)
Mongolia	31.6 (of adult population)	2007	Population that ever moved from "birthplace"	Shi (2011), analysis of Household Economic and Social Survey of Mongolia 2007/08
Cambodia	12.2	2008	Interprovince migration: population that ever moved across provinces	Cambodia General Population Census (2008), online tables (National Institute of Statistics of Cambodia 2008)

mobility within the region has become so important that the Association of Southeast Asian Nations Economic Community has set a goal to liberalize the mobility of skilled workers in member states by 2015.

Finally, and critical to explaining why the impact of employment on well-being is such a fast-growing policy concern in the region despite relatively low rates of open unemployment, work in East Asia Pacific is also characterized by a high degree of "informality"—that is, work or other transactions in unregulated and untaxed markets. As with the rate of population aging in East Asia Pacific, we return to this observation repeatedly, and it is the subject of a "spotlight" prior to chapter 3.

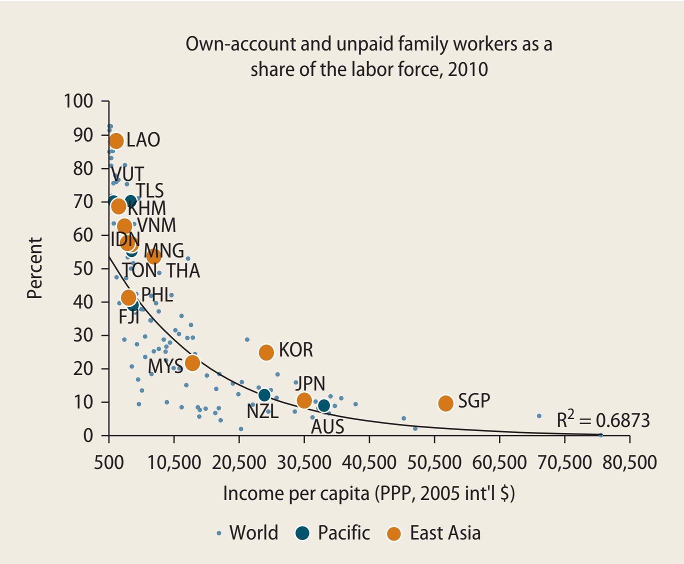
A large portion of unregistered, untaxed work in countries like Cambodia, Lao PDR, and Papua New Guinea can be thought of as *structural informality*, explained by a large share of the labor force still working in subsistence or small shareholder farming. In most countries, this portion of the informal economy decreases almost mechanically with economic growth and the structural change out of agriculture. As shown in figure 2.16, the share of

FIGURE 2.15 Several Pacific island economies have the highest emigration rates



Source: World Bank 2011.

FIGURE 2.16 "Vulnerable" forms of work are more common in East Asia Pacific than in other countries at similar levels of development



Source: Estimates based on data from World Bank 2013d.

"vulnerable employment" (defined as own-account and unpaid family work) is negatively correlated with income per capita. Also evident in this figure is the fact that vulnerable forms of work are more common in East Asia Pacific economies than in other countries at similar income levels.

However, setting aside people who are self-employed farmers or unpaid workers in a family business—what labor economists sometimes refer to as "residual beneficiaries"—there is a persistent remainder in all middle-income countries that can vary widely in size. The remaining share of informal work—whether measured by proxies such as nonfarm self-employment, the share of people working in microenterprises with five or fewer workers, or the workforce that is not contributing for social insurance coverage—is higher in many of the economies in East Asia Pacific than in other parts of the world at similar levels of income.

Conversely, the share of the labor force in "formal" dependent wage and salaried employment in East Asia Pacific economies is among the lowest across low- and middle-income regions, surpassed only by countries in Sub-Saharan Africa. Subsequent parts of this report shed further light on informality. Chapter 6, in particular, examines the extent to which labor regulations and interventions in some countries intensify informal employment.

Note

1. Various definitions of small and medium enterprises exist. The typical categories include SME100, SME200, and SME250, which correspond to the maximum size thresholds of 100, 200, or 250 employees, respectively.

References

ADB (Asian Development Bank). 2009. "Enterprises in Asia: Fostering Dynamism in SMEs, Key Indicators for Asia and the Pacific 2009." ADB, Manila.

Ayyagari, Meghana, Aslı Demirgüç-Kunt, and Vojislav Maksimovic. 2011. "Small vs. Young Firms across the World: Contribution to Employment, Job Creation, and Growth." Policy Research Working Paper 5631, World Bank, Washington, DC, April.

Badiani, Reena, et al. 2012. *Well Begun, Not Yet Done: Vietnam's Remarkable Progress on Poverty Reduction and the Emerging Challenges*. Hanoi: World Bank. http://documents.worldbank.org/curated/en/2012/01/17207159/2012-vietnam-poverty-assessment-well-begun-not-yet-done-vietnams-remarkable-progress-poverty-reduction-emerging-challenges.

BPS (Statistics Indonesia). 2012. *Statistical Yearbook of Indonesia*. Jakarta: BPS.

General Statistics Office of Vietnam. 2012. *Statistical Yearbook of Vietnam 2012*. Hanoi: General Statistics Office of Vietnam.

Global Entrepreneurship Research Association. 2010. *GEM 2010 Global Report*. London: London Business School, Global Entrepreneurship Research Association. http://www.gemconsortium.org/docs/266/gem-2010-global-report.

———. 2013. *GEM 2013 Global Report*. London: London Business School, Global Entrepreneurship Research Association.

http://www.gemconsortium.org/docs/3106/gem-2013-global-report.

International Finance Corporation. 2013. *Jobs: Private Sector Solutions for Development*. Washington, DC: IFC.

Kanamori, Tokoshi, and Zhijun Zhao. 2004. *Private Sector Development in the People's Republic of China*. Manila: Asian Development Bank Institute.

National Bureau of Statistics of China. 2012. *China Statistical Yearbook 2012*. Beijing: China Statistics Press.

National Institute of Statistics of Cambodia. 2008. *Cambodia General Population Census*. Phnom Penh: National Institute of Statistics of Cambodia.

National Statistical Office of Thailand. 2009. *The 2009 Migration Survey*. Bangkok: National Statistical Office of Thailand.

Shi, Anqing. 2011. "Rural Out-Migration and Family Life in Cities in Mongolia: Background Paper." World Bank, Washington, DC.

World Bank. 2011. *Migration and Remittances Factbook 2011*. Washington, DC: World Bank. http://data.worldbank.org/data-catalog/migration-and-remittances.

———. 2012a. *Toward Gender Equality in East Asia and the Pacific*. World Bank East Asia Pacific Regional Report, Washington DC: World Bank.

———. 2012b. *World Development Report 2013: Jobs*. Washington, DC: World Bank.

———. 2013a. *Doing Business 2014*. Washington, DC: World Bank.

———. 2013b. I2D2 (International Income and Distribution Database). Washington, DC: World Bank.

———. 2013c. *International Migration and Development in the East Asia and Pacific Region*. World Bank East Asia Pacific Regional Report. Washington, DC.

———. 2013d. World Development Indicators. Washington, DC: World Bank. http://data.worldbank.org.

Spotlight 1
Work in the Informal Economy

What is the informal economy?

Few of the phenomena that occupy the time of governments, economists, and others in the business of crafting and executing policy are as ambiguously defined and as difficult to measure as the "informal economy." It is inherently difficult to observe that which, by its very nature, people are trying to hide (Schneider, Buehn, and Montenegro 2010). A form of economic activity that first captured the interest of anthropologists and sociologists in the 1950s and came under the scrutiny of development economists in the early 1970s with a seminal report by the International Labour Organization (ILO), the informal economy became a central focus of policy in the late 1980s and early 1990s, when sufficient data became available to show that it was far more than cottage industry, taxi drivers, and children selling candy on street corners.

So what is the informal economy? Definitions change according to who is asking and what motivates their question. A minister of finance might ask in order to know where and how many untapped sources of additional tax revenue can be found. But a minister of labor or the leader of a trade union might ask in order to have a better idea of where to concentrate efforts to ensure that the rights and protections of labor market regulation are upheld. A minister of trade and industry or the head of the local chamber of commerce might ask in order to know where opportunities to expand sales, ensure fairer competition, and improve productivity might lie. A neighbor, frustrated by the time it takes to get his electricity service installed, might want to know who could do the job sooner, faster, and probably for less if paid cash in hand. And from each of these perspectives, a different definition can be drawn of what exactly the informal economy is.

In 2002, at the ninetieth session of the International Labor Conference, the term "informal economy" was defined as "all economic activities by workers and economic units that are not recognized, regulated, or protected by existing legal or regulatory frameworks and non-remunerative work undertaken in an income-producing enterprise."[1] Although this definition seems comprehensive, it can be unwieldy. The Organisation for Economic Co-operation and Development (OECD 2004, 2008) offered a more parsimonious definition: the informal economy is "employment or other economic activity engaged in producing legal goods and services where one or more of the legal requirements associated with employment and production are not complied with." This is a more widely applicable definition, although still challenging to measure.

In this report, we use the overarching term "informal economy" in reference to market-based production of goods and services that are, in essence, legal under prevailing laws, but concealed to avoid payment of income taxes and social insurance contributions and to escape product and factor market regulation. We count as the "informal" workforce the self-employed and employers who employ five or fewer workers, workers without a written employment contract, unpaid family workers, and those who do not make social insurance contributions. Data limitations, discussed later in this section, rarely allow measurement to be as precise as definition, however, and force us to use one observable feature or another throughout this report.

Why does it matter?

Why should policy makers be concerned about informal employment and the informal economy? People work and do business outside the confines of social, labor, and business regulation for a variety of reasons. Some *exit* the structures of the formal economy to escape regulatory costs or to enjoy greater flexibility, while others are *excluded* by a lack of opportunities for advancement and actual barriers to better-protected, higher-productivity jobs (Perry et al. 2007; Packard, Koettl, and Montenegro 2012).

But whether they are working informally because they "exited" or are "excluded" from formal employment, widespread informal work and a large informal economy can be treated as evidence of inadequate and unsustainable social institutions: the very institutions the state puts in place to help households to build, sustain, and protect their investment in human capital as they enter the labor market to seek a return on this investment. Indeed, a large and growing informal economy can been seen as the consequence of a mass opting out of institutions by firms and individuals and "a blunt societal indictment of the quality of the state's services provision" (Perry et al. 2007).

Informal employment has long concerned policy makers for several reasons.

First, there is the problem of the individual and her family. People working informally and their dependents face explicit and implicit barriers to public and privately provided insurance instruments for managing potentially impoverishing shocks to their income. Even if people are able to manage many risks to their well-being without the help of the state, they may find it difficult to assess the costs of certain needs accurately, such as their health care or a period of job search, or to make sufficient provision for losses far in the future, such as adequate income arrangements when they can no longer work in old age. Nor do people who work informally have easy access to credit or recourse to rights and the legal protections these afford when things go wrong.

Second, there is the problem of the firm. In countries with large informal economies, bigger firms are often taxed excessively to make up for revenue lost to the government from widespread evasion. This can discourage investment and hinder growth. Furthermore, firms operating within the rules face unfair competition from those operating outside the rules. Firms that operate in the informal economy can be constrained to a small size to escape detection by the tax authorities and may have to forgo a more efficient scale of production. And like households where the main breadwinner works informally, these informal firms also have limited access to credit and recourse to legal protection when they need it.

Third, there is the problem for society as a whole. A large informal economy imposes heavy costs that deteriorate services and public goods. This is what economists like to call a "free-rider problem"; in extreme cases, it can corrode civic structures to such an extent as to contribute to government failure. As a specific example of this corrosive process, a country's social "risk pools," such as public old age, unemployment, and health insurance and the tax and transfer system, become fragmented, inefficient, and too expensive to remain viable.

What to do about the extent of informal employment and the size of the informal economy is a dilemma that has been gaining urgency. The forces that accompany globalization put a premium on mobility and skill renewal. Rapid population aging will require that people work longer and be far more productive. To achieve this, social institutions have to be more "pro-work," encouraging greater participation. As the rate of growth moderates, public financial resources will be increasingly scarce, giving urgency to measures that can significantly and sustainably increase tax revenue.

How is informal employment measured?

It is particularly challenging to measure the informal economy and informal work in East Asia Pacific economies. Microdata from household and labor force surveys are abundant and, for some countries, of excellent quality. These data can be used to identify employers, people in self-employment, and people working in a family business without payment. We have used firm surveys to identify the demand for labor from smaller enterprises and compare this with demand from larger businesses that are more likely to be formal.[2] However, none of the surveys we have exploited for this report asks respondents the crucial questions required to identify unregulated dependent employment. In most low- and middle-income countries in Latin America and the Caribbean and in Europe and Central Asia, it has now become standard in labor force surveys to ask respondents about (1) the size of the firm in which they work (that is, the number of people employed), (2) whether they have a written labor contract, and (3) whether they make contributions to a social insurance plan (retirement pensions, health care, or unemployment insurance) or whether their employer does so on their behalf. The last two are particularly important for identifying people working informally in otherwise formal enterprises. To the best of our knowledge, in East Asia Pacific, only in Indonesia and the Philippines have the statistics authorities included these questions in their surveys and only in a one-off, special-purpose survey in the latter.

Given the limitations of available microdata from East Asia Pacific countries, we use three measures throughout this report as proxies for the extent of informal work: self-employment, "vulnerable" employment, and the share of the labor force not making contributions to social insurance. Each measure has limitations.

Not all self-employed people are working in the informal economy. Even if they are a minority, many people who report self-employment as their main form of economic activity comply with regulatory and tax requirements. While it is the proxy measure that is most observable and widely available across countries and over time, the share of the labor force in self-employment will include people who are not working informally according to any of the dimensions discussed above.

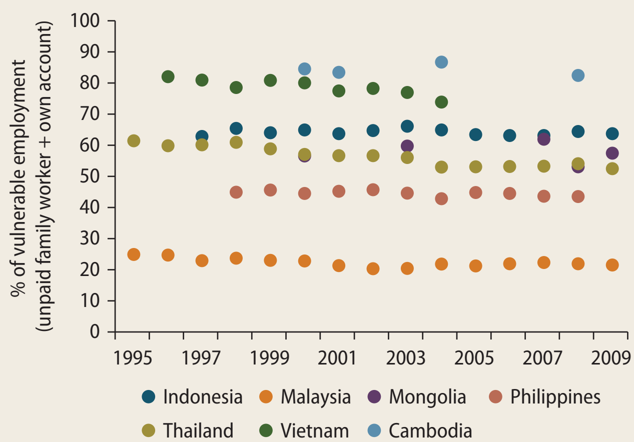
So-called "vulnerable" employment is derived simply by adding people in unpaid family work to the self-employed. Although also widely available, this variable has the added ambiguity of including people who, although not receiving wages, may be residual beneficiaries of family enterprises. If the family business prospers, in most cases it is reasonable to assume that they will prosper too.

Finally, the share of the workforce not contributing to social insurance is the inverse ratio of two aggregate statistics—the number of contributors and the economically active population. However, although it is a fairly precise measure of people working without the protection of social insurance (at least in countries where access to protection requires a history of contributions), it is not widely available.

Informal employment in East Asia Pacific

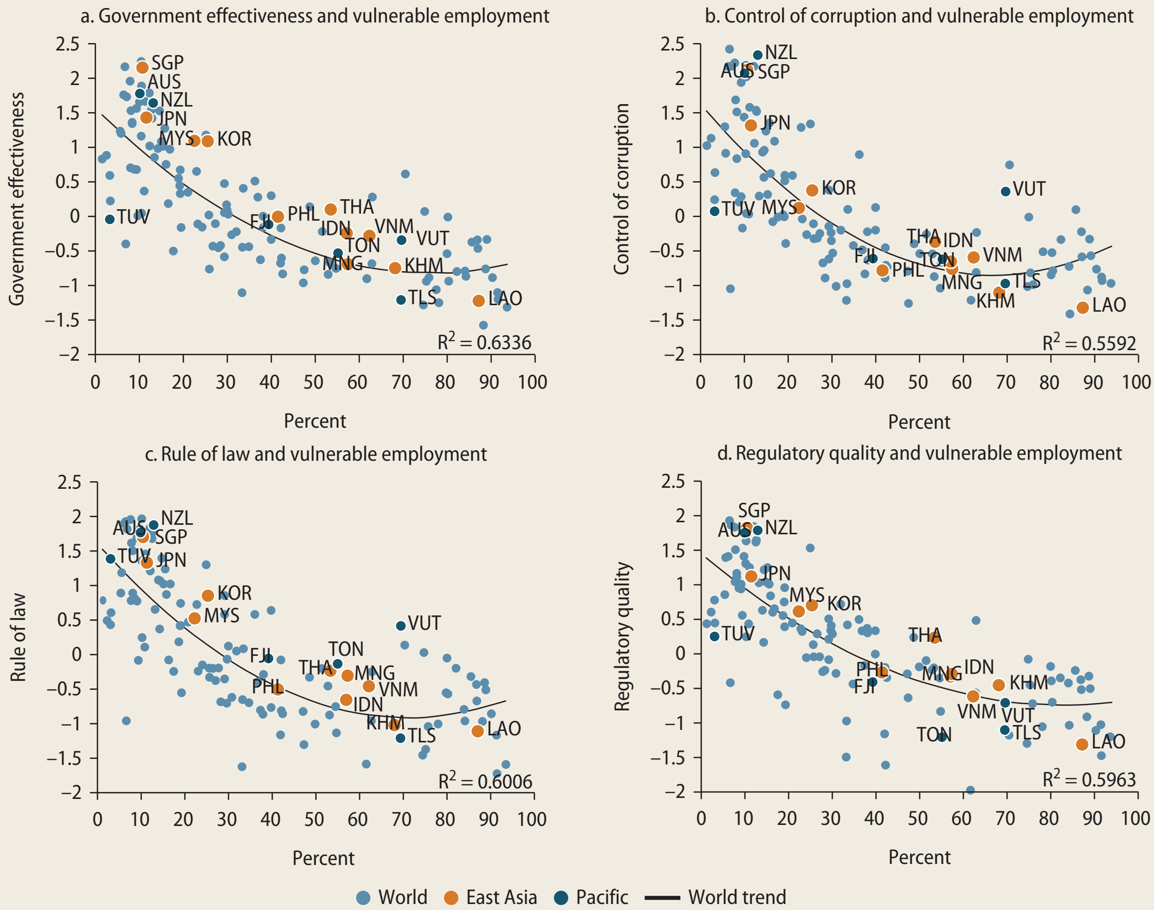
Have the economies of East Asia Pacific been creating more formal than informal work in recent years? Figure S1.1 shows

FIGURE S1.1 Vulnerable employment has remained steady in most East Asia Pacific countries



Source: World Bank 2013a.

FIGURE S1.2 **Informal employment is higher where governance is weaker**



Sources: Estimates based on data in World Bank 2013a, 2013b.

that the share of unpaid family and own-account workers remained fairly stable in most economies of the region during the past decade, except for Mongolia, which experienced a slight reduction. This is in sharp contrast to low- and middle-income countries in Latin America and the Caribbean and in Europe and Central Asia. However, when measured by the share of contributors to social insurance, formal work has increased in China, Mongolia, and Vietnam (chapter 7). By this same measure, there has been little change in Indonesia and the Philippines.

By most proxy measures, the low- and middle-income economies of East Asia Pacific stand out as places with extensive informal employment. Only countries in Sub-Saharan Africa tend to show consistently higher rates of informality, while those in South Asia may show higher rates by some measures. Much of informal work, however, is "structural" informality: it reflects a large portion of people still working in subsistence and small-scale commercial agriculture beyond the reach of regulation and taxation, as well as the speed of migration to towns and cities. While there are good reasons to expect widespread informality to persist even with urbanization (Ghani and Kanbur 2013), a significant portion of the informal sector tends to disappear as countries grow in wealth.

However, in the chapters of part II we present evidence that associates the extent of informal employment with taxation and, more evidently, with labor market policies. These factors are important to take into account. But as research from Latin America and Eastern and Southern Europe shows, neither differences in taxation nor differences in regulation provide a fully satisfactory answer to the question of what drives people into informal work. What matters just as much as labor regulation and taxation is the credibility of the state as provider of services and public goods.

Figure S1.2 shows that vulnerable employment tends to be higher in countries with weaker institutions and governance. Just as policy makers have to look beyond the labor market for ways to sustain demand for employment, "formalizing" a greater share of economic activity can require measures to improve governance and the credibility of the state in the eyes of working people.

Notes

1. Informal employment, according to the ILO, includes own-account workers (self-employed without employees) and employers employed in their own informal sector enterprises; unpaid family workers, irrespective of whether they work in formal or informal sector enterprises; members of informal producers' cooperatives; own-account workers engaged in the production of goods exclusively for final use by their household; and employees holding informal jobs in formal or informal sector enterprises or working in households as paid domestic workers. For this last category, *informal jobs* are those where the employment relationship is not subject to legislation, income taxation, social protection, or entitlement to codified benefits, such as advance notice of dismissal, severance pay, paid annual leave, or sick leave.
2. We have not, however, separated firms into those registered and those not registered, which would be the best accepted practice for quantifying demand for work from businesses that operate fully in the informal economy.

References

Ghani, Ejaz, and Ravi Kanbur. 2013. "Urbanization and (In)Formalization." Policy Research Working Paper 6374, World Bank, Washington, DC.

OECD (Organisation for Economic Co-operation and Development). 2004. *2004 OECD Employment Outlook*. Paris: OECD.

———. 2008. *2008 OECD Employment Outlook*. Paris: OECD.

Packard, Truman, Johaness Koettl, and Claudio E. Montenegro. 2012. *In from the Shadow: Integrating Europe's Informal Labor.* Washington, DC: World Bank.

Perry, Guillermo, William F. Maloney, Omar S. Arias, Pablo Fajnzylber, Andrew D. Mason, and Jaime Saavedra-Chanduvi. 2007. *Informality: Exit and Exclusion*. World Bank Latin American and Caribbean Regional Study. Washington, DC: World Bank.

Schneider, Friedrich, Andreas Buehn, and Claudio Montenegro. 2010. "Shadow Economies All over the World: New Estimates for 162 Countries from 1999 to 2007." Policy Research Working Paper 5356, World Bank, Washington, DC.

World Bank. 2013a. World Development Indicators. Washington, DC: World Bank. http://ddp.worldbank.org/ddp/home.do.

———. 2013b. World Governance Indicators. Washington, DC: World Bank. http://info.worldbank.org/governance/wgi/index.aspx#home.

Is Work in East Asia Pacific Transformational? Greater Productivity, Living Standards, and Social Cohesion

3

East Asia Pacific has reached a stage in its development when productivity gains, improved living standards, and greater social cohesion from work—the so-called "development transformations"—can no longer be taken for granted.

By economic convention, growth in output generates work since demand for labor is derived from demand for final goods and services. However, the *World Development Report 2013: Jobs* (World Bank 2012e; hereafter WDR 2013) argues that, rather than just a product of the demand for output, jobs also propel the process of development by contributing to three important and interrelated objectives—economic growth, poverty reduction, and cohesive societies. Toward these ends, people's work can act as a conduit for three transformations that drive a country's development: *increasing productivity, improving living standards,* and *strengthening social cohesion*. In reality, is work an effective channel for these three transformations? Are these gains from work always expected in a region with respectable economic growth like East Asia Pacific? These questions motivate a deeper discussion of employment and development than provided by the simple correlations between employment and growth or by the labor supply and demand profiles presented in chapters 1 and 2.

This chapter presents evidence of the three development transformations in East Asia Pacific economies and the role of work in bringing them about. Work has indeed been an effective channel for economic growth as well as individual and societal well-being in the region. During the past 20 years, remarkable improvements in economic productivity, living standards, and social cohesion happened in tandem and reinforced each other in many parts of East Asia Pacific. In many parts of the region, rapid economic growth was fueled by shifts in the structure and factors of production to increase agricultural output and to support the rise of manufacturing and services in towns and cities, accelerating labor productivity. East Asia Pacific's ongoing and relatively successful urbanization process indicates that the three transformations have, on the whole, been occurring simultaneously. Engagement in global markets through light manufacturing exports created substantial opportunities for employment, drawing rural migrants to towns and cities, creating access to better services, and raising living standards. In many countries of the region, growth has promoted social cohesion, brought more women into market work, benefited people who are poor or living in economically lagging and rural areas, and helped to prevent social fragmentation. In other words, consistent with the arguments in the WDR 2013, greater productivity has paved the way for rising living standards and stronger social cohesion.

But we also show in this chapter that the region is at a stage in its development where productivity gains, improvements in living standards, and advances in social cohesion can no longer be taken for granted. One or more of the development transformations propelled by work are now starting to lag. Some East Asia Pacific countries experience direct threats to social cohesion, while others struggle to achieve productivity growth, to sustain gains in living standards, and to accelerate poverty reduction. During structural transformation, the movements of so many working people, while improving individual well-being, have also reshaped the distribution of welfare and opportunities in society. Increasing inequality in earnings, rising returns to skills, and disparities in well-being across geography and communities are driving rising consumption or income inequality in China, Indonesia, the Lao People's Democratic Republic, and Vietnam. Several East Asia Pacific countries now have among the highest rates of youth unemployment and inactivity in the world. These signs raise concerns about social cohesion. In addition, moderated growth rates in the region are associated with slower gains in living standards than many people have come to expect over the past two decades. Emerging imbalances in the pace of the transformations pose a challenge to well-being from work that East Asia Pacific countries cannot afford to ignore.

Work and productivity

Economies grow as people become more productive at what they do. Productivity gains also happen as less productive work disappears and more productive work is created. In low-income and lower-middle-income countries, this process often takes the form of people moving from less productive to more productive sectors, such as from farms to firms, and labor being combined more effectively with land and capital. In the early phases of development, a large fraction of the population typically works in agriculture, and this sector accounts for a dominant share of economic output. At this stage, the share of employment in agriculture usually exceeds its share in output (World Bank 2007). But as productivity in the agriculture sector increases and as industry gains strength, labor is drawn from agriculture and into industry equipped with more capital, and overall productivity and gross domestic product (GDP) increase.

With a few exceptions, most East Asian countries have experienced steady improvements in productivity in recent decades, contributing to overall economic growth. Figure 3.1 demonstrates substantial increases in labor productivity throughout the 1990s and 2000s in many countries in the region. China's threefold productivity growth since 2000 was the most impressive, followed by Vietnam's nearly twofold increase. China's GDP growth from 1978 to 2007 can be accounted for primarily by productivity growth, while its pre-1978 growth was mostly due to growth in physical and human capital (Zhu 2012). Labor productivity growth was also notable in Indonesia, Malaysia, Mongolia, and Thailand. However, productivity growth only started to take off in Cambodia in the mid-2000s. Labor productivity in the Philippines was stagnant until 2002 and increased the least among East Asian economies over the past 20 years. But on the whole, the region's impressive productivity growth was an important determinant of its output growth.

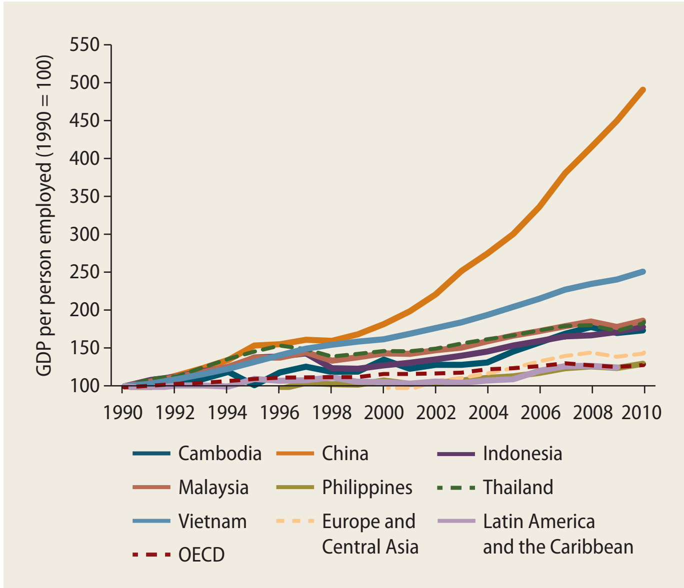
Work has been an effective conduit for productivity gains in East Asia Pacific, notably through people taking up more productive forms of work. This process, when led by enhancements in farm productivity, has enabled successful structural transformation and contributed to better paid work and poverty reduction in many countries of the region. Increased farm productivity raised farmers' income, promoted downstream agricultural businesses, created demand for rural nonfarm services, and released large amounts of labor from agriculture to join urban manufacturing and services. The reallocation of labor across sectors was a significant driver of labor productivity gains in most of the region. However, as slowing global demand tends to moderate economic growth and as farm-to-firm movements decelerate, countries in the region can no longer take for granted the sort of productivity gains they have experienced until now.

Productivity on farms

Across most of the region, agricultural productivity has increased in recent decades. Figure 3.2 shows trends in crop yields (output per hectare) for six East Asian countries for which data are available. Growth in land productivity has been especially impressive in China, but much slower in the Philippines. In Cambodia and Lao PDR, farm productivity growth took off at a later stage, resulting in a surge in crop yields starting in 2000. These gains in agricultural productivity increased rural income and helped to reduce poverty in the region (as discussed later in this chapter).

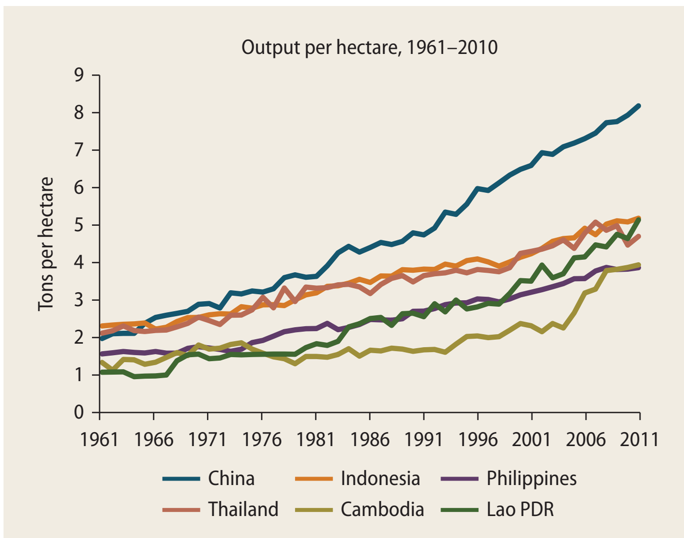
Several factors contribute to changes in the productivity of agriculture. Farm size is widely viewed as an important correlate, since output per hectare is a combination of output per worker (labor productivity) and land per worker. A famous and recurring empirical observation documented in the literature is the inverse relationship between farm size and productivity. Studies from South Asia and Sub-Saharan Africa find that farm size is inversely related to productivity, implying that an increase in farm size results in a reduction in crop yields (World Bank 2012e). One commonly cited explanation for this relationship is that most farms in low-income countries are household farms that may have an excess of domestic on-farm labor supply relative to other factor inputs, such as fertilizer and land, resulting in large household farms being relatively less productive (World Bank 2012e). However, this relationship is not always statistically robust. Between 1961

FIGURE 3.1 Labor productivity grew faster in most East Asia Pacific countries than elsewhere



Source: World Bank 2012a.
Note: OECD = Organisation for Economic Co-operation and Development.

FIGURE 3.2 Crop yields have increased substantially across the region



Source: FAO 2013.
Note: Crop production comprises cereals, fiber crops, fruits, oil crops, pulses, roots and tubers, tree nuts, and vegetables.

and 2000, average farm size decreased in China and remained constant in Thailand, while land productivity grew 2.9 percent in China and 2.5 percent in Thailand. However, once differences in soil quality and irrigation are taken into account, the inverse farm size–productivity relationship often breaks down (Fan and Chan-Kang 2005).[1]

Far more important is the impact that institutions and public policy can have on the productivity of agriculture. For instance, agricultural productivity growth from 1978 to 1984 in China was driven mostly by institutional arrangements and incentives for farmers rather than by technological improvements. But after 1984, liberalization of the sector incentivized the adoption of new technologies by farmers (Zhu 2012).

Tenancy arrangements and ownership rights are fundamental institutions that affect household investments in land and, as a result, can contribute to agricultural productivity. Sharecropping, still a common tenancy arrangement in East Asia Pacific, correlates negatively with productivity (Ray 1998; Banerjee, Gertler, and Ghatak 2002). For instance, Shaban (1999) finds differences in input and output intensities between plots where households are owners and those where they are sharecroppers, even after differences in plot characteristics and irrigation have been taken into account. Similarly, Jacoby and Mansuri (2009) find that yields on sharecropped plots are about 2.3 percent lower, although this difference is not statistically significant. In terms of land rights, Markussen (2008) finds that plots in Cambodia with legal documentation have higher output and sales value per hectare. Analyzing the 1993 land law reform in Vietnam, Do and Iyer (2008) find that extending the coverage of land titling increased the cultivation area of long-term crops as well as the time spent on nonfarm activities. World Bank (2013b) argues that limited access to land by smallholder farmers in the Philippines has contributed to low agricultural productivity and high food prices.

The gender of the owner, farmer, or manager of a farm can also matter to the productivity of agriculture in certain contexts, although there is less evidence of gender being a significant factor in East Asia Pacific countries. Within farm households, evidence from outside the region shows differences in yields between land plots controlled by men and those controlled by women, with inferior and lower factor inputs on the plots farmed by women (see, for instance, Udry 1996; Kilic, Palacios-Lopez, and Goldstein 2013; Andrews, Golan, and Lay 2013). Evidence from East Asia Pacific on gender differences in farm productivity is scarce, but findings from China suggest that farms managed by women are as productive as those managed by men and that women farmers face no substantial differences in the quantity or quality of land, labor inputs, or access to credit compared to men farmers (de Brauw et al. 2008).

Structural transformation and productivity growth

As agricultural productivity increased, many East Asian countries experienced large-scale movements of labor away from agriculture and toward labor-intensive manufacturing and services in towns and cities. Some countries in the Pacific have experienced similar structural dynamics, but at considerably smaller relative volumes. Surplus labor that was freed to move off of more productive farms was pulled into urban manufacturing as part of the export-led growth model enabled by increasing global integration. This structural transformation drove productivity gains in East Asia Pacific, as people moved from less productive to more productive forms of work and as the agglomeration effects of concentrating people and firms in towns and cities took hold (Gill and Kharas 2007; World Bank 2008a).

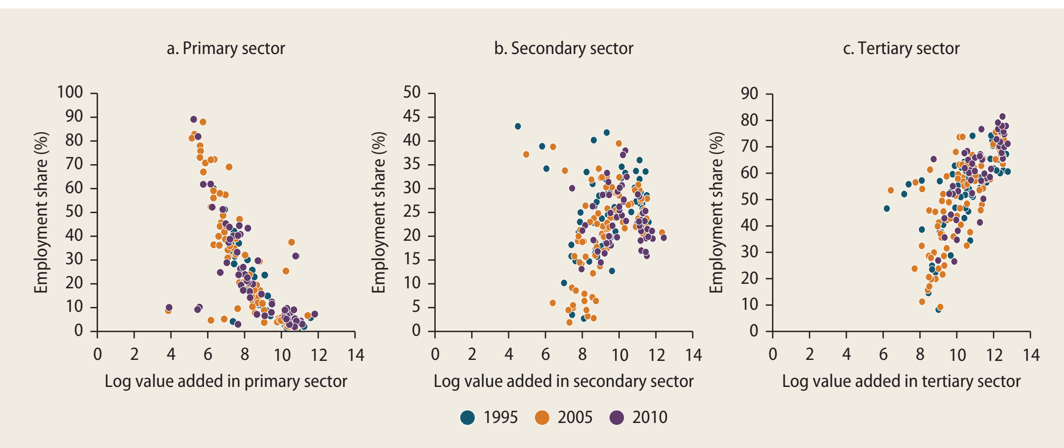
A shift of the factors of production away from the primary sector and toward the secondary and tertiary sectors often results in an overall gain in productivity. The share of the workforce in East Asia Pacific working in agriculture fell from approximately 60 percent in 1991 to slightly over 40 percent in 2008 (World Bank 2013c), reflecting a similar pattern in low- and middle-income countries in other regions. As farming became more productive, employment in agriculture fell. As productivity rose in manufacturing and services, more people took up work in these activities. Figure 3.3 shows the dynamic relationship between employment shares and productivity by sector from 1995 to 2010. Rising value added in the primary sector is correlated with a decline of employment in that sector, while the opposite is observed in the secondary and tertiary sectors, where rising value added is correlated with rising employment. The positive relationship is more significant and visible in the tertiary sector than in the secondary sector. Value added in manufacturing and services goes hand-in-hand with increased employment in these segments of the economy over time.

Both within-sector and across-sector productivity changes were important to overall productivity growth in low- and middle-income countries the world over, but labor reallocation across sectors was a stronger contributor to higher productivity in East Asia Pacific than in any other region. In other words, the contribution to overall productivity improvements of people moving from one form of work to another was particularly important in the rapid development of countries in East Asia Pacific. This is clearly illustrated by decomposing overall labor productivity growth into movements within and across sectors in 81 countries during the 1999–2008 period (figure 3.4).

From 1999 to 2008, labor productivity grew at a faster rate in East Asia Pacific than in any other region, at 5.3 percent annually. The next fastest was in South Asia and Central South East Europe, at 5 percent (figure 3.4). The reallocation of labor across sectors accounted for 2.5 percentage points of annual labor productivity growth in East Asia Pacific, surpassing the other regions both in absolute size and in contribution to overall labor productivity growth. In China, labor reallocation across sectors accounted for 4.1 percentage points of the 7.3 percent annual growth in labor productivity. In Vietnam, it accounted for 2.6 percentage points of the 4.2 percent annual labor productivity growth. But this regional characteristic is not just a story of China and Vietnam: in two-thirds of the countries depicted, cross-sectoral movement was a more important driver of labor productivity gains than in other regions, where reallocation of labor within sectors was more dominant.[2]

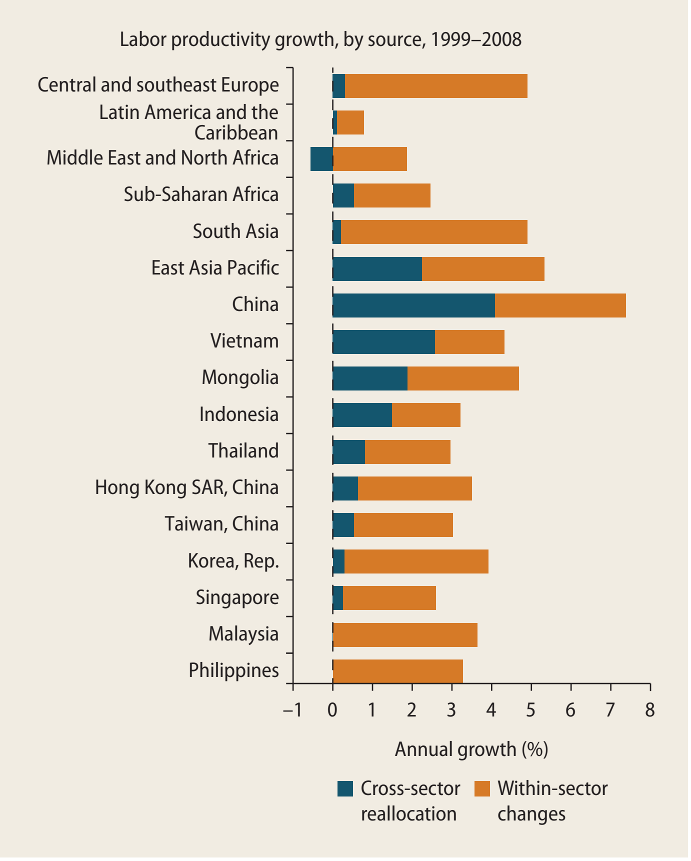
The geographic redistribution of work that took place as part of the structural transformation in many East Asia Pacific countries

FIGURE 3.3 Productivity gains in agriculture spurred the shift of labor to higher value-added sectors



Source: Based on World Bank 2012e.
Note: Each circle represents a country, and the colors represent different points in time.

FIGURE 3.4 Movement of labor across sectors was an important driver of productivity growth in East Asia Pacific



Sources: Kucera and Roncolato 2012; World Bank 2012e.
Note: The figure decomposes labor productivity growth in 81 countries over 1999–2008 into changes in productivity due to changes within sectors and reallocation between sectors. Seven sectors are considered: agriculture, hunting, forestry, and fishing; mining and utilities; manufacturing; construction; trade, restaurants, and hotels; transport, storage, and communication; and other services. The regional growth rates are weighted averages, with weights based on a country's share of regional GDP.

also propelled productivity as people and firms concentrated in urban centers. Location matters for factor productivity, and urban "agglomeration economies" have had a substantial role to play in East Asia's advances (Gill and Kharas 2007; World Bank 2008a, 2008b). Agglomerations can form when firms concentrate in the same location, reducing costs as a result of cheaper labor supply, competition between firms, and knowledge spillovers, all resulting in higher productivity. Concentration of people in cities can boost demand for products, provide a pool of labor, enhance returns on infrastructure investment, and reduce transportation costs. Growth, then, attracts more people and firms and so accelerates the process of agglomeration (World Bank 2008b). A 10 percent increase in the density of urban employment can increase wages and firm productivity about 0.2 to 1 percent, and larger cities produce more innovations per capita (Duranton 2012).

In East Asia, large volumes of labor migration into towns and cities led to productivity gains from agglomeration (Gill and Kharas 2007; World Bank 2008a). Chinese manufacturing became more geographically concentrated, specifically in coastal provinces, as the economic transition proceeded (He 2008). In Indonesia, economic activity shifted toward Java-Bali—centering in Jakarta—which was the fastest-growing region between 1976 and 2004. Estimates from the Republic of Korea suggest that firms that moved to a city could increase plant output 20–25 percent, while holding the composition of inputs constant. In China, firms are more productive in the more populated cities (World Bank 2008a), and income per worker rises as cities become larger (Au and Henderson 2006).[3]

East Asia Pacific's high degree of economic integration creates employment in exporting and foreign-owned firms and, in doing so, is likely to boost overall productivity. Integrating into the global economy can increase firm productivity since the global market provides scope for economies of scale and exposes firms to international competition and knowledge (Baldwin and Gu 2004). Evidence from across East Asia Pacific suggests that exporting and foreign-owned firms are more productive, without inferring causality (Hallward-Driemeier, Larossi, and Sokoloff 2002). As the share of working people employed in these firms rose in East Asia Pacific, so did overall productivity. Using manufacturing census data from Indonesia, Amiti and Konings (2007) find that, between 1991 and 2001, a 10 percentage point reduction in input tariffs was associated with a 12 percentage point increase in productivity for firms importing inputs, while a reduction in output tariffs by the same amount increased productivity only 1 to 6 percent.

Using panel data of manufacturing firms collected between 2001 and 2005 in China, Sun and Hong (2011) find that, when exporting firms increase the ratio of export to sales by one unit, they increase output 2.6 percent.

While export-led growth and structural transformation has spurred tremendous productivity growth in many parts of East Asia Pacific, achieving similar gains in the future can be difficult, especially for countries where progress on this front has been slow up until now. For instance, geography and size constrain opportunities for export-led economic growth in the Pacific island countries (see chapter 8 for more details). Evidence from the Philippines suggests an "incomplete structural transformation": stagnant agriculture and manufacturing sectors have led most of the labor force that migrated from rural areas into cities to end up in low-productivity, informal service sector work (World Bank 2013b). Indeed, the contribution of cross-sectoral labor reallocation to productivity was negligible in the Philippines (figure 3.4).

In addition, several East Asian countries are now at a stage of development where they face possible obstacles to sustaining productivity gains from work. Less favorable global economic prospects, more intense global competition, and eroding labor cost advantages (including the trend toward "re-shoring" and "near-shoring" in textiles and other light manufacturing) are likely to imply a moderation in export demand and economic growth in East Asia in the coming years. For the East Asian countries that are now substantially urbanized, much of the large productivity gains associated with the transformation from agriculture to light manufacturing has already been realized. It is not easy to take the next transformational step toward higher value-added manufacturing or high-skill services (Gill and Kharas 2007). In Indonesia, for example, manufacturing firms are finding it difficult to move up the value chain and innovate, which is constraining the sector's productivity and competitiveness. Stagnating growth in manufacturing is limiting the country's potential to create demand for work (World Bank 2012b, 2012c).[4]

Firm dynamics and labor productivity

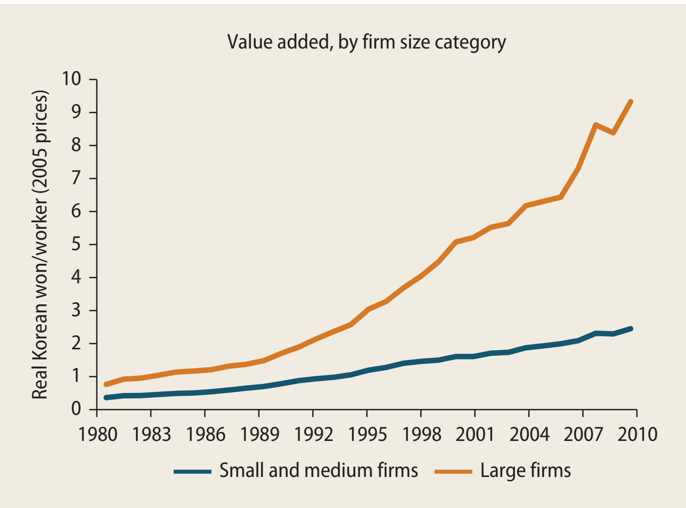
Supporting the large-scale structural shifts discussed earlier are firm dynamics that involve constant reallocations of capital and labor. At the firm level, productivity growth involves the creation of more productive forms of work as well as the destruction of less productive ones. The structural and spatial changes experienced by most countries of East Asia Pacific unleashed "creative destruction" that was a large part of increased productivity in the region. Productivity gains through innovation, while expected to enhance growth in the long run, may have positive or negative impacts on employment in the short or medium run. Product innovations usually create new businesses and new employment. They may also lead to firms downsizing or exiting in the short term if the new product substitutes existing goods and the new firm becomes monopolistic. Process innovations can reduce the amount of labor in immediate need. In the East Asia Pacific region, firm-level evidence from China suggests that more than half of the growth in value added in the manufacturing sector from 1998 to 2007 can be attributed to total factor productivity (TFP) growth stemming from existing firms becoming more productive and net firm entry (Brandt, van Biesebroeck, and Zhang 2012). Evidence from Indonesian manufacturing census data (1991–2001) suggests that some creative destruction occurred during the 1998 crisis: new firms were relatively more productive, which helped to mitigate the fall in aggregate productivity. The crisis, however, did not unequivocally improve the reallocation process, causing many productive firms to exit (Hallward-Driemeier and Rijkers 2011).

Even though most people work in micro, small, and medium enterprises and most new employment is created in these firms (as shown in chapter 2), they are rarely an engine of productivity growth. Evidence from developed countries indicates that bigger firms are relatively more likely to survive, while many of the small firms created are quickly destroyed (Bartelsman, Haltiwanger, and Scarpetta 2004). Data from the Small and

Medium Business Administration database in Korea suggest that, during the past decades, the productivity gap between large firms and small and medium enterprises (SMEs) has widened (figure 3.5).

Evidence from middle- and low-income countries is similar. For example, micro, small, and medium enterprises account for more than 90 percent of employment, but only 36 percent of GDP in the Philippines (World Bank 2013b). Using enterprise survey data from 99 developing countries, Ayyagari, Demirgüç-Kunt, and Maksimovic (2011) confirm that, although SMEs account for a large share of employment and (permanent, full-time) employment creation, this does not necessarily translate into productivity growth. Smaller and younger firms exhibit higher employment growth than larger and more mature firms. However, the latter segment has the highest productivity growth, both in East Asia Pacific and in the full sample of developing countries. Controlling for firm size, younger firms have relatively higher productivity growth. Even in the segment of very small and informal family enterprises not covered by enterprise surveys, firm size and age matter for labor productivity. Evidence from the Indonesia Family Life Survey suggests that, among household firms with up to five employees, labor productivity is higher in own-account and more mature micro firms (figures 3.6 and 3.7), even after controlling for factors such as industry and household effects (Badiani, Golan, and Posadas in progress).

FIGURE 3.5 The productivity gap between large and small firms in Korea has widened



Source: Based on Rostom, Song, and Kim in progress, using the Small and Medium Business Administration database in Korea.
Note: In manufacturing, SMEs constitute fewer than 300 workers and capital worth ₩8 billion or less; in mining, construction, and transportation, they constitute fewer than 300 workers and capital worth ₩3 billion or less; in publication, information and communication, administrative and support service activities, human health and social work activities, and professional scientific and technical activities, they constitute fewer than 300 workers and sales worth ₩30 billion or less; in agriculture, forestry and fishery, electricity, gas, steam, and waterworks business, wholesale and retail trade, accommodation and food service activities, financial and insurance activities, and arts, entertainment, and recreation, they constitute fewer than 200 workers and sales worth ₩20 billion or less; in sewerage, waste management, and remediation activities, education, repair, and other services, they constitute fewer than 100 workers and sales worth ₩10 billion or less; in real estate, rental, and leasing activities, they constitute fewer than 50 workers and sales worth ₩5 billion or less.

Informal, micro firms in East Asia Pacific often emerge out of necessity rather than entrepreneurship and consequently tend to be less productive than larger, registered formal enterprises. Even though the marginal returns to initial capital investments are expected to be high for low-capital-stock informal enterprises, micro firms do not necessarily realize this great growth potential. Using panel data on formal and informal enterprises for 2004 and 2006 in Vietnam, Nguyen and Nordman (2012) find that informal household enterprises have lower value added per worker, fewer workers, and a lower initial capital stock than formal enterprises. In the Philippines, informality was identified as a major constraint to doing business by enterprises with 10 to 200 employees (World Bank 2013b). As discussed in chapter 2, high levels of self-employment in many middle-income East Asia Pacific countries are more likely to result from working people trying to meet subsistence needs than from transformational entrepreneurship. This phenomenon may explain the short life span and low productivity of household micro businesses in many East Asia Pacific countries.

Work and living standards

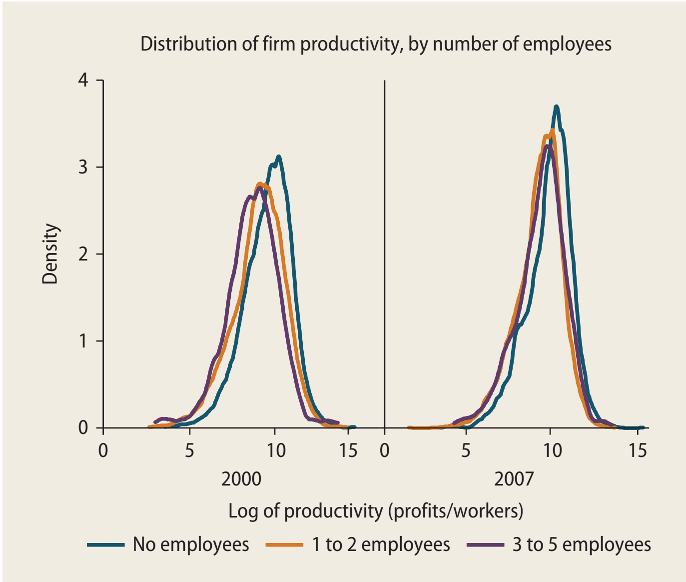
The productivity gains described above have allowed more working people in East Asia Pacific to improve their welfare in the last two decades than in any earlier period. The share of the region's population living on less than

US$1.25 a day declined from 56.2 percent in 1990 to 12.5 percent in 2010, from one of the highest to among the lowest across developing regions (World Bank 2013c). Impressive poverty reduction took place not only in China but also in many other countries, including Cambodia, Indonesia, Thailand, and Vietnam. However, the official poverty headcount has remained stagnant at around 26.5 percent in the Philippines since 2003. Any slowdown in growth in the future will likely imply slower improvements in living standards than what many people in East Asia have come to expect.

From 2000 to 2012, real wages rose in several East Asian countries. Figure 3.8 shows this trend for the countries where data are available. In Indonesia, the manufacturing real wage rose quickly in the early 2000s, remained stagnant for several years, and only recently started to rise again. Thailand's real wages have been very close to their 2001 levels during the past decade and only recently started to rise substantially. However, in several other countries, manufacturing real wages have been rising rapidly. In Mongolia, real wage increases have been especially rapid since 2006. China and Malaysia saw improvements in the real wage index since 2003 and 2004, respectively. The annual wage of a Chinese urban worker rose from US$1,004 in 1978 to US$5,487 in 2010 (Li et al. 2012), and manufacturers in China expect wages to rise 9.2 percent in 2013 (Narayanan, Lau, and Green 2013).

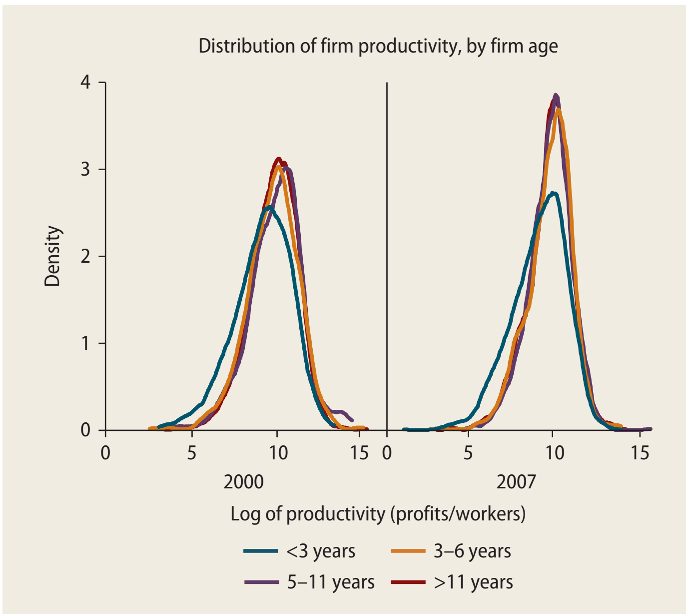
Remunerated work is often the most important factor in determining peoples' living standards in low- and middle-income countries, for at least three reasons. First, as affirmed in chapter 1, people's most valuable assets are their talent, skills, and ability to work. In low- and middle-income countries where few people are investors and the welfare state is limited, the main source of household income is the return on these assets in the form of paid work. Second, work-related events drive economic mobility. For example, transitions out of poverty usually take place when family members are able to earn higher income from their current work or from a new occupation.

FIGURE 3.6 Among household enterprises, those with fewer workers are more productive



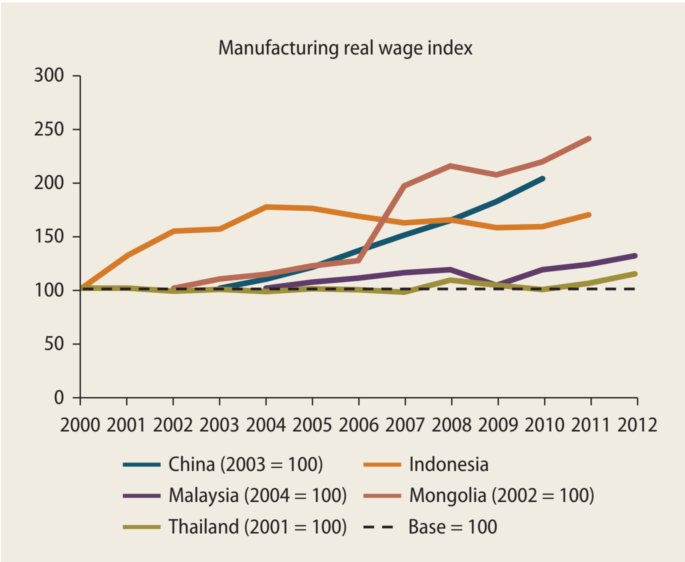
Source: Based on Badiani, Golan, and Posadas in progress, using the Indonesia Family Life Survey for 2000 and 2007.

FIGURE 3.7 Among household enterprises, mature firms are more productive



Source: Based on Badiani, Golan, and Posadas in progress, using the Indonesia Family Life Survey for 2000 and 2007.

FIGURE 3.8 Real wages have been rising in many East Asian countries



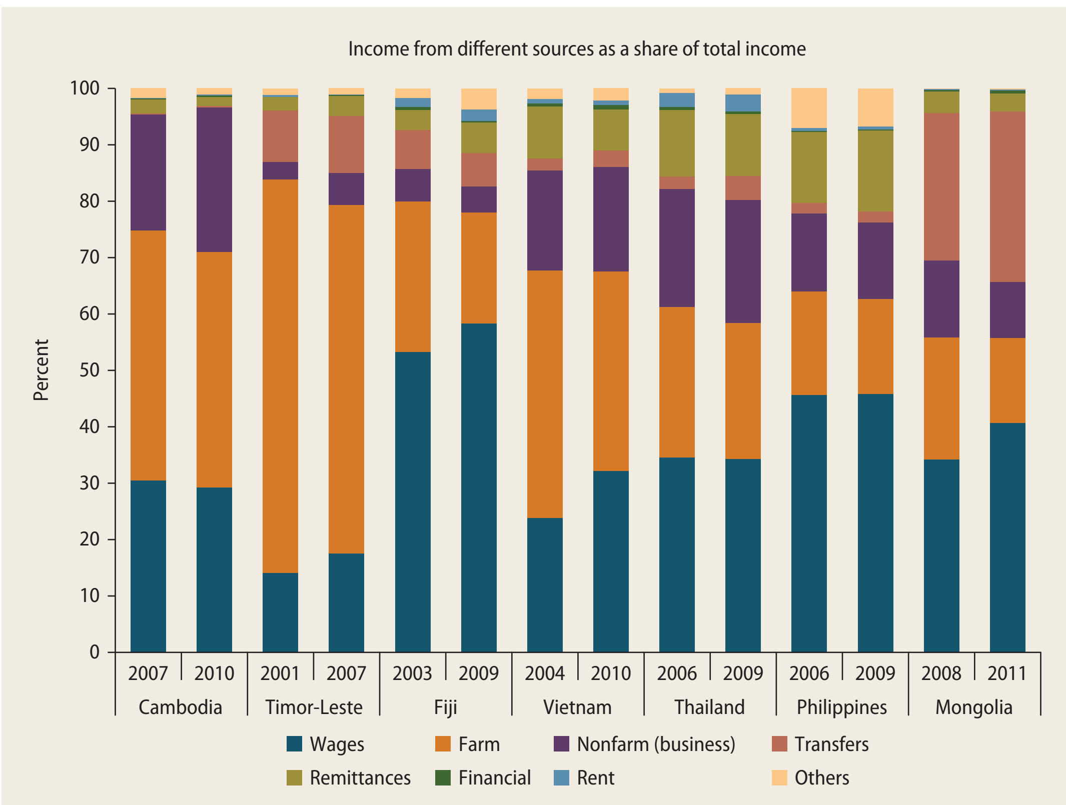
Sources: CEIC 2012; NBS 2011.

Much of the gain in living standards in East Asia Pacific happens through migration for work. Third, living standards and well-being are measured not just in money. In addition to earnings, several other aspects of having work affect living standards and life satisfaction. Income and consumption are commonly used measures of welfare, but access to services, security, freedom, and life satisfaction also matter and correlate with living in a household in which adult family members have employment. For a detailed discussion of the role of work in life satisfaction, see the WDR 2013 (World Bank 2012e).

How important is income from work to living standards?

In East Asia Pacific countries, labor earnings are without doubt an important source of income. Figure 3.9 shows the

FIGURE 3.9 Labor earnings are an important source of household income in East Asia Pacific



Source: Estimates based on various household income and expenditure surveys.

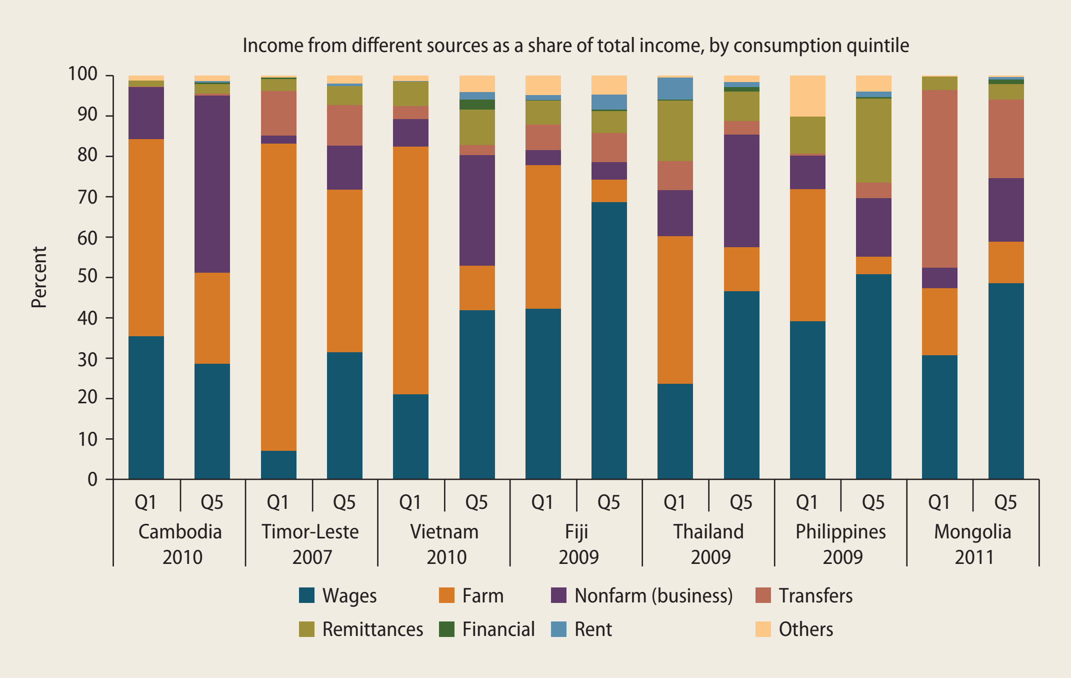
composition of household income by source in a selection of East Asia Pacific countries where detailed data on income are available. Across all countries, labor earnings—income from the farm, own businesses, and wages—constitute the main source of household income.

But there are important differences across countries in the nature of work and how the characteristics of work change with economic development. As expected, for countries with a large share of the population in agriculture, incomes from farm work or other types of self-employment constitute an important fraction of household income. Households in more developed and urbanized economies like the Philippines and Thailand derive a greater average share of household income from wages and salaries than places like Cambodia or Vietnam. Over the periods examined, in most countries, the composition of household income moved away from farm production and toward wages from dependent employment (figure 3.9). In Cambodia, the share of income from nonfarm businesses rose, while incomes from wages remained constant. In a resource-rich country with generous social welfare like Mongolia, the share of income from farm work fell and that of income from transfers rose.

Within countries, the share of income from work varies by gender and across wealth groups. The ratio of women's and men's wages for similar work in the region ranges from 52 percent in the Republic of Korea to 81 percent in Mongolia (World Bank 2012d). And the type of work and related income differ between the poor and the rich, as shown in figure 3.10. For all the countries we were able to analyze, the bottom income quintile (the poorest 20 percent) derives a greater fraction of its income from farm production, while the top income quintile (the richest 20 percent) derives a greater proportion from wages. In Cambodia, nonfarm business incomes (more than wages) are a main source of income for the richest people, while the poorest people derive most of their income from farm production. In fact, in a cross-country study, Ligon and Sadoulet (2011) find that growth of agricultural income is particularly beneficial for increasing the expenditures of the poorest households: a 1 percent increase in income from agriculture is estimated to increase the expenditure of households in the poorest decile by about 1.65 percent. A similar increase in nonfarm income does not have the same effect. Over time, however, the share of agriculture in the overall income composition of the poorest group declined, except in Timor-Leste (figure 3.11). In Mongolia, labor income plays a less dominant role among the poor than nonlabor income. Nearly 50 percent of the income of the poorest consists of transfers, and their relative weight in the income composition of the poorest households increased in recent years.

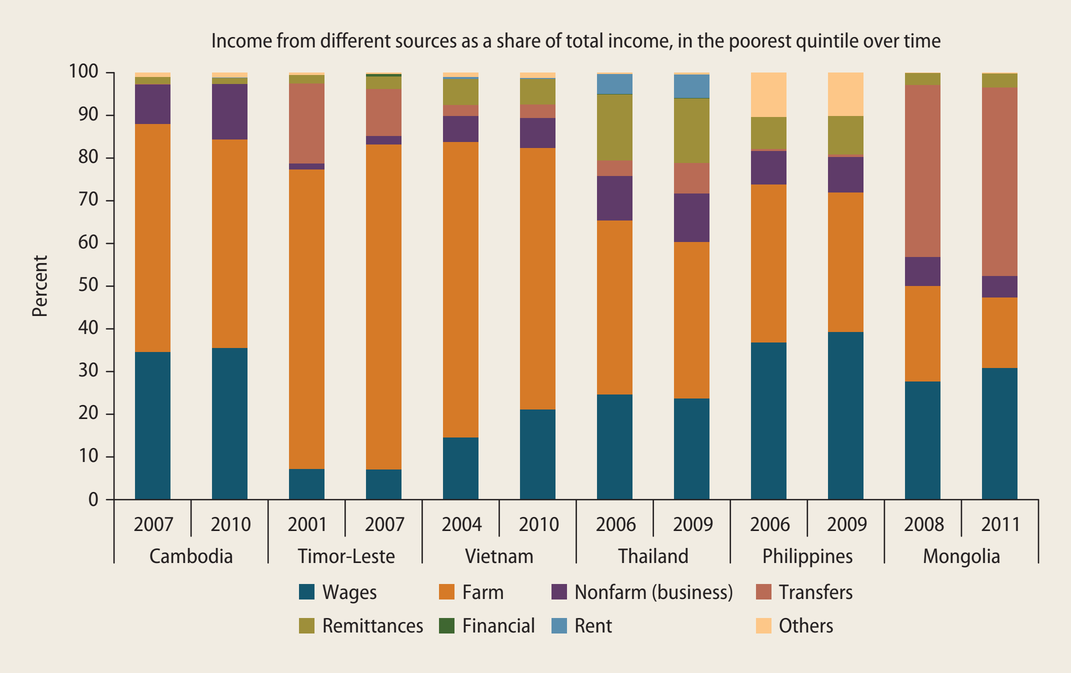
Income from work has been an important force for lifting people out of poverty and boosting prosperity in East Asia Pacific. But the channel is not automatic nor can it be taken for granted: many poor people work long hours and earn little income, which does not necessarily allow them to escape poverty. Nor is work the sole factor in overcoming poverty: multiple factors, such as changes in household composition, assets, and transfers, can also raise the likelihood of escaping poverty. One way to assess the contribution of labor income to poverty reduction is by decomposing changes in poverty by source of income. Badiani et al. (2013) decompose changes in income poverty into the contributions of different income sources in East Asia Pacific countries. Figure 3.12 presents the results of the decomposition; the sum of contributions from wage, farm, and nonfarm work and the share of working adults represent the role of work and labor income. Nonlabor income includes income from assets, private remittances, public social assistance or insurance, and other transfers. In all but one of the countries for which there are data to conduct the decomposition, income from work explains more than 40 percent of the observed reductions in poverty.

FIGURE 3.10 People in poor households derive a large share of their income from agriculture



Source: Estimates based on various household income and expenditure surveys.
Note: Q = quintile.

FIGURE 3.11 The share of earnings from agriculture in overall income of the poorest group has fallen



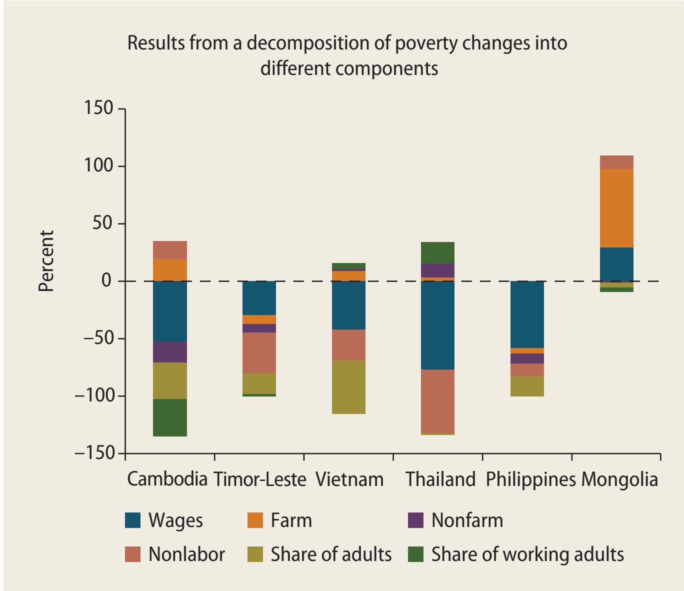
Source: Estimates based on various household income and expenditure surveys.

In Cambodia and Vietnam, in particular, changes in labor income contributed to more than 70 percent of poverty reduction. In Timor-Leste, the loss of labor income from 2001 to 2007 explains almost all of the increase in poverty.

Not all sources of income for work have the same impact on poverty and living standards. The sector of work and the constraints on entering certain sectors, such as the nonagricultural sector, affect individuals' future income prospects. In the early years of the structural transformation, work in agriculture was a key driver of poverty reduction. For example, Glewwe, Gragnolatti, and Zaman (2002) and Ravallion and Chen (2007) show that agricultural productivity gains and land reforms, rural infrastructure improvement, and off-farm activities were important to reducing poverty in the 1980s and 1990s in China and Vietnam. Higher farm incomes paved the way for individuals to engage in off-farm employment in China and were associated with the most poverty reduction (de Brauw et al. 2002). Evidence from Indonesia shows that rising rural incomes between 2001 and 2006 were driven primarily by increased value of agricultural production (Klasen, Priebe, and Rudolf 2010).

More recent analysis shows that income from different types of work has had different effects on welfare. For instance, wage income has been an important contributor to poverty reduction in Cambodia and Vietnam. In Mongolia and the Philippines, increases in wage income have also been a key factor for reducing poverty, and the loss of farm incomes has had an adverse impact. As observed in figure 3.9, households in the Philippines experienced a small reduction in the share of farm incomes over the period 2006–09. From 2007 to 2011 in Mongolia, agricultural production was adversely affected by severe weather conditions, while social transfers increased and constituted an increasing fraction of the income of the poorest. Similar to Mongolia, in Thailand, nonlabor incomes were an important factor in poverty reduction. The composition of income in Thailand has been relatively stable, but the share of transfers in aggregate income nearly doubled during the time period and increased in importance for the poor. In Timor-Leste from 2001 to 2007, the loss of farm income followed the loss of wage income and contributed a large part to higher poverty.

FIGURE 3.12 Income from work explains a large share of reduction in poverty



Sources: Estimates based on Cambodia Socio-Economic Survey (2007, 2010), Thailand Household Socio-Economic Survey (2006, 2009), Philippines Family Income and Expenditure Survey (2006, 2009), Vietnam Living Standards Measurement Survey (2004, 2010), Mongolia Household Socio-Economic Survey (2007–08, 2011), and Timor-Leste Survey of Living Standards (2001, 2007).
Note: Poverty is measured as the fraction of the population with per capita income of less than US$1.25 a day for all the countries except for Thailand, where it is measured using the US$2.50 poverty line.

Work and economic mobility

Work-related choices and events, broadly defined, provide opportunities to improve livelihoods in many parts of the world, including East Asia Pacific. In Indonesia, changes in employment of the head of the household were important for explaining changes in household income (Fields et al. 2003). Using data collected in 1985 and 2008 from villages in Central Luzon and Panay Islands of the Philippines, Matsumoto et al. (2012) find that formal wage incomes and overseas remittances were the largest component of rising rural incomes for those who exited poverty or remained nonpoor. Evidence from the 1990s in Vietnam suggests that exiting poverty was related to employment growth in the export sectors. In rural Vietnam, work-related events accounted for 62 percent of the probability of escaping poverty during the 1990s (Inchauste 2012).[5] Evidence from rural Thailand suggests that earning rises as a result of moving from the farm to the nonfarm sector, but also that, in recent years, there is limited mobility between sectors and upward mobility within the nonfarm sector (see box 3.1). Qualitative accounts from Cambodia, Indonesia, the Philippines, and Thailand indicate that finding employment and starting new businesses are the most frequently offered explanations for households moving out of poverty (Narayan, Pritchett, and Kapoor 2009).

Adults' work can also have an important impact on the prospects and welfare of their children, thereby promoting economic mobility from one generation to the next. Children from wealthier families commonly possess better health and education outcomes since income helps them to pay for investments in children's human capital, which strengthens their labor market prospects in the future. Evidence also shows that cross-border migration and remittances help to improve consumption, benefit children's education, and reduce child labor, although counteracting effects on the family structure can be non-negligible (World Bank forthcoming). In addition, parents' form of work can be a predictor of that of their children. Using data from the Vietnam Living Standard Survey 1992/3, Emran and Shilpi (2010) find that having a mother (father) working in the nonfarm sector increases the likelihood that daughters will participate in the nonfarm sector by 22 percent (7 percent). Having a father or mother working in the nonfarm sector also is important for predicting the likelihood that sons will participate in the nonfarm sector. The study also finds that the intergenerational correlation of employment in the agriculture sector between parents and children can be accounted for by factors that are not observed, such as preferences.

BOX 3.1 Nonfarm labor market dynamics in rural Thailand

Combining rural village-level census data and individual-level panel data from rural Thailand, Chawanote and Barrett (2013) find that nonfarm employers and employees earn more than farmers and own-account self-employed in rural Thailand. They show that, between 2005 and 2010, occupational mobility was relatively limited and tended to be more downward than upward: individuals were more likely to transit from nonfarm self-employment to farming than to nonfarm employee or employer positions. While 28 percent of persons who were nonfarm employers in 2005 were nonfarm self-employed in 2010, only 3.3 percent of those who were self-employed in 2005 were nonfarm employers in 2010.

Regression analysis of changes in log real earnings controlling for base earnings, individual and household characteristics, and possible employment transitions shows significant gains in earnings for those who were employed in nonfarm activities and remained as such compared to those who remained working on the farm during the whole time interval. Accordingly, transiting from nonfarm employment to farm employment is associated with lower earnings for the nonfarm self-employed and employees, while transiting from farming to the nonfarm sector correlates with higher earnings for farm workers (except when transiting into nonfarm self-employment).

Source: Chawanote and Barrett 2013.

While work-related choices and events can help people to transition out of poverty, shocks transmitted through the labor market can make households vulnerable and affect their living standards. Shocks include the death of a working-age household member, a sudden fall in commodity prices that cuts into farmers' profits, economic downturns, and, for countries heavily reliant on remittances from emigrants, recessions in migrant-receiving countries. The 1997–98 East Asian crisis showed how a systemic economic shock can reduce living standards: this period was the only halt in an otherwise continuous downward trend of extreme poverty in the developing countries of East Asia Pacific since 1990. In the more recent global financial crisis, as discussed in chapter 1, countries in East Asia Pacific were more resilient than countries in other regions. Although employment remained steady, there was still a substantial downward adjustment in earnings.

Thus while work has been transformational in reducing poverty and raising the living standards of many people in East Asia Pacific, the small share of working people covered by social protection (see chapter 6) leaves many households without sufficient formal insurance against shocks to well-being transmitted through their work. In addition, a moderation of growth rates in several countries of the region is expected to translate into slower gains in living standards than many people have experienced over recent decades.

Work and social cohesion

What is social cohesion and how is it influenced by work? Social cohesion is a very broad and mostly intangible public good, easier to identify when there is less of it or it is missing altogether. The term typically refers to the ability of all citizens to enjoy access to fundamental social and economic rights without discrimination and on an equal footing (Jenson 2010). The Organisation for Economic Co-operation and Development (OECD) defines a cohesive society as one that "works toward the well-being of all its members" (OECD 2011, cited in World Bank 2012e, 128). Social cohesion can be measured in several ways and is shaped by many factors, including work.[6] Work creates opportunities and shapes interactions between individuals and groups. It affects how people think of themselves and relate to others. Societies thrive where work connects people from different groups and creates opportunities for them to fulfill their potential. Employment can also provide access to voice. The distribution of employment and earnings and how people interact in the labor market can shape their aspirations and perception of fairness. Work can influence social cohesion through all of these channels.

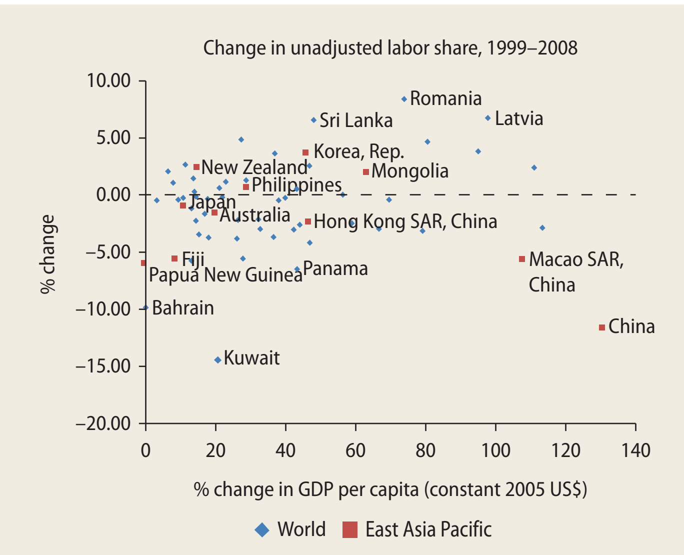
Given how broad the concept of social cohesion is, how it is affected by work will vary widely from country to country. Norms, value systems, and institutions matter (Kilroy 2012). In some countries, threats to social cohesion may arise along the rural-urban divide or from the marginalization of youth and ethnic minorities. In other places, the threat may come from widespread unemployment leading to social unrest and conflict. In many countries, social cohesion is threatened by high levels of welfare inequality—including unequal access to health, education, and opportunities for advancement—which limit the extent to which a country's prosperity is shared.

Work has contributed to social cohesion in East Asia Pacific in recent decades. The region's remarkable progress in economic growth has led to improvements in the life of many people, including poor people and disadvantaged groups, mainly through their work. Income from work has risen among people in poor households. According to estimates using household survey data, the share of wages in total income for the poorest quintile rose 44 percent in Vietnam, 6.5 percent in the Philippines, and 3.4 percent in Mongolia. Li et al. (2012) document that the annual average wage increases in China from 1978 to 2010 were broadly shared: wages increased for both skilled and unskilled workers, for people working in coastal and inland areas, and for workers in both exporting and nonexporting firms. Rural residents in many parts of the region benefited. Rural migrants were able to find better work opportunities in towns and cities. And the remittances they sent back contributed to improving the welfare and living conditions of their families as well as investment in the next generation. Economic growth and development in the region narrowed gender gaps in several areas, such as access to education and health; as a consequence, women in the region are more likely to participate in the labor force (World Bank 2012d).

All the above notwithstanding, evidence increasingly points to concerns that people may not be deriving as much well-being from work as they did in the past. Across the world and in several East Asia Pacific countries, the share of national income that goes to labor rather than to capital has been declining.[7] Figure 3.13 plots changes in the share of labor in GDP against economic growth. China stands out not only for the exceptionally fast rise in GDP per capita but also for the large decline of 12 percentage points in the labor share in GDP during the 1999–2008 period. Fiji and Papua New Guinea also show a decline. This statistic should be taken with a caveat: it reflects the total compensation to wage and salaried employees only, as data often do not allow for an accurate measure of self-employment income. Nonetheless, falling labor shares imply that productivity gains and growth no longer translate into the same rate of pay rises or employment creation in the formal sector. As new entrants to the labor market, youths are likely to face more difficulty when employment creation is limited. Larger benefits accruing to owners of capital also often indicate rises in overall income inequality, raising concerns for social cohesion.

In the remainder of this section, we argue that the effect of the transformation of work on social cohesion is starting to lag in several countries, especially (but not only) in the most populous, China and Indonesia. We focus our discussion on two measurable threats to social cohesion that are a cause for concern in those East Asia Pacific countries: youth inactivity and economic inequality. As discussed in earlier sections, economic growth has been the most important determinant of poverty reduction in East Asia Pacific through work. Prior to 1990, this occurred alongside improvements in equality across the region, from Japan, Korea, and Taiwan, China, to Indonesia, Malaysia, the Philippines, and Thailand. However, since 1990, economic growth and poverty reduction have been accompanied by greater inequality in a few countries, including China and Indonesia. While some inequality of economic outcomes can spur aspirations, endeavor, and enterprise, past certain thresholds, high inequality limits the extent to which economic growth will pull people out of poverty. Youth unemployment and inactivity contribute to this process. Mounting evidence from high-income and emerging-market countries shows that how young

FIGURE 3.13 Share of labor in GDP declined in China and several other East Asia Pacific economies



Sources: Based on ILO data; World Bank 2013c.
Note: The unadjusted wage share is simply the total compensation of employees as a percent of GDP. The adjusted wage share adjusts for the self-employed. The period of change for Fiji is 1999–2005; for Mongolia, 2000–08; and for Papua New Guinea, 1999–2006; all others are for 1999–2008.

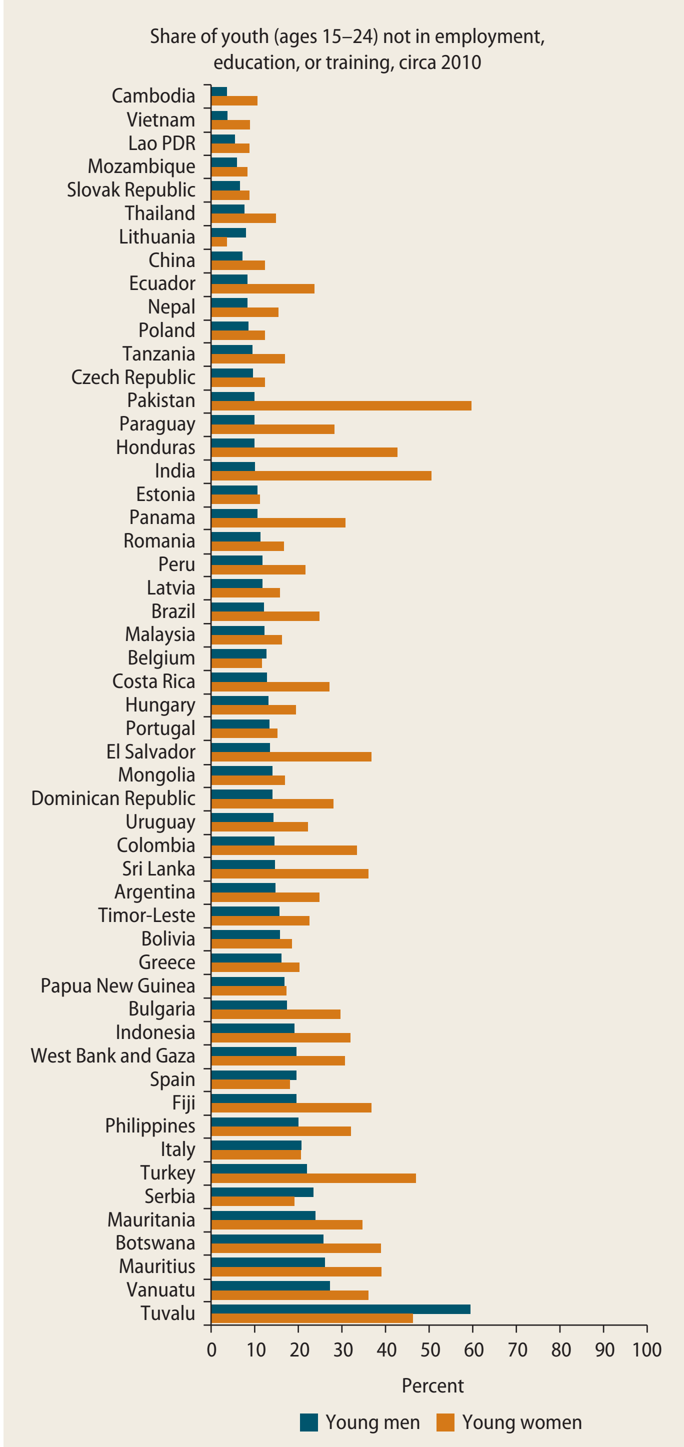
people fare on entry and in their first few years in the labor market can have a lasting impact on their prospects through the rest of their working lives. Empirical evidence of "scarring" from early and extended periods of unemployment and underemployment make the high and persistent share of young people without work, discouraged, and inactive all the more worrisome. Although not as acute a problem in the whole of East Asia Pacific as in other regions (an important point discussed in chapter 7), many governments in the region still consider youth unemployment and inactivity to be a threat to social cohesion.

Youth unemployment and inactivity

Youth unemployment and inactivity are high in several East Asia Pacific countries. While open unemployment is generally low in the region, youth unemployment and the share of youth not in employment, education, or training in several Pacific island countries, Indonesia, and the Philippines stand out, being higher than in countries in Southern Europe and close to the levels observed in some countries in Europe and Central Asia (figure 3.14). Low levels of employment among youth can be good or bad depending on the exact cause. In some countries, youth unemployment or underemployment is explained more by idleness than by schooling. In others, youth spend more time pursuing higher education than entering the market in search of work or more time seeking employment or between jobs. But because every young person must find initial employment with limited search skills and little work experience, youth unemployment is a higher risk than unemployment for other age groups. To the extent that unemployment, extended periods of search for work, or underemployment can have long-term, negative consequences on the future labor market prospects of young people, there is greater cause for concern.

A large body of research, focused mainly on high-income countries, has identified the

FIGURE 3.14 Youth idleness is high in some of the Pacific island countries, Indonesia, and the Philippines



Sources: World Bank 2012e, 2013a.

long-run career impacts of periods of unemployment and employment in different types of work, particularly casual, unregulated "informal" work. A spell of unemployment can increase a person's chances of being unemployed in the future and reduce his or her earnings prospects (Heckman and Borjas 1980; Arulampalam, Gregg, and Gregory 2001; Arulampalam, Booth, and Taylor 2000). This type of "scarring" is commonly identified from spells of unemployment among young people, who are at greatest risk of experiencing long-term consequences of poor outcomes early in their experience of the labor market. For instance, evidence from the United Kingdom shows that having experienced more than 13 months of unemployment in their early careers reduces the wages of prime-age men by 15 percent compared to those who did not experience unemployment in their youth (Gregg and Tominey 2005). This wage penalty varies in size over time—from a higher penalty earlier and a lower penalty later in working life. Furthermore, evidence of scarring has expanded to identify lasting prejudicial effects from particular types of employment in the first years of working life, such as self-employment (Hyytinen and Rouvinen 2008), contingent (nonpermanent) employment (Yu 2012), and employment in the informal sector (Cruces, Ham, and Viollaz 2012). Empirical findings in developing East Asia Pacific are more limited. Recent research focused on Indonesia confirms the link between youth unemployment and the prevalence of informal work and actual segmentation in the labor market. Youth in Indonesia often enter the labor market through informal work, which lowers their chances of moving out of informal employment at a later stage in their working lives (see box 3.2).

Another concern with high unemployment, youth unemployment, and inactivity, particularly in the Pacific island countries, is the potential for an extreme breakdown of social cohesion, in the form of violence and conflict. Lack of work has been linked to broader social unrest. Collier and Hoeffler (2004) find that unemployed or inactive youth, lacking identity and social belonging, are more likely to engage in gangs or criminal activities. These threats to social cohesion and ultimately to stability are at the forefront of concern in Papua New Guinea, the Solomon Islands, Timor-Leste, and elsewhere. However, the empirical evidence linking unemployment and idleness to violence in East Asia Pacific countries is mixed (box 3.3).

Rising inequality

Inequality is a topic worthy of a report in its own right. Many factors underlie the aggregate measures of income and consumption inequality and how these change over time. The discussion in this section is limited to the linkages between inequality and the labor market.

Alongside the decline in poverty in the region, inequality has been on the rise in several East Asia Pacific countries. Figure 3.15 shows relative inequality as measured by either the consumption or the income-based Gini coefficients, from the late 1990s to the late 2000s. The Gini coefficient has risen in China, Indonesia, and Lao PDR over this period. China's levels of inequality are among the highest in East Asia Pacific.[8] In China, Fiji, the Philippines, and Thailand, inequality is now comparable to the levels observed in Latin America and parts of Africa. Among salaried workers in Indonesia, annual wage increases between 1999 and 2003 were 9.3 percent for nonpoor workers but only 6 percent for poor and near-poor workers (World Bank 2010). Even in a country like Vietnam with little noticeable increase in the consumption Gini, income inequality rose moderately between 2004 and 2010 (Badiani et al. 2012). Although high relative to the rest of the region, inequality declined in Fiji, the Philippines, and Thailand.

In terms of absolute inequality, there are stark differences in welfare between rural and urban areas and between the poorest

BOX 3.2 Are young people "scarred" from how they enter the labor market?

There are understandable reasons why the rate of market inactivity and unemployment is typically higher for young people than for the working-age population as a whole. Many people between the ages of 15 and 24 are still building their human capital. Those who have ventured into the market have less experience looking for work or starting their own enterprise. If they have never worked before, they present a more risky prospect to employers or to financial supporters than otherwise similarly qualified applicants for employment or a business loan. When the number of young people who are idle—not in employment, education, and training—is significant, there is more pressing cause for concern.

But even for those young people who overcome the foreseeable odds and find work, the earliest experiences in the labor market can have consequences that last long into their working lives. Some of the circumstances that shape market entry and early work experiences are "systemic"—for example, an economic crisis or recession lowering the demand for labor and human capital overall. Others are "idiosyncratic" obstacles and sometimes reflect preferences. All can have a measurable impact on the welfare that young people can expect to derive from work in later years and, for this reason, can be important to crafting policy.

Recent research on the labor market in Indonesia shows evidence of the "scarring" effects of young people's early work experiences. Naidoo, Packard, and Auwalin (2014) exploit the panel dimension of the Indonesia Family Life Survey extending from 1993 to 2007 and find very little mobility across sectors and types of work over time. Young people who are self-employed sole traders, for example, are likely to remain in this type of work well into their adult life. From 1993 to 2000, 3 percent of 15- to 24-year-old men in the category of self-employed sole traders ("self-employed without hired staff") transitioned to self-employment with hired staff. For the period 2000 to 2007, only 2.6 percent of young men made this transition. The rates of transition are similarly low for adults and for women. Those who enter the market in registered dependent employment in the private or public sector are also likely to remain in these forms of work long into their working lives.

Low likelihood of mobility across sectors and types of work is consistent with scarring, but it is not in itself evidence of scarring. Differences in ability, human capital, and preferences may lead individuals to sort systematically into certain types of work and then to remain in these types of work. Using objective and subjective measures of "job quality" (for example, a written employment contract, access to training opportunities, nonpecuniary benefits like housing and meals, reported levels of stress and satisfaction), self-employed sole traders in Indonesia appear to be in less desirable forms of work than other working people in the same age cohort. This is in contrast, for example, to young government employees and young private sector employees—34 and 23 percent, respectively, who work with the security of some type of contract and 42 and 22 percent, respectively, who receive employer-provided training.

While the human capital implications of different types of work are not directly observable, the long-run impact on wages of experience in different types of work can be measured. Naidoo, Packard, and Auwalin (2014) find that certain forms of work in Indonesia, specifically sole-trader self-employment, are associated with human capital deterioration—or at least stagnation—resulting in zero or negative returns in later spells of employment. In addition to the absence of detectable returns to self-employment and the lack of training and contracts, the median wage in 2007 for youth in such work was about Rp 285,000 per month in contrast to government work and private sector work, for which it was Rp 475,000 and Rp 512,000, respectively.

Although far from definitive, as evidence grows of scarring from how young people enter the labor market and their early work experience, so does the public policy rationale for early intervention with employment search and other work-related assistance programs for young people.

BOX 3.3 Unemployment and conflict: Is the link strong in East Asia Pacific countries?

Empirical evidence of a relationship between unemployment and the extreme breakdown of social cohesion in the form of conflict is limited and ambiguous. Cross-country evidence appears weak (Cramer 2010), and the evidence using microdata is mixed. For instance, although a larger share of unemployed people increases the likelihood of village-level conflict in Indonesia, where a "10 percentage point increase in unemployment is associated with a 0.6 percentage point ... increase in the likelihood of conflict" (Barron, Kaiser, and Pradhan 2004, 22), there is no clear link using province-level data from the Philippines during the period 1997–2006 (Berman et al. 2009).

The relationship between employment outcomes and conflict is also hard to pin down empirically because the causal links can run in both directions—that is, unemployment can fuel frustrations that may eventually erupt into violence, or violence can raise risks that discourage the investment and enterprise that create employment. Indeed, qualitative accounts from the Philippines suggest that conflicts can influence employment by shaping the context in which entrepreneurs make investment decisions (World Bank 2013b). In 2011, "conflict provinces" in the Philippines had a lower unemployment rate than nonconflict provinces, but had a higher underemployment rate (23 compared to 17 percent). Also, employment was concentrated in agriculture as opposed to the service sector, and the fraction of self-employed and unpaid laborers was higher in conflict than in nonconflict provinces. Real wages were lower in conflict provinces than in nonconflict provinces (₱145 compared to ₱191). Within conflict provinces, New People's Army (NPA) provinces exhibited lower real wages and higher unemployment and underemployment rates than Muslim provinces. These provinces also had higher shares of temporary workers. However, NPA provinces had a higher proportion of workers who were earning wages than workers who were unpaid (49 and 33 percent, respectively, for wage earners and 15 and 20 percent, respectively, for unpaid workers). The level of industrial work was also higher (12 and 7 percent, respectively). Given that NPA conflicts have spanned more than six decades and have had significant adverse impacts on the local business environment, these accounts suggest that recurring episodes of conflict, even if not reported in the headlines, can also have significant negative impacts on the quality of work (World Bank 2013b).

Understanding each particular context is crucial to explaining why unemployment is accompanied by social unrest in some instances, but not in others. As Wietzke and McLeod (2012) argue, "Recent histories in the Arab World, North Africa, and some high-income countries suggest that even societies with relatively large differences between groups in the labor market can be remarkably stable over time, until latent tensions between groups quickly become politically salient as economic or political outlooks change. However, whether and when these tensions actually erupt into conflict appear to be driven by a multitude of other factors that are harder to predict with the quantitative data and methods available."

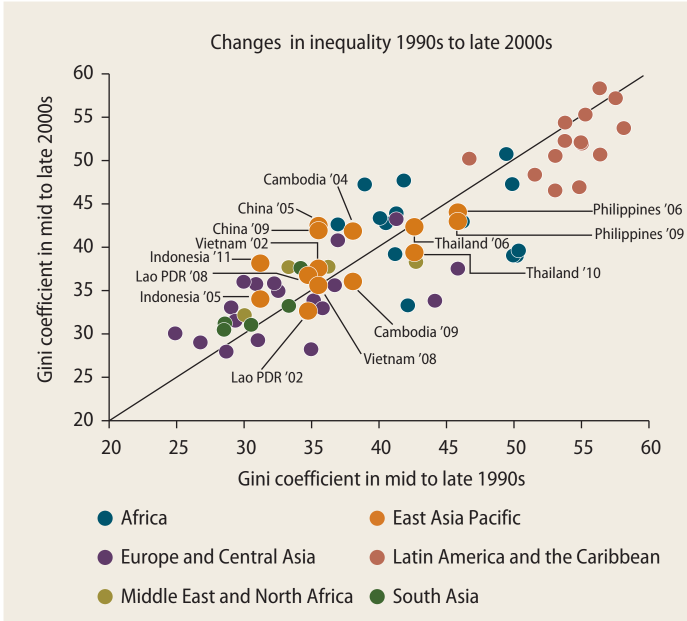
and richest parts of the population. The average per capita consumption in urban China was at least four times that in rural China in 2008, with a similarly large gap within urban areas (NBS 2012). Per capita consumption at the ninetieth percentile is four to six times that at the tenth percentile in Indonesia, Mongolia, the Philippines, Thailand, and Vietnam (figure 3.16).

Even though ethnic minorities have benefited from the economic success of the population as a whole, significant gaps in welfare between ethnic groups persist. In Vietnam, for example, poverty for the Kinh majority is about 10 percent, while poverty for their ethnic-minority counterparts is nearly 70 percent—a gap that has been widening between the two groups (figure 3.17). This gap relates to differences in types of work. Ethnic minorities in Vietnam depend almost exclusively on agriculture and forestry for their livelihoods. The Kinh poor have more diversified sources of income, with low-skill, low-paid off-farm jobs in rural areas supplementing farm income (Badiani et al. 2012). Similarly, ethnic minorities in Lao PDR have poorer labor market outcomes. The Lao-Tai/Tai-Kada ethnic majority and the Chine-Tibet have higher average wages than the other ethnic groups (figure 3.18). The Lao-Tai are also more likely to work outside agriculture, especially when residing in urban areas. All other ethnic groups work mainly in agriculture, irrespective of where they live.

Should inequality be worrisome? Some periods of rising inequality coincide with periods of fast economic growth, and, for this reason, greater inequality on its own may not be problematic. However, a growing body of evidence shows that high and persistently rising levels of inequality can undermine development. Ravallion (2005) shows how high inequality impedes the potential for poverty reduction, even with rapid economic growth. Balakrishnan, Steinberg, and Syed (2013) estimate that a 1 percent rise in the Gini coefficient directly offsets the beneficial impact of 1 percent economic growth on poverty reduction.[9] Globally, income disparity and other manifestations of inequality in welfare are now perceived as one of the most threatening risks (World Economic Forum 2013). In China, perception surveys show that citizens consider the wide income disparity in the country as undesirable and are concerned that such gaps can undermine social stability (Whyte 2010).

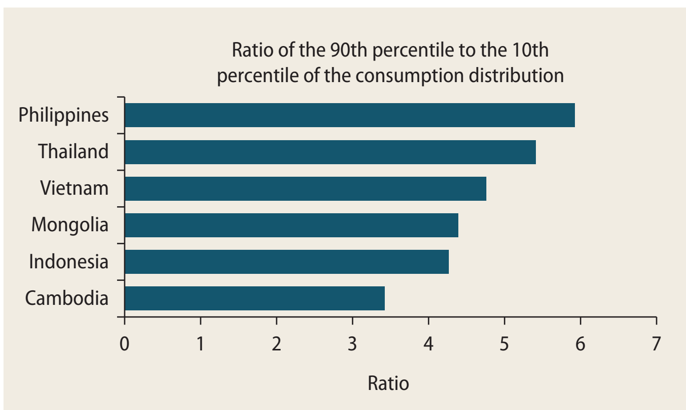
High levels of inequality have the potential to weaken social cohesion. Inequality affects people's expectations about their economic mobility, aspirations, and perception of fairness, as well as their motivations and choices. Inequality can affect welfare directly in places where there are strong social norms and preferences for equity and can shape political outcomes through demands for redistribution. Inequality can also impede efficiency and growth. If inequality grows to such an extent that it eventually leads to elite groups controlling access to markets and political institutions

FIGURE 3.15 Inequality has been rising in several countries, including China and Indonesia



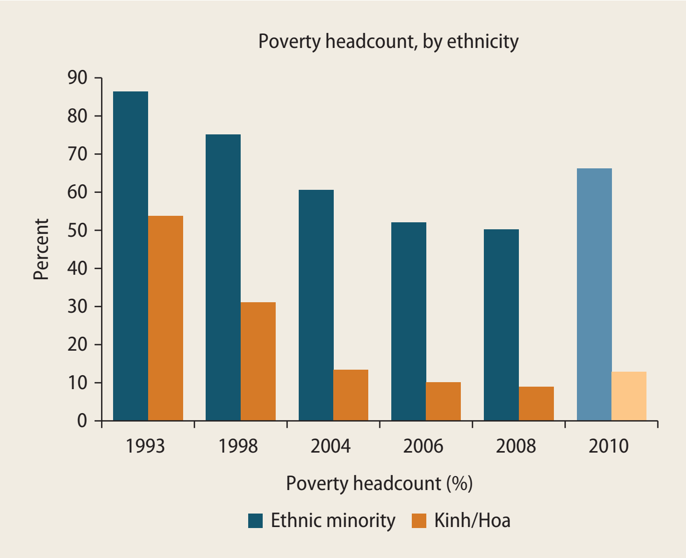
Source: World Bank 2013c.
Note: The figure shows the Gini coefficients at three points in time: country points lying above the 45-degree line imply an increase in inequality from the late 1990s to the labeled year in the late 2000s.

FIGURE 3.16 The welfare gap between rich and poor can be very large



Sources: Estimates based on national consumption aggregates from the Vietnam Housing Living Standards Survey (2010), Cambodia Socio-Economic Survey (2011), Mongolia Household Socio-Economic Survey (2011), and Thailand Socio-Economic Survey (2010). Estimates for Indonesia and the Philippines are for 2009 and 2010 and are from the East Asia Pacific poverty monitoring system.

FIGURE 3.17 The poverty rate among ethnic minorities and the majority in Vietnam has fallen over time, but the gap persists



Source: Badiani et al. 2012.
Note: The 2010 poverty rate is constructed based on a new welfare aggregate and is not strictly comparable to earlier years.

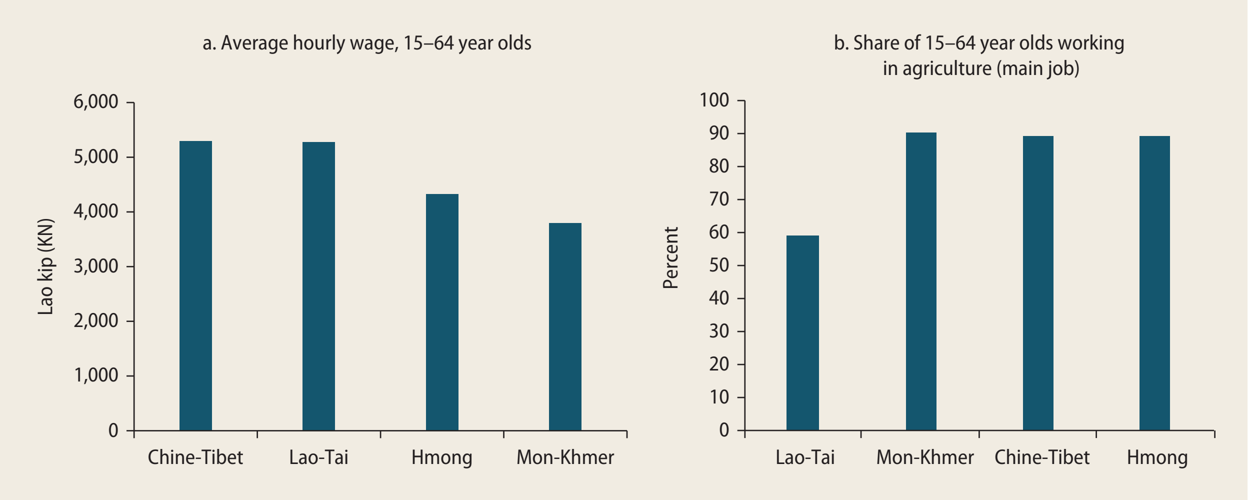
and constraining pluralistic democracy, the process of creative destruction can slow down and even come to a halt, causing societies to go into decline (Acemoglu and Robinson 2012). History is punctuated by instances of economic and social decline that were precipitated by extreme inequality and the consequent ability of elite groups to limit the contestability of markets through their control of political institutions.

Income and consumption inequality is closely linked to the labor market. Changes in inequality can arise from changes in the distribution of assets and characteristics (endowment effects), changes in the returns to assets (price effects), or changes in how individuals use these assets in their work (occupational choice effects; Bourguignon, Ferreira, and Lustig 2005). In East Asia Pacific countries, inequality linked to work is driven mainly by increasing returns to skills and differences in labor earnings. The wage premium to higher education (relative to primary education) has risen sharply in several countries, such as in Cambodia, China, Mongolia, and Vietnam since the mid-1990s (figure 3.19). In these countries, the demand for skills is rising sharply and outstripping the available supply of skills in the workforce, a topic discussed further in chapter 5.

Inequality in wages and other labor market outcomes can result from inequality of opportunity—that is, systematic differences due to factors beyond people's control. The circumstances into which an individual is born, such as location, gender, ethnicity, and parental education, can also influence the opportunities that an individual has early in life and later in the labor market. Abras et al. (2012) quantify the contribution of these circumstances to explaining the observed differences in work opportunity (defined as having employment of 20 hours and more) for countries in Europe and Central Asia and Mongolia. Their results attribute a significant share of this inequality in employment opportunity to circumstances beyond an individual's control. In Mongolia, it is as high as 50 percent.

In most societies, people are content to see others succeed—through hard work and within social norms—as long as they are afforded the same opportunities. But recent evidence shows discontent among people in many parts of East Asia Pacific about certain types of inequality that are perceived as unfair. A study of perceptions in China suggests that the average Chinese citizen is content to see others succeed based on merit: talent, hard work, and education. But the same respondents have little tolerance for advancement based on connections and unequal opportunities determined by circumstances such as gender, family size, and household registration status (Whyte 2010). Similar perception studies in Mongolia and Vietnam suggest that there is widespread acceptance of inequality that arises from "good" processes: "Those who have talent and luck are conditioned to succeed. Those who have none just suffer. I heard no complaint about inequalities. Such [type

FIGURE 3.18 Ethnic minorities in Lao PDR experience poorer labor market outcomes



Source: Estimates based on Lao PDR Expenditure and Consumption Survey (2007–08).

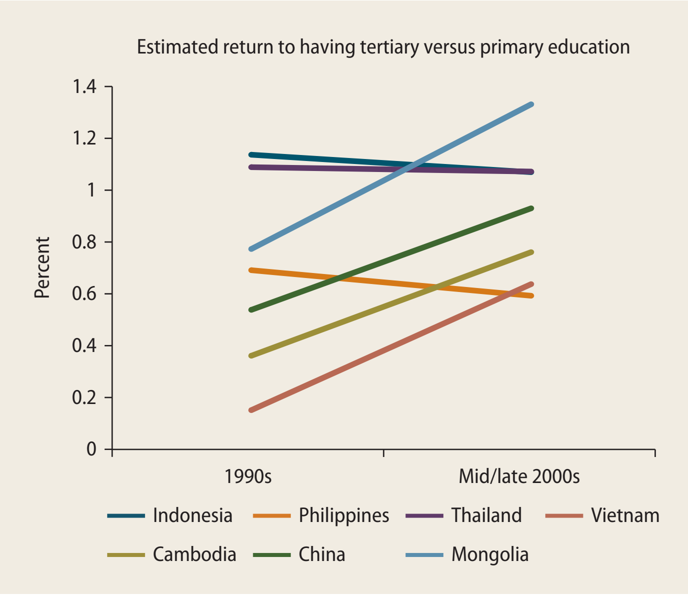
of inequalities] is reasonable" (village cadre group, Cam Hung commune, Hai Duong). There is considerably less tolerance for inequality of opportunities arising from "unfair" processes, such as access to employment through personal connections: "There are types of illegitimate riches, and we do not accept these types; we see them as injustice" (youth group, Chieng Khoa commune, Son La; Badiani et al. 2012). When this sort of discontent becomes widespread, the ability of work to create cohesive societies is compromised.

Conclusion: Do not take the transformative role of work for granted

Countries in the East Asia Pacific region have taken advantage of a prospering global economy and, in doing so, have themselves become more prosperous. Their success has come about mainly through working people. Work in East Asia Pacific has been the conduit connecting and enabling three critical and interrelated development transformations: *rising productivity, improving living standards,* and *strengthening social cohesion*. In this chapter, we have shown how, in recent decades, households in much of East Asia Pacific have experienced these three development transformations in tandem. However, we have also presented evidence suggesting that this phenomenon could soon change, with several of the most populous countries in the region reaching a critical development threshold when economic growth and welfare gains from work cannot be taken for granted.

In some countries, economic success has been accompanied by rising income and consumption inequality. Despite gains in living standards on average, welfare is distributed more unevenly than in the past in the population "giants" China and Indonesia as well as in Lao PDR. Furthermore, some East Asia Pacific countries are now facing challenges to building more inclusive societies through people's access and ability to work, particularly young people. For the region as a whole, more than 30 percent of people ages 15–24 are not in employment, education, or training. Fiji, Indonesia, the Philippines, Tuvalu, and Vanuatu have among the highest rates of youth inactivity in the world. High levels of youth inactivity have been linked to violence and the erosion of social

FIGURE 3.19 Skills premia in labor earnings have risen sharply in many East Asian countries



Source: di Gropello and Sakellariou 2010.
Note: Estimates are based on an ordinary least squares regression of log wages that controls for basic individual characteristics and industry affiliation for those who work for a wage. The wage premium is expressed as the differential between tertiary and primary returns (relative to no completed primary education).

cohesion, providing strong motivation for governments to pay closer attention to the opportunities for youth to work and build their human capital.

What might at first appear as growing challenges to social cohesion are also linked to a general slowing of economic growth in the region, which is more pronounced in countries where productivity and living standards have been lagging for a long time. For example, in the past decade, the Philippines experienced much slower poverty reduction than its neighbors, despite respectable economic growth. This stagnation in living standards is linked to the low productivity of most forms of employment created by the economy. Many economies, including Cambodia, Indonesia, Lao PDR, and the Philippines, need to find ways to create and sustain productive work, amid more difficult global economic prospects and more intense international competition. With rising wages, the labor cost advantage that has enabled many East Asia Pacific countries to benefit tremendously from global markets is now starting to erode.

To face these challenges, governments need to understand how current policies shape the environment for work and how they can prejudice or promote productivity growth, living standards, and social cohesion. We turn to this discussion in part II of this report.

Notes

1. See Carletto, Savastano, and Zezza (2011) on how measurement error of land size can affect the strength of the inverse farm size–productivity relation.
2. Structural change had a different impact on productivity in East Asia than in Latin America. By decomposing productivity growth into within-sector components and structural movements, McMillan and Rodrik (2011) find that structural change was "growth-enhancing" in Asia (labor moved from agriculture and other low-productivity activities to high-productivity activities), but "growth-reducing" in Latin America (people moved from high-productivity to low-productivity activities), in part explained by shrinking manufacturing and expanding, informally provided services.
3. He (2008) demonstrates a positive relationship between industrial agglomeration (measured as the Gini coefficient of gross industrial output) and labor productivity in China between 1980 and 2004, controlling for capital per worker.
4. World Bank (2012b) shows that the level of export sophistication in the manufacturing sector in Indonesia rose and converged with that of other countries in the region until 2000, but stagnated in the aftermath of the Asian crisis.
5. This said, Dang and Lanjouw (2012) show that the transition of households out of poverty in Vietnam took place predominantly through working people earning higher income in the same sector of work, rather than through shifting from farm to nonfarm work, as in other parts of East Asia Pacific.
6. See World Bank (2012e) for a further discussion on measures such as trust and civic engagement.

7. Increasing research in this area, at least existing evidence in OECD countries, tends to argue that globalization and technology have benefited capital at the expense of labor.
8. According to official estimates, quoted by Balakrishnan, Steinberg, and Syed (2013), China's Gini coefficient rose from 37 percent in the mid-1990s to 49 percent in 2008. The same official sources estimate that the Gini has since fallen and stood at 47.4 percent in 2012.
9. An increase in the Gini coefficient of about 25 percent—as observed in urban China from 1995 to 2005—reduces the impact of a 1 percent increase in income to about a 1.5 percent decline in the poverty headcount from a 2 percent decline if the Gini had not changed.

References

Abras, Ana, Alejandro Hoyos, Ambar Narayan, and Sailesh Tiwari. 2012. "Inequality of Opportunities in the Labor Market: Evidence from Life in Transition Surveys in Europe and Central Asia." Background paper for the WDR 2013, World Bank, Washington, DC.

Acemoglu, Daron, and James Robinson. 2012. *Why Nations Fail: The Origins of Power, Prosperity, and Poverty*. New York: Crown Publishing, Random House.

Amiti, Mary, and Jozef Konings. 2007. "Trade Liberalization, Intermediate Inputs, and Productivity: Evidence from Indonesia." *American Economic Review* 97 (5): 1611–38.

Andrews, Martyn, Jennifer Golan, and Jann Lay. 2013. "Inefficiency of Male and Female Labour Supply in Agricultural Households: Evidence from Uganda." Mimeo. http://www.inesad.edu.bo/bcde2010/contributed/d31_20.pdf.

Arulampalam, Wiji, Alison L. Booth, and Mark P. Taylor. 2000. "Unemployment Persistence." *Oxford Economic Papers* 52 (1): 24–50.

Arulampalam, Wiji, Paul Gregg, and Mary Gregory. 2001. "Unemployment Scarring." *Economic Journal* 111 (475): 577–84.

Au, Chun-Chung, and Vernon Henderson. 2006. "Are Chinese Cities Too Small?" *Review of Economic Studies* 73 (3): 549–76.

Ayyagari, Meghana, Aslı Demirgüç-Kunt, and Vojislav Maksimovic. 2011. "Small vs. Young Firms across the World: Contribution to Employment, Job Creation, and Growth." Policy Research Working Paper 5631, World Bank, Washington, DC.

Badiani, Reena, Reno Dewina, Jennifer Golan, and Trang Nguyen. 2013. "Escaping Poverty through Work in East Asia and the Pacific." Working Paper, World Bank, Washington, DC.

Badiani, Reena, Jennifer Golan, and Josefine Posadas. In progress. "Understanding Gender Differentials in Productivity in Non-Farm Household Business Enterprises in Indonesia." Mimeo, World Bank, Washington, DC.

Badiani, Reena, et al. 2012. *2012 Vietnam Poverty Assessment: Well Begun, Not Yet Done; Vietnam's Remarkable Progress on Poverty Reduction and the Emerging Challenges*. Hanoi: World Bank. http://documents.worldbank.org/curated/en/2012/01/17207159/2012-vietnam-poverty-assessment-well-begun-not-yet-done-vietnams-remarkable-progress-poverty-reduction-emerging-challenges.

Balakrishnan, Ravi, Chad Steinberg, and Murtaza Syed. 2013. "The Elusive Quest for Inclusive Growth: Growth, Poverty, and Inequality in Asia." Working Paper WP/13/152, International Monetary Fund, Washington, DC.

Baldwin, John R., and Wulong Gu. 2004. "Trade Liberalization: Export-Market Participation, Productivity Growth, and Innovation." *Oxford Review of Economic Policy* 20 (3): 372–92.

Banerjee, Abhijit V., Paul J. Gertler, and Maitreesh Ghatak. 2002. "Empowerment and Efficiency: Tenancy Reform in West Bengal." *Journal of Political Economy* 110 (2): 239–80.

Barron, Patrick, Kai Kaiser, and Menno Pradhan. 2004. "Local Conflict in Indonesia: Measuring Incidence and Identifying Patterns." Policy Research Working Paper 3384, World Bank, Washington, DC.

Bartelsman, Eric, John Haltiwanger, and Stefano Scarpetta. 2004. "Microeconomic Evidence of Creative Destruction in Industrial and Developing Countries." Policy Research Working Paper 3464, World Bank, Washington, DC.

Berman, Eli, Michael Callen, Joseph H. Felter, and Jacob N. Shapiro. 2009. "Do Working Men Rebel? Insurgency and Unemployment in Iraq and the Philippines." NBER Working Paper 15547, National Bureau of Economic Research, Cambridge, MA.

Bourguignon, Francois, Francisco Ferreira, and Nora Lustig, eds. 2005. *The Microeconomics* *of Income Distribution Dynamics in East Asia and Latin America*. New York: Oxford University Press.

Brandt, Loren, Johannes van Biesebroeck, and Yifan Zhang. 2012. "Creative Accounting or Creative Destruction? Firm-Level Productivity Growth in Chinese Manufacturing." *Journal of Development Economics* 97 (2): 339–51.

Carletto, Calogero, Sara Savastano, and Alberto Zezza. 2011. "Fact or Artefact: The Impact of Measurement Errors on the Farm Size-Productivity Relationship." Policy Research Working Paper 5908, World Bank, Washington, DC.

CEIC. 2012. CEIC Database. New York: CEIC Data. http://www.ceicdata.com/.

Chawanote, Chayanee, and Christopher B. Barrett. 2013. "Non-Farm Occupational and Earnings Dynamics in Rural Thailand." Cornell University, Ithaca, NY. http://dyson.cornell.edu/faculty_sites/cbb2/Papers/NonfarmDynamics_ChawanoteBarrett%2025%20March%202013%20Revisions.pdf.

Collier, Paul, and Anke Hoeffler. 2004. "Greed and Grievance in Civil War." *Oxford Economic Papers* 56 (4): 563–95.

Cramer, Christopher. 2010. "Unemployment and Participation in Violence." Background paper for the WDR 2011, World Bank, Washington, DC.

Cruces, Guillermo, Andrés Ham, and Mariana Viollaz. 2012. "Scarring Effects of Youth Unemployment and Informality: Evidence from Argentina and Brazil." Unpublished project paper for "Mercados laborales el crecimiento inclusivo en América Latina," supported by the International Development Research Centre (IDRC) and carried out at Center for Distributive, Labor, and Social Studies (CEDLAS), La Plata, Argentina.

Dang, Hai-Anh, and Peter Lanjouw. 2012. "Measuring Poverty Dynamics and Labor Transitions with Synthetic Panels Based on Cross-Sections." World Bank, Washington, DC.

de Brauw, Alan, Jikun Huang, Scott Rozelle, Linxiu Zhang, and Yigang Zhang. 2002. "The Evolution of China's Rural Labor Markets during the Reforms." *Journal of Comparative Economics* 30 (2): 329–53.

de Brauw, Alan, Qiang Li, Chengfang Liu, Scott Rozelle, and Linxiu Zhang. 2008. "Feminization of Agriculture in China? Myths Surrounding Women's Participation in Farming." *China Quarterly* 194 (June): 327–48.

di Gropello, Emanuela, and Chris Sakellariou. 2010. "Industry and Skill Wage Premiums in East Asia." Policy Research Working Paper 5379, World Bank, Washington, DC.

Do, Quy-Toan, and Lakshmi Iyer. 2008. "Land Titling and Rural Transition in Vietnam." *Economic Development and Cultural Change* 56 (3): 531–79.

Duranton, Gilles. 2012. "Agglomeration and Jobs in Developing Countries." Background paper for the WDR 2013, World Bank, Washington, DC.

Emran, M. Shahe, and Forhad Shilpi. 2010. "Intergenerational Occupational Mobility in Rural Economy: Evidence from Nepal and Vietnam." *Journal of Human Resources* 46 (2): 427–58.

Fan, Shenggen, and Connie Chan-Kang. 2005. "Is Small Beautiful? Farm Size, Productivity, and Poverty in Asian Agriculture." *Agricultural Economics* 32 (s1): 135–46.

FAO (Food and Agriculture Organization). 2013. "Production: Crops." FAOSTAT-Agriculture Database, Food and Agriculture Organization of the United Nations, Rome. http://faostat.fao.org/site/567/default.aspx#ancor.

Fields, Gary, Paul Cichello, Samuel Freije, Marta Menendez, and David Newhouse. 2003. "Household Income Dynamics: A Four-Country Story." *Journal of Development Studies* 40 (2): 30–54.

Gill, Indermit, and Homi Kharas. 2007. *An East Asian Renaissance: Ideas for Economic Growth*. Washington, DC: World Bank.

Glewwe, Paul, Michele Gragnolatti, and Hassan Zaman. 2002. "Who Gained from Vietnam's Boom in the 1990s?" *Economic Development and Cultural Change* 50 (4): 773–92.

Gregg, Paul, and Emma Tominey. 2005. "The Wage Scar from Male Youth Unemployment." *Labour Economics* 12 (4): 487–509.

Hallward-Driemeier, Mary, Giuseppe Larossi, and Kenneth L. Sokoloff. 2002. "Exports and Manufacturing Productivity in East Asia: A Comparative Analysis with Firm-Level Data." NBER Working Paper Series 8894, National Bureau of Economic Research, Cambridge, MA.

Hallward-Driemeier, Mary, and Bob Rijkers. 2011. "Do Crises Catalyze Creative Destruction? Firm-Level Evidence from

Indonesia." Working Paper 5869, World Bank, Washington, DC.

He, Canfei. 2008. "Industrial Agglomeration and Economic Performance in Transitional China." In *Reshaping Economic Geography in East Asia,* edited by Yukon Huang and Alessandro Magnoli Bocchi. Washington, DC: World Bank.

Heckman, James J., and George J. Borjas. 1980. "Does Unemployment Cause Future Unemployment? Definitions, Questions, and Answers from a Continuous Time Model of Heterogeneity and State Dependence." *Economica* 47 (187): 247–83.

Hyytinen, Ari, and Petri Rouvinen. 2008. "The Labour Market Consequences of Self-Employment Spells: European Evidence." *Labour Economics* 15: 246–71.

Inchauste, Gabriela. 2012. "Jobs and Transitions Out of Poverty: A Literature Review." Background paper for the WDR 2013, World Bank, Washington, DC.

Jacoby, Hanan G., and Ghazala Mansuri. 2009. "Incentives, Supervision, and Sharecropper Productivity." *Journal of Development Economics* 88 (2): 232–41.

Jenson, Jane. 2010. "Defining and Measuring Social Cohesion." Commonwealth Secretariat and United Nations Research Institute for Social Development, London, U.K. http://www.unrisd.org/80256B3C005BCCF9/httpNetITFramePDF?ReadForm&parentunid=170C271B7168CC30C12577D0004BA206&parentdoctype=book&netitpath=80256B3C005BCCF9/%28httpAuxPages%29/170C271B7168CC30C12577D0004BA206/$file/Jenson%20ebook.pdf.

Kilic, Talip, Amparo Palacios-Lopez, and Markus Goldstein. 2013. "Caught in a Productivity Trap: A Distributional Perspective on Gender Differences in Malawian Agriculture." Policy Research Working Paper 6381, World Bank, Washington, DC.

Kilroy, Austin. 2012. "Jobs to Social Cohesion: Via Interests, Attitudes, and Identities." Background paper for the WDR 2013, World Bank, Washington, DC.

Klasen, Stephan, Jan Priebe, and Robert Rudolf. 2010. "Cash Crop Choice and Income Dynamics in Rural Areas: Evidence for Post-Crisis Indonesia." Discussion Paper 33, Courant Research Centre, Goettingen.

Kucera, David, and Leanne Roncolato. 2012. "Structure Matters: Sectoral Drivers of Growth and the Labour Productivity-Employment Relationship." International Labour Organization, Geneva.

Li, Hongbin, Lei Li, Binzhen Wu, and Yanyan Xiong. 2012. "The End of Cheap Chinese Labor." *Journal of Economic Perspectives* 26 (4): 57–74.

Ligon, Ethan A., and Elisabeth Sadoulet. 2011. "Estimating the Effects of Aggregate Agricultural Growth on the Distribution of Expenditures." Working Paper qt4435r7bm, University of California, Berkeley, Department of Agricultural and Resource Economics, Berkeley, CA.

Markussen, T. 2008. "Property Rights, Productivity, and Common Property Resources: Insights from Rural Cambodia." *World Development* 36 (11): 2277–96.

Matsumoto, T., N. S. Kumanayake, J. P. Estudillo, H. C. Z. Uddin, and K. Otsuka. 2012. "Labor Markets, Occupational Choice, and Rural Poverty in Selected Countries in Asia and Sub-Saharan Africa." Background paper for the WDR 2013, World Bank, Washington, DC.

McMillan, Margaret, and Dani Rodrik. 2011. "Globalization, Structural Change, and Productivity Growth." NBER Working Paper 17143, National Bureau of Economic Research, Cambridge, MA.

Naidoo, Darian, Truman Packard, and Ilmiawan Auwalin. 2014. "Mobility, Scarring, and Job Quality in the Indonesian Labor Market." Mimeo, World Bank, Washington, DC.

Narayan, Deepa, Lant Pritchett, and Soumya Kapoor. 2009. *Success from the Bottom Up.* Vol. 2: *Moving out of Poverty*. New York: Palgrave Macmillan.

Narayanan, Chidambarathanu, Kelvin Lau, and Steven Green. 2013. "China: More Than 300 Clients Talk Wages in the PRD." Standard Chartered Global Research, March 4. https://research.standardchartered.com/researchdocuments/Pages/ResearchArticle.aspx?&R=103759.

NBS (National Bureau of Statistics of China). 2011. *China Statistical Yearbook 2011*. Beijing: NBS.

———. 2012. *China Statistical Yearbook 2012*. Beijing: NBS.

Nguyen, Huu Chi, and Christophe J. Nordman. 2012. "Household Entrepreneurship and Social Networks: Panel Data Evidence from Vietnam." Mimeo, Université de Paris and Institute for the Study of Labor (IZA).

http://www.iza.org/conference_files/worldb2012/nordman_c2712.pdf.

OECD (Organisation for Economic Co-operation and Development). 2011. *Perspectives on Global Development 2012: Social Cohesion in a Shifting World*. Paris: OECD.

Ravallion, Martin. 2005. "Inequality Is Bad for the Poor." Policy Research Working Paper 3677, World Bank, Washington, DC.

Ravallion, Martin, and Shaohua Chen. 2007. "China's (Uneven) Progress against Poverty." *Journal of Development Economics* 82 (1): 1–42.

Ray, D. 1998. *Development Economics*. Princeton, NJ: Princeton University Press.

Rostom, Ahmed, Jiyoung Song, and Mee-Jung Kim. In progress. "Determinants of Firms Productivity in Korea: A Vector Equilibrium Correction Analysis." Mimeo, World Bank, Washington, DC.

Shaban, Radwan A. 1999. "Testing between Competing Models of Sharecropping." In *Readings in Development Economics,* vol. 2, edited by Pranab Bardhan and Christopher Udry, 139–69. Cambridge, MA: MIT Press.

Sun, Xiaonan, and Junjie Hong. 2011. "Exports, Ownership, and Firm Productivity: Evidence from China." *World Economy* 34 (7): 1199–215.

Udry, Christopher. 1996. "Gender, Agricultural Production, and the Theory of the Household." *Journal of Political Economy* 104 (5): 1010–46.

Whyte, Martin. 2010. "Fair Versus Unfair: How Do Chinese Citizens View Current Inequalities?" In *Growing Pains: Tensions and Opportunity in China's Transformation*, edited by Jean C. Oi, Scott Rozelle, and Xueguang Zhou. Stanford, CA: Shorenstein Center.

Wietzke, Frank-Borge, and Catriona McLeod. 2012. "Jobs, Well-Being, and Social Cohesion: Evidence from Value and Perception Surveys." Background paper for the WDR 2013, World Bank, Washington, DC.

World Bank. 2007. *World Development Report 2008: Agriculture for Development*. New York: Oxford University Press.

———. 2008a. *Reshaping Economic Geography in East Asia,* edited by Yukon Huang and Alessandro Magnoli Bocchi. Washington, DC: World Bank.

———. 2008b. *World Development Report 2009: Reshaping Economic Geography*. New York: Oxford University Press.

———. 2010. *Indonesia Jobs Report*. Washington, DC: World Bank.

———. 2012a. *East Asia and Pacific Economic Update 2012,* vol. 2: *Remaining Resilient*. Washington, DC: World Bank, December.

———. 2012b. "Export Competitiveness in Indonesia's Manufacturing Sector: An Assessment of Export Performance and Determinants of Competitiveness in Indonesia's Manufacturing Sector Based on an Analysis of the Apparel, Wood Furniture, and Automotive Components Sectors." World Bank, Washington, DC.

———. 2012c. "Picking up the Pace: Reviving Growth in Indonesia's Manufacturing Sector." World Bank, Jakarta.

———. 2012d. "Toward Gender Equality in East Asia and the Pacific." World Bank, Washington, DC.

———. 2012e. *World Development Report 2013: Jobs*. New York: Oxford University Press.

———. 2013a. International Income Distribution Database (I2D2). Washington, DC: World Bank.

———. 2013b. *Philippine Development Report: Creating More and Better Jobs*. Washington, DC: World Bank.

———. 2013c. World Development Indicators. Washington, DC: World Bank.

———. Forthcoming. *International Migration and Development in East Asia and Pacific Region*. Washington, DC: World Bank.

World Economic Forum. 2013. *Global Risks 2013,* 8th ed. Geneva: World Economic Forum. http://www3.weforum.org/docs/WEF_GlobalRisks_Report_2013.pdf.

Zhu, Xiaodong. 2012. "Understanding China's Growth: Past, Present, and Future." *Journal of Economic Perspectives* 26 (4): 103–24.

Yu, Wei-hsin. 2012. "Better Off Jobless? Scarring Effects of Contingent Employment in Japan." *Social Forces* 90 (3): 735–68.

The Fundamentals

4

On the whole—and relative to their peers in other emerging-market countries—governments in East Asia Pacific have gotten the "fundamentals" right, creating an enabling environment for both the demand for and the supply of labor and human capital.

Although most work arises from private demand, governments play a critical part in shaping the market for labor and human capital by reducing uncertainty and providing public goods.[1] These include macroeconomic and regulatory stability, the rule of law, investment in basic infrastructure, and the contestability of markets. Because firms and households cannot cope with inflation effectively on their own, price stability and a country's macroeconomic policy environment are particularly important. Investment and employment creation can be harmed by erratic fluctuations in prices or exchange rates, onerous tax structures, and restrictive regulations on businesses. Thus getting these "fundamentals" right is important to attract and sustain investment and to minimize—or at least smooth—aggregate fluctuations in an economy's demand for work. Sound fundamentals may not be sufficient for strong and sustainable employment creation, but they are still necessary.

This chapter examines the extent to which fundamental policies—monetary, fiscal, and regulatory—currently in place in East Asia Pacific economies support enterprise and the demand for work. It describes the policy environment that shapes the economy's demand for and households' supply of labor and human capital. It seeks to answer one underlying question: Are the policy fundamentals observed in East Asia Pacific "pro-work"? To answer this question, we examine how the macro policy levers are currently set and whether the prevailing regulatory models ensure a competitive climate that attracts investment and encourages employment. Further, we discuss whether policies are geared toward preventing macroeconomic imbalances, instability, and crises that can translate into both lower real earnings and unemployment.

Each of these *fundamentals* is worthy of a report in its own right. And a large body of theoretical and empirical literature already exists, much of it illustrating the recent experience of East Asia Pacific countries. But beyond a general consensus favoring "sound outcomes"—price stability, prudence and predictability in public spending, rule of law, and competitive markets—there is probably more argument than agreement over the specific policies that governments should put in place to achieve these outcomes, such as the degree of central bank independence, whether to peg or float the exchange rate, or the relative intensity of taxes on income or profits versus taxes on consumption. History is littered with prescriptions and orthodoxies that, with the test of time, were found wanting. And economists have become more modest in their admission that it is more important that governments achieve the desired outcomes than how they are achieved. So to contain the discussion, we have limited this chapter to monetary and exchange rate policies, spending and taxation, and the regulatory environment for businesses. Rather than pretend to solve what are welcome and still active debates in the literature and in practice, the chapter highlights the points on each side that are most salient to the demand for and supply of labor and human capital.

With regard to public spending specifically, this chapter is limited to a general review of the cyclicality of aggregate net spending. Other important aspects of fiscal policy that shape the demand for and supply of human capital—such as spending on education and health, "active" labor market programs, and government investments to support sectors of the economy deemed strategic—are taken up elsewhere in this report (see chapters 5 and 6 and spotlight 2). For the sake of brevity, other fundamentals such as public sector management and governance are treated only tangentially.

Across the region, there has been greater price stability, with inflation decelerating in recent years to low and stable levels. Contributing to stability and reflecting difficult lessons from the East Asian financial crisis in the late 1990s, exchange rate policies have shifted toward greater flexibility among the worst-affected countries. A long track record of fiscal prudence allowed East Asia Pacific economies to react quickly in the recent global fiscal crisis of 2008–10, sustaining support for aggregate demand and even launching substantial fiscal stimulus packages that, along with more flexible exchange rates, helped to contain the costs of the crisis borne by households. With respect to taxation, economies in the region stand out on the whole as places where firms are not overly burdened by the level of tax or by the costs of complying with tax obligations. This is in stark contrast to countries in Eastern Europe and in Latin America and the Caribbean. And when it comes to the business climate, on the whole, governments have created an encouraging environment for enterprise, although access to finance, shortages of skills, unfair competition from informal enterprises, and insufficient and unreliable electricity may be unnecessarily constraining growth and demand for labor and human capital.

Prices and exchange rates

An economy generally relies on low, stable inflation. Employers require a certain degree of reliability concerning their investments in and returns from the production process. Volatile prices lead to greater risks for businesses, influencing their medium- and longer-term decisions about investment and their demand for human capital. This is true of all sectors: unstable prices influence the decisions that farmers make about which crops to plant, by vendors about what goods and services are most likely to sell, and by larger firms about how many workers to hire for future production. Governments use monetary policy, wielded by their central monetary authorities, to maintain economic and price stability through, in particular, interest rates, the money supply, and exchange rates. Although achieving price stability through monetary policy is critical to sustaining investment and employment, decisions that are often taken can lower the demand for labor and human capital in the short term.

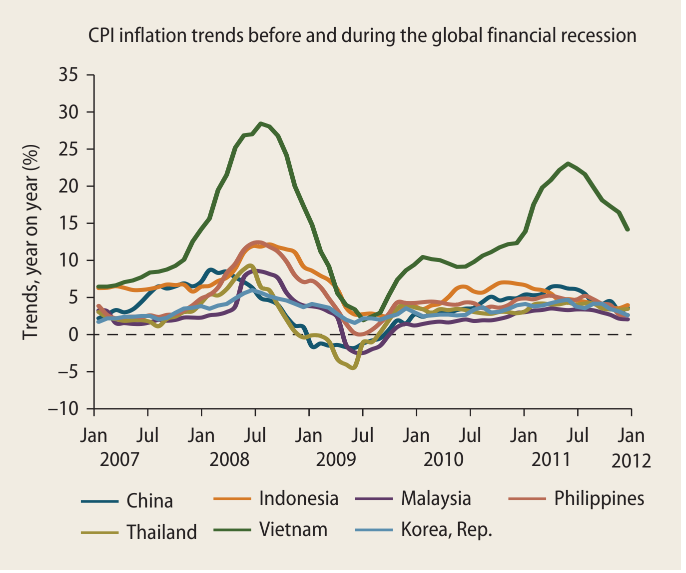
Economies in East Asia are achieving greater price stability than in the past (figure 4.1). Inflation has decelerated across the region. Even Vietnam, which has struggled with higher rates of inflation than its neighbors, is showing some recent progress in this regard.

High inflation distorts price signals, blurring the link between an asset's productivity and its price. This can distort investment decisions, leading to either underinvestment due to cautiousness or asset bubbles due to overconfidence. Savers will demand higher premiums when inflation is high. This can result in an inefficient allocation of resources and further hampers investment. Finally, inflation may provide incentives for investors to put their money in safe but unproductive assets such as gold, reducing economic activity.[2] Thus high inflation can reduce long-run economic growth and demand for work through suboptimal investment, while it can also cause large boom-and-bust cycles by aggravating fluctuations in the business cycle (Baer 1967; Campos 1967; Mundell 1971; Dornbusch and Reynoso 1989; Freedman and Laxton 2009).

A stable inflation environment can reduce structural unemployment (Freedman and Laxton 2009). Economic growth has exceeded inflation in most economies in the East Asia Pacific region, with an average inflation rate below 3 percent. In high-income countries, inflation beyond 3 percent can be harmful, while in low- and middle-income countries, inflation above 7–11 percent can suppress growth (Khan and Senhadji 2000).[3] Economies where inflation runs below 3 percent tend to have lower unemployment overall as well as lower rates of youth unemployment (table 4.1).

Many countries actively target a low inflation rate, yet evidence on the impact of inflation targeting on performance is mixed. Some studies find that inflation targeting can help to build institutional credibility and thus increase long-run growth and reduce economic volatility (IMF 2006; Goncalves and Salles 2008). Others find that moderate rates of inflation (even up to 20 percent or more) have no detectable effect on real variables such as growth, investment, foreign direct investment, or employment (Bruno and Easterly 1998; Epstein 2000). Especially in emerging economies, recent evidence suggests

FIGURE 4.1 East Asian economies have achieved price stability



Source: Data derived from IMF 2013b.
Note: CPI = consumer price index.

that the effect of inflation targeting on the real economy may have been overestimated.[4]

Six economies in East Asia Pacific use inflation targeting to fix their consumer price index (table 4.2). Globally, 28 countries set these monetary policy targets (IMF 2012). The four developing economies in East Asia with inflation targets adopted the policy after the East Asian financial crisis in 1997. While there is evidence that inflation targeting has helped to reduce inflation (Gerlach and Tillman 2011), there is little evidence that the policy has significantly improved growth and employment, relative to economies that have not adopted targeting, such as China; Hong Kong SAR, China; Malaysia; and Singapore (Naqvi and Rizvi 2010).

Beyond inflation targeting, the arguments that central banks need to establish more comprehensive mandates that include employment promotion are growing stronger (Epstein and Yeldan 2008; Epstein 2009). Whether central banks should consider adopting stronger mandates regarding employment raises several technical issues. One is how to set a target—for example,

TABLE 4.1 Economies in East Asia Pacific with lower inflation also have low unemployment

GDP growth rates and unemployment rates, by inflation rates, using 2000–11 averages across East Asia Pacific economies and developing regions

Economy	Inflation, consumer prices (annual %)	GDP growth (annual %)	Unemployment (% of total labor force)	Youth unemployment (% of total labor force, ages 15–24)
−1–2% average annual inflation				
Japan	−0.3	0.8	4.7	9.0
Hong Kong SAR, China	0.5	4.5	5.5	11.6
Brunei Darussalam	0.7	1.5	—	—
Taiwan, China	1.0	4.1	4.4	11.0
Singapore	1.9	5.9	4.8	8.4
2–3% average annual inflation				
Macao SAR, China	2.2	12.3	4.8	8.6
Malaysia	2.2	5.0	3.4	10.0[a]
China	2.3	10.2	4.0	—
Thailand	2.6	4.0	1.6	5.2
Vanuatu	2.7	3.5	4.6[a]	—
3–5% average annual inflation				
Korea, Rep.	3.2	4.5	3.6	9.8
Fiji	4.0	1.1	5.9[a]	—
Middle East and North Africa	4.4	4.3	12.3[a]	24.9[a]
Philippines	4.6	4.7	9.3	18.7
East Asia Pacific	4.9	8.9	4.6	—
5–6% average annual inflation				
Cambodia	5.1	8.0	2.0[a]	3.4[a]
Latin America and the Caribbean	5.3	3.5	8.3	16.4
Samoa	5.4	3.3	5.0	12.2
7–19% average annual inflation				
Tonga	7.5	1.3	3.1[a]	11.9[a]
Papua New Guinea	7.6	3.7	—	5.3
Europe and Central Asia	7.6	5.1	8.9	18.5
Vietnam	7.9	7.1	2.3[a]	4.9[a]
Indonesia	7.9	5.3	8.8	26.3
Lao PDR	9.1	7.1	1.4[a]	—
Mongolia	9.2	7.0	3.4[a]	20.0[a]
Myanmar	18.7	12.9[a]	—	—

Source: Based on data from World Bank 2013d.
Note: — = not available. Regional averages only reflect developing countries in the region. Inflation is based on consumer prices.
a. Reflects the average for less than eight observations over these 12 years.

based on overall employment, full employment, or a composite measure of employment. Another is that such a shift in policy focus would require collection of high-frequency employment data, which presents challenges for many countries. Also, an employment target may produce policy rigidities. For central banks to monitor the extent to which their objectives are being achieved, it is necessary to have in-depth analysis of the performance of the labor market. Yet, as shown in table 4.2, in several countries in the region, central bank reporting lacks detailed analysis of employment trends, even among high-income countries.

This discussion notwithstanding, monetary policy can be used effectively to smooth fluctuations in the business cycle and to stabilize employment outcomes in the short run. During an economic slowdown or

TABLE 4.2 Several central banks in East Asia Pacific have adopted inflation targeting, but few include detailed labor market analysis in their annual reports

Central banks' targeting of inflation and level of reporting on employment across East Asian countries

	Inflation data				Employment analysis in the latest available annual reports of central banks		
Country	Inflation targeting adoption date	Inflation rate at adoption date	2010 end-of-year inflation	Target inflation rate	None	Brief analysis	Detailed analysis
Australia	1993	2.0	2.7	2–3	√		
Cambodia	n.a.	n.a.	n.a.	n.a.	√		
China	n.a.	n.a.	n.a.	n.a.			√
Indonesia	2005	7.4	7.0	5[a]			√
Lao PDR	n.a.	n.a.	n.a.	n.a.	√		
Korea, Rep.	2001	2.9	3.5	3[a]			√
Malaysia	n.a.	n.a.	n.a.	n.a.			√
New Zealand	1990	3.3	4.0	1–3	√		
Philippines	2002	4.5	3.0	4[a]		√	
Thailand	2000	0.8	3.1	0.5–3			√
Vietnam	n.a.	n.a.	n.a.	n.a.		√	

Sources: Data for the first four columns are derived from International Monetary Fund calculations, Hammond 2011, and Roger 2010, while data for the last three columns are derived from annual reports of central banks and Bhattacharyya 2012.

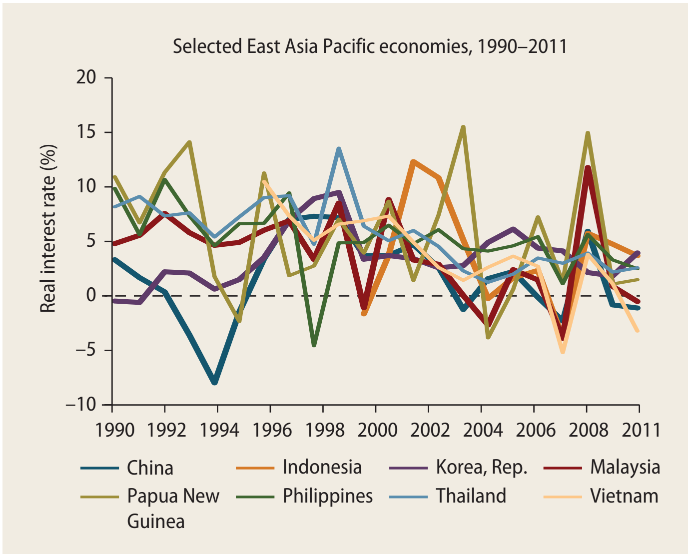
Note: n.a. = not applicable. Employment analysis refers to the latest available English-language annual report of central banks that are accessible online. While the 2012 annual report of the central bank in Australia lacks an employment analysis, the "maintenance of full employment" in the country is one of the three explicit functions of the Reserve Bank.

a. Plus or minus 1.

contraction, increasing the money supply and lowering interest rates can help to increase employment, as lower financing costs can boost consumption and investment. Indeed, central banks often use monetary policy to counteract short-term fluctuations in the business cycle. There is broad consensus that, while "priming the pump" is often effective in the short run, monetary authorities should do so with great care (Friedman and Schwartz 1963; Hossain and Chowdhury 1996). As figure 4.2 shows, real interest rates have been volatile in several East Asia Pacific economies. However, in the years immediately following the Asian financial crisis and the global financial crisis, real interest rates in all of these economies fell back to precrisis levels.

Use of exchange rate policy as a monetary lever to sustain demand for labor and human capital grows in importance as a country's integration with the global economy increases. As pointed out in chapter 1, economies in East Asia Pacific have experienced years of sustained global and regional economic integration at higher levels than countries in other regions. Thus for this region more than others, exchange rate policies have a direct impact on the demand for and supply of labor and human capital through several channels.

FIGURE 4.2 Although still volatile, interest rates in many East Asia Pacific economies are trending downward



Source: Based on data from World Bank 2013c.

First, depreciation of a country's exchange rate decreases the relative price of labor, which helps to increase exports and consequently the labor demand for traded goods that are domestically produced. This can lead to an increase in output and help to increase employment in the "tradable" sectors. The boost can spill over to nontradable production since the consumption of workers in these sectors helps to raise demand for nontraded goods—typically, services—raising employment overall. This has been East Asia's experience through several periods of exchange rate depreciation (Kim and Yung-Hasiang 2007). Second, movements in exchange rates alter the relative price of labor and capital. When a country's currency depreciates, the relative cost of labor falls, making it more attractive at the margin for businesses to raise the labor intensity of their production. Third, in the medium and longer term, exchange rate depreciation increases economic competitiveness and raises the potential profitability of businesses since input costs fall and demand rises. Through each of these channels, exchange rate policy can function as an instrument to boost employment, typically as part of government's broader industrial policies: similar to tariffs, exchange rate policies can raise import costs and make export-oriented sectors more competitive (Frenkel and Ros 2006; Rodrik 2003).

The value of a country's currency can also move in the opposite direction of exchange rate appreciation. Large increases in foreign exchange earnings can cause a currency to overvalue, leading to exports that are less competitive. Appreciation pressures are a constant concern of policy makers in resource-rich countries like Australia, Mongolia, and Papua New Guinea and in countries where foreign assistance accounts for a large share of the national budget. Surges in foreign exchange earnings can also impede labor and export diversification. A fixed exchange rate regime can—in principle—reduce this volatility and help to lower inflation, when pegged to a low-inflation currency. However, maintaining price stability requires much more than exchange rate policy. And because there is little evidence that exchange rate pegs lead to more trade or investment, what a country might gain in price stability could come at the cost of longer-term imbalances (Obstfeld and Rogoff 1995).

Exchange rate policies in countries that were deeply affected by the 1997 East Asian financial crisis shifted toward greater flexibility after that crisis (table 4.3). The experience of some affected East Asian economies demonstrates how costly maintaining rigidly pegged currencies can be, creating vulnerability to speculative activities. The imbalances caused by fixed exchange rates likely contributed to the crisis (Fischer 2001). The countries most affected—Indonesia, the Republic of Korea, and Thailand—reformed their exchange rate regimes to allow for more flexibility. Flexible exchange rates tend to be associated with better medium- and long-term growth, particularly in developing countries (Rogoff et al. 2003; Levy-Yeyati and Sturzenegger 2003; Levy-Yeyati, Sturzenegger, and Reggio 2005; Harms and Kretschmann 2009), even if some economies with managed exchange rates, such as China, have had solid economic and labor market performance.

In an important departure from the trend in exchange rate policies since 1997, after the

TABLE 4.3 East Asia's financial crisis motivated a move to greater exchange rate flexibility

Official exchange rate regimes pre- and post-1997 in East Asian countries affected by the 1997 financial crisis

Economy	Time period	Type of regime
Indonesia	November 1978–June 1997	Managed floating
	July 1997–December 2000	Independently floating
Korea, Rep.	March 1980–October 1997	Managed floating
	November 1997–December 2000	Independently floating
Malaysia	March 1990–November 1992	Fixed
	December 1992–September 1998	Managed floating
	September 1998–December 2000	Pegged arrangement
Philippines	January 1988–December 2000	Independently floating
Thailand	January 1970–June 1997	Fixed
	July 1997–December 2000	Independently floating

Sources: IMF data derived from several issues of *Exchange Arrangements and Exchange Restrictions* and based on Hernández and Montiel 2001.

financial crisis, Malaysia moved to a pegged arrangement underpinned by capital controls (see box 4.1). Following a sustained period of liberalization, some governments reimposed capital controls after the shock of the East Asian financial crisis to help to manage volatility and avoid contagion from financial shocks (Fischer 2001; Kaplan and Rodrik 2002). Several governments continue pursuing some form of exchange rate management to smooth volatility (World Bank 2012a). This is particularly the case of Timor-Leste and many of the small island countries in the Pacific (table 4.4).

More recently, some of the East Asian economies that made their exchange rates more flexible appear to have been well served by this flexibility during the global financial crisis of 2008–10 (figure 4.3). In contrast to other low- and middle-income-country regions, economies in East Asia were left relatively unscathed and recovered quickly. Whereas rigid exchange rate regimes elsewhere forced labor markets to "quantity adjust" through widespread job losses, East Asian economies experienced mainly a downward adjustment in earnings. One explanation for this contrasting experience is that a large portion of the "blow" of the global financial crisis was absorbed by exchange rate movements that kept East Asia's exports competitive. This said, exchange rate management—mostly through systematically undervaluing exchange rates—has been a consistent part of the success of some other countries in the region, such as China, in promoting sustained labor-intensive growth.

But trends in long-term real exchange rate movements are more revealing and important than a government's official exchange rate policy. Since 2005, there has been an upward trend among East Asia Pacific economies in

BOX 4.1 Capital controls: An alternative for sustaining demand for work?

Capital controls—the management of capital flows in and out of a country—are another monetary policy instrument with an impact on the labor market. Malaysia used this tool intensively to manage the impact of the 1997 financial crisis.

Restrictions on capital flows were implemented to ensure public resource space for a countercyclical response and to minimize the impact of the financial crisis. The objectives of the capital controls policy included fostering expansionary macroeconomic policy, defending the exchange rate, minimizing capital flight, safeguarding foreign exchange reserves, and managing without an International Monetary Fund (IMF) stabilization program (Jenkins 2010).

The measures adopted were a policy to halt offshore speculation of the national currency, the ringgit; the need for residents to obtain government approval to export foreign currencies to mitigate speculative capital flows; a requirement to repatriate export profits within half a year from export; and the creation of a one-year prohibition on the export of external portfolio capital. These capital controls, while still controversial among some within the finance community, effectively constrained outflows of foreign exchange reserves and currency speculation, without observably deterring foreign direct investment, and accelerated recovery (Jenkins 2010).

China's capital controls also attract substantial criticism. In particular, they may create fear among investors of being "locked in" during a crisis (Edwards 1999). There is some empirical evidence that in East Asia, capital controls deter some foreign direct investment (Asiedu and Lien 2004). Similarly, evidence from Malaysia suggests that capital controls can foster an environment more amenable to corruption and cronyism (Johnson and Mitton 2003). The effect of capital controls on growth and demand for work is thus not always clear.

TABLE 4.4 De facto classification of exchange rate arrangements, 2011

Economy	General classification	Further detailed classification
Brunei Darussalam	Currency board	Hard pegs
Cambodia	Stabilized	Soft pegs
China	Crawl-like	Soft pegs
Fiji	Conventional peg	Soft pegs
Hong Kong SAR, China	Currency board	Hard pegs
Indonesia	Floating	Floating regimes
Japan	Free floating	Floating regimes
Kiribati	No separate legal tender	Hard pegs
Lao PDR	Stabilized	Soft pegs
Malaysia	Other managed	Residual category
Marshall Islands	No separate legal tender	Hard pegs
Micronesia, Fed. Sts.	No separate legal tender	Hard pegs
Mongolia	Floating	Floating regimes
Palau	No separate legal tender	Hard pegs
Philippines	Floating	Floating regimes
Samoa	Conventional peg	Soft pegs
Singapore	Other managed	Residual category
Solomon Islands	Other managed	Residual category
Korea, Rep.	Floating	Floating regimes
Thailand	Floating	Floating regimes
Timor-Leste	No separate legal tender	Hard pegs
Tonga	Pegged with horizontal bands	Soft pegs
Vanuatu	Other managed	Residual category
Vietnam	Stabilized	Soft pegs

Source: Data derived from IMF 2012.
Note: The table distinguishes among four major categories: hard pegs (such as exchange arrangements with no separate legal tender and currency board arrangements); soft pegs (including conventional pegged arrangements, pegged exchange rates within horizontal bands, crawling pegs, stabilized arrangements, and crawl-like arrangements); floating regimes (such as floating and free floating); and a residual category, "other managed."
Data reflect the status as of April 30, 2011.

real effective exchange rates—measured as the value of a currency against a weighted average of several foreign currencies and adjusted for inflation (figure 4.4). If this trend continues, alternative means will be needed to sustain export competitiveness and boost domestic consumption to fuel demand for work.

Public spending and taxation

Fiscal policy can be a powerful tool in the hands of governments pursuing employment goals, often through longer-term public investments, especially in human capital (discussed in chapter 5), but also through shorter-term spending. Sustained investments in health and education generally support growth and productive employment. With direct influence on demand for work, public spending can stimulate aggregate demand or expand aggregate supply. These "active" policies and the overall fiscal structures with less explicit employment objectives help to explain how net spending moves with the economic cycle. With respect to work, the outcomes that policy makers seek to achieve are predictability and countercyclicality of public spending. Households are engaged in a constant struggle to smooth their consumption over the ebb and flow of aggregate demand. An important objective of governments' spending and taxation policies should be to support their efforts.

Public sector investments in human capital programs designed to promote employment directly as well as countries' strategic investments are discussed elsewhere in this report (chapters 5 and 6 and spotlight 2). In this section, we focus first on the overall "cyclicality" of spending—that is, whether a government sets the spending and revenue "levers" so that it is net spending (if necessary, running deficits and accumulating debt) during downturns and contractions and net saving (running budget surpluses, paying down debt, and piling up reserves) during periods of growth. Second, we analyze the impact of taxation policy on employment.

In the Organisation for Economic Co-operation and Development (OECD) countries, progressive tax systems with a broad base of contributors and unemployment insurance schemes act as passive or "automatic" stabilizers. In low- and middle-income countries where taxes are not levied on a similarly broad or diverse base and where coverage of unemployment insurance plans is low (if they exist at all), governments have to be more active to achieve countercyclical fiscal spending. In countries with a large share of natural resource exports, countercyclical fiscal policy measures can help to manage the impact of price volatility of minerals and commodities on aggregate demand and revenues.

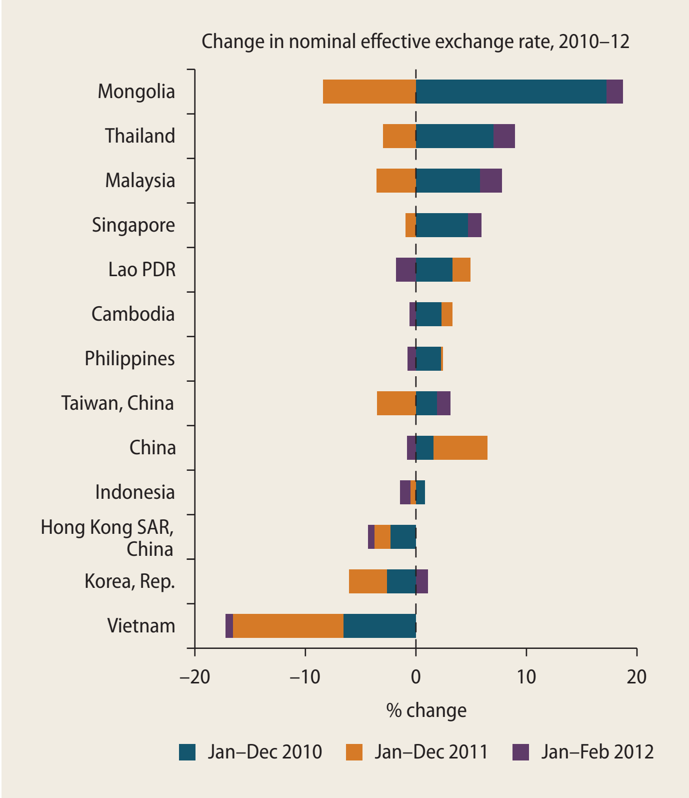
Do countries in the region take these measures to ensure countercyclicality? Countercyclical policies can be very effective at compensating reductions in aggregate demand and, in doing so, containing unemployment during a downturn. This is one of the important lessons from the East Asian financial crisis (IMF 2009). During the regional crisis, among economies where gross domestic product (GDP) contracted the most, such as Indonesia and Malaysia, government consumption actually fell. In contrast, public spending rose in Brunei Darussalam; Fiji; Hong Kong SAR, China; Korea; Macao SAR, China; the Philippines; and Thailand.

More recently, to manage the contraction in the wake of the global financial crisis, governments in East Asia Pacific were better positioned to adopt countercyclical spending, including fiscal stimulus. Figure 4.5 shows trends in general government final consumption expenditure (as a percent of GDP, a proxy for fiscal stimulus) and growth over the period 1990–2011. While GDP growth in nearly all East Asia Pacific economies with available data fell between 2007 and 2009, levels of government consumption expenditure increased, especially between 2008 and 2009.

In 2009, 32 countries announced economic stimulus packages, including all G-20 members, accounting for 1.4 percent of global GDP. About 90 percent of the global stimulus came from G-20 economies. China announced the largest stimulus package as a share of GDP worldwide (Y 4 trillion, equal to 13 percent of GDP), followed by Saudi Arabia, Malaysia, and then the United States (Khatiwada 2009). The magnitude of fiscal stimulus packages varied widely across East Asian economies (table 4.5). Infrastructure spending accounted for more than 60 percent of the stimulus packages in China, Korea, the Philippines, and Thailand (table 4.6). However, even though many short- and medium-term instruments and measures other than infrastructure exist for raising aggregate demand, there does not appear to have been a clear rationale for the composition of stimulus packages (Doraisami 2011).

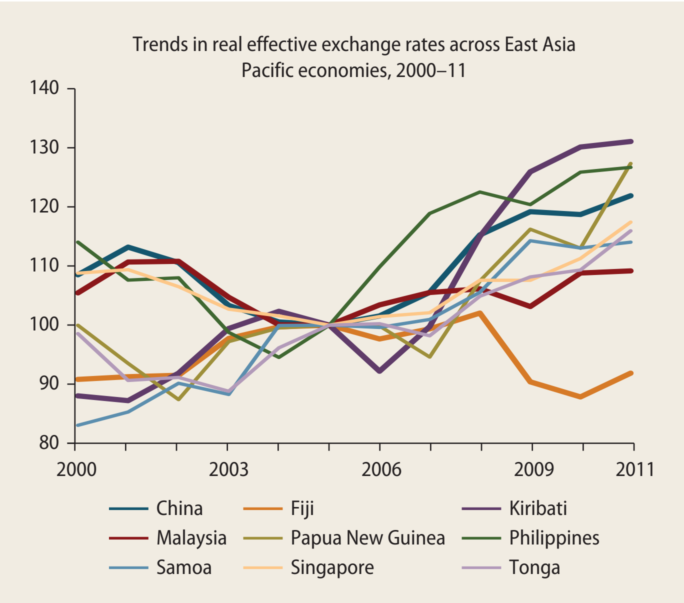
With the exception of some countries in the North Pacific, Timor-Leste, and more recently Mongolia, economies in East Asia Pacific generally forgo the national stabilization and savings mechanisms that governments elsewhere use to achieve countercyclical fiscal aims. The premier examples from middle-income countries are the stabilization funds and fiscal rules employed by many governments in Latin America, albeit with varying levels of success. Chile's stabilization fund and fiscal rules have been widely acclaimed for smoothing public spending over the business cycle and effectively supporting aggregate demand and employment. In a country where unemployment insurance was only introduced in 2002 and covers a little more than half of working people in any given year, the stabilization fund and fiscal rules are foundational to Chile's countercyclical outcomes, particularly its ability to sustain employment in the wake of the global financial crisis.

FIGURE 4.3 Flexible exchange rates helped to absorb the blow of the global financial crisis in East Asian economies



Source: Data derived from Haver Analytics 2013.

FIGURE 4.4 Real effective exchange rates are on the rise across East Asia Pacific



Source: Data derived from Haver Analytics 2013.

The economies of East Asia have a much longer track record for sustained, prudent fiscal policy that creates relatively greater credibility and instills greater confidence than countries at similar levels of development in other regions. This, and relatively fewer instances of resource windfalls of the sort often experienced by Mexico and the República Bolivariana de Venezuela, may have lessened the need to institute nondiscretionary, contingent rules and other policy devices. However, this still begs the question of whether, in a downturn, governments in East Asia Pacific are adequately prepared, not only with savings but also with plans, to step up in a timely manner.

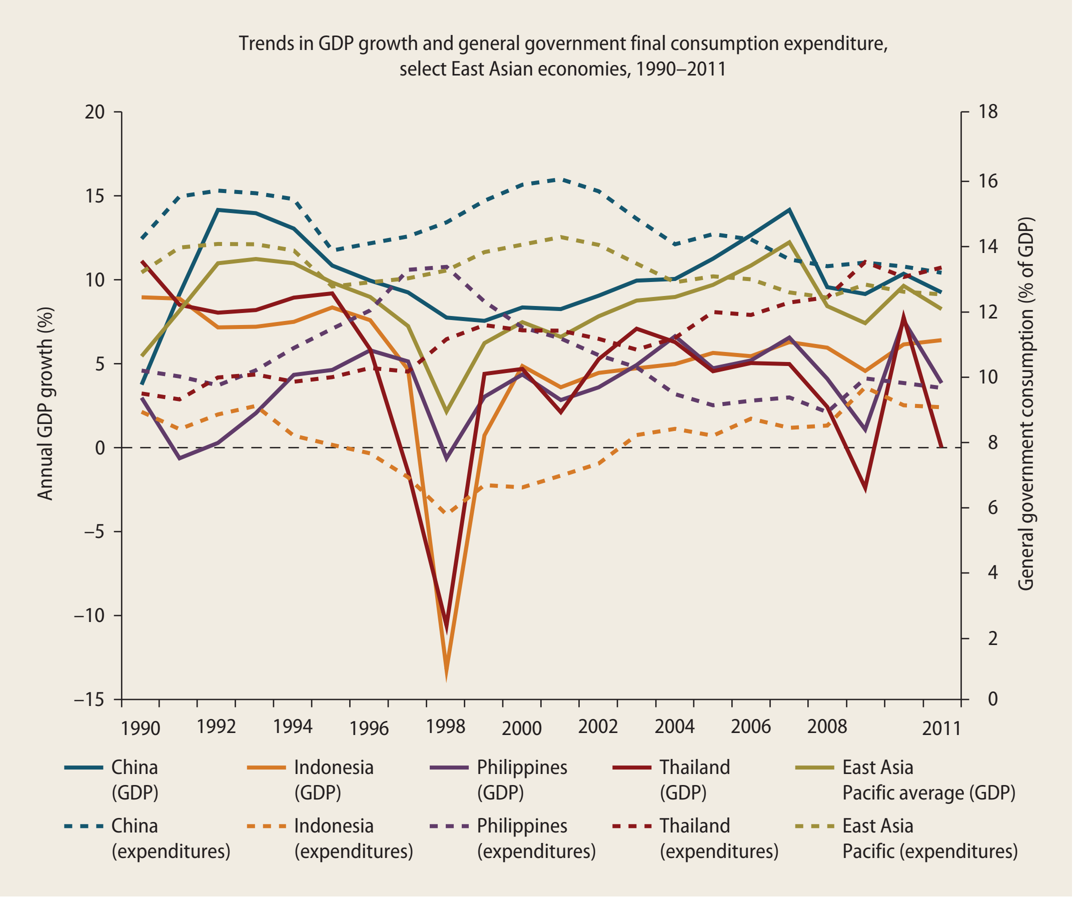
Ultimately, the longer track record of relative fiscal prudence places several East Asia Pacific economies in a much better position than other developing countries to manage shocks using countercyclical policies, such as fiscal stimulus, to sustain demand for labor and human capital. Part of this fiscal prudence reflects smaller budgets and high saving rates across the region. Another part reflects the structure of taxation.

There is an important interplay among public revenue structures, incentives for investment, and the demand for as well as supply of labor and human capital. Governments are always looking for ways to broaden their tax base and raise revenue. How earnings are taxed and at what rate can influence incentives, especially corporate tax rates. Similar to price uncertainty, uncertainty about taxation can affect the decisions of firms and households.

Can the structure of taxation foster higher employment? The theoretical debate tends to revolve around two basic ideas. Advocates of limited taxation claim that entrepreneurs in high-tax countries have less capital for reinvestment and, by extension, less ability to grow and increase their demand for work. Among households, higher direct taxes are expected to lower work effort and discourage the supply of labor and human capital. Higher-taxation advocates, however, argue that when more revenue flows into government, greater investment can be made in better infrastructure and a more qualified workforce, which makes the broader business environment functional, attracts foreign investment, and promotes more inclusive, productive employment.

With no clear theoretical consensus, the question can only be answered empirically, and the evidence from countries around the world is mixed. Scandinavian countries have both the highest labor force participation rates as well as the highest tax revenue as a share of GDP. Among 143 countries with available data, there is no clear relationship between changes in a country's labor force participation rate between 1990 and 2011 and either its level of tax revenue as a share of GDP (figure 4.6, panel a) or its share of revenue from taxes on income, profits, and capital gains (figure 4.6, panel b). Indeed, the top 20 countries in the world with the strongest increase in labor force participation over these two decades had an average share of tax revenue of 17.9 percent of GDP, while the bottom 20 countries with the strongest reduction in labor force participation had an average share of tax revenue of

FIGURE 4.5 East Asian economies were in a better position to adopt countercyclical spending to manage the global financial crisis



Source: Based on data derived from World Bank 2013d.
Note: General government final consumption expenditure (formerly general government consumption) includes all government current expenditures for purchases of goods and services (including compensation of employees). It also includes most expenditure on national defense and security, but excludes government military expenditures that are part of government capital formation. Once again, the East Asia Pacific average is strongly driven by trends in China.

TABLE 4.5 China and Korea led in the volume of fiscal stimulus during the crisis
Fiscal stimulus packages in selected East Asian economies

Country	Forecasted drop in GDP[a]	Ratio of stimulus to GDP, 2008 (%)[b]	Ratio of deficit to GDP, 2008 (%)	Ratio of deficit to GDP, 2009 (%)	Ratio of debt to GDP, 2008 (%)	Ratio of current account balance to GDP, 2008 (%)
Indonesia	−3.6	1.2	−0.1	−2.1	33	0.2
Malaysia	−7.3	10	−4.8	−7.6	42.5	17.6
Philippines	−4.6	4.1	−0.9	−2.3	56	2.5
China	−2.5	13	−0.4	−3.2	17.6	10.1
Korea, Rep.	−6.2	12.8	0.3	−6.5	33	−0.4
Thailand[c]	−10	1.1	−1.1	−6	33.6	−0.1

Sources: Khatiwada 2009; IMF 2013b.
a. The difference in the IMF's GDP forecasts between 2008 and 2009.
b. Estimated as the result of implementing the stimulus as announced by national authorities.
c. New package of more than 17 percent of GDP over three years.

18.1 percent of GDP. The five economies in East Asia Pacific where labor force participation fell the most between 1990 and 2011 (China; Hong Kong SAR, China; Lao PDR; Malaysia; and Thailand) had an average share of tax revenue of 12.6 percent of GDP over this period, while the five economies in the region with the largest increase in labor force participation (Fiji; Japan; Macao SAR, China; New Zealand; and Singapore) had an average share of tax revenue of 19.6 percent of GDP.[5]

TABLE 4.6 Stimulus packages were heavily weighted toward infrastructure investment

Features of fiscal stimulus package: three major items of expenditure

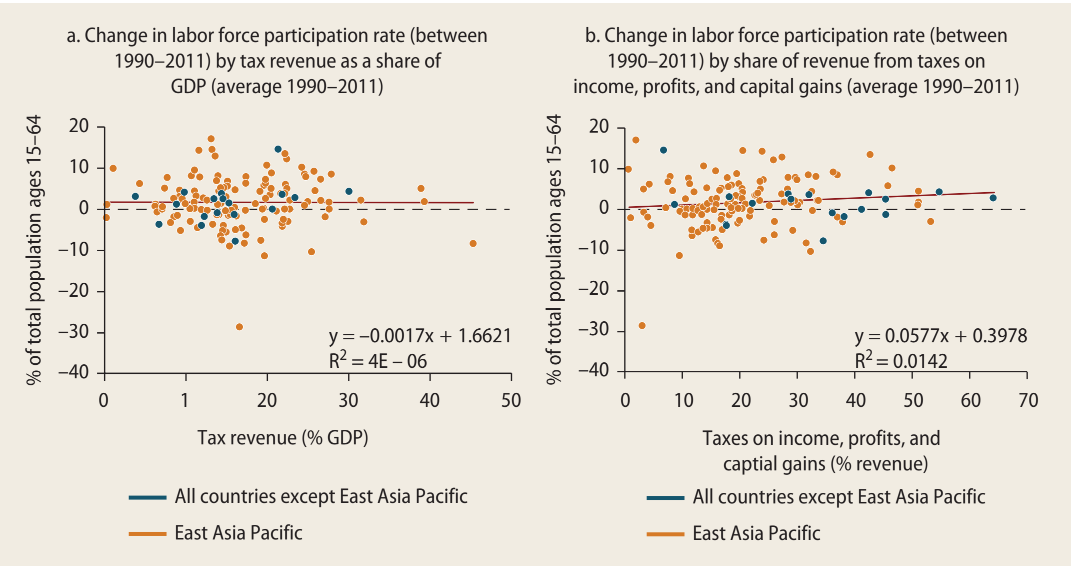
Country	Infrastructure	Tax breaks	Transfers	Other
Indonesia	√	√		Waived import duties
Malaysia				Guarantee funds, equity investment
Philippines	√	√		General increase in budget
China	√			Health care reform
Korea, Rep.	√	√	√	
Thailand		√	√	Education

Source: Doraisami 2011.

Relative to other low- and middle-income-country groupings, East Asia Pacific is a "low-tax" region. Tax revenue as a share of GDP is lower than in any other developing-country region, accounting for only 11 percent of GDP compared, for example, to 15.6 percent in Eastern Europe and Central Asia and 17.5 percent in Middle East and North Africa. That revenue from taxation is so low reflects, in part, the stage in the structural transformation in which most East Asia Pacific economies find themselves. Subsistence and small-scale commercial agriculture is still a very large segment of the economy in most countries. The volume of unregistered and unregulated economic activity constrains what governments can collect in tax revenue.

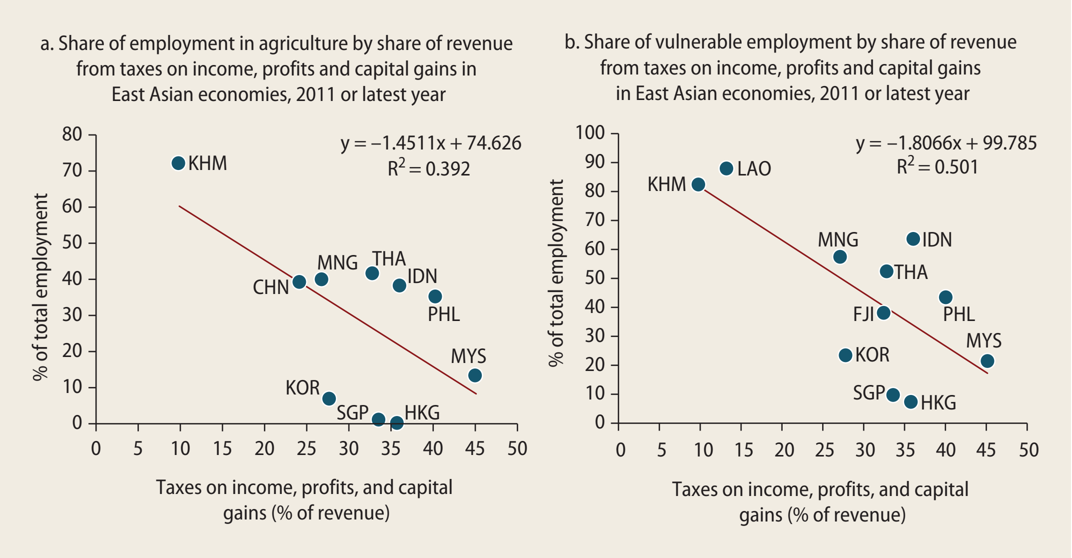
Figure 4.7 shows negative correlations between employment in agriculture and tax revenue across East Asian economies with available data. In an average East Asian economy with a 10 percentage point smaller share of people employed in agriculture, the government collects an average of about 6.9 percentage points more in taxes on income, profits, and capital gains as a share of government revenue. Economies in the region with higher shares of "vulnerably employed"

FIGURE 4.6 The volume of taxation does not appear to have a strong effect on labor force participation



Source: Based on data from World Bank 2013d.

FIGURE 4.7 A large number of people still in agriculture and unregistered forms of work constrains government revenue in many East Asia Pacific economies



Sources: Data derived from the IMF and the International Labour Organization (ILO); see World Bank 2013c, 2013d.
Note: Data reflect the latest year between 2005 and 2011 for all East Asian economies with available data, with the exception of Macao SAR, China, an offshore financial center and tax haven with no control regime for foreign exchange. OECD = Organisation for Economic Co-operation and Development.

people (own-account and unpaid family workers; see spotlight 1) tend to raise less revenue from taxes on income, profits, and capital gains.[6] In East Asia, a decline in a country's share of vulnerably employed people by 10 percentage points is associated with an average increase in taxes on income, profits, and capital gains as a share of revenue of about 5.5 percentage points.

A dominant commodities sector contributes to more limited tax collection and a more volatile pool of public resources in several East Asia Pacific economies. Having a very high share of total employment in agriculture—for example, in Cambodia, Vanuatu, and Vietnam, at over 50 percent—can contribute to greater volatility in overall economic output (due largely to greater price fluctuations in the agriculture sector) and therefore greater volatility in tax revenue. Many workers in these countries are subsistence farmers and consume most of their output, so they often have no margin of income above subsistence to make even limited contributions to tax revenue or to make future investments in human capital. Taxes are a burden often falling largely on the share of the population working in industry and services as well as natural resource exports.

Even those people working mostly in the formal economy report evading taxes. Using data derived from the East Asia Barometer (2013), table 4.7 shows the reported levels of tax evasion of respondents by their occupation. For the survey, respondents' were asked if they "refused to pay taxes or fees to the government" at least once during the last three years. People in all types of occupations evade paying taxes. Evasion appears particularly pervasive in Mongolia, the Philippines, and Thailand. Yet the likelihood that a salaried employee will report tax evasion is similar to that of people in other forms of work. Limited government capacity to enforce tax obligations or dissatisfaction with public services may be contributing to tax evasion, regardless of where and how people are working.

We now turn to the structure of taxation. East Asia Pacific economies have relatively low tax rates on commercial profits, at an average of 36.2 percent, compared with

TABLE 4.7 Self-reported tax evasion appears to vary little across different ways of working

% of population who refused to pay taxes or fees to the government one or more times in the past three years within East Asian countries, by main occupation

Economy and year	Total	Salaried workers (excluding unpaid family workers)	Employers and self-employed	Presently unemployed but looking for work	Presently unemployed and not looking for work	Never worked before	Unpaid family workers	Purely property owner	Number of observations
Indonesia (2006)	5.3	5.5	9.5	0	4.5	10.0	0	—	1,569
Mongolia (2006)	8.2	8.2	7.0	7.5	7.1	12.5	—	—	1,201
Philippines (2005)	9.9	9.7	10.9	8.1	10.4	5.0	0	33.6	1,166
Singapore (2006)	1.4	2.0	0	1.4	0	1.8	—	—	1,003
Taiwan, China (2006)	4.0	3.9	3.9	11.7	2.2	0	5.3	—	1,544
Thailand (2006)	7.9	8.6	7.3	11.3	7.6	3.7		21.4	1,490
Vietnam (2005)	1.6	0.9	1.5	2.9	3.9	6.7	0	0	1,172

Source: Based on data derived from East Asia Barometer 2013.
Note: — = not available. Due to a limited number of observations, data on "purely property owners" should be read with caution.

Europe and Central Asia at 41.6 percent and Latin America and the Caribbean at 47.6 percent.[7] In several countries, individual income tax rates have declined since 2005 (table 4.8). Corporate tax rates have also declined in nearly all East Asia Pacific economies. Indonesia, in particular, has taken substantial steps to reform its tax environment and has reduced individual income and corporate tax rates more than any other East Asian economy.[8] Over the past seven years, the maximum corporate tax rate fell 8 percentage points in China and Taiwan, China, and 5 percentage points in Indonesia, contributing to a more welcoming environment for foreign investment.

In contrast, indirect taxation, although relatively low, is on the rise. In East Asia Pacific economies, on average 29.4 percent of revenue is collected from taxes on the consumption of goods and services, compared to an average of 36.8 percent in Europe and Central Asia and 40.1 percent in Latin America and the Caribbean. In spite of (or likely due to) corporate and individual taxes having fallen in many economies in the region, indirect taxes have been stable and, in some cases, have risen. Indirect taxes—such as value added tax, goods and services tax, and sales tax—appear to be, in part, compensating for lower revenues from corporate and individual taxes. Fiji, the Philippines, and Singapore are actively redistributing the tax burden mainly from firms (↓ corporate tax) to consumers (↑ indirect tax).

From a public finance perspective, diversifying and broadening the tax base by using indirect taxes more intensively can help to stabilize revenues. From a labor market perspective, shifting the mix of taxation instruments could improve incentives for work. The shift away from income tax to greater taxation of consumption should, all else equal, provide households with greater incentives to supply human capital. To the extent that social insurance is financed mainly from the same sort of tax rather than from mandatory contributions paid by employers, the shift should create greater incentives for firms to hire. This discussion is taken up in greater detail in chapters 6 and 9. Given that the region as a whole has the lowest indirect tax rates in the world (with consumers in Singapore; Taiwan, China; and Thailand, for example, paying only 7 percent or less in indirect taxes), policy makers in East Asia Pacific economies, especially those with fiscal difficulties, should perhaps consider adjusting indirect tax rates upward before raising other types of taxes.

More intensive use of indirect taxes, however, raises concerns about equity and the well-being of lower-income households. There are trade-offs between income taxes,

TABLE 4.8 Direct taxes have been declining in many East Asia Pacific economies
Individual income tax, corporate tax, and indirect tax rates in East Asia Pacific economies, 2005–12

	Maximum individual income tax rate			Maximum corporate tax rate			Indirect tax rate		
Economy	2005	2012	Difference	2005	2012	Difference	2005	2012	Difference
Cambodia	—	—	—	—	20	—	—	10	—
China	45	45	0	33	25	−8	17	17	0
Fiji	31	31	0	31	28	−3	12.5	15	2.5
Hong Kong SAR, China	16	15	−1	17.5	16.5	−1	—	—	—
Indonesia	35	30	−5	30	25	−5	10	10	0
Korea, Rep.	35	38	3	27.5	24.2	−3	10	10	0
Macao SAR, China	12	12	0	12	12	0	—	—	—
Malaysia	28	26	−2	28	25	−3	10	10	0
Papua New Guinea	47	42	−5	30	30	0	10	10	0
Philippines	32	32	0	32	30	−2	10	12	2
Samoa	—	—	—	29	27	−2	—	15	—
Singapore	21	20	−1	20	17	−3	5	7	2
Taiwan, China	40	40	0	25	17	−8	5	5	0
Thailand	37	37	0	30	30	0	7	7	0
Vanuatu	—	—	—	0	0	0	—	12.5	—
Vietnam	40	35	−5	28	25	−3	10	10	0
Regional average									
Africa	30.2	26.8	−3.4	31	28.9	−2.1	13.7	14.2	0.5
Asia	29.1	34.9	5.8	29.8	23.1	−6.7	12.3	12.2	0.0
European Union	40.1	37.4	−2.7	25.3	22.8	−2.6	19.5	21	1.5
Latin America	31.7	31.8	0.2	29.7	28.3	−1.4	15	12.8	−2.2
Oceania	41	37.8	−3.3	30.6	28.6	−2.0	11.3	12.9	1.7
OECD	41.8	40.6	−1.2	28.5	25.4	−3.1	17.7	18.8	1.0
Global	33	31.8	−1.2	27.9	24.4	−3.5	15.8	15.4	−0.4

Source: Based on data derived from KPMG 2013.
Note: — = not available. Data reflect all East Asian economies with available data. For detailed information on a particular economy's specific tax breakdown, see www.kpmg.com/Global/en/WhatWeDo/Tax/tax-tools-and-resources.

which tend to be progressive, and sales or value added taxes, which tend to be regressive, as lower-income groups consume a higher fraction of their disposable income. Therefore, raising value added taxes or goods and services taxes could be more politically difficult if not accompanied by compensating measures to limit the impact on lower-income households.

From the standpoint of firms' incentives, the current structure of taxation in the region is not burdensome. Generally, firms in East Asia Pacific find it easier to pay taxes than firms in other developing regions, although their experience varies widely from country to country. The last column of table 4.9 ranks economies on the ease of paying taxes for firms among 183 economies. Hong Kong SAR, China; and Singapore have the most favorable tax regulation environments in the region. Vietnam has the least favorable. Firms in Vietnam spend the most time paying their taxes: on average, 941 hours per year to prepare, file, and pay (or withhold) corporate income tax, value added tax, and social insurance contributions. Vietnam is followed by the Philippines and then Indonesia. Firms in Indonesia make, on average, the highest total number of tax payments per year (51 payments), compared to their neighbors.

Relative to countries in any other region, East Asia Pacific economies also have, on average, the lowest share of firms that identify tax administration and tax rates as a major constraint (table 4.10). While this is reassuring for the region's overall business and

TABLE 4.9 The current structure of taxation in East Asia Pacific is not as burdensome as it is elsewhere
Indicators for the ease of paying taxes, 2010

	Paying taxes						
Economy	Payments (number per year)[a]	Time spent (hours per year)[b]	Profit tax (%)[c]	Labor tax and contributions (%)[d]	Other taxes (%)[e]	Total tax rate (% profit)[f]	Global rank for paying taxes
Brunei Darussalam	27	96	8.3	8.5	0.0	16.8	20
Cambodia	39	173	18.9	0.1	3.5	22.5	54
China	7	398	5.9	49.6	7.9	63.5	122
Fiji	33	163	28.0	10.2	0.2	38.3	80
Hong Kong SAR, China	3	80	17.6	5.3	0.1	23.0	3
Indonesia	51	266	23.7	10.6	0.1	34.5	131
Kiribati	7	120	23.4	8.5	0.0	31.8	6
Korea, Rep.	12	225	15.1	13.0	1.5	29.7	38
Lao PDR	34	362	24.8	5.6	2.9	33.3	123
Malaysia	13	133	17.0	15.6	1.4	34.0	41
Marshall Islands	21	128	0.0	11.8	53.0	64.9	96
Micronesia, Fed. Sts.	21	128	0.0	6.8	52.0	58.7	92
Mongolia	41	192	10.2	12.4	2.0	24.6	57
Palau	19	128	65.9	6.5	0.5	73.0	97
Papua New Guinea	33	194	22.0	11.7	8.6	42.3	106
Philippines	47	195	21.0	11.3	14.2	46.5	136
Samoa	37	224	11.9	7.0	0.0	18.9	66
Singapore	5	84	6.5	15.9	4.7	27.1	4
Solomon Islands	33	80	14.6	8.5	3.1	26.2	25
Taiwan, China	15	245	13.7	18.4	3.5	35.6	71
Thailand	23	264	28.8	5.7	3.0	37.5	100
Timor-Leste	6	276	0.0	0	0.2	0.2	31
Tonga	20	164	24.3	0	1.4	25.7	29
Vanuatu	31	120	0.0	4.5	3.9	8.4	32
Vietnam	32	941	17.2	22.6	0.3	40.1	151
Regional average							
East Asia Pacific	25	215	16.8	10.7	6.9	34.5	n.a.
Europe and Central Asia	37	302	9.3	21.7	9.5	40.5	n.a.
High-income OECD	13	186	15.4	24.0	3.2	42.7	n.a.
Latin America and the Caribbean	32	382	19.9	14.6	13.2	47.7	n.a.
Middle East and North Africa	21	188	11.3	16.9	4.0	32.2	n.a.
South Asia	28	281	18.6	7.7	18.2	44.4	n.a.
Sub-Saharan Africa	37	318	18.1	13.5	25.5	57.1	n.a.

Source: Data derived from World Bank 2013a.
Note: n.a. = not applicable. Data on paying taxes reflect the results from the most recent round of data collection, which was in December 2010, while the rankings for all economies are benchmarked to June 2011. Names of taxes have been standardized; for instance, income tax, profit tax, and tax on company's income are all classified as corporate income tax. OECD = Organisation for Economic Co-operation and Development.
a. The total number of taxes and contributions paid, the method of payment, the frequency of payment, and the number of agencies involved for a standardized case during the second year of operation.
b. The time it takes to prepare, file, and pay (or withhold) the corporate income tax, the value added tax, and Social Security contributions (in hours per year). The hours for value added tax include all the value added and sales taxes applicable. The hours for Social Security include all the hours for labor taxes and mandatory contributions in general.
c. The amount of taxes on profits paid by the business as a percent of commercial profits.
d. The amount of taxes and mandatory contributions on labor paid by the business as a percent of commercial profits.
e. The amount of taxes and mandatory contributions paid by the business as a percent of commercial profits that are not already included in the categories of profit or labor taxes.
f. The amount of taxes and mandatory contributions payable by the business in the second year of operation, expressed as a percent of commercial profits. For further information on methodology, see http://www.doingbusiness.org/methodology/paying-taxes.

TABLE 4.10 Taxes are not frequently reported as a constraint on businesses in East Asia Pacific
Firm-level data on whether taxes and regulations are constraints and data on the informal sector in East Asia and Pacific economies

	Taxation and tax regulations			Informal economy			
Economy and year	% of firms identifying tax rates as a major constraint	% of firms identifying tax administration as a major constraint	% of firms saying that senior managers spent the most time dealing with government regulations	% of firms identifying practices of competitors in the informal sector as a major constraint	% of firms competing against unregistered or informal firms	% of firms formally registered when they started operations	Number of years firm operated without formal registration
Cambodia (2007)	16.3	14.8	5.6	32.8	—	87.5	0.7
Fiji (2009)	26.6	16.1	4.4	15.1	39.6	93.5	1.1
Indonesia (2009)	4.4	4.8	1.6	14.7	65.1	29.1	2.4
Korea, Rep. (2005)	15.1	9.1	0.1	—	—	—	—
Lao PDR (2009)	43.2	24.7	1.2	6.9	12.8	93.5	0.2
Malaysia (2007)	21.4	16.9	7.8	16.2	—	53	0
Micronesia, Fed. Sts. (2009)	22.7	23.9	12.4	11.8	41.1	96.9	0.2
Mongolia (2009)	32.6	9.1	12.1	25.5	43	90.1	2.5
Philippines (2009)	19.5	15.2	9.1	23.7	37.5	97.5	0.5
Samoa (2009)	33.5	19.7	13.9	16.3	63.6	88.4	0.6
Thailand (2006)	36	34.9	0.4	—	—	—	—
Timor-Leste (2009)	3.5	2.5	3.8	18.8	66.4	91.8	0.7
Tonga (2009)	16.6	8	6.6	32.4	86.8	93.5	0.3
Vanuatu (2009)	26.6	9.8	7.5	9.7	39.9	88.1	1.3
Vietnam (2009)	6.3	5.3	4.6	14.3	55.6	87.5	1.4
Regional average							
East Asia Pacific	22.1	14.7	6.5	18.3	50.1	83.9	0.9
Europe and Central Asia	39.5	20.6	10.6	28.5	44.7	96.2	1.1
High-income OECD	29.3	19.7	4.2	22	44.1	99.3	0
Latin America and the Caribbean	35.1	22.7	12.7	30.2	62.3	86.8	1.1
Middle East and North Africa	47.1	34.4	10.8	42.7	50	85.2	0.4
South Asia	24.2	18.8	6.1	21	36.9	89.6	1.1
Sub-Saharan Africa	36.5	26.6	7.5	38.7	65.6	82	0.7
World	34.9	23	9.1	31.7	56.2	87.8	0.9

Source: Data derived from World Bank 2013b.
Note: — = not available. Data reflect all East Asia and Pacific economies with available data. Typically, 1,200–1,800 interviews are conducted in larger economies, 360 interviews are conducted in medium-size economies, and 150 interviews are conducted in smaller economies. For information on methodology, see http://www.enterprisesurveys.org/Methodology.

tax environment, in countries such as Lao PDR and especially Thailand, large shares of firms report that administering taxes is a major constraint to doing business (24.7 and 34.9 percent, respectively). The economies in the region in which senior managers of firms spend the most time in a typical week dealing with government regulations (for example, paying taxes, dealing with customs and completing forms) are the Federated States of Micronesia (12.4 percent of their time), Mongolia (12.1 percent), and Samoa (13.9 percent). The countries where firms reported the highest average number of visits or required meetings with tax officials were Lao PDR and Mongolia.

Overall, deploying a wide range of tax instruments over the broadest possible base is healthy for an economy and for employment outcomes. The level of taxation but also the mix of tax instruments vary across the region, with top economic performers deploying contrasting revenue measures. Top performers in the region range from China, with high overall tax rates, to Singapore; Taiwan, China; Hong Kong SAR, China; and Macao SAR, China, with overall low tax rates. Despite very different tax levels, all five economies experienced unemployment rates below 5.5 percent and GDP growth rates above 4 percent over the period 2000–11.

An enabling environment for enterprise?

This section assesses the degree to which a country's business environment constrains or enables work. Governments play a key role in shaping the business environment, which provides the basic public goods and services necessary for the private sector to conduct operations. These public goods and services range from providing access to financial institutions and administering regulation and licensing to providing infrastructure including electricity and roads. The business environment creates the conditions for firms and workers to be functional and keeps investment costs manageable (IFC 2012; IMF and World Bank 2012). The business environment is the background against which customers, producers, distributors, competitors, and, among others, exporters interact.[9] In East Asia Pacific, performance on business climate indicators is mixed, with some of the world's top performers (Singapore and Korea), but also the poorest performers (Lao PDR and Timor-Leste) in the world (figure 4.8).

FIGURE 4.8 East Asia Pacific has both the leaders and the laggards in "ease of doing business"

Source: Data derived from World Bank 2013a.

The four largest constraints reported by businesses in East Asia Pacific are (in order of reported importance) access to finance, an inadequately educated workforce, practices of the informal sector (informal competition), and insufficient or unreliable supply of electricity. Analysis of nationally representative, firm-level survey data of an economy's private sector in table 4.11 illustrates the key obstacles reported by businesses across all East Asia Pacific economies that have available data. These top four obstacles for private sector businesses are consistent across different firms and economies at different levels of development. The subsequent discussion outlines each of these major obstacles further, giving particular emphasis to the reported top constraint, access to finance.

Access to finance is the most frequently reported obstacle facing businesses in the region. Access to financial services, including savings accounts, credit cards, and loans, facilitates operations and helps firms to make longer-term plans to expand. Thus it can foster economic growth and sustain demand for human capital. For households, access to financial services can also help to smooth consumption and better

TABLE 4.11 East Asia Pacific lives up to its reputation as a business-friendly region, but several obstacles constrain enterprises

Obstacles to businesses and the extent of their impediment across East Asian and Pacific countries

Economy and year	Access to finance	Inad-equately educated workforce	Practices of the informal sector	Electricity	Tax rates	Political instability	Corruption	Crime, theft, and disorder	Transpor-tation	Business licensing and permits	Access to land	Tax adminis-tration	Labor regulations	Customs and trade regula-tions	Courts
	Most frequently reported						→			→		*→ Least frequently reported*			
	1	*2*	*3*	*4*	*5*	*6*	*7*	*8*	*9*	*10*	*11*	*12*	*13*	*14*	*15*
Cambodia (2007)	4.9	2.9	9.1	16.6	5.1	16.5	24.1	6.3	2.7	2.8	2.8	1.9	0.8	2.0	1.5
Fiji (2009)	6.3	4.5	5.4	3.9	8.0	44.4	2.5	8.6	1.7	0.6	1.1	1.1	8.8	3.3	0.0
Indonesia (2009)	47.9	4.3	13.7	6.5	1.3	6.9	1.6	3.0	4.3	3.3	3.9	0.4	1.3	1.4	0.2
Lao PDR (2009)	21.2	16.5	4.0	8.9	36.8	0.0	0.2	0.1	2.8	0.5	6.8	0.6	0.0	1.5	0.3
Malaysia (2007)	7.2	33.6	0.0	0.0	0.0	0.7	11.1	2.2	0.0	15.2	2.3	17.9	4.8	5.0	0.0
Micronesia, Fed. Sts. (2009)	8.1	25.2	4.5	15.8	9.7	0.0	1.6	1.6	12.6	4.8	4.8	6.5	4.8	0.0	0.0
Mongolia (2009)	30.3	10.2	7.1	3.4	16.0	7.0	4.4	1.1	2.6	6.5	4.5	3.3	0.3	3.1	0.1
Philippines (2009)	14.8	2.6	26.4	11.3	13.0	6.2	4.9	4.4	2.3	5.8	0.8	1.6	1.9	3.8	0.2
Samoa (2009)	13.3	11.6	13.8	8.6	16.9	0.9	1.9	13.8	4.7	1.0	3.9	6.9	1.9	1.0	0.0
Timor-Leste (2009)	12.1	7.8	2.0	36.3	0.0	10.2	6.7	12.7	4.5	3.5	3.6	0.0	0.0	0.7	0.0
Tonga (2009)	7.4	15.5	20.1	1.3	15.6	14.3	17.0	0.3	1.6	0.1	5.4	1.3	0.0	0.0	0.0
Vanuatu (2009)	14.8	13.9	9.5	15.7	4.4	4.2	2.6	14.3	4.9	3.5	1.6	0.9	8.0	1.5	0.0
Vietnam (2009)	24.7	10.2	19.3	4.3	3.5	0.4	3.3	1.0	13.3	1.4	6.9	6.3	0.9	4.2	0.3
Regional average															
East Asia Pacific	16.4	12.2	10.4	10.2	10.0	8.6	6.3	5.3	4.5	3.8	3.7	3.7	2.6	2.1	0.2
World average	16.4	7.8	11.0	14.0	10.6	8.4	6.7	5.3	3.2	3.0	3.3	3.2	2.6	3.4	1.0

Source: Based on data derived from World Bank 2013b.

Note: Data reflect the shares of firms that report each of the 15 obstacles as the major constraint (these shares add up to 100%). Year reflects the latest survey year. The enterprise survey is answered by business owners and top managers. Sometimes the survey respondent calls company accountants and human resource managers into the interview to answer questions in the sales and labor sections of the survey. Typically, 1,200 and 1,800 interviews are conducted in larger economies, 360 interviews are conducted in medium-size economies, and 150 interviews are conducted in smaller economies. For more information on methodology, see http://www.enterprisesurveys.org/Methodology.

manage times of unemployment. In short, better-functioning financial markets facilitate the use of resources more productively: the more inclusive a financial system is, the better and the more broadly it can mobilize savings that can then be translated into investments that support overall economic growth and work. A large body of empirical evidence shows that access to finance is one of the most important drivers of economic growth (see, for example, Levine 2005; Beck 2008; Hanusch 2011).

Compared to other developing regions, people in East Asia Pacific have relatively good access to financial institutions, but with strong variation across economies. East Asia Pacific economies rank fairly well internationally in providing access to bank accounts at formal financial institutions (table 4.12). About 55 percent of adults in the region have a bank account, allowing them to save, lend, make payments, and cope with risks. The region also ranks well internationally according to the share of people who have received a loan from a financial institution in the past year (8.6 percent).

However, in some economies in the region less than a quarter of adults 15 years or older have an account at a formal financial institution—for example, Vietnam (21.4 percent), Indonesia (19.6 percent), and Cambodia (3.7 percent). Only 51.5 percent of firms in Indonesia have a checking or savings account, the lowest rate in the region among economies with available data (based on World Bank's enterprise survey data). Moreover, despite good access to bank accounts, the region's coverage of credit cards is far lower than that of Latin America and the Caribbean and Eastern Europe. Part of the problem of financial inclusion is that few countries have credit registries that provide

TABLE 4.12 People in East Asia Pacific have relatively good access to finance, but with strong variation across economies
Indicators of financial inclusion across East Asia Pacific, 2011, % of respondents age 15+

Economy	Have a credit card	Have an account at a formal financial institution	Have used an account to receive wages	Saved at a financial institution in the past year	Saved any money in the past year	Received a loan from a financial institution in the past year	Received a loan from a private lender in the past year	Received any loan in the past year
Cambodia	0.1	3.7	1.1	0.8	31.0	19.5	12.8	59.5
China	8.2	63.8	18.7	32.1	38.4	7.3	1.1	29.4
Hong Kong SAR, China	58.1	88.7	48.7	42.8	59.0	7.9	2.1	27.7
Indonesia	0.5	19.6	7.7	15.3	40.5	8.5	2.0	49.1
Korea, Rep.	56.4	93.0	49.4	46.9	64.5	16.6	0.6	32.5
Lao PDR	3.1	26.8	3.0	19.4	54.5	18.1	4.9	32.5
Malaysia	11.9	66.2	26.3	35.4	51.0	11.2	2.2	32.5
Mongolia	1.9	77.7	29.4	23.2	33.5	24.8	5.0	45.8
Philippines	3.2	26.6	8.5	14.7	45.5	10.5	12.7	58.1
Singapore	37.3	98.2	52.5	58.4	60.9	10.0	1.7	32.7
Taiwan, China	45.9	87.3	41.8	45.7	58.1	9.6	1.7	24.0
Thailand	4.5	72.7	33.5	42.8	60.0	19.4	2.3	27.2
Vietnam	1.2	21.4	5.8	7.7	35.3	16.2	3.0	43.9
Regional average								
East Asia Pacific	6.6	54.9	16.9	28.4	39.8	8.6	1.9	33.8
Europe and Central Asia	16.2	44.9	27.3	7.0	20.4	7.7	1.5	39.5
Latin America and the Caribbean	18.4	39.3	20.2	9.7	26.0	7.9	2.5	25.4
Middle East and North Africa	2.4	17.7	6.0	4.5	20.0	5.1	4.7	41.8
Sub-Saharan Africa	2.9	24.0	9.9	14.2	40.2	4.8	5.4	46.8

Source: World Bank 2013c, based on nationally representative survey data.
Note: Data for a region only reflect developing countries in that region.

a history of debtors' creditworthiness (World Bank 2012b).

Access to finance is particularly important for small and medium enterprises (SMEs), whose revenues can be episodic and which are often constrained in their ability to raise financial resources. Globally, access to finance is not only the leading constraint reported by firms but also a challenge that particularly affects smaller firms in low- and middle-income countries. While SMEs are not always the key drivers of economic growth in every country, a vibrant SME sector is a common characteristic of dynamic economies. SMEs tend to be a source of demand for labor and human capital in East Asia Pacific (see chapter 2).[10] When it comes to access to credit for SMEs, the region has the best (Malaysia) and the second worst (Palau) performers. The Pacific island states rank especially poorly on this indicator. There remains much scope for improving the rules for obtaining credit and extending financial inclusion.

Skills shortages are the second most pressing constraint to doing business (table 4.11). Global evidence shows that this constraint is particularly binding for large firms or firms in more developed countries. Within the region, the largest shares of firms identifying an inadequately educated workforce as a major constraint are in the Pacific, particularly Malaysia (33.6 percent) and the Federated States of Micronesia (25.2 percent), while the lowest are in Cambodia (2.9 percent) and the Philippines (2.6 percent). These "gaps" between the skills that firms say they need and what they are able to find exist the world over, and they are often the sign of dynamic, growing, and diversifying economies. However, where they persist, a country's growth and employment potential may be constrained by outdated institutions. A deeper discussion of how countries' human capital supply systems perform and where and why they fall short is taken up in chapter 5.

The third most important obstacle reported by businesses in the region is the competition they face from firms operating informally, beyond the reach of regulation and taxation. Just over half (50.1 percent) of firms in the region reported that they compete against unregistered enterprises, while 18.3 percent of firms in the region identified the practices of competitors in the informal economy as a major constraint. Cambodia has the highest share, at 32.8 percent. High levels of informality not only deprive the government of tax revenue but also can lower standards and weaken the regulation of products and services that these businesses provide.

Access to electricity is the next most frequently reported constraint to firms and their expansion. As many as 10.2 percent of firms in East Asia Pacific identified insufficient electricity as a major constraint to their businesses, with this share ranging from 1.3 percent in Tonga to 36.3 percent in Timor-Leste, based on calculations of enterprise survey data. Firms in the region reported an average of 2.5 electrical outages in a typical month. Ensuring a reliable and affordable flow of electricity enables businesses to produce more added-value products, helps to free up time from household tasks, and, especially in rural areas, can increase the number of women in the labor market (Dinkelman 2011).

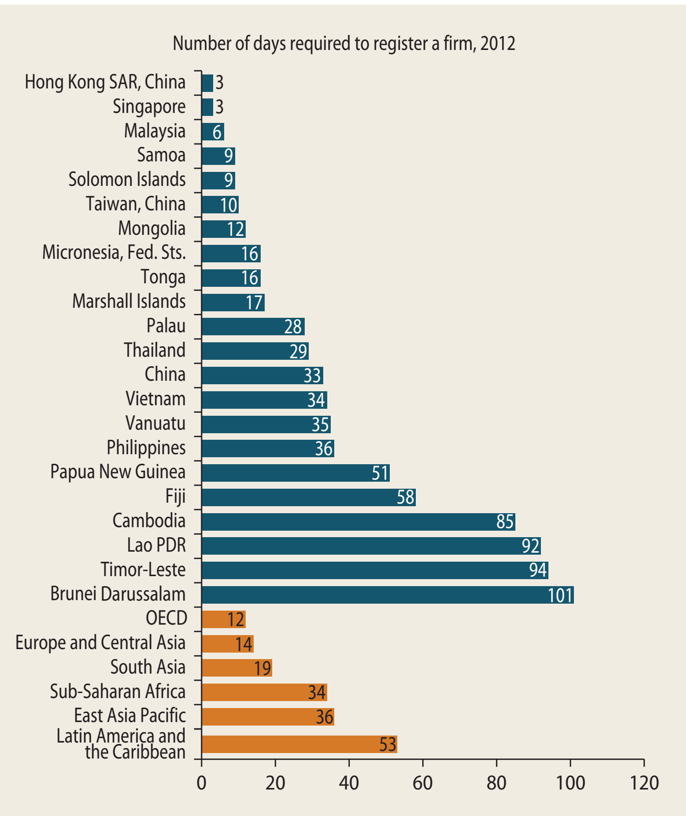
Although not among the top reported obstacles to enterprises, transportation constraints caused by critical infrastructure gaps also pose problems, particularly in countries with adverse geographic conditions. Anybody who has experienced traffic in Jakarta or Manila is likely to agree. One in five firms or more in Mongolia, Thailand, Timor-Leste, Vanuatu, and Samoa report transportation as a major constraint. Infrastructure gaps in these countries constrain access to markets. Within areas of poor public provision of basic infrastructure, large firms at times construct roads for their own needs, acquire generators, and build water wells. These are examples of firms' resilience and their making up for the failures of government, rather than coordinated partnership between public and private sector. This type of private effort is not the most cost-effective means of providing basic infrastructure services or the most equitable, as small firms often do not have the minimum resources needed to make such investments (IMF and World Bank 2012).

Much like the rate of taxation and costs of compliance, regulation does not appear to discourage business activity in the region. Small shares of firms report that business licensing and permits (3.8 percent), labor regulations (2.6 percent), and customs and trade regulations (2.1 percent) present obstacles. Nonetheless, since different firms within the same country report different experiences with the time needed to receive their license or to comply with certain regulations, this could explain why corruption is reported as the seventh most important obstacle to enterprise in the region (Hallward-Driemeier, Khun-Jush, and Pritchett 2010). Corruption is reported to be very high in Cambodia and Papua New Guinea, while Hong Kong SAR, China; and Singapore have some of the lowest reported levels, according to the World Governance Indicators (World Bank 2013e).

The time required for businesses to acquire licenses and permits is an obstacle that, although not in the top-ranked problems reported by firms, presents unnecessary constraints to business in several South East Asian economies. On the whole, East Asia Pacific lags behind the global average in the "number of days required to register a firm," measured as the median duration that incorporation lawyers report is needed to finalize the process with minimum follow-up and no extra payments. Some countries are particularly lagging, with an average waiting time of two and a half months or more to register a firm in Brunei Darussalam, Cambodia, Lao PDR, and Timor-Leste. Such extended periods of time may discourage business activity and stand in stark contrast to the experience in many of the higher-performing economies in the region (figure 4.9).

Key indicators of the business environment in the region have improved markedly over the past decade. Figure 4.10 illustrates these trends. Without attributing causality, economies in which unemployment rates have fallen more than 2 percent since 2003—Hong Kong SAR, China; Indonesia; and the Philippines—all improved their business climate during this period by reducing the total number of days required to start a business, the number of days needed to comply with all procedures to export goods, and the total tax rate as a share of commercial profits.

FIGURE 4.9 The time required to register a business varies widely across East Asia Pacific

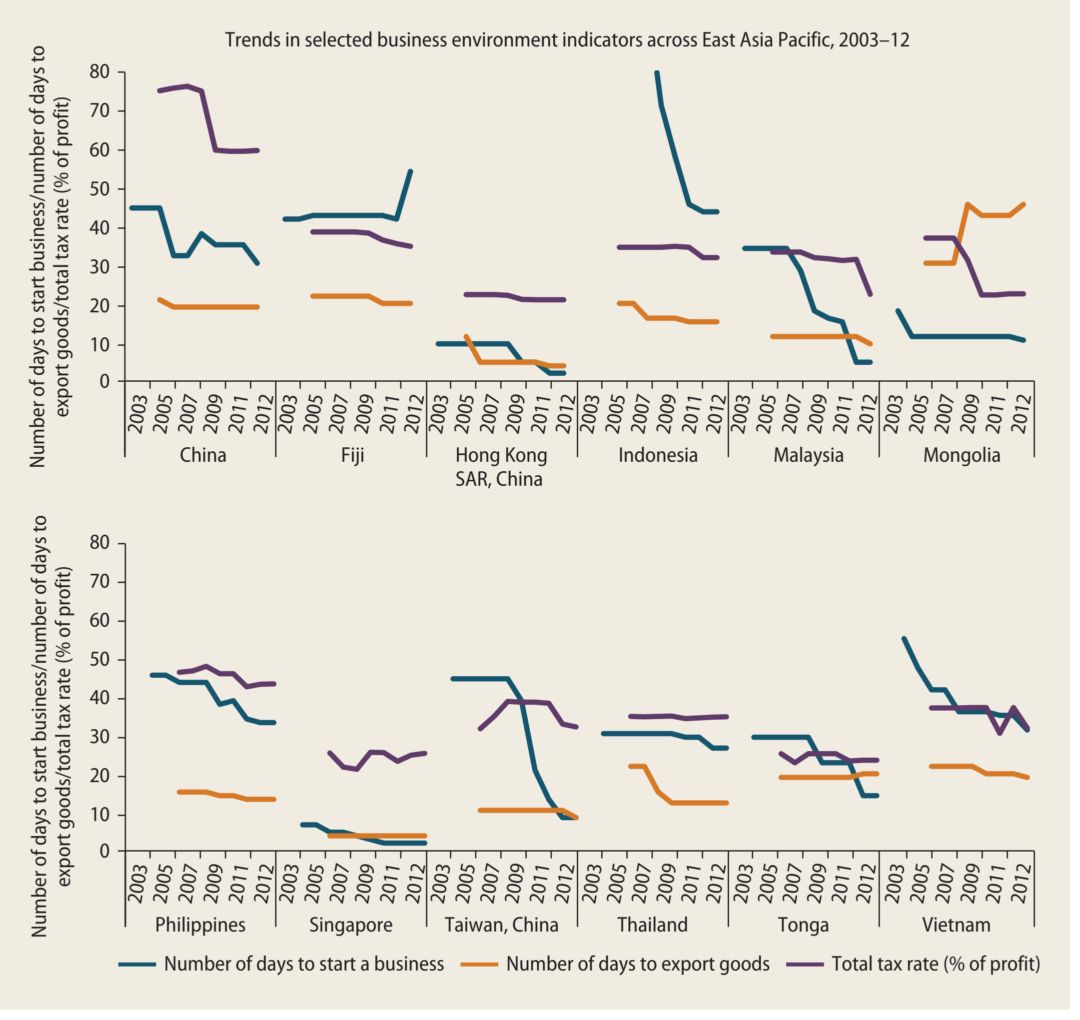


Source: Data derived from World Bank 2013a.
Note: Data collection for this survey round was completed in June 2012. OECD = Organisation for Economic Co-operation and Development.

Are the "fundamentals" in East Asia Pacific pro-work?

The state plays a critical role in enabling employment. It shapes the overall environment within which firms operate and can

FIGURE 4.10 Several indicators of the business environment have improved substantially across East Asia Pacific



Source: Illustration based on data derived from World Bank 2013a.
Note: In Indonesia, the number of days to start a business dropped from 168 to 105 days between 2003 and 2007. As a significant outlier, Indonesia was omitted from the figure to allow for a consistent display of data. Data were not included on other important indicators of investment climate such as the number of days to get electricity (given that the number of days in most countries did not change over this period) and access to credit rankings (given the lack of data for many years across all countries).

adopt policies to mitigate macro shocks and address market imperfections. It can also adopt more proactive policies to improve the environment for enterprise. Macroeconomic policy administrators—including ministries of finance, central bankers, and the respective regulatory agencies—can, therefore, be not only guardians of macro stability but also facilitators of employment. Public policies affecting a country's inflation, exchange rates, and cyclicality of public spending can influence fluctuations in employment and the business cycle, as the private sector demands a certain degree of stability concerning returns and decisions about savings and investments.

While monetary policy can be useful for smoothing business cycle fluctuations and stabilizing labor market outcomes in the short run, it does not directly offer long-term policy prescriptions. In terms of inflation targeting, some evidence exists on the effect of existing measures on inflation, but limited evidence is available of their effect on growth and employment. Whereas many East Asian governments might have succeeded in promoting export-led growth and employment by fixing their currencies at low exchange rates, this strategy ultimately came at too high a cost for some countries, resulting in imbalances and vulnerability to speculation that they could not withstand. Exchange rate policies among the most affected countries largely shifted toward greater flexibility after the 1997 financial crisis, while several countries also adopted inflation targets to gain the confidence of markets. China, of course, is an important exception to this trend, with a nonconvertible currency that many argue is undervalued. Some countries, especially many Pacific island states, maintain hard-pegged regimes. The question is not whether or not to peg or float, but rather what combination of monetary and exchange rate policies is going to help governments to achieve flexibility with credibility.

When it comes to the demand for and supply of labor and human capital, the fiscal outcomes that count are predictability and countercyclicality of spending to help households in their day-to-day efforts to smooth consumption. Yet fiscal policies linked to employment goals can be designed not only to expand aggregate supply but also to stimulate aggregate demand. Countercyclical policies and large-scale stimulus packages can have critical effects by compensating for reductions in aggregate demand and sustaining demand for work in the short term. Economies in East Asia Pacific performed well in containing the costs to households of the global financial crisis. Arguably, there is room for further precautionary preparation and mitigation policies to reduce the extent of discretion and to speed the flow of public resources to where they will most effectively sustain demand and employment.

Greater stability and countercyclicality could be achieved through a broader and more diversified tax base. In terms of tax policy reforms, some governments in the region have begun to redistribute the tax burden mainly by reducing tax rates on firm profits (but also, to a lesser extent, on individual incomes) and by increasing indirect tax rates. There is likely space for policy makers to continue this trend in most countries in the region, as indirect tax rates are currently some of the lowest in the world. Tax reforms aimed at increasing value added taxes or goods and services taxes will, however, be difficult, particularly in countries without redistributional social protection policies.

Firm-level survey data reveal that the business environment and the demand for labor and human capital are generally encouraging. In the region, performance on the indicators of overall business climate is, however, mixed, with some of the top performers (Korea and Singapore) but also the poorest performers (Lao PDR and Timor-Leste) in the world. Yet fewer firms in the region complain about taxation, restrictive labor regulation, costs of dealing with government, or corruption. This sets economies in East Asia Pacific quite apart from other low- and middle-income countries. But the favorable business environment is fragile, requiring the close care of policy makers to maintain.

The four most frequently reported constraints on businesses in East Asia Pacific are limited access to finance, an inadequately educated workforce, unfair competition from firms in the informal economy, and insufficient and unreliable electricity. Governments can play a critical role in removing these constraints and therefore in promoting an enabling business environment that makes the conditions for firms and workers functional and allows firms to invest, expand, and increase their demand for labor and human capital.

Annex 4A Supplementary data for chapter 4

TABLE 4A.1 Tax revenue by type of tax and various employment indicators in East Asia Pacific economies, 2011 or latest year

		% of tax revenue				% of total revenue			% of commercial profits			
Economy	Tax revenue (% of GDP)	Customs and other import duties	Taxes on exports	Taxes on income, profits, and capital gains	Taxes on goods and services	Taxes on income, profits, and capital gains	Taxes on international trade	Other taxes	Labor tax and contributions	Profit tax	Other taxes payable by businesses	Total tax rate
Cambodia	10.1	21.8	2.5	16.8	34.5	9.9	14.3	0.1	0.1	18.9	3.5	22.5
China	10.5	4.2	–25.2	27.8	58.9	24.6	3.7	1.2	49.6	5.9	7.9	63.5
Fiji	23.2	16.9	0.7	35.8	40.9	32.5	15.9	1.4	10.2	28.0	0.2	38.3
Hong Kong SAR, China	12.8	0.6		58.6	8.6	36.2	0.4	16.6	5.3	17.6	0.1	23.0
Indonesia	10.9	3.5	2.8	50.6	29.4	36.5	2.0	4.1	10.6	23.7	0.1	34.5
Kiribati									8.5	23.4	0.0	31.8
Korea, Rep.	15.2	6.0		42.0	26.7	28.1	4.0	8.0	13.0	15.1	1.5	29.7
Lao PDR	12.7	10.8	0.8	21.1	41.9	13.4	7.3	0.6	5.6	24.8	2.9	33.3
Macao SAR, China	34.7	—	—	4.1	88.6	3.9	—	1.6	—	—	—	—
Malaysia	14.3	1.8	1.7	66.5	16.7	45.6	2.4	3.9	15.6	17.0	1.4	34.0
Marshall Islands									11.8	0.0	53.0	64.9
Micronesia, Fed. Sts.									6.8	0.0	52.0	58.7
Mongolia	22.7	10.1	0.0	42.6	28.5	27.1	6.4	1.6	12.4	10.2	2.0	24.6
Myanmar	3.9	3.9		43.3	30.7	25.2	2.3	—	—	—	—	—
Palau	—	—	—	—	—	—	—	—	6.5	65.9	0.5	73.0
Papua New Guinea	—	—	—	—	—	—	—	—	11.7	22.0	8.6	42.3
Philippines	12.1	23.7		44.7	28.6	40.5	21.5	5.9	11.3	21.0	14.2	46.5
Samoa	—	—	—	—	—	—	—	—	7.0	11.9	0.0	18.9
Singapore	13.8	0.1		44.6	26.2	34.0	0.0	16.0	15.9	6.5	4.7	27.1
Solomon Islands	—	—	—	—	—	—	—	—	8.5	14.6	3.1	26.2
Taiwan, China	—	—	—	—	—	—	—	—	18.4	13.7	3.5	35.6
Thailand	16.0	5.7	0.0	42.3	40.2	33.2	4.5	0.6	5.7	28.8	3.0	37.5
Tonga	—	—	—	—	—	—	—	—	0.0	24.3	1.4	25.7
Vanuatu	—	—	—	—	—	—	—	—	4.5	0.0	3.9	8.4
Vietnam	—	—	—	—	—	—	—	—	22.6	17.2	0.3	40.1

table continued next page

TABLE 4A.1 Tax revenue by type of tax and various employment indicators in East Asia and Pacific economies, 2011 or latest year *(continued)*

Economy	Tax revenue (% of GDP)	% of tax revenue			% of total revenue				% of commercial profits			
		Customs and other import duties	Taxes on exports	Taxes on income, profits, and capital gains	Taxes on goods and services	Taxes on income, profits, and capital gains	Taxes on international trade	Other taxes	Labor tax and contributions	Profit tax	Other taxes payable by businesses	Total tax rate
Regional average												
East Asia Pacific (all income levels)	11.5	—	—	—	28.6	—	4.0	1.6	11.1	17.9	6.3	35.3
East Asia Pacific	11.0	—	—	—	29.4	—	6.4	0.8	10.5	17.9	7.9	36.2
Europe and Central Asia	15.6	—	—	—	36.8	—	2.5	0.1	22.2	9.2	10.2	41.6
Latin America and the Caribbean		—	—	—	40.1	—	4.0	1.8	15.4	19.8	12.5	47.6
Middle East and North Africa	17.5	—	—	—	31.4	—	6.0	2.8	19.1	15.5	6.0	40.6
Sub-Saharan Africa	15.7	—	—	—		—			13.2	18.5	25.6	57.3
World (all income levels)	14.2	—	—	—	32.4	—	3.9	1.7	16.2	16.0	12.6	44.8

Sources: Data from IMF 2013a and ILO data files; see World Bank 2013c, 2013d.
Note: — = not available. Data reflect the latest year between 2011 and 2005 for all East Asian countries with available data. Taxes on income, profits, and capital gains are levied on the actual or presumptive net income of individuals, on the profits of corporations and enterprises, and on capital gains, whether realized or not, on land, securities, and other assets; intragovernmental payments were eliminated in consolidation. For detailed definitions of other indicators employed, see http://data.worldbank.org/. Regional data refer only to the average for developing countries in the region—that is, not all countries, unless otherwise indicated.

Notes

1. An important exception to the first assertion in this sentence can be found in the Pacific island countries, where the public sector is a significant provider of employment, discussed in chapter 8.
2. However, some economists argue that keeping a looser rein on inflation in the shorter term could help both indebted consumers and governments to meet their obligations and at the same time support consumption. These arguments are less important in East Asia Pacific given the region's high level of saving and solid track record of fiscal prudence.
3. However, higher unemployment can weaken the collective bargaining power of workers, constraining wage demands. Thus higher unemployment weakens pressure on wages, which translates into lower inflation. The negative empirical relationship between unemployment and inflation is described by the so-called Phillips Curve (Phillips 1958). Recent experience in East Asia and elsewhere disputes this relationship.
4. Brito and Bystedt (2009) reexamine studies documenting a strong positive effect of inflation targeting and find that (a) growth has tended to drop in emerging economies that have adopted inflation targeting and (b) countries with inflation targeting regimes have not displayed superior economic performance in the longer run relative to countries that did not adopt inflation targeting. This finding could be, in part, because emerging countries often adopt inflation targets that may be appropriate for developed countries but not for faster-growing developing countries (Anwar and Islam 2011).
5. Similarly, historical data indicate that employment creation in the United States has historically been strongest under higher tax rates and weakest under lower tax rates. Indeed, during the period 1940–70, the top individual income tax rate in the United States averaged 83 percent.
6. Taxes on income, profits, and capital gains are levied on the actual or presumptive net income of individuals, on the profits of corporations and enterprises, and on capital gains, whether realized or not, on land, securities, and other assets (see http://data.worldbank.org/indicator/GC.TAX.YPKG.RV.ZS).
7. Regional data presented here refer only to the average for developing countries in the region—that is, no high-income countries are included.
8. Indonesia's parliament adopted a new income tax law in late 2008, which established a single income tax rate for corporate taxpayers and permanent establishments and replaced the previous progressive tax rates. The measure was widely praised by the country's private sector (Asia Law and Practice 2008).
9. For an in-depth discussion on the importance of a solid business climate for development, see World Bank (2004).
10. Access to finance is also important to households' supply of labor and human capital. Households borrow partly for non-business-related purposes, especially consumption, yet access to credit also allows them to improve their productivity by investing in health and education. This, in turn, can help them to find or improve employment opportunities (FDIC 2009; Demirgüç-Kunt and Klapper 2012).

References

Anwar, Sarah, and Iyanatul Islam. 2011. "Should Developing Countries Target Low, Single-Digit Inflation to Promote Growth and Employment?" Employment Working Paper 87, International Labour Organization, Geneva.

Asia Law and Practice. 2008. *Indonesia's New Income Tax Law*. Hong Kong: Asia Law and Practice. http://www.asialaw.com/Article/2023096/Channel/22098/Indonesias-new-Income-Tax-Law.html.

Asiedu, Elizabeth, and Donald Lien. 2004. "Capital Controls and Foreign Direct Investment." *World Development* 32 (3): 479–90.

Baer, Werner. 1967. "The Inflation Controversy in Latin America: A Survey." *Latin American Research Review* 2 (2): 3–25.

Beck, Thorsten. 2008. "Policy Choices for an Efficient and Inclusive Financial System." In *Secured Transactions Reform and Access to Credit*, edited by Frederique Dahan and John Simpson. Cheltenham: Edward Elgar.

Bhattacharyya, Nikhilesh. 2012. *Monetary Policy and Employment in Developing Asia*. Geneva: ILO.

Brito, Ricardo, and Brianne Bystedt. 2009. "Inflation Targeting in Emerging Economies: Panel Evidence." *Journal of Development Economics* 91 (2): 198–210.

Bruno, Michael, and William Easterly. 1998. "Inflation Crises and Long-Run Growth." *Journal of Monetary Economics* 41 (1): 3–26.

Campos, Roberto de Oliveira. 1967. *Reflections on Latin American Development*. Austin: University of Texas Press.

Demirgüç-Kunt, Aslı, and Leora Klapper. 2012. "Measuring Financial Inclusion: The Global Findex Database." Policy Research Working Paper 6025, World Bank, Washington, DC.

Dinkelman, Taryn. 2011. "The Effects of Rural Electrification on Employment: New Evidence from South Africa." *American Economic Review* 101 (7): 3078–108.

Doraisami, Anita. 2011. "The Global Financial Crisis: Countercyclical Fiscal Policy Issues and Challenges in Malaysia, Indonesia, the Philippines, and Singapore." Working Paper, Asian Development Bank Institute, Manila.

Dornbusch, Rudiger, and Alejandro Reynoso. 1989. "Financial Factors in Economic Development." *American Economic Review Papers and Proceedings* 79 (2): 204–09.

East Asia Barometer. 2013. *East Asia Barometer Surveys*. Taipei: National Taiwan University. http://www.jdsurvey.net/eab/eab.jsp.

Edwards, Sebastian. 1999. "How Effective Are Capital Controls?" NBER Working Paper 7413, National Bureau of Economic Research, Cambridge, MA.

Epstein, Gerald. 2000. "Myth, Mendacity, and Mischief in the Theory and Practice of Central Banking." PERI Working Paper, University of Amherst, Political Economy Research Institute, Amherst, MA.

———. 2009. *Beyond Inflation Targeting: Monetary Policy for Employment Generation and Poverty Reduction*. Northampton: Edward Elgar Press.

Epstein, Gerald, and Erinc Yeldan. 2008. "Inflation Targeting, Employment Creation, and Economic Development: Assessing the Impacts and Policy Alternatives." *International Review of Applied Economics* 22 (2): 131–44.

FDIC (Federal Deposit Insurance Corporation). 2009. "FDIC National Survey of Unbanked and Underbanked Households." FDIC, Washington, DC. http://www.fdic.gov/householdsurvey/.

Fischer, Stanley. 2001. "Exchange Rate Regimes: Is the Bipolar View Correct?" *Journal of Economic Perspectives* 15 (2): 3–24.

Freedman, Charles, and Douglas Laxton. 2009. "Why Inflation Targeting." IMF Working Paper 09/86, International Monetary Fund, Washington, DC.

Frenkel, Roberto, and Jaime Ros. 2006. "Unemployment and the Real Exchange Rate in Latin America." *World Development* 34 (4): 631–46.

Friedman, Milton, and Anna Schwartz. 1963. *A Monetary History of the United States, 1867–1960*. Princeton, NJ: Princeton University Press.

Gerlach, Stefan, and Peter Tillman. 2011. "Inflation Targeting and Inflation Persistence in Asia-Pacific." HKIMR Working Paper 25/2011, Hong Kong Institute for Monetary Research.

Goncalves, Carlos E. S., and Jao M. Salles. 2008. "Inflation Targeting in Emerging Economies: What Do the Data Say?" *Journal of Development Economics* 85 (1-2): 312–18.

Hallward-Driemeier, Mary, Gita Khun-Jush, and Lant Pritchett. 2010. "Deals Versus Rules: Policy Implementation Uncertainty and Why Firms Hate It." NBER Working Paper 16001, National Bureau of Economic Research, Cambridge, MA.

Hammond, Gill. 2011. *State of the Art of Inflation Targeting*. Centre for Central Banking Studies Handbook 29. London: Bank of England.

Hanusch, Marek. 2011. "The Doing Business Indicators, Economic Growth, and Regulatory Reform." Mimeo, World Bank, Washington, DC.

Harms, Philipp, and Marco Kretschmann. 2009. "Words, Deeds, and Outcomes: A Survey on the Growth Effects of Exchange Rate Regimes." *Journal of Economic Surveys* 23 (1): 139–64.

Haver Analytics. 2013. Haver Analytics Database. New York: Haver Analytics.

Hernández, Leonardo, and Peter Montiel. 2001. "Post-Crisis Exchange Rate Policy in Five Asian Countries: Filling in the Hollow Middle?" IMF Working Paper, International Monetary Fund, Washington, DC.

Hossain, Akhtar, and Anis Chowdhury. 1996. *Monetary and Financial Policies in Developing Countries*. London: Routledge.

IFC (International Finance Commission). 2012. "IFC Jobs Study: Assessing Private

Sector Contributions to Job Creation and Poverty Reduction; Preliminary Findings and Conclusions—Draft." IFC, Washington, DC, October.

IMF (International Monetary Fund). 2006. *Inflation Targeting and the IMF*. Washington, DC: IMF.

———. 2009. *World Economic Outlook 2009*. Washington, DC: IMF.

———. 2012. *Financial Operations and Transactions*. App. II. Washington, DC: IMF.

———. 2013a. *Government Finance Statistics Yearbook*. Vol. 36. Washington, DC: IMF.

———. 2013b. International Financial Statistics Database. Washington, DC: IMF.

IMF and World Bank. 2012. "Creating Jobs Good for Development: Policy Directions from the 2013 World Development Report on Jobs." Report prepared by the IMF and World Bank, Washington, DC, prepared for the Development Committee, September.

Jenkins, Hamish. 2010. *Decent Work and Fair Globalization: A Guide to Policy Dialogue*. New York and Geneva: United Nations Conference on Trade and Development /United Nations Non-Governmental Liaison Service.

Johnson, Simon, and Todd Mitton. 2003. "Cronyism and Capital Controls: Evidence from Malaysia." *Journal of Financial Economics* 67 (2): 352–82.

Kaplan, Ethan, and Dani Rodrik. 2002. "Did the Malaysian Capital Controls Work?" In *Preventing Currency Crises in Emerging Markets,* edited by Sebastian Edwards and Jeffrey A. Frankel. Chicago: University of Chicago Press.

Khan, Mohsin, and Abdelhak Senhadji. 2000. "Threshold Effects in the Relationship between Inflation and Growth." IMF Working Paper 00/110, International Monetary Fund, Washington, DC.

Khatiwada, Sameer. 2009. *Stimulus Packages to Counter Global Economic Crisis: A Review*. International Institute for Labor Studies Discussion Paper 196. Geneva: ILO.

Kim, Yoonbai, and Ying Yung-Hasiang. 2007. "An Empirical Assessment of Currency Valuation in East Asian Countries." *Journal of International Money and Finance* 26 (2): 265–83.

KPMG. 2013. *Global Tax Rates Tables*. New York: KPMG International. http://www.kpmg.com/GLOBAL/EN/SERVICES/TAX/TAX-TOOLS-AND-RESOURCES/Pages/default.aspx.

Levine, Ross. 2005. "Finance and Growth: Theory and Evidence." In *Handbook of Economic Growth*, Vol. 1, pt. A, edited by Philippe Aghion and Steven N. Durlauf, 865–934. Amsterdam: Elsevier.

Levy-Yeyati, Eduardo, and Frederico Sturzenegger. 2003. "To Float or to Fix: Evidence on the Impact of Exchange Rate Regimes on Growth." *American Economic Review* 93 (4): 1173–93.

Levy-Yeyati, Eduardo, Frederico Sturzenegger, and Iliana G. Reggio. 2005. "Classifying Exchange Rate Regimes: Deeds vs. Words." *European Economic Review* 49 (6): 1603–35.

Mundell, Robert. 1971. *Monetary Theory*. San Francisco: Goodyear Publishing.

Naqvi, Bushra, and Syed Kumail Abbas Rizvi. 2010. "Inflation Targeting Framework: Is the Story Different for Asian Economies?" Paper presented at the "Twenty-seventh Symposium of Money, Banking, and Finance," Bordeaux, France, June 17–18.

Obstfeld, Maurice, and Kenneth Rogoff. 1995. "The Mirage of Fixed Exchange Rates." *Journal of Economic Perspectives* 9 (4): 73–96.

Phillips, Arthur. 1958. "The Relationship between Unemployment and the Rate of Change of Money Wages in the United Kingdom 1861–1957." *Economica* 25 (100): 283–99.

Rodrik, Dani. 2003. "Growth Strategies." NBER Working Paper 10050, National Bureau of Economic Research, Cambridge, MA .

Roger, Scott. 2010. "Inflation Targeting Turns 20." *Finance and Development* 47 (1): 46–49.

Rogoff, Kenneth S., Aasim M. Husain, Ashoka Mody, Robin Brooks, and Nienke Oomes. 2003. "Evolution and Performance of Exchange Rate Regimes." IMF Working Paper 243, International Monetary Fund, Washington, DC.

World Bank. 2004. *World Development Report 2005: A Better Investment Climate for Everyone*. New York: Oxford University Press.

———. 2012a. *Modern Jobs: Malaysia Economic Monitor, April 2012*. Washington, DC: World Bank.

———. 2012b. *World Development Report 2013: Jobs*. Washington, DC: World Bank.

———. 2013a. Doing Business Database. Washington, DC: World Bank. http://www.doingbusiness.org/.

———. 2013b. Enterprise Surveys Database. Washington, DC: World Bank. http://www.enterprisesurveys.org/data.

———. 2013c. Global Financial Development Database. Washington, DC: World Bank.

———. 2013d. World Development Indicators Database. Washington, DC: World Bank. http://data.worldbank.org/data-catalog/world-development-indicators.

———. 2013e. World Governance Indicators Database. Washington, DC: World Bank. http://data.worldbank.org/data-catalog/worldwide-governance-indicators.

Building Human Capital 5

Despite some progress in East Asia Pacific, governments' current investments in human capital are skewed away from the foundational health and education services that build the most valuable skills in dynamic economies.

Human capital, in the form of individuals' health, talent, knowledge, and other productive attributes, contributes to economic growth and employment creation. Economies with more human capital are more likely to grow faster through higher productivity, greater innovation, and successful adaptation of new knowledge (Warsh 2006). One of the most robust predictors of gross domestic product (GDP) growth across countries is the quality of education, as indicated, for example, by scores on international standardized tests taken by secondary school students (Hanushek and Woessman 2009; Jimenez, Nguyen, and Patrinos 2012). In addition, workers' health influences their availability to work and their productivity at work. Poor health has negative impacts on GDP growth through lost labor productivity and the costs of treatment (Abegunde et al. 2007).

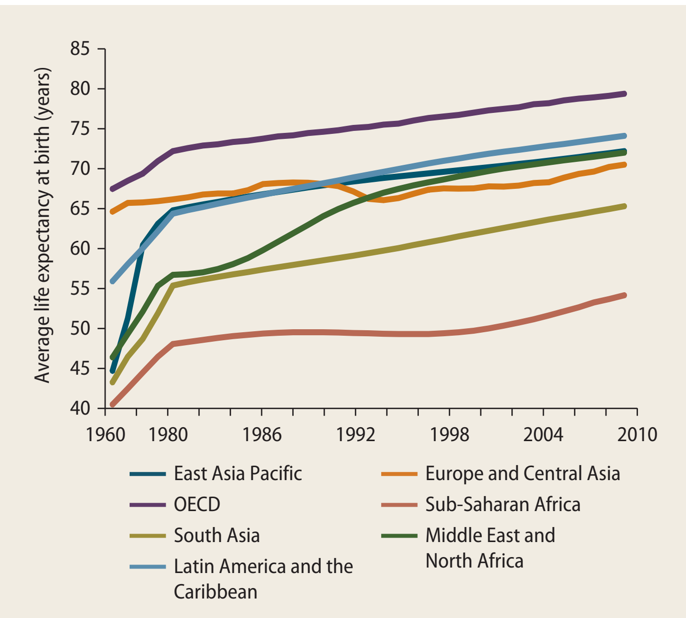
Human capital directly enables the three development transformations that occur through work, which are discussed in chapter 3. At the individual level, workers with greater human capital are likely to earn more and enjoy improved living standards. Improved nutrition, particularly early in life, can directly increase earnings later in life (Behrman and Rosenzweig 2001; Hoddinott et al. 2008). Private returns to every additional year of schooling are estimated at 10 percent, on average, around the world, with even higher rates in less developed countries (Barro and Lee 2012; Montenegro and Patrinos 2012).[1] At the aggregate level, labor productivity has risen faster in East Asia than in any other region since 1999, and investments in human capital have played an important part in fueling this growth (Chansarn 2010; Kucera and Roncolato 2012). However, as argued in chapter 3, these trends have been uneven across and within countries, and unequal opportunities to build, maintain, and protect the human capital that people need to succeed in the labor market may threaten social cohesion.

People in East Asia Pacific have enjoyed substantial improvements in health outcomes and in educational attainment, but indicators of these successes are only indirect measures of their human capital. Across the region, most people complete basic education and enjoy longer life expectancy than in previous generations. While some of the lower-income countries in the region continue to struggle with low levels of educational attainment, many countries are now turning to the challenge of expanding higher education and capabilities for the labor market. Education, health, and work experience can all contribute to skills—the specific competencies that individuals can productively apply to their work. However, just because more children are going to school does not necessarily mean that they are learning and building skills, which are much harder to observe directly.

This chapter examines the supply of and demand for skills in the region and provides a conceptual framework for understanding "skills gaps," specifically their causes and broad implications for policy. When should skills gaps motivate policy intervention? A time lag or gap between the skills that employers seek and workers have to offer is to be expected in any dynamic economy, as new workers with different skills enter the labor market and existing workers adjust their skills. Only in an economy in perpetual equilibrium, producing the same goods and services and cut off from technological advances in the rest of the world, would the skills sought by employers always be readily available. This explains why, in today's globalized economy, employers in almost every country report a shortage of skills to be a constraint on the growth of their businesses. Thus it is not the existence of skills gaps that should be a worry, but rather which gaps are found and how persistently they remain. Gaps in foundational skills are particularly inefficient, and gaps in all types of skills can hamper growth when they are too wide and too persistent. Governments have an important role to play in filling skills gaps when the health and education systems and the existing labor force are slow to adjust to changing demand or when market failures distort people's choice of skills investments and firms' choice of production technology.

The demand for skills is evolving rapidly in East Asia Pacific countries, creating wide and persistent skills gaps—shortfalls in cognitive, behavioral, as well as employment-specific skills—that may constrain economic growth and the well-being that households can derive from work. Skills development in the region needs to go beyond the focus on technical and vocational education, a set of education services that provide only a fraction of the skills demanded in these fast-changing economies. Moreover, there are multiple causes of skills gaps, rooted in both the education systems and the labor markets of East Asia Pacific countries. This multiplicity of causes creates an imperative for policy makers to identify the nature of the skills problems they face before designing solutions.

FIGURE 5.1 East Asia Pacific has the third highest average regional life expectancy

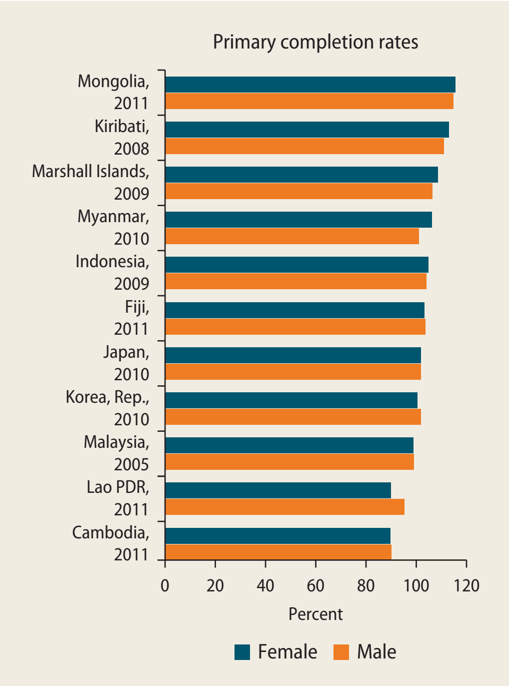


Source: World Bank 2013g.
Note: OECD = Organisation for Economic Co-operation and Development.

Progress in health and education

Countries in the East Asia Pacific region are highly ranked according to many standard indicators of health and education outcomes that are commonly used as measures of human capital. For example, as shown in figure 5.1, the region as a whole now has the

FIGURE 5.2 Most girls and boys complete primary school in East Asia Pacific economies

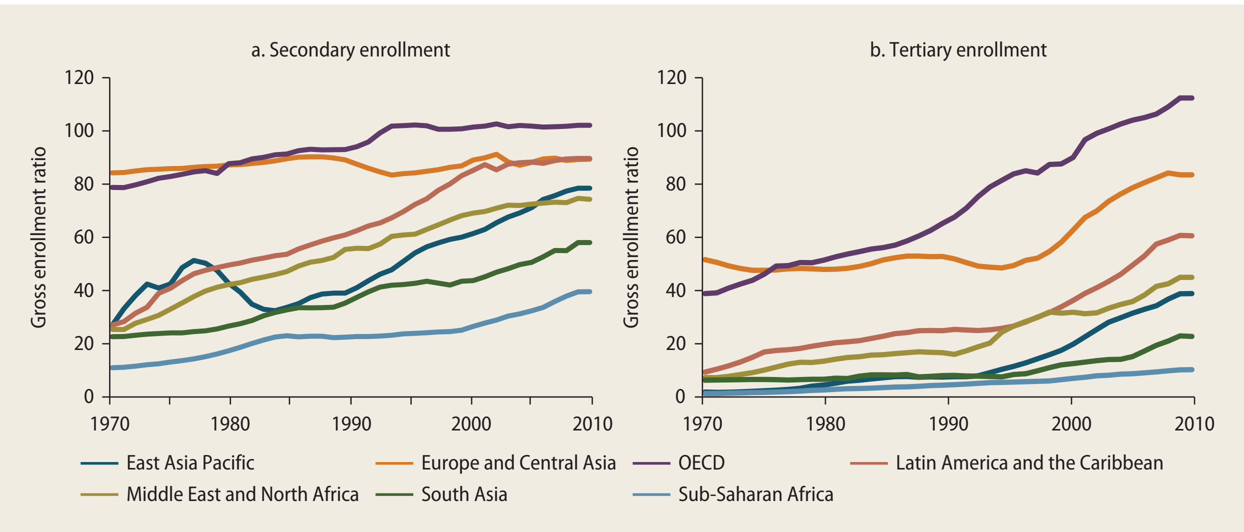


Source: World Bank 2013f.

third highest level of life expectancy globally. Schooling attainment has grown substantially across East Asia Pacific over the past several decades: for example, in Indonesia the population had, on average, 34 percent more schooling in 2010 than in 1995. This improvement has also narrowed gender disparities: the majority of both girls and boys—more than 90 percent in many countries—now attain a basic education (figure 5.2). While East Asia Pacific has experienced the largest gains in secondary school enrollment, the region still trails behind many other regions in tertiary schooling (figure 5.3).

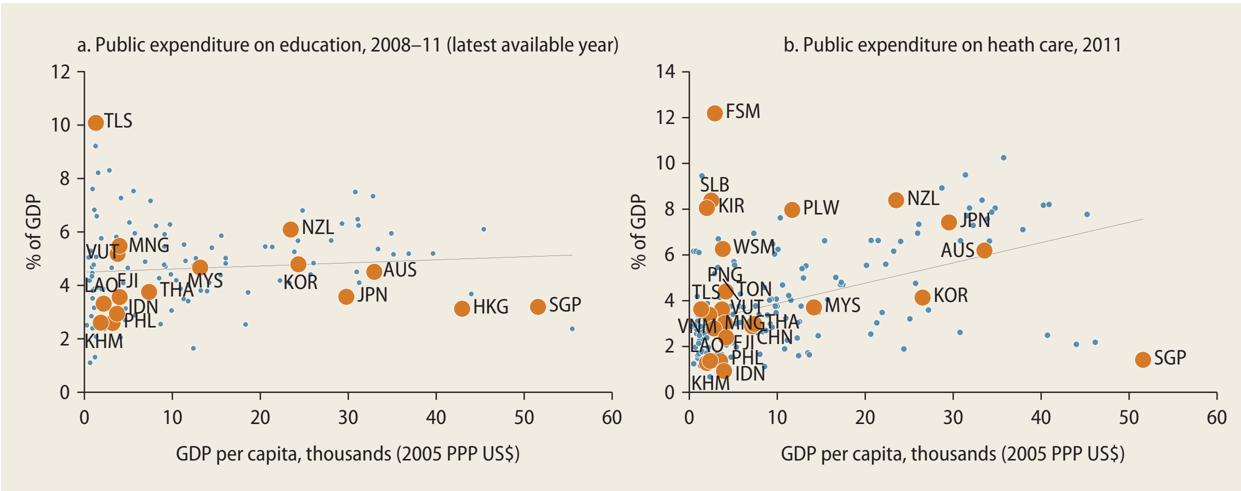
Countries in the East Asia Pacific region have achieved these levels of performance without a notably high level of spending on health and education, although the public sector's role differs substantially across countries. Figure 5.4 shows spending on health and education as a share of GDP for countries at different income levels. In general, low- and middle-income countries spend relatively less on education and health as a share of GDP than richer economies. Governments in East

FIGURE 5.3 East Asia Pacific has made the largest gains in secondary enrollment, but lags behind in tertiary schooling



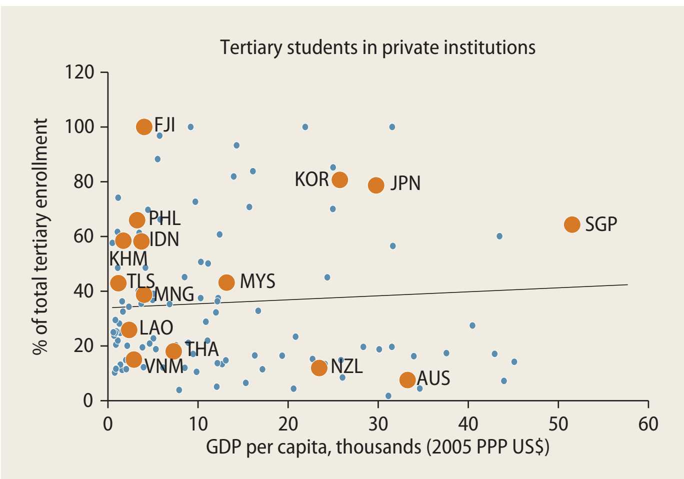
Source: World Bank 2013f.
Note: OECD= Organisation for Economic Co-operation and Development.

FIGURE 5.4 East Asian economies spend less on education and health care than countries at similar income levels, while Pacific island countries spend relatively more on health care



Sources: World Bank 2013b, 2013f.

FIGURE 5.5 Private tertiary institutions play an important role in some countries

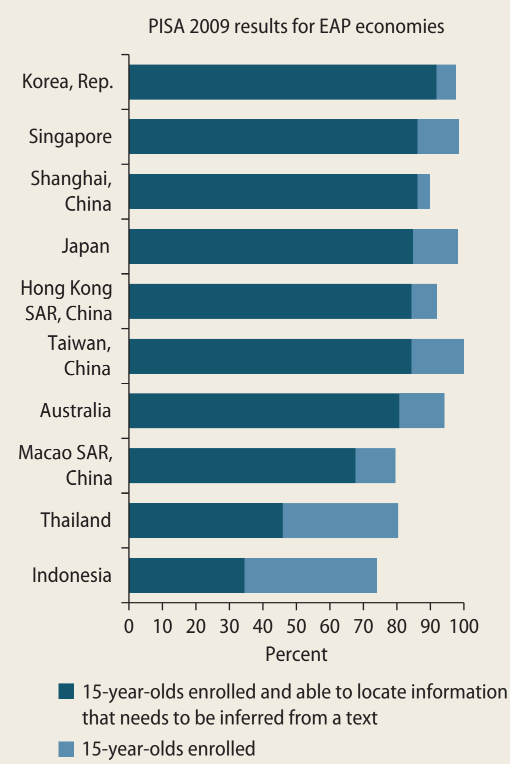


Source: World Bank 2013f.

Asia, including Cambodia, Indonesia, the Lao People's Democratic Republic, and the Philippines, tend to spend less on both health and education than other countries at similar levels of income. Several Pacific island countries, including Kiribati, the Federated States of Micronesia, Samoa, and the Solomon Islands, devote relatively large amounts of public spending to health care, often funding costly curative care as well as basic services. In higher education, the private sector plays a significant role in some countries, including Cambodia, Indonesia, and the Philippines, where more than 50 percent of students attend private institutions, compared to less than 20 percent of students in Thailand and Vietnam (figure 5.5). In China, where about 50 percent of the region's tertiary students reside, more than 80 percent attended public institutions in 2008 (Liu and Wang 2011).

Although health and education indicators are readily available, the skills derived from human capital that directly affect productivity are harder to observe. Even high levels of education may be inadequate due to poor quality or poor alignment of the skills taught with the skills demanded in the labor market. School systems vary in their ability to produce skills. As an imperfect illustration of this, figure 5.6 shows that the fraction of 15-year-olds who master an expected competency level, as measured in the Program for International Student Assessment (PISA) standardized test, is always lower than the fraction enrolled in school across East Asia. The gap is particularly stark in Indonesia and Thailand. In addition, the alignment of education with what employers need is an area of increasing

FIGURE 5.6 School enrollment does not guarantee learning



Source: OECD 2010.
Note: PISA (Program for International Student Assessment) tests the skills and knowledge of 15-year-old students in three key areas: reading, math, and science. The results graphed here correspond to attaining level 2 in overall reading proficiency (out of 7 levels: 1a, 1b, 2, 3, 4, 5, 6). Across the Organisation for Economic Co-operation and Development (OECD), 81.2% of students participating in the 2009 round of PISA attained this level or higher.

concern, as traditional schooling systems face challenges in meeting rapidly evolving demand for different skills. The remainder of this chapter examines skills directly in order to identify the factors that limit the production of skills demanded in the labor market.

Supply, demand, and skills gaps

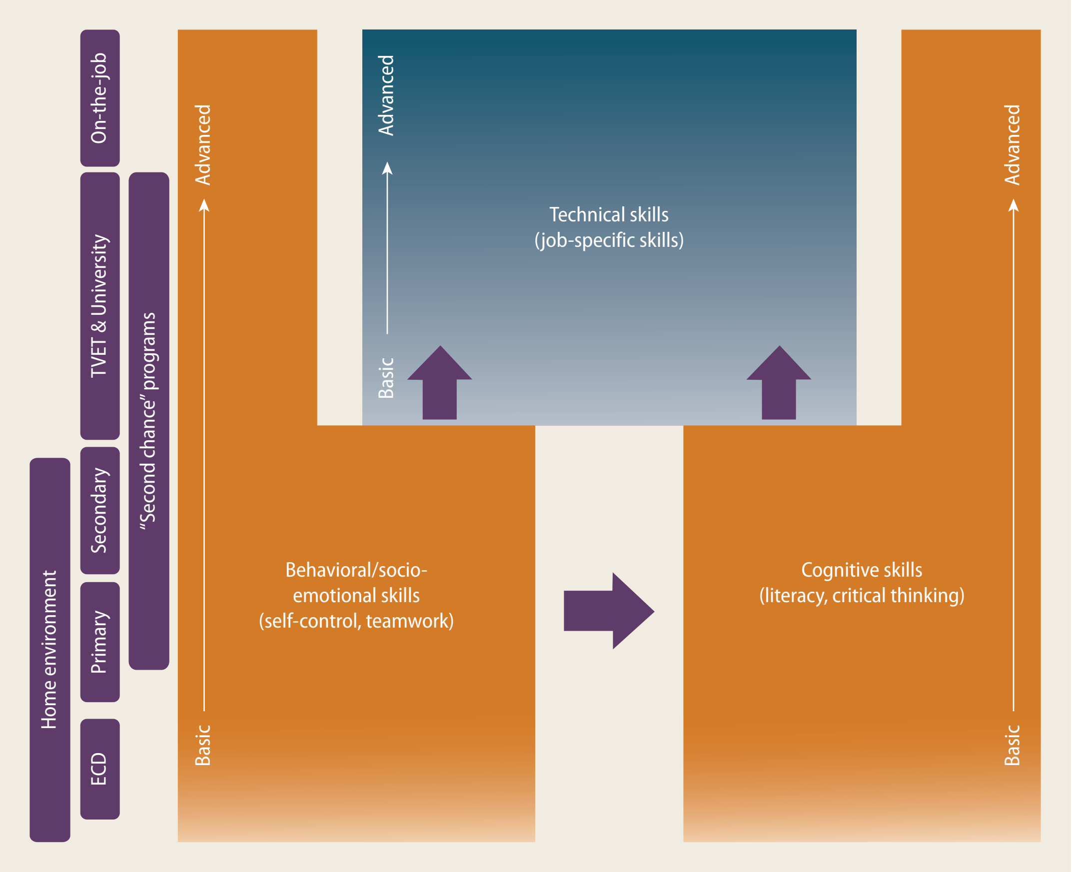
What are skills? This chapter builds on the rubric created by the World Bank's STEP (Skills Toward Employment and Productivity) Skills Measurement Project to define skills. In STEP, skills are grouped into three broad categories: (a) cognitive, (b) behavioral/socio-emotional, and (c) technical. Cognitive skills include numeracy, problem solving, verbal communication, and memory. Behavioral/socio-emotional skills include teamwork, work effort, reliability, and discipline. Technical skills are skills required in specific work or for specific tasks.

How are skills formed? Building skills is a progressive, life-long activity that involves many critical inputs, with the highest returns to investments made at early ages. Figure 5.7 provides a schema to summarize the formation of different types of skills through different stages in life. Basic cognitive and behavioral skills, also called "foundational" skills, begin building early on and are influenced by nutrition, home environment, and quality of schooling. Further schooling and training, as well as on-the-job learning, build both technical skills and advanced cognitive and behavioral skills. Evidence from a wide range of countries shows that basic cognitive and behavioral skills acquired early on form the critical foundation for future acquisition of skills. The malleability of different types of skills varies: for example, socio-emotional skills are malleable at least through adolescence (Borghans et al. 2008). However, across all categories of skills, the earlier in life investments are made, the more effective they are in forming enduring skills (Heckman 2008). This occurs, in part, because future investments, built on solid foundations, will have higher returns (Cunha and Heckman 2007). Therefore, the capacity to learn must be supported from the very earliest ages.

The supply of skills

While the educational attainment of successive generations has been rising throughout East Asia Pacific, the ability of health, education, and training systems to produce skills varies substantially across the region. Direct measures of skills supply, both for the "flow" of new entrants into the labor market and for the "stock" of existing workers, are scarce. However, several indicators, as well as recent surveys of households

FIGURE 5.7 Skill building starts early, involves many inputs, and continues throughout life



Source: World Bank 2013d.
Note: Color gradation represents progress from basic to advanced level of each skill type. Examples of types of skills are provided in parentheses. Basic cognitive and behavioral skills are frequently referred to as foundational skills throughout the chapter. ECD = early childhood development; TVET = technical and vocational education and training.

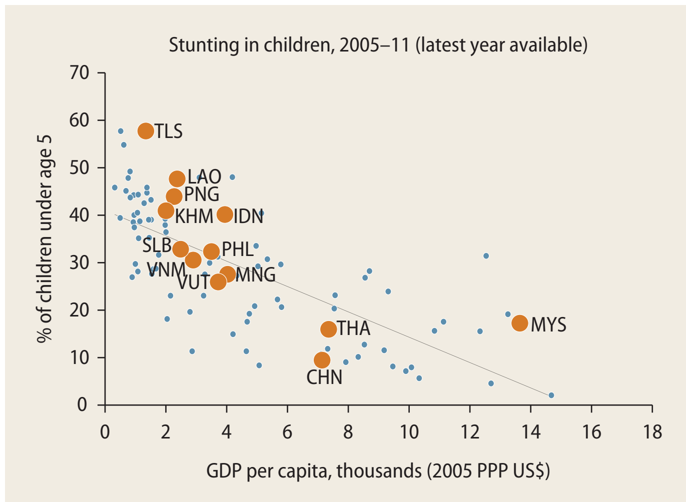
and employers across the region, suggest that behavioral, cognitive, and technical skills are inadequate, even among educated workers.

Nutrition and early life circumstances are critical inputs to foundational skills, but many children in East Asia Pacific are not getting off to a good start. Stunting, a manifestation of chronic malnutrition, afflicts large numbers of children in the region and is likely to affect the accumulation of skills throughout their lives. More than 40 percent of children under 5 in Cambodia, Lao PDR, Papua New Guinea, and Timor-Leste are stunted, as shown in figure 5.8. The lack of particular nutrients also plays a direct role in inhibiting skill formation. In Thailand, iodine deficiency is a major cause of relatively low IQ scores among children, found to be 91 on average in 2009 compared to 104 in developed countries (World Bank 2012a). Recent legislation in Thailand aims to tackle this problem by mandating the iodization of all salt destined for consumption in the country.

Some countries have a strong and growing stock of foundational skills, while others continue to struggle with the quality of basic education. The World Bank's STEP Skills Measurement Project provides new data on both the supply of and demand for cognitive, behavioral, and technical skills in labor markets around the world. In 2011, household and employer surveys were carried out in six countries, including Lao PDR, Vietnam, and Yunnan Province in China. Figure 5.9 shows the fraction of individuals achieving each score, on a scale of 1–9, on the basic literacy test conducted as part of the STEP household survey. On average, a graduate of primary school in Vietnam scored better on the test than a graduate of secondary school in Lao PDR. Overall, only 67 percent of participants in Lao PDR passed the literacy test, while 95 and 99 percent passed in Vietnam and Yunnan, China, respectively (World Bank 2013c, 2013d; Liang and Chen 2013). These results suggest that Lao PDR, where school enrollment rates are lower, faces ongoing challenges with increasing both access to and quality of education. Many Pacific island countries have even more serious deficits in their stock of foundational skills and ongoing challenges to producing skills in their education systems. For example, in the Solomon Islands, recent surveys have found that the functional literacy rate in the population is only about 17 percent, and, although the net primary enrollment rate is 91 percent, only 22 percent of primary students are functionally literate (World Bank 2012e).

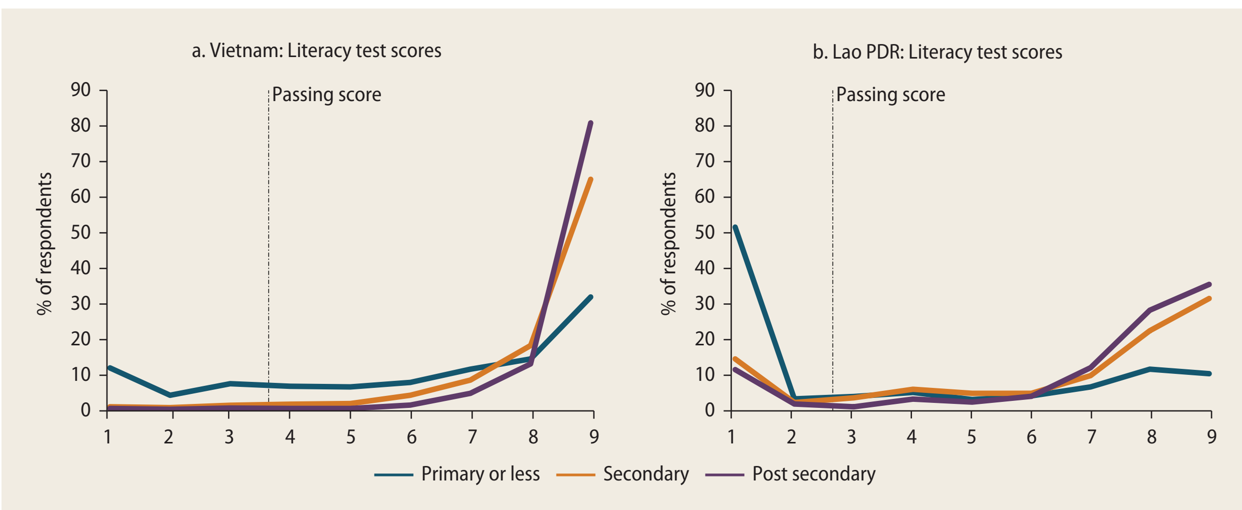
The supply of technical and advanced cognitive and behavioral skills in East Asia Pacific countries depends on the quality of their higher education and training programs as well as their alignment, that is, how

FIGURE 5.8 Stunting threatens the foundational skills of 20–60 percent of children in many East Asia Pacific economies



Sources: Global Health Observatory (http://www.who.int/gho); World Bank 2013g.
Note: GDP data for the Democratic People's Republic of Korea are not available, but stunting in children under 5 years old was estimated to be 32.4% in 2009.

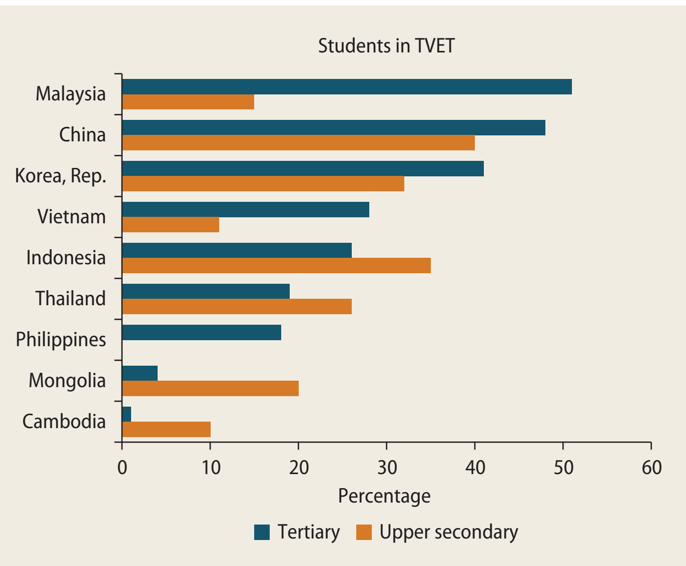
FIGURE 5.9 Both the amount and quality of education are inadequate in Lao PDR



Source: World Bank 2013c, 2013d.
Note: The literacy test designed to assess foundational reading skills was administered to survey respondents as part of the Skills Toward Employability and Productivity household surveys.

well-matched programs are to current and future demand of firms. Across most countries, the stock of advanced skills is small, as small shares of the population have tertiary degrees. While the flow of college graduates is increasing quickly, it is still limited: the regional tertiary gross enrollment ratio is less than 30 percent. In addition, the flow of technical and advanced cognitive and behavioral skills may not be well aligned with current and future demand. Among those enrolled in upper-secondary and tertiary education, several countries in developing East Asia—notably China, Indonesia, and Malaysia—have a large number of students in specialized technical and vocational education and training (TVET; figure 5.10). These students may possess formidable technical skills but insufficient advanced cognitive and behavioral skills required for work due to the sometimes limited focus of TVET programs. Even the supply of technical skills, produced by both general education and TVET programs, may not align with the needs of employers. As figure 5.11 illustrates, the fraction of students enrolled in engineering and natural sciences is often much smaller than the fraction enrolled in social sciences in most countries, except in Malaysia and Thailand. In Cambodia, for example, the high share of social science graduates is creating concern that the skills needed to fuel Cambodia's economic growth—namely, natural sciences—are not being created (World Bank 2012c). The most popular fields of study also differ between men and women, contributing to possible gender differences in skills attainment (box 5.1).

FIGURE 5.10 Technical and vocational education and training programs are a large part of education systems in several East Asian countries



Source: World Bank 2012d.
Note: TVET = Technical and vocational education and training.

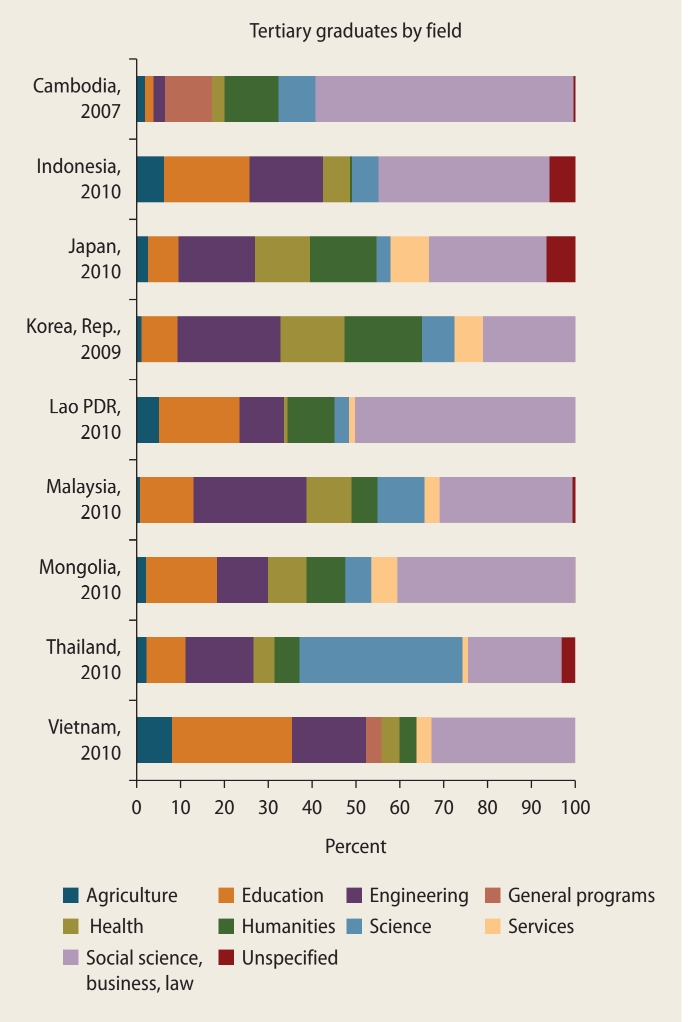
The demand for skills

The demand for skills from employers in East Asia Pacific economies goes well beyond technical skills. In most surveys, employers report that cognitive, behavioral, and technical skills are *all* important for their workforce. Evidence of this demand for a broad set of skills is clear from survey results in China and Indonesia (figure 5.12).[2] In Indonesia, thinking and behavioral skills are considered very important, alongside math. In Yunnan, China, many firms say that leadership and communication skills are as important as employment-specific skills. Similarly, professional workers in Malaysia say that they value a range of skills: computer, presentation, problem-solving, and writing skills are all associated with a higher wage premium (World Bank 2013a).

Technological advances are rapidly changing the mix of skills demanded in the labor markets of both developing and advanced economies. Globally, steeply declining costs for computer processing capacity are driving skill-intensive technological change, whereby the returns to work requiring skills that complement what computers do well have increased, while work requiring skills that are similar to what computers do well are disappearing (Autor, Levy, and Murnane 2003). Computers substitute for workers in tasks that can be carried out by following an explicit set of rules (which Autor, Levy, and Murnane label "routine" tasks), while computers complement workers in problem-solving, communications, and complex cognitive activities, as well as in manual activities that cannot be easily characterized by a set of rules (or "non-routine" tasks). Figure 5.13 shows that in Malaysia and the Philippines the share of employment in non-routine skill-intensive occupations has been rising, while the share in routine skill-intensive occupations, substitutable by computers and computer-operated machinery, has been declining.

In East Asia, economic transformation and global integration are increasing the demand for an educated workforce and for relevant skills. These trends are evident from recent skills survey data from Indonesia and the Philippines. In both countries, the surveys were carried out in 2008 and included representative samples of several hundred manufacturing and service firms in high-growth geographic regions: 473 firms in Indonesia and 300 firms in the Philippines (di Gropello 2010, 2011). Firm managers, as well as employees, were asked about the nature of the business, current and future skill needs, and local and national supply of skills. Survey results show that recent hires in manufacturing and services firms have been mostly workers with secondary or tertiary education, especially for exporting firms. Across most East Asian firms, higher worker education levels are strongly linked to foreign direct investment, exporting status, and innovative activity (Almeida 2009).[3] More than 95 percent of manufacturing and services firms in Indonesia report expecting their demand for skills to increase in the next 10 years (di Gropello and Sakellariou 2010). Figure 5.14 shows that higher standards and increased competition are the top reasons given for the higher demand for worker skills. Similar forces appear to be at work around the world: GDP per capita and the intensity of non-routine cognitive skills used in the labor force are positively correlated, both in a cross-section of countries and within countries over time (Aedo et al. 2013).

FIGURE 5.11 Social sciences may be oversupplied in Cambodia, Lao PDR, and other countries



Source: World Bank 2013f.

Skills gaps

What are skills gaps? Skills gaps are defined differently for foundational skills versus technical and advanced skills. Because foundational skills (basic cognitive and basic behavioral skills) such as literacy improve people's well-being, they have intrinsic value and are development goals in their own right. Gaps are therefore defined relative to universal possession of these foundational skills. Even when they are not pure public

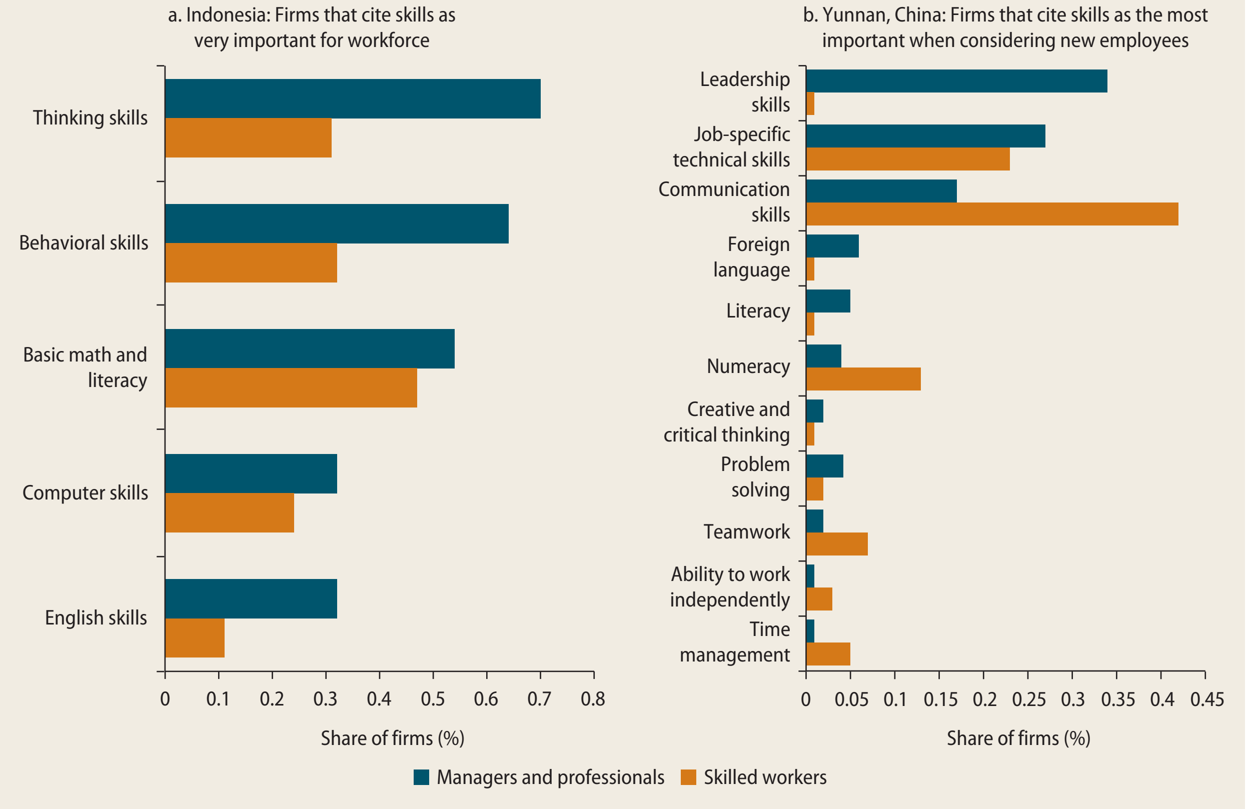
BOX 5.1 Gender differences in education and skills attainment

Gender gaps in education in East Asia Pacific countries have narrowed substantially since the 1990s and, in some cases, have even been reversed. In primary and secondary schools, the enrollment of girls and boys is roughly on par across countries. This is true even at the tertiary level. In many countries, including China, Malaysia, Mongolia, the Philippines, and Thailand, girls and women have higher enrollment rates than boys and men at both the secondary and tertiary levels. Girls in Indonesia, Malaysia, the Philippines, and Thailand also tend to outperform boys on international standardized tests of reading, math, and sciences.

However, women may still have very different marketable skills than men for several reasons. On technical skills, women's completion rates in vocational training are lower than men's in Indonesia, Mongolia, Thailand, and Vietnam, even though the reverse tends to be true for completion of general secondary education (Cambodia experiences the opposite pattern). In tertiary education, women tend to sort into very different fields of study than men. For example, many young women in Indonesia, Thailand, and Vietnam choose education over law and engineering, even though the returns in terms of earnings are not as high. The choice reflects social norms, curriculum, expectations about the labor market, and other factors. With regard to behavioral skills, research in the United States has found that girls display better behavior and socio-emotional abilities than boys from an early age, affecting grades and school progression (Jacob 2002; Cornwell, Mustard, and Van Parys 2013).

Source: World Bank 2012f.

FIGURE 5.12 Cognitive, behavioral, and technical skills are all important to employers



Sources: di Gropello 2010; Liang and Chen 2013.

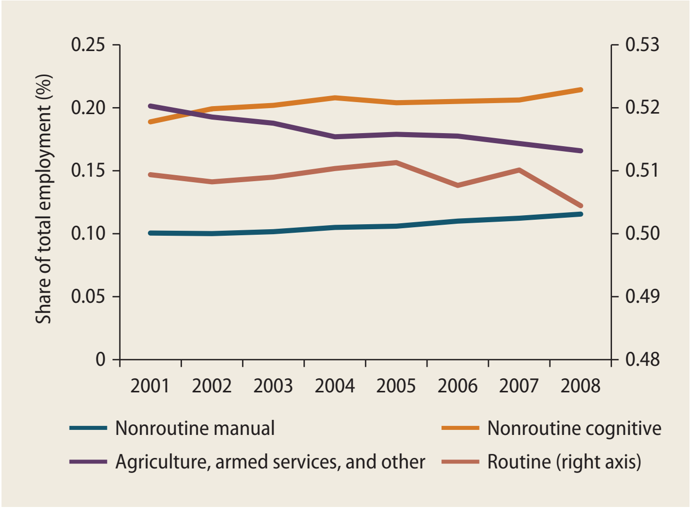
goods (in the classical sense), the externalities from these foundational skills for societies are so large that they merit public financing to minimize gaps as far as possible. For technical and advanced cognitive and behavioral skills, gaps are defined by the relative difference between supply and demand. Specifically, a gap exists when the supply of skills is not enough to meet demand. High demand would drive up wages and employment for workers with the right skills or particular sets of skills.[4] Workers without the demanded skills would experience higher rates of unemployment, while some jobs would go unfilled because of a lack of appropriately skilled workers.

The detailed data on worker characteristics and experiences in the labor force that are needed to identify skills gaps directly are limited in East Asia Pacific and many other regions. In addition, many skills are inherently difficult to measure precisely, such as behavioral skills. Therefore, in this chapter we rely on evidence of education shortfalls and employer opinions to infer the existence and nature of skills gaps.

The supply of skilled workers may be inadequate to meet the demand for skills for three reasons: inadequate quantity, poor quality, or misalignment. In some countries, the quantity of educated workers may be scarce relative to employer needs, as evidenced by quickly rising returns to education. While demand for educated workers cannot be observed directly, it can be inferred by observing the evolution of labor market returns to education with simultaneous changes in supply (Katz and Murphy 1992).[5] In the handful of East Asian countries where data are available—for example, Cambodia, the Philippines, and Vietnam—wage premiums have increased or held steady in the face of rising supply (figure 5.15). These simultaneous increases in supply and returns suggest that demand for educated workers has grown in pace with or even faster than supply.

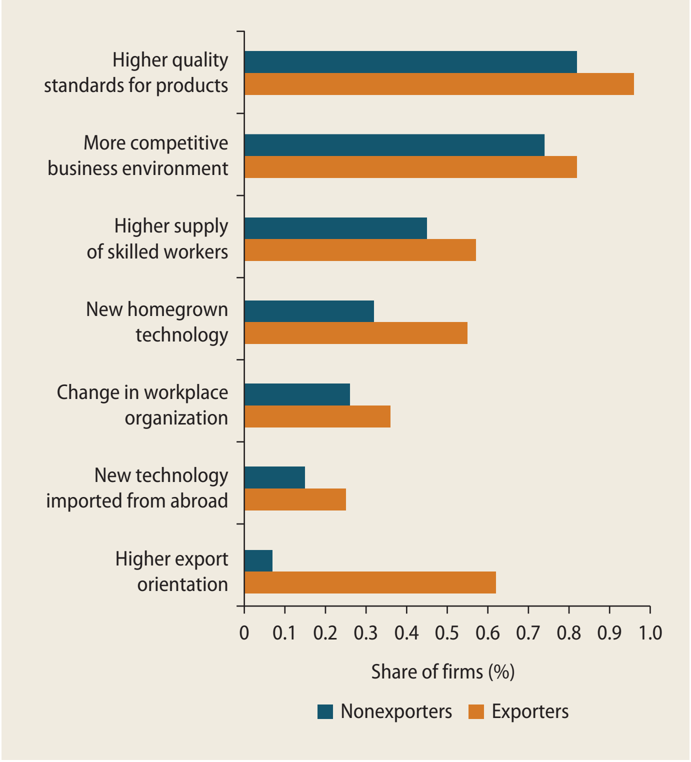
Across countries, employers take issue with the skills of the existing workforce and, which is perhaps a greater concern, with the skills of new graduates. In Malaysia

FIGURE 5.13 Routine work is declining in Malaysia and the Philippines



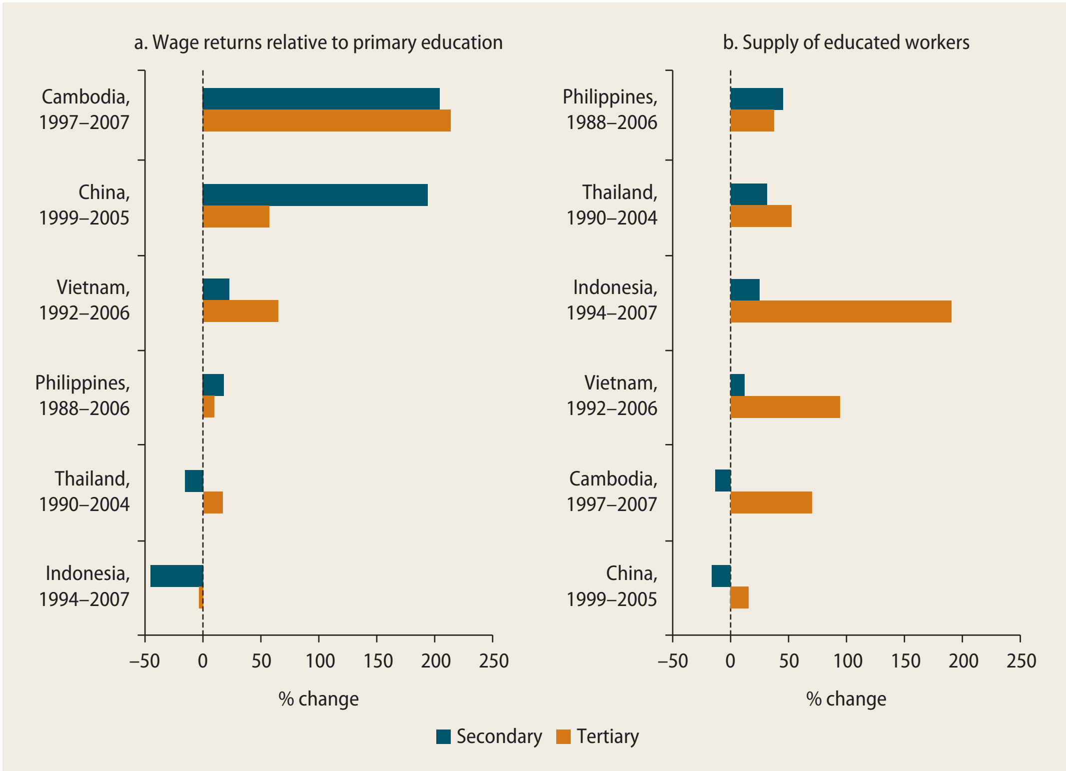
Source: ILO 2013b.
Note: Occupations are categorized according to Jaimovich and Siu 2012; ILO 2013a.

FIGURE 5.14 Employers in Indonesia report higher standards of quality and more intense competition as key drivers of the demand for skills



Source: di Gropello 2010.

FIGURE 5.15 Education wage premiums have increased or held steady in the face of rising supply



Source: di Gropello and Sakellariou 2010.

(and many other countries), export-oriented and innovating firms are more likely to complain about an inadequate stock of skills in the workforce, consistent with the earlier discussion of the impacts of globalization on the demand for skills (World Bank 2013e). Employers also complain about the flow of new skills. For example, in a recent survey of employers regarding the education and skills of their staff and the workforce overall, 76 percent of Cambodian employers claimed that new graduates are not equipped with the right set of skills (World Bank 2012c). In Vietnam, nearly 50 percent of employers assert that the education system does not produce the skills required to meet the needs of their workplace (World Bank 2013d). Employer perceptions of TVET and general higher education graduates are often similarly negative. In Lao PDR, 40–60 percent of employers said that neither system produces the right levels and types of skills they need (World Bank 2013c).

Cognitive and behavioral skills are just as much of an issue as technical skills for many employers. While policy makers often focus on expanding TVET to address skills gaps, the challenges are much broader and relate to both general and technical vocational education. When queried, employers complain that their staff lack a range of skills, including many cognitive and behavioral skills. For example, employers complain about severe skills gaps in creativity and leadership, but less severe gaps in technical skills (table 5.1). In addition, the performance of TVET graduates compared to general graduates varies by occupation and country and is likely linked to the quality of training and breadth of skills taught (World Bank 2012d). In Indonesia, secondary TVET students score significantly less well on national standardized tests than

TABLE 5.1 Gaps in creativity, information technology, and leadership skills are the most common across East Asia, severity of skills gaps, by type of skills, as reported by employers

Country	Creativity	Information technology	English	Leadership	Communication	Problem solving	Work attitude	Technical skills	Numeracy/ literacy
Mongolia									
Philippines									
Indonesia									
Thailand									
Malaysia									

Source: World Bank 2012d.
Note: Data come from various employer surveys and are not perfectly comparable. Darker shades indicate more severe skills gaps.

general secondary students, suggesting that some other cognitive skills may be lower (Chen 2009). However, in many countries, TVET is considered an inferior option for students, making it difficult to compare the quality of the systems.

Why do skills gaps exist and persist?

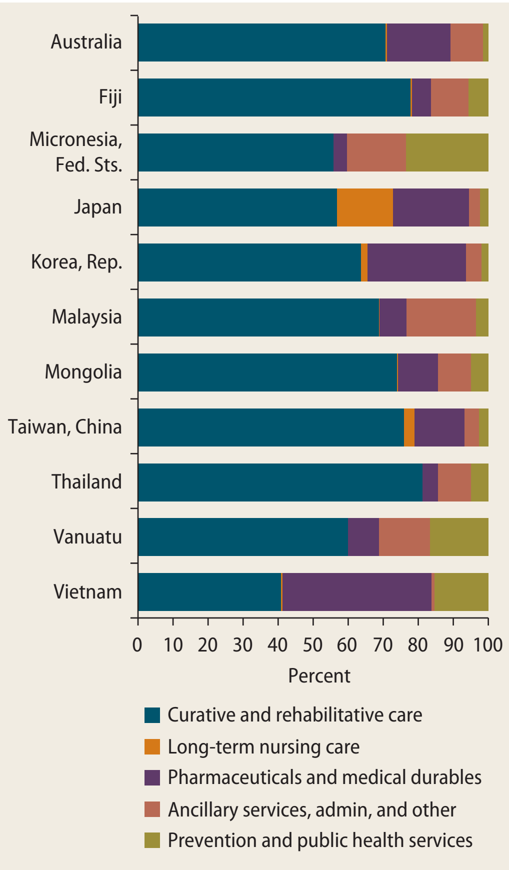
Several types of failures in both education and training systems as well as labor markets lead to the skills gaps observed in East Asia Pacific countries. Skills gaps are "a symptom of many diseases." Gaps in foundational skills are largely due to government failure to ensure that all citizens have adequate nutrition, quality basic health, and basic education. Gaps in technical and advanced cognitive and behavioral skills can be a result of both government and market failures. This section discusses a conceptual framework for understanding the production and use of skills and within this framework, highlights available evidence of failures leading to skills gaps in the region. Understanding these failures can enable East Asia Pacific countries to address skills gaps effectively.

Failures in producing foundational cognitive and behavioral skills

Without government interventions, investments in foundational skills are unlikely to be optimal. With perfect incentives, individuals and their families would invest in skills up to the point where their marginal costs of investment equaled their marginal return from the labor market, and this level of investment would be socially optimal if the individual's private return and cost were identical to the return and cost for society. In the real world, this does not happen for several reasons. First, incentives are imperfect. Parents may be unaware of the importance of early investments in the development of their children or, even if aware, be unable to finance these investments. Second, individual acquisition of foundational skills benefits society by making individuals more engaged and responsible citizens and better parents as well as by potentially increasing the overall level of productivity and growth in the economy (Moretti 2006; Oreopoulos and Salvanes 2011). To the extent that individuals do not take these benefits into account when making investment decisions, government funding can increase the efficiency of investment in foundational skills.[6] In addition, basic cognitive and behavioral skills are the foundation on which advanced and technical skills are built. These factors provide the rationale for government involvement in building foundational skills through public funding of early childhood development and primary and secondary education.

However, across East Asia Pacific, many governments do not put sufficient emphasis on or make adequate investments in producing foundational skills. Spending on child nutrition and primary health care is often insufficient to provide the foundation for good health and learning for all children and for sustained health and productivity for adults later in life. As shown in figure 5.16, the share of total health expenditures spent on preventive care is low across low-, middle-, and high-income countries in the region. This pattern of spending does not in itself reveal a skewed policy stance and, to a degree, simply reflects the higher relative cost of secondary and tertiary health care, (particularly in the Pacific island countries, which spend a lot sending patients abroad for treatment). However, the point remains: most countries in the region underinvest in nutrition and in preventive and primary care. Many of the negative effects of malnutrition and lack of primary health care early in life are irreversible, with few second chances to correct these deficits (Naudeau et al. 2011). People who incur these deficits early in life struggle to maintain good health during their learning and working years.

FIGURE 5.16 Spending on preventive care and public health is relatively low



Sources: Department of Health and Social Affairs 2010; Hyoung-sun and Rannan-Eliya 2010.
Note: Data come from national health accounts and include public and private spending.

Similarly, in education, public spending on early childhood programs is relatively low, and existing investments are sometimes ineffective. Most countries use less than 5 percent of overall public spending in education for preprimary schooling, except Mongolia, New Zealand (a globally recognized leader in early child development and education), and Thailand (figure 5.17). Even at the primary level, where governments spend large shares of their education budgets, inappropriate organizational arrangements, weak systems, and low capacity can limit the effectiveness of spending. For example, the Solomon Islands spends about 25 percent of its government budget on education, and about half of this goes toward primary education. Yet high absenteeism and low teacher quality, poor management, and other challenges limit the production of skills from this spending (World Bank 2012e). In Cambodia, where only 3.8 percent of adults had completed secondary education in 2007, a shortage of teachers and limited facilities contribute to low quality and low attainment (World Bank 2010). Similar challenges exist in Lao PDR, where only about 49 percent of the country's villages have a "complete" primary school offering instruction in all five primary grades (McLaughlin 2011).

Effective "second-chance" programs to complement the formal school system can help to fill the gaps in foundational skills. Those who leave the schooling system before gaining foundational skills, including literacy and numeracy, face difficulty in acquiring technical skills and more advanced cognitive and behavioral skills. This issue is significant in many countries of East Asia Pacific, where large numbers of youth drop out of school before completing full courses of secondary education and sometimes even before completing primary education. For example, in Indonesia, about 1 million dropouts from the formal education system enter the government's equivalency system every year (di Gropello and Sakellariou 2010). However, evaluating the effectiveness of these second-chance systems is difficult due to the limited information collected on their performance or the outcomes of their participants.

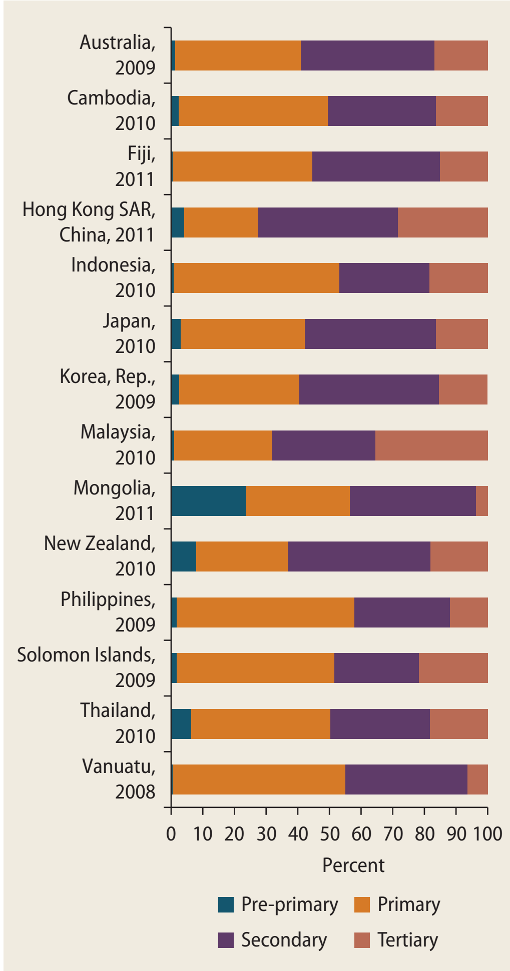
Even when basic education systems are strong and of good quality, the changing demand for skills in the labor market is creating new challenges to pedagogical emphasis and curriculum content. For example, creative problem solving is a cognitive skill increasingly required in workplaces undergoing rapid technological change (Levy 2010). Yet education systems in East Asia Pacific countries often emphasize memorization. For example, Vietnam, a country with nearly universal primary school enrollment and very high secondary school enrollment, faces this challenge in the kind of cognitive skills its education system produces. Fifth graders do well on math problems requiring the application of known rules, but they falter when required to apply the same mathematical principles to new contexts (World Bank 2013d).

Failures in producing technical skills and advanced cognitive and behavioral skills

When do gaps in technical and advanced skills merit policy intervention? While gaps in foundational skills should ideally be addressed wherever they are found, gaps in technical and advanced cognitive and behavioral skills are to be expected in any dynamic economy, as demand evolves quickly. But these gaps are inefficient when they are too wide and persistent, and they can hamper employment growth when the skills of new workers flowing into the labor market and the adjustment of the stock of skills of existing workers are inadequate.

Skills gaps may constrain employment in East Asia Pacific. In Indonesia, the Philippines, and several Pacific island countries, youth unemployment and inactivity rates are high relative to those in the rest of

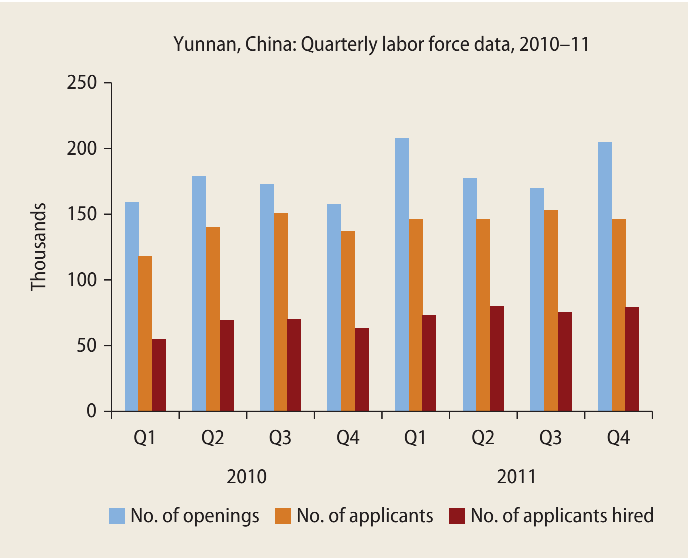
FIGURE 5.17 Spending on early childhood education is relatively low



Source: World Bank 2013f.

the region (see chapter 3). Firms across the region cite an inadequately educated workforce as the second most important obstacle to their operations (see chapter 4). In Yunnan Province, China, recent labor force data show that the majority of employment vacancies are going unfilled (figure 5.18). Several factors play a role in unemployment and unfilled vacancies. Employers in China and Lao PDR cite applicant dissatisfaction with the wages they are offered and with working conditions, suggesting that workers have high reservation wages or expect higher returns to their investments and wait

FIGURE 5.18 More than a third of recent employment vacancies in Yunnan, China, went unfilled

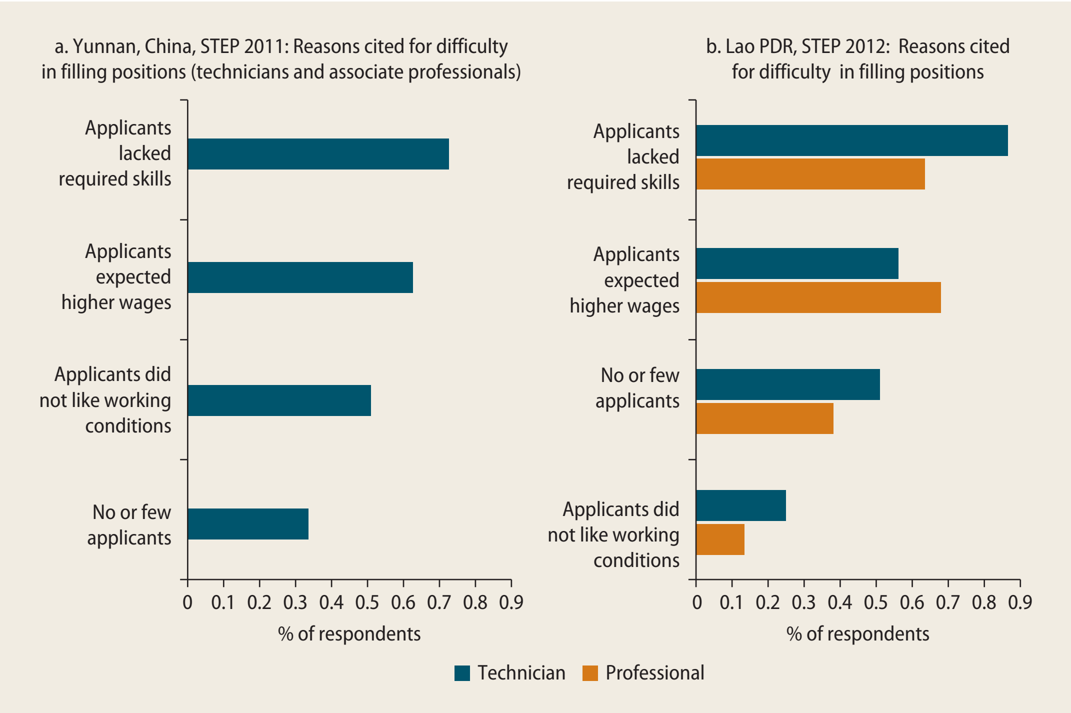


Source: Liang and Chen 2013.

for better-paying employment. But the data also indicate that a lack of skills is clearly an important reason for difficulties in filling vacancies (figure 5.19). Employer perceptions may be due to both a true lack of skills in the labor market or difficulties in matching jobs with the right job seekers. A conceptual framework for understanding the underlying causes of skills gaps is necessary in order to identify effective policies to narrow them.

Gaps in advanced and technical skills arise and persist from a range of market failures, which justify the need for government involvement, as well as from failures of government itself.[7] Market failures can be grouped into four broad categories: failures in labor markets, credit markets, and coordination, and limitations in decision making.[8] Table 5.2 provides some detail on the nature of these failures as well as the government failures that can compound them. In reality, countries are often faced with several

FIGURE 5.19 Employers cite lack of skills among applicants as a top reason for persistent vacancies



Sources: Liang and Chen 2013; World Bank 2013c.
Note: Data come from the Skills Toward Employability and Productivity employer survey.

TABLE 5.2 A range of failures explains gaps in technical and advanced cognitive and behavioral skills

Failure	Description
Labor markets	Imperfect competition for worker skills; costly search and limited information for both workers and firms
Credit markets	Inability of individuals to access adequate credit to fund skill acquisition; inability of firms to access adequate credit to fund training
Decision making	Missing information on market returns or the quality of education and training providers; high discounting of the future
Coordination	Employer use of low-skill technologies because high-skill workers are not available; worker failure to invest in skills because jobs are not available
Government	Weak policy-making process; inappropriate institutional arrangements; limited information

Source: Adapted from Almeida, Behrman, and Robalino 2012.

BOX 5.2 Skills poaching and matching in imperfect labor markets

Poaching externalities arise because most of the skills that individuals acquire are valuable to more than one prospective employer. With limited competition between firms for workers with particular skills, neither workers nor firms can fully capture the returns to investments in skills because a future employer could benefit from these investments by "poaching" the worker.

Matching externalities arise from the time, effort, and limited information that characterize many workers' search for employment and firms' search for workers. When workers and firms find each other, some bargaining over wages occurs, because only limited information is usually available on the market rates for a worker's particular set of skills. The negotiated wage will depend in part on the relative bargaining power of firms and workers. Specifically, the more bargaining power a firm has, the lower the wage will be for any given skill and the less a worker will invest in that skill. Several factors can influence firms' bargaining power, including the number of competing job seekers and the firms' alternatives, such as using a lower-skill technology.

More broadly than these two specific externalities, any characteristics of the labor market that reduce the expected value of skill investments for workers or firms may contribute to skills gaps.

Sources: Burdett and Smith 1996; Stevens 1996.

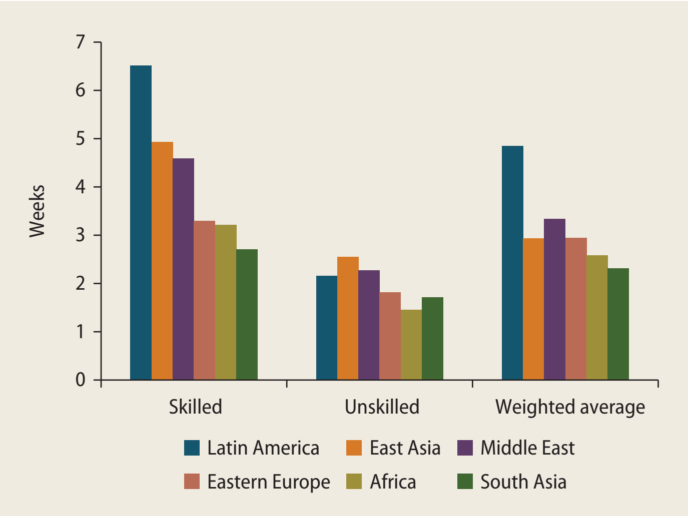
of these failures simultaneously and to varying degrees. But considering each separately clarifies both the underlying challenges and, as elaborated in the next section, the implications for public policy.

Labor market failures

Two important labor market externalities can lead to underinvestment in skills. In a perfectly competitive labor market, firms compete for workers, who are able to capture their full marginal product and thus have the incentive to invest in skills to their privately optimal level.[9] This level of investment may still be below the social optimum if technical and advanced cognitive and behavioral skills have substantial positive externalities, as discussed earlier. However, actual labor markets are far from perfect, due to many factors, including the costs of searching for vacancies and for workers and labor market regulations. Two important externalities for skills investment are created by these deviations: "poaching" and "matching" externalities (see box 5.2).

Labor market imperfections in East Asia Pacific economies play a role in creating skills gaps. Vacancies for skilled workers are open longer in East Asia Pacific than in any other region except for Latin America (Almeida and Jesus Filho 2011). It takes close

FIGURE 5.20 Vacancies for skilled workers in East Asian countries remain unfilled longer than in most other regions



Source: Almeida and Jesus Filho 2011.
Note: Data are from World Bank enterprise surveys 2002–05. East Asia includes Cambodia, China, Indonesia, Thailand, and Vietnam.

to five weeks on average to fill the position for a skilled employee (figure 5.20). These long durations may exist in part because employment seekers and firms with openings have difficulty finding each other. In Indonesia, for example, only 10 percent of firms use a private employment service or a recruiter, and only 30 percent use newspaper ads. Similarly, 16–17 percent of workers use newspaper ads and vacancy notices to find work, and only 4 percent use employment services. The majority of firms and workers rely on private networks and recommendations when searching for candidates and vacancies, respectively (tables 5.3 and 5.4). These recruitment and employment search practices likely limit the pool of qualified candidates identified by firms, increasing their perceptions of skills gaps. In addition, they may reduce workers' expectations of finding a good job and therefore their incentive to invest in skills.

Credit market failures

In many developing countries, individuals and firms are often unable to borrow enough money to finance investments in technical and advanced cognitive and behavioral skills. Lenders may lack information on the creditworthiness of potential borrowers and on the expected returns to their skills investments. For relatively expensive education or training that pays off slowly over time, loans are too risky for traditional private lenders unless potential borrowers have collateral, which individuals and small firms often lack in low- and middle-income countries.

Across East Asia Pacific, where student fees represent an increasingly large share of education financing, governments have responded to this market failure by creating loan and scholarship programs. However, the costs of higher education remain particularly

TABLE 5.3 Few Indonesian firms recruit widely for vacancies

Method of filling vacancies	% of firms using the method
Private network	80
Employee recommendation	50
Newspaper ad	30
Notice posted outside of firm	20
Internal promotion	20
Internet	10
Private employment service	10
Recruiter	10
Contact with schools	10
Job fair or contact with schools	1
Public employment service	1

Source: di Gropello 2010.

TABLE 5.4 Most Indonesians rely on private networks to find employment

Method of finding employment	% of workers using the method
Private network	47
Employer recommendation	36
Newspaper ad	17
Vacancy notice	16
Job fair or school	9
Internet	8
Internal promotion	8
Employment service	4

Source: di Gropello 2010.

burdensome for many families (World Bank 2012d). In China, for example, average university payments (including tuition and living costs) net of grants, loans, and work study still amount to 30 percent of average household income (Ma 2010). Government student loan programs exist in several countries, including China, Malaysia, Mongolia, Thailand, and Vietnam. However, they have a limited effect on increasing access for lower-income students: because allocation and eligibility for these programs is not granted on the basis of needs, the programs cover a small proportion of students and have relatively short payback periods of 6 or 10 years (World Bank 2012d).

A lack of access to finance may also limit some firms' investment in worker skills, particularly for small or informal firms. Training programs can be costly to purchase or set up in-house, potentially limiting the ability of small firms to invest in skills, even when it may be profitable to do so. For example, 58 percent of Filipino firms and 34 percent of Indonesian firms cited poor access to finance as a reason for not providing formal training (di Gropello 2010, 2011).

Information and decision-making failures

Individuals face a scarcity of information when making decisions about investments in skills. Prospective students often have little information about the relative labor market returns to different types of technical skills when deciding on a course of study. In addition, the quality of education and training institutions, particularly in the private sector, can be difficult to determine without reliable accreditation systems. In East Asia Pacific, very few countries have national qualification frameworks in place; even in those that do, many challenges remain. For example, independent accreditation bodies exist in the Philippines, where about 70 percent of all higher education institutions are private. However, as of 2007, more than 80 percent of higher education institutions had no accredited programs (di Gropello 2011). Challenges to full implementation of qualification systems include resistance from universities and other institutions that fear losing autonomy and complications in coordinating effectively across government departments, independent bodies, education and training providers, and employers (APEC 2009).

Even when information is adequate, individuals can still make poor skills investment decisions. Impatience or an undervaluing of the lifetime returns to skills can lead some to drop out of school or training too early. Financial pressures and the low quality of instruction are also common causes for early school leaving. While most countries have some form of second-chance system, investing later in life is more difficult, as some skills become less malleable, while personal responsibilities to family and work increase.

Social norms and family pressures can also exert a strong influence on the types of skills that individuals choose to acquire, particularly when information about the labor market and the quality of training is limited. A 2008 survey in Cambodia found that only 1 in 5 graduating secondary students based their decision about what to study on the labor market, while 7 in 10 followed their parents' advice (World Bank 2012d). Without systematic collection of data on labor market demand, students' ability to make good investment decisions will be limited. For example, while the returns to postsecondary TVET are nearly equal to the returns to university education, only 17 percent of Cambodian students express an interest in enrolling in TVET (World Bank 2012c).

Coordination failures

Coordination failures occur when firms benefit from workers investing in skills, and workers benefit from firms demanding more skills in ways that cannot be compensated through the market mechanism due to externalities. Two types of externalities can cause coordination failures, based on the level of skills involved: innovation and vacancy externalities. Innovation externalities occur when workers' advanced technical skills facilitate the adoption or generation of new technologies, which, in turn, increase firms' success. However, firms requiring such high-level skills are less likely to enter markets where few workers possess such skills, and workers are less likely to invest in these skills because they see few employment opportunities (Almeida, Behrman, and Robalino 2012). Vacancy externalities occur when workers' medium-level technical skills make firms more productive, but firms do not hire workers with these skills because they are scarce and can demand relatively high wages. Due to a lack of employment opportunities, workers do not invest in such skills.

Some countries in East Asia may be facing skills gaps due in part to coordination failures. In Malaysia and the Philippines, where large shares of skilled workers migrate internationally, individuals may choose to invest in skills that meet the needs of the external labor market rather than in skills that are demanded domestically (World Bank 2012b). Because the skills they would need are relatively scarce, firms in these countries may find it more profitable to use lower-skill technologies. The Cambodian tourism industry provides an example of vacancy externalities. Tourism employers complain that low-level workers lack behavioral and foreign language skills that would make firms more productive. Only about 12 percent of the labor force is able to speak a language other than Khmer. However, employers likely find it more profitable to use workers without these skills, because workers with them are scarce and thus expensive to hire (World Bank 2010).

Government failures

The many market failures contributing to gaps in technical and advanced cognitive and behavioral skills provide strong motivation for government action. However, as with basic education, governments often fall short of achieving the outcomes they want. The most difficult challenge facing governments is the difficulty of building higher-order skills on weak foundations. In several East Asia Pacific countries, foundational skills are not strong. As a consequence, only a limited number of people in the workforce can attain advanced skills, regardless of the volume of public spending directed toward higher education. There are inequitable consequences to the current challenge as well: in countries like the Solomon Islands, where only a small share of the student population is able to read to the standard required to complete secondary school—more likely to be students from better-off households—public spending on tertiary education is likely to be very regressive. This challenge underscores the importance of high-quality government-financed formation of foundational skills at early ages for both economic growth and equity.

In addition, policy-making processes and institutional arrangements within government often limit policy makers' ability to set an integrated strategy for skills development. Responsibility for the various steps in the process of skills development is usually divided across multiple ministries, creating obstacles to effective communication and cooperation. For example, in Malaysia, 10 federal ministries and agencies play a role in the ownership, funding, operation, or regulation of TVET institutes (Bin Omar 2013). Such complex institutional arrangements create numerous challenges to building skills, and Malaysia is implementing a comprehensive human capital framework to address these challenges.

Inappropriate institutional arrangements between public administration and service providers, combined with excessive regulation and limited information, also constrain governments' ability to correct market failures. Governments frequently fail to give service providers, public or private, sufficient autonomy or accountability, limiting their ability and incentives to improve performance (World Bank 2012d). Accountability requires information on the outcomes of individual schools, universities, and training centers—such as graduation rates, certification exam pass rates, and employment rates of recent graduates. This type of information is often neither collected nor reported. To give indicative evidence of government failures, a standardized assessment of the public policy environment for skills development is available for a handful of East Asia Pacific countries. The Systems Approach for Better Education Results–Workforce Development (SABER–WfD) scores countries' policies and institutions for workforce development, including institutional arrangements and accountability, on a scale moving from "latent," "emerging," and "established" to "advanced" (box 5.3). Vietnam's policy environment is on the "emerging" end of the scale, trailing behind Malaysia's "emerging/established" ranking, and Singapore's "established/advanced" performance.

Lastly, governments often need to collect more information about the labor market if they are to play an effective role in higher education and TVET, in particular. As providers, funders, or regulators of institutions that produce technical skills, governments often have insufficient knowledge of the current state of the labor market and of expected changes. This challenge is especially stark in East Asia, where economies grow and change quickly, resulting in constantly evolving demand for skills. Without updated information on employment trends, effective oversight of programs and institutions producing technical work-specific skills is limited.

BOX 5.3 The Systems Approach for Better Education Results–Workforce Development

SABER-WfD is a new diagnostic tool for assessing government policies and institutions for workforce development relative to international good practice. Countries are assessed on three dimensions:

1. *Strategic framework*, which pertains to policies that set the direction for workforce development and define its authorizing environment
2. *System oversight*, which relates to the "rules of the game" (including funding regimes) that guide the functioning of the system
3. *Service delivery*, which concerns the provision of training services to equip individuals with market- and job-relevant skills.

Each dimension is underpinned by nine policy goals, which are defined by three tangible policy actions per goal. Data to assess each policy action are gathered from interviews with credible informants as well as documentary sources, and scores for each dimension are calculated on a scale from one to four (corresponding to latent, emerging, established, and advanced).

Countries that achieve advanced scores have largely overcome the government failures in building skills discussed in this chapter. SABER–WfD is currently being carried out around the world in countries at different levels of development. To date, the results of six countries are available, as shown in table B5.3.1.

TABLE B5.3.1 SABER–WfD assesses a country's policies and institutions for workforce development

Country and year	Strategic framework	System oversight	Service delivery
Ireland, 2000	Advanced	Established	Advanced
Korea, Rep., 2010	Advanced	Advanced	Established
Malaysia, 2010	Established	Established	Established
Singapore, 2010	Advanced	Established	Advanced
Uganda, 2011	Emerging	Latent	Latent
Vietnam	Emerging	Emerging	Emerging

Sources: World Bank 2012g, 2013e.

Policy priorities and examples of success in skills development

The preceding sections have provided evidence of skills gaps in East Asia Pacific countries and of the need for governments both to mitigate market failures and to improve their own performance in order to fill those gaps. Gaps in foundational skills persist in several countries in the region, despite greater access to health and education services. In these countries, governments' policy priority should be to ensure adequate financing and high-quality provision of nutrition, basic health, and basic education services. Whether governments provide these services directly, oversee private provision, or use a combination of public and private provision is of less importance than whether households have information and access to good-quality services to ensure the right investment at the earliest possible age. The foundation of basic cognitive and behavioral skills has important social benefits; without it, efforts to build more advanced skills and increase the productive capacity of the labor force are limited in their effectiveness. However, the effects of investments in foundational skills take many years to be realized, as they affect the flow of new skills into the labor market with a long lag. Governments must assess the trade-offs between these long-term efforts and investments with more immediate returns.

To address gaps in technical and advanced cognitive and behavioral skills, the policy focus needs to go beyond the expansion of technical vocational education to ensuring the efficient production of in-demand skills throughout the secondary and postsecondary education and training system. The evidence presented in this chapter suggests that the rapidly evolving demand for skills in East Asia Pacific countries creates gaps in *all* types of skills—cognitive, behavioral, as well as technical. TVET programs tend to focus too narrowly on employment-specific skills at the expense of broader cognitive and behavioral skills and sometimes do not provide the level of technical skills demanded. General programs can often have the opposite shortcoming, by not focusing enough on producing strong technical skills. The focus in all types of education and training programs therefore needs to shift to providing the full set of skills demanded by employers.

The chapter also has shown that the policy focus needs to go beyond addressing the supply side to improving the functioning of the markets for skills production and the signals they receive from the labor market. Some market failures, including in education systems and labor markets, cause skills gaps and provide a strong motivation for government action. However, governments often lack information about market demand, particularly in technical skills, and this problem becomes more severe the faster an economy grows and changes. Therefore, rather than focusing on direct public provision of technical and advanced cognitive and behavioral skills, governments could focus instead on collecting and disseminating labor market information, acting as effective regulators of education and training institutions, and subsidizing demand with financing that enables individuals to make more nimble choices as returns from the labor market shift for certain skills.[10]

Because skills gaps arise and persist for many reasons, addressing the particular set of challenges a country faces warrants different policy actions. Figure 5.21 lays out a framework for the broad priority actions required: generate and disseminate information, align incentives, and increase capacity. These three areas address the problems of information, incentives, and capacity identified as the cause of the disconnects in higher education that, in turn, fail to produce the skills demanded (World Bank 2012d). Figure 5.21 also gives examples of specific policy actions to address the market and government failures discussed in the chapter, but many more potential solutions are likely available, depending on the nature of the failure faced and the broader country context.

Several economies in East Asia Pacific have become global leaders in producing

FIGURE 5.21 Alternative policy actions respond to different skills challenges

	Generate and disseminate information	Align incentives	Increase capacity
Labor markets	• Create and manage appropriate labor market information systems	• Enforce apprenticeship contracts between firms and workers	• Facilitate recruiting links between schools/training centers and firms
Credit markets	• Collect earnings data in labor market information systems	• Provide guarantees or other incentives to private banks	• Expand public student loan programs
Decision making	• Collect data on school and training provider performance and disseminate to students and families	• Subsidize opportunity and other costs of education and training to make staying in school easier	• Provide counseling and support services to youth at risk of dropping out
Coordination	• Facilitate information flows between firms and schools/ training centers on current and expected demand	• Subsidize worker training and firm upgrading/technology adoption in specific sectors	• Facilitate firm opportunities to support schools/training centers with instructors, materials, or facilities
Government	• Collect and utilize data to evaluate school and training provider performance	• Hold providers accountable for performance through funding mechanisms or other incentives • Make providers accountable to students through voucher systems	• Improve institutional arrangements to provide sufficient autonomy at all levels • Deliver needed support to teachers and administrators at school level

the skills required to fuel economic growth, and their experiences provide valuable examples of success. In the 1960s and 1970s, the Republic of Korea; Singapore; and Taiwan, China, overcame the coordination failures common to low- and middle-income countries by effectively aligning the incentives of households, employers, and training providers. Governments in all three places pursued strategic plans that created demand for high-skilled labor and subsidized the technical training to meet this demand. A ready supply of high-skilled labor subsequently spurred the growth of the technology-intensive sectors that are the engine of these economies today (Ashton et al. 2002; Almeida, Behrman, and Robalino 2012).

Recent experiences with generating and disseminating information and increasing capacity in Korea provide examples of promising approaches to addressing multiple failures. Since 2008, Korea has built up a quality assurance system for tertiary education, combining compulsory disclosure of information about operations and performance with a public-private accreditation system (Jones 2013). Information generated from this system, including graduation and employment rates, is disseminated to the public through a well-used public website, and high-performing education institutions are rewarded with grants. In addition, recognizing the burden that the high costs of tertiary education impose on families, Korea is expanding its needs-based student loan program to increase the capacity of individuals to build technical and advanced cognitive and behavioral skills. These initiatives promote accountability and competition among education and training providers on important outcomes and enable students and their families to make better choices.

However, critical to the success of policies for skills production in Korea and other high-income East Asian economies was developing a foundation of good nutrition and strong basic health and education. In each of these countries, governments went to great lengths to ensure the broadest possible access to foundational human capital investments and high standards of quality. Without this foundation, attempts to build higher-order skills in a significant share of the workforce could not have succeeded.

Many other countries in the region, and around the world, are taking this lesson seriously and are successfully closing their skills gaps. In the Philippines, for example, a large elementary school reform program, the Third Elementary Education Project, targeted government failures in the provision of foundational skills through measures to increase capacity and align incentives. From 2000 to 2006, the program provided teachers with training, devolved management to schools, increased the distribution of school supplies, and deployed several other measures to improve quality. These measures were implemented effectively and not only raised test scores, but also increased the educational attainment of girls and their eventual labor market earnings (Yamauchi and Liu 2012).[11]

Notes

1. Private returns are measured as increases in individuals' earnings. On average, returns are larger for women than for men, and in recent years, the returns to tertiary schooling have been higher than the returns to primary or secondary schooling (Montenegro and Patrinos 2012).
2. Surveys differ substantially across countries, making comparisons difficult. In addition, surveys often focus on a subset of all employers, such as formal employers with a minimum number of employees or employers in urban areas. These restrictions mean that survey results are not fully representative of the demand for labor skills, but they do identify the fastest-growing sectors in countries.
3. China is an exception to this finding, where exporting status is correlated with *lower* worker education, likely due to specialization in low-skilled manufacturing (Almeida 2009).
4. A specific set of skills can be thought of as defining an occupation.
5. Katz and Murphy's approach is a relative one—for example, the supply of highly educated workers relative to that of less educated workers and the relative wage premium between the two groups.
6. Investments have social returns at all levels of skills, and the size of social returns relative to private returns of education is an area of ongoing research (Topel 2004).
7. In addition to the market and government failures discussed, another factor for consideration in the undersupply of advanced skills is the role of institutions of higher education in producing research and innovation. For example, universities and research institutes often produce basic research that increases fundamental knowledge in a field and research that is highly valuable but too expensive for individual firms to undertake. Such research and innovation can ultimately contribute to productivity and competitiveness and to economic growth (World Bank 2012d).
8. The conceptual aspects of the discussion that follows draw heavily from Almeida, Behrman, and Robalino (2012).
9. Conversely, in a monopoly, a firm could capture all the returns to workers' skills and would therefore be incentivized to invest.
10. Several European countries, including the Netherlands, Norway, and more recently Hungary and Romania, have successfully generated and disseminated information through tracer studies of university graduates. Tracer studies track graduates and interview them at one or multiple points after graduation on a range of subjects, primarily to gauge their labor market experiences (Sondergaard and Murthi 2012). Ideally, such studies would track all graduates, as they do in the Netherlands, or a representative sample of graduates. This information could help to address multiple failures by providing both potential students and governments with information on the performance of education and training providers and trends in the labor market.
11. In the Philippines, the returns to education are higher for women than for men, and the program results are in line with these existing gender differences.

References

Abegunde, Dele, Colin Mathers, Taghreed Adam, Monica Ortegon, and Kathleen Strong. 2007. "The Burden and Costs of Chronic Diseases in Low-Income and Middle-Income Countries." *The Lancet* 370 (9603): 1929–38.

Aedo, Christian, Jesko Hentschel, Javier Luque, and Martin Moreno. 2013. "From Occupations to Embedded Skills: A Cross-Country Comparison." Background paper for the 2013 World Development Report, World Bank, Washington, DC.

Almeida, Rita. 2009. *Openness and Technological Innovation in East Asia: Have They Increased the Demand for Skills?* IZA Discussion Paper 4474. Bonn: IZA.

Almeida, Rita, Jere Behrman, and David Robalino, eds. 2012. *The Right Skills for the Job? Rethinking Training Policies for Workers*. Washington, DC: World Bank.

Almeida, Rita, and Jaime Jesus Filho. 2011. "Technology Adoption and the Demand for Skills: Learning from the Time to Fill Job Vacancies in LAC." Mimeo, World Bank, Washington, DC.

APEC (Asia-Pacific Economic Cooperation). 2009. "Mapping Qualifications Frameworks across APEC Economies." Report prepared for the APEC Human Resources Development Working Group, Busan, Korea.

Ashton, David, Francis Green, Johnny Sung, and Donna James. 2002. "The Evolution of Education and Training Strategies in Singapore, Taiwan, and South Korea: A Development Model of Skill Formation." *Journal of Education and Work* 15 (1): 5–30.

Autor, David, Frank Levy, and Richard Murnane. 2003. "The Skill Content of Recent Technological Change: An Empirical Exploration." *Quarterly Journal of Economics* 118 (4): 1279–334.

Barro, Robert, and Jong-Wha Lee. 2012. "A New Data Set of Educational Attainment in the World, 1950–2010." *Journal of Development Economics* 104 (September): 184–98. http://dx.doi.org/10.1016/j.jdeveco.2012.10.001.

Behrman, Jere, and Mark Rosenzweig. 2001. "The Returns to Increasing Bodyweight." Working Paper 01-052, University of Pennsylvania, Penn Institute for Economic Research, Philadelphia.

Bin Omar, Amir. 2013. "Developing Skills for Innovation and High Income Economy in Malaysia." Presentation given at the "Workshop on Skills Development in East Asia," Korea Research Institute for Vocational Education and Training (KRIVET) and World Bank, March 29.

Borghans, Lex, Angela Lee Duckworth, James Heckman, and Bas ter Weel. 2008. "The Economics and Psychology of Personality Traits." *Journal of Human Resources* 43 (4): 972–1059.

Burdett, Kenneth, and Eric Smith. 1996. "Education and Matching Externalities." In *Acquiring Skills: Market Failures, Their Symptoms, and Policy Responses,* edited by Alison L. Booth and Dennis J. Snower. Cambridge, U.K.: Cambridge University Press.

Chansarn, Supachet. 2010. "Productivity Growth, Education, Health, and Technological Progress: A Cross-Country Analysis." *Economic Analysis and Policy* 40 (2): 249–61.

Chen, Dandan. 2009. "Vocational Schooling, Labor Market Outcomes, and College Entry." Policy Research Working Paper 4814, World Bank, Washington, DC.

Cornwell, Christopher, David Mustard, and Jessica Van Parys. 2013. "Non-cognitive Skills and the Gender Disparities in Test Scores and Teacher Assessments: Evidence from Primary School." Mimeo, University of Georgia, Athens.

Cunha, Flavio, and James Heckman. 2007. "The Technology of Skill Formation." *American Economic Review* 97 (2): 31–47.

Department of Health and Social Affairs. 2010. *Federated States of Micronesia National Health Expenditure 2005–2008*. Palikir: Department of Health and Social Affairs, Federated States of Micronesia.

di Gropello, Emanuela. 2010. *Skills for the Labor Market in Indonesia: Trends in Demand, Gaps, and Supply*. Directions in Development Series. Washington, DC: World Bank.

———. 2011. *Skills for the Labor Market in the Philippines*. Directions in Development Series. Washington, DC: World Bank.

di Gropello, Emanuela, and Chris Sakellariou. 2010. "Industry and Skill Wage Premiums in East Asia." Policy Research Working Paper 5379, World Bank, Washington, DC.

Hanushek, Eric A., and Ludger Woessman. 2009. "Do Better Skills Lead to More Growth? Cognitive Skills, Economic Outcomes, and Causation." NBER Working Paper 14633, National Bureau of Economic Research, Cambridge, MA.

Heckman, James. 2008. "Schools, Skills, and Synapses." NBER Working Paper 14064, National Bureau of Economic Research, Cambridge, MA.

Hoddinott, John, John Maluccio, Jere Behrman, Rafael Flores, and Reynaldo Martorell. 2008. "Effect of a Nutrition Intervention during Early Childhood on Economic Productivity in Guatemalan Adults." *The Lancet* 371 (9610): 411–16.

Hyoung-sun, Jeong, and Ravi Rannan-Eliya. 2010. "SHA-Based Health Accounts in Twelve Asia/Pacific Economies: A Comparative Analysis." System of Health Accounts Technical Paper 10, OECD and Korea Policy Centre Health and Social Policy Program, Seoul.

ILO (International Labour Organization). 2013a. *Global Employment Trends 2013: Recovering from a Second Jobs Dip*. Geneva: ILO.

———. 2013b. *Key Indicators of the Labor Market*. Geneva: International Labor Organization. http://www.ilo.org/kilm.

Jacob, Brian. 2002. "Where the Boys Aren't: Noncognitive Skills, Returns to School and the Gender Gap in Higher Education." *Economics of Education Review* 21 (6): 589–98.

Jaimovich, Nir, and Henry Siu. 2012. "The Trend Is the Cycle: Job Polarization and Jobless Recoveries." NBER Working Paper 18334, National Bureau of Economic Research, Cambridge, MA.

Jimenez, Emmanuel, Vy Nguyen, and Harry Patrinos. 2012. "Human Capital Development and Economic Growth in Malaysia and Thailand." Policy Research Working Paper 6283, World Bank, Washington, DC.

Jones, R. S. 2013. "Education Reform in Korea." Economics Department Working Paper 1067, OECD Publishing, Paris. http://dx.doi.org/10.1787/5k43nxs1t9vh-en.

Katz, Lawrence, and Kevin Murphy. 1992. "Changes in Relative Wages, 1963–1987: Supply and Demand Factors." *Quarterly Journal of Economics* 107 (1): 35–78.

Kucera, David, and Leanne Roncolato. 2012. "Structure Matters: Sectoral Drivers of Development and the Labour Productivity-Employment Relationship." ILO Research Paper 3, ILO, Geneva.

Levy, Frank. 2010. "How Technology Changes Demands for Human Skills." Education Working Paper 45, OECD, Directorate for Education, Paris.

Liang, Xiaoyan, and Shuang Chen. 2013. *Developing Skills for Economic Transformation and Social Harmony in Yunnan, China*. Directions in Development Series. Washington, DC: World Bank.

Liu, Jian, and Xiaoyan Wang. 2011. "Expansion and Differentiation in Chinese Higher Education." *International Higher Education* 62 (2): 213–29.

Ma, Wanhua. 2010. "Equity and Access to Tertiary Education: Case Study—China." Background paper prepared for World Bank, Washington, DC.

McLaughlin, Bob. 2011. "Schools of Quality: A Case Study on Rights-Based Education Reform in the Lao People's Democratic Republic." UNICEF Education Section, Programme Division.

Montenegro, Claudio, and Harry Patrinos. 2012. "Returns to Schooling around the World." Background paper for the 2013 World Development Report, World Bank, Washington, DC.

Moretti, Enrico. 2006. "Private and Social Returns to Education." *Rivista di Politica Economica* (May–June): 3–46.

Naudeau, Sophie, Naoko Kataoka, Alexandria Valerio, Michelle J. Neuman, and Leslie Kennedy Elder. 2011. *Investing in Young Children: An Early Childhood Development Guide for Policy Dialogue and Project Preparation*. Directions in Development Series. Washington, DC: World Bank.

OECD (Organisation for Economic Co-operation and Development). 2010. *PISA: 2009 Results*. Paris: OECD.

Oreopoulos, Philip, and Kjell Salvanes. 2011. "Priceless: The Nonpecuniary Benefits of Schooling." *Journal of Economic Perspectives* 25 (1): 159–84.

Sondergaard, Lars, and Mamta Murthi. 2012. *Skills, Not Just Diplomas: Managing Education for Results in Eastern Europe and Central Asia*. Directions in Development Series. Washington, DC: World Bank.

Stevens, Margaret. 1996. "Transferable Training and Poaching Externalities." In *Acquiring Skills: Market Failures, Their Symptoms, and Policy Responses,* edited by Alison L. Booth and Dennis J. Snower. Cambridge, U.K.: Cambridge University Press.

Topel, Robert. 2004. "The Private and Social Values of Education." Keynote address to the "Conference on Education and Economic

Development," Federal Reserve Bank of Cleveland.

Warsh, David. 2006. *Knowledge and the Wealth of Nations: A Story of Economic Discovery*. New York: W. W. Norton.

World Bank. 2010. *Providing Skills for Equity and Growth: Preparing Cambodia's Youth for the Labor Market*. Washington, DC: World Bank.

———. 2012a. *Leading with Ideas: Skills for Growth and Equity in Thailand*. Washington, DC: World Bank.

———. 2012b. *Malaysia Economic Monitor: Modern Jobs*. Washington, DC: World Bank.

———. 2012c. *Matching Aspirations: Skills for Implementing Cambodia's Growth Strategy*. Washington, DC: World Bank.

———. 2012d. *Putting Higher Education to Work: Skills and Research for Growth in East Asia*. Washington, DC: World Bank.

———. 2012e. *Skills for Solomon Islands: Opening New Opportunities*. Washington, DC: World Bank.

———. 2012f. *Toward Gender Equality in East Asia and the Pacific*. Washington, DC: World Bank.

———. 2012g. "Workforce Development–SABER Country Reports: Ireland, Uganda, Singapore, and Vietnam." Washington, DC: World Bank.

———. 2013a. "Developing Skills for Innovation and High Income Economy in Malaysia." World Bank, Washington, DC.

———. 2013b. Health, Nutrition, and Population Statistics. Washington, DC: World Bank. http://databank.worldbank.org.

———. 2013c. *Skills for Quality Jobs and Development in Lao PDR*. Washington, DC: World Bank.

———. 2013d. *Vietnam Development Report*. Washington, DC: World Bank.

———. 2013e. "Workforce Development–SABER Country Reports: Republic of Korea, Malaysia." Washington, DC: World Bank.

———. 2013f. World Bank Education Statistics. Washington, DC: World Bank. http://databank.worldbank.org.

———. 2013g. World Development Indicators Database. Washington, DC: World Bank. http://databank.worldbank.org.

Yamauchi, Futoshi, and Yanyan Liu. 2012. "School Quality, Labor Markets, and Human Capital Investment: Long-Term Impacts of an Early Stage Education Intervention in the Philippines." Policy Research Working Paper 6247, World Bank, Washington, DC.

Labor Market Regulations, Interventions, and Institutions 6

Although relative newcomers to labor market regulation and social protection, many East Asia Pacific governments are becoming more activist, but they are moving in the wrong direction.

In this chapter, we turn to labor market policies, including social protection from risks to earnings from work. If there is a stereotype of how governments in East Asia Pacific approach policy in this area, it is characterized by high flexibility and scant protection. The analysis in this chapter shows how weak that stereotype has become. We distinguish between labor *regulations*, *interventions*, and *institutions*. The distinctions are much more than semantic and are important to understand how each influences the demand for and supply of labor and human capital. *Regulations* set the legal parameters of employment, in the form of minimum wages or restrictions on dismissal, and imply costs to employers and workers. *Interventions* are deployed by the state to make up for market shortcomings, such as the inability of private financial markets to insure the risk of unemployment. The costs of interventions are borne by all taxpayers whether they participate in the labor market or not. *Institutions* are the condoned structures, norms, and agreed procedures by which interested parties exert their influence and make and carry out decisions that shape regulations and interventions. In the labor market, the best example of an institution is the space afforded in the legal code of many countries for collective bargaining. But institutions can also refer more expansively to the conventions of a pluralist, representative democracy that influence the demand for and supply of labor and human capital.

Labor market regulations and interventions are formulated according to each country's institutions in an attempt to address market imperfections, such as uneven power between those who seek and those who sell labor and human capital, information failures on all sides, and limited or weak insurance to mitigate the risks to household well-being from loss of work. The *2013 World Development Report: Jobs* (hereafter referred to as WDR 2013; World Bank 2012b) argues that in most countries—as well as in the academic literature—the debate about these structures absorbs more time and is far more heated than their actual impact on efficiency outcomes (market participation, employment, unemployment, and earnings) would seem to merit.

In this chapter, we examine whether this broad conclusion also applies to the countries of East Asia Pacific. We devote much of the chapter to taking stock of regulations, interventions, and institutions in the region as well as to measuring how they compare with similar structures in other countries. We have applied measurement tools from the *Jobs Study* of the Organisation for Economic Co-operation and Development (OECD) to low- and middle-income countries in East Asia (OECD 1994).[1] While plenty of alternative measures are available,[2] this application provides helpful insights. For in choosing their labor market and social protection policies, most countries in the region have elected models crafted for labor markets in Europe, codified late in that continent's industrial revolution or in the interwar period (the minimum wage's origins in New Zealand, notwithstanding).

The discussion in this chapter focuses mainly on labor regulations, interventions, and institutions in the Association of Southeast Asian Nations (ASEAN) group of countries as well as China and Mongolia. Where available, evidence from additional countries in East Asia Pacific is also brought to bear. Comparable measures of regulation drawn from the labor codes of these countries show that the average level of employment protection in East Asia is actually higher than the OECD average and that there are notable outliers like Indonesia, where workers whose employment is regulated enjoy more protection than workers in France, Greece, or Portugal and only a little less protection than workers in Spain. In China, workers in regulated employment are de jure more difficult to dismiss than workers in Belgium and Italy. Similarly, reflecting only what is codified in labor laws, the Philippines has the highest average statutory minimum wage in the region, followed by Cambodia and Indonesia. When ranked by the ratio of the minimum wage to value added per worker, the average statutory minimum wage in the Philippines is among the highest in the world. Indeed, by this measure, it is much higher than in Belgium and France and more generous than in high-income East Asia Pacific countries with statutory minimum wages, such as Australia and New Zealand.

While restrictions on dismissal and wage regulation are being loosened in most middle- and high-income countries in other regions, regulation in East Asia Pacific is moving in the opposite direction. The regulatory framework in East Asia Pacific countries is becoming more restrictive. And as more people seek work in the manufacturing and services sectors, as governments become better able to enforce regulations, and as firms find it harder to evade, these extreme levels of regulation in the labor code will become more binding constraints. Indeed, for a segment of firms in many East Asia Pacific economies that are already too large to evade detection—many of them international companies—onerous levels of regulation are a problem and, for many, a source of unfair competition from smaller rivals that can still ignore the rules and hire informally.

But do the laws on the books matter? After taking stock of de jure structures, we review the evidence of de facto outcomes gathered for this and companion regional reports recently published by the World Bank and elsewhere. The evidence gathered for this report shows that, while labor policies may indeed still have a limited impact on employment, unemployment, and wages, they have distributional consequences that favor prime-age men at the expense of women, young people, and those who work part time or in self-employment. For example, rising minimum wages in Indonesia disproportionally lower the employment opportunities of women with fewer skills, young workers, and recent entrants to the labor market. In Thailand, increases in the minimum wage have had an adverse impact on the employment prospects of women, low-skilled workers, and elderly working people. In Vietnam, women are more likely than men to be earning at levels close to the minimum wage. This makes working women in Vietnam more vulnerable than men to changes in the minimum wage. We argue that this uneven impact should come as no surprise, since the prevailing models of labor market regulation and interventions were conceived in parts of the world and during periods in history when prime-age men in full-time, dependent employment made up the largest group of working people.

The evidence we have gathered from countries in East Asia Pacific and elsewhere indicates that, particularly for women, younger workers, self-employed people, and people who either have to or prefer to work part time, overly constricting policies can create more damaging distortions than the market failures they were designed to correct. The biased impact of prevailing models of labor regulations and social protection on forms of work that are prevalent in most East Asia Pacific countries is a growing problem that creates both segmentation and exclusion from the labor force altogether. Evidence gathered for this and companion World Bank reports shows a positive association between the levels of employment protection, social insurance contributions, and other taxes on labor and the extent of informal economic activity. For example, in China, the attempt with the 2008 Labor Contract Law to expand coverage of social insurance financed from payroll taxes was associated with a lower probability that certain workers were protected (Giles, Wang, and Park 2013).

These unintended consequences can be even more damaging in places where, due to limited government capacity, regulations are applied only to certain sectors of the economy or are poorly enforced. Similarly, even when reasonably designed, poorly administered, and narrowly applied, regulations and interventions can aggravate rather than correct inequitable outcomes, all at a cost to taxpayers.

In addition, this chapter looks at why organized labor is less powerful in East Asian countries than in countries at a similar level of development in Latin America and the Caribbean and Central and Eastern Europe. For a few countries where the power of unions is already high or rapidly increasing (such as Indonesia and the Philippines), unions may be exercising a monopoly in representing working people in dialogue with the government and employers and failing to represent the voices and views of the majority who do not work in dependent wage relationships. An analogous concern can be raised about employers' associations. Labor market institutions that only allow the participation of a narrow group of stakeholders—whether labor unions on the supply side or industry associations on the demand side—can become fiefdoms where selected interests become entrenched and where decisions are taken that make labor and human capital markets less rather than more contestable, threatening productivity and sustained well-being from work.

Regulations

Regulations set the legal parameters of employment, including minimum wages, employment protection legislation (EPL), and regulations on the movement of people. We deal with each in turn.[3]

Minimum wages

Minimum wages have become a nearly universal instrument of labor market regulation and are applied in more than 90 percent of International Labour Organization (ILO) member countries (ILO 2012). Most countries in East Asia Pacific have adopted a statutory wage policy. However, East Asia's low- and middle-income countries are "latecomers" to labor market regulation when compared to countries in other regions. The governments in Latin America adopted European models of labor market regulation, including minimum wages, in the 1920s and 1930s.[4] As they became independent, many of the former colonies in South Asia, the Middle East, and Africa retained regulations that were applied mainly to public sector employment and in urban, industrial sectors of production. The details of the minimum wage policies in the countries reviewed here are presented in table 6A.1 in the annex to this chapter. The Philippines was the first country in East

Asia Pacific to implement a national minimum wage in 1951. After the Second World War, Burma, Malaysia, and other colonies established wage legislation similar to that of Great Britain, but coverage was minimal (Starr 1993). Almost a quarter century would pass before another government in East Asia Pacific would decide to regulate wages.

Indonesia instituted a minimum wage in the early 1970s for people working in the urban manufacturing sector. Thailand introduced a minimum wage in 1972 for Bangkok and the metropolitan area. In 1974, nationwide enforcement began, and minimum wage rates were established for Bangkok and the metropolitan area, 38 large provinces, and the remaining provinces. Vietnam set a minimum wage for foreign companies in 1992; however, over time it also established a minimum wage for domestic firms. In 2011, the government eliminated discrepancies in the rates and set one common rate for foreign companies and national private companies. More recently, the level was made uniform for all of the private sector. China passed the first legislation allowing states to enact a minimum wage policy in 1993. Regulation was further strengthened in 2004. Mongolia introduced a procedure for determining minimum wages for employees in state-owned and joint stock enterprises in 1995. In 1998, coverage was extended to the private sector. Cambodia adopted a minimum wage policy in 1997 after promulgating the first Labor Law. In the Lao People's Democratic Republic, a minimum wage was introduced for the private sector in 2006. Although Malaysia did not have an active minimum wage in 2010, a minimum wage act was passed in 2011, and the policy came into effect in January 2013. Although Singapore is the only country in ASEAN without a statutory minimum wage, the Ministry of Manpower makes recommendations for wage adjustments.

Wage regulation typically is outlined in legislation that gives legal force to the terms of agreements negotiated among employers, trade unions, and employees (Deakin and Wilkinson 2009). A companion World Bank report on minimum wage policies (World Bank 2013b) shows that countries in East Asia Pacific differ greatly in the goals they want to achieve when establishing or modifying their minimum wage regulation. Countries can be sorted by these objectives into three groups: the first group seeks to reduce poverty and inequality by increasing the earnings of low-income workers (Devereux 2005), the second seeks to promote productivity growth, and the third seeks to address efficiency issues in the labor market to improve outcomes for employers and workers.

A notable feature of minimum wage regulation in East Asia Pacific countries is that the level of minimum wages typically varies widely across provinces and districts and often between economic sectors. Prior to 2012, only Lao PDR and Mongolia had a single national minimum wage. All of the other countries reviewed have different minimum wages at the subnational and sectoral levels. Cambodia has three national minimum wage rates for workers in the garment sector based on occupational level (apprentice, probationary, and regular levels). Although the Cambodian Labor Law includes some provisions for the establishment of minimum wages in all sectors, minimum wages are only set for the garment sector.

Myanmar has national sector-specific minimum wage rates for employees in public service and the rice-milling, cheroot-rolling, and cigar-rolling industries. In Indonesia, minimum wage levels are set for each province and may be further set for districts and economic sectors.[5] In China, minimum wage rates exist for each of the 33 provinces. In the Philippines, there are multiple regulated minimum wage levels as well, varying by region, province, and sector. Within regions, rates may also be set for different provinces or localities and for different sectors: nonagricultural, agricultural, and retail and service. In Vietnam, rates vary according to location and employer. Prior to 2011, basic rates in Vietnam were set for four broad regions. Within each region, rates were set separately for private domestic firms and for foreign companies. Currently, four regional rates apply to workers employed in the private sector, and one national rate applies to public sector workers. Thailand used to have about 32 minimum wage levels, varying by provinces and sector, but in 2011, the government proposed a unified minimum wage rate of B 300 across the country.

In most cases, minimum wage levels are set by the national government after consultations with a *tripartite* body, with the required representation of employers, workers, and government. In Cambodia, Malaysia, Mongolia, Myanmar, Thailand, and Vietnam, the national government and a tripartite body has a critical role in setting the minimum wage level.[6] However, in practice it is unclear how balanced the tripartite body really is, making it difficult to ascertain the level of consultation that takes place in the adjustment process. In Indonesia, China, and the Philippines, minimum wages are set by regional governments in consultation with tripartite committees. Only in Lao PDR is the minimum wage set unilaterally by the national government. In Indonesia, the 2003 Manpower Law established that minimum wage levels were the responsibility of regional governments following recommendations from the provincial wage councils.[7] In China, the departments of labor and social security of provinces, autonomous regions, or municipalities set the rates in consultation with the regional trade unions and federations of enterprises. In the Philippines, minimum wages are set by regional tripartite wage and productivity boards.[8] We take up this discussion again in the section on institutions.

Across much of the region, the average level of minimum wage relative to average and median wages and as a proportion of value added per worker varies significantly. Few countries in the region have maintained the level of minimum wages consistent with their codified wage adjustment formulas. Some countries (or regions within these countries) have made minimal adjustments, allowing the value of the minimum wage to fall with respect to productivity or to deteriorate with inflation. Other countries have enacted dramatic increases, with little observable relationship to changes in worker productivity (World Bank 2013b).

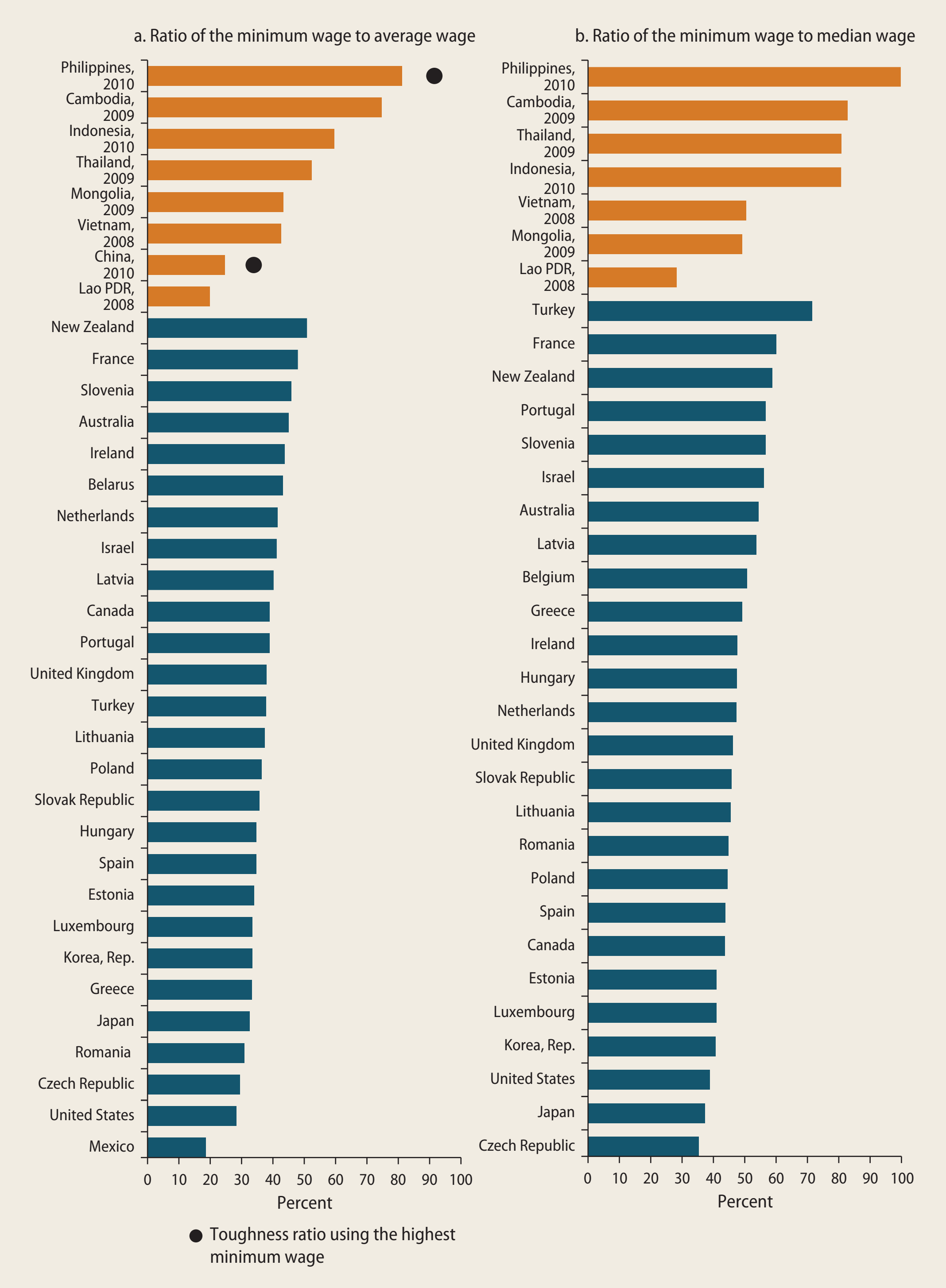
Among the countries reviewed in this chapter, Thailand had the lowest level of monthly minimum wage in 2011 relative to the country's gross domestic product (GDP) per capita. This changed with enactment of a single national minimum wage level in 2012. Most Indonesian provinces had similarly low minimum wage levels, until changes made recently. In 2008, the real value of the minimum wage for most ASEAN countries fell in the wake of a sharp rise in inflation. In response to growing pressure from certain groups of workers and the increasing frequency of strikes since 2011, the governments of Cambodia, Lao PDR, Indonesia, and Thailand enacted substantial increases in their minimum wage levels.

The Philippines has the highest minimum wage, especially relative to the average wage. In 2012, the Philippines had an average national minimum wage set above the ninetieth percentile of countries in the world, ranked by the ratio of the minimum wage to value added per worker.[9] In figure 6.1, the dot indicates that the level in some regions of the country is even higher (or tougher), while the bar shows the average for all regions. The measure in figure 6.1 is a synthetic index reflecting what is in the labor codes of the countries included rather than what people are actually being paid on average.

Employment protection legislation

A second widespread form of labor market regulation, employment protection legislation restricts the ability of employers to dismiss workers. An EPL index for ASEAN countries, China, and Mongolia compares some of the most critical employment costs that employers face in these countries. The index ranges from 0 to 6, with 0 being the least restrictive and 6 being the most restrictive legislation. Figure 6.2 compares economies in East Asia Pacific with OECD countries and gives the average

FIGURE 6.1 **Minimum wages are highest in Cambodia, Indonesia, and the Philippines**



Source: World Bank 2013b.
Note: Average wage corresponds to the average wage of employees working in sectors covered by the minimum wage laws.

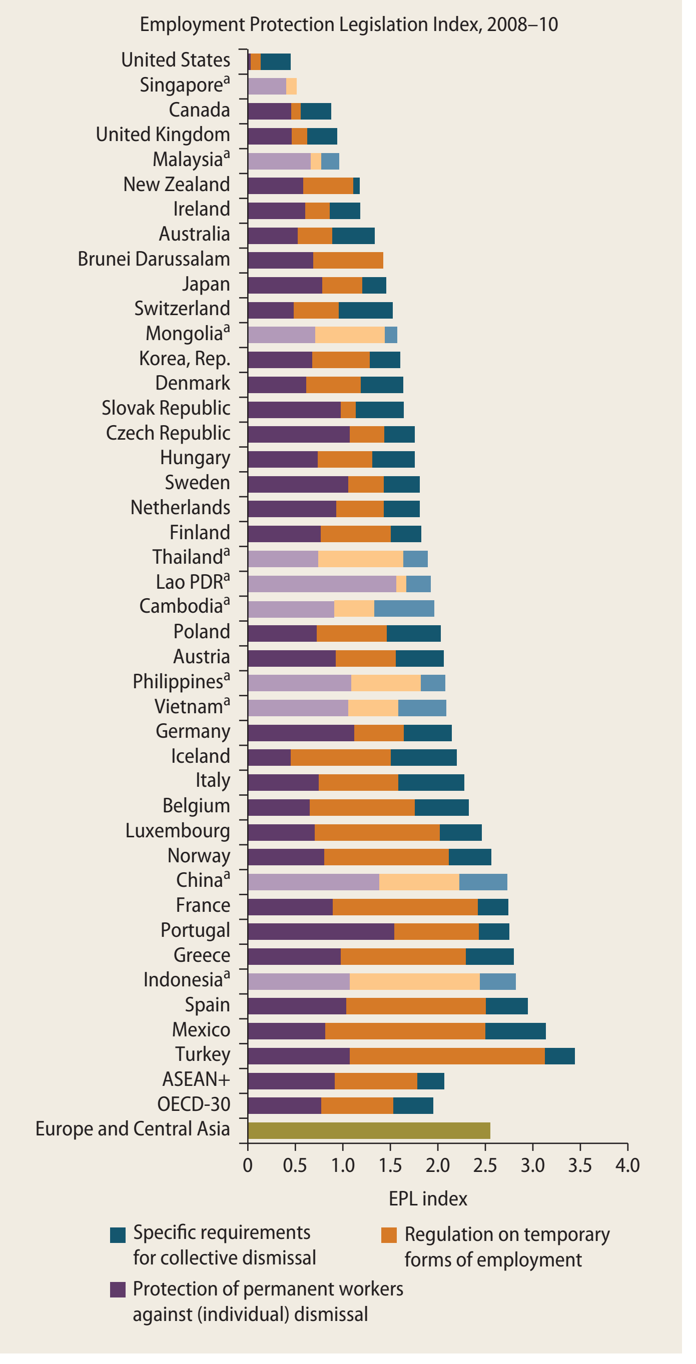
for Europe and Central Asia. The average level of restriction from EPL in the ASEAN countries (1.8) is slightly lower for the period 2009–10 than the average for OECD countries (1.9). There is, however, significant variation in how restrictive employment protection is, ranging from as low as 0.59 in Singapore to 2.79 in Indonesia.

On the whole, countries in East Asia Pacific do not have especially tight restrictions on dismissal. The levels of employment protection are consistent with the low frequency with which firms report labor market regulation to be an obstacle to their growth (presented in chapter 4). However, China, Indonesia, the Philippines, and Vietnam stand out for having the most restrictive employment protection regulation. In the Philippines and Vietnam, much of the stringency reflected in the index stems from regulations on the dismissal of permanent workers and the hiring of workers on fixed-term contracts. At the other end of the spectrum, employers in Malaysia and Singapore are the least restricted by employment protection regulation.

Many high- and middle-income countries have relaxed their employment protection regulation over the past 20 years.[10] Reforms have generally entailed extending the maximum length of fixed-term contracts, allowing renewals of fixed-term contracts, and encouraging firms to contract from temporary work agencies. Restrictions in high-income countries have been eased further by modifying severance payment, shortening notice periods, and reducing requirements for collective dismissals (ILO 2012). Similarly, countries in Eastern Europe and Central Asia and in Sub-Saharan Africa have made employment regulation more flexible with the hope that more flexibility will lead to increased investment and employment.

In East Asia Pacific, however, changes in employment protection have generally increased the restrictions on firms, and where governments were not actively regulating the labor market, they have stepped in with regulation on the more restrictive end of the scale. Indonesia, for instance, reformed labor

FIGURE 6.2 Some countries in East Asia Pacific have similar levels of restriction to southern Europe



Source: Estimates for the Association of Southeast Asian Nations (ASEAN), China, and Mongolia are derived using country labor codes. Measures for the Organisation for Economic Co-operation and Development (OECD) member countries are the latest available on at www.oecd.org.
Notes: Score ranges from 0 (least stringent) to 6 (most restrictive). OECD average includes a sample of 30 countries, and figures are for 2010. Europe and Central Asia figures are for 2007.
a. ASEAN+ countries.

regulation with passage of the Manpower Law (Act no. 13) in 2003, which tightened labor regulation by increasing the amount of mandated severance payments and restricting the use of temporary employment (that is, fixed-term contracts and subcontracting). China adopted a Labor Contract Law in January 2008, which made significant changes to the 1994 Labor Law and increased worker protection. The new law was passed in response to recurrent problems of labor abuse and violations of worker rights.[11]

Employment protection regulation typically includes dismissal costs for regular workers, rules about the use of temporary workers, and fixed-term contracts. Tables 6A.2 and 6A.3 in the annex to this chapter provide details drawn from the labor codes of each country reviewed. Dismissal costs mainly take the form of severance pay.[12] In East Asia, Indonesia and Lao PDR have the highest dismissal costs in the form of severance pay. In Indonesia, the 2003 Manpower Law increased severance pay for workers with three or more years of service and established an additional 15 percent of severance pay as a gratuity payment in compensation for the loss of housing and health care benefits. Employers in Indonesia and Lao PDR must pay the equivalent of seven months of full wages to dismiss a worker with four years of tenure. The dismissal costs for workers with longer tenure rises steeply; for instance, a worker with 20 years of service receives an average severance payment equal to 36 months of wages in Lao PDR and 25 months of wages in Indonesia (figure 6.3). This is six times more in severance than what the labor code in the average OECD country requires for a dismissed worker with 20 years of service.

The statutory notice periods in the East Asia Pacific countries reviewed are typically between 1 to 1.5 months for a worker with four years of tenure, which is about the same length as in OECD countries. Although most countries do not have onerous procedures and requirements for dismissing workers, there are some exceptions. In Brunei Darussalam, Cambodia, China, Indonesia, Lao PDR, and the Philippines, employers are obligated to notify a third party, typically workers' representatives, before making a worker redundant. Further, in Brunei Darussalam, Indonesia, and Lao PDR, employers are not allowed to lay off workers without permission from the appointed government agency. All of the countries reviewed, except Malaysia, allow reinstatement after unfair dismissal.

Legal allowances for using temporary contracts and contracting additional workers from temporary agencies are commonplace. The use of temporary or "fixed-term" contracts provides flexibility by allowing employers to hire without incurring some of the costs for hiring permanent workers. With this type of contract, in theory, employers can adjust their labor input with fluctuations in market demand. They can also use the extended trial period to gauge the workers' productivity level and decide whether to hire the worker permanently. However, there are also disadvantages. For example, employers have less incentive to invest in the human capital of workers on shorter, fixed-term contracts (Nielen and Schiersch 2012).

Many European countries introduced fixed-term contracts to reduce high levels of unemployment in the mid-1980s. Previously, the labor code of most European countries restricted the use of fixed-term contracts, but such contracts have become far more common. Powerful unions have, however, constrained the extent of liberalization, leading to "two-tier" labor markets particularly in Southern Europe (see box 6.1).[13] Among the East Asia Pacific countries reviewed, about half have put in place restrictions on the use of temporary work: Brunei Darussalam, Indonesia, Mongolia, the Philippines, and Thailand all restrict the use of fixed-term contracts. Cambodia, China, Lao PDR, Malaysia, Singapore, and Vietnam have legislation enabling employers to use fixed-term contracts for permanent tasks, although the level of flexibility varies. Few countries in East Asia Pacific limit the duration of these contracts or restrict the number of times they can be renewed. Lao PDR, Malaysia, and Singapore are the most flexible. Indonesia

FIGURE 6.3 Firms face the highest severance costs in China, Indonesia, and Lao PDR

Source: Estimates based on the labor code in each country.

BOX 6.1 Temporary contracts and labor flexibility: A cautionary note on partial reforms

Spain had the highest incidence of temporary contracts prior to the global financial crisis and little possibility of workers moving from temporary to regular employment. In 1984, a two-tier EPL reform liberalized the use of temporary contracts, after which temporary jobs rose dramatically, from 11 percent of total employment in 1983 to about 35 percent in 1995 (Guell and Petrongolo 2007). Most European Union (EU) member states that introduced partial EPL reforms have seen an increase in temporary employment since the mid-1980s. In contrast, countries that long had less stringent regulations for permanent contracts—like Denmark, Ireland, and the United Kingdom—did not experience the same increase in temporary employment.

Younger people are more likely to be employed with a temporary contract. In most EU member states, 40 percent of young people (ages 15–39) are on temporary contracts, especially those under 25. The share of temporary employment among workers 15–24 ranges from more than 50 percent in France, Germany, Poland, Slovenia, and Spain to less than 20 percent in Bulgaria, the Czech Republic, Latvia, Lithuania, Romania, the Slovak Republic, and the United Kingdom.

Temporary contracts have both positive and adverse effects. They can help to make labor markets more dynamic. Bover and Gomez (2004) find that in Spain, exit rates from unemployment into temporary contracts were 10 times higher than exit rates into permanent contracts between 1987 and 1994. Bentolila, Dolado, and Jimeno (2008) find that they helped to decrease long-term unemployment, especially in periods of high growth. Temporary contracts can help firms to evaluate workers' suitability and be a stepping stone to more permanent employment. Temporary contracts can also absorb shocks, protecting firms from fluctuations in demand by avoiding costly adjustments to their core labor force.

However, segmentation arises when there is little possibility of movement from temporary to open-ended contracts. Where employment protection for workers on open-ended contracts remains restrictive and the employment benefits protected are relatively generous, firms can use temporary contracts to reduce labor costs by substituting permanent with temporary workers. These incentives can lead to exclusion and adversely affect productivity and investment in skills. Boeri and Garibaldi (2007)

continued

BOX 6.1 *(continued)*

find that the share of temporary workers in Italy had a large negative impact on firm-level productivity growth. Rising employment in the aftermath of two-tier EPL reforms led to falling labor productivity by decreasing the marginal returns to labor. Although the partial liberalization of EPL in Spain and Italy led to an increase in turnover, a reduction in long-term unemployment, and an increase in employment, it was also associated with a fall in investment in firm-specific skills and a decrease in labor productivity.

Germany's experience has been much better, as deregulation of EPL was accompanied by reforms to social protection benefits. Prior to the reforms in 2004, Germany had average annual unemployment rates of almost 10 percent, compared to 5 percent in the United States. By 2004, almost 4.5 million Germans were unemployed. Less skilled and older workers had higher unemployment rates; vocational school graduates and high school dropouts had unemployment rates of about 18 percent. Implemented between 2003 and 2005, the reforms modernized public employment services and social welfare centers, modified existing labor programs, and introduced new ones. They changed the institutional and legal framework for the rights and responsibilities of the unemployed and the beneficiaries of social assistance. But, as with other parts of Europe, employment protection was reduced for only certain segments of the labor market.

Germany's reforms helped to reduce unemployment dramatically. Despite the crisis, the unemployment rate in Germany remained low. Many of the newly introduced part-time and temporary jobs have served as a bridge to regular jobs. But the reforms might also have reduced the income of low-wage earners, which declined 16–22 percent over the last decade.

Europe's experience has been shared by high-income countries in East Asia Pacific that have strict employment protection. Duality or segmentation has emerged in Japan and the Republic of Korea, where the share of "non-regular" workers accounts for about a third of the workforce. Because non-regular workers are typically unable to convert their contracts to more permanent forms of employment, there is now a clear division between "insiders" and "outsiders," similar to that found in labor markets in Southern European countries. Deregulation in Japan and Korea was motivated by the need to increase labor market flexibility. But in both countries, strong interests limited the extent of deregulation. Compared with similarly qualified regular workers, "non-regular" workers typically earn much less, have stagnant earnings, and do not have access to the same protection.

These experiences with liberalization raise several questions. First, given the difficulty of comprehensive labor reforms, does a partial liberalization targeted at some groups or sectors work? Second, do allowances in the labor code for more flexible forms of employment lead to a "two-tier" market and a legally sanctioned underclass? Third, do flexible and temporary forms of employment serve as a step toward advancement, or are people who enter through a fixed-term or part-time job scarred in ways that limit their future options?

Sources: Gill and Raiser 2012; Gill, Koettl, and Packard 2013.

is the most restrictive: people on fixed-term contracts are prohibited from filling roles deemed permanent; for roles deemed temporary, the duration of a fixed-term contract cannot exceed three years (two years and a single year renewal). This period was recently shortened from five years.

Turning to the final element of employment protection measured in figure 6.2, few East Asia Pacific countries regulate additional protective measures for collective dismissals or large-volume layoffs as part of retrenchment, downsizing, and redundancies. The most restrictive additional regulations on mass redundancies are found in Cambodia, China, and Vietnam. In Cambodia, employers must notify the labor authorities and workers' representatives in writing of the circumstances for layoffs and receive guidance on how to minimize the effects of the reduction. Dismissed workers have priority to be rehired for the same position within two years.

In China, the Labor Contract Law defines collective dismissals as layoffs involving more than 20 employees or at least 10 percent of the total number of employees in a firm. Collective dismissals are only permitted when an employer is adjusting its business operations or has run into serious operational difficulties. Employers are required to notify and consult with labor unions and employees about the dismissal 30 days in advance, consider their opinions, and submit a workforce layoff plan to the labor administrative department. If an employer that has gone through this process is able to hire again within six months, its former employees have to be given preferential consideration. In Vietnam, the law does not specify the number or percentage of laid-off employees that constitute a "collective" dismissal. The provision applies to any layoffs resulting from technological change or organizational restructuring. Employers must engage in consultations with labor unions and an executive committee to formulate specific criteria (business requirements, seniority, skill, family conditions) for dismissals.

Regulation on the movement of people

Although movement of people across borders is more likely to capture news headlines, the largest movement of people seeking work happens within countries.[14] As discussed in earlier chapters, this has been especially true in East Asia Pacific and, as shown in the chapters that follow, is still under way. Voluntary internal migration from rural areas to cities has been gaining importance since the mid-1970s. This shift is especially notable in the urbanizing economies of South and East Asia, with the rapid rise of manufacturing and services. In China, with the easing of residency restrictions, the migration of population from rural areas to cities in the past 30 years has been the largest movement of people in the world.

Indeed, attempts by China to channel the flow and settlement of its people provide a useful synopsis of the regulation of labor migration. In the second half of the twentieth century, China undertook some of the most active internal migration policies ever observed, initially to great economic benefit. Following the communist accession to power in 1949, the Chinese government sought to stimulate industrialization through policies that encouraged rapid urbanization. Households were given incentives to move to cities, and rural workers responded en masse. As a result, by 1953, the urban population of China had grown by a third, to 78 million people.

Seemingly in response to the larger than expected flow from rural areas, the government quickly attempted to stem the tide, establishing departments that centralized hiring in 1953 and soon after instituting restrictions on travel and rationing grain in cities. But these measures failed to slow the outflow of rural workers significantly, and by the late 1950s, the population pressure on cities grew to such an extent that the government mobilized millions to move back to the countryside. But with the Great Leap Forward (1958–60), the government abandoned all attempts to control the flow of labor and again sought to accelerate industrial development, motivating another surge of workers to China's cities. By 1960, China's urban population had doubled from that in 1949.

In the early 1980s, the government became particularly preoccupied with the speed of urbanization. Although rural-to-urban migration was responsible for only 20 percent of the growth of China's cities from 1949 to 1980, mounting evidence of burdened infrastructure and services in the "megacities" of Beijing and Shanghai concentrated the attention of policy makers on movement from rural areas.

The government regulated the flow of workers largely through the household registration system of "hukou," which is based on four tenets: migration, especially to urban areas, should be allowed only if compatible with economic development, rural-to-urban migration must be strictly controlled, movement between settlements of similar population size need not be controlled, and flows from larger to smaller settlements or between rural areas should be encouraged. Under the hukou, each individual has an official place of residence. People are allowed to work legally, receive social security benefits including health coverage, and access food rations only in their place of residence. A change can be granted only by permission, similar to a local authority granting a visa. But some forms of legal temporary migration are allowed to meet shifts in labor demand. As the government's preoccupation with the size of China's cities and the pace of urban growth has changed, the hukou has been tightened or loosened. Despite the controls, lax enforcement has allowed large flows of migrant workers to settle in cities under "temporary" status. Indeed, in the last 30 years, the labor force needed to fuel China's spectacular growth has relied on temporary migrants, who are permanent de facto.

Today the surge of people from rural areas is ebbing. Yet one in five rural workers migrates, and migrant labor accounts for a third of urban employment. China's industries are in constant demand of low-cost labor, which has become very difficult to find. Recognizing the growth dividend from allowing labor to flow, the government has been loosening the hukou in recent years and is even facilitating migration. Migration restrictions have declined, the labor market has become more efficient, and decisions regarding mobility have become much more responsive to economic factors. Beginning with pilots in selected municipalities, migrants from rural areas will receive access to health and social protection services; training, labor market information, and job search assistance; and recourse to protection in case of employer abuse and exploitation.

International migration, defined as the movement of people across national borders, has important economic, social, and political implications that influence regulation of the labor market. The number of people moving across borders, both legally and illegally, has been rising steadily in the last five decades, especially from countries in East Asia Pacific. According to recent estimates of cross-border migration, emigrants from East Asia Pacific countries total 21.7 million people (World Bank 2013a). The flows out of East Asia Pacific countries have included more women in recent years, but the majority of people crossing borders are still men.

Cross-border migration in East Asia Pacific is mostly economically motivated and still flows largely to high-income OECD countries. However, the wide disparities in wealth and earnings across low- and middle-income countries in East Asia Pacific attract migrants from within the region. As emerging economies in East Asia Pacific continue to grow rapidly, the movement of people across the region's borders is likely to increase. A conservative estimate is that 7 million cross-border migrants from East Asia Pacific countries are working within the region (World Bank 2013a).

High-income countries like the Republic of Korea and Singapore depend on foreign workers to fill labor shortage gaps. As these countries and the region's upper-middle-income countries age, labor shortages will grow. Labor and skills gaps, discussed in the previous chapter, will also be a persistent product of rapid growth and provide further incentive for people from lower-income countries to emigrate for work. In Malaysia and Thailand, the local labor force is largely skilled, but the economy still requires low-skilled workers to work in the growing labor-intensive segments of the manufacturing sector (namely, electronics, textiles, nonmetallic, and mineral industries). Conversely, in Indonesia and Lao PDR, gaps at the higher skill level compel domestic and foreign companies to recruit professionals and managers from Thailand and Vietnam.

Economic opportunities and large prospective earnings differentials are a product of East Asia Pacific's particular mix of economic integration, high growth, and aging populations. The inflow of foreign workers to middle-income countries in the region is no longer considered a temporary phenomenon. The ASEAN regional block provides a case in point: economic integration has led to increased interest in the movement of human capital across borders. To that end, the ASEAN Economic Community has set the mobility of skilled workers as a goal for 2015. The rising volume of movement across borders has compelled many East Asia Pacific countries to establish well-defined regulations on immigration. Recent liberalization of the movement of labor across borders takes the form of bilateral labor agreements.

Destination countries like Malaysia, Singapore, and to an extent Thailand have had to design comprehensive labor migration management systems aligned with their long-term economic goals. In Malaysia, unemployment affects mainly youth, especially unskilled youth. For this reason, Malaysia currently limits (or makes more costly) the inflow of low-skilled immigrants. But like many other countries around the world, Malaysia faces shortages of skilled workers, so it also has initiatives to attract well-educated foreigners. Several features of immigration policy from high-income countries in East Asia Pacific are influencing the new policies of middle-income destination countries like Malaysia and Thailand. For instance, Australia uses a quota system that is publicly announced every year as part of the federal budget process. The objective is to limit the number of visas issued for permanent residency, while keeping the system highly responsive to economic conditions and the needs of employers.

Interventions

Labor market interventions—"active" labor market programs like training and job search assistance and "passive" unemployment benefits and other forms of social insurance—are relatively rare in East Asia Pacific countries (table 6.1). Spending on social protection programs tends to be concentrated on social insurance and then mainly on retirement pensions (ADB 2013). The mandate to contribute to finance these interventions can be perceived as a tax on employers or on workers who would otherwise save less or who do not consider the promise of social insurance benefits to be credible. The expected impact of this tax on the incentives to hire or informalize labor is relatively straightforward: all else equal, a higher tax wedge should lower employment or increase the extent of informal employment. But the expected impact of active and passive labor market programs is more ambiguous.

By their intended purpose, active programs that improve workers' human capital or eliminate some of the information asymmetries that delay and frustrate "matching" in the labor market should lower the extent of unemployment. Active programs might also lower the search and training costs of firms and so indirectly subsidize employment creation. Passive programs, like unemployment benefits, can remove the urgency of finding new work and improve the quality of matches. However, the effectiveness of active programs is checkered at best, and if unemployment benefits are overly generous or poorly designed, they can perversely

TABLE 6.1 Employment interventions are still rare in East Asia Pacific

Average annual expenditure (US$ purchasing power parity), not including administrative costs, unless otherwise noted

Region	Unemployment benefits and active labor programs	Public works	All social insurance	All social protection	Ratio of employment interventions to social insurance (%)	Ratio of employment interventions to all social protection (%)
East Asia Pacific[a]	0.7	16.6	16,862.3	21,390.7	0.1	0.1
Europe and Central Asia	4,211.4	—	145,732.0	173,506.0	2.9	2.4
Latin America and the Caribbean	—	24.7	241,520.0	270,627.0	0.0	0.0
Middle East and North Africa	—	29.1	448.7	622.7	6.5	4.7
South Asia	—	—	3,117.6	5,003.5	0.0	0.0
Sub-Saharan Africa	—	7.1	1,799.2	3,216.4	0.4	0.2

Sources: World Bank 2013c.
Note: — = not available in a uniform way.
a. Numbers are not likely to capture recent increases in spending as part of stimulus programs.

lower peoples' motivation to look for and accept employment.

"Passive" programs

Social insurance plans to cover labor market risks are relatively rare in East Asia Pacific countries. In middle- and upper-middle-income countries of Europe and Central Asia and Latin America, they are a prominent tool in the state's social protection arsenal. Unemployment benefits protect individuals against the risks to their consumption from job loss for a period of job search. Only three of the countries reviewed for this report—China, Thailand, and Vietnam—have introduced unemployment insurance schemes. China, for instance, introduced an unemployment insurance program in 1986 following the start of economic reform, while Thailand and Vietnam introduced unemployment programs in 2004 and 2009, respectively.

Table 6.2 describes the level and duration of unemployment benefits for China, Thailand, and Vietnam and the conditions required to qualify for benefits. Unemployment insurance benefits in Thailand and Vietnam are as generous as they are in many high-income countries. The benefit levels or replacement rates (the portion of previous income replaced by insurance benefits) are similar (40–75 percent) to those in OECD countries. In Vietnam, the monthly benefit is equivalent to 60 percent of the average earnings in the six months before unemployment. In Thailand, the benefit level depends on the reason for becoming unemployed. If unemployment is involuntary, the laid-off worker receives 50 percent of his or her previous daily wage (average daily wage in the highest paid three months during the nine months before unemployment). Unlike other countries, in China the program has a flat benefit level set by the local authorities, which should be higher than the local public assistance benefit, but lower than the local minimum wage.

In China and Vietnam, the duration of benefits varies according to the worker's years of contributions. In China, a worker who contributed for less than 5 years may receive benefits for up to 12 months, a worker who contributed for 5 to 10 years may receive benefits for up to 18 months, and a person who contributed for more than 10 years may receive benefits for up to 24 months. In Vietnam, the duration of benefits ranges from 3 months for a worker who contributed for 12–36 months to 12 months for a worker who contributed for 144 months.

TABLE 6.2 Unemployment insurance is still rare in East Asia Pacific countries

Main features of unemployment insurance in Thailand, China, and Vietnam

Country	Average unemployment benefit	Unemployment insurance benefit duration (months)	Qualifying conditions
Thailand	50 percent of the average daily wage in the highest paid 3 months during the 9 months before unemployment; the maximum daily benefit is B 250	6 months in any 1 year	6-month contribution within 15 months before unemployment
China	Flat benefit level set by the local authorities; higher than the local public assistance benefit, but lower than the local minimum wage	12–24 months, depending on applicant's years of contribution	Maximum of 1 year with less than 5 years of contributions; maximum of 1.5 years with 5 or more but less than 10 years of contributions; maximum of 2 years with 10 or more years of contributions
Vietnam	60 percent of the average monthly earnings in the 6 months before unemployment	3–12 months, varying by contribution	3 months with 12–35 months of contributions; 6 months with 36–71 months of contributions; 9 months with 72–143 months of contributions; 12 months with 144 months of contributions or more

"Active" programs

Labor-intensive public works and other "active" labor market programs—targeted training programs (covered in the previous chapter), wage subsidies, and employment search assistance—are also rare in low- and middle-income East Asia Pacific countries, when compared to their prevalence in Latin America and especially in Europe and Central Asia, where they are the mainstay of formal social protection policy.

Prior to the East Asian crisis of 1997–98, labor market programs only existed in the high-income countries of the region. In the wake of that crisis, governments rapidly deployed a broad arsenal of programs, with varying degrees of effectiveness. Low levels of registered and verifiable job losses, generally incomplete and poor-quality administrative data, and the rush to mobilize limited the ability of governments to target active programs effectively. Benefits were set at high levels relative to average wages and the lost earnings of the neediest households, which hindered the self-targeting features of public works (Betcherman and Islam 2001). Nevertheless, the experience of responding to extensive unemployment in the wake of the East Asian crisis left governments in the region a lot wiser.

Building on their experience in the late 1990s, some countries in East Asia Pacific are using active labor market policies as part of their permanent arsenal of interventions to help households to mitigate employment risks. This stood governments in good stead during the global financial crisis of 2009–10. In response to the crisis, Malaysia was quick to provide subsidized training and monetary incentives for employers to encourage worker retention and rehiring of retrenched workers. Thailand devoted significant stimulus funds to an intensive vocational training program that aimed to train 500,000 unemployed, soon to be unemployed, and new graduates during 2009–10, providing one month of training and three-month cash allowances to help individuals to find employment or start a business. To address the problem of unemployed urban workers, Cambodia implemented a cash-for-training program that provides vocational training in agriculture, industry, and mechanics. Lao PDR experimented with food-for-training, with a particular focus on women. Again, as in the case of unemployment insurance, the overall effectiveness of active labor market policies in reaching poor and otherwise vulnerable people has been limited, since many of these programs are only able to reach people who have lost registered forms of work (World Bank 2012a).

Labor-intensive public works programs, however, do not have the same design limitations. Public works programs can be effective at reaching people who have lost work or whose small businesses have gone under even if work was unregistered and informal. Public works programs are a preferred instrument in countries where most employment cannot be verified legally or where employment information systems are poor or have only partial coverage of the workforce. This is mainly because of their self-targeting features, specifically a cash (or in-kind) "stipend" amount set at low levels with respect to market wages for low-skilled labor, a full-time work requirement, and relatively difficult work (see box 6.2).

In general, public works programs have played a smaller role in the nascent social protection systems in East Asia Pacific countries than in other developing-country regions. In East Asia Pacific, public works programs have taken the form of cash- and food-for-work schemes, as in Cambodia and Lao PDR. In other countries, they are offered in a traditional manner similar to that of India's National Rural Employment Guarantee or Argentina's Jefes y Jefas de Hogar. In China, the government has encouraged the use of public works and public works community systems as a means of providing retrenched workers with employment opportunities. According to the All-China Women's Federation, around 40 percent of laid-off women, who accounted for more than half of the country's unemployed in 2002, found

BOX 6.2 Can public works act as social insurance for informal workers?

The risk of losses from unemployment is generally not considered "insurable" by markets since it can be highly systemic—that is, when unemployment strikes, say in a crisis or recession, a large number of individuals in the risk pool are affected. Since there are typically not enough "winners" to compensate "losers" from the employment shock, it becomes too expensive for insurers to cover losses. However, protecting household earnings is important, both for social as well as for efficiency reasons: earnings protection can help households to cope in the wake of a shock to income, but also help to improve the matching of employment with those seeking work by removing an element of urgency from their search. For this reason, governments help to correct this market failure by providing or mandating earnings insurance instruments, including risk pooling at the firm level in the form of severance programs or at the individual level in the form of pay-as-you-go systems of unemployment insurance and even systems based on individual savings accounts underpinned by minimum benefit guarantees.

However, in economies where large segments of the labor force are self-employed or work informally, providing earnings insurance through any of these traditional devices is institutionally difficult and can even lead to regressive subsidies to relatively well-off "formal" workers. What is more, financing social insurance structures from payroll contributions draws a sharp distinction between the protection enjoyed by workers with a legal contract and that of those without, including the self-employed. This distinction can create segmentation and obstacles to labor mobility.

To surmount these problems and protect earnings, governments in many middle- and lower-income countries offer labor-intensive public works or "cash-for-work" programs (Subbarao 1997). These programs featured prominently in the government responses to the sharp rise in unemployment in upper-middle income Central European countries in 2009 and 2010 (Azam, Ferre, and Ajwad 2012). Since public works programs are financed directly from general revenues and typically do not discriminate according to the type of employment individuals have lost (that is, whether registered employment, informal jobs, or self-employment), these structures can function as a social insurance instrument (that is, a public risk-pooling intervention). Indeed, if correctly structured, they can be the form of social insurance that is most likely to reach workers who lose employment in the informal sector or the self-employed whose businesses fail in a downturn (Ravallion and Galasso 2004).

The program wage or stipend is the critical parameter that directly determines whether public works programs succeed as earnings insurance for informal workers. Setting the program wage correctly is critical to ensuring that protection reaches those who need it most, is readily available in an economic downturn, and does not introduce damaging distortions when labor markets recover.

The most effective way to ensure that public works programs provide reliable and sustainable earnings protection to households that are at greatest risk is to pay program wages below the statutory minimum wage and ensure that the work is relatively undesirable to the individual. However, many governments make the mistake of setting program wages at the minimum wage level, well above the market-clearing wage for unskilled manual labor. Offering above-market wages imposes three separate economic costs. They attract more workers to public programs than really need assistance, pay workers more than they would otherwise accept, and crowd out private employment. As many governments have discovered, if public employment programs offer (or subsidize) above-market wages, the fiscal costs of these programs can rise unless protection is rationed. But this places government in the uncomfortable position of working through quantities rather than through prices and hinders the program's ability to protect households. Where governments pay statutory minimum wages, they are forced to ration the number of hours and work days offered to contain costs. In effect, this forgoes self-targeting forms of earnings protection for relatively expensive (in terms of above-market wage costs) forms of income assistance with limited coverage that is vulnerable to rent seeking (Subbarao et al. 2013).

employment in community positions in their neighborhoods.

In several countries in East Asia Pacific that have experienced violence and remain fragile ostensibly due to high rates of youth unemployment and inactivity, governments have deployed labor-intensive public works to restore stability and put young people on a path to employability through training and apprenticeships. Such is the case in Papua New Guinea, the Solomon Islands, and Timor-Leste. In the Solomon Islands, the Rapid Employment Program has been credited with helping to bring stability to Honiara after troubles threatened to pull the country apart. As the Solomon Islands moves from stabilization back to the path of development, the program is expected to keep helping young people to gain skills and find work.

Labor tax wedges

Interventions are, by design, financed mainly by mandatory contributions from employers and workers. We have discussed the relative scarcity of unemployment insurance and active labor market programs in East Asia Pacific countries (World Bank 2012a; ADB 2013). Yet the mandatory contributions paid by formal workers and employers are substantial. This would appear incongruent but for the provisions that many governments in the region have made to allow contributing workers to access their mandatory retirement savings in the event of a household shock, such as loss of work. Indeed, these provisions have acted as financial self-insurance for many people—albeit still only the minority of people in registered, formal work—in lieu of explicit arrangements to mitigate the risk of unemployment (Betcherman and Islam 2001).

If workers and employers assign little value to these interventions, the mandate to contribute creates a "tax wedge" between the cost of labor to a firm and the take-home pay of employees. The size of this wedge can influence both the demand for and supply of labor. The impact on incentives is greater where government has a poor track record of performance and, whether because of inflation or corruption, few workers believe they will ever benefit from these interventions. If the tax wedge is large and net wages are too low, workers may be discouraged from participating in the regulated part of the labor market, finding outside options—unemployment or unregistered, informal work—more attractive. Similarly, because taxes increase the costs of employing someone, they can discourage employers from hiring.

The tax wedge on labor provides a measure of the extent to which the social protection and tax systems can discourage employment. It is calculated as the difference between the salary costs of a worker to the employer and the amount of net income that workers receive ("take-home pay"), expressed as a percentage of the total labor cost. These estimates differ considerably from the statutory tax rates on income discussed in chapter 4. This is because the tax wedge is calculated taking into account the circumstances of a representative worker, including what the labor code requires them to pay in mandatory contributions for employment programs and social insurance.[15]

Figure 6.4 presents the tax wedge for selected East Asia Pacific and OECD countries. The tax wedge is significantly lower in the East Asian (averaging 23 percent) than in the OECD (37 percent) and the European Union (41 percent) countries. Countries differ greatly in the overall labor taxes, ranging from a low of 8.2 percent in Cambodia to a high of 36.8 percent in Malaysia. Between 2002 and 2010, the average tax wedge for the region[16] increased 4 percentage points, rising in all countries except China, where it decreased 1.2 percentage points.

Cambodia, Indonesia, and Thailand have the lowest tax wedges among the East Asia Pacific countries reviewed. The smaller tax wedge in Cambodia reflects the absence of a statutory social security tax, something that will change soon.[17] In Indonesia and Thailand, the smaller tax wedges reflect the fact that workers earning average wages are exempted from paying taxes.[18] Malaysia has the highest tax wedge—above 35 percent—which is

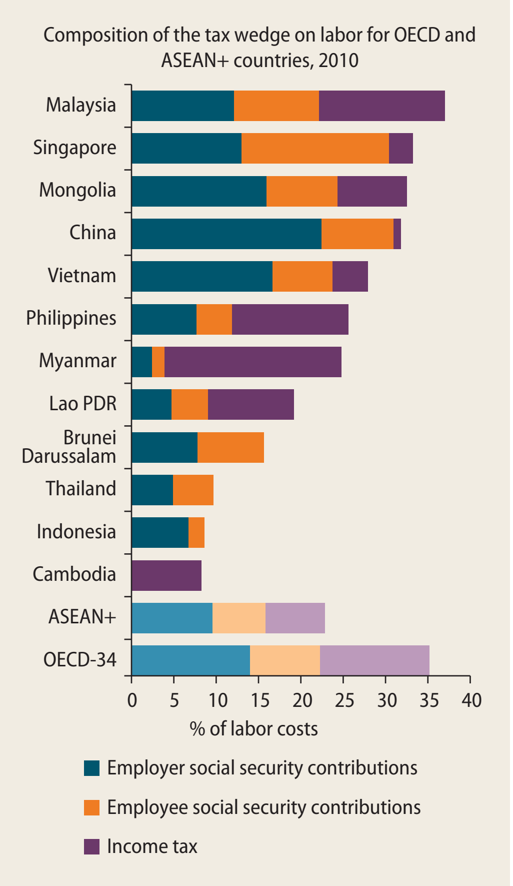
FIGURE 6.4 The highest labor tax wedge is in Malaysia, and the lowest is in Cambodia

Sources: Estimates for Association of Southeast Asian Nations (ASEAN), China, and Mongolia are derived using countries' tax regulations; KPMG 2012; OECD 2012.
Note: Unweighted average for ASEAN+ and OECD.

similar to the levels observed for Luxembourg and Norway. Malaysia has a relatively higher level of taxation on personal income for workers earning the average wage (16 percent of the average gross salary) as well as high mandatory contributions to social security (22 percent of the average gross salary).

Social insurance contributions account for the largest portion of the tax wedge in East Asia Pacific countries (figure 6.5). In most countries, employers pay the majority of these contributions (with notable exceptions). China imposes the highest social insurance contributions among the countries reviewed; it represents 22 percent of the total labor cost for a worker (or 29 percent of the gross salary).

FIGURE 6.5 The largest portion of the tax wedge is employers' contributions to social insurance



Source: Estimates for Association of Southeast Asian Nations (ASEAN), China, and Mongolia are derived using countries' tax regulations; KPMG 2012; OECD 2012.

Singapore, in contrast, imposes most of the tax burden for social insurance on workers, who contribute 17 percent of the total labor cost for social insurance, while employers pay only 13 percent. At the margin, and all else equal, a larger share of contributions paid by workers should more closely link eventual benefits and contributions, lowering the pure tax element of the wedge between labor taxes and take-home pay. The extent to which the statutory allocation of mandatory contributions between employers or workers actually matters will vary greatly, but will depend primarily on how workers value the benefits that these contributions finance.

Institutions: Organized labor in East Asia Pacific

Although it is impossible to isolate institutions that have an impact on the labor market from those that shape other social and economic interactions, one in particular is directly relevant to the discussion in this chapter: collective bargaining and organized labor. As with labor policies generally and regulation specifically, the advent of organized labor and collective bargaining came later to countries in East Asia Pacific than to countries in other regions (table 6.3). A large body of historical, sociological, and political science literature has been written in which various hypotheses for this late advent are put forward and debated.

Some writers contend that the relatively greater importance of hierarchy and fealty in East Asian societies has prevented the adversarial model of organized labor and collective bargaining from taking hold. But this explanation is disputed with examples of labor unions gaining membership and influence in similarly hierarchical and familial cultures in Latin America and Central Europe (Minns and Tierney 2003).[19] Some historians and political scientists claim that longer periods of authoritarian government and political repression in East Asia Pacific are a more plausible explanation for weaker labor unions. And while countries in Latin America and Central Europe also experienced periods of authoritarian rule, these often followed significant periods of pluralist democracy in which organized labor gained a secure footing, from which it often played a key part in overthrowing dictatorships. In contrast, pluralist democracy is a relatively new phenomenon in East Asia Pacific.

In the East Asia Pacific countries with longer histories of democracy, the politicization of labor movements is blamed for their weakness. Links between trade unions and political parties, which often formed out of a liberation struggle and fight against dictatorship in several East Asia Pacific countries, detracted from their mandate of representing the rights of workers. This led to trade union leadership that is government selected, conservative, and dynastic (Traub-Merz 2002). Indeed, the politicization and co-option of unions by authorities in several East Asia Pacific countries is often offered as an explanation for their weakness. Some argue that Chinese labor unions are carrying out the conflicting functions of protecting workers' rights, on the one hand, and acting as "a transmission belt" between the party and the working masses, on the other (Cooney 2011).

Alternative explanations tie the later rise and relative weakness of organized labor to a much later urbanization and industrialization in most of East Asia Pacific countries compared to countries in Latin America and Central Europe. In mainly rural agrarian economies, the labor force is still living in relatively disbursed settlements, engaged in subsistence or small-scale commercial agriculture. In these settings it is more difficult to distinguish who is a worker or a tenant and who is an employer or a landowner. But even where these lines are clearly drawn, the transaction costs of organizing and coordinating are much greater for working people in rural areas than for working people in towns and cities.

The more compelling explanations for relatively weaker labor unions in East Asia Pacific countries take account of the form in which industrialization has taken place, while acknowledging all of the explanations summarized above. The structural transformation

TABLE 6.3 Unions came late to East Asia Pacific

Ratification year of the ILO Freedom of Association and Protection of the Right to Organize Convention (C 87) and Right to Organize and Collective Bargaining Convention (C 98)

East Asia Pacific			Latin America and the Caribbean			Europe and Central Asia		
Economy	**C 87**	**C 98**	**Country**	**C 87**	**C 98**	**Country**	**C 87**	**C 98**
Australia	1973	1973	Argentina	1960	1956	Albania	1957	1957
Brunei Darussalam	—	—	Belize	1983	1983	Armenia	2006	2003
Cambodia	1999	1999	Brazil	—	1952	Azerbaijan	1992	1992
China	—	—	Chile	1999	1999	Belarus	1956	1956
Fiji	2002	1974	Colombia	1976	1976	Bosnia and Herzegovina	1993	1993
Indonesia	1998	1957	Costa Rica	1960	1960	Bulgaria	1959	1959
Japan	1965	1953	Dominican Republic	1956	1953	Croatia	1991	1991
Kiribati	2000	2000	Ecuador	1967	1959	Czech Republic	1993	1993
Korea, Rep.	—	—	El Salvador	2006	2006	Estonia	1994	1994
Lao PDR	—	—	Guatemala	1952	1952	Georgia	1999	1993
Malaysia	—	1961	Guyana	1967	1966	Hungary	1957	1957
Marshall Islands	—	—	Honduras	1956	1956	Kazakhstan	2000	2001
Mongolia	1969	1969	Mexico	1950	—	Kyrgyz Republic	1992	1992
Myanmar	1955	—	Nicaragua	1967	1967	Latvia	1992	1992
New Zealand	—	2003	Panama	1958	1966	Lithuania	1994	1994
Palau	—	—	Paraguay	1962	1966	Moldova	1996	1996
Papua New Guinea	2000	1976	Peru	1960	1964	Montenegro	2006	2006
Philippines	1953	1953	Suriname	1976	1996	Poland	1957	1957
Samoa	2008	2008	Uruguay	1954	1954	Romania	1957	1958
Singapore	—	1965	Venezuela, RB	1982	1968	Russian Federation	1956	1956
Solomon Islands	2012	2012				Serbia	2000	2000
Thailand	—	—				Slovak Republic	1993	1993
Timor-Leste	2009	2009				Slovenia	1992	1992
Tuvalu	—	—				Tajikistan	1993	1993
Vanuatu	2006	2006				Macedonia, FYR	1991	1991
Vietnam	—	—				Turkey	1993	1952
						Ukraine	1956	1956
						Uzbekistan	—	1992

Source: Data derived from ILO (http://www.ilo.org/dyn/normlex/en/f?p=1000:10011:0::NO:10011:P10011_DISPLAY_BY,P10011_CONVENTION_TYPE_CODE:3,F).
Note: — = not a signatory. ILO = International Labour Organization. Historically, it can be very difficult at a national level to identify specific years in which labor unions were first established and gained momentum. From a legal perspective, it is easier to find the year in which countries ratified the ILO Freedom of Association and Protection of the Right to Organize Convention from 1948 (C 87) and the ILO Right to Organize and Collective Bargaining Convention from 1949 (C 98). In theory, ratifying these conventions allows labor unions the legal right to form, bargain, and exercise voice. Some East Asia Pacific countries have not yet adopted either of these conventions, including China and Vietnam, where "wild cat" labor union strikes are a growing phenomenon. Generally, countries in East Asia adopted them in the 1990s and 2000s, while countries in Latin America adopted them in the 1950s and 1960s. Thus the legal space for labor to organize was granted significantly later in East Asia Pacific countries than in countries in Latin America. The restrictions of Soviet communism confound further extrapolation to Eastern Europe and Central Asia.

in most East Asia Pacific countries shifted employment out of agriculture and into light industry for export-led growth (Deyo 1989). Growing light-industry factories attracted low-skilled, low-wage workers with few advancement opportunities, little employment security, high turnover, and hence low commitment to firms, places of work, and unions. In the Latin American countries, import-substituting industrialization encouraged heavier industries requiring a relatively skilled workforce. A relatively higher-skilled workforce had more incentives to organize and negotiate protection and higher returns on their relatively greater investments in human capital. This theory also helps to explain the contrasting experience of Korea, where the growth of heavy industry was accompanied by much stronger labor unions than in other East Asia Pacific countries.

The extent of unionization (union density) in the economies of East Asia Pacific today is lower than in other parts of the world (table 6.4). But it is difficult to draw a general profile. The Philippines, which is culturally and institutionally similar to Latin America, has rates of unionization similar to Argentina. However, more workers are members of unions in Taiwan, China, than in any countries in the Southern Cone of Latin America (table 6.5). As in other regions, membership in trade unions has been declining (figure 6.6). China is a notable exception to this trend (figure 6.7).

TABLE 6.4 Unionization is lower in most East Asia Pacific economies than in other regions

Union density (union members as a % of the labor force) in selected countries of East Asia, Latin America, and European Central Asia

East Asia Pacific			Latin America and the Caribbean			Europe and Central Asia		
Economy	Union density	Year	Country	Union density	Year	Country	Union density	Year
Australia	20	2006	Argentina	28.9	2002	Albania	20	2006
China	90.3	2000	Bolivia	25	2006	Bulgaria	16	2001
Hong Kong SAR, China	22.1	2002	Brazil	18.1	2002	Czech Republic	14	2004
Indonesia	14	2005	Chile	12	2001	Estonia	11	2005
Japan	18.7	2005	Costa Rica	15	2002	Georgia	80	2005
Korea, Rep.	10.3	2005	Ecuador	12	2002	Hungary	17	2004
Malaysia	17.5	2000	El Salvador	5.3	2003	Kazakhstan	31	2002
New Zealand	21.1	2004	Honduras	14	2003	Latvia	16	2006
Philippines	26.8	2002	Mexico	13	2001	Lithuania	14	2006
Singapore	18.5	2006	Panama	11	2005	Macedonia, FYR	75	2006
Taiwan, China	38.3	2003	Peru	5	2002	Moldova	80	2005
Thailand	3.3	2006	Uruguay	15.9	2000	Poland	16	2006
						Romania	30	2005
						Russian Federation	45	2003
						Slovak Republic	30	2004
						Slovenia	45	2004
						Tajikistan	90	2006

Sources: Data derived from OECD 2010; Hall-Jones 2010; Johnson 2004.

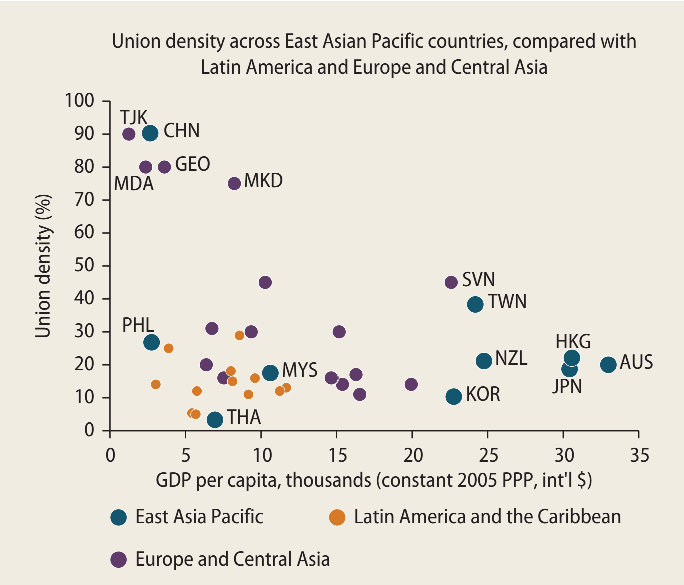
TABLE 6.5 Outside of China, the number of labor unions has also been declining

Trends in the number of trade unions in East Asia Pacific economies

	Earliest and latest year of data			
Economy	Time period	Earliest year	Latest year	% change over time
Australia	1980–95	325	142	–56
China	1980–2010	376,000	1,976,000	426
Hong Kong SAR, China	1989–2011	439	788	80
Japan	1980–2009	72,693	56,347	–23
Korea, Rep.	1980–2008	2,618	4,886	87
Malaysia	1980–2010	391	690	77
New Zealand	1992–2011	58	145	150
Singapore	1980–2010	83	65	–22
Taiwan, China	1987–2010	2,510	4,924	96

Source: Estimates based on data derived from ILO (http://laborsta.ilo.org/xls_data_E.html).
Note: The Philippines was omitted due to lack of comparability as a result of the new calculation methodology applied in the early 2000s.

FIGURE 6.6 Unionization in East Asia Pacific is low, accounting for the level of development



Sources: Estimates based on GDP per capita, derived from World Bank 2013c, combined with union density data derived from OECD 2010; Hall-Jones 2010; Johnson 2004.
Note: Union density is defined as the percent of union members among paid dependent employment. Data on union density are provided for the most recent year between 2000 and 2010, matching data on GDP per capita for the same year. Singapore was omitted because it is an outlier with GDP per capita of about US$48,000 in 2006.

A key factor that has sapped the strength of organized labor in many countries, particularly in East Asia Pacific, is the tendency of labor unions to be narrowly aligned with sectors where dependent, full-time work is the dominant form of engagement. The inclusion of groups that mobilize people in other forms of work—like India's Self Employed Women's Association and, globally, the Service Employees International Union—is still uncommon in the organized labor movements of most countries in East Asia Pacific.

The growth of organized labor in many East Asia Pacific nations is also significantly hindered by the reluctance of unions to recognize migrant workers and workers employed in services and in the "private" (domestic) sphere (Ford 2004). Labor unions around the world are facing a similar existential threat. People in self-employment, irregular employment, and migrant work, particularly working women, are often overlooked by organized labor as a significant source of grassroots mobilization. The bargains that labor unions strike for members can come at the cost of unrepresented workers. However, labor unions in high-income countries with large, fast-changing service sectors have begun to reach out enthusiastically to working people with more heterogeneous profiles. In East Asia Pacific, migrant labor organizations and associations sponsored by nongovernmental organizations in Indonesia and Hong Kong SAR, China, are a part of this trend and are providing a wider segment of working people with opportunities to engage in labor institutions (Ford 2004; see box 6.3).

The impact of labor policy on work and earnings

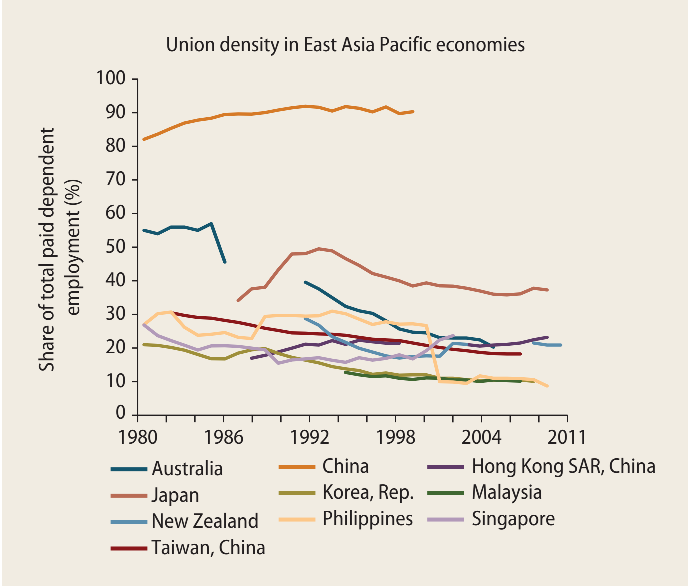
The textbook predictions of how regulations, like a minimum wage and restrictions on dismissals, create a wedge between the cost of labor and what people take home are well known and actively debated. A large literature has been produced applying the textbook models in countries where most people work beyond the reach of regulation and taxes in the informal economy (figure 6.8; Perry et al. 2007; Packard, Koettl, and Montenegro 2012). Tables 6A.4 through A6.6 in the annex to this chapter present simple conditional correlations between aggregate (country-level) measures of informal work and labor policies. These are interacted with measures of governance and administrative capacity. In East Asia Pacific, as in other regions, a mixed picture emerges from these simple correlations using aggregate data that sometimes challenge what the textbook theories predict.

"Segmentation" of the labor market can happen when a floor is imposed on wages—either from a legislated minimum wage or from the strength of labor institutions, such as a collective bargaining process and the power of labor unions in that process, that forces a wedge between the earnings of workers not covered by these arrangements and those that are. The traditional models predict that a minimum wage increases labor costs for firms and prevents them from offering formal employment to workers whose marginal productivity does not exceed the minimum. The effect will be stronger for workers with the lowest marginal productivity, especially younger, less experienced workers. "Priced out" of formal employment, they can join those genuinely unemployed, take informal employment, or seek formal work while working informally. Workers who remain formally employed—those with higher marginal labor productivity—benefit from higher earnings.

Elaborations in the literature, however, reveal more ambiguity about the effect of regulations and interventions. A minimum wage might motivate workers to increase productivity in the "efficient wages" framework (Rebitzer and Taylor 1995; Manning 1995) or persuade job seekers and some waiting outside the labor market to hold out for a formal job even if plenty of informal employment is on offer. To the extent that employers have to report to the tax authorities at least the portion of their wage bill equivalent to some multiple of the minimum wage, raising the minimum might in some circumstances force "formalization" at the margin of transactions and inputs to their production process.

There is even less agreement on the effects of employment protection legislation on outcomes. EPL can reduce flows into, but also out of, unemployment. EPL reduces turnover and increases average tenure. But it can also slow new employment if restrictions on dismissing workers make employers wary of taking on someone new. These restrictions increase the attraction of using fixed-term contracts; past a certain threshold they can cause employers to hire informally. For instance, in the face of waning demand, EPL will reduce layoffs, but if firms' ability to adjust has been too constrained, even when demand rises again, employers might pause knowing they could face high dismissal costs should demand drop again. While EPL can encourage employers to invest in training to make their workers more productive, it can

FIGURE 6.7 Other than in China, union membership has been declining in East Asia Pacific



Source: Data derived from ILO (http://laborsta.ilo.org/xls_data_E.html).
Note: The figure includes all years and all East Asia Pacific economies for which data on trade union membership are available. The drop in union membership in the Philippines in 2001 was due to multiple counting of membership (company workers being captured in the statistics of several competing unions) and the inclusion of inactive unions (inactive union names remaining on the registry list), which together inflate the country's statistics on unionism before 2001. After 2000, efforts were made to capture the real number of unions and union membership, for example, by distinguishing between active and inactive unions (Ofreneo and Hernandez 2011).

also slow productivity growth if it forces firms to keep unproductive workers. Employers that are unable to change their workforce to keep up with new technology or otherwise align it with changing needs could soon find themselves at a competitive disadvantage.[20]

The impact of interventions like unemployment benefits is also ambiguous. On the one hand, unemployment benefits improve the quality of matches between employers and workers. Workers who are covered by benefits are able to search for a new job with greater care, facilitating a more efficient job-matching process (Boeri and van Ours 2008). If the quality of matching between firms and workers improves, structural unemployment can fall. On the other hand, insurance benefits may give unemployed workers a reason to search with less effort and intent than they otherwise would have and to turn down available work. If the level of unemployment benefits is high or the maximum duration of

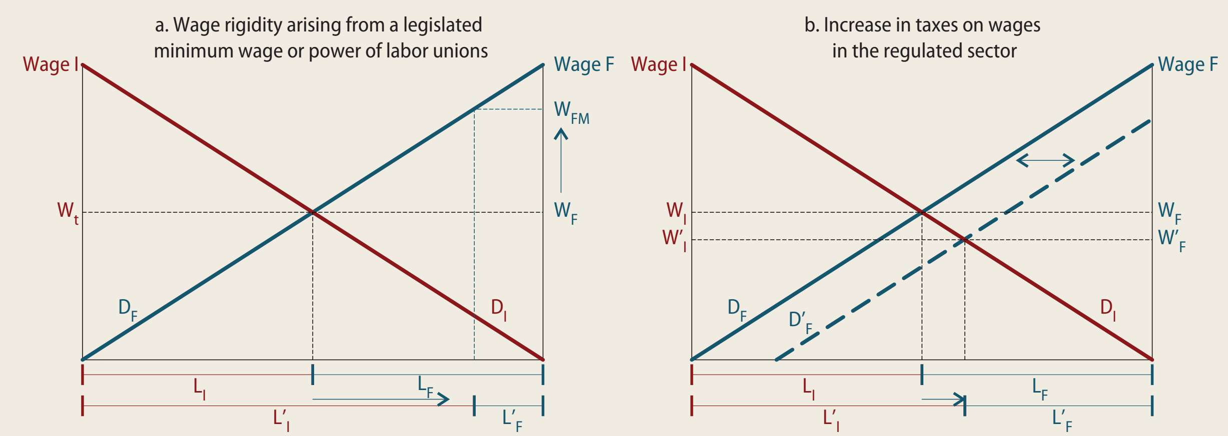
BOX 6.3 Do trade unions have a hand in monetary stability?

Central banks are not the sole administrators of inflation. Trade unions also influence price developments in the macroeconomy as their bargaining on wages is reflected in product prices and thus inflation in the goods market. While it is often assumed that labor unions are only concerned with employee benefits and employment levels, they may also favor low inflation, as high levels can undermine real wages. Even though central banks are concerned largely with reducing inflation, some monetary authorities have mandates to reduce inflation and promote employment, while others are not free to target inflation at the cost of other policy priorities. The competing interests and preferences for inflation and unemployment, among both trade unions and central banks, and their interplay can have important effects on employment levels.

Wage bargaining can have two potential effects on prices and employment (Coricelli, Cukierman, and Dalmazz 2006). The *relative price effect* works through goods substitution. Employers pass higher negotiated nominal wages on to consumers through product prices. This reduces demand for the product and for labor in the sector. Second, the *real balance effect* erodes the real money supply, thus impeding credit and economic growth. A central bank can avert an economic downturn through an accommodative monetary policy at the cost of higher inflation. It can also aggravate a downturn by tightening the money supply further to tackle inflation.

In conditions when unions are more concerned about unemployment than inflation, a conservative, independent central bank is welfare improving. The credible threat to tighten the money supply to keep inflation in check can discipline unions in their wage demands and thus stabilize inflation and employment. However, when unions care about inflation or internalize the cost of their wage demands on the economy (as is often the case in centralized bargaining systems), the central bank can be more accommodative. Yet most studies on these interconnected relationships are based largely on developed economies. While the degree of central bank independence differs largely across East Asia, unionization is generally low in the region. It is thus unclear to what extent central bank independence and unionization matter more for employment in East Asia.

FIGURE 6.8 The predicted impact of labor market policies from textbook models is well known



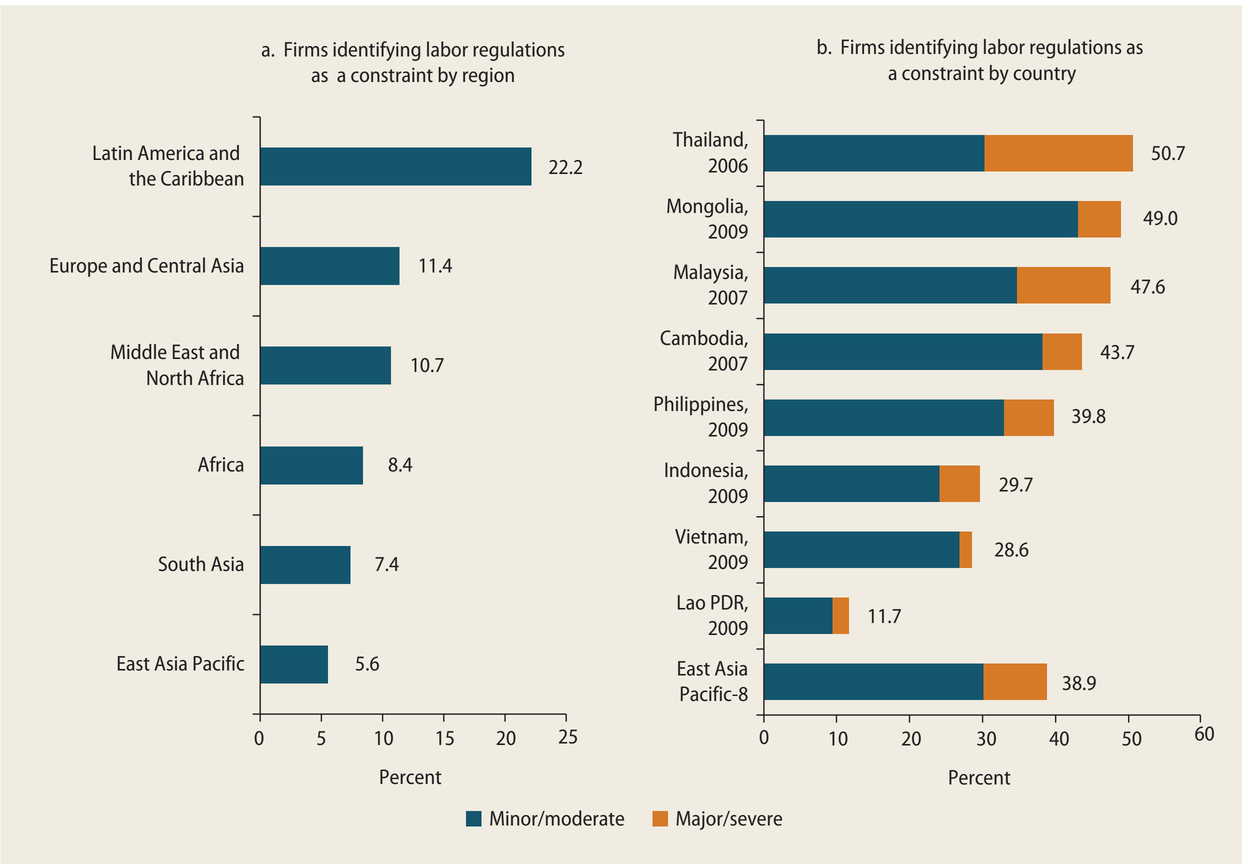
Source: Adapted from Perry et al. 2007.
Note: In panel a, a two-sector model, the size of the formal labor force is shown by L_F and the informal labor force is shown by L_I. Imposition of a minimum wage (or the power of unions representing formal workers) pushes the formal wage from W_F to W_{FM}, causing L_F to contract to L'_F and L_I to expand to L'_I. All else equal, similarly qualified workers would prefer employment in L'_F. In panel b, restrictions on dismissal or higher taxes on labor shift the demand curve for formal labor, causing L_F to contract to L'_F, and L_I to expand to L'_I.

benefits is long, the urgency of finding new work is diminished. This moral hazard can lower the intensity of job search and lengthen spells of unemployment (Mortensen 1977).

Most reviews of empirical evidence of the impact of labor market policies reflect these ambiguities in economic theory. Trying to identify the impact of any of these measures is made more difficult by obvious differences in what a country mandates and what firms and households practice. Despite what the labor code and social protection laws say, these are partially and poorly enforced in many low- and middle-income countries. Actual restrictions on the choices of firms and individuals are, in most cases, far less binding than what the laws intend. This may be one of the best explanations as to why employers in East Asia Pacific countries do not identify labor regulation, interventions, and institutions as binding constraints on their growth. As mentioned in chapter 4, countries in East Asia Pacific have the lowest share of firms reporting that regulations like minimum wages and other labor laws are a "major" or "severe" obstacle to their operation and growth. Employers in countries with very rigid regulations, such as Indonesia, Lao PDR, and Vietnam, are far less likely to identify labor regulation as a major or severe constraint to doing business (figure 6.9).[21]

High levels of unregulated work in East Asia Pacific—variously referred to as "informal" or "vulnerable," including

FIGURE 6.9 Firms in East Asia Pacific are less likely to report that labor regulations are a constraint on their growth, even where the labor code is restrictive

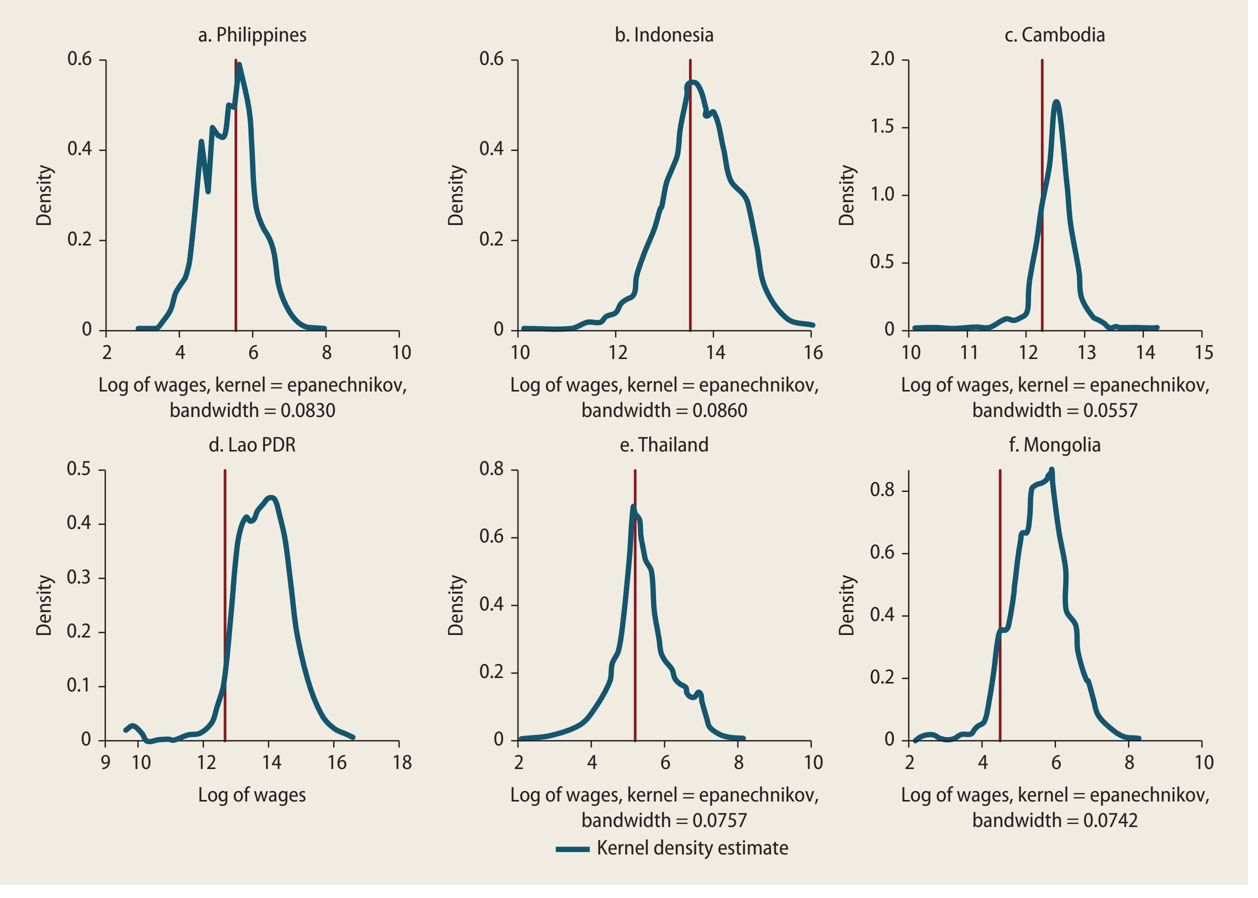


Source: World Bank investment climate surveys.
Note: East Asia Pacific-8 is the average of the eight East Asia Pacific countries.

self-employment, as discussed in spotlight 1—are likely to be both a result of regulations and interventions as well as a reason why restrictions in the labor code are not broadly observed in practice. In most low- and middle-income countries, including those of East Asia Pacific, limited compliance combines with low levels of enforcement capacity in government (Caraway 2008). And while economic theory may be ambiguous about the impact of regulation and interventions when they are perfectly applied, there is greater consensus that the effects of partial or poor enforcement will be negative (Betcherman 2012). In Cambodia, for instance, the law mandates that all workers in the garment sector must be paid at or above the minimum wage. However, the mean level of wage compliance at the firm level in the sector is only around 80 percent. Nearly 20 percent of workers in the apparel sector earn less than the minimum wage. Noncompliance rates in Indonesia and Thailand are estimated to be as high as 30 percent. Noncompliance in Vietnam is estimated at about 10 percent (World Bank 2013b).

So what does the available empirical evidence show? Figure 6.10 presents the

FIGURE 6.10 A large share of workers are earning less than the minimum wage



Source: World Bank 2013a.
Note: The red line corresponds to the minimum wage.

distribution of earnings in six East Asian countries. There is a clear clustering around the vertical national minimum wage line (taken as the average statutory minimum wage level) in three of the six countries. In Indonesia, the Philippines, and Thailand, a large share of working people are earning wages below the statutory minimum levels. About 51 percent of workers in the Philippines report making less than the minimum wage. In Indonesia and Thailand, around 36 and 37 percent of workers are earning less than the minimum wage, respectively. However, the steep slopes as the curves approach the minimum wage line (in the case of the Philippines, a sharp, horizontal rise) indicate that, for a significant portion of workers, the minimum wage is binding. The steeper the approach of the distribution curve to the minimum wage line, the more likely it is that increases in the minimum wage will lead to dismissals or the informalization of employment contracts for those earning close to the minimum.

Whether the introduction of—or an increase in—statutory minimum wages has a positive or a negative effect on earnings and productivity rests largely on whether workers with lower marginal labor productivity remain employed. If, after the introduction of or increase in minimum wages, these people can find or remain in work that pays the minimum, the impact is likely to be positive.[22] Figure 6.11 suggests only a weak relationship between higher minimum wages and employment. The reported correlations are not statistically significant, and there are too few observations and high dispersion in the data for proper inferences to be made. Yet the ambiguous picture is consistent with findings of more rigorous empirical studies from middle- and high-income countries around the world, indicating that, when statistically significant, the effects of minimum wages on aggregate employment are negative but only very modest (Betcherman 2012; World Bank 2013a). Where a positive impact on employment is found, it can usually be explained by stronger enforcement capacity or fewer options for employers to offer unregulated employment to workers with low marginal labor productivity.[23]

The evidence from research in East Asia Pacific where a large informal economy in most countries introduces greater discretion for firms and workers shows more significant negative effects, particularly on workers in smaller firms. Much of the rigorous empirical work is from Indonesia, where good data and relatively frequent changes and variation in how minimum wages are applied across the country offer opportunities to study the impact of this policy in detail. Alatas and Cameron (2008) study the effects of changes in the minimum wage in Indonesia between 1990 and 1996, prior to the East Asian crisis, on the employment of production workers in clothing, textiles, footwear, and leather firms in greater Jakarta. They find a negative employment impact on people working in small firms, but not on people working in large firms. Similarly, Harrison and Scorse (2010) find that a 10 percent increase in the real minimum wage in Indonesia reduces the employment of production workers by an average of 1.2 percent in foreign-owned, exporting firms in the textiles, footwear, and apparel sectors.[24] They also find evidence of reduced investment, falling profits, and a greater likelihood that smaller registered (formal) firms will go out of business. More recent analysis of the Indonesian manufacturing sector covering the period 1993 to 2006 also finds that minimum wage increases have a clear and consistently negative employment impact on small firms, but a limited impact on employment in large firms. However, since there are many more small firms, the aggregate effect of rising minimum wages in Indonesia's manufacturing sector is to lower formal employment (Del Carpio, Nguyen, and Wang 2012).[25]

In the Philippines, Del Carpio, Margolis, and Okamura (2013) find that increases in the real minimum wage had negligible effects on overall employment, owing to limited coverage of the regulation and high rates of noncompliance. However, in sectors of the Philippine economy with high coverage and compliance, Lanzona (2012) finds negative

FIGURE 6.11 The relationship between the level of minimum wages and employment is weak

Source: Estimates based on World Development Indicators and countries' labor codes.
Note: Employment rates are averages between 2008 and 2010.
*** p<0.01, ** p<0.05, * p<0.1

effects on employment. A 10 percent increase in the minimum wage in manufacturing reduces formal employment in the sector by up to 8 percent (World Bank 2013a). In Vietnam, where minimum wages are high relative to average wages, Del Carpio, Nguyen, and Wang (2013) find that an increase in the minimum wage causes a reduction in formal employment. Again in Indonesia, Comola and de Mello (2011) find that an increase in the relative minimum wage (minimum-to-mean wage ratio) is associated with an increase in informal employment, which, in turn, offsets the corresponding destruction of formal jobs and yields a net increase in total employment. Lower overall employment in the wake of a minimum wage increase is concentrated largely among labor-intensive firms with unskilled or less-skilled workers (Del Carpio, Nguyen, and Wang 2012).

Where administrative and enforcement capacity is stronger and compliance is more widespread, the introduction of a minimum wage could have positive effects on both formal employment and output. More workers would be willing to work at the higher wage, and employers would still make profits and be willing to hire. This was the case in Malaysia and Hong Kong SAR, China, prior to the introduction of minimum wage policies in 2010 and 2011–12 (World Bank 2009). Thus the extent of coverage and compliance with minimum wage policies is a critical determinant of their overall impact on employment and earnings. As discussed earlier, if a large proportion of workers are not subject to minimum wages—whether due to legal exemptions or low compliance—minimum wage adjustments will likely have limited impact on overall employment.

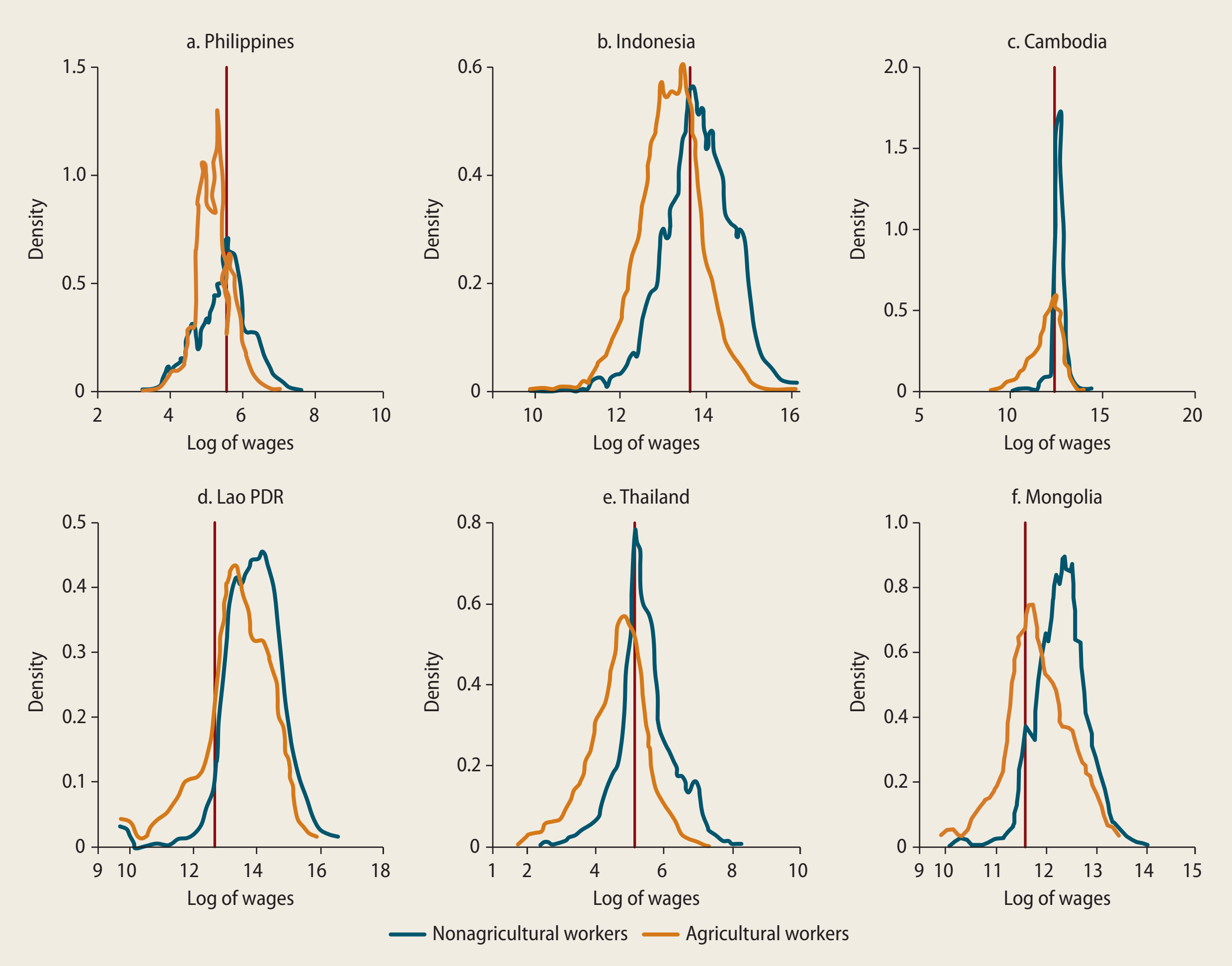
An additional complication in predicting the outcomes of a minimum wage policy arises where there is a greater degree of integration and higher mobility of factors between the formal and informal economy. In countries with very competitive factor markets, where the distinction between formal and informal is defined mainly by compliance with taxes and entitlements to social benefits but little else and where employers are competing to attract workers, a statutory minimum wage can inform the negotiation of informal labor contracts. A statutory minimum wage in these contexts can have a signaling or "lighthouse" effect (Neri, Gonzaga, and Camargo 2000). Set at levels reasonably related to workers' productivity, the minimum wage has an impact on the earnings distribution of all workers in dependent employment.[26] Looking again at the distribution of earnings around the statutory minimum wage, in figure 6.12, the reported earnings of agricultural workers are added separately as a proxy for informal dependent labor. Unfortunately, no better variable for identifying informal wage employees is available in these labor market surveys. The earnings of agricultural workers appear to be affected by the statutory minimum wage, as indicated by the clustering of reported earnings around the vertical line. This is true even in countries where statutory minimum wages are limited to contracts in certain sectors, like Cambodia, where the minimum wage policy informs only contracts in the garment sector.

Although the impact of minimum wages on overall employment can vary widely, the negative impact on employment—in the form of higher unemployment among women and younger workers—is found more consistently across countries. Rising minimum wages in Indonesia disproportionally lower the employment opportunities of women with low skills, younger workers, and recent entrants to the labor market (Del Carpio, Nguyen, and Wang 2012). In several countries in East Asia Pacific, women generally bear a higher burden of employment losses than men. In Thailand, increases in the minimum wage level have had an adverse impact on the employment of women, low-skilled workers, and elderly workers (Del Carpio, Messina, and Sanz-de-Galdeano 2013). In Vietnam, men are more likely to earn higher wages than women and are less likely to be working for less than the minimum wage. Women are more likely to be earning at levels close to (below and above) the minimum wage level. This makes working women in Vietnam more vulnerable than men to changes in the minimum wage level (Nguyen, Nguyen, and Wang 2013).[27]

The gender impacts of minimum wages can also differ by type of worker, as illustrated again by research from Indonesia. For people in nonproduction employment—that is, those not directly involved in the firm's production, such as cleaners, guards, and caterers—a rise in the minimum wage disproportionately hurts women. A 10 percent increase in the minimum wage leads to a 0.6 to 0.7 percent decline in the employment of women nonproduction workers in small firms (Del Carpio, Nguyen, and Wang 2013).

Turning to other labor regulations, a review of evidence from around the world indicates that employment protection has only a modest effect, lowering employment, raising unemployment, and motivating people to work informally (Betcherman 2012; Nickell 1997; Boeri and van Ours 2008; Sanchez 2010). However, like the impact of minimum wage regulation in East Asia Pacific countries, employment protection measures have a consistently negative impact

FIGURE 6.12 Minimum wages can have an impact on earnings, even for informal workers



Source: Estimates based on labor market survey microdata in the International Income Distribution Database (I2D2) of the World Bank.
Note: The red line corresponds to the minimum wage.

on young people and women. Indeed, in the countries for which empirical work has been cited in this chapter, it is difficult to separate the impact of employment protection from that of the minimum wage. But whereas the prejudicial impact of minimum wages may be determined more by poor or partial enforcement, even where perfectly enforced, employment protection measures are biased against younger people and those who might prefer or require part-time employment (Heckman and Pages 2004). Poor or partial enforcement of EPL is likely to aggravate these biases.

Restrictive employment protection regulations are often associated with lower employment of young workers, women, new entrants to the labor market, and unskilled workers (OECD 2004; Heckman and Pages 2004; Perry et al. 2007; Packard, Koettl, and Montenegro 2012). These groups tend to be among the first to be laid off when labor costs rise or to be blocked from entry altogether

(Lustig and McLeod 1996). In figure 6.13, the correlations between EPL and unemployment become much stronger and statistically significant for women and young people. And there is clearer evidence of EPL creating segmentation, possibly forcing men and women into self-employment in East Asia Pacific countries. If self-employment is used as a proxy for informal work, this finding could indicate that when employers are faced with higher potential costs, they hire fewer workers formally and, as a result, many

FIGURE 6.13 In East Asia Pacific countries, restrictive employment protection is associated with higher unemployment among women and youth

Source: World Development Indicators and countries' labor codes. Employment protection legislation (EPL) estimates for the Organisation for Economic Co-operation and Development (OECD) are the latest available on www.oecd.org.
Note: Unemployment rates are averages between 2008 and 2010.
** p<0.05

workers, typically those with lower skills, are forced to work informally (figure 6.14). In other words, employment protection regulation potentially encourages firms to shift workers from formal to informal contracts when labor costs are too high and enforcement of regulations is weak. More rigorous evidence from countries around the world is consistent: more restrictive EPL raises the share of self-employment and decreases

FIGURE 6.14 In East Asia Pacific countries, restrictive employment protection is associated with higher self-employment, particularly among working women

Source: Estimates using World Development Indicators and countries' labor codes.
Note: Self-employment rates are averages between 2008 and 2010.
** $p<0.05$

dependent employment in low- and middle-income countries.[28]

Finally, turning to interventions, most empirical work focuses on the impact of the labor tax wedge on outcomes, since this is a composite (though incomplete) measure of the costs of interventions to employers and workers. Interventions are financed by governments either through earmarked revenues from mandatory contributions or through general taxation. In most countries, firms and workers are expected to bear some, if not all, of the costs of interventions. The labor code can be explicit about what share of mandatory contributions is borne by employers and what share by workers, but in practice, which party bears the actual costs is determined mostly by the value that workers attach to benefit promises. This is a critical dimension to consider and one that is even more contingent on the state's credibility and track record of performance. If workers value the benefits of interventions like unemployment insurance, disability protection, and pensions and believe that benefits will be available when they are needed, they are more likely to consider mandatory contributions as part of their compensation package rather than as a tax. The opposite also holds. This reconciles the apparent paradox of high labor tax wedges and enviable labor market outcomes in Northern Europe, with those in Southern and Central Europe where labor taxes are often lower, but employment outcomes are particularly poor (Packard, Koettl, and Montenegro 2012; World Bank 2012a).

In East Asia Pacific countries, a higher labor tax wedge is associated with higher unemployment rates as well as lower employment rates (figures 6.15 and 6.16). The negative and significant correlation between the size of the labor tax wedge and employment remains when considering only women and youth, but, in contrast to labor regulations, it appears weaker. With respect to unemployment, however, there is a stronger association between the size of the labor tax wedge and higher unemployment among women and youth. In China, with by far the largest labor market in the region, passage of the 2008 Labor Contract Law to expand coverage of social insurance financed from payroll taxes led to a lower probability that certain workers were covered (Giles, Wang, and Park 2013).

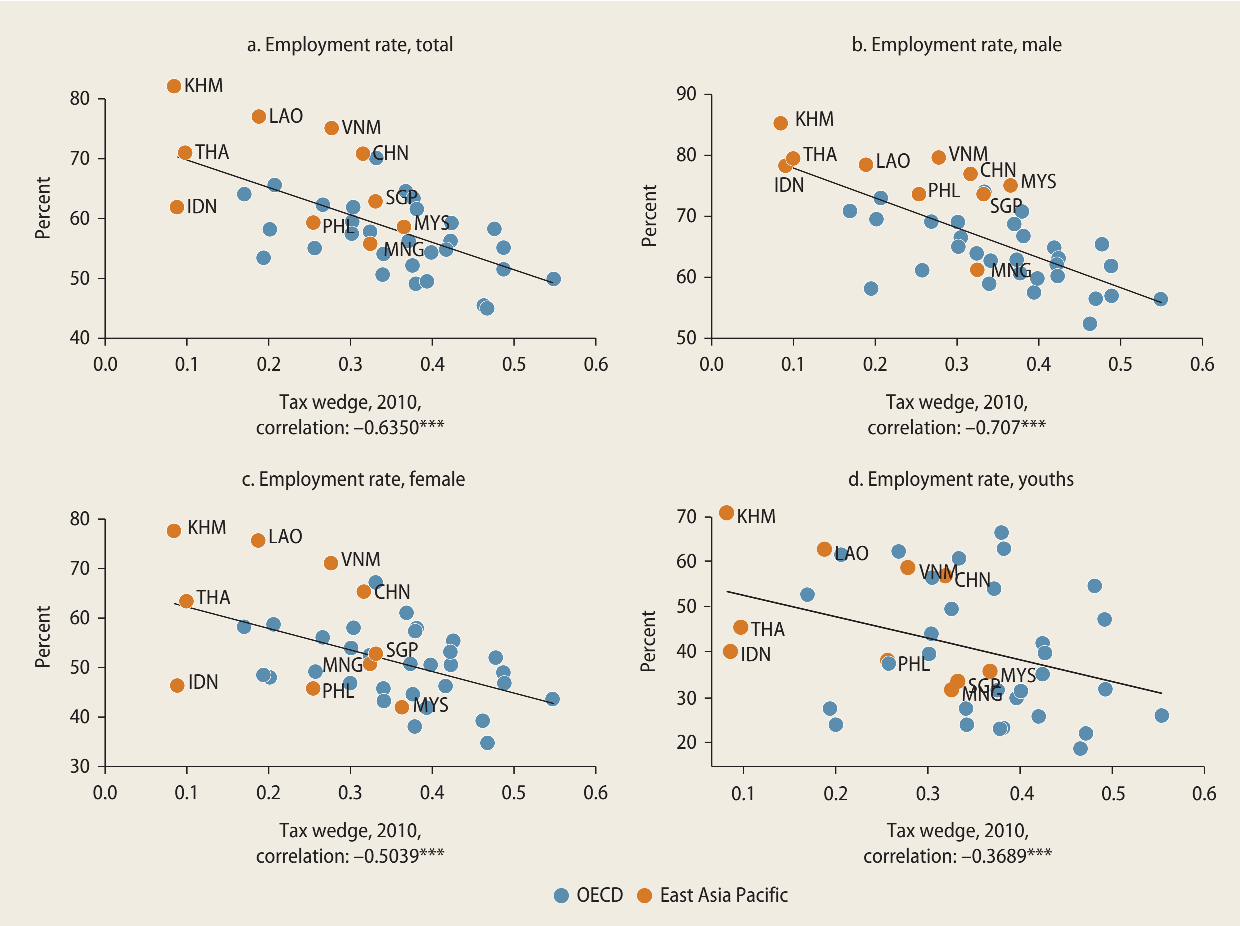
Conclusions

Labor regulations, interventions, and the institutions from which they emerge are intended to address the imperfections that exist in labor markets in the form of inadequate information, uneven bargaining power, and insufficient insurance against work-related risks. The effects of these policies on the creation and destruction of employment—and ultimately on people's well-being—have long been debated in Europe, the Americas, and elsewhere. There is consensus that at very restrictive levels, regulations on earnings and dismissal create damaging distortions of their own rather than correcting market imperfections.

The WDR 2013 argues that the relatively modest impact of labor regulations and interventions on the level of employment and wages does not merit the heated tones of the debate surrounding these measures. The report points out that most countries are avoiding extremes of too little and too much regulation and have placed themselves on a "plateau" between these two extreme "cliffs." On this plateau, labor policies have a modest impact on efficiency outcomes (employment, unemployment, and earnings). However, even on this plateau, labor policies tend to redistribute gains toward prime-age men at the expense of women, young people, those who need or prefer to work part time, and self-employed people. This finding should come as no surprise, since the prevailing models of labor regulation and interventions that are most often deployed today were first conceived in countries and during periods in history when men working in full-time, dependent employment were the largest group in the labor force.

The experience of countries in East Asia Pacific with labor market and social protection policies is short compared with that of countries in other regions. The higher-income

FIGURE 6.15 A larger tax wedge is associated with lower levels of employment



Source: Estimates using World Development Indicators, and countries' labor and tax codes.
Note: Employment to working-age population rates are averages between 2008 and 2010.
*** p<0.01

East Asian countries (Japan, Korea, and Singapore) exhibit more modest levels of regulation and protection, similar to those in Australia, Great Britain, New Zealand, and North America. However, although governments in many low- and middle-income countries in the region have stepped into this area of policy making much later than their peers in Latin America and Central Europe, they have done so with an orientation similar to that taken in several Southern European countries. A simple reading of the labor codes in several East Asia Pacific countries reveals that in several cases, employment regulation is more restrictive than in OECD countries. And in contrast to middle- and high-income countries elsewhere, recent changes in regulation in East Asia have been toward greater restrictions.

In East Asia, employment protection legislation is most restrictive in Indonesia, where workers whose employment is regulated by the labor code enjoy more protection than workers in France, Greece, or Portugal and only a little less than workers in Spain. Regulation on dismissal is also relatively restrictive in China and Lao PDR. With high levels of structural informality

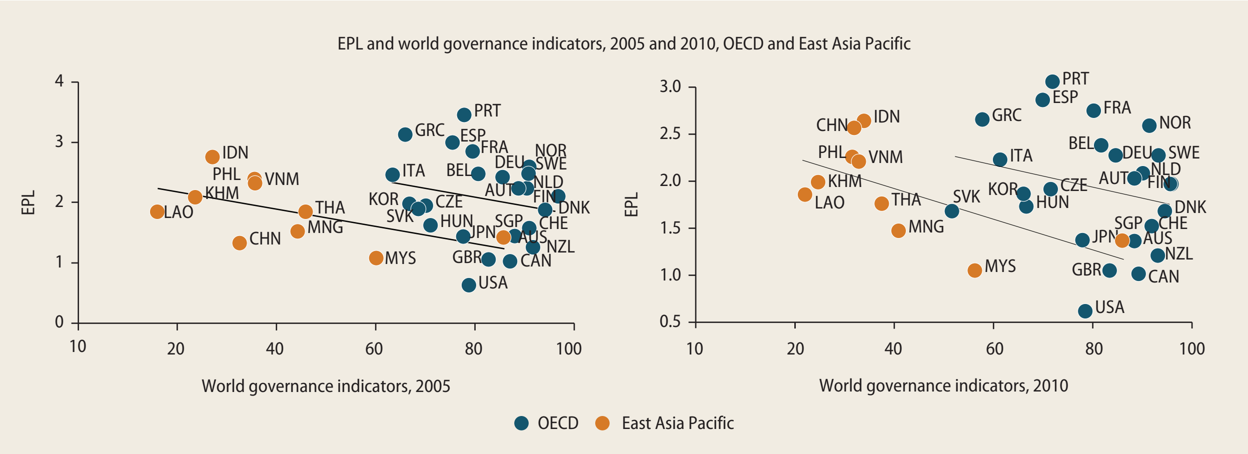
FIGURE 6.16 A larger tax wedge is associated with higher levels of unemployment

Source: Estimates using countries' labor and tax codes.
Note: Unemployment rates are averages between 2008 and 2010.
** p<0.05

and widespread avoidance of labor regulation in the manufacturing and service sectors, restrictive regulations on paper may have little impact on outcomes. Indeed, the relatively restrictive orientation of the labor code in emerging East Asian economies has probably had only minor impact thus far, relative to the impact of structural change on employment. However, this should not be a reason for complacency. These countries also tend to have relatively low levels of institutional development (figure 6.17). When combined with poor implementation and enforcement capacity, even reasonable labor policies can aggravate the market failures they were designed to overcome, creating segmentation and social exclusion.

For firms that are too large to evade—many of them international companies—onerous levels of regulation are already a problem and a source of unfair competition from smaller rivals that can still ignore the rules and hire informally. As more people in East Asia Pacific seek work in the manufacturing and services sectors, as governments improve their capacity to enforce regulations, and as firms find it harder to evade, restrictive regulations in the labor code could become more binding constraints on well-being from work.

FIGURE 6.17 Many countries in East Asia Pacific combine highly restrictive levels of labor regulation with low institutional capacity



Source: Estimates based on countries' labor codes and World Bank 2013d for World Governance Indicators.
Note: The World Governance Indicators include various indicators such as voice, accountability, governance, corruption, regulatory quality, violence, and rule of law.

Annex 6A Supplementary Tables

TABLE 6A.1 Summary of minimum wage systems in selected East Asia Pacific countries

Country and year of introduction	Government entity responsible for setting minimum wages	Levels at which minimum wages are determined	Coverage	Frequency of adjustments
Indonesia (early 1970s)	Regional governments, following recommendations from the provincial or district wage council	Province, which may set separate rates for districts and for economic sectors	Applies only to workers employed by firms and intended to be applied solely to workers with less than a year's service	No specific provision in the law, but in practice adjusted once a year
Thailand (1972)	Ministry of Labor, based on recommendations from the National Wage Commission, the provincial minimum wage subcommittees, and the subcommittee on technical affairs and review	Regional and for sector and occupation; in practice, rates are only set for provinces; 31 geographically differentiated minimum wages are set by decentralized committees in the 76 provinces and Bangkok	All full-time workers on a daily base, regardless of nationality	Annual adjustment, but not followed in practice
Cambodia (1997)	Ministry of Labor, after receipt of recommendations made by the Labor Advisory Committee	Rates set only for the garment sector; three levels of minimum wages, depending on the worker's experience (apprentice, probationary, and regular levels)	Set only for workers in the textile, garment, and shoe-sewing sector	No scheduled frequency of adjustment identified; adjusted from time to time in accordance with the evolution of economic conditions and the cost of living
Lao PDR (2006)	National government	National	Applies to all employees and employers who carry out activities in labor units; also applies to persons working under written contracts for employment of three months or more; excludes civil servants	No scheduled frequency of adjustment identified; last update was in 2009
Philippines (1951)	At the regional level by regional tripartite wage and productivity boards; the National Wages and Productivity Commission reviews each of the regional minimum wage rates	By region as well as by industry (agriculture and nonagriculture)	All workers and employees in the private sector	No provision in the law for the frequency of adjustment; changes occur every year or even every 17 months
Vietnam (1992)	The government (that is, Ministry of Labor, War Invalids, and Social Affairs) in consultation with the Vietnam General Confederation of Labor and the representatives of employers	Set for four regions; different minimum wages for different types of enterprises: domestic and foreign owned	All employees and employers in all sectors of the economy and in all forms of ownership	No specific time period for adjustment; ministry has the discretion to vary rates from time to time
Myanmar (1948)	The president, following recommendations from the Minimum Wage Council	Set at the sectoral level (public sector workers and workers in rice-milling, cigar-rolling, and cheroot-rolling industries)	All workers except those employed on a casual basis	No provision in the law for frequency of adjustment

(continued)

TABLE 6A.1 Summary of minimum wage systems in selected East Asia Pacific countries *(continued)*

Country and year of introduction	Government entity responsible for setting minimum wages	Levels at which minimum wages are determined	Coverage	Frequency of adjustments
Malaysia (2012)[a]	National government, after consultations with the National Wage Consultative Council	Regional (for peninsular Malaysia and for Sabah, Sarawak, and Labuan)	Private sector workers	Not applicable
Mongolia (1995)	Government, after taking account of proposals of national organizations representing employers' and workers' interests	National	Domestic business entities or organizations and citizens of Mongolia, foreign citizens, or stateless persons	Adjusted at least once a year
China (1993)	Local government, with each province, municipality, or region setting its own minimum wage in accordance with its own local conditions	Set for each province, region, autonomous region, and municipality and for sectors	Enterprises, private nonenterprise entities, individual industrial and commercial households with employees (the employing entities), and laborers who have formed a labor relationship with them	Adjusted at least once every two years

a. Malaysia's first minimum wage will come into effect in January 2013.

TABLE 6A.2 Summary of regulations for dismissal of permanent workers

Country	Notification procedures	Notice period (4 years tenure, months)	Length of trial period (maximum, months)	Compensation following unfair dismissal (worker with 20 years tenure, months)	Possibility of reinstatement
Brunei Darussalam	Consent of the commissioner is necessary for termination	0.5	<60	0	Yes
Cambodia	Notification to the labor inspector is necessary	1	<3	0	Yes
Indonesia	Approval from the institution for the settlement of industrial relations disputes	1	<3	0	Yes
Lao PDR	Approval from the labor authority	1–1.5, depending on workers' skills	1–2	48	Yes
Malaysia	Written statement is enough	1.5	<24	0	No, specified in the law
Philippines	Not known	1	6	0	Yes
Singapore	Written statement is enough	0.5	Not specified in the law	0	Yes
Thailand	Written statement is enough	1.0	Not specified in the law	0	Yes
Vietnam	Written statement is enough	1.5	1–2	20	Yes
China	Notice must be given in writing, and the labor union notified of the reason in advance	1	6	40	Yes
Mongolia	Written statement is enough	1	6	0	Yes

Sources: Countries' labor regulation; International Labour Organization's Employment Protection Legislation Database (http://www.ilo.org/dyn/eplex/termmain.home).

TABLE 6A.3 Fixed-term contract regulations in East Asian countries

Country	Valid reason for use of fixed-term contract	Maximum number of successive fixed-term contracts	Maximum cumulative duration of successive fixed-term contracts	Temporary working agencies
Brunei Darussalam	For specific time and type of work	No limitation	No limitation	Need a license, but no limitations on the type of employment
Cambodia	No limitation	No limitation	24 months	No limitation
China	No limitation	2	10 years	Placement of workers from temporary agencies apply to temporary, ancillary, and substitute positions
Indonesia	Fixed-term contracts are prohibited for permanent work; allowed for temporary, time-bound (that is, work that can be completed within three years), seasonal, or experimental work	2	36 months	Need a license; allowed to contract workers for auxiliary service activities or activities that are related only indirectly to production
Lao PDR	No limitation	No limitation	No limitation	Not regulated
Malaysia	No limitation	No limitation	No limitation	No restrictions
Mongolia	For a specified term for temporary replacement of worker, seasonal, or temporary work; probationary or training period for apprentices	No limitation	No limitation	Not regulated
Philippines	Fixed-term contracts prohibited for permanent work; allowed for specific projects	No limitation	No limitation	Do not need to register; no limitations on the work that can be performed, but the secretary of labor and employment may, by appropriate regulations, restrict or prohibit the contracting out of labor to protect workers

(continued)

TABLE 6A.3 Fixed-term contract regulations in East Asian countries *(continued)*

Country	Valid reason for use of fixed-term contract	Maximum number of successive fixed-term contracts	Maximum cumulative duration of successive fixed-term contracts	Temporary working agencies
Singapore	No limitation	No limitation	No limitation	Need a license
Thailand	Fixed-term contracts prohibited for permanent work; allowed for specific projects or for occasional work or for seasonal jobs	No limitation	24 months	No limit
Vietnam	No limitation	2	72 months	Not regulated, but fixed-term contract regulation applies

Sources: Countries' labor regulation; International Labour Organization's Employment Protection Legislation Database (http://www.ilo.org/dyn/eplex/termmain.home).

TABLE 6A.4 Informal work, conditional correlations using basic specification

	Vulnerable employment			Self-employment		
Variable	OLS (1)	FE (2)	RE (3)	OLS (1)	FE (2)	RE (3)
Tax wedge	−0.444***	−0.449***	−0.444***	−0.627***	−0.632***	−0.627***
	(0.154)	(0.134)	(0.134)	(0.136)	(0.136)	(0.136)
EPL	2.042	2.107	2.042	4.307*	4.358**	4.307**
	(2.434)	(1.811)	(1.820)	(2.394)	(1.783)	(1.785)
Union density	0.0947	0.0874	0.0947*	0.0139	0.00827	0.0139
	(0.0782)	(0.0542)	(0.0543)	(0.0849)	(0.0546)	(0.0545)
Min. Wage : Av. Wage	0.0426	0.0332	0.0426	0.00830	0.00121	0.00830
	(0.0688)	(0.0618)	(0.0618)	(0.0765)	(0.0628)	(0.0625)
Log of GDP per capita	−12.06***	−12.14***	−12.06***	−12.72***	−12.80***	−12.72***
	(1.777)	(1.324)	(1.330)	(1.817)	(1.345)	(1.345)
Inflation	0.0334	0.0498	0.0334	−0.00462	0.0111	−0.00462
	(0.244)	(0.244)	(0.245)	(0.238)	(0.248)	(0.248)
Constant	142.9***	144.0***	142.9***	154.4***	155.5***	154.4***
	(20.18)	(14.60)	(14.66)	(20.73)	(14.92)	(14.91)
Observations	96	96	96	97	97	97
R^2	0.630	0.637	0.682	0.648	0.653	0.719
Number of period		2	2		2	2

Note: OLS = ordinary least squares; FE = fixed effects; RE = random effects. Robust standard errors in parentheses. OLS with cluster robust standard errors (clustering on countries).
*** p<0.01, ** p<0.05, * p<0.1

TABLE 6A.5 Vulnerable employment, conditional correlations using fixed-effect estimation

Variable	(1)	(2)	(3)	(4)	(5)	(6)	(7)
Tax wedge (tw)	−0.450***	−0.578***	−0.570***	−0.590***	−0.553***	1.426	−1.455
	(0.132)	(0.140)	(0.142)	(0.189)	(0.132)	(1.401)	(2.668)
EPL (epl)	1.958	1.020	37.90***	−2.196	0.472	1.790	−6.312
	(1.765)	(2.224)	(13.38)	(3.065)	(2.190)	(2.302)	(30.68)
Union density (ud)	0.0891*	0.0289	−0.0124	0.0487	−1.325***	0.00721	−1.363*
	(0.0527)	(0.0583)	(0.0590)	(0.0911)	(0.449)	(0.0591)	(0.764)
Minimum wage: average wage (mw)	0.0348	−0.00520	−0.0447	−0.0308	−0.0476	−0.0317	−0.875
	(0.0610)	(0.0647)	(0.0653)	(1.520)	(0.0625)	(0.0630)	(1.591)
Log of GDP per capita	−12.23***	−7.911***	−8.782***	−9.452**	−7.152***	−6.374***	−13.57**
	(1.155)	(2.129)	(2.093)	(3.848)	(2.193)	(2.256)	(5.044)
Government effectiveness		−6.846**	−21.36**	−3.429	−12.91***	−15.28	−37.23
		(3.057)	(8.257)	(15.97)	(4.623)	(9.496)	(29.35)

(continued)

TABLE 6A.5 Vulnerable employment, conditional correlations using fixed-effect estimation *(continued)*

Variable	(1)	(2)	(3)	(4)	(5)	(6)	(7)
Investment Freedom		−0.135	0.113	−0.0401	−0.503***	−0.360	−0.517
		(0.0967)	(0.275)	(0.590)	(0.173)	(0.328)	(0.877)
Trade Freedom		0.187	0.215	0.0370	0.435*	0.237	0.462
		(0.251)	(0.243)	(0.394)	(0.244)	(0.242)	(0.379)
Business Freedom		0.154	0.866	0.750	0.240	0.632	1.256
		(0.150)	(0.526)	(0.730)	(0.250)	(0.514)	(1.260)
Fiscal Freedom		−0.118	0.227	−0.793	−0.384*	0.850	−1.888
		(0.120)	(0.321)	(0.810)	(0.213)	(0.525)	(1.378)
epl*Government Effective			6.828*				4.455
			(3.798)				(7.080)
epl*Trade Freedom			−0.131				−0.333
			(0.127)				(0.244)
epl*Business Freedom			−0.309				0.406
			(0.231)				(0.374)
epl*Fiscal Freedom			−0.152				−0.0952
			(0.146)				(0.365)
mw*Government Effective				−0.193			−0.0698
				(0.396)			(0.427)
mw*Trade Freedom				−0.00205			
				(0.0149)			
mw*Business Freedom				−0.0105			−0.0218
				(0.0177)			(0.0169)
mw*Fiscal Freedom				0.00942			0.0195
				(0.0213)			(0.0222)
mw*Investment Freedom							0.00845
							(0.0157)
ud*Government Effective					0.0927		0.239
					(0.102)		(0.234)
ud*Trade Freedom					0.0124***		
					(0.00443)		
ud*Business Freedom					−0.00163		−0.00638
					(0.00587)		(0.0109)
ud*Fiscal Freedom					0.00967**		0.00837
					(0.00450)		(0.0110)
ud*Investment Freedom							0.0222***
							(0.00807)
tw*Government Effective						0.246	0.674
						(0.267)	(0.534)
tw*Trade Freedom						0.00570	
						(0.00928)	
tw*Business Freedom						−0.0125	−0.0201
						(0.0141)	(0.0202)
tw*Fiscal Freedom						−0.0232	0.0297
						(0.0139)	(0.0300)
tw*Investment Freedom							−0.00307
							(0.0148)
Constant	145.4***	109.5***	35.40	154.1*	123.5***	6.951	254.3*
	(12.82)	(28.03)	(37.96)	(80.57)	(30.69)	(56.03)	(129.8)
Observations	97	92	92	60	92	92	60
R^2	0.636	0.685	0.726	0.749	0.738	0.725	0.876
Number of period	2	2	2	2	2	2	2

*** p<0.01, ** p<0.05, * p<0.1

TABLE 6A.6 Self-employment, conditional correlations using fixed-effect estimation

Variable	(1)	(2)	(3)	(4)	(5)	(6)	(7)
Tax wedge (tw)	−0.585***	−0.619***	−0.651***	−0.570***	−0.590***	2.341*	−3.639
	(0.128)	(0.139)	(0.138)	(0.183)	(0.127)	(1.374)	(2.655)
EPL (epl)	3.387**	1.327	44.13***	1.367	0.625	2.413	18.94
	(1.654)	(2.107)	(12.87)	(2.803)	(2.022)	(2.165)	(30.21)
Union density (ud)	0.0266	−0.0283	−0.0498	0.0475	−1.746***	−0.0641	−1.674**
	(0.0505)	(0.0566)	(0.0558)	(0.0892)	(0.432)	(0.0572)	(0.727)
Min. Wage : Av. Wage (mw)	0.0163	−0.0246	−0.0424	−1.196	−0.0823	−0.0560	−1.008
	(0.0587)	(0.0637)	(0.0630)	(1.469)	(0.0599)	(0.0616)	(1.504)
Log of GDP per capita	−11.56***	−9.856***	−10.19***	−11.11***	−8.878***	−8.787***	−11.97**
	(1.109)	(2.089)	(2.010)	(3.859)	(2.108)	(2.201)	(5.053)
Government Effectiveness		−7.501**	−12.94	−10.44	−12.60***	−14.45	−48.27*
		(2.948)	(7.796)	(15.97)	(4.395)	(9.284)	(27.60)
Investment Freedom		−0.0250	0.134	−0.0171	−0.431**	−0.173	−0.270
		(0.0959)	(0.266)	(0.594)	(0.166)	(0.322)	(0.874)
Trade Freedom		0.177	0.182	0.0196	0.441*	0.235	0.450
		(0.248)	(0.235)	(0.394)	(0.235)	(0.237)	(0.381)
Business Freedom		0.149	0.567	0.321	0.156	0.725	0.900
		(0.149)	(0.494)	(0.701)	(0.240)	(0.505)	(1.188)
Fiscal Freedom		−0.262**	0.472	−1.125	−0.602***	1.002*	−2.494*
		(0.117)	(0.301)	(0.812)	(0.203)	(0.514)	(1.315)
epl*Government Effective			2.033				−0.157
			(3.621)				(6.973)
epl*Trade Freedom			−0.0745				−0.361
			(0.123)				(0.246)
epl*Business Freedom			−0.187				0.482
			(0.217)				(0.353)
epl*Fiscal Freedom			−0.355**				−0.430
			(0.139)				(0.367)
mw*Government Effective				0.0233			0.143
				(0.392)			(0.410)
mw*Trade Freedom				−0.00124			
				(0.0150)			
mw*Business Freedom				2.98e-05			−0.0174
				(0.0170)			(0.0165)
mw*Fiscal Freedom				0.0176			0.0209
				(0.0213)			(0.0218)
ud*Government Effective					0.0568		0.306
					(0.0978)		(0.228)
ud*Trade Freedom					0.0138***		
					(0.00426)		
ud*Business Freedom					0.000691		−0.000946
					(0.00563)		(0.0110)
ud*Fiscal Freedom					0.0114**		0.0112
					(0.00434)		(0.0108)
tw*Government Effective						0.201	0.875
						(0.263)	(0.519)
tw*Trade Freedom						0.00317	
						(0.00912)	
tw*Business Freedom						−0.0148	−0.0256
						(0.0138)	(0.0201)

(continued)

TABLE 6A.6 Self-employment, conditional correlations using fixed-effect estimation *(continued)*

Variable	(1)	(2)	(3)	(4)	(5)	(6)	(7)
tw*Fiscal Freedom						−0.0317**	0.0579*
						(0.0137)	(0.0294)
tw*Investment Freedom							0.00274
							(0.0148)
ud*Investment Freedom							0.0168**
							(0.00805)
mw*Investment Freedom							0.00616
							(0.0158)
Constant	145.6***	138.3***	51.86	208.4**	162.6***	5.892	289.6**
	(12.37)	(27.79)	(36.70)	(80.23)	(29.63)	(55.11)	(119.3)
Observations	99	94	94	62	94	94	62
R^2	0.642	0.674	0.728	0.739	0.743	0.719	0.868
Number of period	2	2	2	2	2	2	2

*** p<0.01, ** p<0.05, * p<0.1

Notes

1. The resulting indicators and measures have been used to track trends in labor market policy in subsequent Employment Outlook reports (OECD 1997, 2004, 2006, 2007).
2. A rich set of labor market policy indicators is available from the World Bank's Doing Business Database, Employing Workers.
3. It would be difficult to separate our discussion of regulations completely from that of institutions—the norms and structures from which regulations and interventions emerge. For this reason, this section also includes some description of collective bargaining; a more analytical discussion of labor institutions is taken up later in the chapter.
4. Latin American countries were among the first developing countries to adopt labor codes and to institute minimum wages. Beginning in the mid-1930s and especially during the 1940s, minimum wage legislation was adopted in most of Latin America. This process was associated with the promulgation of comprehensive labor codes, which became common in Latin America in the 1930s. In some cases, the introduction of labor codes was preceded by constitutional provisions that laid the basis for the regulation of workers' rights. Labor legislation in Latin America first appeared in Chile and Mexico in the early 1930s. Mexico was the first country to establish a minimum wage policy (1931), and Brazil (1938), Costa Rica (1943), Uruguay (1943), and Colombia (1945) soon followed.
5. Several provinces have set sector minimum wages for agriculture, mining, manufacturing, utilities, forestry, and rubber industries.
6. In Thailand and Vietnam, regional rates are set at the central level by the Ministry of Labor after consultations with the representatives of employers and employees.
7. The wage council consists of government, entrepreneurs, and labor organization representatives.
8. Each of the 16 regions in the Philippines has its own regional board. Before 1989, minimum wages in the Philippines were set nationally by Congress. However, since 1989, with enactment of the Wage Rationalization Act/the Republic Act no. 6727, minimum wages are established at the regional level.
9. In the East Asia Pacific region, only Fiji, the Federated States of Micronesia, the Solomon Islands, and Vanuatu have higher relative minimum wages, and all these ratios are within 5 percentage points of each other. See the 2013 Doing Business, Employing Workers, Database (http://www.doingbusiness.org/~/media/GIAWB/Doing percent 20Business/Documents/Miscellaneous/EWI-DB2013-data.ashx).
10. Most high-income OECD countries relaxed their employment protection regulations in the last two decades, mainly by easing the restrictions on temporary employment (OECD 2004; World Bank 2012a).

11. The law passed after the slave labor scandal in the coal mines of Shanxi and Henan provinces. The government was concerned that these gross violations of workers' rights, not to mention the resulting strikes, would negatively affect social stability and economic development.
12. This is due, in part, to the difficulty of administering national income protection plans (Vodopivec 2006).
13. In Germany, the share of workers with fixed-term contracts rose from 30 percent in 2000 to 45 percent in 2010 (Nielen and Schiersch 2012).
14. In this section, we focus on internal migration. Labor migration across borders is discussed in much greater detail in a companion regional report (World Bank 2013a).
15. The tax wedge constructed for the ASEAN countries, China, and Mongolia reflect the wages for single individuals, without children, living in urban areas and earning the average wage in service and manufacturing industries (OECD 2012). The tax rates and social insurance contributions are prescribed by a country's laws and regulations and therefore differ for each country.
16. Excluding Lao PDR and Singapore, for which data on taxes are not available for 2002.
17. In Cambodia, a new law has been prepared, stipulating that social security contributions for civil servants will be shared between the government (18 percent) and workers (6 percent).
18. In these countries, generous allowances are provided by law, substantially reducing the taxable income of average wage workers.
19. Deyo (1989, 5) argues that the Confucian cultural explanation holding that "values of hierarchy, cooperation, industriousness, paternalism, and the subordination of individual to state" does not account for other regions where labor unions are strong and also hold strong cultural values of "authoritarian acquiescence," such as Iberian corporatism in Latin America.
20. This constraint can be offset if firms become more selective with the new hires and if they are encouraged to invest more in worker training (Boeri and van Ours 2008).
21. This said, the impact of stringent labor regulation may be showing up in other responses to firm surveys. Firms in several East Asia Pacific countries rank "practices of the informal sector" as a pressing problem, which could reflect the competition from firms able to evade regulation and thus gain market advantage.
22. If a mandatory floor on wages can create incentives for firms to increase the output of their workers by investing in training or new technology, the aggregate impact on productivity can be positive.
23. Although theory predicts that minimum wages are likely to hurt the chances of young people, the slightly positive relationship between the minimum wage and youth employment for OECD countries (bottom right-hand quadrant of figure 6.11) is also consistent with a few studies attributing this positive outcome to well-enforced minimum wages attracting younger people with low labor productivity into work.
24. Islam and Nazara (2000), Suryahadi et al. (2003), and Pratomo (2011) also find negative effects of minimum wages on overall employment and earnings in Indonesia.
25. Also in Indonesia, Rama (2001) finds a negative employment effect among firms with 20 or fewer workers, but a positive effect for medium and large firms.
26. The statutory minimum wage helped several countries to narrow the gap between formal and informal wages, by providing a clear signal of what the market wage rate for similar skill sets should be and changing the equilibrium efficiency wage in (at least parts of) the informal sector (Dinkelman and Ranchhod 2012). Recent studies have found evidence of this lighthouse effect in Brazil and Ghana (Boeri, Garibaldi, and Ribeiro 2010). Gindling and Terrell (2007) also find that, in Costa Rica, increases in the minimum wage narrow the wage gap between formal and informal sectors. They argue that an increase in the minimum wage raises wages not only in the urban formal sector (large urban enterprises) but also across all workers covered and not covered by minimum wage legislation (likely in small urban enterprises, large rural enterprises, and small rural enterprises). In other words, the minimum wage functions as a signal to the entire labor market.
27. When the data are disaggregated by demographic groups, similar findings are observed for the OECD and Latin America where,

despite aggregate gains in employment and wages, the gains are often concentrated among prime-age, skilled workers and men who keep their jobs (Cunningham 2007).

28. Addison and Teixeira (2001); Betcherman, Luinstra, and Ogawa (2001); Besley and Burgess (2004); Kugler (2005), Kugler and Kugler (2008), and Kugler and Pica (2008) for Colombia; and Haltiwanger, Scarpetta, and Vodopivec (2003) for emerging Europe, the Russian Federation, and Ukraine.

References

ADB (Asian Development Bank). 2013. "The Social Protection Index: Assessing Results for Asia and the Pacific." ADB, Manila.

Addison, John, and Paulino Teixeira. 2001. *The Economics of Employment Protection*. IZA Discussion Paper 381. Bonn: IZA.

Alatas, Vivi, and Lisa Cameron. 2008. "The Impact of Minimum Wages on Employment in a Low-Income Country." *Industrial and Labor Relations Review* 61 (January): 201–23.

Azam, Mehtabul, Céline Ferre, and Mohamed Ajwad. 2012. "Did Latvia's Public Works Program Mitigate the Impact of the 2008–2010 Crisis?" Policy Research Working Paper 6144, World Bank, Washington, DC.

Bentolila, Samuel, Juan Dolado, and Juan Jimeno. 2008. "Two-Tier Employment Protection Reforms: The Spanish Experience." *CESifo DICE Report* 6 (4): 49–56.

Besley, Timothy, and Robin Burgess. 2004. "Can Labor Regulation Hinder Economic Performance? Evidence from India." *Quarterly Journal of Economics* 65 (February): 389–430.

Betcherman, Gordon. 2012. "Labor Market Institutions: A Review of the Literature." Background paper for WDR 2013, World Bank, Washington, DC.

Betcherman, Gordon, and Rizwanul Islam, eds. 2001. *East Asian Labor Markets and the Economic Crisis: Impacts, Responses, and Lessons*. Washington, DC: World Bank; Geneva: International Labour Organization.

Betcherman, Gordon, Amy Luinstra, and Makoto Ogawa. 2001. *Labor Market Regulation: International Experience in Promoting Employment and Social Protection*. Social Protection Discussion Paper 128. Washington, DC: World Bank, Human Development Network.

Boeri, Tito, and Pietro Garibaldi. 2007. "Two-Tier Reforms of Employment Protection Legislation: A Honeymoon Effect." *Economic Journal* 117 (521): 357–85.

Boeri, Tito, and Pietro Garibaldi, and Marta Ribeiro. 2010. *Behind the Lighthouse Effect*. IZA Discussion Paper 4890. Bonn: IZA.

Boeri, Tito, and Jan van Ours. 2008. *The Economics of Imperfect Labor Markets*. Princeton, NJ: Princeton University Press.

Bover, Olympia, and Ramón Gomez. 2004. "Another Look at Unemployment Duration: Exit to a Permanent versus a Temporary Job." *Investigaciones Economicas* 28 (2): 285–314.

Caraway, Teri. 2008. "Labor Standards and Labor Market Flexibility in East Asia." *Studies in Comparative International Development* 45 (2): 225–49.

Comola, Margherita, and Luiz de Mello. 2011. "How Does Decentralized Minimum Wage Setting Affect Employment and Informality? The Case of Indonesia." *Review of Income and Wealth* 57 (5): S79–99.

Cooney, Sean. 2011. "Bring Employers to the Table: China, Australia, and Compulsory Arbitration." *Redefining Collective Bargaining in Asia* 79 (April-June): n.p.

Coricelli, Fabrizio, Alex Cukierman, and Alberto Dalmazz. 2006. "Monetary Institutions, Monopolistic Competition, Unionized Labor Markets, and Economic Performance." *Scandinavian Journal of Economics* 108 (1): 39–63.

Cunningham, Wendy. 2007. *Minimum Wages and Social Policy: Lessons from Developing Countries*. Washington, DC: World Bank.

Deakin, Simon, and Frank Wilkinson. 2009. "Minimum Wage Legislation." In *Encyclopedia of Law and Economics: Labor and Employment Law and Economics*, edited by Kenneth Dau-Schmidt, Seth Harris, and Orly Lobel. Cheltenham: Edward Elgar.

Del Carpio, Ximena, David Margolis, and Yuko Okamura. 2013. "Effects of Minimum Wages on Labor Markets and Welfare in the Philippines: A Micro-Simulation Based Estimation." World Bank, East Asia and Pacific Social Protection and Labor Unit, Washington, DC.

Del Carpio, Ximena, Julián Messina, and Anna Sanz-de-Galdeano. 2013. "Minimum Wages and Labor Market Outcomes in Thailand." Mimeo, World Bank, East Asia Pacific Social Protection and Labor Unit, Washington, DC.

Del Carpio, Ximena, Ha Nguyen, and Liang Choon Wang. 2012. "Does the Minimum Wage Affect Employment? Evidence from the Manufacturing Sector in Indonesia." Research Working Paper Series, World Bank, Washington, DC.

———. 2013. "The Impacts of Minimum Wages on Employment, Wages, and Welfare: The Case of Vietnam." Mimeo, World Bank, East Asia Pacific Social Protection and Labor Unit, Washington, DC.

Devereux, Stephen. 2005. "Can Minimum Wages Contribute to Poverty Reduction in Poor Countries?" *Journal of International Development* 17 (7): 899–912.

Deyo, F. C. 1989. *Beneath the Miracle: Labor Subordination in the New Asian Industrialism*. Los Angeles: University of California Press.

Dinkelman, Taryn, and Vimal Ranchhod. 2012. "Evidence on the Impact of Minimum Wage Laws in an Informal Sector: Domestic Workers in South Africa." *Journal of Development Economics* 99 (1): 27–45.

Ford, Michele. 2004. "Organizing the Unorganizable: Unions, NGOs, and Indonesian Migrant Labor." *International Migration* 42 (5): 99–113.

Giles, John, Dewen Wang, and Albert Park. 2013. "Expanding Social Insurance Coverage in Urban China." *Labor Market Issues in China, Research in Labor Economics* 37: 123–79.

Gill, Indermit, Johannes Koettl, and Truman Packard. 2013. "Full Employment: A Distant Dream for Europe." Mimeo, World Bank, Washington, DC.

Gill, Indermt, and Martin Raiser. 2012. *Golden Growth: Restoring the Luster of the European Economic Model*. Washington, DC: World Bank.

Gindling, Thomas H., and Katherine Terrell. 2007. "The Effects of Multiple Minimum Wages throughout the Labour Market: The Case of Costa Rica." *Labour Economics* 14 (3): 485–511.

Guell, Maia, and Barbara Petrongolo. 2007. "How Binding Are Legal Limits? Transitions from Temporary to Permanent Work in Spain." *Labour Economics* 14 (2): 153–83.

Hall-Jones, Peter. 2010. "Unionism and Economic Performance." New Unionism. http://www.newunionism.net.

Haltiwanger, John, Stefano Scarpetta, and Milan Vodopivec. 2003. "How Institutions Affect Labor Market Outcomes: Evidence from Transition Countries." World Bank Economists' Forum, Washington, DC, April 10.

Harrison, Ann, and Jason Scorse. 2010. "Multinationals and Anti-Sweatshop Activism." *American Economic Review* 100 (1): 247–73.

Heckman, James, and Carmen Pages. 2004. "Introduction." In *Law and Employment: Lessons from Latin America and the Caribbean*, edited by James Heckman and Carmen Pages. NBER Conference Report. Chicago: University of Chicago Press.

ILO (International Labour Organization). 2012. "Employment Protection and Industrial Relations: Recent Trends and Labor Market Impacts." In *World of Work Report 2012: Better Jobs for a Better Economy*. Geneva: ILO. http://www.ilo.org/public/english/bureau/inst/.

Islam, Iyanatul, and Suahasil Nazara. 2000. *Minimum Wage and the Welfare of Indonesian Workers*. Occasional Discussion Paper. Jakarta: ILO.

Johnson, Susan. 2004. *An Empirical Examination of Union Density in Six Countries: Canada, Ecuador, Mexico, Nicaragua, the United States, and Venezuela*. Washington, DC: Inter-American Development Bank.

KPMG. 2012. "KPMG's Individual Income Tax and Social Security Rate Survey 2012." KPMG. http://www.kpmg.com/Global/en/IssuesAndInsights/ArticlesPublications/Documents/individual-income-tax-rate-survey-2012.pdf.

Kugler, Adriana. 2005. "Wage-Shifting Effects of Severance Payments Savings Accounts in Colombia." *Journal of Public Economics* 89 (2-3): 487–500.

Kugler, Adriana, and Maurice Kugler. 2008. "Labor Market Effects of Payroll Taxes in Developing Countries: Evidence from Colombia." NBER Working Paper 13855, National Bureau of Economic Research, Cambridge, MA.

Kugler, Adriana, and Giovanni Pica. 2008. "Effects of Employment Protection on Job and Worker Flows: Evidence from the 1990 Italian Reform." *Labour Economics* 15 (1): 78–95.

Lanzona, Leonardo. 2012. "The Impact of Minimum Wages on Output and Employment in Labor-Intensive Manufacturing Industries in the Philippines" Background paper for the *Philippine Development Report 2013*, World Bank, Manila.

Lustig, Nora, and Darryl McLeod. 1996. *Minimum Wages and Poverty in Developing Countries: Some Evidence*. Discussion Paper 125. Washington, DC: Brookings Institution.

Manning, Alan.1995. "How Do We Know Real Wages Are Too High?" *Quarterly Journal of Economics* 110 (4): 1111–25.

Minns, John, and Robert Tierney. 2003. "The Labor Movement in Taiwan." *Labor History* 85 (November): 103–28.

Mortensen, Dale. 1977. "Unemployment Insurance and Job Search Decisions." *Industrial and Labor Relations Review* 30 (4): 505–17.

Neri, M., G. Gonzaga, and J. M. Camargo. 2000. "Efeitos informais do salário mínimo e pobreza [The informality sector and its effects on minimum wages and poverty]." *Revista de Economia Política* 18 (1): 120–40.

Nguyen, H., Viet Cuong Nguyen, and C. Wang. 2013. "The Impact of Minimum Wages on Wages and Employment in Vietnam." Mimeo, World Bank, Washington, DC.

Nickell, Stephen. 1997. "Unemployment and Labor Market Rigidities: Europe versus North America." *Journal of Economic Perspectives* 11 (3): 55–74.

Nielen, Sebastian, and Alexander Schiersch. 2012. *Productivity in German Manufacturing Firms: Does Fixed-Term Employment Matter?* Schumpeter Discussion Paper 2012-004. University of Wuppertal, Schumpeter School of Business and Economics, Wuppertal, Germany. http://nbn-resolving.de/urn:nbn:de:hbz:468-20120312-105213-9.

OECD (Organisation for Economic Co-operation and Development). 1994. *Jobs Study*. Paris: OECD Publishing.

———. 1997. *Employment Outlook*. Paris: OECD Publishing.

———. 2004. *Employment Outlook*. Paris: OECD Publishing.

———. 2006. *Employment Outlook*. Paris: OECD Publishing.

———. 2007. *Employment Outlook*. Paris: OECD Publishing.

———. 2010. *Statistics on Trade Union Density*. Paris: OECD Publishing.

———. 2012. "Methodology." In *Taxing Wages 2011*. Paris: OECD Publishing.

Ofreneo, Rene, and Joy Hernandez. 2011. *Freedom of Association and Collective Bargaining in the Philippine Export Processing Sector*. Quezon City: CLJ, SOLAIR.

Packard, Truman, Johannes Koettl, and Claudio E. Montenegro. 2012. *In from the Shadow: Integrating Europe's Informal Labor*. Washington, DC: World Bank.

Perry, Guillermo, William F. Maloney, Omar S. Arias, Pablo Fajnzylber, Andrew D. Mason, and Jaime Saavedra-Chanduvi. 2007. *Informality: Exit and Exclusion*. World Bank Latin American and Caribbean Regional Study. Washington, DC: World Bank.

Pratomo, Devanto. 2011. "The Effects of Changes in Minimum Wage on Employment in Indonesia: Regional Panel Data Analysis." *International Research Journal of Finance and Economics* 62 (February): 15–27.

Rama, Martin. 2001. "The Consequences of Doubling the Minimum Wage: The Case of Indonesia." *Industrial and Labor Relations Review* 54 (4): 864–81.

Ravallion, Martin, and Emanuela Galasso. 2004. "Social Protection in a Crisis: Argentina's Plan Jefes y Jefas." *World Bank Economic Review* 18 (3): 367–99.

Rebitzer, James, and Lowell Taylor. 1995. "The Consequences of Minimum Wage Laws: Some New Theoretical Ideas." *Journal of Public Economics* 56 (2): 245–55.

Sanchez, Maria L. 2010. *Labor Market Policy Research for Developing Countries: Recent Examples from the Literature: What Do We Know and What Should We Know?* Social Protection Discussion Paper 1001N. Washington, DC: World Bank.

Starr, Gerald. 1993. "Minimum Wage Fixing: An International Review of Practices." ILO, Geneva.

Subbarao, Kalanidhi. 1997. "Public Works as an Anti-Poverty Program: A Review of Cross-Country Experience." *American Journal of Agricultural Economics* 79 (2): 678–83.

Subbarao, Kalanidhi, Carlo del Ninno, Colin Andrews, and Claudia Rodriguez-Alas. 2013. *Public Works as a Safety Net: Design, Evidence, and Implementation*. Directions in Development. Washington, DC: World Bank.

Suryahadi, Asep, Wenefrida Widyanti, Daniel Perwira, and Sudarno Sumarto. 2003. "Minimum Wage Policy and Its Impact on Employment in the Urban Formal Sector." *Bulletin of Indonesian Economic Studies* 39 (1): 29–50.

Traub-Merz, Rudolf. 2002. "Towards a New Philippines Labor Movement." Friedrich Ebert Stiftung, Philippine Office.

Vodopivec, Milan. 2006. "Choosing a System of Unemployment Income Support: Guidelines for Developing and Transition Countries." *World Bank Research Observer* 21 (1): 49–90.

World Bank. 2009. *Doing Business 2010: Reforming through Difficult Times*. Washington, DC: World Bank.

———. 2012a. "Addressing Vulnerability in East Asia: A Regional Study." Report 69871-EAP, World Bank, Washington, DC.

———. 2012b. *World Development Report 2013: Jobs*. New York: Oxford University Press.

———. 2013a. "International Migration and Development in the East Asia and Pacific Region." Regional Report 63362-EAP, World Bank, Washington, DC.

———. 2013b. "Minimum Wage Policy: Lessons with a Focus on the ASEAN Region." World Bank, Washington DC.

———. 2013c. World Development Indicators Database. Washington, DC: World Bank.

———. 2013d. World Governance Indicators Database. Washington, DC: World Bank.

Priority Policy Challenges to Well-being from Work in East Asia Pacific

7

Priorities vary widely across countries in East Asia Pacific, but most people live in countries where sustaining well-being from work will require that cities be better managed and that the barriers that cause segmentation in the market for labor and human capital be removed.

The demand for and supply of labor and human capital need to be not only sustained but also stoked. The *World Development Report, 2013: Jobs* (hereafter referred to as WDR 2013; World Bank 2012) claims that 600 million jobs will have to be created in the next 15 years simply to maintain current levels of employment. For this reason, policy makers everywhere are worried about the relatively slow pace at which the market for labor and human capital is recovering after the sharp contraction in 2009 and 2010. While the economies of East Asia Pacific fared far better than most and enjoy much lower rates of unemployment, similar concerns dwell on the minds of policy makers in the region, increasing their appetite for policy guidance. In part II of this report, we discussed the importance of sound fundamentals, of policies that encourage formation of the right human capital, and of the institutions, regulations, and interventions most likely to balance the needs of enterprise with those of working people. These elements of policy are essential to sustaining the demand for and supply of human capital in any country. In chapters 4, 5, and 6, we assessed the performance of governments in East Asia Pacific countries in ensuring that they are in place.

But, growth, although necessary, is neither sufficient to sustain demand for labor and human capital nor enough to encourage adequate supply. And while the labor code can shape outcomes, even the best designed and implemented institutions, regulations, and interventions will only get a country so far. More is required of policy makers, particularly to sustain the types of work that are most likely to transform countries along the three dimensions of development discussed in the WDR 2013 and in chapter 3—namely, productivity, living standards, and social cohesion.

These additional priority challenges vary widely from country to country, and even in the same country they can change dramatically over time. As the WDR explains, “The types of jobs that can contribute the most to development depend on the country context. Jobs that connect the economy to the world may matter the most in some situations; in others, the biggest payoff may be for jobs that reduce poverty or defuse conflict" (World Bank 2012, 17). This important assertion notwithstanding, the WDR 2013 offers a typology that policy makers can apply to identify and prioritize their particular policy challenges and the steps they can take toward overcoming them.[1]

This chapter applies the WDR "jobs challenges" typology using observable data to categorize East Asia Pacific economies. By doing so, it sheds light on the implications of these challenges for setting policy priorities. The exercise is controversial, but, we believe, also yields important insights. In categorizing the countries of East Asia Pacific, the chapter highlights two important features that set the region apart from other low- and middle-income-country regions. The first feature is *diversity*: East Asia Pacific countries can be found in almost all eight categories of the WDR's typology, in contrast to countries in Latin America and the Caribbean, emerging Europe, the Middle East and North Africa, and South Asia, where countries tend to cluster in one or two types. This should come as no surprise. After all, the East Asia Pacific region encompasses China, an economic powerhouse and home to 1.3 billion people, as well as Tuvalu, a remote island country of just 10,000 people. The second feature that sets the region apart from others is *dynamism*: because of the pace of change over the last 30 years, many East Asia Pacific economies can fit into more than one category. To capture this unprecedented pace of change, the chapter takes the WDR's categorization a step further by considering the importance of countries' transitions from one category to another. Of particular importance to the conclusions of this report are the critical economic transitions from "agrarian" to "urbanizing," "urbanizing" to "formalizing," and "formalizing" to "aging."

As argued in chapter 3, the three development transformations associated with work have for the most part unfolded at a similar pace in East Asia Pacific countries. Chapter 3 also points out that it is important not to take the transformative nature of work for granted, given mounting evidence that some of the transformations may be starting to lag. In this chapter, we show that, on close inspection, significant imbalances are apparent in the pace of productivity gains, changes in living standards, and social cohesion. In mainly agrarian economies like Cambodia or the Lao People's Democratic Republic, labor productivity in agriculture remains too low and so do living standards. In urbanizing economies like Indonesia and the Philippines, growing congestion and poor land management are undermining the productivity gains from agglomeration. In small island nations, idle youth feel frustrated and could become increasingly disengaged. In resource-rich countries like Mongolia and Papua New Guinea, some forms of employment are hugely productive, but there are too few of them and there is a temptation to use the natural resource bounty to subsidize employment creation for the rest. In formalizing countries like China and potentially Indonesia, rigid regulatory models tried in Europe and Latin America are being adopted at a time when productivity gains are bound to come from firm-to-firm employment transitions rather than from rural-to-urban movement. And in societies bound to age quickly, like Thailand and Vietnam, mechanisms to reconcile long working lives with protection in old age are missing almost altogether.

Although we have done our best to appeal to data in categorizing East Asia Pacific countries, our application of the typology is ultimately subjective. The categorization exercise is intended neither to constitute a definitive diagnosis nor to produce a conclusive set of prescriptions about which policies should be prioritized. We expect as many readers to disagree with how countries have been categorized as to agree. This exercise is only useful if it provides clues to policy makers about where the most important challenges to boosting work may lie. If the chapter provokes debate about which challenges are the most pressing, then it will have served its purpose. Given the unique geographic constraints of Pacific Island countries, the discussion here is followed by a chapter focused specifically on the formidable challenges that they face.

The "jobs challenges" typology

The "jobs challenges" typology presented in the 2013 WDR starts with four broad categories: a country's level of development, demography, institutions, and natural endowments. The last of these categories is substantially different from the rest, in that the term "natural endowments" is less likely to present a continuum along which a country can move. For example, a country can move from a lower to a higher level of development or from one demographic profile to another. Natural endowments—particularly a country's geography—are relatively fixed. This presents the immediate possibility of overlap (for example, a country with high levels of youth unemployment can also be resource rich and conflict affected, a small island state can also be rapidly urbanizing, and so forth). From these four broad categories, eight specific "country types" are drawn (table 7.1).

We use data (some presented in earlier chapters) to map the countries of East Asia Pacific into these types. We apply empirical "thresholds" to the data to sort countries into categories. The thresholds are potentially the source of most contention in this chapter in that how they are chosen determines which challenges countries could prioritize. We have used the same data-driven formulation of the WDR's typology. Indeed, most of the data sources and thresholds are the same as those used in the WDR's analysis.[2]

This process is intended to be insightful and stimulating rather than definitive or conclusive. The thresholds are determined by assessing the global distribution of data, but legitimate alternatives could just as easily yield a different distribution of countries into the eight categories.[3] We are not making this point to undermine the exercise: indeed, the outcomes of the mapping have been assessed at length with supporting data and appear both robust to alternative thresholds as well as persuasive. Rather, we want to acknowledge that the process of placing countries into "types" will always be controversial, open to differences in interpretation and dispute. The chapter seeks to exploit this inevitability to achieve deeper insights.

Obviously many countries are facing not just one but several challenges. As the WDR stresses, "These criteria [used to categorize countries] are not mutually exclusive" (World Bank 2012, 190). By applying

TABLE 7.1 WDR 2013 presents eight country types to identify priority challenges
The "jobs challenges" typology, by level of development, demography, institutions, and natural endowments.

Broad category	Specific type	Dominant, defining feature
Level of development	1. Agrarian	Majority of the population living in rural areas
	2. Urbanizing	Agricultural modernization and rural-urban migration rapidly taking place
	3. Formalizing	An urban middle class coexisting with a large share of informal employment
Demography	4. Aging	Rapidly increasing old-age dependency ratios
	5. High youth unemployment	Youth unemployment and idleness rates at unusually high levels
Institutions	6. Conflict affected	Livelihoods altered by war and violence
Natural endowments	7. Resource rich	Extractive industries are a substantial share of exports
	8. Small island state	Islands with less than 1 million in population

Source: World Bank 2012, ch. 6.

the empirical thresholds, it is clear that most countries in East Asia Pacific map to more than one category (table 7.2). Fast-changing Vietnam can be mapped to four. Compared to other regions, East Asia Pacific countries are more heavily represented in three categories: urbanizing, resource rich, and small island states. The last clearly reflects the large number of sovereign countries in the Pacific, which are discussed at length in the next chapter. In contrast, countries in emerging Europe and Central Asia are more likely to cluster into the categories of aging and formalizing. Countries in South Asia and in the Middle East and North Africa are more likely to cluster in the categories of agrarian and high youth unemployment, respectively. In Latin America and the Caribbean, countries cluster in the category of formalizing. Argentina, Brazil, Chile, and Uruguay also qualify as aging.

Country categorization by level of development

Level of development encompasses agrarian, urbanizing, and formalizing economies. We discuss each in turn.

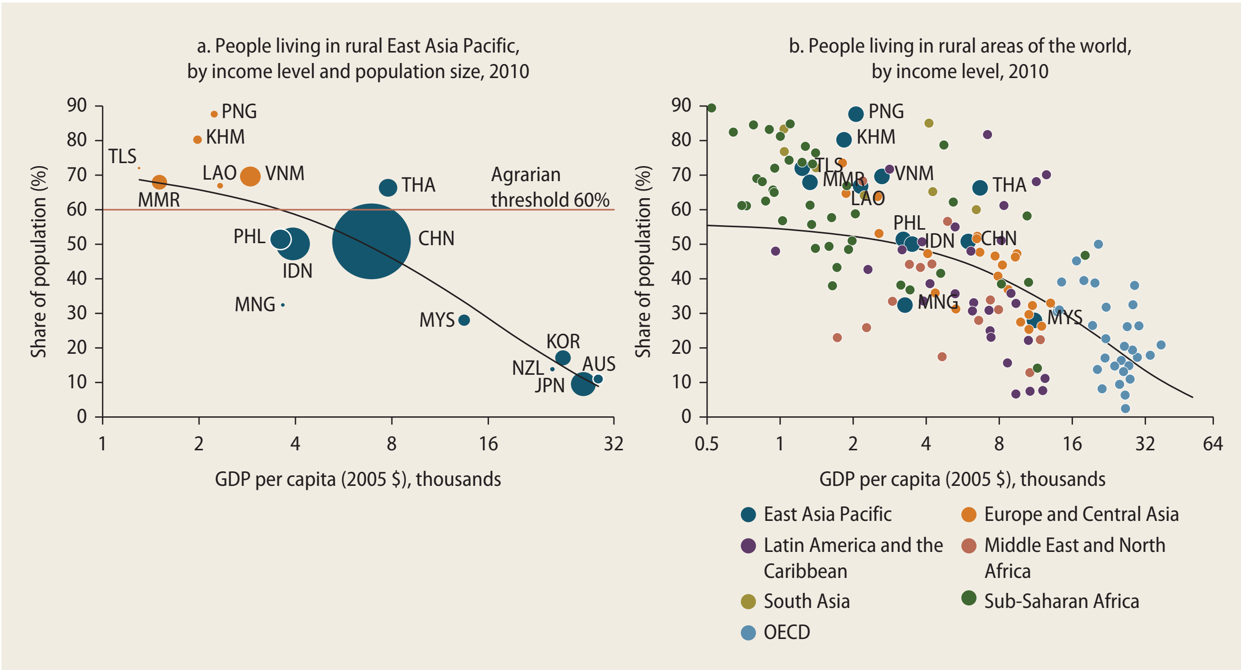
Agrarian

An agrarian economy is one in which the majority of the population still lives in rural areas, where work consists mainly of subsistence and small-scale commercial farming and related industries. A country is considered agrarian if 60 percent or more of the population is living in rural areas. As shown on figure 7.1, panel a, seven countries in East Asia Pacific qualify as agrarian according to that criterion: Cambodia, Lao PDR, Myanmar, Papua New Guinea, Thailand, Timor-Leste, and Vietnam. In the figure, the size of the sphere corresponds

TABLE 7.2 Countries in East Asia Pacific are more likely to be mapped to more than one category and tend to cluster in four types: Agrarian, urbanizing, resource rich, and small island state

Country	Agrarian	Urbanizing	Formalizing	Aging	High youth unemployment	Resource rich	Small island state	Conflict affected
Cambodia	✓							
China		✓	✓	✓				
Fiji							✓	
Indonesia		✓		✓	✓	✓		
Kiribati							✓	
Lao PDR	✓	✓				✓		
Malaysia		✓	✓					
Marshall Islands							✓	
Micronesia, Fed. Sts.							✓	
Mongolia		✓	✓		✓	✓		
Myanmar	✓					✓		
Palau							✓	
Papua New Guinea	✓					✓		
Philippines		✓			✓			
Samoa							✓	
Solmon Islands							✓	
Thailand	✓			✓				
Timor-Leste	✓					✓		
Tonga							✓	
Tuvalu							✓	
Vanuatu							✓	
Vietnam	✓	✓	✓	✓				

FIGURE 7.1 Seven countries in East Asia Pacific are still agrarian



Source: Based on data from World Bank 2013c.
Note: Spheres = total population in 2010; OECD = Organisation for Economic Co-operation and Development.

to the population of each country. This is an important dimension of analysis that is employed throughout this chapter, as it allows a quick determination not only of where countries are mapped, but also of where most people in the region are mapped. Figure 7.1, panel b, includes countries from other regions to convey a sense of how the countries of East Asia Pacific compare. Countries in Sub-Saharan Africa and South Asia still have a large share of their population living in rural areas.

In mainly agrarian contexts, increasing the productivity of agriculture can have a significant impact on a country's development, as discussed in chapter 3. Indeed, the International Food Policy Research Institute has found that, among 42 developing countries over 1981–2003, growth in gross domestic product (GDP) of 1 percent originating in agriculture was associated with an increase in the expenditures of the three poorest deciles of at least 2.5 times as much as growth originating in the rest of the economy (World Bank 2007, 30). Yet in many countries in this category, lack of land tenure and limited use of fertilizers and other technology mean that farming is still taking place at a relatively unproductive level, with significant resources devoted simply to producing goods for household consumption (Gollin et al. 2002). The priority challenge to boosting well-being from work in mainly agrarian economies is to raise the productivity of agriculture. Gains made in labor productivity in agriculture release labor and human capital from the land to engage in off-farm rural employment. This move is eventually compounded by the pull of wages in towns and cities.

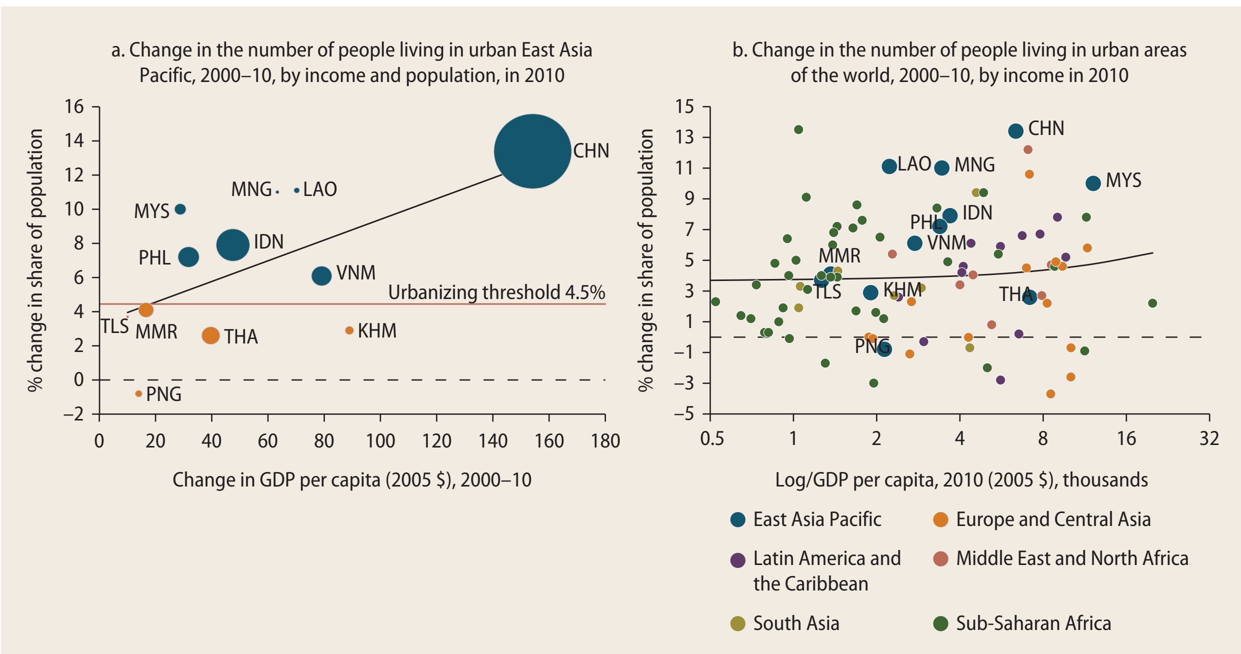
Other than in Lao PDR and Vietnam, in the past 10 years there has been very little movement of people to towns and cities in most of the East Asia Pacific countries categorized as still mainly agrarian. This has clearly been the case in Myanmar, Papua New Guinea, and Timor-Leste. This relatively static picture suggests that these countries will remain mainly agrarian in the medium term.

Urbanizing

As discussed in earlier chapters, many countries in East Asia Pacific have been urbanizing at an unprecedented speed. Indeed, evidence in earlier chapters shows that the recent pace of urbanization has been much faster in East Asia Pacific than in any other region. As an abundance of unskilled labor released from farming and nonfarm rural industry moves to towns and cities, governments face the challenge of quickly integrating migrants into the urban economy. In the course of urbanization, countries typically pass through an important developmental juncture at which the participation of women in work outside the home begins to rise significantly. This compounds the positive effect that urbanization has on all three development transformations. The challenge for governments is to stay ahead of the urbanization process, in order to avoid exclusion and urban poverty and to minimize the costs of congestion so that migrants contribute to agglomeration economies. The arena for governments to prioritize action is in urban planning and management—in particular, to ensure connectivity, transportation infrastructure, linkages, and well-functioning land markets.

Figure 7.2, panel a, shows the change in the share of each country's population living in urban areas over a 10-year period. The figure distinguishes which countries are urbanizing (a flow concept) from those that are already mainly urban (a measure of stock). To be considered urbanizing, 60 percent or less of the country's population had to be living in urban areas in 2000 and the share of population in urban areas had to have risen 4.5 percentage points or more between 2000 and 2010. By these criteria, seven East Asia Pacific countries are categorized

FIGURE 7.2 Most people in East Asia Pacific live in countries that are urbanizing rapidly



Source: Based on data from World Bank 2013c.
Note: Spheres = total population in 2010.

as urbanizing: China, Indonesia, Lao PDR, Malaysia, Mongolia, the Philippines, and Vietnam.[4] As the size of each country's sphere makes plain, most people in East Asia Pacific work in countries that are urbanizing. This is not to say that most people are working in urban areas, but that they are living in countries where the process of urbanization is happening fastest. This empirical point is critical to the conclusions and recommendations made in the final chapter of this report.

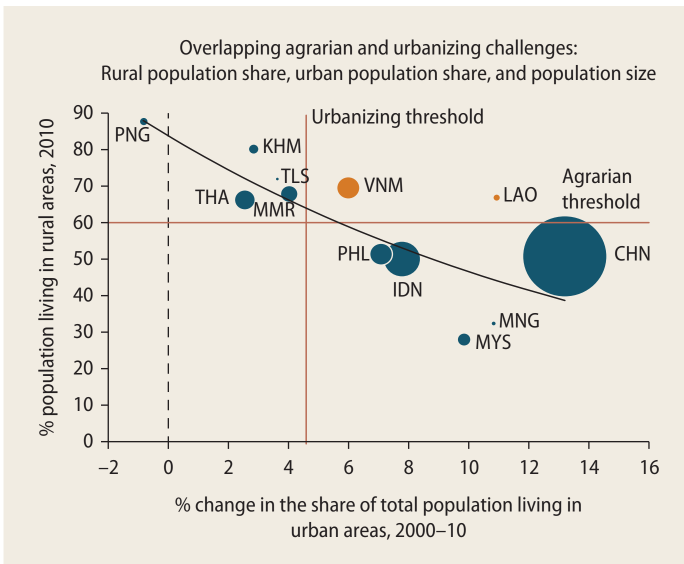
Within the fast-growing East Asian cities, factor markets are deepening, producers are accessing inputs with greater ease, industry can expand in new directions thanks to innovation, and firms can find ever-narrower niches of specialization as well as achieve valuable and powerful scale economies (Yusuf and Saich 2008, 19). But none of these dynamics is inevitable. Bad policy can still constrain the forces of demand for and supply of labor and human capital that urbanization should unleash. As anybody who has been stuck in a traffic jam in Manila or Jakarta can attest, urban planning is too often ignored, particularly investment in connective transportation infrastructure.

Thailand is an unusual outlier in figure 7.2. It has among the highest income per capita among middle-income countries in East Asia Pacific, and yet the pace of urbanization is sluggish: the second slowest of all the countries in the region over the 10-year period. This is perhaps, in part, an artifact of measurement and differences in rural-urban classifications from country to country, even in data sets with uniform indicators like the World Bank's World Development Indicators. During the same 10-year period, Thailand was shedding agricultural employment, and employment in services increased by nearly the same amount as in its neighbors. This observation suggests that either Thailand's urbanization is underreported or policies are encouraging movement from farming into nonfarm industry in rural areas rather than migration from rural areas to towns and cities.

As may already be apparent, Lao PDR and Vietnam are categorized as being both agrarian and urbanizing. Figure 7.3 illustrates how the challenges of agrarian and urbanizing countries overlap. Countries in the top left-hand quadrant of the figure are still mainly agrarian, but not yet urbanizing at a significant pace. For these countries, increasing the productivity of agriculture may remain a policy priority for long a while. Countries that achieve this show a definitive move to the right quadrant where, like Vietnam, they begin to urbanize in earnest. These countries will continue to face the challenge of improving agricultural productivity, even as they facilitate the integration of migrants into towns and cities.

The history of agricultural development and urbanization in the Philippines provides an example of what can happen when this process is not facilitated or when it is distorted with unclear land tenure and uneven provision of services, particularly in rural areas. This year's *Philippines Development Report*

FIGURE 7.3 The challenge facing most governments in East Asia Pacific is how to manage the transition from mainly agrarian to urban economies



Source: Based on data from World Bank 2013c.
Note: Spheres = total population in 2010.

details that, despite a head start in manufacturing compared to its neighbors, the Philippines has failed to industrialize fully (World Bank 2013a, 3). Instead, the share of manufacturing in GDP has stagnated at around 25 percent since 1960. The share of manufacturing employment in total employment rose barely 10 percent. The report argues that the Philippines "missed crucial steps in the structural transformation process"—namely, ensuring substantive improvements in agricultural productivity, developing a rural nonfarm economy, and facilitating the rise of manufacturing in towns and cities. The Philippines example shows the importance of meeting agrarian challenges, even as the process of urbanization gets under way. Critical to facilitating urbanization is ensuring that rural areas benefit from good-quality services to build the human capital of people likely to stay in farming and rural industry as well as that of aspiring migrants. The report argues that, because successive governments ignored rural service delivery at critical stages of development, the quality of migration was compromised. When migrants have low levels of human capital on arrival in towns and cities, they are only able to take up low-skilled employment, usually low-skilled services. "The service sector has been the largest employer since 1997. However, more than three-quarters of the service sector is composed of low-wage or low-skilled jobs … and there has been no corresponding significant increase in productivity in the service sector" (World Bank 2013a, 3).

Vietnam's history provides a more positive example of how countries can manage the transition from a mainly agrarian to an urbanizing economy. In 1993, 79 percent of Vietnam's population lived in rural areas, 70 percent of working people were engaged in agriculture, and the poverty rate stood at 58 percent. Between 2000 and 2010, Vietnam's share of employment in agriculture fell 13.6 percent, and employment in industry and services rose 7.8 and 5.9 percent, respectively. The share of the population living in rural areas was 9 percentage points lower in 2010 than in 1993. Alongside Vietnam's move from a centralized to a more market-led economy came rapid increases in agricultural productivity. Policies were enacted to ensure more even delivery of human capital across the country and to foster employment outside of agriculture. Vietnam has since reduced its poverty rate at an unprecedented pace and moved from low-income, least-developed status to lower-middle-income status (World Bank 2012).

Countries in the bottom right-hand quadrant of figure 7.3 are urbanizing fastest. With work being created primarily in the secondary (manufacturing) and tertiary (services) sectors, policy makers in these countries will be concerned with sustaining agglomeration and mitigating the ever-present threat of congestion, including to the environment. However, as with the blurred line between agrarian and urbanizing countries, countries where urbanization is already advanced also face overlapping challenges.

Formalizing

Countries in the formalizing category, like China and Indonesia, typically already have large and mature urban centers. Yet the pace of urbanization can result in a significant share of employment being concentrated in the informal economy. Indeed, rather than expect urbanization to lead mechanically to greater formalization, agglomeration economies may be far more suited to and better serve the smaller, more nimble, and specialized economic units commonly observed in the informal sector (Ghani and Kanbur 2013). The challenge in such a context is to ensure access to protection and opportunities so that informality does not become a source of segmentation. Structures that create barriers between the informal and formal economy constrain the movement of capital and labor, limit productivity, impose a ceiling on living standards for many, and, in doing so, corrode social cohesion.

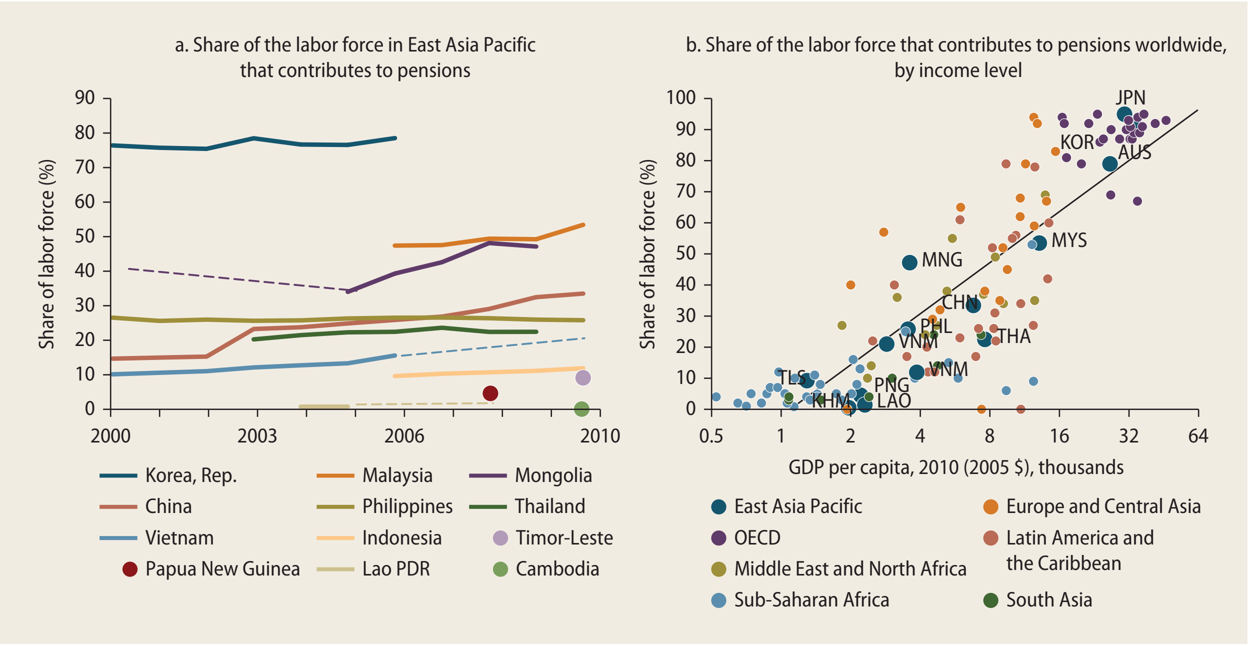
The varying dimensions and definitions of "informal employment" and the "informal economy" have been discussed in earlier parts of the report. For the purposes of categorizing countries in this chapter, we use a single proxy indicator of the extent of formal employment: coverage of social insurance, taken as the share of the labor force contributing to a pension plan. To be defined as formalizing, a country has to have had a significant (20 percent or more) and growing share of the labor force actively contributing to a pension plan during the last decade.[5] As figure 7.4 shows, only four countries in East Asia Pacific are categorized as formalizing: China, Malaysia, Mongolia, and Vietnam.

Both the Philippines and Thailand have "significant" shares of their labor force contributing to pensions. However, the time-series trends show that there has been almost no growth in the share of contributors in recent years. Lack of formalization by this measure might be of particular concern in rapidly aging Thailand; however, that country's decision to offer health coverage on a "noncontributory" or "universal" basis has provided wider protection and eliminated what in most countries can become an important driver of segmentation. In the Philippines, however, where social protection is still based mainly on contributions, stagnating levels of participation raise greater concern for segmentation (figure 7.4, panel a).

Vietnam only recently broke above the significance threshold of 20 percent. However, it has had the strongest expansion in the share of formal employment in the region. Despite what remains a relatively low share of contributors compared to the other formalizing countries, the rapid pace of expansion is encouraging.

Cambodia, Lao PDR, Papua New Guinea, and Timor-Leste appear to be firmly agrarian economies, with neither a significant nor a growing share of workers in formal employment. But in most of these countries, the extent of informal employment is still structural rather than based on incentives and institutions that create segmentation and exclusion. Of much greater concern is

FIGURE 7.4 When urbanization is well advanced, a significant share of working people should be formalizing

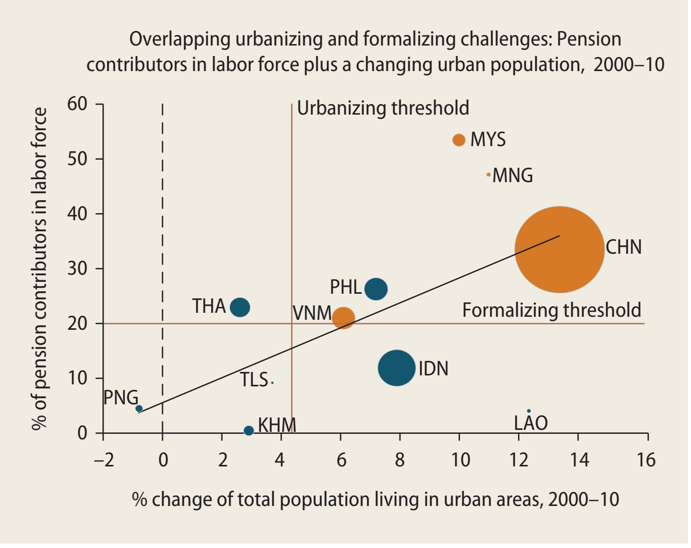


Sources: Based on data from World Bank 2013b, 2013c.
Note: Data are from 2010 or latest year.
The dashed lines in part a represent missing values in the time series. OECD = Organisation for Economic Co-operation and Development.

Indonesia, a country that is among the fastest urbanizing, but that has levels of pension coverage comparable to those of Timor-Leste. The extent and persistence of the informal economy in Indonesia are far less likely to be structural and more likely to be based on incentives to evade as well as on institutions that create segmentation and exclusion.

As with the analysis of overlapping agrarian and urbanizing challenges, the dual categorization of urbanizing and formalizing countries offers helpful insights. In figure 7.5, the orange spheres indicate the countries that have "growing" shares of pension contributors in the labor force, while the threshold indicates the "significance" level. In the bottom left-hand quadrant are the agrarian economies that are neither significantly urbanizing nor formalizing. Thailand straddles an interesting line—beneath the urbanizing threshold and above the formalizing threshold—but lacks significant growth in the share of contributors to pensions in the formalizing time series. Again, Thailand's decision to extend coverage of essential protection at least against the cost of health care may alleviate some of the concern raised by the mapping in figure 7.5.

FIGURE 7.5 Formalization is not an inevitable outcome of an urbanizing economy



Sources: Based on data from World Bank 2013b, 2013c.

Countries in the bottom right-hand quadrant, like Indonesia and Lao PDR, are urbanizing quickly, but they do not yet have a significant level of formal employment. The Philippines appears in the top right-hand quadrant above the significance threshold for formalizing, but the lack of expansion of pension contributors raises concerns for the quality of its urbanization and suggests that segmentation is unnecessarily constraining the potential agglomeration economies.

Countries in the top right-hand quadrant with orange spheres are both urbanizing and formalizing—that is, they have a level of formal employment that is both significant and growing. However, this is not a cause for complacency. The challenges of urbanization require continuous attention; with the exception of Malaysia, most of these formalizing countries in East Asia Pacific still have relatively low shares of contributors when compared to many of the countries in Latin America and emerging Europe (figure 7.4b). The challenges of an already urbanized, formalizing economy are new to countries in East Asia Pacific. This is another important point influencing the conclusions of this report. These new challenges indicate that the prevailing model that has served the region so well may need updating. But as newcomers to facing these challenges, countries in East Asia are less constrained in how they choose to respond.

Country categorization by demographics

In addition to the particular challenges faced by countries according to their level of development, the WDR's typology also contends that a country's priority challenge for sustaining well-being from work may be primarily demographic in nature. That is, a country could be aging or could have very high youth unemployment.

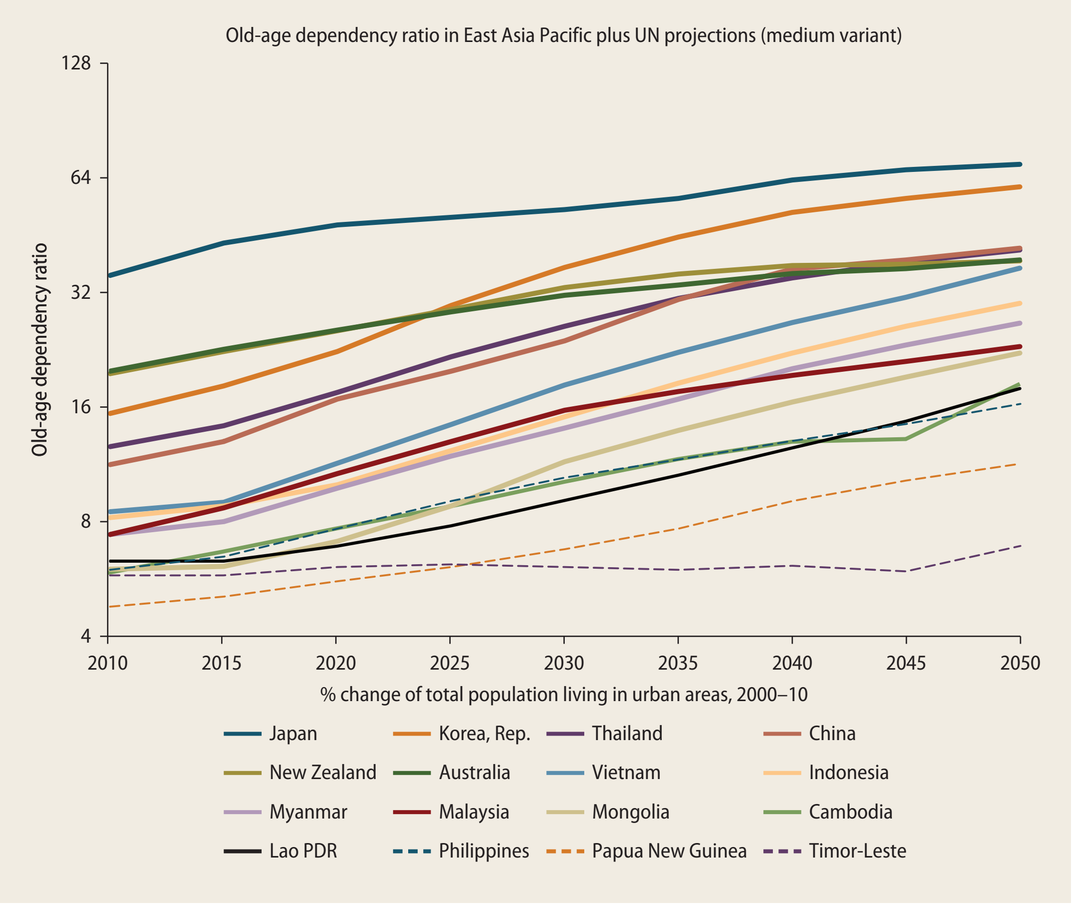
Aging

Aging economies face the specter of a shrinking working-age population, made more foreboding by the costs of caring for the elderly. Fewer and fewer people of working age must generate enough output and income to meet the needs of a growing elderly population. The policy challenge with respect to work is to ensure that more people are productive for as long as they can be and that the most productive retire at later ages. Extending coverage of social insurance is another challenge, with fewer workers having to cover the costs of pensions and health care.

Figure 7.6 shows the old-age dependency (OAD) ratio for countries in East Asia Pacific. To be classified as aging, a country needs to have an old-age dependency ratio of 8 percent or more in 2010, based on the global distribution. Four countries are categorized as aging by this measure: China, Indonesia, Thailand, and Vietnam.

By 2015, United Nations (UN) projections suggest that most of the countries in East Asia Pacific will begin to see a significant increase in their dependency ratios, with the OAD projections showing a steeper trajectory in the years that follow. Those countries categorized as aging in 2010 (OAD of at

FIGURE 7.6 East Asia Pacific is on the verge of rapid population aging



Source: United Nations Population Division.
Note: Dependency ratio = population older than age 64 relative to the population ages 15–64.

least 8 percent) are already showing the fastest increase in OAD ratios in the world. The high-income countries of East Asia Pacific, including Australia, Japan, the Republic of Korea, and New Zealand, are also included on figure 7.6 for illustrative purposes. Japan's level of old-age dependence (35 percent) in 2010 is visually underemphasized by the logarithmic scale on the vertical axis. Japan's OAD ratio is 16 percentage points higher than the second highest OAD ratio in the region: that of Australia, at 19 percent.

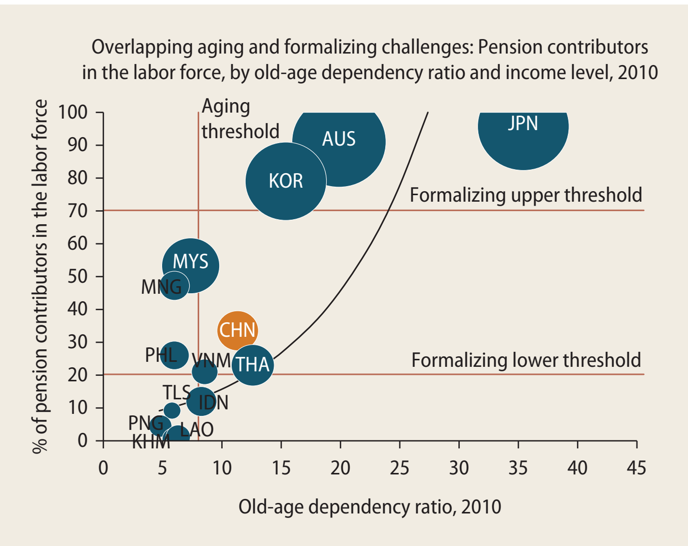
The challenge for the four aging economies in emerging East Asia will be relatively acute, with China and Thailand reaching OAD ratios by 2045 equivalent to the Japanese ratio in 2010. Vietnam will reach that point in 2050 and in the same year is expected to be on par with Australia and New Zealand. Indeed, aging in East Asia Pacific countries is occurring at a much faster pace than it did in North America, Western Europe, and Northeast Asia (East-West Center 2002, 94).

In addition, the low- and middle-income countries of East Asia will have to meet the challenges of aging at much lower levels of wealth than Japan. This, indeed, is a key point where aging is concerned. Most countries grappling with the onset of aging achieved higher levels of wealth before they did so. Facing the challenges of aging before becoming very wealthy—for example, in almost all the countries of emerging Europe and in the Southern Cone of Latin America—makes the task for policy makers far more difficult. Middle-income East Asian countries approaching rapid population aging are in greater danger of growing old before they get rich simply because of the speed of the oncoming demographic wave. Figure 7.7 shows three dimensions of this problem. In this figure, the spheres represent income per capita in 2010 rather than population, as in earlier figures.

Pictured in the top right-hand quadrant of the figure are three high-income East Asia Pacific countries: Australia, Japan, and Korea. Their income per capita spheres are large, and, according to the World Bank Pension Database, they are firmly formalized, with more than 75 percent of their labor force contributing to pensions. While facing acute aging challenges, they are relatively wealthy and thus better able to manage the costs of caring for their elderly, albeit with some struggle.

However, emerging East Asia Pacific countries are coming to experience aging with much lower levels of income and social insurance coverage. Relative to their Organisation for Economic Co-operation and Development (OECD) neighbors, rapidly aging China, Indonesia, Thailand, and Vietnam have significantly lower levels of income per capita. Yet their OAD ratios are increasing at pace. Furthermore, Thailand, with a formalization rate that has been stagnant at 23 percent of the workforce during the last decade, appears unprepared to care for its growing elderly population. And China is only just over that formalizing threshold. Conversely, Malaysia appears to be in a stronger position to contend with this demographic transition. At 7.3 percent, Malaysia is not significantly aging yet, but, as an upper-middle income country, its income

FIGURE 7.7 The constraints on growth from a large informal economy are dangerous as countries age



Sources: World Bank 2013b; United Nations Population Division.
Note: Dependency ratio = population older than age 64 relative to the population ages 15–64.

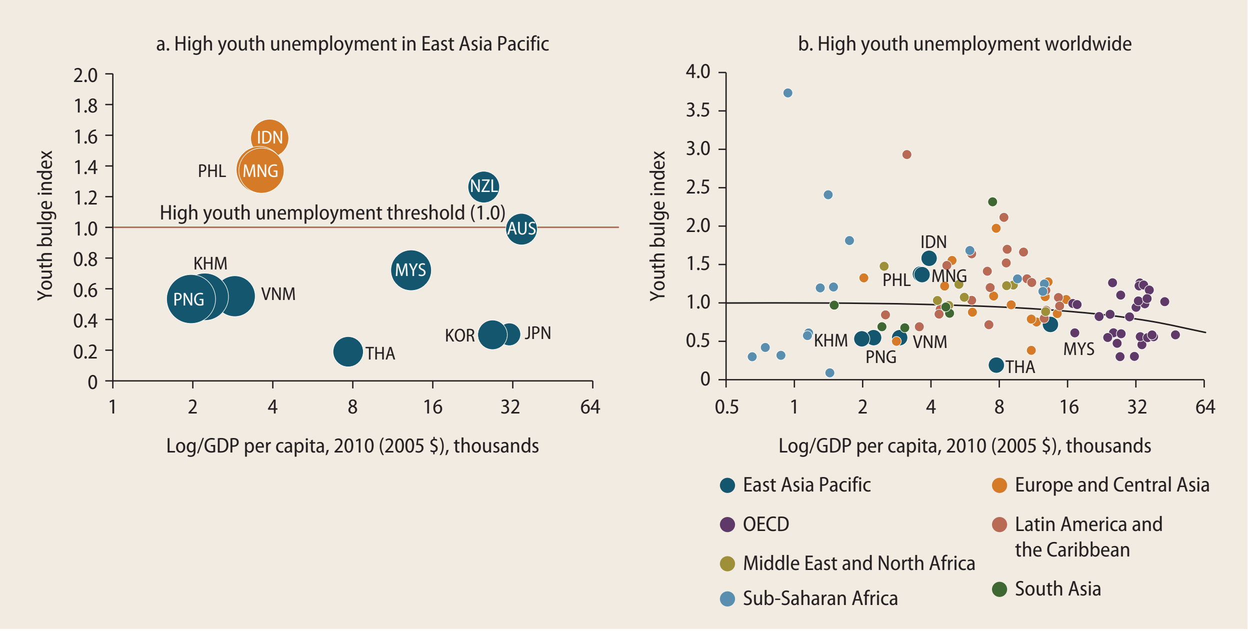
per capita is significantly higher than that of China, Indonesia, Thailand, and Vietnam. At 54 percent, a majority of Malaysia's labor force is actively contributing to pensions. Although our proxy for formalization in this chapter is related directly to the coverage of systems to care for the elderly, the more fundamental danger of a small formal economy comes from the potential for segmentation: getting stuck at levels of low productivity and low growth, while the process of aging moves relentlessly onward.

High youth unemployment

At the opposite end of the demographic scale are countries with large youth cohorts and high youth unemployment and disengagement rates. As discussed in earlier chapters, high youth unemployment with a large youth "bulge" in the population puts downward pressure on earnings and can prejudice the outcomes that members of the youth cohort experience into later ages. A large portion of unemployed young people can also contribute to crime and political fragility.

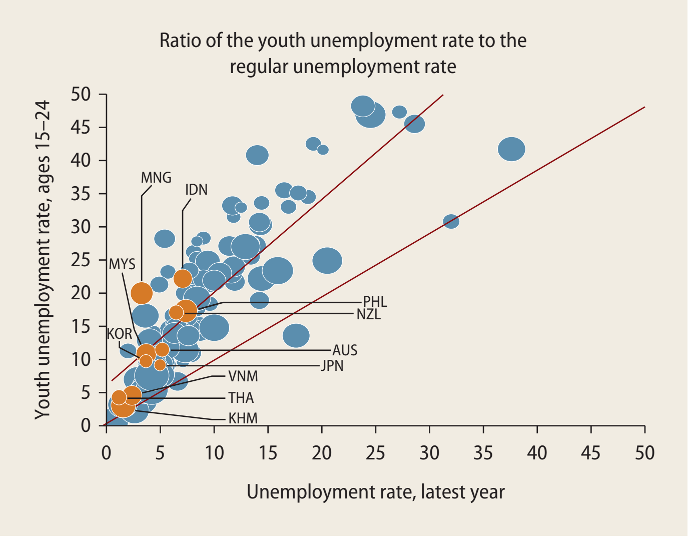
In earlier chapters, youth unemployment and inactivity were shown to be a concern in Indonesia, the Philippines, and some of the Pacific island countries. In this chapter, in order to assess whether countries have "high" youth unemployment rates, we constructed the WDR 2013's youth bulge index: the number of employed youth multiplied by the youth unemployment rate (latest year) and divided by the total population in 2010. Figure 7.8 shows that, relative to the rest of the world, countries in East Asia Pacific have relatively fewer unemployed young people. This contrasts sharply with the countries of the Middle East and North Africa. Three notable exceptions stand out: Indonesia, the Philippines, as shown before, and Mongolia. Indonesia and the Philippines also stand out in the ranking of countries by measures of youth idleness, presented in chapter 3.

FIGURE 7.8 The problem of high youth unemployment is less acute than in other regions, but still a concern in Indonesia, Mongolia, and the Philippines



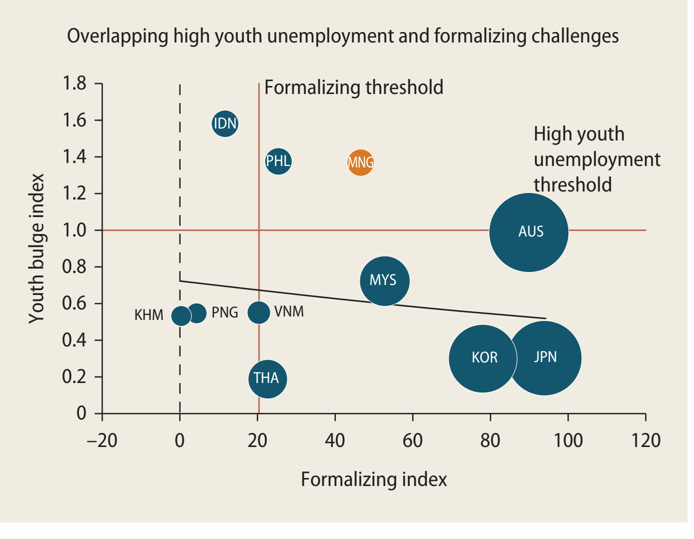
Source: Based on data in World Bank 2013c.
Note: Youth bulge index = number of employed youth multiplied by the youth unemployment rate (latest year), divided by the total population in 2010. Bubble size = youth bulge (population ages 15–24 relative to ages 15–64); OECD = Organisation for Economic Co-operation and Development.

FIGURE 7.9 The gap between youth and overall unemployment is highest in Indonesia, Mongolia, and the Philippines



Source: World Bank 2013c.
Note: Size of the sphere reflects the youth bulge index.

FIGURE 7.10 Low levels of formalization combine with high youth unemployment to prejudice the longer-term prospects of young people and constrain growth



Sources: Based on data from World Bank 2013b, 2013c.
Note: Sphere size = income per capita, 2010 ($2005).

Youth unemployment and idleness are still a worry for many governments in East Asia Pacific, even if on a global scale the challenge appears more acute elsewhere. Alternate measures of the relative challenge facing young people may do a better job of explaining why. Figure 7.9 shows how youth unemployment compares to overall unemployment in a large sample of countries, including those in East Asia Pacific. The 45° line and the global regression line emphasize that youth unemployment typically is higher than unemployment in the general population and that the two rates are strongly, positively correlated. Concern arises when the youth unemployment rate deviates substantially from the overall unemployment rate. Mongolia has a relatively large youth bulge (size of the sphere) and a youth unemployment rate of 20 percent, which far outstrips the overall unemployment rate of 3.3 percent. This is also true of Indonesia, with a youth unemployment rate of 22.2 percent, compared to an overall unemployment rate of 7.1 percent. In these countries, a substantially higher youth unemployment rate does not simply reflect higher overall unemployment; rather it is the product of specific barriers to employment opportunities faced by young people. Some of these arise from regulation and how social protection systems are structured and financed, as discussed in chapter 6.

With respect to high youth unemployment, a large informal economy introduces additional challenges. As indicated in figure 7.10, Indonesia—in the top left-hand quadrant—has low levels of formal employment combined with high youth unemployment. Having few formal employment options when they enter the labor market or early in their careers can adversely affect the future work prospects of young people (Hyytinen and Rouvinen 2008; Cruces, Ham, and Viollaz 2012). Furthermore, to the extent that a large informal economy reflects widespread use of outdated technology and constrains productivity, these countries may be poorly positioned to take optimal advantage of the relatively large youth cohorts entering the labor market. For these reasons, although many East Asia Pacific countries lie below the 2013 WDR's global threshold of high youth unemployment, this particular challenge to well-being from work cannot be ignored.

Country categorization by endowments

Countries can also be categorized by their endowments and physical geography as resource rich or as small island states. We discuss each in turn.

Resource rich

Sitting atop a wealth of mineral resources may seem like a blessing, but it raises pressing challenges for the supply of and demand for labor and human capital. Extractive industries necessary to exploit mineral resources rarely create work beyond an initial construction phase. Two pertinent references in the WDR 2013 emphasize this point using countries from the East Asia Pacific region. In Papua New Guinea, the Liquid Natural Gas Project created an initial investment equivalent to 230 percent of GDP and generated some 9,300 jobs in the leading construction phase, but failed to retain more than 1,000 people at work after completion. Papua New Guinea's landowner companies are helping to mitigate these risks to employment and to ensure more equitable distribution of welfare from resources (box 7.1). In Mongolia, the Oyu Tolgoi copper mine motivated an investment equivalent to 74 percent of GDP and created 14,800 jobs during the construction phase.

BOX 7.1 Papua New Guinea's landowner companies: Leveraging the extractive sector for nonextractive employment

Papua New Guinea is enjoying a natural resource boom. However, the pitfalls that turn a resource bounty into a resource curse are well documented for countries in Latin America, Africa, Europe, and Central Asia, and Papua New Guinea has the opportunity to learn from past mistakes. Papua New Guinea's landowner companies provide an example of government, international companies, and stakeholders working together to spread the welfare benefits from natural resource extraction and create employment even beyond the extraction sectors.

Family groups hold traditional ownership of the vast majority of Papua New Guinea's land mass. These ownership claims tend to be hereditary, passing through the clan structure and following an area's tribal lines. They reflect farming and living practices that can extend back generations.

The government of Papua New Guinea holds formal legal ownership of the nation's subsurface resources. This legal ownership is the basis of agreements between the government and resource companies to develop and market the country's enormous mineral and energy wealth. This extraction funds the country's imports and much of the budgets of national and many provincial governments. But many of the richest deposits are in remote areas where treacherous terrain makes outside access difficult and services such as public health clinics, schools, or security unreliable.

The government has the legal right to purchase equity holdings in resource projects, up to limits defined in legislation. These equity holdings generate dividend streams for the government, which allocates a portion to traditional landowners. The allocation is set in legislation—for example, the government may purchase up to 22.5 percent of the equity of a petroleum project and allocate 2 percentage points to traditional landowners.

In addition, resource developers are required to develop domestic supply capacity and human skills. Resource investments are required to include national material and labor content plans, and many resource companies include such plans within their corporate social responsibility commitments.

continued

BOX 7.1 *(continued)*

Many landowner groups seek to use these requirements to negotiate contracts to supply services to the project. The government supports this process through a national framework agreement for negotiations and a specific agency to support the negotiation process. This agency, the Minerals Resource Development Corporation, organizes forums that bring traditional landowners, resource developers, and government agencies together to develop benefit-sharing arrangements. It also assists landowner groups to form landowner companies.

Landowner companies represent traditional titles and claims, distribute payments, and enter into contracts. They are incorporated under Papua New Guinea's Corporations Law, and an internal constitution determines various aspects of their operations.

Most landowner firms distribute revenue shares among members of their particular clan. Many invest some of these revenues in assets (such as real estate) or businesses that generate ongoing income for the landowners. Some create employment opportunities for their shareholders by filling the service contract provisions of the benefit-sharing contracts. These contracts are usually for low-skilled ancillary services, such as providing security (paying local groups to protect the mine site, equipment, and workforce) or labor for civil works; they may also be for catering and camp maintenance or logistics.

A few landowner companies have built commercial enterprises supplying similar services to customers under one umbrella. These larger businesses tend to collect several landowner companies connected to the same resource project. They then manage the commercial businesses via separate but wholly owned companies. These "entrepreneurial landowner companies" are emerging as a model for Papua New Guinea to develop a diversified, job-intensive, and modern domestic service sector out of the country's traditional institutions and natural resource wealth.

A half-dozen landowner companies combine these skills. For example, Anitua unites the landowner companies of the six clans around Newcrest's large gold mine on the Lihir group of islands plus the local government's business arm. Out of its catering contracts with the mine, it developed National Catering Services, which in the mid-2000s started tendering for other contracts—some at mine construction sites but also outside of the resource sector. Key to the success of entrepreneurial landowner companies has been separating their social roles from their business activities and their solid governance of both.

The larger landowner companies are more exposed to a downturn in the global economy than the less ambitious companies. Some are clearly preparing for this uncertainty. For example, Star Mountain is investing heavily in technical training colleges and developing capacity in mining services, ahead of the decline at Ok Tedi, the key mine associated with the company.

In sum, a handful of landowner companies have used the government's input requirements to build diversified, growing enterprises. Most have limited their objectives to extracting and distributing revenues from a one-off project, while some have failed even to ensure that their members receive the benefits they are due. Far-sighted business vision and skilled leadership distinguish the most successful companies from the rest. These companies represent a means of building diversified domestic services and upstream sectors, providing a path for thousands to transition into work and the modern cash economy. But, as the recent surge in demand passes, they will need to become more competitive if this structure is to remain viable.

Source: Contributed by Timothy Bulman, World Bank country economist for Papua New Guinea.

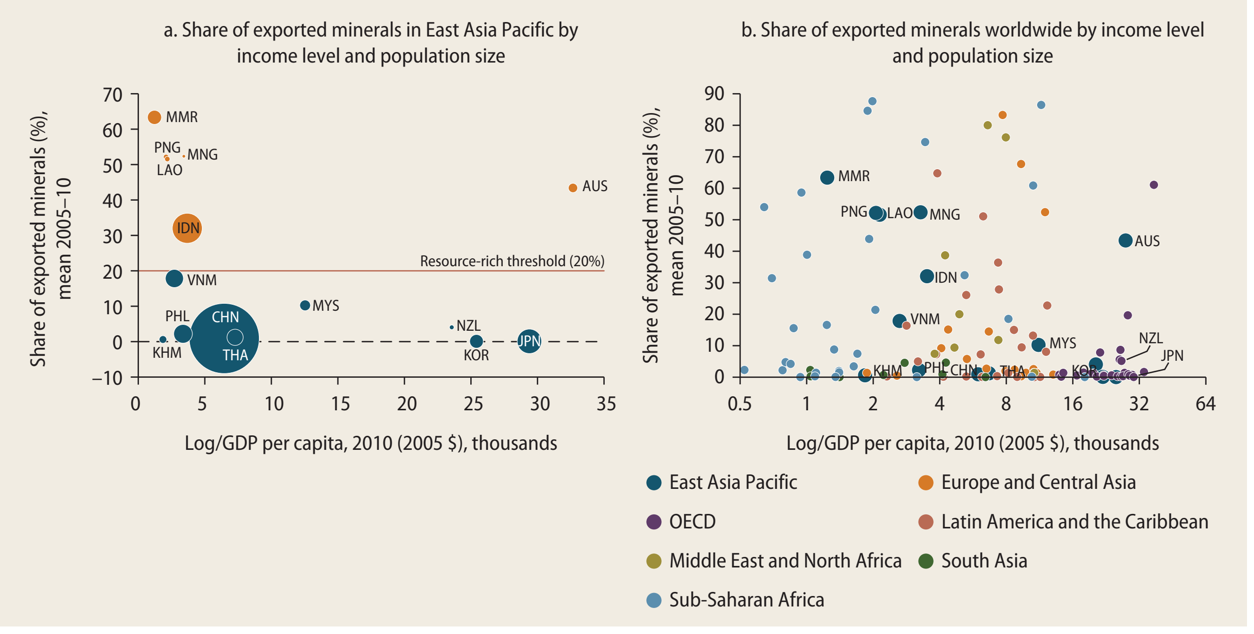
But the mine retained fewer than 4,000 workers after construction was complete. Furthermore, the benefits of mining sector employment for reducing poverty are debated. Work in the mining sector in Lao PDR has had a limited impact on reducing poverty and raising living standards.[6]

Mineral resources can also account for a large share of export revenue, attracting large flows of foreign exchange that can induce inflation and "Dutch-disease" effects, causing the currency to appreciate and harming the competitiveness of other industries that employ large numbers of people. The best forms of work to further the development transformations in these contexts are those that grow the economy outside of the extractive industries sector and that diversify the export base. Resource-rich countries can also look to generate fiscal windfalls by imposing higher taxes and royalty revenues on the extractive industries in order to spend fiscal resources on pro-poor, pro-employment initiatives in areas like education, health, electrification, and connective transportation infrastructure.

For figure 7.11, data from the World Integrated Trade Solution Database on the share of minerals in total exports, 2005–10, were used to assign countries to the resource-rich category.[7] A country is categorized as "resource rich" if the portion of minerals in its exports is 20 percent or higher. By this criterion, figure 7.11, panel a, highlights five East Asia Pacific countries that are categorized as resource rich: Indonesia, Lao PDR, Myanmar, Mongolia, and Papua New Guinea. Although not shown, Timor-Leste also falls into this category.[8] Among the high-income countries of East Asia Pacific, Australia alone is categorized as resource rich, and indeed, in 2012 and 2013, the country has lost employment in steel and car production as well as in tourism and the wine industry, even as overall unemployment has remained at a low 5.5 percent.

Figure 7.11, panel a, illustrates that as many low- and middle-income countries in East Asia Pacific are categorized as resource rich as those that are not. Figure 7.11, panel b, emphasizes just how important this category and its challenges are in East Asia Pacific. Although a larger number of Sub-Saharan African countries and as many Latin American countries can also be found in the resource-rich category, both regions have many more countries overall than East Asia Pacific. However, relative to their number, addressing the challenge of resource riches is particularly important to sustaining the demand for work in East Asia Pacific countries.

FIGURE 7.11 Many economies in East Asia Pacific depend heavily on mineral exports



Sources: Based on data from World Bank 2013c, 2013d.
Note: OECD = Organisation for Economic Co-operation and Development.

Small island states

The challenge of raising and sustaining the demand for and supply of human capital in small islands states is presented by geographic limits to productivity and growth. Small island countries have a limited and fragmented landmass and—as is especially challenging for the Pacific islands—are remote from large markets. These limitations are relatively immovable restraints on growth. The priority in such settings is to foster emigration. In doing so, workers access larger economic centers, cheaper inputs, and more investment, allowing them to earn higher incomes. Crucial for the development of small island economies is that these higher wages translate into remittances.

The typology sets an upper limit on what could be considered a small island state. To qualify, an island country needs to have a population of less than 1 million. Consequently, Papua New Guinea and Timor-Leste—defined as island nations by the UN list of small island developing states—do not fall into this category. Table 7.3 presents data on the populations of the small island states in the region in 2010. The population figures are shown alongside data on land mass. Tuvalu, with a population of less than 10,000, has a land mass of just 30 square kilometers. Fiji, with some 18,000 square kilometers more in landmass than Tuvalu, is divided across 332 islands. Kiribati, one of the most remote and geographically dispersed countries in the world, has a landmass of 810 square kilometers, consisting of 33 islands spread over 3.5 million square kilometers of ocean—an area larger than India.

The challenges of East Asia Pacific's small island states are particularly acute and pressing, even if they are experienced by less than 2.5 million people. These challenges are taken up in much greater detail in the next chapter of this report.

TABLE 7.3 Small populations and limited land constrain growth and the demand for work

Small island state	Land area (sq. km)	Population, total, 2011
Papua New Guinea	452,860	7,013,829
Timor-Leste	14,870	1,175,880
Fiji	18,270	868,406
Solomon Islands	27,990	552,267
Vanuatu	12,190	245,619
Samoa	2,830	183,874
Micronesia, Fed. Sts.	700	111,542
Tonga	720	104,509
Kiribati	810	101,093
Marshall Islands	180	54,816
Palau	460	20,609
Tuvalu	30	9,847
Total	64,180	2,252,282

Source: UN list of small island states.

Country categorization by institutional factors

Lastly, the WDR's typology contends that a country's priority may be based on the weakness of its institutions, with specific reference to conflict-affected countries. The challenge for these countries is severe and focuses on the promised gains of social cohesion by demobilizing former combatants and reintegrating their displaced populations through productive work. East Asia Pacific does not have many conflict-affected countries, in the way that this category shapes thinking about employment in the Middle East and Africa. However, as touched on in chapter 3, the Solomon Islands, Timor-Leste, and parts of the Philippines provide the exceptions.

To define this category, the WDR drew on two sources of information. First, any country in the Uppsala Conflict Data Program database that had at least 1,000 battle deaths in an "internal or internationalized internal conflict" in 2010 (the latest available year) is categorized as conflict affected. Second, any country included in the 2012 World Bank fragility list that had UN peacekeeping and peace-building missions was also categorized as conflict affected. By at least one of these criteria, Timor-Leste could be categorized as a conflict-affected country, and it is the only such country in the region. That said, the UN peacekeeping force has since left Timor-Leste, indicating that the country's primary challenges to increasing well-being from work in the coming years lie in increasing the productivity of agriculture and rural nonagriculture industry and in managing the potential volatility of its enormous petroleum wealth.

Implications for policy makers concerned about work

Setting aside for the time being the challenges faced by small—and more important, *distant*—Pacific Island countries, which we return to in chapter 8, and those of resource-rich countries (Indonesia, Mongolia, Myanmar, Papua New Guinea, and Timor-Leste), most countries in the East Asia Pacific region are agrarian or urbanizing. Indeed, as shown by the size of the spheres in figure 7.1, most *people* in the East Asia Pacific region are living and working in mainly agrarian and rapidly urbanizing contexts. This is an important insight because, according to the WDR 2013, when countries are (or are close to) urbanizing, all three development transformations tend to happen in tandem: productivity and wages are increasing, living standards are rising, and as more people move out of poverty and into the urban middle class, there is greater social cohesion. Chapter 3 presents a large body of evidence showing how all three development transformations have unfolded in East Asia Pacific countries.

As shown in the previous section, most people in East Asia Pacific are now or soon will be living and working in countries that are nearing the end of the structural transition from agrarian to urbanizing economies. During the transition from agrarian to urbanizing—which in East Asia has generally coincided with lower fertility and the emergence of the demographic dividend—the economic forces released by the large-scale movement of people from rural farms to urban firms are so powerful that they propel all three development transformations, with only a minimal need for policy interventions. However, at a critical point when urbanization is already well advanced, one or more of the three development transformations can start to lag. In East Asia Pacific countries, the evidence presented in chapter 3 suggests that these lags are indeed starting to appear in China and Indonesia. In the Philippines, lagging productivity gains and a slower rise in living standards have been apparent longer. When these lags appear or become significant, people can begin to question the extent to which work is still a conduit of well-being—whether economic growth is sufficiently inclusive—and to demand that governments adopt employment strategies. Notably, the development trajectories of East Asia's high-income successes—Japan, Korea, Singapore, and others—all included periods calling for "jobs strategies." But the answers that made sense for those countries at the time may not be viable today, as we discuss in spotlight 2.

For countries that are still mainly agrarian, the priority policy challenge is to increase the productivity of agriculture and to free labor to work in rural off-farm enterprise and eventually migrate to towns and cities. The policy instruments for increasing agricultural productivity and facilitating the structural transition are land reform, agricultural extension programs, deregulation of prices, rural infrastructure, and good-quality education and health services for building human capital. Policies and programs that create implicit or explicit restrictions to labor moving off the farm and into nonfarm industry in rural areas or manufacturing and services in cities will be the main obstacles to sustaining the supply of and demand for labor and human capital. Government action should enable as fluid a structural transition as possible. The WDR showcases Vietnam's experience in the 1990s and the first decade of the twenty-first century as an example of success. The danger to be avoided is urbanization in spite of rather than enabled by policy. This process is characterized by unproductive use of land, migration in search of better health and education services, cities unprepared for fast population growth, and rapid divergence in living standards between town and country. This is the history of the notably less successful transformation of the Philippines.

For countries that are already rapidly urbanizing, the priority policy challenge is to make cities work. Somewhat counterintuitively in a discussion about work, the factor market that policy makers should pay the greatest attention to is the market for land. Since land is the least mobile factor of production, good urban planning, land registration and titling, liberalization, and appropriate taxation are the key instruments to increase the flexibility of land use. Urban planning is the area of policy making with the greatest impact on the incentives of firms in towns and cities to form, to grow, to move up the value chain, and thus to create and sustain employment. Also important are planning and management of connective urban infrastructure and service provision. Providing adequate connective transportation infrastructure and services (water, sanitation, health, and education) can ensure that growing cities with plenty of skilled people foster economies from agglomeration rather than incur burdensome costs from congestion. Korea's example is instructive in this regard and provides valuable guidance for policy makers in fast-urbanizing countries of East Asia Pacific.

For countries where most people live in cities and a rising share of economic activity is formalizing, the priority challenge lies in avoiding the formation or entrenchment of a policy and regulatory environment that causes segmentation. Segmentation creates the problem of cleavages in factor markets that impede competition, impair labor mobility, and limit the coverage of essential work-risk and social protection. In this way, segmentation creates unnecessary constraints on a country's productivity, rations gains in living standards to connected groups, and in so doing threatens social cohesion. Segmentation of the factor markets can be caused by differences in how income from different sources is taxed; by rules for providing credit that explicitly or implicitly exclude self-employed people; by the types of work that are recognized in the labor code and those that are not; and by how nonwage social protection benefits are designed and financed. Models of labor regulation and social protection that tie eligibility to certain forms of work and are financed from mandatory contributions from employees and employers create segmentation by design, even when they are administered perfectly. In most low- and middle-income countries, segmentation by design is aggravated by weak institutional and administrative capacity.

Avoiding and eliminating segmentation of factor markets is essential if countries of East Asia Pacific are to grow in wealth before they have to face the more difficult challenges of an aging economy. This is the current quandary of many middle-income countries in Central Europe and the Southern Cone of Latin America that got old before they got rich. Their example should strike a strong note of caution for policy makers in East Asia Pacific countries where the average age of the labor force and the share of the elderly in the population are rising quickly.

Notes

1. For an in-depth discussion of the typology and its implications for policy, see World Bank (2012, ch. 6, 190–216).
2. The notes highlight the instances where the analysis in this chapter differs significantly from that undertaken by WDR 2013.
3. Regions in which countries crowd into one country type may heavily influence the global distribution of data in each case. For example, the prevalence of agrarian countries in Sub-Saharan Africa means that a threshold based on a global distribution may not be the perfect device for identifying which countries in East Asia Pacific are primarily agrarian.
4. High-income countries are excluded by virtue of the lower bound being less than 60 percent urbanized in 2000.
5. The indicator "pension contributors as a share of the labor force" is available in the World Bank's Pension Database (World Bank 2013b). This indicator is the proxy used by

the WDR typology—a one-year measure of active contributors to pensions as a share of the labor force and thresholds that are greater than or equal to 25 percent and less than or equal to 75 percent. Additional data collected for this report have made available more data points for East Asia Pacific countries than were available in the WDR sample. This has allowed us to assess the increase in the share of formal employment over time.

6. "[In Lao PDR] direct gains from employment did not significantly contribute to overall poverty reduction … even though poverty among mining sector employees fell by more than 23 percentage points between 2003 and 2008 … Because of its small share in overall employment, the mining sector's total contribution to poverty reduction was less than 0.1 percent out of the 6 percent nationwide reduction achieved in that same period" (World Bank 2010, 17).
7. Data were also collected on *net* exports of minerals in order to see if this had any significant impact on the countries that were deemed to be resource rich and on the dual challenges of job creation and Dutch disease. It did not change the categorization—all were also net exporters.
8. For Timor-Leste, alternative World Bank sources were used.

References

Cruces, Guillermo, Andrés Ham, and Mariana Viollaz. 2012. "Scarring Effects of Youth Unemployment and Informality: Evidence from Argentina and Brazil." Paper for the project "*Mercados laborales el crecimiento inclusivo en América Latina*" supported by the International Development Research Centre and carried out by the Center for Distributive, Labor, and Social Studies, University of La Plata.

East-West Center. 2002. *Asia's Aging Population: The Future of Population in Asia*. Honolulu: East-West Center.

Ghani, Ejaz, and Ravi Kanbur. 2013. "Urbanization and (In)Formalization." Policy Research Working Paper 6374, World Bank, Washington, DC.

Gollin, Douglas, et al. 2002. "The Role of Agriculture in Development." *American Economic Review* 92 (2): 160–64.

Hyytinen, Ari, and Petri Rouvinen. 2008. "The Labour Market Consequences of Self-Employment Spells: European Evidence." *Labour Economics* 15 (2): 246–71.

World Bank. 2007. *The World Development Report 2008: Agriculture for Development*. New York: Oxford University Press.

———. 2010. *Lao Development Report: Natural Resource Management for Sustainable Development*. Washington, DC: World Bank.

———. 2012. *The World Development Report 2013: Jobs*. New York: Oxford University Press.

———. 2013a. "Executive Summary." In *Philippines Development Report 2013: Creating More and Better Jobs*. Draft. Washington, DC: World Bank.

———. 2013b. World Bank Pension Database. Washington, DC: World Bank.

———. 2013c. World Development Indicators Database. Washington, DC: World Bank.

———. 2013d. World Integrated Trade Solution (WITS) Database. Washington, DC: World Bank.

Yusuf, Shahid, and Tony Saich. 2008. *China Urbanizes: Consequences, Strategies, and Policies*. Directions in Development. Washington, DC: World Bank.

Spotlight 2

Past Jobs Strategies in East Asia: Could They Work Today?

What exactly are employment—or jobs—strategies?

Few participants in the debates about inclusive growth policies can agree on where to draw the boundaries of employment or "jobs strategies." To some, the concept refers narrowly to the set of regulations and direct interventions in the labor market that aim to improve employment outcomes. Discussed in chapter 6, they range from employment protection regulations and wage policies to passive and active labor market programs. For example, the European Employment Strategy is a legal mechanism designed to coordinate employment policies in the European Union member states. This strategy set out annual employment guidelines and emphasized priority areas for action over the period 2008–10, including raising the employability of the labor force through training, changing regulations to make the labor market more flexible, and strengthening structures that provide working people with income security (Goetschy 1999).[1] Other common examples are national youth employment strategies or national action plans that specifically aim to curb youth unemployment—involving a set of measures such as skills building, passive and active labor market programs, and support for prospective young entrepreneurs (UN 2007). Employment strategies that focus even more narrowly on skills development range from manpower planning—setting targets, based on forecasts, for building specific technical skills—to more fluid and integrated approaches to workforce development, discussed in chapter 5.

However, employment strategies are typically cast more broadly and encompass actions across a wide range of government activity. As discussed in detail in earlier chapters, many policies directly or indirectly affect the supply of and demand for labor and human capital, either by design or collaterally. Some governments find it effective to package monetary, fiscal, and economic policy measures in a single strategy, which helps them to coordinate the actions they take and demonstrates their commitment to improving employment outcomes. A broad employment strategy can also include government interventions in the product and factor markets that directly affect employment outcomes. Indeed, many governments go so far as to design and deploy policies that support certain industries or areas of production that they consider to be strategic and aligned with national goals. *Jobs strategies* that are embedded in this sort of "industrial policy" will often explicitly promote sectors that the government thinks have the most potential to create employment.

Successful examples of past strategies in East Asia indicate that employment or jobs strategies should be a complement rather than a substitute for sound fundamentals and institutions. In fact, they may not differ much in content from a growth or "inclusive growth" strategy, other than an explicit focus on employment outcomes. The *World Development Report 2013: Jobs* (World Bank 2012) argues that, when measures to boost and sustain economic growth are designed to capture the external "spillovers" and social value of work, there is little need for a separate, stand-alone jobs strategy. However, in some circumstances where these external, social benefits of work are not adequately accounted for by decision makers, not identified, or not fully realized, a separate strategy may be warranted to assess and remove constraints on creating employment and sustaining well-being from work.

East Asia's experience with employment strategies

The East Asian Tigers—Hong Kong SAR, China; the Republic of Korea; Singapore; and Taiwan, China—achieved high-income status and fairly inclusive growth over the past several decades, sometimes in the course of a single generation (World Bank 1993; Gill and Kharas 2007). At important points in their development, most adopted explicit jobs strategies, designed and administered from the top to achieve national objectives and either embedded in or separate from growth strategies and industrial policy. For example, Taiwan, China, introduced preferential policies for "strategic industries" in the 1980s, mainly mechanical products, information technology, and consumer electronics (Yang 1993). Korea and Singapore followed a similar course, for varying sectors and to varying degrees. However, their strategies—considered by many as the most successful examples of industrial policy—also included and benefited from the necessary work of building sound "fundamentals," including property rights, basic education, infrastructure, and openness to trade and global competition.

Singapore's development strategies since the 1950s, while featuring strong state intervention to promote competitiveness in targeted industries and to raise employment outcomes and living standards, also built on solid fundamentals. Singapore's industrial strategy featured the following core components: strong institutions, orientation toward free trade and foreign direct investment, infrastructure and education investments, and solid macroeconomic stability. After the country shifted from colonial rule to self-government in 1959, it needed to tackle high unemployment and rising ethnic tensions. The focus on jobs in the government's strategy was explicit as well as urgent. An Industrial Promotion Board was created to foster private sector–led manufacturing and to boost employment. In the period 1960–65, an import substitution phase of industrialization, the government concentrated on processing industries such as petroleum refinement; processing of food, wood, and rubber; the garment industry; assembly of electronic products; and ship repair. Singapore moved to a development model led by exports and foreign direct investment in 1965. During the period 1979–90, in reaction to the spread of low-cost manufacturing across Southeast Asia, Singapore supported industrial upgrading to higher value-added activities and increased the demand for high-skilled labor. This strategy involved, for example, improving the base of education and skills as well as promoting high-tech manufacturing. The objective of raising employment outcomes was folded into the objective of spurring economic growth. Over this period, Singapore transitioned from assembling to producing electronics and became a services hub for transport, trade, communications, and finance (Siow Yue 2005).

In its early stages of development, the Korean government adopted national development planning with explicit industrial and employment strategies. Korea supported and protected young, emerging industries with preferential credit and import quotas, among other measures. Starting in the early 1960s with low-technology manufacturing goods, Korea subsequently targeted the iron and steel industry as well as petrochemical products in the late 1960s to early 1970s. By the end of the 1970s, the policy focus shifted to naval construction, capital goods, durable consumer goods, and chemical products. In the 1980s and 1990s, the government supported electronics industries (Ray 1997). In addition, Korea engaged in intensive manpower planning to link education, training, and development of the labor force to the requirements of its growing industries. With forecasts of industrial and sector needs for human resources based on medium- to long-term macroeconomic plans, human resource development policies supported technical vocational education and training as well as university training. What is frequently overlooked, however, is that these policies had strong foundations in prior investments that ensured basic education for all, starting in the 1960s and continuing in the 1970s.

China has also employed various forms of industrial policy with the implicit and explicit objective of increasing productive employment and raising well-being. Since economic liberalization began under Deng Xiaoping in the 1970s, China's industrialization has featured industrial policy programs (Heilmann and Shih 2013), but these have benefited from massive investment in infrastructure and trade logistics. China's special economic zones and preferential treatment for the targeted sectors dominating those zones drew large amounts of labor from rural agriculture to light manufacturing in the coastal areas. In addition to mobilizing labor, China's success is the result of tremendous capital investments that provided the necessary underpinnings for fast economic growth. To sustain capital investment, the Chinese government made intense use of directed credit, allocating credit through state-owned or private banks, and financial repression in the banking system, depressing commercial interest rates so that central and local governments could borrow at low rates to invest in capital projects (Huang 2012a, 2012b, 2012c). China's stellar growth has reignited discussion about industrial policy that had been largely discredited in the 1980s (Lin 2012).

Are these strategies viable for emerging East Asia Pacific countries now?

Jobs strategies in many East Asian countries have been embedded mainly in broader industrial policies. The benefits of industrial policy are hotly debated in theory and mixed in practice. Proponents of a principal role of the state base their arguments on three forms of externalities and market failures: knowledge spillovers and dynamic scale economies, coordination failures, and information externalities. Several policy approaches have furthered the thinking on industrial policy. Proponents of the New Structural Economics argue that planners and administrators in a country should analyze other countries with similar endowments but slightly higher levels of income to identify and target industries with a solid export history and potential (Lin 2012). Another approach is to promote public-private partnerships for tackling coordination failures and facilitating the exchange of information between the public and private sectors. Finally, several researchers propose fostering spillovers of productive knowledge to support the development of industry with higher knowledge content and greater value added (Cimoli, Dosi, and Stiglitz 2009).

Skeptics of industrial policy argue that most low- and middle-income-country governments lack the information and capacity to "pick winners"—to identify and capture knowledge spillovers or to exploit dynamic scale economies in certain industries. Another challenge is the need for governments to be able to monitor and learn from their experimentation, in order to know when to shift resources from old to new industries. And there is the danger that vested economic interests will exert political power: few low- and middle-income governments that have engaged actively in industrial policy in the past have been able to withdraw protection easily from industries in which the country no longer has a comparative advantage. Thus industrial policy can be not only costly, but also politically risky for many countries with low state capacity and weak governance, given the high potential for rent seeking and locked investment in unproductive activities (Krueger 1974).

Experiences with industrial policy in other parts of the world—often deployed with explicit employment objectives—have been more sobering than the story of East Asia's now high-income countries. Within East Asia Pacific, critics often point to mistakes in Japan's history of industrial policy, such as when the government discouraged Honda from entering the automobile industry and Sony from entering consumer electronics. However, examples outside the region, such as the track record of import substitution in Latin America up to the 1980s and India's protected industrial groups prior to trade liberalization in the 1990s, featured overall slow economic growth and high fiscal costs, frequently in the form of subsidies captured by interest groups. Such strategies created costly distortions and hampered broad-based improvements in employment outcomes; they did not correct the market failures or address the externalities for which they were designed. Some argue that these unsuccessful experiences were due to poor design and implementation rather than the idea of industrial policy per se, but many would agree that setting the right institutions is a key element in any inclusive growth and jobs strategy. In countries with weak political institutions, industrial policy measures are likely to result in large misallocations and inefficiencies (Beck 2008). In Pakistan, for example, directed credit helps to boost the performance of small exporters but has little impact on the performance of larger exporters. Yet large exporters, usually companies with political clout, are the main benefactors of cheaper loans (Zia 2008).

Even some of the policies that have served the Chinese economy well in the past, such as directed credit and interest rate ceilings, have been less positive elsewhere and may not be appropriate for China any longer. Financial repression is no longer a sustainable strategy to achieve high income, contributing to inflated asset prices, property price bubbles, and a large shadow banking system. As the Chinese private sector becomes more sophisticated, deregulating interest rates will become an imperative for the private sector to respond adequately to growing demand (Huang 2012a, 2012b, 2012c).

Should the employment strategies that worked in the past be attractive options for emerging East Asia Pacific countries now? The kind of national development strategies described earlier are unlikely to succeed without sufficient information and institutional capacity to design and implement them effectively, transparently, and flexibly. The governments of China, Korea, and Singapore have all developed very high levels of capacity not only to identify target sectors and industries for preferential policy but also to jump-start and implement these policies, which requires the creation and destruction of specific industries and continual restructuring of the economy. The low- and middle-income countries of East Asia Pacific, however, have weaker institutions and governance. Attempting to replicate past top-down strategies with limited capacity and information raises the risk of government failures and rent seeking and can exacerbate the very market failures that policies are intended to correct. In addition, jobs strategies embedded in top-down industrial policy were typically pursued in East Asian countries by authoritarian regimes, aside from Singapore. Top-down industrial policy may be more difficult to undertake in a pluralistic democracy of the sort found in Indonesia, Malaysia, the Philippines, and Thailand today.

Policy makers in the emerging economies of East Asia Pacific operate in a very different world from two or three decades ago. Today's global policy environment provides opportunities and tendencies to influence national economic policies through multilateral, regional, and bilateral agreements. For example, many of East Asia Pacific's developing countries are now members of the World Trade Organization and, in principle, subject to its restrictions on export subsidies and rules on intellectual property rights, among others. Moreover, the potential costs of government failures in implementing the sort of employment strategies and industrial policies that might have been successful in the past are likely on the rise with increasing global and regional integration. The fast pace of globalization intensifies competition in the product and factor markets, making it increasingly costly to interfere unnecessarily with households' and firms' incentives and responses to market signals. In the East Asian economies with rapidly evolving demand for work, "top-down" approaches like past forms of targeted sectors and manpower planning could become too rigid, adjust too slowly, and overemphasize technical skills over foundational cognitive and behavioral skills, a danger discussed in chapter 5.

Korea is notable for the changing nature of its jobs strategy. Leipziger and Petri (1993) argue that in the early 1990s, Korea's industrial policy had not kept pace with the enormous political, economic, domestic, and international changes taking place, leading to increased conflicts between government and business and confusion in economic policy making—for example, policies toward conglomerates (chaebols). In 1996, Korea abandoned the top-down industrial policy and development planning that it had adopted with much vigor. Skills development involved much less central manpower planning and a more integrated and comprehensive system to support the quality and market relevance of education and to form closer partnerships between the skills-supply structures and the private sector (Kim 2002). The government recently shifted to a focused, market-led employment strategy. In 2010, Korea adopted an employment strategy with the objective of increasing the employment rate of the working-age population to 70 percent by 2020. The new employment strategy has four main components: (1) "employment-friendly" economic and industrial policies; (2) labor regulation reform to improve flexibility and fairness; (3) skills development and measures to increase the labor force participation of women, youth, and older workers; and (4) active labor market programs to facilitate the transition from welfare to work (World Bank 2012).

History offers useful lessons. The experience of today's high-income East Asian countries suggests that whatever employment strategy is adopted to address market failures needs to complement rather than substitute for sound fundamentals and institutions. As tempting as it may be for emerging East Asia Pacific countries to strive to replicate past strategies of its high-income neighbors, their earlier forms of rigid, top-down industrial policy—with and without an explicit employment objective—may not be viable options in today's more globalized, rules-based, and fast-changing economic environment. Instead, the useful lesson to take away is the need to set the right fundamentals, institutions, and factor market policies. Priority public investments will build on those fundamentals, releasing constraints on the creation of employment that propels productivity, improves living standards, and strengthens social cohesion.

Note

1. See also http://www.eurofound.europa.eu/areas/industrialrelations/dictionary/definitions/europeanemploymentstrategy.htm.

References

Beck, Thorsten. 2008. "Policy Choices for an Efficient and Inclusive Financial System." In *Secured Transactions Reform and Access to Credit,* edited by Frederique Dahan and John Simpson. Cheltenham: Edward Elgar.

Cimoli, Mario, Giovanni Dosi, and Joseph Stiglitz. 2009. *Industrial Policy and Development: The Political Economy of Capabilities Accumulation*. Oxford: Oxford University Press.

Gill, Indermet, and Jomi Kharas. 2007. *East Asian Renaissance*. Washington, DC: World Bank.

Goetschy, Janine. 1999. "The European Strategy from Amsterdam to Stockholm: Has It Reached Its Cruising Speed?" *Industrial Relations Journal* 32 (5): 401–18.

Heilmann, Sebastian, and Lea Shih. 2013. "The Rise of Industrial Policy in China, 1978–2012." Working Paper, Harvard-Yenching Institute, Cambridge, MA.

Huang, Yukon. 2012a. "In the Middle Kingdom's Shadow." *Wall Street Journal*, March 26.

———. 2012b. "The Stimulus China Really Needs." *Wall Street Journal*, June 13.

———. 2012c. "Time for China to Give up Financial Repression." *Financial Times*, May 2.

Kim, Gwang-Jo. 2002. "Education Policies and Reform in South Korea." In *Secondary Education in Africa: Strategies for Renewal*, edited by Lawrence Mastri, 29–40. Washington, DC: World Bank.

Krueger, Anne O. 1974. "The Political Economy of the Rent-Seeking Society." *American Economic Review* 64 (3): 291–303.

Leipziger, Danny, and Peter Petri. 1993. "Korean Industrial Policy: Legacies of the Past and Directions for the Future." Discussion Paper 197, World Bank, Washington, DC.

Lin, Justin. 2012. *New Structural Economics: A Framework for Rethinking Development and Policy*. Washington, DC: World Bank.

Ray, Debraj. 1997. *Economía del desarrollo*. Barcelona: Antoni Bosch.

Siow Yue, Chia. 2005. *The Singapore Model of Industrial Policy: Past Evolution and Current Thinking*. Washington, DC: Inter-American Development Bank; Manila: Asian Development Bank Institute.

UN (United Nations). 2007. "Review of National Action Plans on Youth Employment: Putting Commitment into Action." United Nations, New York. http://www.un.org/esa/socdev/social/documents/National.Action.Plans.2007.pdf.

World Bank. 1993. *The East Asian Miracle: Economic Growth and Public Policy*. Washington, DC: World Bank.

———. 2012. *World Development Report 2013: Jobs*. New York: Oxford University Press.

Yang, Ya-Hwei. 1993. "Government Policy and Strategic Industries: The Case of Taiwan." In *Trade and Protectionism, NBER East Asia Seminar on Economics*, vol. 2, edited by Takatoshi Ito and Anne Krueger. Chicago: University of Chicago Press.

Zia, Bilal. 2008. "Export Incentives, Financial Constraints, and the (Mis)Allocation of Credit: Micro-Level Evidence from Subsidized Export Loans." *Journal of Financial Economics* 27 (2): 498–527.

Well-being from Work in the Pacific Island Countries

8

In the Pacific island countries, which are small and far from world markets, labor mobility represents the most significant and substantial opportunity for overcoming geographic constraints on employment.

This chapter presents a brief overview of employment challenges in small Pacific island countries (PICs) and offers recommendations for addressing them. It is very different in nature from the rest of the report in the sense that it is a self-contained piece. The Pacific island countries are not only very different from the rest of the East Asia Pacific region but also unique in the world. Therefore, to be useful, a coherent discussion of work in these countries requires its own space to describe the context, analyze employment outcomes, and recommend policies.

We begin with an assumption that, due to realities of economic geography, small PICs are unlikely to follow the employment trajectory of fast-growing East Asian economies. Given the particular challenges and opportunities facing these countries, discussion in this chapter relates to the Pacific island states with populations of significantly less than 1 million, including Kiribati, the Marshall Islands, the Federated States of Micronesia, Palau, Samoa, the Solomon Islands, Tonga, Tuvalu, and Vanuatu. Economic growth and diversification have been very limited in these countries because of the barriers imposed by smallness and distance, and these barriers will not be overcome quickly. Policy tweaks to the business environment aimed at fostering the emergence of an export-oriented private sector are unlikely to be effective in generating substantial expansion of employment opportunities. The challenge for policy makers is therefore to think about how to meet employment challenges within the formidable constraints imposed by geography.

Slow economic growth, rapid population growth, and accelerating urbanization mean that employment creation is a pressing priority for small Pacific island countries.[1] The appropriate employment strategy will vary between these countries, given their diversity in size, location, natural resource endowments, and demographics. Nevertheless, the chapter proposes five priorities that are likely to be broadly applicable to this unique group of countries.

First, stakeholders' expectations about the trajectory of development will need to be realistic. Due to inherent geographic obstacles, PICs are unlikely to experience export-driven development and associated employment creation on the scale seen in the broader East Asia Pacific region. While business environment reforms can open up new opportunities for private sector development and employment creation, such measures are unlikely to spur sufficient work to meet emerging demands even in the best possible business environment. Employment strategies must therefore include less conventional policy options and focus on areas where PICs have established strengths and advantages.

Second, the volume of international labor mobility should be increased through the erosion of regulatory barriers and investment in transferable human capital. PICs will never be able to achieve the scale and integration seen in larger regional economies. The greatest potential for work is therefore through the movement of Pacific Islanders to areas where employment opportunities are concentrated. The priority for policy is to provide people from PICs with access to work wherever it exists. Echoing the conclusions of earlier World Bank reports (Luthria 2006), this will require both changes in the immigration policies of the nearest large economies and careful investment in internationally transferable human capital by small PIC governments.

Third, governments can work to harness the positive potential of urbanization through investment in improved rural services, connective infrastructure, and improved urban administration. Urbanization is a reality in most PICs and one that should be enthusiastically embraced. Urbanization accompanies development, allowing the realization of scale economies, greater thickness in markets, and increased specialization. Urbanization driven by these positive economic benefits should be facilitated. But urbanization occurring as a result of poor services in rural areas, conflict, food insecurity, or land shortages simply leads to congestion and urban unemployment, delivering few economic benefits and placing pressure on social cohesion. Policies should not be biased toward employment in either urban or rural areas, but rather should seek to ensure acceptable standards of living across all communities and allow individuals to respond as they choose to the inevitable concentration of economic opportunities in urban areas. This will require (1) movement away from policies aimed at preventing urbanization, such as inadequate legal protection for recent arrivals in urban areas, underprovision of peri-urban services and infrastructure, and production subsidies for rural areas; (2) sufficient public investment in infrastructure links between agricultural areas and urban areas; (3) improved land administration and increased investment in services in urban areas; and (4) interventions to assist agricultural productivity and support rural services and standards of living.

Fourth, productive public spending can be used as a mechanism for creating new employment opportunities. Large public sectors in PICs are often a source of concern, with public sector employment thought to exist at the expense of increased private sector employment. In reality, the scope for private sector–led employment creation is often constrained by geography. Public sectors, while large relative to the size of the economy, remain small in absolute terms and with regard to diseconomies of scale in administration and service delivery. Public sector employment is therefore likely to continue to provide a substantial share of work in PICs. Policy attention can usefully focus on ensuring that such employment is productive and sustainable rather than on reducing the number of public sector jobs. Private participation can provide incentives for efficient delivery of public services, but needs to be approached carefully and selectively. Broader public sector reforms to ensure efficiency and effectiveness need to continue. Donor agencies and governments can work to ensure that development expenditure supports the creation of local employment opportunities.

Finally, policies can ensure that natural resource industries provide a sustainable source of employment creation. Natural resource industries can flourish in PICs despite higher cost structures. But work in natural resource industries is often unsustainable and contributes little to living standards. Judgments about policy interventions to create employment within these industries should consider the quality and sustainability of the work they are likely to create. PICs might often benefit most from converting rents from natural resource industries into improved infrastructure, services, and human capital, rather than seeking to create direct large-scale employment in those industries through implicit or explicit subsidization.

In the remaining sections of this chapter, we present an overview of work in the Pacific and a summary of emerging employment challenges. We then provide recommendations for dealing with these challenges. In the final section, we summarize policy conclusions.

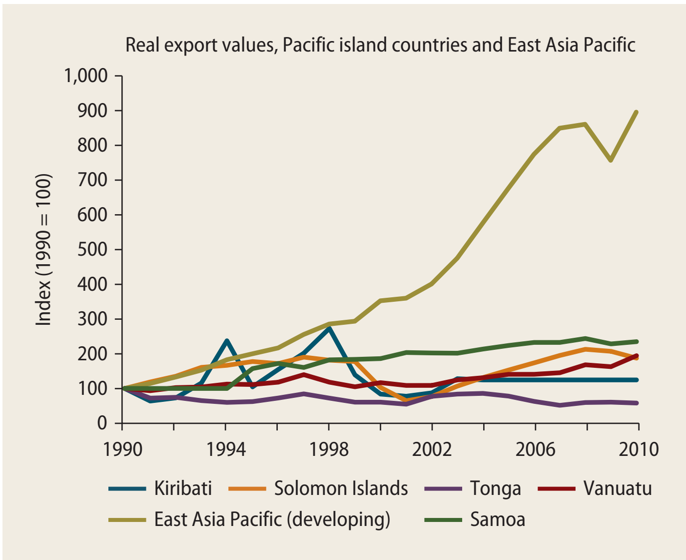
Employment challenges of the small Pacific island countries

The Pacific island countries are following an employment trajectory different from the rest of the region. As shown in the early chapters of this report, much of East Asia Pacific has enjoyed rapid economic growth and economy-wide increases in productivity in recent years, driven by the large emerging economies of East Asia. This has occurred with an explosion of work opportunities in higher-productivity manufacturing and service sectors, often globally integrated and focused on exporting and almost entirely in urban areas. This transformation has fed on itself, with productivity gains from agglomeration and increasing wage incomes fueling domestic demand. In short, export-driven structural transitions of East Asian economies have contributed to creating employment and boosting the well-being that people get from work. The experience of East Asia, however, has not been the experience of most Pacific island countries. There is little sign in PICs of the broader economic changes that are transforming much of the region. Access to regular paid work is limited, and labor productivity remains almost static. Real gross domestic product (GDP) per capita has increased 650 percent for the East Asia Pacific region since 1982, but for the larger of the economies discussed in this chapter, output per person has increased only 38 percent. Real exports from East Asia Pacific as a whole have increased by a factor of nine since 1990, while exports from these Pacific island countries are only about twice their 1990 value (figure 8.1). The percentage of the population living in cities in the average small PIC is about the same as the percentage of the population living in cities in East Asia in 1960, and the scale of urbanization since 1990 has been significantly less (figure 8.2).

Official statistics are scarce, providing an incomplete picture of employment and work in small Pacific island countries. Little data on employment are available beyond that which are collected from household income and expenditure surveys and censuses. There are important inconsistencies in the definitions used in available surveys across countries, leading to large variation in reported labor force participation and unemployment rates that do not reflect underlying economic or social realities.

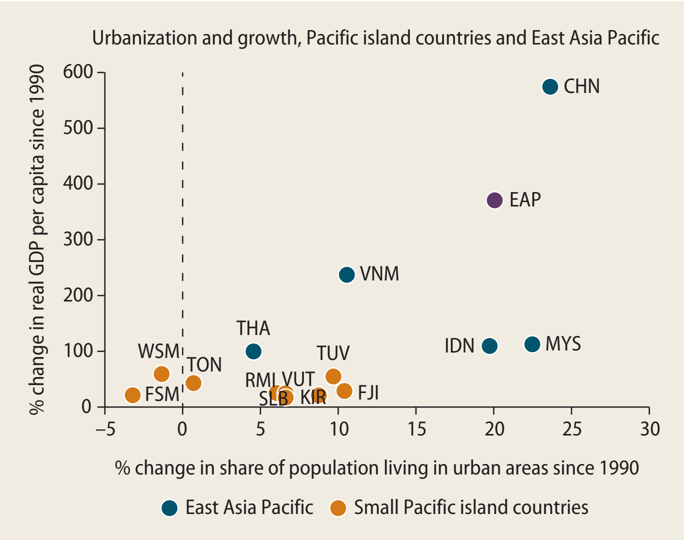
Some employment patterns are common across most PICs. A small number of Pacific Islanders have formal employment, most of which is in cities and much of which is in the

FIGURE 8.1 Pacific island countries have not transitioned to export-led manufacturing and services



Source: World Development Indicators.

FIGURE 8.2 Pacific island countries have lower rates of growth and are less urbanized than the rest of East Asia Pacific



Source: World Development Indicators.

public sector (box 8.1). Most Pacific Islanders engage in some combination of agriculture, subsistence activities and cash or barter exchange, and informal small-business activity, either as part-time employees or as business owners. In cities, many individuals are employed on a part-time or casual basis by small businesses operating informally, while many others generate income through a range of informal and part-time own-business trading opportunities, such as operating a temporary retail stall or selling products in the town market. Many Pacific Islanders move between agricultural production for exchange, subsistence agriculture, and informal small-business activities and cannot easily be assigned to a single employment category. Those with formal employment may also engage in agricultural or subsistence activities at various times to generate additional cash income or meet various social obligations.[2]

Work patterns vary strongly by gender (figure 8.3). Across Pacific island countries, men dominate paid employment outside of agriculture, with approximately half as many women accessing these opportunities. In Melanesia, women occupy only a third of positions within the formal economy. Women's economic activity tends to be concentrated in the informal sector, especially in agriculture (UNESCAP 2007). While data constraints preclude extensive analysis, it is clear that women have access to a narrower range of employment opportunities than men and often lack access to higher-paid work. This imposes costs on the economy, with analysis from the broader East Asia Pacific region suggesting that eliminating barriers to women's participation in certain sectors and occupations could improve labor productivity by up to 25 percent for some countries (UNESCAP 2007).

Growing youth populations put pressure on the economy to generate enough work. High fertility rates are driving rapid population growth in several PICs, with the Pacific population expected to double over the next 28 years. PICs also face a youth bulge: 54 percent of the population is below the age of 24—a higher proportion than in East Asia, all developing countries, and the world. The number of people between the ages of 0 and 14 substantially exceeds the proportion of the population between the ages of 14 and 25, and the number of working-age youth is expected to grow quickly over the next decade (figures 8.4 and 8.5). Previous research by the World Bank has shown that it will be a challenge for the private sector to generate enough new jobs to meet expected increases in labor supply. Formal employment opportunities are already limited relative to the labor force in many PICs. Recent estimates from the International Labour Organization (ILO) suggest that the percentage of men between 20 and 24 years of age who are not engaged in *productive activities* (defined as "paid or unpaid activity that contributes to their personal livelihood or that of their family and community as a whole") is as high as 58 percent in Kiribati, 44 percent in the Marshall Islands, and 46 percent in Samoa (ILO 2013).

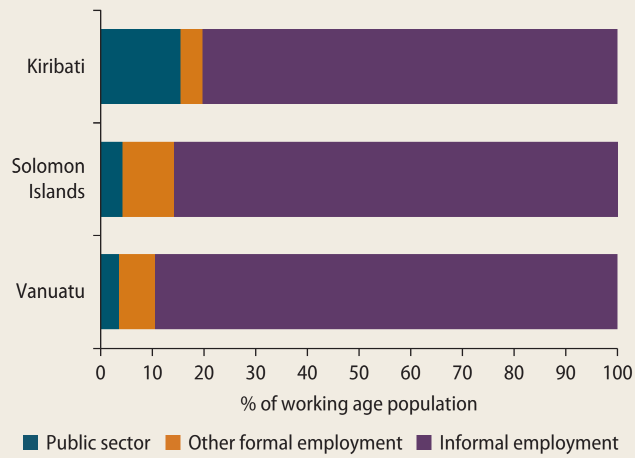
Other factors will also affect the demand for work. Social services have achieved remarkable success in improving health and education outcomes across small Pacific countries in recent decades. At the same

BOX 8.1 Where is the work?

Based on data from the National Provident Funds of Kiribati, the Solomon Islands, and Vanuatu, figure B8.1.1 shows employment shares in the formal private sector, the public sector, and various forms of informal employment.

A large share of formal employment is in the public sector, ranging from 30 percent in the Solomon Islands to nearly 80 percent in Kiribati. Given that the vast majority of Pacific Islanders are engaged in some form of work, the dominance of informal employment, including agriculture for exchange, is also clear from the size of the working-age population without formal work.

FIGURE B8.1.1 The majority of Pacific islanders are engaged in some form of work, many in informal employment

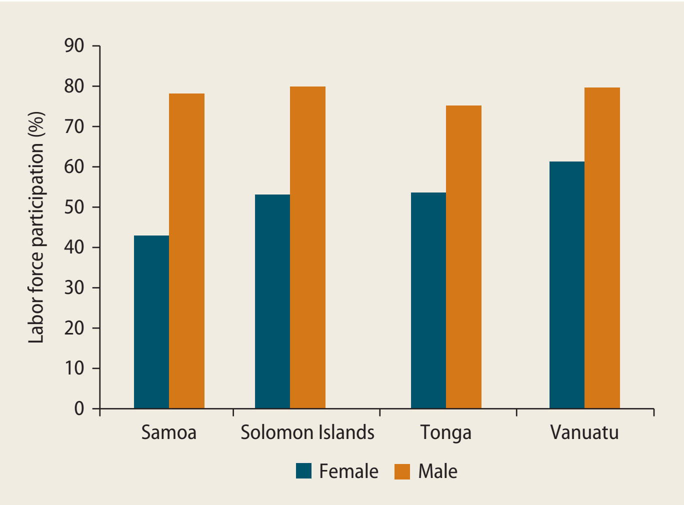


Sources: National Provident Fund and census data.

time, the spread of telecommunications and mass media has fueled aspirations for higher living standards and increased awareness of the wider world. Relatively better-educated and healthier people are more likely to have aspirations beyond village-based and family-oriented agricultural and fishing activities. The pressure associated with these growing aspirations is already spilling over into higher rates of urban migration as young people seek cash incomes and broader opportunities. It is likely to be felt most acutely in countries with currently low levels of emigration and limited formal sector employment opportunities. While global trends suggest that agriculture-based livelihoods are becoming less desirable, they may also be becoming more difficult. In some countries, including Kiribati and the Solomon Islands, rural population growth is placing pressure on subsistence systems, leading to falling productivity and crop yields (Reddy 2007). Pressure on subsistence systems may become an additional driver of urban migration and demand for alternative employment opportunities.

Small Pacific island countries face a cluster of overlapping employment challenges

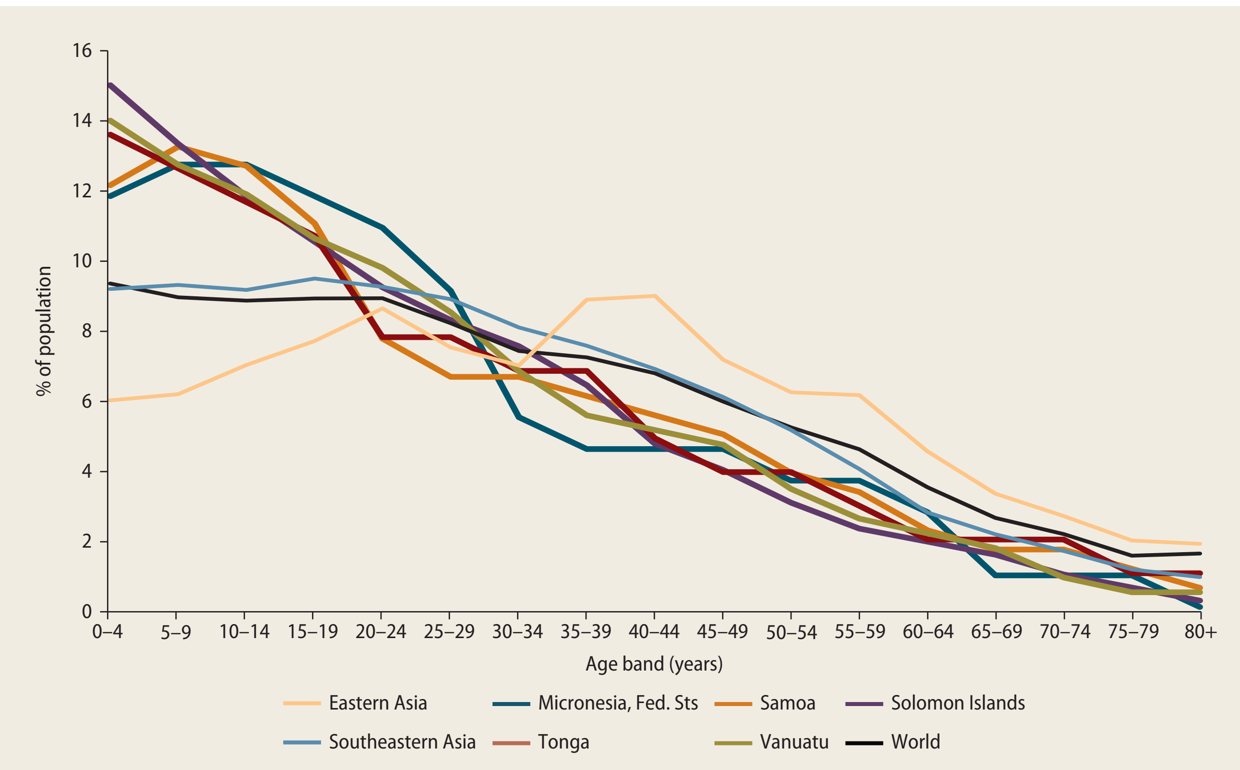
FIGURE 8.3 Women are less likely than men to participate in the labor force



Source: World Development Indicators.

(box 8.2). Without the opportunities generated by rapid economic transformation, PICs face several challenges to creating employment. Many have rapidly growing populations of young people who are unlikely to be satisfied with the limited opportunities for self-advancement offered by agricultural subsistence. Some small PICs are already facing the related challenge of rapid urbanization and are struggling to generate work for growing urban populations. Some have emerged from conflict and face ongoing conflict pressures, with the accompanying need to maintain access to opportunities and ensure their careful distribution between groups and regions. Several countries are struggling to ensure sustainable benefits from extractive resource industries, including encouraging the development of ancillary industries, diversification, and sustainable employment generation.

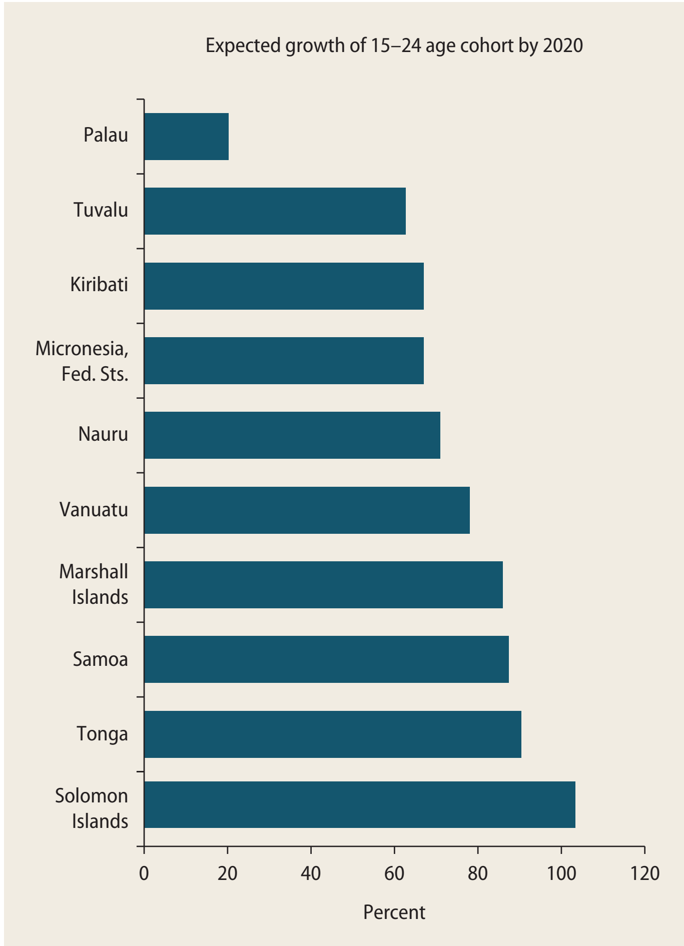
FIGURE 8.4 Pacific island countries have very young populations



Source: United Nations Department of Economic and Social Affairs.

Governments and donors are concerned about the quality and quantity of employment available to Pacific Islanders. Governments and donors in PICs and elsewhere have previously implemented policies to support employment creation in specific geographic locations or sectors, based on prior assumptions about what "good" employment is. Often, policies have sought to support employment in rural areas over employment in urban areas; work within the local economy over work in larger markets; private sector employment over public sector employment; and employment within specific natural resource industries, through concessions or subsidies. Results of this approach have mostly been unsatisfactory, with underlying economic realities derailing well-intentioned plans. As discussed in the *World Development Report 2013; Jobs* (hereafter referred to as WDR 2013), and in prior chapters of this report, the employment strategies that are most likely to succeed focus on ensuring that work raises living standards, drives greater productivity, and contributes to greater social cohesion, regardless of the geographic location or sector where that work takes place.

FIGURE 8.5 Rapid growth in the number of youth is expected over the coming years



Source: Adapted from Bedford 2012.

Five employment priorities for Pacific island countries

In this section we present five employment priorities for PICs. The applicability of these priorities varies across countries according to size, location, demographic profile, natural resource endowments, and nature of existing economic activities. No single strategy will be appropriate for all countries. Nonetheless, shared geographic characteristics suggest some shared challenges and some potential common solutions.

Trajectory of development

Priority 1 Set realistic expectations about the trajectory of development

- *Summary*. Due to inherent geographic obstacles, Pacific island countries are unlikely to experience export-driven development and associated employment creation of the scale and nature seen in much of the East Asia Pacific region, even with the best possible business environment. Employment strategies need to include less conventional policy options and focus on areas where Pacific countries have established strengths and advantages.
- *Countries of relevance*. All Pacific island countries, especially those where populations are very small and dispersed.
- *Living standards*. Forces of economic geography mean that Pacific island countries are unlikely to see rapid improvements

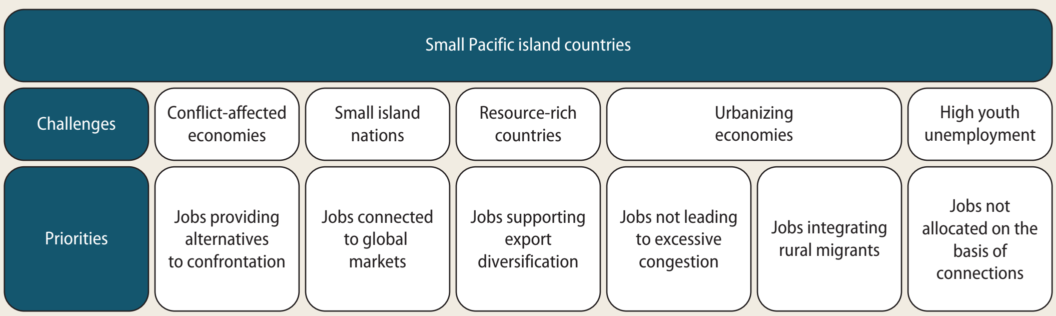
BOX 8.2 Pacific island countries face overlapping employment challenges

The *World Development Report 2013: Jobs* (hereafter WDR 2013; World Bank 2012c) explicitly recognizes that different employment challenges will require different policy responses, discussed at length in chapter 7. Small Pacific island countries face a complex and overlapping range of challenges, including at least five of the challenges specifically identified in the WDR 2013. Figure B8.2.1 shows the challenges relevant to PICs and the associated priorities for policy makers identified in the WDR 2013. These priorities are elaborated in the recommendations of this chapter.

All small island countries face inherent barriers of scale and distance, which can preclude the development of manufacturing and service industries associated with high-productivity, better-paid work. Many countries in the region are endowed with natural resources, in the form of mineral deposits, forests, and fisheries. The development of these industries can lead to uneven and unsustainable development and squeeze out growth in other parts of the economy. The Solomon Islands remains a postconflict country and faces continued conflict pressures arising partly from uneven distribution of economic opportunities, including the concentration of formal sector employment in the capital city, Honiara. Urbanization continues to generate pressures for small Pacific island countries like Kiribati, the Marshall Islands, the Solomon Islands, and Vanuatu, with the pace of growth in urban populations outstripping the pace of employment creation and feeding concerns regarding youth unemployment and associated social problems. These problems are exacerbated by very large and growing youth populations in many PICs, especially in Melanesia.

Source: World Bank 2012c.

FIGURE B8.2.1 Small Pacific island countries face a complex and overlapping range of challenges requiring a range of priorities



in living standards from private sector employment creation. Alternative means of supporting higher living standards through work are required.

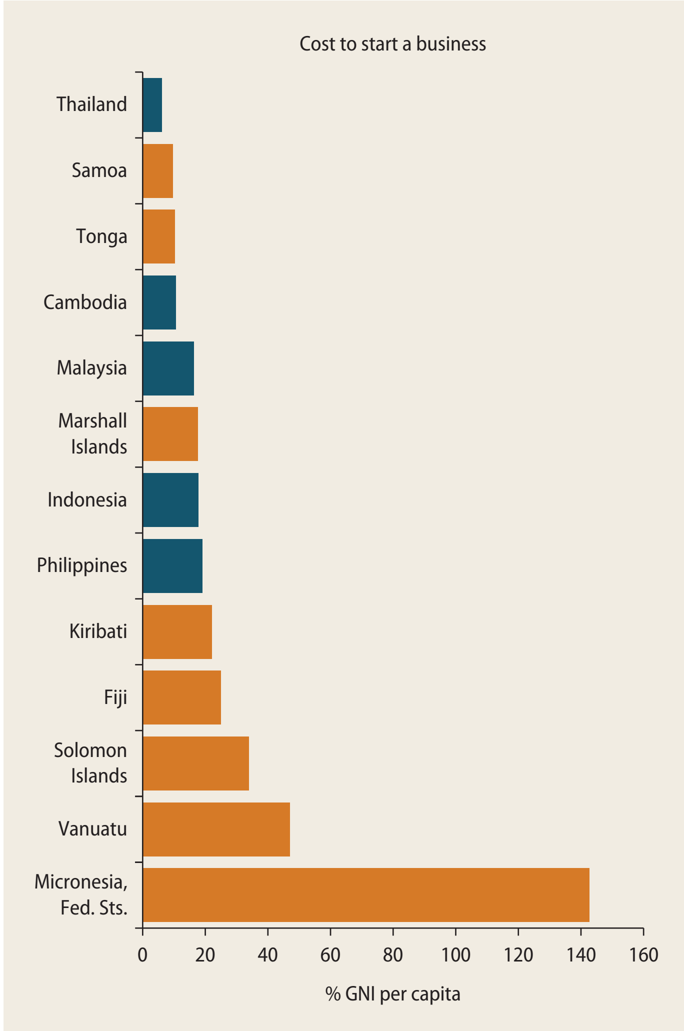
- *Productivity*. Scale and concentration are vital for productivity. Small, dispersed, and distant populations face inherent limits to productivity that need to be reflected in employment strategies.
- *Social cohesion*. Social cohesion can be undermined by unrealistic expectations regarding the prospects for economic and employment growth.

Export-driven, private sector development is unlikely to be the answer to employment challenges facing small Pacific island countries. A common message in reports regarding economic growth or employment creation in PICs is the importance of reforms aimed at improving the environment for the private sector. Improving the business environment can deliver important benefits to small Pacific island countries. A legal and regulatory framework that supports investment and the sound functioning of factor markets can facilitate the creation of employment within businesses supplying local markets or in niche export industries. Continued investment in reforms to reduce the costs of doing business therefore remains an important priority, especially for countries where compliance costs facing businesses are out of line with regional or global norms (figures 8.6 and 8.7 and box 8.3). It is important, however, not to overstate the likely impact of such reforms on employment creation. Due to inherent geographic obstacles, PICs are unlikely to experience the scale of export-driven development and associated employment growth seen in much of the East Asia Pacific region under any regulatory or policy setting.

The formidable geographic challenges of smallness and distance impose costs. The small PICs discussed in this chapter are among the world's 50 smallest countries. Smallness makes it hard for businesses to achieve economies of scale. With relatively few domestic businesses, firms find it difficult to outsource upward and downward through the supply chain. Firms also experience less exposure to positive knowledge externalities, as they are unable to observe the practices of other firms in the same industry and lack access to a pool of workers with experience in different firms. In other small countries, firms overcome some of the costs of smallness by trading internationally. But PICs are also some of the most isolated countries in the world, when measured using a variety of economic measures.[3] Great distances increase the costs of exporting and the price of imported inputs.

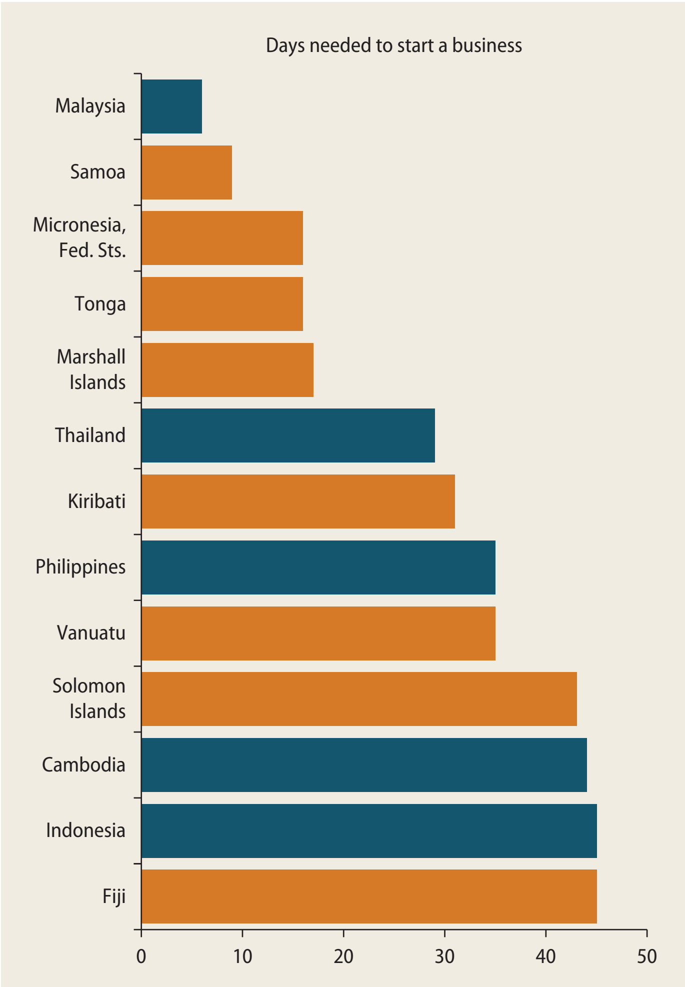
The combined impacts of smallness and distance on cost are sufficient to undermine competitiveness of the industries that have supported growth in larger economies (figures 8.8 and 8.9). Recent quantitative research has investigated just how significant the costs arising from small scale and remoteness might be for countries like those in the Pacific (Yang et al. 2012; Tumbarello, Cabezon, and Wu 2013). Winters and Martins (2004) find that capital would earn negative returns if it were invested in export manufacturing in nearly all of the Pacific island economies. Even if wages were zero in most Pacific countries, total costs would still

FIGURE 8.6 Costs to start a business are higher in many Pacific island countries



Source: Doing Business Indicators 2013.

FIGURE 8.7 The time required to start a business is burdensome in Pacific island countries



Source: Doing Business Indicators 2013.

exceed world prices both in manufacturing and also in a service industry such as tourism.

Constraints of geography have been consistently reflected in the structure and performance of small PIC economies. The economies of small PICs have remained dependent on aid, remittances, and natural resource industries (Bertram and Watters 1985). Large structural current account deficits have continued for all but a few natural resource–rich Pacific countries. Growth in consumption, fueled by aid and remittances, has been met almost entirely by increased imports rather than increased domestic production, reflecting higher local cost structures. Economic activity and employment have occurred in areas where inevitably higher costs do not undermine viability and local activity does not face direct international competition (World Bank 2011). These areas include (1) public services and infrastructure, which account for a large share of formal employment; (2) nontradable private sector goods and services, often focused on meeting demand from the public sector or public sector employees; and (3) natural resource industries, including tourism, where rents can be generated despite higher cost structures. Although the economic drivers in small PICs are different from those in larger economies, they have served PICs very well in lifting incomes and living standards well above those in many larger and less isolated developing economies.

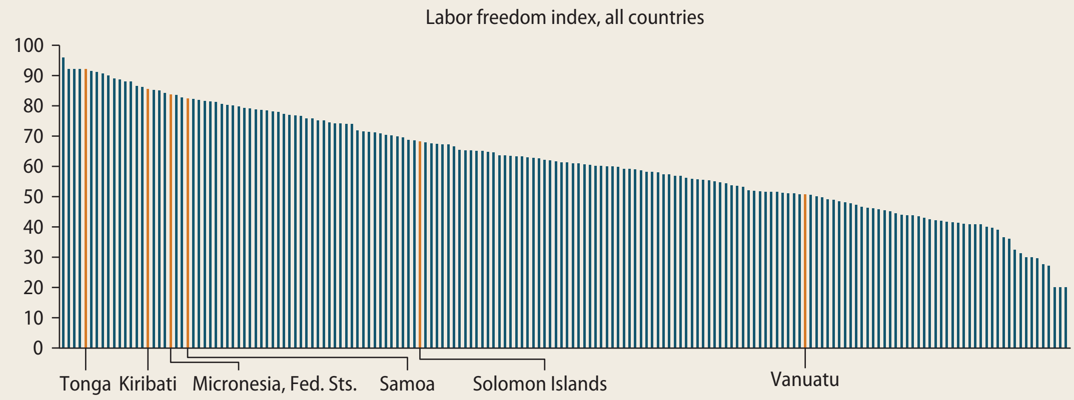
The geographic forces that determine what work is available in PICs will remain significant over time. Contrary to the East Asian experience of diversification, PICs might expect further concentration in traditional areas as preferential access arrangements for key export industries are removed, trade and investment are liberalized, and transport and communication links are improved. Loss of preferential access will mean that PICs face the full impacts of higher costs in manufacturing and services for export, while economic integration will reduce barriers to competition from imports. As global economic activity becomes more and more concentrated and the benefits of agglomeration in large urban centers increase, the scale disadvantages faced by PICs will become relatively more significant.

Employment strategies will need to be feasible within the constraints imposed by geography. The extent of employment creation from improvements in the business environment should not be overstated. Even under the best possible business environment, it is not clear that the private sector would be able to generate significant employment through export-driven growth, due to the cost disadvantages of geography (box 8.4). This is not, however, reason for pessimism. Policy

BOX 8.3 Is labor regulation "off the plateau" in Pacific island countries?

Very limited data are available on labor market policies and their impacts on PICs. The Labor Freedom Index—a component of the Heritage Foundation's Index of Economic Freedom—ranks the restrictiveness of labor regulations from an employer perspective, using data collected through the World Bank's Doing Business survey. Reaching any firm conclusions regarding labor regulation in PICs would require better information, as labor regulations imposed on firms are just one element of labor market policies (see chapter 6 of this report). These data suggest, however, that labor regulation in PICs is not unusually restrictive (figure B8.3.1). Four of seven PICs included in the index are among the 25 countries with the least restrictive policies. Only Vanuatu is among the "more restrictive" half of countries covered by the index. On the basis of this evidence, it seems unlikely that overly prescriptive labor regulation is a primary constraint on private sector growth and productivity in most PICs.

FIGURE B8.3.1 Labor market regulation is not especially restrictive in Pacific island countries



Source: Heritage Foundation Labor Freedom Index.

options are available that build on Pacific island countries' existing strengths, despite inherent geographic constraints.

Labor mobility

Priority 2 Improve international labor mobility through the erosion of regulatory barriers and investment in transferable human capital

- *Summary.* Geographic realities will constrain work opportunities in Pacific island countries. Governments and donors can facilitate access of Pacific Islanders to employment opportunities even across national boundaries. This will require both changes in the immigration policies of the large regional economies and careful investment in internationally transferable human capital.
- *Countries of relevance.* All Pacific island countries, especially those where population growth is rapid and current access to international labor markets is limited.
- *Living standards.* Overseas employment opportunities have been shown to support higher living standards for migrant workers and their families.

FIGURE 8.8 Pacific island countries are unique in their combination of smallness and isolation

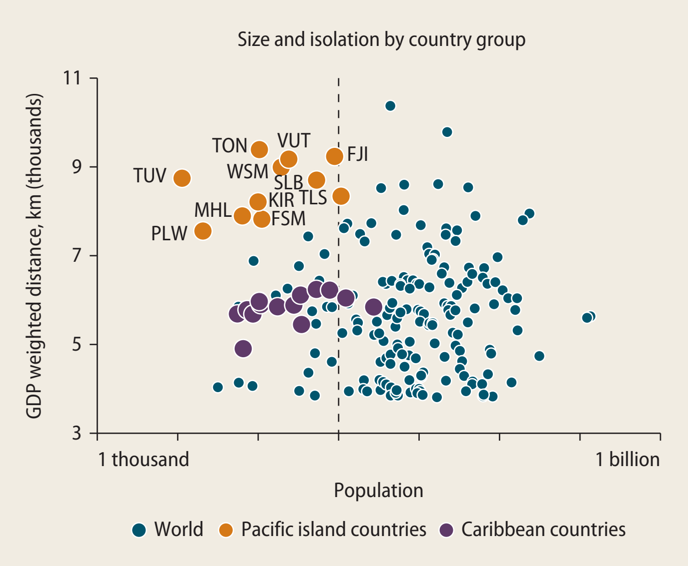
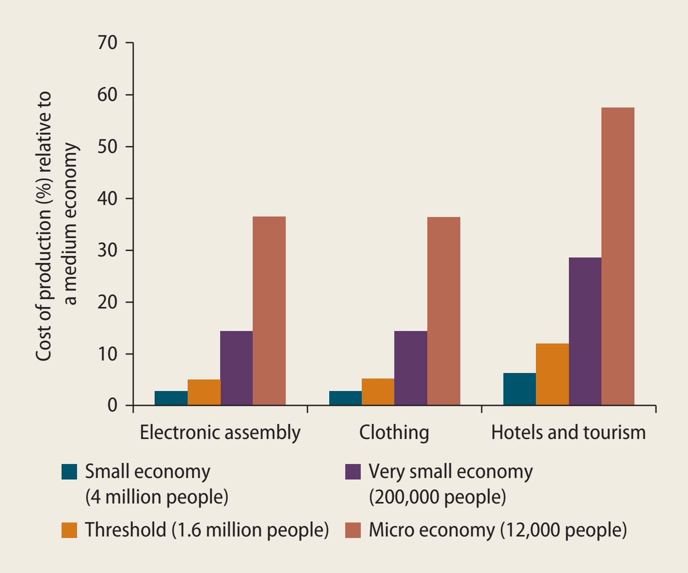


FIGURE 8.9 The costs of smallness and isolation undermine competitiveness in transformational industries



Source: Adapted from Winters and Martins 2004.

- *Productivity.* Mobility allows labor to flow to areas where it can be employed most productively. Labor mobility can encourage investment in human capital, benefiting both sending and receiving countries.
- *Social cohesion.* Labor mobility can reduce pressures arising from youth unemployment and defuse contests over access to economic opportunities.

Labor mobility represents the most significant and substantial opportunity for overcoming geographic constraints to employment in the PICs. A key lesson from the *World Development Report 2009: Reshaping Economic Geography* (World Bank 2008) is that productivity is associated with scale, density, and concentration. The geographic location of a worker is an important determinant of that worker's productivity and, therefore, income. Even within the same densely populated industrial country, a worker in a large city typically earns more than a worker with identical experience and skills in a smaller city because of the productivity benefits associated with scale, specialization, and knowledge spillovers (Venables 2006). Work in small PIC economies, with small, dispersed populations and located thousands of kilometers from global centers of production, is likely to remain, on average, substantially less economically productive, and therefore less well paid, than work in larger, better integrated economies. GDP per capita of Australia is now around 20 times that of Vanuatu and 40 times that of the Solomon Islands. Living and working in nearby Australia and New Zealand provides a range and depth of economic opportunity far beyond what is likely to be available in small Pacific economies for the foreseeable future, given low rates of growth and limited opportunities for economic diversification (box 8.5; World Bank 2011). A key opportunity for improving the living standards and productivity of PIC workers is to provide improved access to employment opportunities in places that do not face the same constraints of smallness and isolation. A growing body of evidence demonstrates that improved labor mobility for Pacific Islanders would provide benefits to migrants, their families, sending countries, and receiving countries.

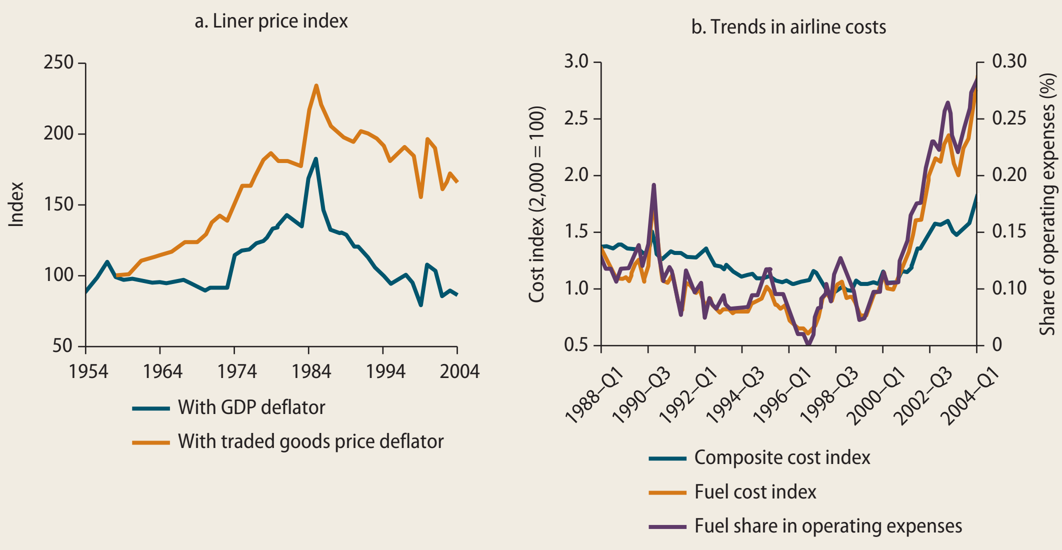
Migrants and their families benefit from labor mobility. The attractiveness of

BOX 8.4 Are the costs of distance declining?

Advances in technology might be expected to have reduced the costs of transport over time, mitigating the disadvantages faced by PICs in accessing international export markets and reducing the cost of imported inputs. A trend of falling transport costs might suggest new export and economic development opportunities for PICs and a decline in the significance of geography in constraining employment creation in the private sector. Unfortunately, available evidence suggests that geographic proximity remains a primary determinant of trade links and shows no significant reduction in costs of distance over time.

Analysis from economic "gravity models" shows that even in the current age of globalization, 90 percent of the trade that occurs over a distance of 1,000 kilometers would cease at a distance of 9,000 kilometers. Because costs of distance are so important, around 23 percent of global trade occurs across a shared land border between countries. This proportion has been constant for several decades. Hummels (2007) provides a detailed analysis of air and ship freight costs over time. He finds that, despite innovations including containerization and introduction of the jet engine, there has been no significant reduction in shipping costs (as a proportion of the value of products shipped) since the 1950s, while air transport costs have actually increased substantially over the past decade (figure B8.4.1). Cost trends have been driven by higher fuel costs, with oil price increases more than offsetting the cost reductions associated with new technologies.

FIGURE B8.4.1 Shipping costs remained relatively stable, while air transport costs have risen substantially over the past decade



Sources: Venables 2006; Hummels 2007; Yang et al. 2012.

migration is reflected in large proportions of the working-age population of some PICs now living abroad. While social and economic indicators for recent migrants to these countries can lag those of the broader population in migrant-receiving countries, migrants generally foresee broader educational and economic opportunities for their children, even for those whose own immediate opportunities are limited. Recent analyses

BOX 8.5 Labor mobility arrangements in Australia and New Zealand affect development outcomes in Pacific island countries

New Zealand, Australian, and U.S. migration policies continue to have an important impact on labor mobility and broader development outcomes in PICs. Increases in Pacific populations living in New Zealand and Australia have fueled remittance flows, offset population growth, and expanded economic opportunities. Since 1971, the Pacific-born population of New Zealand and Australia has increased from 46,000 to more than 250,000, with around 140,000 in New Zealand and 110,000 in Australia (Bedford 2012). The growth in Pacific-born populations has occurred through very different channels, reflecting divergent policy approaches to Pacific migration.

Alongside its country-neutral points-based immigration schemes, New Zealand has maintained a range of special access arrangements for PICs. These are targeted toward those countries that have the strongest constitutional or historical links to New Zealand. Such arrangements include the following measures:

- *Special citizenship relationships*. The populations of the Cook Islands, Niue, and Tokelau have full New Zealand citizenship and associated rights to work in New Zealand.
- *The Samoan quota*. New Zealand allocates residence visas, by ballot, to 1,100 Samoans between the ages of 18 and 45 each year. Successful primary applicants must obtain an offer of work in New Zealand before immigration is approved. The scheme is typically oversubscribed, partly due to the number of places taken up by secondary applicants, who are included within the quota cap. Over the past three years, 1,201 out of 19,326 registrations were drawn from the ballot, representing odds of around 6 percent (Gibson, McKenzie, and Stillman 2011, 11).
- *The Pacific access category*. Under the Pacific access category, 250 citizens of Tonga, 75 citizens of Tuvalu, and 75 citizens of Kiribati can be granted residence-class visas in New Zealand each year. The cap includes principal applicants, partners, and dependent children. Applicants must meet English language proficiency standards and have a "suitable offer of employment" that provides a salary equal to a specified minimum income requirement (currently NZ$31,500). This scheme is also oversubscribed, despite offer-of-employment requirements.
- *Recognized seasonal employer (RSE) scheme*. Under this scheme, up to 8,000 PIC workers can be hired on a part-time basis by New Zealand farmers in the horticulture and viticulture industry.

In contrast to New Zealand, Australia has very limited special labor access for Pacific island countries. Consequently, three times more Pacific islanders migrated to New Zealand than to Australia between 2003 and 2007, despite Australia's much larger population and economy (Bedford 2012). Nearly all Pacific-born workers in Australia either qualified for entry through country-neutral schemes (including large numbers of relatively highly educated Fijians, following recent coups) or traveled to Australia after acquiring New Zealand citizenship through the Trans-Tasman Travel Arrangement, which allows free movement of Australian and New Zealand citizens across both countries. A very small number of Pacific-born workers have accessed employment opportunities in Australia through the recent pilot of the Pacific seasonal worker scheme, which operates on a basis similar to New Zealand's RSE scheme. Places within the scheme were limited to 2,500 over the four years from 2008 to 2012, and only around 1,600 places were offered due to low uptake by employers (Reed et al. 2011). Participation has increased slowly, with around 710 visas being issued under the scheme during the first half of FY2013/14, and the cap is still unlikely to be reached.

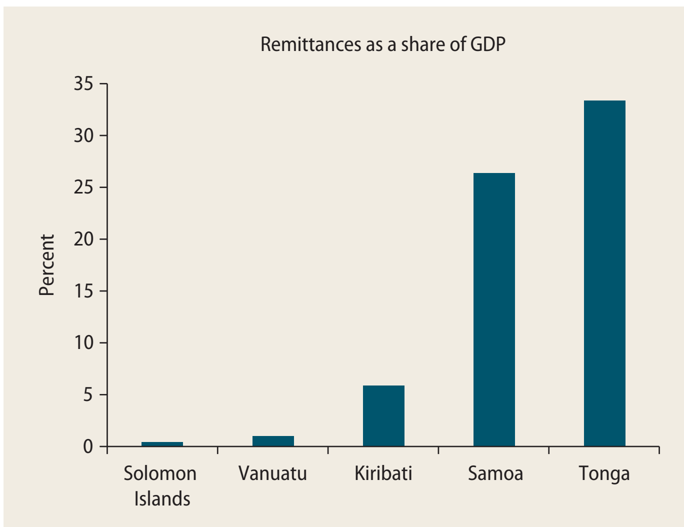
of the recognized seasonal employer (RSE) scheme, which provides short-term access to New Zealand labor opportunities, primarily in horticulture, and broader survey data of families with members working overseas, demonstrate the benefits to families in sending countries of both short-term and permanent migration (McKenzie and Gibson 2010; Gibson, McKenzie, and Stillman 2011; Luthria et al. 2006; Gibson and McKenzie 2011). Households in PICs with family members working overseas experience the following improvements:

- Higher per capita incomes over comparator groups, driven by remittances
- Increased subjective economic welfare, with households reporting that they benefited from labor mobility opportunities
- Improved ownership of assets, including radios, ovens, and DVD players
- Higher rates of financial inclusion and savings, including a greater likelihood of holding a bank account
- Improved educational attainment, with school attendance rates shown to have increased, and broader evidence of a positive impact of remittances on primary and tertiary educational attainment, likely due to improved affordability with higher incomes.

Labor mobility provides economy-wide benefits to migrant-sending countries. Remittance-receiving households benefit the broader economy through increased investment in business activities (McKenzie and Gibson 2010). Opportunities for migration can also generate incentives for increased human capital development, which can potentially offset any loss of human capital experienced by sending countries. Recent evidence from Fiji demonstrates that the expectation of migration opportunities generated an increase in the level of tertiary education of Fijians, with the stock of Fijians with tertiary education remaining within Fiji also increasing (Chand and Clemens 2008). Available evidence from small countries suggests that the benefits to sending countries from the emigration of high-performing students and academics—including remittances and knowledge transfer—generally outweigh the costs, especially when high rates of return migration are taken into account (Gibson and McKenzie 2010, 2013). Knowledge transfer is particularly significant, with 13 percent of expatriate Tongans from a sample of academic high achievers providing advice to the Tongan government while overseas, more than 50 percent providing advice to Tongan residents on study and work opportunities, and 20 percent providing sponsorships for Tongan residents seeking work overseas (Gibson and McKenzie 2010). Diaspora tourism resulting from large emigrant populations is also an important benefit to sending countries, accounting for a large share of tourism industries in Pacific countries, with 40 percent of arrivals in Samoa from New Zealand visiting friends and relatives (Scheyvens and Russell 2009). Remittance flows clearly can reduce income inequality and create new opportunities for the disadvantaged. Remittances from long-term migrants have been shown to reduce disparities in income between households in Fiji and Tonga, while participants in New Zealand's seasonal employer scheme are typically from poorer rural households in Tonga (Luthria et al. 2006; Gibson and McKenzie 2009).[4]

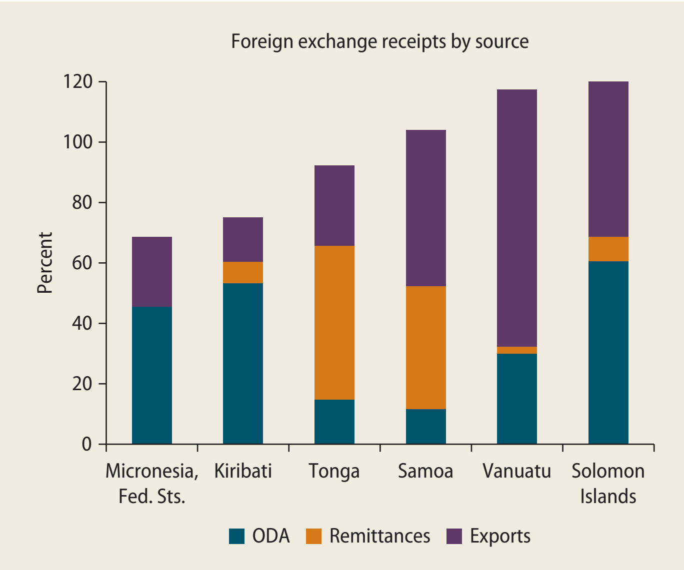
Remittances provide an important and relatively stable source of foreign exchange. Remittances provide a substantial proportion of foreign exchange receipts in several PICs, increasing imports and consumption (see figures 8.10 and 8.11). While some PICs have been heavily affected by the decline in

FIGURE 8.10 Remittances are very significant for some Pacific island economies



Source: Estimates based on data from country authorities.

FIGURE 8.11 Remittances support imports, consumption, and living standards



Source: Estimates based on data from country authorities.
Note: ODA = official development assistance.

remittances during the recent global economic crisis, over the longer term, remittances tend to provide a more dependable source of foreign exchange than the natural resource industries or donor aid flows on which small PICs typically rely.[5]

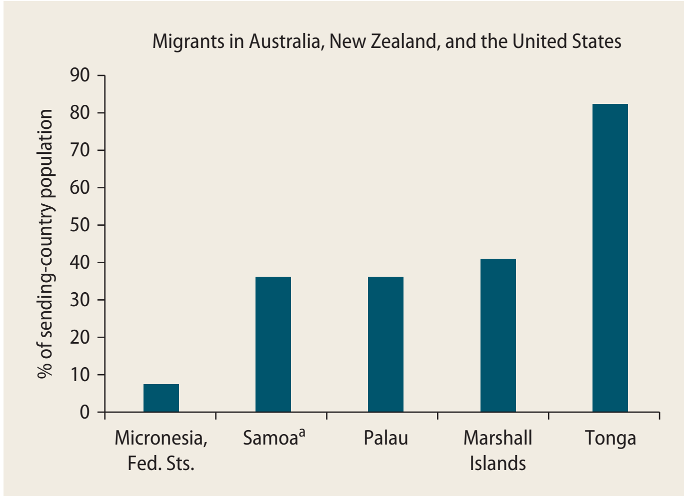
Demographic shifts are creating opportunities for greater mutual benefit from mobility (figures 8.12 and 8.13). Patterns of demographic change vary between countries in the Pacific region. While some PICs have large and growing youth populations, the populations of the larger regional economies are aging and likely to decline over coming decades. The larger regional economies face impending labor shortages that could partially be met by Pacific labor. Permanent migration to New Zealand during fiscal 2010–11 was below planned levels by 9,000 places, even as the Samoan quota and Pacific access entries remained oversubscribed (Department of Labour 2013). In fiscal 2011–12, net permanent and long-term migration to New Zealand was negative for the first time in more than a decade (Department of Labour 2013). Shortages of unskilled labor during the construction boom following the Christchurch earthquake have led the local business community to call for increased migration opportunities.[6] Recent labor shortages in Australia, where Pacific-born workers currently constitute a negligible proportion of migrants and the total workforce, have also led to appeals from the business community for increased temporary work arrangements from developing countries (Earl 2012).

Differences in the supply of and demand for labor across countries present opportunities for mutual benefits from mobility (Bedford 2012). The net economic gains from labor mobility have been long established in the economic literature (World Bank 2006; Walmsley, Ahmed, and Parsons 2005). Recent evaluations have demonstrated how businesses have benefited from reliable and relatively low-cost labor provided through New Zealand's RSE scheme at the micro level (Department of Labour 2010). The benefits of labor mobility will increase further as demographic trends lead to a scarcity of young workers in the larger regional economies.

Distribution of opportunities could be better matched with development needs. Many PICs already enjoy relatively easy access to larger labor markets, including the North Pacific countries with access to the U.S. labor market. Samoa and Tonga have strong historical ties with New Zealand, and preferential access to the New Zealand labor market has translated, through step migration, into large populations in Australia. Partly because of migration opportunities and their large Australian and New Zealand populations, Samoa and Tonga have some of the best development outcomes in the Pacific. Strong education outcomes and transport links support participation in seasonal worker schemes, with Samoa and Tonga accounting for 50 percent of participants in the first seasons of the New Zealand scheme and more than 80 percent of participants in the Australian scheme. Other Pacific countries, where domestic economic opportunities are most constrained by smallness and isolation (Tuvalu) or where incomes are lowest (Kiribati and the Solomon Islands), tend to have less access to short-term and permanent migration opportunities and are constrained in their participation in seasonal schemes by costs of transport and institutional weaknesses.

Greater policy effort on the part of receiving countries is required to expand access. Opportunities for labor mobility are heavily constrained by the immigration policies of large neighboring countries, such as Australia and New Zealand. These same neighboring countries allocate a large proportion of their overseas development budgets to the Pacific region with the stated aim of improving economic opportunities and living standards in the region. Increased policy coherence between aid and immigration policies would see a large expansion in temporary and permanent labor mobility opportunities available to Pacific people. This would not only represent a very cost-effective development intervention, but also bring economic benefits to those receiving countries, especially as their populations age. Achieving the greatest mutual benefits from emerging demographic transitions will require more action from large economies in the region on several fronts:

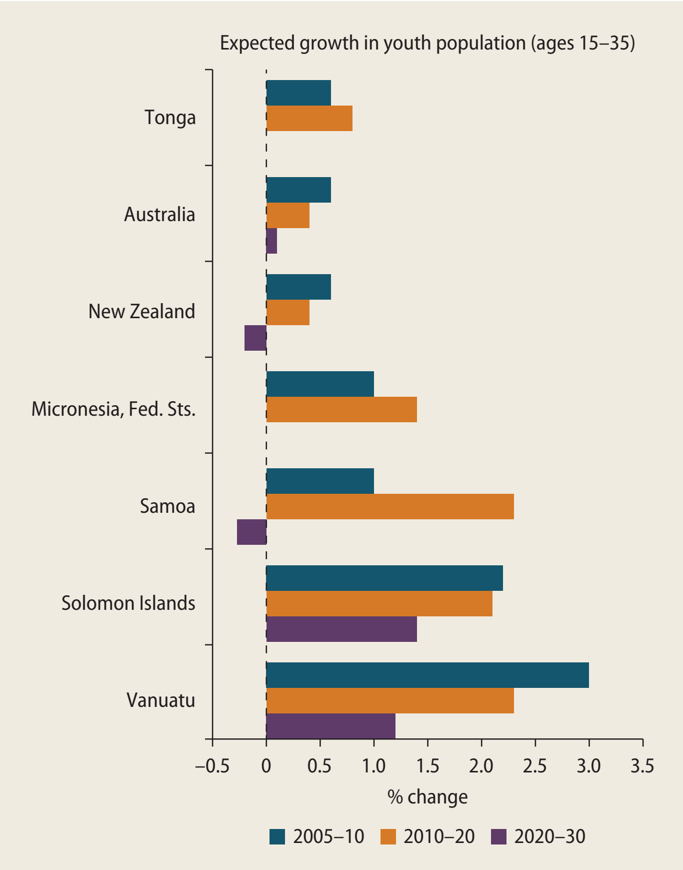
FIGURE 8.12 Migrants to high-income countries make up a substantial portion of Pacific working people



Source: Adapted from Bedford 2012.
Note: Opportunities for permanent labor mobility are greatest for Polynesian countries.
a. Samoa excludes the U.S. diaspora due to inability to isolate American Samoa in census data.

- *Expansion and improvement of temporary worker schemes.* Efforts to expand participation in the seasonal worker schemes could bring substantial benefits to PICs. Seasonal schemes currently make only a small contribution to overall remittance flows to Pacific countries. Samoa and Tonga alone receive around US$270 million a year in remittances from permanent migrants, compared to around US$30 million a year in remittances from seasonal workers in Australia and New Zealand. If Australia were to offer as many seasonal worker places as New Zealand relative to its population, however, total remittances from seasonal workers in the scheme could reach 10 percent of the GDP of participating countries or 60 percent of their current aid flows (see box 8.6). Scope to expand seasonal worker schemes in both Australia and New Zealand can be demonstrated by the relatively small number of seasonal workers arriving from Pacific countries, compared to the number of job opportunities available to citizens of much wealthier countries through “working holiday” visa schemes (figures 8.14 and 8.15). Expansion of the successful New Zealand scheme and improvements to the Australian scheme could generate development impacts that are significant at the macroeconomic scale.
- *Increased permanent migration*. While seasonal schemes could provide important opportunities for generating remittances, evidence demonstrates the broader range of benefits accruing to Pacific island countries from access to permanent labor. Such benefits include skills and knowledge transfer, increased tourism receipts, and huge improvements in living standards for permanent migrants. Under any scenario, seasonal schemes will not close the very large gap in incomes between large regional economies and small Pacific islands. The best opportunities for

FIGURE 8.13 Demographic differences suggest mutual gains from mobility for receiving and sending countries



Source: Adapted from Bedford 2012.
Note: Population pressures are building in Melanesia, while the working-age population is declining in nearby large economies.

improved productivity and incomes for many Pacific Islanders will be to move to where greater opportunities exist. Seasonal schemes must be viewed as a complement to, rather than a substitute for, increased permanent labor mobility. Seasonal schemes are appropriate only to certain industries, and not those, such as elderly care and construction, where demand is likely to be greatest over coming decades. Seasonal work schemes require intensive involvement of sending and receiving governments and therefore impose administrative costs with sustainable gains less easily assured. Finally, male workers tend to dominate in the sectors best suited to seasonal work schemes—such as agriculture and horticulture—posing challenges for greater participation by women. Permanent migration must therefore remain a key focus of policy attention. Allocations for New Zealand's existing Pacific Access category could be expanded and a broader range of countries could be offered a dedicated quota (as provided to Samoa). Australia could consider the introduction of similar quota or lottery-based permanent access schemes. A modest start-point would be the introduction of an Australian Pacific Access category visa, with 2,000 permanent visas offered per year to immigrants from small PICs, based on the New Zealand Pacific Access category allocations adjusted for Australia's larger population size.[7] Another important priority is to develop processes through which seasonal workers can transition to more permanent visas.

- *Reorientation of mobility links.* With the exception of high Vanuatu participation in the New Zealand seasonal worker scheme, existing labor mobility arrangements deliver greatest benefit to the Pacific countries where incomes are highest and development outcomes are strongest. To boost well-being from work, further expansion of both seasonal and permanent labor mobility arrangements should be targeted toward countries such as Kiribati and the Solomon Islands, where domestic economic prospects and mobility opportunities are heavily constrained and challenges from growing youth populations and accelerating urbanization are most severe. Increased participation of these countries in seasonal schemes would likely require further country-specific donor subsidization of training and transport costs.

Improving and expanding seasonal labor mobility opportunities for Pacific Islanders offers immediate benefits without any significant costs. Large policy shifts toward

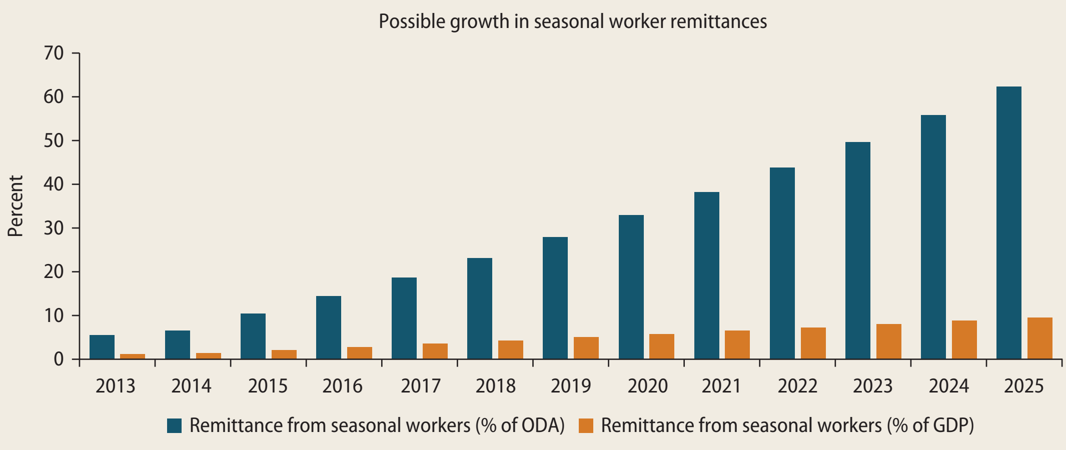
BOX 8.6 An expanded seasonal worker scheme has potential benefits

Existing data from seasonal worker schemes in New Zealand and Australia can be used to model the potential impacts of an expanded scheme. As a starting point, we assume that the number of seasonal workers to New Zealand remains constant at around 8,000 a year, while Australia expands its scheme to provide an equivalent number of places relative to population (roughly 40,000 places, by 2025). We make the following assumptions:

- Workers work an average of 20 weeks a year
- Workers remit the same proportion of income as in the New Zealand scheme and under the Australian pilot, allowing for deductions and worker spending
- Places offered in Australia increase to 8,000 in 2014 and then grow 30 percent annually until the target of 40,000 places is reached (equal to 30 percent of the number of current working holiday visas issued annually)
- All places are offered to citizens of small Pacific island countries currently participating in the scheme (Kiribati, Samoa, the Solomon Islands, Tonga, Tuvalu, and Vanuatu).
- Wages increase at a rate of 3 percent a year, allowing economy-wide total factor productivity growth and labor productivity improvements associated with repeated participation in the scheme.

Given these assumptions, total remittances from the Australian and New Zealand schemes could reach US$390 million by 2025 (in 2013 U.S. dollars), equivalent to 10 percent of GDP of currently participating small Pacific island countries or 60 percent of their total aid flows (figure B8.6.1). These estimates rely heavily on an expansion of participation of Kiribati and the Solomon Islands within the scheme, which will be required to avoid a damagingly large, accelerated drain of human capital from Samoa, Tonga, and Vanuatu.

FIGURE B8.6.1 **Remittances could grow significantly with expanded seasonal work opportunities**



Note: ODA = official development assistance.

increased permanent labor mobility also offer clear mutual benefits, but will require some balancing of several important objectives: protecting labor rights while ensuring access to employment for relatively low-skilled immigrant workers; expanding low-skilled immigration while avoiding the displacement of opportunities for low-skilled New Zealand and Australian workers; and expanding migration opportunities to lower-skilled

FIGURE 8.14 Immigration policies in Australia favor guest workers from high-income countries

Source: Department of Immigration and Citizenship 2012.
Note: The number of working holiday visas approved in Australia and New Zealand demonstrates potential to expand seasonal worker opportunities.

FIGURE 8.15 Pacific seasonal workers account for a small proportion of temporary work visas in New Zealand

Source: Department of Labour 2013.
Note: The number of working holiday visas approved in Australia and New Zealand demonstrates potential to expand seasonal worker opportunities.

and less-educated Pacific Islanders while ensuring that these workers have adequate skills for employment within Australian and New Zealand businesses. New Zealand and Australia both have demonstrated strong commitment to improving development outcomes in neighboring Pacific countries over recent decades. Improved labor access for Pacific workers offers one of the most effective means of achieving this objective and can help to address growing labor shortages as the Australian and New Zealand populations age (box 8.7).

Policy action is also needed from governments in sending countries. Within Pacific island countries, continued investment is needed to build human capital through both health and education, so that working-age Pacific Islanders have the capacity to take advantage of the overseas opportunities that are available. This is an immediate priority in the “compact countries” of the North Pacific, where—despite populations having access to the U.S. labor market—remittance flows and development impacts have so far been limited because migrants can only access very low-paying work (Connell and Brown 2005). As argued in chapter 5, basic numeracy, literacy, and behavioral skills are transferable across work types and countries and should continue to receive strong emphasis within human development strategies. More specifically, PIC governments could ensure that some qualifications are recognized internationally, through the adoption of Australian, New Zealand, or U.S. education standards. The Kiribati Institute of Technology, for example, now offers a curriculum and qualifications fully aligned with those of Technical and Further Education Australia, while international accreditation has been achieved by the Marine Training Centre, allowing graduates to access a wide range of international opportunities.

Policies should be designed to improve opportunities for women. Women have limited access to labor mobility options. The majority of participants in the Australian and New Zealand seasonal worker schemes are men, exacerbating gender differences in

BOX 8.7 Seasonal worker schemes in New Zealand and Australia are an important opportunity to expand work opportunities for Pacific people

New Zealand's seasonal labor scheme was launched in 2007, allowing 5,000 workers to fill positions for 7 months over an 11-month period in the horticulture and viticulture industries. Kiribati, Samoa, Tonga, Tuvalu, and Vanuatu were selected for special assistance in mobilizing workers, but the scheme is open to all Pacific Island Forum member countries other than Fiji. A "New Zealander first" principle is applied, under which vacancies have to be lodged with government agencies responsible for social welfare benefits so that available opportunities are offered to local employment seekers before they are offered to migrant workers. Pacific workers can be hired directly by employers, through agents, or through a prescreened "work-ready pool" administered by government agencies. Demand has been strong, with the number of workers in the "work-ready pool" far outstripping the number of available places. Since its introduction, 24,600 workers have participated in the scheme (with annual quotas of 5,000–8,000 workers). More than half of workers return at least once, and 23 percent of workers have participated in all four seasons, suggesting that the scheme can provide a sustainable source of income. Knowledge of and access to the scheme are uneven, with the majority of workers from Tonga and Vanuatu.

The scheme has been subject to several evaluations (Department of Labour 2010; McKenzie and Gibson 2010; Merwood 2012; Research New Zealand 2012). The following are the key findings:

- *The scheme benefits employers*. Employers rate Pacific RSE workers higher than all other groups of employees for their dependability, enthusiasm while working, and productivity. Specifically, Pacific RSE workers are viewed as significantly more dependable, productive, and enthusiastic than all other categories of seasonal worker. Many employers (86 percent) believe that returning workers are "much more productive" than those in the initial season. Almost all employers (93 percent) believe that the benefits of participating in the scheme outweigh the costs. At least 95 percent of employers agree that participation in the program has resulted in better-quality and more productive workers and a more stable workforce than in previous years.
- *The scheme benefits worker-sending families*. Research carried out in Tonga and Vanuatu found that participating in the RSE scheme has a large and statistically significant positive impact on household income per capita. Household expenditure per capita also increases with participation in the RSE scheme in Tonga. Substantial, statistically significant increases in subjective well-being were identified, along with positive impacts on housing quality and higher ownership rates of durable assets.
- *The scheme increases incomes of workers*. The median after-tax income earned in New Zealand, as reported by seasonal migrants, is approximately $NZ12,000, several times the income per capita of those not participating in the scheme (approximately $NZ1,400 in Tonga and $NZ2,500 in Vanuatu).

With the New Zealand scheme considered "one of the most effective development policies evaluated to date," there is a clear case to expand the number of available places, including through expansion into additional sectors where domestic labor shortages are present or emerging (Mackenzie and Gibson 2010).

The Australian seasonal worker scheme was introduced following completion of a pilot scheme in 2012. An evaluation of the scheme's development impacts found significant benefits for the small number of participating households in Tonga, with incomes per household increasing almost 40 percent. Evaluations have also shown productivity benefits for participating farmers (Leith and Davidson 2013). But the scheme operates at a much smaller scale than the New Zealand scheme and has been subject to various implementation problems. During the pilot, 2,300 places were offered, but only 1,600 of these were actually filled. The number of workers recruited was around 100 a month in 2012, about half of the cap and a third of the number hired under the New Zealand program.

The largest constraint to uptake is the absence of labor shortages in targeted sectors of agriculture and horticulture. Such labor shortages have

continued

BOX 8.7 *(continued)*

historically been very significant. But, in 2006, reforms were implemented under which primarily European "backpackers" on working holiday visas are offered one-year visa extensions subject to working for three months or more in the agriculture or horticulture sectors. These reforms—and the associated increase in supply of farm labor from backpackers—are reported to have almost entirely eliminated previously pressing labor shortages. The continued prevalence of illegal labor in the horticulture industry also undermines demand for seasonal workers. Additional factors constraining growth of the scheme include (a) lack of knowledge of the scheme among potential employers (a recent review found that around half of farmers have simply not heard of the scheme) and (b) perceptions that the scheme involves high transaction costs and red tape (Howes and Hay 2012).

Australia has recently decided to expand the scheme, opening opportunities in additional sectors, including tourism, and placing a higher cap on the total number of participants. However, uptake in new sectors has also been very low, and significant reforms of the scheme and broader policy settings are needed if it is to achieve the same success as the New Zealand program. The first priority is to address the existing policy distortion that encourages backpackers to work for short periods in the agriculture and horticulture sectors in order to access a visa extension. Options include simply removing this offer of extension to backpackers, offering it to those who work in a different or broader range of sectors, or making Pacific Islanders eligible for the same visa class (that is, the working holiday maker visa). Additional priorities include (a) addressing the widespread use of illegal labor in the agriculture and horticultural sectors; (b) investing in promotion of the scheme to potential employers; (c) reducing the minimum number of employment hours in order to ensure a good balance between flexibility to employers and certainty to workers; (d) requiring employers to meet a lower proportion of travel costs (given the differential in minimum wages between Australia and New Zealand, most workers under the scheme would have the capacity to meet a larger proportion of transport costs); and (e) reviewing reporting and paperwork requirements to reduce transaction costs that are frequently cited as a major constraint to participation.

For both the New Zealand and Australian schemes, future work could also focus on opportunities to expand the participation of small PICs where domestic employment opportunities are most constrained and participation in seasonal schemes has so far been limited (such as Kiribati, the Solomon Islands, and Tuvalu). In these cases, further investment could be made in two important areas. First, donor agencies could do more to support training and vetting of potential participants to ensure that participating workers are able to meet the productivity expectations of farmers and other employers. This would maximize the likelihood of repeated participation and ensure that seasonal workers from that country build a good reputation among potential employers. Second, donor agencies could consider subsidizing the transport costs for those participating from more remote PICs. This would address an important existing cost wedge that disadvantages some of the small PICs with greatest need.

access to paid work. Such disparities arise primarily because of disproportionate male representation in the pool of workers nominated for potential selection by recruitment agencies and authorities within Pacific island countries. Such gender disparities may be of particular concern given evidence that women migrants remit a greater proportion of their income more regularly and are more likely to send remittances to other women members of the household (Connell and Brown 2005). Broadening seasonal work opportunities in sectors such as hospitality would be likely to create new opportunities for women. Expansion of permanent migration schemes may also have positive gender impacts. Evidence from Fiji and Tonga suggests that equivalent numbers of men and women are able to access long-term and permanent migration opportunities (Luthria et al. 2006). Family access provisions under preferential New Zealand schemes allow spouses to access the New Zealand labor market, regardless of the gender of the primary applicant, ensuring rough gender balance. Ensuring equitable access to educational opportunities for women (including support for dependent family members for scholarship recipients), increasing women's participation in seasonal schemes (including through addressing constraints to uptake in new sectors), expanding permanent migration opportunities for families, and closely monitoring the impacts on women of the long-term absence of males from households participating in seasonal schemes are important priorities.

International assistance is needed to support the policy and institutional improvements required for increased international mobility of Pacific Islanders. Institutions with responsibility for negotiating international labor arrangements need to be strengthened. Financial and technical support continues to be needed for agencies facilitating the participation of workers in regional or global schemes, such as divisions within PIC foreign ministries responsible for selecting workers for participation in Australia's and New Zealand's seasonal worker schemes. Finally, ongoing aid assistance for all levels of education—including provision of tertiary scholarships—can provide a major boost to prospects for increased labor mobility through seasonal and permanent schemes.

Urbanization

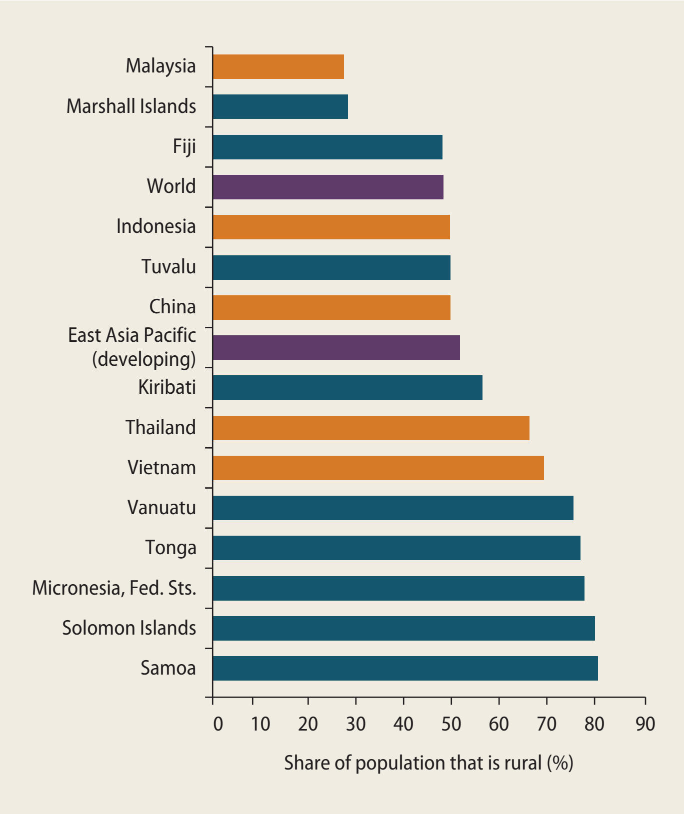
Priority 3 Make the most of urbanization through investment in rural services, connective infrastructure, and improved urban administration

- *Summary.* Urbanization brings employment benefits if it allows the realization of scale economies, greater thickness in markets, and increased specialization. But urbanization occurring as a result of poor services in rural areas, conflict, food insecurity, or land shortages simply leads to congestion and urban unemployment, delivering few economic benefits and placing pressure on social cohesion. Policies should not be biased toward jobs in either urban or rural areas, but rather seek to ensure acceptable standards of living across all communities and allow individuals to respond as they choose to the concentration of economic opportunities in urban areas.
- *Countries of relevance.* Rapidly urbanizing Pacific island countries, including Kiribati, the Marshall Islands, the Solomon Islands, and Vanuatu.
- *Living standards.* Access to paid employment is, and will likely remain, concentrated in urban areas. People should be free to seek the broader opportunities available in cities. But adequate living standards, involving access to adequate services, must be maintained in rural areas.
- *Productivity.* Population concentration allows specialization and some economies of scale. Urbanization therefore presents an important opportunity for productivity growth. Subsidizing work in particular places is an inefficient use of resources and undermines the potential benefits of concentration for private sector development.
- *Social cohesion.* Poorly managed urbanization can weaken social cohesion. Public investment should be prioritized toward improving urban administration and services rather than preventing urbanization from occurring.

Urbanization is an important phenomenon for employment in the Pacific. Pacific cities are growing very rapidly. Measured as the percentage growth of urban populations, Kiribati, the Solomon Islands, and Vanuatu are urbanizing at similar rates as the rapidly growing East Asian economies (figures 8.16 and 8.17).[8] Even in countries where recorded rates of urban growth are slower, urbanization is frequently cited as a major policy issue. A challenge for policy makers is to ensure that the potential benefits of urbanization can be realized while minimizing the costs.

Urbanization can be an engine of growth and employment opportunities. It is typically

FIGURE 8.16 Pacific populations remain largely rural



Source: United Nations Department of Economic and Social Affairs.

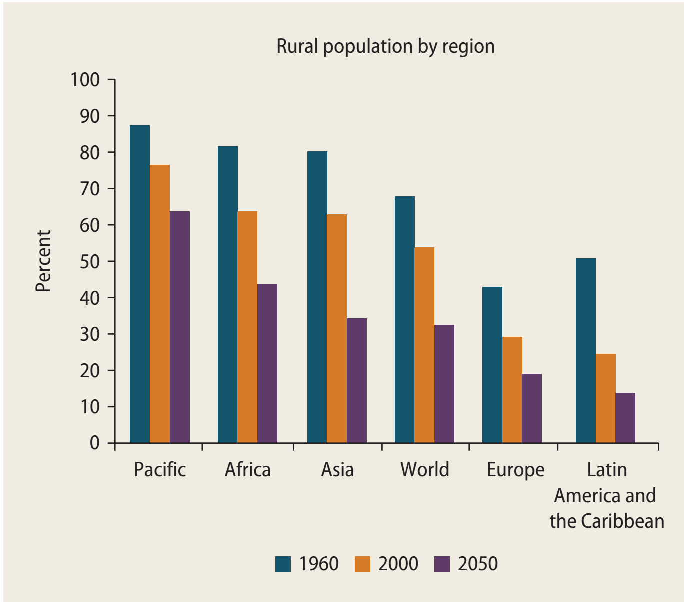
associated with higher incomes, improved service quality and coverage, lower fertility rates leading to slower population growth, more integration with global markets, and diversification leading to broader economic opportunities (World Bank 2008; United Nations Center for Human Settlements 1994; see figure 8.18). Urbanization in PICs can provide an engine for employment creation. Increased urban populations offer businesses the opportunity to integrate into supply chains, thicker labor and input markets, and larger markets for goods and services. While prospects for export-driven diversification into manufacturing and service exports are likely to remain limited even in the largest Pacific island cities, the best prospects for expanding private sector opportunities in the provision of services for local markets, including the public sector, lie in a more urbanized future. Urbanization also offers governments the chance to provide services and infrastructure at efficient scale—reducing the costs associated with serving disbursed and inaccessible rural populations—and facilitating important improvements in quality and coverage. Many Pacific Islanders demonstrate a strong revealed preference for urban life, which provides improved access to earning opportunities, relief from the insecurity and physical labor associated with rural subsistence, access to consumer goods and services, and the prospect of upward social mobility.

Urbanization in PICs is not always happening for the right reasons. People who are moving to cities are not always doing so because they expect more productive and better-paid work. Rather, urbanization is also being fueled by a lack of adequate services and declining living standards in rural areas (figures 8.19 and 8.20). For these reasons, some PICs face an unusual combination of slow economic growth and rapid urbanization (figure 8.21). Even when relatively broad coverage is achieved in rural areas, the quality of services typically lags far behind what is available in urban areas. Inadequate services are compounded by poor agricultural productivity. Agricultural production in PICs remains concentrated around smallholder subsistence production, with marketing options often constrained by insufficient scale, poor transport links between islands or regions, limited access to finance, and lack of knowledge and training on agricultural production techniques. Subsistence farming in rural areas is often only weakly linked to food markets in urban areas, with PICs heavily reliant on food imports despite large agriculture sectors. There is little evidence of any significant increase in agricultural productivity in PICs over recent decades, while population growth has placed pressure on agricultural subsistence systems in some areas.

Potential benefits are in danger of being outweighed by a range of social and economic costs. Rather than moving into productive work that spurs economic growth and finances increased service delivery, many urban arrivals face limited prospects and simply add to the burden on overstretched urban services and infrastructure. Urbanization in PICs is therefore often associated with a higher risk of poverty, high youth unemployment, and frustrated aspirations for social mobility, feeding into increased rates of substance abuse, crime, and loss of social cohesion (Allen and others 2013). The breakdown in family structures and informal social safety net systems as young people move to cities has led to unprecedented levels of inequality and crime. These dangers are frequently cited in analyses of Pacific urbanization and are reflected in available statistics on crime and violence (Connell 2011; ADB 2012a; United Nations Office on Drugs and Crime data from Storey 2003).

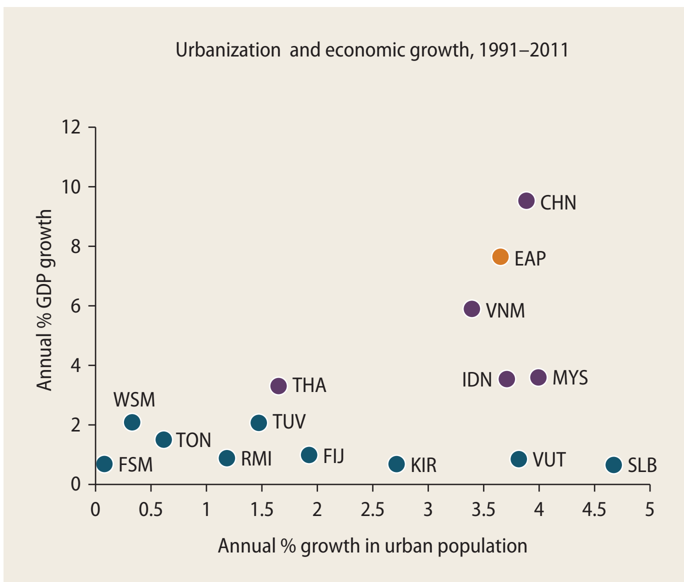
The right reforms can facilitate both urban and rural development (box 8.8). Policy discussions of urbanization in PICs often pose an artificial choice between rural and urban employment. Obvious problems of urbanization, accompanied by stagnation in rural livelihoods, have fostered opposition to urbanization and fed perceptions that economic development in urban centers is occurring at the cost of development in rural areas. Common complaints include the inequitable concentration of public and private sector employment in urban areas, the loss of human capital in rural areas as working-age people move to cities, and growing disparities in access to services and infrastructure between urban and rural areas. But economic development is not a zero-sum game, and urban development does not have to impose costs on rural areas. Urbanization can provide a pathway to employment for many if it occurs for the right reasons. With appropriate linkages between urban and rural areas, economic opportunities in urban areas can support improvements in rural standards of living. At the same time, reasonable services and living standards in rural areas can ensure that urbanization is driven by opportunity rather than desperation and leads to good outcomes. Focusing on the following policy

FIGURE 8.17 And this will continue despite urbanization



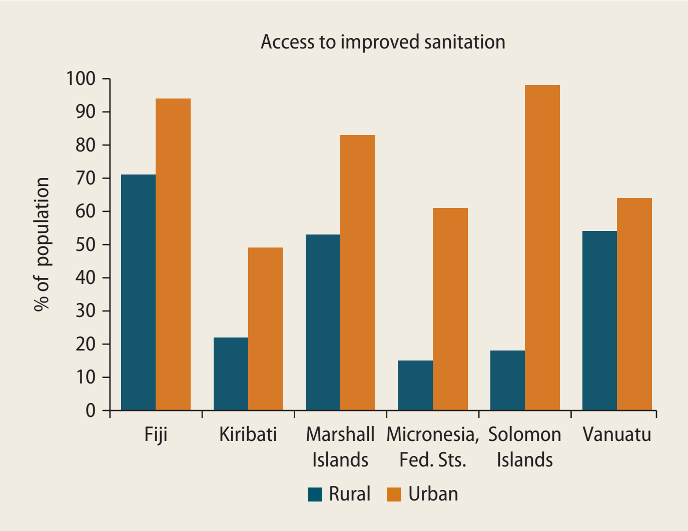
Source: United Nations Department of Economic and Social Affairs.

FIGURE 8.18 Urbanization is associated with improved human development



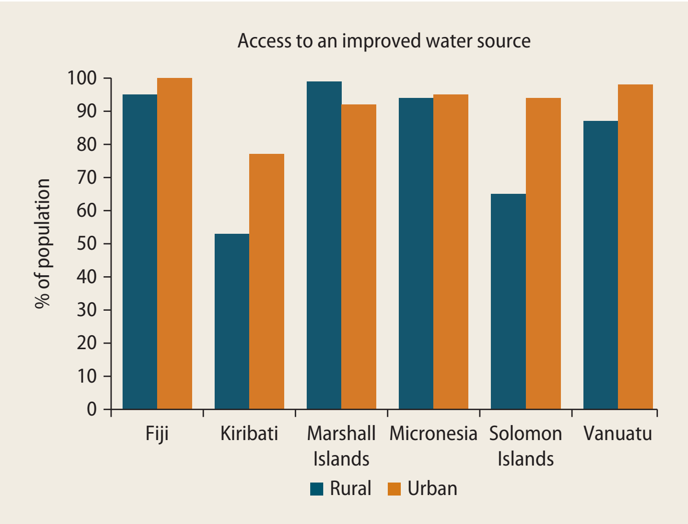
Source: World Development Indicators.

FIGURE 8.19 Access to sanitation in rural areas is not as good as in urban areas



Source: World Development Indicators.

FIGURE 8.20 Access to water in rural areas is not as good as in urban areas



Source: World Development Indicators.

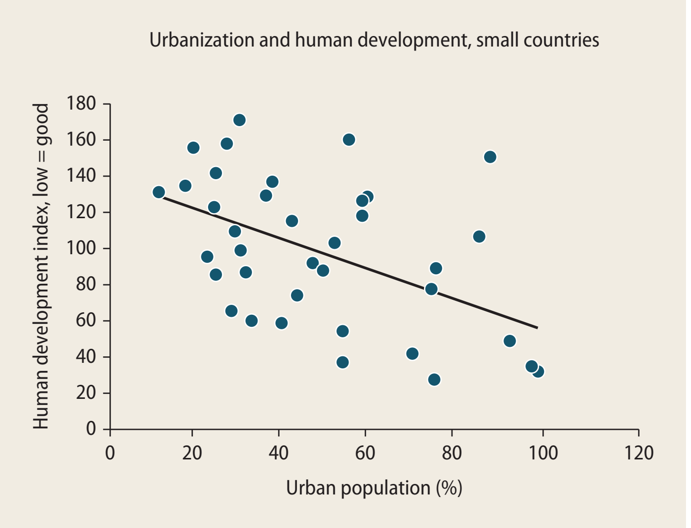
areas may increase the likelihood of complementary urban and rural development:

- *Avoid policies to prevent urbanization.* In several PICs, policies have been discussed or implemented that are explicitly intended to slow or prevent urbanization and redistribute economic production to rural areas. Examples include (a) the explicit or implicit subsidization of economic activities in rural areas (including production subsidies and government investment in production facilities); (b) deliberate underinvestment in provision of urban services and infrastructure to growing urban populations (especially in squatter settlements where recent arrivals are concentrated); (c) absence of measures by which squatters can acquire formal land rights; and (d) destruction of residential and commercial properties in settlement areas by state or municipal authorities. Such measures have destroyed jobs and seldom fostered sustainable economic growth in rural areas or arrested the pace of urbanization.
- *Provide adequate basic services across all communities.* Urbanization fueled by uneven access to services leads to the congestion of urban facilities and excess supply of low-skilled labor in urban areas. Relatively large aid flows to PICs provide an opportunity to finance a basic standard of services in all communities, allowing migration decisions to be based on economic opportunities and preferences rather than basic service needs.
- *Invest in connective infrastructure.* Rural areas can share the benefits of increased employment opportunities and improved service delivery in urban areas if people, goods, and information can move freely and at reasonable cost. Infrastructure links between capitals and other areas of concentrated population are vital to facilitate the supply of urban markets by rural producers. Subsidization of transport links can facilitate access of rural people to urban services, reducing urbanization motivated by the desire to access services. Good-quality, low-cost, and reliable transport can also allow people to take advantage of work opportunities on a short-term basis, as they arise, allowing reversibility and reducing the risks facing persons seeking urban jobs.

- *Facilitate efficient use of urban land.* Lack of access to land and dysfunction in land markets often undermine living standards and private sector development in urban areas. It is important to ensure that housing is available to new arrivals in urban areas and that land is allocated to its most efficient use. Measures that provide formal recognition of landownership and transactions in squatter areas can provide vital security to new migrants and facilitate improved access to finance when property rights over land can be used as collateral. Reforms to land administration in urban areas, where land has typically been alienated from traditional ownership, can often be implemented without undermining collective land ownership systems in rural areas (AusAID 2008).

Urbanization gains can be increased through urban investments that take account of the needs of women. Research from the region demonstrates that women stand to benefit from improved services and access to income generation opportunities resulting from urbanization, supporting broader economic and development gains. Gains, however, are often constrained by household work requirements limiting the time available for broader economic participation. Infrastructure that meets the transport needs of women can free up women's time for new economic activities, as can

FIGURE 8.21 Slow growth is not preventing urbanization in some Pacific island countries



Sources: United Nations Development Programme and World Development Indicators.

BOX 8.8 A copra subsidy scheme intended to support rural development in Kiribati is costly and inefficient

Kiribati has one of the most widely dispersed populations in the world. While nearly half of the population of 100,000 lives in and around the urban center of South Tarawa, the other half is distributed across 20 islands spread across 3.5 million square kilometers of ocean. Since independence, the government has operated a copra subsidy scheme, through which inhabitants of outer islands can sell copra to a state-owned enterprise at a regulated price. Copra production has become the primary source of cash income for many communities in the outer islands, and the scheme is explicitly intended to protect livelihoods and reduce urbanization pressures in the outer islands.

But with volatile world copra prices, inefficiencies in processing, and high transport costs, the scheme is imposing increasingly unaffordable costs on government. There is an economic loss of more than US$1 for every kilogram of copra produced in the outer islands, with total costs of the scheme reaching nearly 5 percent of GDP. The scheme is also regressive, as food and basic needs poverty is concentrated in urban areas. Government is working with the World Bank to reform the scheme. Difficult trade-offs will need to be made between subsidizing rural livelihoods to avoid urbanization pressures and redirecting available resources into more efficient investments in urban services and infrastructure links that may encourage urbanization.

good coverage of sanitation and water services. Adequate public investment in laws and institutions to prevent crime and sexual exploitation can also facilitate women's participation in a broader range of economic activities (box 8.9).

Public spending

Priority 4 Ensure that public spending delivers efficient services and creates employment

- *Summary*. Public sectors in Pacific island countries are often viewed as a source of concern, with public sector employment thought to exist at the expense of private sector employment. In reality, scope for private sector–led employment creation is often constrained by geography, and public sectors, while large relative to the size of the economy, remain small in absolute terms. This is especially true when diseconomies of scale in administration and service delivery are taken into account. Policy attention can usefully focus on improving the quality of public sector jobs, regarding what they provide for civil servants and society, rather than on reducing public sector employment.
- *Countries of relevance*. All Pacific island countries, especially those where populations are very small and employment is concentrated in the public sector.
- *Living standards*. Public servants tend to enjoy higher living standards, with salaries often supporting larger family and community networks.
- *Productivity*. Incentives for effort and skills acquisition are sometimes blunted in the public sector. Selective use of private participation and continued public sector reform have the potential to achieve productivity gains.
- *Social cohesion*. Social cohesion would be strengthened if appointments in the public sector were based on merit and employment opportunities were distributed equitably among social groups and geographic areas.

The public sector provides a large share of cash employment in many Pacific island countries (figures 8.22 and 8.23). PICs face challenges in meeting the high fixed costs associated with a fully functioning sovereign government. Because there are large economies of scale in operating the various institutions required for governance and service delivery, the costs of government are high relative to the size of the economy. At the same time, barriers of geography prevent rapid employment growth in export-oriented manufacturing and services. Consequently, public sector employment is likely to continue to represent a large share of total formal and cash-earning employment, especially for the smallest PICs. Given the continued importance of the public sector, an important challenge for PICs is to ensure that public sector jobs are good jobs, both for public servants and for society.

The benefits of public sector employment are broad and widely shared. Public sector salaries are often well above average levels of income. Recent analysis suggests that the average public servant earns around 5 times GDP per capita in Kiribati and around 2.8 times GDP per capita in Tonga, compared to global norms of about 1.2 times. In both countries, public service salaries are also higher than average private sector salaries. Benefits of public sector employment also include training opportunities, international travel, and opportunities to form global networks that would be very unusual in most private sector employment. Given strong social pressures for sharing wealth, the benefits from higher pay and broader opportunities are often widely shared, with every public sector job often supporting the living standards of a wider family group or community. Training and networking opportunities available to public sector employees are often a key gateway to international labor market opportunities and much higher standards of living, sometimes via scholarships and further higher education.

Public sectors in PICs experience the same incentive problems as public sectors in the rest of the developing world. Given the extent to which their economy-wide resources are

BOX 8.9 Unmanaged urbanization increases poverty and weakens social cohesion in the Solomon Islands

The squatter settlements of Honiara illustrate many of the issues associated with rapid urbanization in PICs. Evidence from the national census and the "people's survey" commissioned by the regional peacekeeping and reconstruction force reflect the risks associated with rapid urbanization driven partly by uneven access to services (figure B8.9.1).

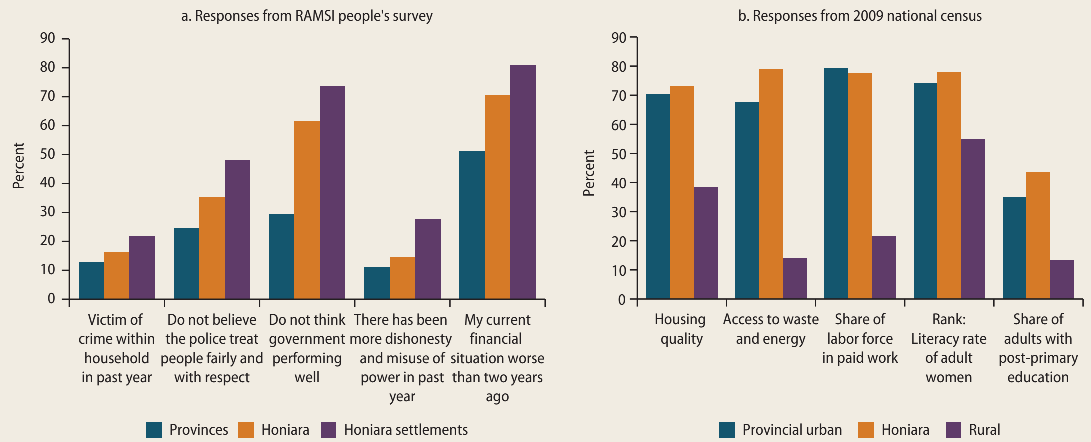
These surveys show that persons living in urban areas not only have far greater access to paid employment than persons living in rural areas, but also far greater access to services and infrastructure. As Solomon Islanders move to access both economic opportunities and better services, the population of Honiara has grown at around 5 percent a year. Weak land administration has led to inflexible land use, contributing to housing shortages and forcing many immigrants to live in squatter settlements located outside the formal town boundaries and with limited access to services and infrastructure.

With urbanization being driven by both economic opportunities and the desire to access services, labor supply has outgrown demand. Underemployment is widespread, especially among youth; in a recent survey, 67 percent of youth residing in the squatter settlement of White River reported that they had no regular source of cash employment and were looking for work. These dynamics have led to declines in social cohesion, including higher levels of crime and violence and dissatisfaction with the performance of police and government.

There is little evidence of significant return migration to rural areas, and challenges in urban areas need to be addressed. Improved administration, improved services, and better infrastructure in urban areas might allow Solomon Islanders to continue to seek the economic opportunities associated with urbanization without facing such severe declines in living standards and social cohesion. Increased investment in rural services might reduce the incentives for migration for those with little prospect of finding employment.

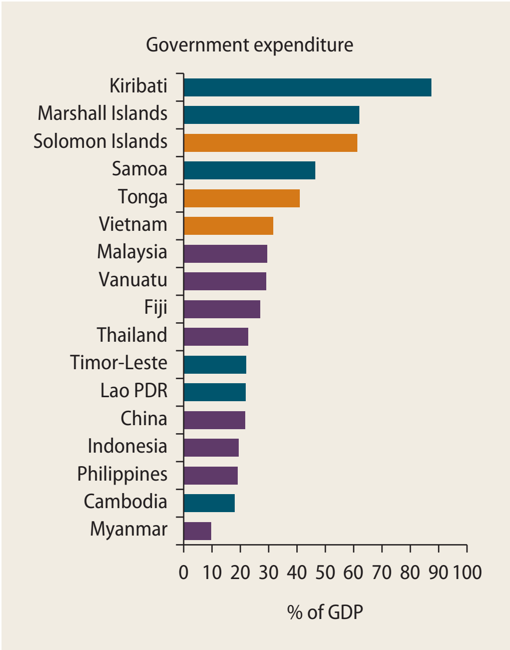
Sources: World Bank 2010a; Regional Assistance Mission to Solomon Islands people's survey 2011; Solomon Islands National Statistics Office.

FIGURE B8.9.1 Rapid urbanization in the Solomon Islands is accompanied by risks



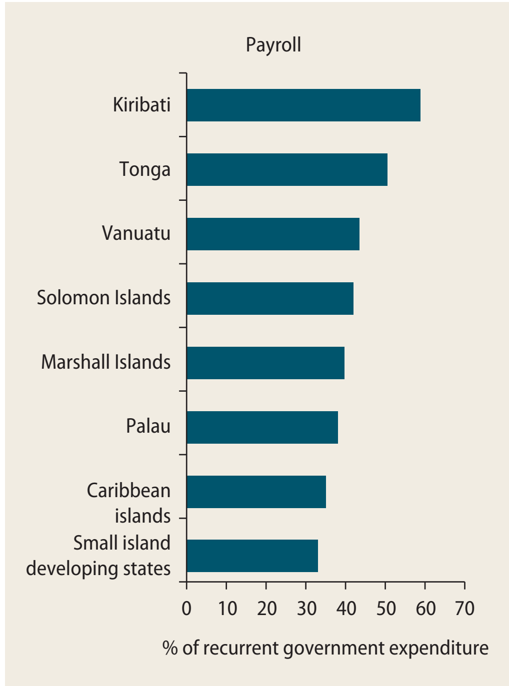
Sources: Data from the Regional Assistance Mission to Solomon Islands (RAMSI) people's survey, 2011; national census, 2009.

FIGURE 8.22 Government in Pacific island countries is large



Source: Estimates based on data from country authorities.

FIGURE 8.23 Public service employment is substantial



Source: Estimates based on data from country authorities.

invested in the public sector, efficiency in public administration and in the delivery of public services is especially important. Good public sector jobs would provide strong incentives for human capital development and productivity, while also supporting adequate living standards for public sector workers and their families. Public services in Pacific island countries, however, face common challenges, including limited accountability, weak performance management systems, and severe capacity constraints that impede the delivery of core government outputs and functions (ADB 2010b). The severity of these challenges varies across countries, but public sector employment, while providing benefits for public sector employees and their families, often does not have as positive an impact on society as it could (ADB 2010b). These issues often lead to calls to reduce government spending and the role of government in the economy.[9]

There is little evidence that simply reducing public spending would lead to improved employment opportunities in PICs. Well-paid jobs in large public sectors can come at a cost to the private sector, with businesses facing higher taxes to support bloated governments and increased public sector competition for labor and associated wage inflation. However, it is not clear that the public sector is crowding out the private sector in PICs.

First, a large proportion of government revenues typically comes from natural resource royalties and aid. Government spending often supplements domestic demand, with public servants supporting the emergence of private sector service economies, especially in capital cities. For some countries, economic growth has closely tracked growth in public spending, with changes in public sector demand exerting a determining influence on private sector performance (see box 8.10).

Second, given sluggish growth, reliance on natural resource industries, and the predominance of agricultural work, it is not

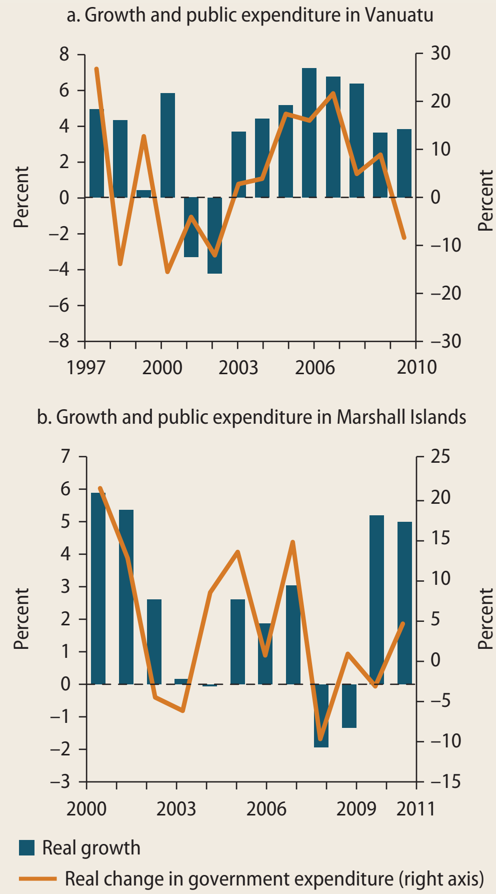
BOX 8.10 Public sector expenditure supports economic growth in Vanuatu and the Marshall Islands

The recent experiences of Vanuatu and the Marshall Islands illustrate the potential for public expenditure and public employment to "crowd in" private sector activity, supporting broader economic growth.

In Vanuatu, tourism-based private sector growth during the previous decade drove a rapid increase in government revenues. This revenue growth supported rapid increases in government expenditure and employment (an increase in real wage expenditure of more than 50 percent), with changes in aggregate economic growth, tourism arrivals, and government spending closely aligned. With many tourism operations weakly integrated into local supply chains, growth of public expenditure through increased tax revenues supported a broader expansion of paid employment opportunities both within the public sector and in private sector businesses supplying goods and services to public servants and government entities.

In the Marshall Islands, under renewed arrangements for fiscal transfers from the United States, public expenditures grew at an annual average rate of 12 percent between fiscal 2003 and fiscal 2007. Employment in the public sector added 507 jobs, growing at an annual average rate of 6 percent over the period. Expansion in public spending fueled growth of 1.9 percent in this period, peaking at 3 percent in 2007. With the flattening off of public expenditure, growth fell during 2008 and 2009, but recovered during 2010 and 2011 partly due to the impact of new publicly funded infrastructure projects. Public expenditure was the dominant driver of both employment creation, inside and outside the public sector, and economic growth in an economy with limited alternative prospects (figure B8.10.1).

FIGURE B8.10.1 In small Pacific island countries, public expenditure and economic growth move in tandem

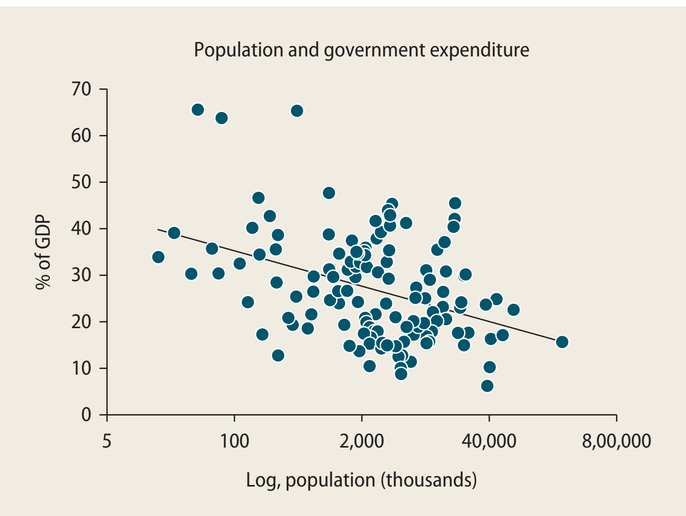


Source: Estimates based on data from country authorities.

clear that public sector workers could find employment acceptable to them in the private sector if the size of government were substantially reduced. For many jobs, competition for labor between the public and private sectors is not always apparent. In some cases, higher public sector salaries for more senior or specialized staff often reflect a legitimate attempt to retain the vital skills required to undertake key government functions in the context of a very narrow pool of appropriately educated professionals and competition from overseas employers, nongovernmental organizations, and donor agencies. Recent reviews of the experience of public sector reforms in the Pacific cast serious doubt on the assumption that the private sector will necessarily absorb retrenched public employees in the context of widespread redundancies (ADB 2009a; Collins and Warrington 1997). The large-scale retrenchment of public sector workers in the Cook Islands and the Marshall Islands led to the emigration of qualified workers rather than their absorption into the private sector.

Finally, public sector spending and public service numbers may need to be large, relative to very small economies and populations, to ensure the delivery of vital services (Brown 2010). Cross-country evidence shows that small countries tend to have larger public sectors and more public sector employment, reflecting diseconomies of scale in service delivery and administration (figure 8.24). Reducing the capacity of governments to hire and retain enough people to carry out all the necessary functions of government and provide the public goods required for successful private sector activity is likely to have an adverse impact on living standards, employment creation, and productivity (World Bank 2011).

FIGURE 8.24 Government is bigger in smaller countries



Source: World Development Indicators.

Outsourcing and privatization should be approached cautiously, but they can sometimes bring benefits. Outsourcing the delivery of services and privatizing government agencies that can operate on a commercial basis are often seen as an effective means of overcoming the agency problems associated with public sector delivery of services. The profit motive and competition can sharpen the incentives for productivity, feeding through into better services at lower cost. Privatizing state-owned enterprises that were competing directly with the private sector in Kiribati, Samoa, and other PICs has led to the expansion of employment opportunities and improvements in services, as inefficiencies associated with poor public sector management have been eliminated (ADB 2011). Restructuring the road transport sector in Samoa to allow the outsourcing of road maintenance has facilitated the emergence of several efficient and well-run private sector firms that provide both employment and vastly improved services to government. But privatization and outsourcing in the absence of a competitive market environment can also undermine service delivery and employment creation. Inadequately regulated private monopolies are no better than public monopolies at expanding access to services and are more likely to involve loss of local employment and expatriation of monopoly rents. Efficient delivery of outsourced government services relies on competition for contracts and effective monitoring of delivery by government agencies. While outsourcing and privatization continue to provide important opportunities for increasing work in the delivery of public services, these opportunities need to be pursued carefully, taking account of the following:

- The economic significance of efficiency benefits that could be achieved through the introduction of private participation
- The impacts on living standards and social cohesion arising from associated public sector employment losses, especially in the context of limited private sector employment opportunities

- The capacity of government to monitor and enforce contractual or regulatory arrangements effectively to realize any potential benefits of private participation.

Basic public sector management systems are important. Given constraints on the range of government functions that can be delivered effectively by the private sector, dramatic reductions in the size of the public sector and public service are unlikely in PICs over the medium term. Because of this, basic systems for public sector management, performance, and accountability need to be improved further. Performance-based budgeting and performance-based pay are likely to be too capacity intensive for effective implementation in PICs over the medium term and to require institutional underpinnings that are seldom present. Public financial management systems that improve transparency and encourage public dialogue regarding the use of resources may represent a useful initial priority to align public sector incentives better with efficient service delivery, along with public sector pay scales and merit-based promotions that generate substantial incentives for skills development and productivity on behalf of individual public servants. Ensuring merit-based appointment and promotion in the public sector is also vital, given the likely continued importance of the public sector as a source of employment. Recent experiences during the Arab Spring indicate the extent to which frustrations regarding nepotism and inequality in the distribution of public sector opportunities can undermine social cohesion and fuel conflict (World Bank 2010b, 2012a).

Donors can support increased local employment in the delivery of projects (box 8.11). With a substantial proportion of public expenditure in small PICs being financed by overseas development assistance, donors can also contribute to local employment creation by increasing the participation of local vendors and labor in project delivery.

BOX 8.11 Outsourcing aid?

Experience with involving local private sector firms in the delivery of aid projects in PICs suggests that such arrangements are not always easy, but can provide long-term benefits both through better projects and the creation of employment opportunities. Donors could consider the following lessons:

- *Actively build, rather than expect the spontaneous emergence of, a private sector able to meet donor needs.* This means providing a sustained source of demand to keep growing firms in business as their capacity improves.
- *Do more to advertise procurement opportunities and streamline procurement processes.* Pacific firms are not likely to come across donor procurement opportunities as they are currently advertised. Ensuring local awareness of opportunities is an important priority. Donors could also ensure that bidding processes are not too complicated for capacity-constrained Pacific firms or could provide direct assistance in preparing tender documents.
- *Ensure that contracts are offered at a size and scope that facilitate local participation.* While not always feasible, dividing work into smaller contracts may provide more opportunities for local firms.
- *Move beyond a single-project perspective when considering the participation of local firms.* Putting the time and effort into engaging local firms may not look appealing for the purposes of any one project. But if gains can be expanded and capitalized on by subsequent projects—through lower costs and better-quality delivery—the cost-benefit equation is likely to look more favorable. It is therefore vital that decisions made at the project level take into account the potential for broader benefits.
- *Make trade-offs between project-level efficiency and broader social and economic benefits.* Involvement of local contractors may sometimes delay projects and force compromises on quality relative to reliance on international contractors. These costs need to be traded off systematically against broader development benefits when decisions are made.

Donors could introduce preferences in their procurement processes for businesses using local labor or produce. Donors could also make greater use of general and sector budget support, with expenditure of this kind typically having a larger impact on local employment than project financing.

Natural resource industries

Priority 5 Generate sustainable employment from natural resource industries

- *Summary.* Natural resource extraction is often seen as an easy source of new employment. In reality, employment in natural resource industries in the Pacific is often unsustainable, of poor quality, and reliant on implicit or explicit subsidies. Countries with natural resource endowments should support employment creation in natural resource industries based on careful consideration of the likely quality of associated work, taking careful account of the opportunity costs of the implicit and explicit subsidies often required.
- *Countries of relevance.* Pacific island countries with natural resource endowments, including fisheries, minerals, and forestry.
- *Living standards.* Natural resource industries have a poor record of delivering sustainable improvements in living standards in the region. The most sustainable improvements may come from investing rents from these activities in areas that open new employment opportunities in other sectors, locally or internationally.
- *Productivity.* Investing rents from natural resource industries into improved service delivery and human capital can avoid the problems of low-productivity employment in natural resource industries.
- *Social cohesion.* Social cohesion can be undermined by geographically concentrated, short-term natural resource–related employment. Public investment of natural resource rents can provide broader and more equitably distributed opportunities.

Natural resource opportunities, including tourism, attract investment to areas where resources and attractions are located rather than to where business costs are low. High business costs in PICs do not, therefore, preclude investment, as economic rent can be earned from the exploitation of natural resources even given the high costs associated with distance. This is reflected in Pacific island countries' historically high reliance on fisheries, minerals, forestry, and tourism for foreign exchange and income. With rapid growth in international tourism arrivals projected over coming decades, a large share of global stocks of certain fish species located in Pacific waters, and ongoing discoveries of new mineral wealth in the region, PICs will continue to attract the attention of natural resource investors (figure 8.25).

Policy makers and the public often want to see substantial direct employment created from natural resource endowments, given growing populations. Sometimes, governments have considered or pursued mandates for local employment creation as a negotiated condition of resource access or have provided tax exemptions or subsidies to encourage tourism investments expected to bring employment. The labor intensity of extractive natural resource industries is typically very low. Work with higher pay and productivity within natural resource industries is often highly specialized and tends to be performed by expatriates rather than local labor. Because PICs lack economies of scale, there are limited opportunities for development of ancillary industries around natural resources, and natural resource industries are not typically integrated into local chains of production. It is generally cheaper for natural resource investors to process products overseas than to develop local production chains, given high operating costs and skill shortages. The forestry industry in the Solomon Islands, for example, which has contributed double-figure shares of GDP and government revenues for several decades, employs only around 5,000 unskilled workers, mostly at wage rates below the national minimum established for all other industries (World Bank 2010a).

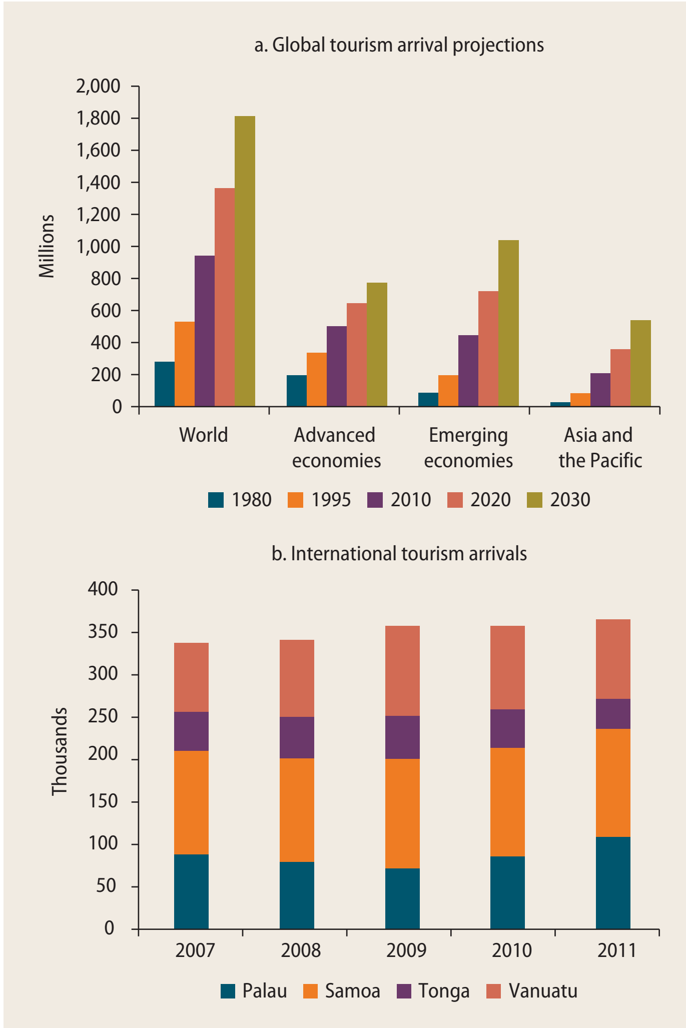
Nearly all processing is undertaken offshore, and forestry methods are purely extractive, with very little local investment. Pacific tuna fishery resources are among the largest in the world and generate more than 10 percent of government revenue for four PICs. But onshore processing and value added have been difficult to establish, with employment in the industry contracting in the years since independence (Gillett 2009).

The need to subsidize tourism investment reflects pressures of regional and global tax competition. In contrast to extractive industries, tourism is relatively labor intensive, hires a large percentage of local workers, and can be better integrated into local supply chains with broader economic impacts (Scheyvens and Russell 2009). For this reason, tourism investment is often attractive, with several PIC governments offering tax concessions for tourism investors. This has fueled "tax competition" in the region, with governments competing to offer the most favorable tax or investment incentive package to international investors, despite high fiscal costs and limited evidence that such concessions exert a determining influence on investment decisions (James 2009).

While tourism has been proven to generate employment that is reasonably sustainable and can open the doors to broader opportunities in Pacific countries, work based on extractive natural resource industries is often short term and limited to the lifespan of extractive activities. Creating unsustainable employment creates risks of lower living standards and pressures on social cohesion when natural resources are exhausted and employment opportunities cease. Work based on extractive natural resource industries also tends to be geographically concentrated around the location of resources. Such concentration can lead to rapid growth in inequality, rapid internal migration, and a corresponding emergence of conflict pressures—a possibility illustrated by natural resource development in Papua New Guinea (Collier and Hoeffler 2004).

Employment in natural resource industries can have negative impacts on women.

FIGURE 8.25 Tourism to the Pacific island countries is expected to keep growing



Source: World Tourism Organization.

Gender discrimination limits the role of women in fisheries in many Pacific island countries, due to prevailing cultural divisions of labor (Novakzec, Mitchell, and Veitayaki 2005). As a result, access to economic opportunities around the tuna industry is strongly gendered in favor of men (Barclay and Cartwright 2007). Fishing, logging, and mining activities have been associated with increased sexual abuse and exploitation in Pacific island countries (Herbert 2007).

More generally, cross-country evidence suggests that reliance on natural resource industries reduces and discourages female labor force participation, which reduces women's political influence (Ross 2008; World Bank 2012b). The historical reliance of PICs on natural resource industries may help to explain, at least in part, slow progress toward gender equality, particularly with respect to voice and influence in society (World Bank 2012a).

Decisions to subsidize employment creation in natural resource industries and tourism should be informed by careful analysis of the opportunity costs of alternative public investments (box 8.12). Ultimately, the public bears the costs of tax concessions and employment creation mandates. Concessions lead directly to forgone tax revenue. Mandating job creation for natural resource industries is only required if such jobs are not efficiently undertaken locally, and government will likely have to meet the costs of associated economic inefficiencies in the form of lower royalties, access payments, or profit taxes. As an alternative to mandating or subsidizing direct employment creation in natural resource industries, PICs could support overall employment in other ways: directly (through sustainable increases in public employment) or indirectly (through investment in the human capital, infrastructure, and social services that can support new economic opportunities in a broad range of sectors, locally and overseas). Therefore, policy makers have to consider carefully the full explicit and implicit costs and benefits of subsidizing employment in natural resource industries and take account of alternative employment-creating investments that potentially could be financed with these resources (box 8.13). This requires the following:

- Careful long-term costing of employment creation concession agreements for

BOX 8.12 Employment in fisheries or employment supported by fisheries revenues?

The fisheries industry in the Pacific is a good example of the pressures faced by government to create work in natural resource industries.

For several decades, Pacific island countries have been working to conserve fish stocks and increase license revenues through coordinated control of access to fisheries resources. Substantial progress has been made in recent years through the establishment of a vessel day scheme by eight Pacific countries with the most significant tuna resources (Kiribati, the Marshall Islands, the Federated States of Micronesia, Nauru, Palau, Papua New Guinea, the Solomon Islands, and Tuvalu). Under this scheme, participating countries are allocated a fixed number of "vessel days," through which rights to undertake any fishing activity are allocated to purse seiner vessels for a 24-hour period. Vessel days can be traded between countries, with the total number of vessel days issued under the scheme nominally equivalent to total effort in 2008. By imposing coordinated controls on access, implementation of the vessel day scheme has allowed parties to the Nauru Agreement to generate significantly higher license fees and improve data collection, strengthening the prospects for sustainable management of the resource. Estimates based on limited public data suggest that the value of a fishing day may have increased from around US$1,350 in 2004 to more than US$5,000 due to the impacts of the scheme (Havice 2013).

Progress toward maximizing license revenues, however, is being slowed by a countervailing trend toward granting special access rights or discounted licenses to foreign fishing firms that commit to supporting domestic economic development and employment (typically through offloading, provisioning, infrastructure investments, and employment of crew). Such discounted access arrangements are sometimes accompanied by tax concessions and various forms of subsidization to fishery operators.

continued

BOX 8.12 *(continued)*

The number of vessels operating under such arrangements increased from 16 in 2001 to 53 by mid-2012, contributing an 18 percent increase in total purse seiner business between 2004 and 2010. PIC governments are often of the view that the employment and direct economic impacts of such arrangements are worth more than the corresponding loss of license fees and revenues. However, policy decisions to grant special access or discounted licenses have seldom been informed by detailed analysis of the costs and benefits. Revenue costs have not been fully calculated. Expected employment creation has sometimes not been realized. Dividends from government shares in joint venture companies have not been forthcoming due to poor accounting practices. As a result, the primary beneficiaries have been foreign fishing companies.

Pacific island countries with the greatest fisheries resources now face a difficult decision between granting further discounted licenses guaranteeing onshore economic and employment impacts and ensuring the best possible price for each license sold. The former option may lead to greater short-term employment in fisheries (dependent on varying degrees of subsidization). The latter may provide a more sustainable and substantial stream of revenues with which to finance public investments for broader employment growth. Whatever option is pursued, PICs will need to assess accurately the full costs and benefits of different options before making potentially costly decisions.

BOX 8.13 Regulatory requirements for extractive industries to support overall employment creation

Sound regulatory and public finance frameworks are indispensable if extractive natural resource industries are to support employment creation in small PICs. International and regional experience illustrates both the importance and the difficulty of establishing basic systems to ensure sound investment of natural resource revenues. Building such frameworks represents a key priority for small PICs that face particular capacity and political economy challenges. Priorities include the following:

- *Policies and legislation governing royalties and taxation*. Good regulations and policies can ensure that a fair share of benefits from natural resource industries flows to government and resource owners. Licensing and tax provisions need to be specified in the law, and appropriate regulations and legislation need to be drafted and passed.
- *Strong capacity in natural resource agencies and tax departments*. Ministries responsible for regulating natural resource industries need capacity to ensure that policies and regulations are well designed and implemented. There is no point in having good policies or fair benefit-sharing arrangements if compliance cannot be monitored and enforced. Specialist capacity may also be required in tax departments to ensure that investors are complying with local tax rules. Some of this capacity is likely to need to be sourced from donors or regional facilities, given the shortage of local specialists.
- *Appropriate measures for managing revenue flows to government*. Increases in government revenue from natural resource activities will only deliver benefits if they are managed and used wisely. Policies are needed to ensure that revenue inflows do not fuel unsustainable and short-term growth in expenditure, but rather allow for sustainable improvements in infrastructure and services, such as health and education. Strong basic public finance management systems are required to ensure that revenues are allocated to areas where investment can facilitate the creation of sustainable employment. Such areas might include connective infrastructure between urban and rural areas, improved administration and services in urban centers, improved extension services for agriculture, and investments in education and health to open local and international employment opportunities for Pacific island workers.

tourism or access arrangements for extractive industries prior to making decisions

- A good understanding of the likely impacts of employment created by these measures on productivity, living standards, and social cohesion
- Comparison of these benefits against employment creation or other public policy goals that could be achieved through alternative public investments financed from forgone tax or royalty revenues
- Careful design of concession or employment mandate schemes to ensure that they incentivize new investment and employment creation rather than reward investors for activities that would have occurred in the absence of subsidies
- Close monitoring of the effectiveness of subsidies and concessions and compliance of investors with employment creation requirements to ensure that expected benefits are being realized.

Conclusions

Pacific island countries will follow a different path to improving employment outcomes. Population growth and rapid urbanization are causing understandable concern in the context of weak historical growth and a shortage of cash-earning employment opportunities. Common policy prescriptions and responses tend to involve a combination of efforts (a) to stem urbanization by subsidizing private sector activities in rural areas, (b) to improve the broad business environment, often including retrenchment of the public sector, in the hope of attracting investment and facilitating private sector employment creation, and (c) to spur employment in natural resource industries, including tourism, often through implicit or explicit subsidization. But these strategies should be considered carefully and implemented selectively.

First, international experience shows very limited success with policy interventions aimed at stemming urbanization. If well managed, the benefits of urbanization—economies of scale in service delivery and potential for new market opportunities in population concentrations—can often outweigh the costs. Second, although improving conditions for the private sector is important, realism is needed regarding the likely extent of private sector growth and employment creation, especially following any large-scale public sector retrenchment. PICs face inherent difficulties of geography, which private sector firms often cite as the primary constraint on growth by private sector firms. Limited financial and human capacity is available to provide all of the institutional, infrastructure, and regulatory needs of globally competitive export sectors. Finally, the employment that is associated with natural resource endowments is seldom sustainable, and the subsidies provided for employment creation in these sectors could often have been put to better use creating employment in other areas.

The most appropriate employment strategy will vary even between Pacific island countries, as will the importance of various options and opportunities. However, strategies should take account of the following realities.

Pacific Islanders have proven adept at taking advantage of economic opportunities, wherever they exist, and converting these opportunities into widely shared improvements in living standards. Facilitating internal and international mobility is likely to be more successful in improving employment than encouraging people to remain in areas where, by accidents of history and geography, opportunities are inevitably limited. To ensure that the benefits of urbanization are shared widely, it is important to invest in infrastructure to connect urban and rural areas and to provide agricultural producers with the tools to take advantage of increased market opportunities accompanying the growth of concentrated urban populations.

Public sectors in Pacific island countries have achieved impressive improvements in social indicators over recent decades, and employment created in delivering these improvements can be socially and economically valuable. But it is important to strengthen the incentives to use public resources efficiently. This can sometimes be achieved through carefully considered and selective involvement of the private sector, but continued progress with public sector reforms is also vital.

Natural resource industries, which can flourish despite higher cost structures in PICs, offer employment opportunities. But improvement in employment supported by natural resource industries does not have to involve the creation of jobs within those industries. Natural resource industries have a poor track record of delivering substantial increases in sustainable jobs. But well-regulated natural resource industries can generate sustainable flows of revenue to support employment in the delivery of public services and opportunities for better local and international employment through improvements in human capital.

Economic growth is not sufficient to create employment or to sustain well-being from work. A key question posed in the WDR 2013 is whether a "job strategy" is any different from a "growth strategy." In PICs, growth—in itself—is not a sufficient goal, considering the role of work in supporting productivity gains, higher living standards, and improved social cohesion. Labor mobility offers the best employment prospects for many Pacific Islanders. But the output produced by Pacific Islanders working overseas is not recorded in GDP statistics at home. The remittances that they send home to their families fuel the consumption of imports and improve living standards but have a negligible impact on GDP growth. Efficiency improvements in public sector work are notoriously difficult to capture in GDP accounts, and the associated improvements in social indicators are not reflected. Natural resource extraction tends to have a similar impact on growth regardless of whether it is sustainably managed or employs the local population. Overall, in PICs, the factors that influence GDP are very different from those that influence living standards and well-being from work. A key priority is to develop better information on employment, economic opportunities, and living standards for people from these countries, wherever they might be living and working, and to use that information to establish targets and monitor progress.

Notes

1. Because of the specific set of challenges facing the smaller independent Pacific countries, we restrict our analysis to countries with populations of significantly less than 1 million, therefore excluding Fiji, Papua New Guinea, and Timor-Leste.
2. Strong institutions of informal reciprocity within kinship groups mean that a broad range of social considerations influence participation in economic activities and the distribution of benefits. Labor (or goods and other services) may be provided in return for access to various common-pool resources without immediate or direct cash compensation. Wages from a single individual with a regular formal sector job are often shared widely and support living standards across family groups. See Attahir (2002) and Curry (1999).
3. The average Pacific island country is 11,456 kilometers from any other randomly selected country weighted by rest-of-the world GDP, compared to 8,103 kilometers for small countries in the Caribbean. The countries that Pacific island countries trade with are typically smaller and more distant than the trade partners of other small states, especially Caribbean countries, which have easy access to the large U.S. market.
4. Ni-Vanuatu participating in the New Zealand seasonal worker scheme, in contrast, tend to be from wealthier households but are still unlikely to have access to overseas labor markets through any other available channels (McKenzie, Garcia-Martinez, and Winters 2008).
5. Although remittance flows typically fluctuate as the composition of and economic conditions facing remitting migrant populations change, evidence shows no secular decline in the amount remitted by Pacific migrants over time, although smaller amounts are remitted less regularly by second- and third- generation migrants (Brown 1998; Connell and Brown 2005).
6. "Desperate Need for Unskilled Workers in New Zealand," PacNews Biz, January 8, 2013.

7. Australia has traditionally opposed such country-based allocations in favor of points-based, country-neutral allocation systems. New Zealand, however, has managed to offer preferential access to Pacific Islanders for many decades without significantly undermining the integrity of its broader points-based system.
8. Recorded growth in urban populations may understate the pace of urbanization in many PICs. Calculations of urban populations are based on populations within formal municipal boundaries. These boundaries often exclude peri-urban settlements where population growth has been most rapid.
9. For examples, see Asian Development Bank economic reports on Pacific island countries (ADB 2007, 2009b, 2010a, 2012b).

References

ADB (Asian Development Bank). 2007. *Tuvalu Economic Report: From Plan to Action*. Manila: ADB.

———. 2009a. *ADB Support for Public Sector Reforms in the Pacific: Enhance Results through Ownership, Continuity, and Capacity*. Manila: ADB.

———. 2009b. *Kiribati Social and Economic Report*. Manila: ADB.

———. 2010a. *Solomon Islands Economic Report*. Manila: ADB.

———. 2010b. *State Performance and Capacity in the Pacific*. Manila: ADB.

———. 2011. *Finding Balance: Benchmarking the Performance of State-Owned Enterprises in Fiji, Marshall Islands, Samoa, Solomon Islands, and Tonga*. Manila: ADB.

———. 2012a. *The State of Pacific Towns and Cities*. Manila: ADB.

———. 2012b. *Tonga Economic and Social Report*. Manila: ADB.

Allen, Matthew, Sinclair Dinnen, Daniel Evans, and Rebecca Monson. 2013. "Justice delivered locally : Systems, challenges, and innovations in Solomon Islands." Justice for the Poor Research Report, World Bank, Washington, DC.

Attahir, Yusuf. 2002. "Perceived Hurdles against Small Business Development in the South Pacific: A Factor Analytical Study." *International Journal of Management* 33 (2).

AusAID (Australian Agency for International Development). 2008. *Making Land Work: Reconciling Customary Land Tenure and Development in the Pacific*. Canberra: AusAID.

Barclay, Kate, and Ian Cartwright. 2007. *Capturing Wealth from Tuna: Case Studies from the Pacific*. Canberra: Asia Pacific Press.

Bedford, Richard. 2012. "Population Movement in the Pacific: A Perspective on Future Prospects." Department of Labour, Labour and Immigration Research Centre, Wellington.

Bertram, Geoffrey, and Raymond Watters. 1985. "The MIRAB Economy in South-Pacific Micro-States." *Pacific Viewpoint* 26 (3): 497–512.

Brown, Deryck. 2010. "Institutional Development in Small States: Evidence from the Commonwealth." *Halduskultuur—Administrative Culture* 11 (1): 45–65.

Brown, Richard. 1998. "Do Migrants' Remittances Decline over Time? Evidence from Tongans and Western Samoans in Australia." *Contemporary Pacific* 10 (1): 107–51.

Chand, Satish, and Michael Clemens. 2008. "Skilled Emigration and Skill Creation: A Quasi-Experiment." Working Paper, Center for Global Development, Washington, DC.

Collier, Paul, and Anke Hoeffler. 2004. "Greed and Grievance in Civil Wars." *Oxford Economic Papers* 56 (4): 563–95.

Collins, Paul, and Edward Warrington. 1997. "The New Public Administration: Lessons from the Experiences of Small Island States." Prepared for the Commonwealth Association of Public Administration and Management Conference, Toronto, July.

Connell, John. 2011. "Elephants in the Pacific? Pacific Urbanization and Its Discontents." *Asia Pacific Viewpoint* 52 (2): 121–35.

Connell, John, and Richard Brown. 2005. *Remittances in the Pacific: An Overview*. Manila: Asian Development Bank.

Curry, George. 1999. "Markets, Social-Embeddedness, and Pre-Capitalist Societies: The Case of Village Tradestores in Papua New Guinea." *Geoforum* 30 (3): 285–98.

Department of Immigration and Citizenship. 2012. "Working Holiday Maker Visa Program Report." Department of Immigration and Citizenship, Canberra.

Department of Labour. 2010. "Final Evaluation Report of the Recognized Seasonal Employer Policy." Department of Labour, Wellington.

———. 2013. "Migration Trends and Outlook 2011–2012." Department of Labour, Wellington.

Earl, Greg. 2012. "Plan Calls for Indonesian Guest Workers." *Australian Financial Review*, November 20.

Gibson, John, and David McKenzie. 2009. "How Pro-Poor Is the Selection of Seasonal Migrant Workers from Tonga under the Recognized Seasonal Employer Program?" *Pacific Economic Bulletin* 23 (3): 187–204.

———. 2010. "The Economic Consequences of 'Brain Drain' of the Best and Brightest: Microeconomic Evidence from Five Countries." Policy Research Working Paper 5394, World Bank, Washington, DC.

———. 2011. "Australia's Pacific Seasonal Workers Pilot Scheme: Development Impacts in the First Two Years." *Asia Pacific Viewpoint* 52 (3): 361–70.

———. 2013. "Scientific Mobility and Knowledge Networks in High Emigration Countries: Evidence from the Pacific." Discussion Paper, Centre for Research and Analysis of Migration, London.

Gibson, John, David McKenzie, and Steve Stillman. 2011. "Accounting for Selectivity and Duration-Dependent Heterogeneity When Estimating the Impact of Emigration on Incomes and Poverty in Sending Areas." Policy Research Working Paper, World Bank, Washington, DC.

Gillett, Robert. 2009. "Fisheries in the Economies of the Pacific Island Countries and Territories." Asian Development Bank, Manila.

Havice, Elizabeth. 2013. "Rights-Based Management in the Western and Central Pacific Ocean Tuna Fishery: Economic and Environmental Change under the Vessel Day Scheme." *Marine Policy* 42: 259–67.

Herbert, Tania. 2007. "Commercial Sexual Exploitation of Children in Solomon Islands: A Report Focusing on the Presence of the Logging Industry in a Remote Region." Christian Care Center, Honiara.

Howes, Stephen, and Danielle Hay. 2012. "*Australia's Pacific Seasonal Worker Pilot* Scheme: Why Has Take-Up Been So Low?" Discussion Paper, Crawford School of Public Policy, Development Policy Centre, Canberra.

Hummels, David. 2007. "Transportation Costs and International Trade in the Second Era of Globalization." *Journal of Economic Perspectives* 21 (3): 131–54.

ILO (International Labour Organization). 2013. "Draft Pacific Youth Strategy." Suva, ILO.

James, Sebastian. 2009. "Incentives and Investments: Evidence and Policy Implications." World Bank, Investment Climate Advisory Services, Washington, DC.

Leith, Robert, and Alistair Davidson. 2013. "Measuring the Efficiency of Horticultural Labour: Case Study on Seasonal Workers and Working Holiday Makers." Australian Bureau of Resource Economics and Sciences, Canberra.

Luthria, Manjula, Ron Duncan, Richard Brown, Peter Mares, and Nic Maclellan. 2006. "At Home and Away: Expanding Job Opportunities for Pacific Islanders through Labour Mobility." World Bank, Washington, DC.

McKenzie, David, Pilar Garcia-Martinez, and L. Alan Winters. 2008. "Who Is Coming from Vanuatu to New Zealand under the New Recognized Seasonal Employer Program?" Policy Research Working Paper 4699, World Bank, Washington, DC.

McKenzie, David, and John Gibson. 2010. "The Development Impacts of a Best Practice Seasonal Worker Policy." Policy Research Working Paper, World Bank, Washington, DC.

Merwood, Paul. 2012. "Return Migration and Earnings of Workers in New Zealand's Recognized Seasonal Employer Scheme." Department of Labour, Wellington.

Novakzec, Irene, Jean Mitchell, and Joeli Veitayaki. 2005. "Pacific Voices: Equity and Sustainability in Pacific Fisheries." University of the South Pacific, Institute of Pacific Studies, Suva.

Reddy, Mahendra. 2007. "Enhancing the Agriculture Sector in Pacific Island Economies." *Pacific Economic Bulletin* 22 (3): 1–15.

Reed, Cheryl, Angela Southwell, Mandy Healy, and Neil Stafford. 2011. "Final Evaluation of the Pacific Seasonal Worker Pilot Scheme." TNS Social Research, Hawthorn, Australia.

Research New Zealand. 2012. "Recognized Seasonal Employer Monitoring: Key Findings from the 2011 Employers Survey." Department of Labour, Wellington.

Ross, Michael. 2008. "Oil, Islam, and Women." *American Political Science Review* 102 (1): 107–23.

Scheyvens, Regina, and Matt Russell. 2009. "Tourism and Poverty Reduction in the South Pacific." New Zealand Agency for International Development, Wellington.

Storey, Donovan. 2003. “The Peri-Urban Pacific: From Exclusive to Inclusive Cities.” *Asia Pacific Viewpoint* 44 (3): 259–79.

Tumbarello, Patrizia, Ezequiel Cabezon, and Yiqun Wu. 2013. “Are the Asia and Pacific Small States Different from Other Small States?” IMF Working Paper 13/123, International Monetary Fund, Washington, DC.

UNESCAP (United Nations Economic and Social Commission for Asia and the Pacific). 2007. “Improving Employment Opportunities in Pacific Island Developing Countries.” Small Island Developing States Series 1, United Nations, Pacific Operations Centre, New York.

United Nations Center for Human Settlements. 1994. “Population, Urbanization, and Quality of Life.” United Nations, New York.

Venables, Anthony. 2006. “Shifts in Economic Geography and Their Causes.” Paper presented at the “Symposium on the New Economic Geography,” Federal Reserve Bank of Kansas City, Jackson Hole, WY, August 24.

Walmsley, Terrie, S. Amer Ahmed, and Christopher Parsons. 2005. “The Impact of Liberalizing Labour Mobility in the Pacific Region.” Background paper prepared for *Towards a New Pacific Regionalism: The Impact of Liberalizing Labor Mobility in the Pacific Region*, joint report to the Pacific Islands Forum Secretariat, Asian Development Bank, and Commonwealth Secretariat.

Winters, L. Alan, and Pedro M. Martins. 2004. “When Comparative Advantage Is Not Enough: Business Costs in Small Remote Economies.” London School of Economics, Center for Economic Performance, London.

World Bank. 2006. *Global Economic Prospects 2006: Economic Implications of Remittances and Migration*. Washington, DC: World Bank.

———. 2008. *World Development Report 2009: Reshaping Economic Geography*. New York: Oxford University Press.

———. 2010a. “Solomon Islands Growth Prospects: Constraints and Policy Priorities.” World Bank, Honiara.

———. 2010b. *World Development Report 2011: Conflict, Security, and Development*. New York: Oxford University Press.

———. 2011. “Discussion Note: Pacific Futures.” World Bank, Pacific Department, Sydney. http://devpolicy.anu.edu.au/pdf/2012/Discussion_Note_Pacific_Futures.pdf.

———. 2012a. *Capabilities, Opportunities, and Participation: Gender Equality and Development in the Middle East and North Africa Region*. Washington, DC: World Bank.

———. 2012b. *Towards Gender Quality in East Asia and the Pacific*. Washington, DC: World Bank.

———. 2012c. *World Development Report 2013: Jobs*. New York: Oxford University Press.

Yang, Yongzheng, Hong Chen, Shiu Raj Singh, and Baljeet Singh. 2012. “The Pacific Speed of Growth: How Fast Can It Be and What Determines It?” IMF Working Paper WP/13/104, International Monetary Fund, Washington, DC.

A Region at a Crossroads

9

Slowing productivity gains, more modest advances in living standards, and rising inequality in some countries indicate that governments in East Asia Pacific will need to intervene to sustain well-being from work, but in order to prepare for the onset of aging, they should do so in ways that support all working people, regardless of where or how they work.

In the past few years, the news headlines from countries in East Asia Pacific have started to change. The exclamations and superlatives about growth and productivity that the world has gotten accustomed to reading are still there. And China's eventual economic supremacy has been foretold so frequently by the press and pundits on television that most of the public now takes it as a foregone conclusion, even as the country's annual growth rate is slowing. Yet squeezed between the usual applauding coverage have started to appear stories of a very different character, seemingly at odds with the widely accepted narrative of the region's rise.

When reports emerged in 2009 that a worker at a Chinese factory committed suicide in despair and protest against poor working conditions, the incident was as unexpected as it was tragic. That this act was then repeated throughout 2010 by several desperate people protesting what they claimed were unreasonable work requirements for meager pay became a cause for concern. In the year that followed, news from Indonesia reported several strikes by mining unions involving thousands of workers and one at Freeport that led to the death of at least three people. And a wave of reports from Vietnam charted a doubling in the number of illegal "wildcat" strikes in 2011. From May through July 2013, reports of clashes between striking garment factory workers and police in Cambodia appeared in the press almost daily.

What were once rare accounts of worker discontent and mobilization from East Asia Pacific countries are becoming more frequent. Images of demonstrating workers that might have emerged from time to time during the 1980s and 1990s from Seoul or Busan are today more likely to be transmitted from places like Chengtu, Ho Chi Minh City, Hue, Kompong Speu, Longhua, and Surabaya. These new headlines out of East Asia Pacific suggest that countries in the region are approaching a critical development threshold and that, to sustain the gains from employment and enterprise, more will be required of policy makers than quick-fix measures to appease growing demands for higher pay and fewer hours. When considered alongside appreciating exchange rates, rising real wages, the "near-shoring" of manufacturing back to Mexico, Morocco, and Turkey, and even the "re-shoring" of certain industries to high-income countries, these reports may indicate that, with respect to the well-being that they derive from work, people in East Asia Pacific are at a crossroads.

In this concluding chapter of the report, we address two questions: Do the emerging economies of East Asia Pacific need employment strategies? What might such strategies entail? Just a few years ago, many governments in the developing countries of East Asia Pacific would not have asked these questions: their economies have been growing quickly, and workers' prospects have been better than in many other parts of the world. Improving well-being through better employment outcomes has not been a core concern of policy makers in the region in quite the same way as it has long worried governments in Latin America and the Caribbean, in Central and Southern Europe, and more recently, in many countries in the Middle East and North Africa and South Asia. But that has begun to change.

This report has shown that many countries in the East Asia Pacific region—certainly the most populous countries—are fast approaching a critical development threshold where the well-being that people derive from work cannot be taken for granted. Youth inactivity and unemployment, rising income, and consumption inequality in some countries are putting pressure on social cohesion. But what appear at first mainly as challenges to social cohesion are also linked to a general slowing of economic growth in the region, which is more pronounced in countries where productivity and living standards have been lagging for a long time. For example, in the past decade, the Philippines experienced much slower poverty reduction than its neighbors, despite respectable economic growth. This stagnant improvement in living standards is linked to slower employment creation and the low productivity of most work created by that economy (World Bank 2013a). Many economies in the region, including Cambodia, the Lao People's Democratic Republic, Indonesia, and the Philippines, have to find ways to create and sustain productive work amid more difficult global economic prospects and more intense international competition.

Furthermore, despite the region's longstanding reputation for welcoming investment and enabling enterprise, several countries still have relatively restrictive business environments. Cambodia, Indonesia, Lao PDR, the Philippines, and Timor-Leste still fare poorly in the global Doing Business rankings, while China, Mongolia, and Vietnam rank only moderately (World Bank 2013a). Limited access to finance and financial services is the most frequently reported obstacle keeping businesses in East Asia Pacific from expanding and creating more employment. Although new small and medium enterprises are an important engine of employment creation, they are particularly constrained in their ability to find financing for expansion.

In addition, skills shortages and mismatches in many East Asia Pacific countries are becoming a binding constraint on further gains in productivity and living standards. Skills gaps threaten growth when health and education systems and the labor force adjust slowly to fast-evolving demands. This is especially the case in countries where incentives for people to invest in skills are distorted by programs driven mainly by centralized planning and government supply rather than market demand. Even shortages of basic skills such as functional literacy and numeracy are a problem in Cambodia, Lao PDR, and several Pacific island countries.

Slowing gains in productivity, more modest advances in living standards, and rising inequality in some East Asia Pacific countries indicate that governments will need to intervene to sustain well-being from work. These changes are made all the more urgent by the rapid pace at which the populations of most East Asia Pacific countries are aging. Business as usual is not an option. This chapter argues that, in order to sustain well-being from work and prepare for the onset of rapid population aging, governments stand a better chance of increasing productivity, raising living standards, and promoting greater social cohesion if they adopt employment strategies that support all working people, regardless of where or how they work.

What should an employment strategy set out to achieve?

Governments in countries around the world are rushing to piece together strategies not only to boost employment, but also to create "better jobs." As is the case elsewhere, in East Asia Pacific countries, there is little agreement on what "better" means exactly (box 9.1), but there is a commonly held intuition that, despite relatively high rates of participation in the labor market, high levels of employment, and low rates of unemployment, current labor market outcomes in East Asia Pacific are no longer good enough.

Several observers of development in the region have warned that East Asia Pacific countries entering middle-income status could get caught in a "trap" in which rising labor costs could threaten competitiveness, productivity could stagnate, and more moderate rates of growth would benefit fewer working people (Gill and Kharas 2007). In the parlance of the *World Development Report 2013: Jobs* (hereafter referred to as WDR 2013), and as shown empirically in chapter 7, the middle-income East Asian countries, in particular, have reached a point in their structural transformation—out of mainly "agrarian" economies and well into "urbanization"—at which gains in productivity, living standards, and social cohesion are no longer achieved at the same pace. The evidence presented in earlier chapters shows how lags are starting to appear in the pace of all three transformations, although to different degrees and in some countries more acutely than in others. At this point in the development trajectory of most countries, policy makers are forced to accept that, although necessary, growth is no longer sufficient and may need a helping hand. The unprecedented speed of population aging in East Asia Pacific countries may motivate policy makers in the region to offer more than just one.

Governments in East Asia Pacific's emerging economies have been slower to intervene in markets to influence employment outcomes than their peers in other low- and middle-income countries, preferring instead to set a broad course of export-led growth and to let markets function more or less unfettered. However, the emerging

BOX 9.1 Decent? Better? What are "good jobs for development"?

Households and governments are no longer content with "more jobs." With increasing frequency, calls are heard for "better jobs." This can make economists uncomfortable: surely whether a job is "better" is in the eye of the proverbial beholder or, more precisely, a person who accepted work of her own free will. For example, whereas one person may not have enough work in a week, another might welcome the flexibility of working part-time, irregular hours. While the episodic income and sometimes fluid nature of owning a business may frighten many people, it may be an essential aspect of earning a living for others. And although many like to leave the rigors of saving and investing for retirement to their employer or the government, others look on the mandate to save for retirement as an affront to their liberty and intelligence, preferring instead to invest and insure for old age on their own. However, in countries and contexts where markets are missing or function poorly, institutions are weak, and "free will" is an elastic concept—where access to opportunities for advancement

continued

BOX 9.1 *(continued)*

through individual merit and enterprise are not as abundant and may be skewed by personal connections and affiliation to a class, religion, or tribe—this is all too glib a dismissal.

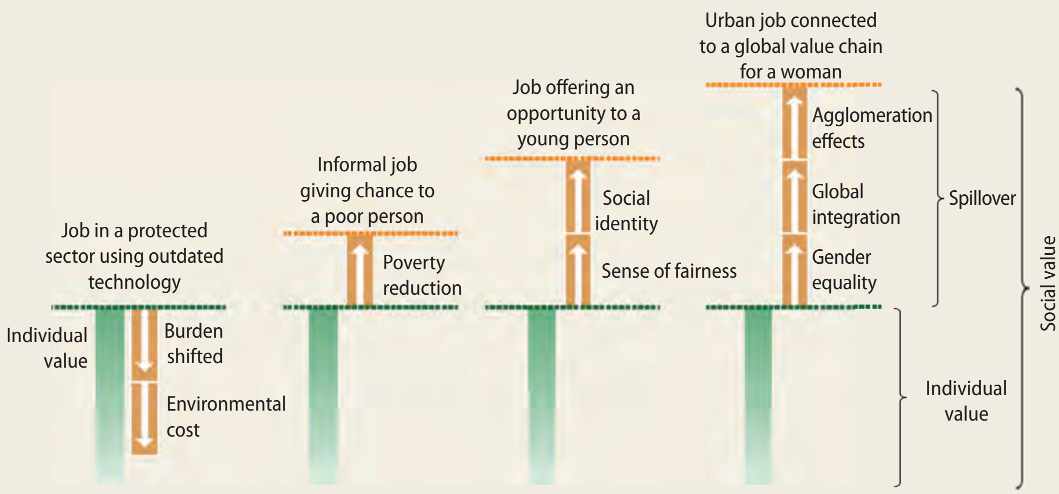
So what is "better"? Will the things that make work better for some make it better for all? Arriving at a definition of "better" employment that will be satisfactory to everybody would be a formidable task. For this reason, policy makers, employers, and civil society took the relatively easier step long ago of defining at least what work should *not* be. From this ongoing deliberation emerged the Core Labor Standards, the Declaration on Fundamental Principles and Rights at Work, and other global resolutions and conventions brokered and monitored by the International Labour Organization (ILO) as part of its advocacy for "decent work for all." It is on these Core Labor Standards that the *World Development Report 2013: Jobs* (WDR 2013; World Bank 2012) constructs a conceptual framework through which policy makers can determine the quality of work. To give dimension to "better," the WDR 2013 refers to the three transformations that drive development, discussed in chapter 3. "Better" work contributes to greater productivity, raises living standards, and enhances social cohesion. However, the value of employment cannot be measured simply in terms of the wages and working conditions enjoyed by individuals. The broader social contributions or costs of work also need to be considered.

According to the WDR 2013, a decent, better, or "good job for development" provides sufficient income to improve standards of living, while also contributing to economy-wide productivity growth and social cohesion. In well-functioning market economies, jobs that are good for employees are often also good for society (figure B9.1.1). Work that provides a high salary but is in an environmentally damaging industry and financed by subsidies might benefit the worker but at the same time damage society and thus should not be considered good.

Thus the WDR 2013 proposes that "good jobs for development" are those that act as conduits for higher incomes, greater productivity, and enhanced social cohesion, by maximizing positive internal *and* external benefits. As discussed at length in chapters 7 and 8, the challenges (constraints) to an economy creating more work that meets these criteria will vary widely across countries and even in the same country over time. This is particularly the case in countries that are experiencing fast-paced economic and social change, like those in the East Asia Pacific region.

Source: World Bank 2012.

FIGURE B9.1.1 Good jobs for development benefit society as well as individuals



lags in the three development transformations have brought the debate about how to sustain well-being from work to the political forefront and, if ignored, could threaten the social contract particularly in the larger East Asian countries. In contrast to the history of today's high-income countries, the rapid economic changes in the emerging countries of East Asia Pacific have not been accompanied by a parallel development of social and civic institutions to accommodate the interests of different groups and classes. As discussed in chapter 6, labor unions have historically been much weaker in East Asia Pacific countries than they were in Southern and Central Europe and in Latin American countries, even when these were at similar stages of development. Where organized labor is strong in the region, unions tend to represent only a small segment of working people and do not yet represent the interests of self-employed or many service workers, as is happening in South Asian countries and even in the United States. The same can be said for employer associations, which tend to represent the interests of a few large firms, rather than the much broader range of small and medium enterprises that provide the bulk of employment in the region.

Without strong formal civic, labor, and social welfare institutions, many East Asia Pacific governments are now facing the challenges of moderating economic growth, eroding labor cost advantages, and increasing inequality in the swelling cities of countries where the structural transformation happened far faster than anywhere previously. At a similar point in their development, leaders at the helm of East Asia's present-day, high-income economies—Japan; the Republic of Korea; Singapore; and Taiwan, China—also had to consider whether employment strategies would be required to sustain productivity, raise living standards, and address threats to social cohesion. At this critical juncture, leaders in today's high-income East Asian countries responded quickly and actively. However, most embedded explicit employment strategies in broader programs of centralized industrial policy, which included a wide array of measures, from market protection to directed credit for industries they identified as strategic.

Do the high-income countries in the region offer lessons to their low- and middle-income neighbors? The answer is "yes" and "no." Yes, it is appropriate to be concerned that productivity is lagging, that living standards might be rising far faster for some people than for most people, and that this could threaten social cohesion and stability. Yes, some intervention is required to help labor, capital, and land markets to work better for firms and households. No, the strategies employed by the likes of Japan, Korea, and Singapore in the past may not be as attractive as many claim them to be, nor may these policies be viable in a far more integrated regional and global economy, especially now that countries are part of an international system of institutions with increasingly binding rules, as argued in spotlight 2. No, interventions in the factor markets and social protection policies do not have to take the form they have in the past and in other regions where the profile of working people is very different. The list is long on both sides.

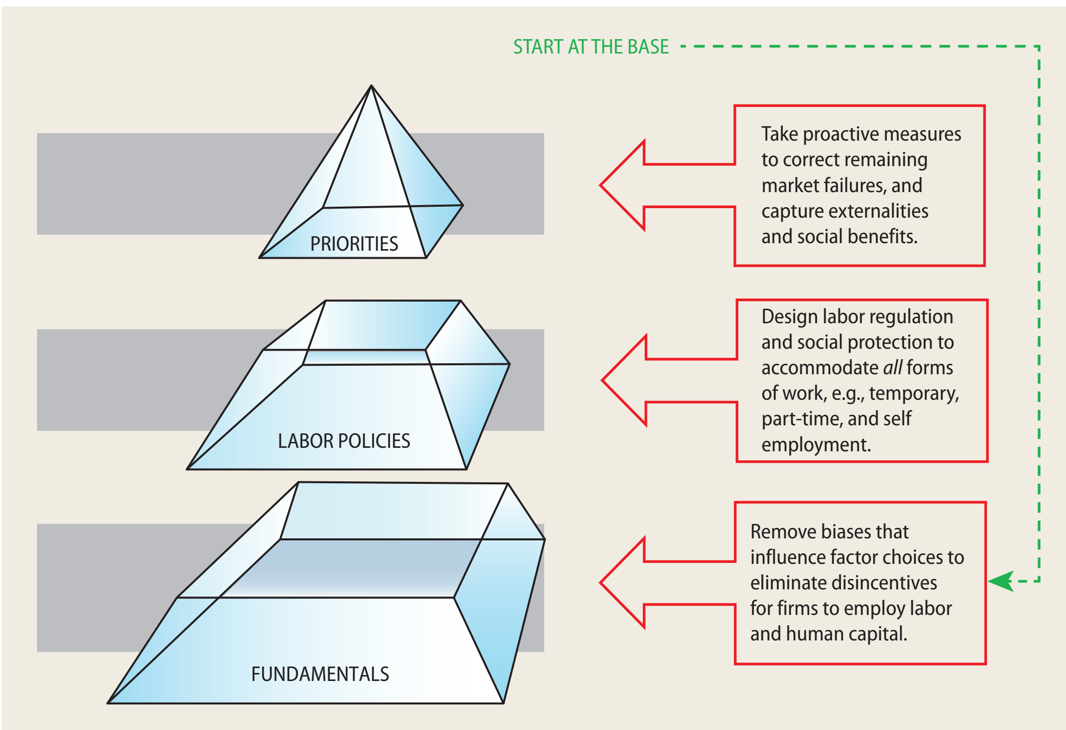
In this chapter, we do not propose a single employment strategy for all the countries of East Asia Pacific. That is not the purpose of a regional report. Indeed, in the preceding two chapters, even though we have shown how countries in East Asia Pacific can be categorized into types and have gained insights from this categorization about where their priority employment challenges might lie, we have also taken great care to demonstrate why each country has unique priority challenges and will require its own package of policies in response. This said, along with the conceptual diagnostic tools offered by the WDR 2013 and used in this report, we add some broad principles in this chapter to guide what employment strategies could set out to achieve for policy makers eager to increase and sustain well-being from work.

In an ever more integrated, interdependent global economy, for countries to sustain productivity gains, ensure rising living standards for a broader segment of the population, and increase social cohesion, a good way for activist governments to start is by eliminating structural biases that can hurt working people and may favor one form of work over others. In doing so, governments can better identify and correct market failures as well as take actions to exploit economic and social externalities. To organize the broad policy guidance in this concluding chapter, we return to the three segments of the policy pyramid introduced in chapter 1: fundamentals (covered in chapters 4 and 5 of this report), labor policy (discussed in chapter 6), and priorities (addressed in chapters 7 and 8). The policy pyramid is reproduced in figure 9.1. This pyramid communicates three important messages. First, successful employment strategies entail action across a broad range of policy areas, not just intervention in the labor market. Second, strategies should start with close scrutiny of "fundamentals," since in getting these right, governments create a stronger foundation for follow-on actions in the factor markets and for additional efforts to address remaining employment challenges. Finally, these additional special efforts, which will vary across countries and even in the same country over time, are a complement to and cannot be a substitute for sound fundamentals and appropriate labor market institutions. Each segment of the policy pyramid in figure 9.1 is accompanied by our additional interpretation of what an employment strategy in East Asia Pacific countries should set out to do.

Remove biases that hurt working people

Policy makers who are worried about employment outcomes and eager to increase and sustain well-being from work should

FIGURE 9.1 Employment strategies consist of actions at each level of the policy pyramid



Source: Adapted from World Bank 2012.

concern themselves first and foremost with ensuring sound fundamentals: namely, macroeconomic stability underpinned by prudent fiscal policies and an attractive environment for building human capital, investing, and doing business. This is because the forces that fundamentally determine the demand for and supply of labor and human capital are shaped by policy making in arenas other than the labor market (World Bank 2012; Development Committee 2012). The placement of these fundamentals at the base of the policy pyramid is intentional. Employment strategies too often consist only of actions to regulate and support factor markets and sometimes focus even more narrowly on the labor market. Without sound and strong macroeconomic and human capital foundations, labor regulation, and social protection, other measures deployed to correct market failures and capture productive and social externalities will fall short of their objectives.

In chapters 4 and 5, we argue that, although there is considerable variation, the macroeconomic, business, and human capital fundamentals in East Asia Pacific are generally sound. Across the region, there has been greater price stability than in the past, with inflation decelerating in recent years to low and stable levels. Contributing to stability and reflecting difficult lessons from the East Asian financial crisis in the late 1990s, exchange rate policies among the worst-affected countries have shifted toward greater flexibility. A long track record of fiscal prudence allowed East Asia Pacific countries to react quickly in the recent global financial and economic crisis, sustaining support for aggregate demand and even launching substantial fiscal stimulus packages that, along with more flexible exchange rates, helped to contain the costs of the crisis borne by households. Countries in the region also stand out on the whole as places where basic health and education are widely available. Furthermore, firms do not seem to be overly burdened either by the level of taxation or by the costs of complying with tax obligations. This is in stark contrast to countries in Eastern Europe and in Latin America and the Caribbean. And governments have created a generally encouraging environment for enterprise, although access to finance and skills shortages are unnecessarily constraining growth and demand for labor and human capital in many parts of China, Indonesia, Vietnam, and elsewhere in the region.

However, governments in the region can do better for working people. In setting the "levers" of monetary and fiscal policy as well as shaping the playing field for enterprise, governments should not only strive for low, stable inflation, fiscal prudence, and a higher ranking in the Doing Business league tables. Governments concerned about the quantity and quality of employment should set out to achieve all of these in a manner that eliminates any explicit or implicit incentives that systematically favor one factor of production over another. Borrowing from well-accepted (if not always applied) principles of taxation (Furman 2008; Pikkety and Saez 2012), macroeconomic policies should seek to be *neutral* with respect to factors of production. For example, all else equal, using one set of revenue instruments more intensively than another could, at the margin, influence firms to invest in an additional unit of capital instead of an additional unit of labor. For the same rate of inflation, monetary and exchange rate policies might have a similar effect unless government intentionally takes a more neutral stance that does not bias the factor choices of firms.

Similarly, in the face of skills shortages, the development of human capital should take a form that does not implicitly or explicitly favor, for instance, financing the provision of certain technical skills over foundational behavioral and cognitive skills. Public resources would be much better invested in building fungible foundational behavioral and cognitive skills. Close study of skills shortages in several dynamic economies, including in East Asia, shows that foundational skills are always in short supply relative to demand. In response to skills shortages, governments can do much more than simply push more resources into technical vocational education and training (TVET) programs.

More often than not, however, this is their first and only policy response. Many TVET programs are only poorly connected to and informed by markets and struggle to keep up with the pace at which markets shift and grow in complexity. Along with more support for foundational behavioral skills, given the importance of agriculture and rural nonfarm industry as well as the prevalence of self-employment in the region, policy makers crafting employment strategies cannot afford to ignore measures to augment the productive skills of farmers, owners of nonfarm enterprises, and entrepreneurs. In the health sector, governments can complement these human capital investments with more and better-quality early childhood nutrition and preventive care.

In crafting employment strategies, with respect to fundamentals, policy makers should be alert to policies, laws, and regulations that intentionally or unintentionally influence firms' decisions at the margin to engage capital or labor. The fundamentals are already more neutral in East Asia Pacific countries than in countries elsewhere. For example, countries in Central Europe overtax earnings from work. Governments in almost every country undertax land. Self-employed people in most Latin American countries have a hard time registering their businesses and paying taxes. Globally, between 2004 and 2012, the burden of taxation shifted away from profits and toward labor earnings, and taxes on labor are now the largest segment of the total tax rate (World Bank 2013d).

As governments in East Asia Pacific respond to demands for new employment strategies, they will need to be vigilant against these biases. The dangers of a policy stance that biases firms' decisions one way or the other are structural imbalances: too much capital and not enough labor in one part of the economy, or vice versa. These imbalances can become embedded economically and even politically. When they do, they can create barriers to the productive process, hinder countries' ability to adjust, evolve, and grow as deeper integration with the global economy accelerates the pace of change necessary to boost prosperity.

Make labor regulation and social protection work for all working people

With sound fundamentals in place, activist governments will stand on far more solid ground as they turn their attention to the labor market. Labor market regulations and social protection interventions are formulated according to each country's institutions in an attempt to address market imperfections, such as uneven power between those who seek and those who sell labor and human capital, information failures on all sides, and limited or weak insurance to mitigate risks to household well-being from loss of work. As mentioned in chapter 6, the WDR 2013 concludes that the parameters of labor policy should ideally be set at a "plateau" level that avoids the extreme "cliffs" of *too little protection* and *too much restriction*.

Comparable measures of regulation drawn from the labor codes of East Asia Pacific countries show that the average level of employment protection is actually higher than the Organisation for Economic Co-operation and Development (OECD) country average. The data presented in chapter 6 also show that there are notable outliers like Indonesia, where workers whose employment is regulated enjoy more de jure protection than workers in France, Greece, or Portugal and only a little less protection than workers in Spain. As sustained high levels of unemployment and informal employment in several Southern European countries make plain, these countries have erred on the side of too much restriction. In China, workers in regulated employment are de jure more difficult to dismiss than workers in Belgium and Italy. Similarly, reflecting what is codified in labor laws, the Philippines has the highest average statutory minimum wage in the region, followed by Cambodia and Indonesia. When ranked by the ratio of the minimum wage to value added per worker, the average statutory minimum wage in the Philippines is among the highest in the world.

In East Asia Pacific countries, restrictions de jure may not be fully felt de facto while many people still work on farms or avoid detection in the informal economy. In this regard, restrictive labor regulations are relatively "toothless." But the body of empirical evidence pointing to problems created by overly restrictive labor regulations is growing, and as urbanization advances, the risk of partially and poorly enforced policies creating barriers to factor mobility is also growing. While restrictions on dismissal and wage regulations are being loosened in most middle- and high-income countries in other regions, regulations in East Asia Pacific are moving in the opposite direction: the regulatory framework in East Asia Pacific countries is becoming more restrictive. And as more people seek work in the manufacturing and service sectors, as governments become better able to enforce regulations, and as firms find it harder to evade, these extreme levels of regulation in the labor code will become more binding constraints.

Indeed, for a segment of firms in many East Asia Pacific countries that are already too large to evade—many of them international companies—onerous levels of regulation are a problem and, for many, a source of unfair competition from smaller rivals who can still ignore the rules and hire informally. These larger, mostly international firms are also the more likely place for employment that acts as a channel for global knowledge transfer and productivity gains. Forcing these firms where "good jobs for development" are more likely to be created behind a barrier of restrictive regulation can unnecessarily retard a country's growth potential.

This said, several East Asia Pacific countries have written their labor codes in a manner that places them on the WDR's conceptual plateau. However, because evidence of the modest negative impact of policies set at this level comes mainly from upper-middle-income and high-income countries, their impact may not be as benign in countries with less administrative capacity and more fragile institutions. Even on the plateau, the prevailing models tend to be biased against working women, young people, and persons outside of full-time dependent work.

Does this mean that low- and middle-income countries should not intervene in the labor market at all? Absolutely not. Labor market imperfections and failures are particularly rife and, as argued in previous sections, cannot be ignored. But there is no good reason for activist governments concerned with the inequitable opportunities and outcomes of labor market imperfections to respond with policies designed to benefit prime-age men in full-time employment—the group that made up the largest segment of the workforce at the time when these models were put in place in countries elsewhere. When they advance to the middle of the policy pyramid (figure 9.1), policy makers should craft labor regulation and social protection policies that favor *all* working people, even if they work part time, work for themselves, or hire others to work with them.

The performance of existing and proposed labor regulations and social protection programs should be evaluated with regard to the extent to which they serve all working people, not just certain segments, sectors, or types of work. As governments in East Asia Pacific get ready to respond to ever more frequent calls for greater activism and intervention, some have responded in a manner that favors one form of work over another. Greater restrictions on the use of term contracts and labor from third-party agencies in Indonesia are cases in point.

Examples have emerged of labor and social protection policies and institutions that support all working people. The Scandinavian countries' emphasis on protecting people rather than protecting employment—the so-called "flexicurity" approach—is a prime example of government activism that achieves a relatively unbiased, *neutral* stance toward managing labor market risks. In separating protection from where or how people work, these measures do not have to compromise the contestability of markets and efficiency (box 9.2).

BOX 9.2 Denmark's "flexicurity": Protection does not have to come at the cost of efficiency

Social protection policies in some Scandinavian countries are famous for "protecting workers, not jobs." This general characterization of their labor regulation and social protection systems grew from Denmark's approach to helping households to manage the risks and opportunities brought by creative destruction. The approach shows that when an activist government takes a more neutral stance, extending protection to working people does not have to come at the expense of contestable labor markets and efficiency.

The Danish labor market is relatively unrestricted, particularly compared with other countries in the European Union (EU). Every year, one out of five Danes loses his or her employment. But they do not lose income security. Unemployment benefits replace close to two-thirds of their earnings, and the government helps them to find work. This combination of flexibility for employers and income security for workers is called "flexicurity." The arrangement has been in place since at least the 1970s, but it has evolved over time, principally in the active component—assistance with retraining and employment search. And it seems to work well. Between 1995 and 2008, Danish unemployment rates averaged 4.9 percent, while the rest of the high-income countries in the EU suffered rates close to 8.5 percent.

Danish employment laws have evolved from the "Gent system," in which unemployment benefits were paid by labor and trade unions, not the government. In the 1970s and 1980s, employment rates were high, and individuals without jobs got good incomes. The arrangements became too expensive and were reformed in the 1990s. The new approach is sometimes called the "Golden Triangle" because it added active labor market programs to flexible hiring and firing laws and generous unemployment benefits.

The first component is flexibility of firing and hiring. Denmark is resolute in not creating obstacles to the creative destruction process. The OECD employment protection legislation (EPL) index for Denmark fell from 2.4 in 1983 to 1.5 today; the OECD average is 1.9. Relatively flexible laws work in Denmark because the country has a history of self-regulation by employers and unions, going back to the "September Compromise" of 1899, which set out rules for resolving labor disputes.

The second component is unemployment insurance financed from contributions and taxes. Membership is voluntary, but it covers around 80 percent of the labor force. Benefits last up to four years, and replacement rates cannot exceed 90 percent of wages up to a capped amount. After four years of getting benefits, recipients have to switch to social assistance, which means a reduction of between 20 and 40 percent of their benefit income (Andersen and Svarer 2007).

The new system uses active labor market programs like job search assistance and training to nudge the unemployed back to work. The spending on these programs is sizable: out of €13 billion spent on labor market programs in 2010, about 75 percent was spent on active instruments.

How well does flexicurity really work? The unemployment rate dropped from 10 percent in 1993 to 3.3 percent in 2008 before the global financial crisis. The incidence of long-term unemployment (those without work for more than a year) decreased from a third of total unemployment in 1994 to a tenth in 2009. Despite liberal firing and hiring practices, employment has not fluctuated much in response to output variability.

However, there are some important qualifications to Denmark's success. First, although official unemployment has fallen, there is a gap between actual unemployment (adding up the unemployed, those in "activation," and early retirees) and official statistics. Second, it is difficult to assess how much of the fall in unemployment is due to flexicurity on its own. Economic performance matters too, of course: active labor policies are useless if the economy is not growing. Finally, the already high fiscal burden can become enormous in a protracted slowdown. The Danish model costs 4.5 percent of GDP. And Denmark spent 2.6 of GDP on labor market programs in 2008 (a good year prior to the crisis), compared with 1.4 percent for the OECD as a whole, 1.5 for Sweden, 2.2 for Finland, and 2.3 for the Netherlands. The Danes have flexicurity because of their history and can afford it in part due to high labor force participation rates of 81 percent; the OECD average was 71 percent in 2009.

Sources: Hansen 2010; OECD 2010; Gill and Raiser 2012.

Is "flexicurity" something countries in East Asia Pacific can achieve? Yes, although with difficulty and adapted to their specific needs. Most of the countries in the East Asia Pacific region have the prerequisite fundamentals, growth, and fiscal discipline. Although a substantial fiscal cost in Denmark, the approach can be adapted to middle- and low-income countries. The essential element of the approach is government intervention to protect the well-being and prospects of working people with income support and employment assistance, rather than raising the costs to firms that need to cut jobs. Although labor market policies have been moving in the opposite direction of the "flexicurity" model, very restrictive policies or structures that favor one form of work over another are still new and are only applied to a small segment of workers. The key challenge is administrative and institutional strengthening to increase the confidence of people and firms.

In contrast to recent changes in employment protection legislation (EPL), the scrutiny and debate around minimum wage policies in several East Asian countries in recent years is an excellent illustration of the important assessment of policy impacts on all working people. Although statutory minimum wages are relatively recent in several East Asian countries (compared with other middle-income countries, as discussed in chapter 6), multiple statutory levels are imposed in the labor codes. This hinders factor mobility, raises enforcement and compliance costs, and may compromise the credibility of their collective bargaining institutions. Multiple minimum wages require a thicket of de jure regulations and an accompanying cadre of people engaged in the process of setting the floor on wages in each province or district and even in different industries in the same localities. If these seem like intimidating labor codes to comply with or even enforce, imagine what they must be like to orchestrate to ensure that the interests of employers, working people, and the public (consumers) are adequately represented (box 9.3).

In order to better serve working people, statutory minimum wages should be benchmarks that prevent exploitation, protect household purchasing power, and ensure that working people share in the benefits of greater productivity. Minimum wage policies should not inadvertently exclude lower-skilled people from work or from the benefits of formal employment. To this end, a country's statutory minimum wage should be set at a level consistent with the productivity of its unskilled workers. Setting the minimum wage too high encourages noncompliance, reducing social protection and tax revenues. Where it proves necessary to make accommodations for special groups whose average marginal productivity is lower, such as young people, exemptions to the national minimum could be considered as part of apprenticeships or other targeted training programs. Simplifying and standardizing earnings regulations by moving to a unified national minimum wage can help to improve employment outcomes. Standardized minimum wage levels—set with reference to the productivity of unskilled workers and adjusted transparently according to clear economic criteria—reduce distortions and compliance costs and improve predictability for employers. With a national minimum wage set at reasonably low levels, governments are also more likely to see improvements from greater investment in monitoring and enforcing compliance.

Specific interventions designed to protect household income and consumption from the risks of unemployment can also be designed with greater neutrality to favor all working people. They need not be organized at the firm or sector level, as are severance schemes, the most prevalent form of income protection in East Asia Pacific countries. Pooling the risk to income from unemployment at the firm level is about the most costly and least efficient way to provide people with protection. More frequently than not, firm-based severance schemes leave workers with unpaid promises. But a country does not have to incur the distortions and administrative costs of a classic pay-as-you-go unemployment insurance scheme in order to harness the efficiency of risk pooling at the national level. A national system of modest,

BOX 9.3 A more neutral minimum wage policy?

World Bank (2013b) quotes Friedrich Hayek: "A general flat minimum-wage law for all industry is permissible ... I know much better methods of providing a minimum for everybody. But once you turn from laying down a general minimum for all industry, to decreeing particular and different minimum for different industries, then, of course, you make the price mechanism inoperative, because it is no longer the price mechanism which will guide people between industries and trades." While Hayek would not have appreciated being quoted in a report on minimum wages whatever the context, his argument illustrates what we mean by *neutrality* applied to a prevalent form of labor market regulation.

In Indonesia, the Philippines, and other East Asian countries, prevailing labor policies allow different minimum wages to be in place, varying not only by locality, but also by sector. A large body of research from Indonesia and the Philippines shows the inefficiency and inequity that minimum wage regulations impose.

Like Indonesia and the Philippines, Thailand had a complex governance structure prior to the unified minimum wage of B 300 introduced in 2012. Before the national minimum wage was implemented, the law specified the appointment of the National Wages Council to recommend wage rates and to ensure that proposed wage rates coming from the provinces were consistent with what "an employee deserves" and "sufficient for an employee's living." The provincial committees deliberated on the adjusted wage rate, given their own context and using tripartite deliberation, and submitted proposals to the central committee. The final decision was made by the minister of labor based on recommendations from the National Wages Council, provincial committee, and the Subcommittee on Technical Affairs and Review. The country had about 32 minimum wage rates in 2011, ranging from B 221 in Phuket (the province with the highest cost of living in Thailand) to B 159 in Payao.

The case of Thailand prior to the adoption of the unified minimum wage illustrates the challenge of ensuring that all three sides in a tripartite system of governance are well represented and equipped to negotiate. In Thailand, the pool of worker representatives in the smaller provinces is small. This is a concern for countries where levels of unionization are low and levels of labor informality are high, because many workers are not represented in the negotiation.

In a system with multiple minimum wages, it can be difficult to keep the tripartite process balanced in many localities, enforce the law once announced, ensure compliance, and avoid further distorting the labor market. The complexity of managing a multilevel system is further exacerbated where enforcement capacity is low. Because of these dangers, the general trend around the world is to move away from differentiating wage levels by geography, occupation, and economic sectors and to move toward having just one national minimum wage.

In Indonesia, recent changes announced by the government (largely in response to repeated worker demonstrations) may reduce the level of minimum wage dispersion in the country in the near future, if the suggested increases made by the government—a rise for Jakarta of 44 percent (equivalent to US$228 a month) and a rise for the rest of the provinces to a uniform level equivalent to US$208 a month—take effect. However, the size and speed of the increase could push many people into unemployment or the informal economy, particularly as there have been several recent increases in the minimum wage and little loosening of regulations on dismissal.

In Vietnam, recent reforms have separated the common minimum wage used in the domestic private sector from that used in the public sector and gradually unified the minimum wages for the private domestic sector and foreign sector. Since October 2011, domestic and foreign firms have, in effect, had the same minimum wage. In Malaysia, the government chose to implement two distinct minimum wages, one for Borneo and one for Peninsula, given that these geographic areas have very distinct labor markets.

Many countries set only one national level for the minimum wage and allow for a few exceptions or reductions. The reductions are granted mainly for particularly low-productivity workers whose employment opportunities become extremely limited when the minimum wage is high. Some of the most common reductions are granted for younger employees, disabled workers, and apprentices.

In the Republic of Korea, a single minimum wage is applied without any regional or occupational

continued

BOX 9.3 *(continued)*

differences. The law initially included only manufacturing establishments and firms with more than 10 employees, but gradually expanded to cover all sectors and firms, regardless of size. The minimum wage does not apply to family businesses that hire only family members and domestic employees. It also exempts persons working on or owning ships. Workers who are disabled are exempt from the law, with the Ministry of Labor granting permission on a case-by-case basis. Workers on probation receive 90 percent of the hourly minimum wage, while security guards and caretakers receive 80 percent.

The minimum wage law in Hong Kong SAR, China, applies to every employee whether full time or part time regardless of nationality or type of contract. There are no deductions or exclusions based on a worker's age or any sectoral differences, mainly to avoid distortions. However, a few exceptions are allowed: (a) people who are not covered by the Employment Ordinance; (b) domestic workers who live in their employers' household free of charge (nearly 280,000 workers, mostly Filipino and Indonesian); (c) workers who are excluded from coverage due to difficulty in calculating their work hours given the round-the-clock nature of their work and the monetization of other benefits such as housing, food, medical care, and free travel to their home countries; (d) apprentices registered under the Apprenticeship Ordinance; and (e) student interns and specified work experience students. Disabled workers are paid a proportion of the minimum wage, estimated by their degree of productivity as assessed in their person-with-disabilities certifications.[a]

Source: World Bank 2013b.
a. To avoid the risk of abuse, the right to invoke such an assessment is vested in the employee rather than the employer.

"noncontributory" unemployment benefits, financed from general revenue, offers the largest possible risk pool, relieving employers of costly severance schemes and providing some incentive for workers currently without any protection to bring their activities to the attention of government by registering. Technology has expanded governments' ability to monitor and verify sufficiently, so that it need no longer delegate this burden to firms.

In several countries, governments are already experimenting with de-linking financial protection and risk pooling for health from where and how people work. They are treading ground previously explored by some of East Asia Pacific's high-income success stories. Thailand's model of universal health coverage is the most successful example of this approach and is credited not only for extending coverage of financial protection, but also for increasing the use of health services (box 9.4).

Finally, institutional structures for collective representation could be more inclusive and enable voice for a broader body of working people than just those in formal labor unions. Associations of self-employed workers—for example, India's Self-Employed Women's Association (SEWA)—are growing in numbers and bargaining power to protect the rights and working conditions of those who work outside of dependent wage employment (World Bank 2012). But just as labor market and social protection institutions should be more inclusive on the side of working people, they should also be expanded to represent the interests of employers in small and medium businesses, where most people in East Asia Pacific work.

Take proactive measures to address remaining failures and capture externalities

Even after eliminating biases in policy fundamentals that could be prejudicing firms' factor choices away from labor and human capital and establishing labor and social

BOX 9.4 Universal health coverage in Thailand: Protecting people no matter where they work

Motivated by the vulnerability of a large segment of the population working without financial protection from the costs of health care, Thailand decided to redefine "social insurance" to meet this need. In 2001, the Thai government introduced a national risk-pooling mechanism that extended protection to people no matter where or how they worked. In 2012, the independent Thai Health Insurance System Research Office published an evaluation of this bold departure from the prevailing social insurance model to assess the impact of the new scheme in its first 10 years (HISRO 2012).

Prior to introducing the scheme, up to 30 percent of the Thai population (or about 18 million people)—mostly people who worked informally beyond the reach of regulation or taxation—had no health insurance or access to affordable medical care. Out-of-pocket payments for health care accounted for 33 percent of total health expenditure in 2001. Out-of-pocket payments for medical care as a share of household income were highest for people living near or below the poverty line. Impoverishment from the costs of health care was common.

Within a year of its launch in 2001, the Universal Coverage Scheme (UCS) extended financial protection for the cost of health care to 47 million people, or 75 percent of the Thai population, including those who were previously unprotected. The other 25 percent of the population were already covered by traditional social health insurance plans: the Civil Servant Medical Benefit Scheme for public sector workers and the Social Security Scheme for workers in registered and taxed forms of private employment.

Thailand's UCS has three defining features: "general-revenue" or budget financing, which allows health services to be provided free of charge or for a small payment (a copayment of B 30 or US$0.70 per visit or per admission was initially enforced, was lifted in 2006, and was reintroduced recently); a well-defined and comprehensive benefits package focused on primary care, including prevention and health promotion; and a fixed budget with caps on provider payments to control costs.

Critical to the labor market and the welfare of working people and their families, the UCS achieves prepayment, risk pooling, and redistribution toward disadvantaged groups—all essential elements of effective, even progressive financial protection—without the degree of distortion or exclusion created by mandatory employer and worker contributions. Furthermore, the scheme achieves greater efficiency from scale by pooling risks and redistributing them at the national level, rather than at the sector, industry, or firm level. Since most traditional social insurance plans are constrained by relatively small risk pools, these efficiency gains are critical to long-term fiscal sustainability of the UCS.

In its first 10 years, the UCS improved access to health services, increased equity of service use, and prevented medical impoverishment. Between 2003 and 2010, the number of outpatient visits per member per year rose from 2.45 to 3.22, and the number of hospital admissions per member per year rose from 0.094 to 0.116. Impoverishment—measured by the additional number of nonpoor households falling below the national poverty line as a result of paying for medicines and health services—decreased significantly from 2.71 percent in 2000 to 0.49 percent in 2009. As expected, the UCS led to a significant increase in government health spending and a marked decline in out-of-pocket expenditure. However, the difference in out-of pocket expenditure between poor and wealthy households was eliminated. The Health Insurance System Research Office's (HISRO's) evaluation found that the UCS increased the equity of public subsidies and that overall health expenditure was very "progressive" or pro-poor.

Looking ahead, there are concerns about inequities in benefits between the UCS and the remaining traditional social health insurance plans, discouragement of labor mobility from the plans operating in parallel, and fiscal sustainability. However, Thailand's experiment is not without precedent in East Asia Pacific. Both Korea and Taiwan, China, preceded Thailand on the path to universal health coverage by breaking with traditional social insurance models. Korea gradually expanded coverage from 9 percent of the population in 1970 to 100 percent by the mid-1990s, and Taiwan, China, moved quickly in the early 1990s with reforms that raised the level of coverage from under 60 percent to full protection (Baeza, Montenegro, and Nunez 2002). In both cases, fiscal space created by economic growth, reliance on financing models with a much broader base than payroll taxes, and close attention to the composition and eventual harmonization of the state-financed benefits package were critical to their success.

Sources: Drawing on HISRO 2012; Baeza, Montenegro, and Nunez 2002.

protection policies as well as the underpinning institutions that accommodate all working people, there will still be market failures that leave many people without work and underemployed or productive externalities unexploited. At the top of the WDR's policy pyramid (figure 9.1) are specific measures to address the remaining priority challenges. As shown in chapter 7, for a region as diverse and dynamic as East Asia Pacific, these remaining challenges will vary widely across countries and in the same country over time. Chapters 7 and 8 discuss these challenges and propose responses in depth. In this section, we summarize that discussion briefly for three categories that present the most salient priority challenges in the region and show how addressing them fits the overall approach.

Before getting into the details, however, the key message for policy makers is, "Don't start at the top of the pyramid!" Too many costly initiatives are launched in countries with the objective of creating employment—often under the broader canopies of industrial policy or regional development initiatives—as substitutes for sound fundamentals and appropriate labor and social protection policies. It is indeed important that governments be aware of and target remaining market failures and unexploited opportunities. But they should do so with measures that complement rather than substitute for the often more difficult, less visible measures that can require more time to show results. The most successful industrial policies (Singapore; Korea; and Taiwan, China) benefited from the difficult, time-consuming work of building sound fundamentals such as clear and protected property rights and universal access to high-quality basic education.

Small island countries

In small island countries, employment creation led by private enterprise is significantly constrained by small and dispersed populations. Outside of niche sectors, small size makes it almost impossible to achieve scale economies. Moreover, the Pacific island countries are particularly constrained by great distances, which makes them very different from the small island countries of the Caribbean or Indian Ocean and conspires against their competitiveness even in activities where endowments should otherwise give them a comparative advantage. While the Pacific island countries are too constrained by economic geography to compete in manufacturing and find it difficult to process their natural resources for export, managing the exploitation of these resources and tourism offer opportunities for work. As information and communication technology improves and brings the islands economically "closer" to distant markets, the opportunities for work in call centers and business-processing services may become more readily available. Policy makers should focus on preparing young people with the human capital they will need to take advantage of these opportunities or to succeed abroad as migrant workers. Indeed, increasing the volume of migration to work in neighboring large markets—particularly Australia, but also Northeast Asian countries—is the single most powerful measure to boost well-being from work for people from the Pacific island countries. "Brain drain" is, of course, a concern in countries with such small populations, particularly where governments and donors are paying for the formation of essential skills. However, it is far easier to manage the prospect of brain drain in a context of greater openness and labor mobility than to do so in a context of restrictions. To increase human capital, service provision itself can become a force for employment creation when populations are dispersed on difficult-to-reach islands.

Agrarian economies

For countries that are still mainly agrarian (particularly Cambodia, Lao PDR, Myanmar, Papua New Guinea, and Timor-Leste), the policy priority for increasing well-being from work is to raise the productivity of agriculture in order to free labor and human capital to work in rural off-farm enterprises and eventually to migrate to towns and cities. When policy makers hear the words "employment strategy," few think of boosting the skills and productivity of people working in agriculture. This is a frequent mistake that can retard and prolong the process of structural adjustment. Most countries that grew from low to middle income and beyond did so by first increasing the productivity of agriculture and rural nonfarm industry and services. The instruments for increasing agricultural productivity and facilitating the structural transition are land reform, agricultural extension programs, deregulation of prices, rural infrastructure, and good-quality education and health services to build human capital. To sustain well-being from work, governments should identify and remove policies and programs that create implicit or explicit restrictions on working people moving off the farm and into rural nonfarm industry and to manufacturing and services in cities. China's *hukou* is a notorious example, but across the region, less visible, but similarly costly and unjust, constraints on workers' decisions to move are also prevalent. Vietnam's experience in the 1990s and the first decade of the twenty-first century is an often-cited example of success. The danger to be avoided is urbanization *in spite of* rather than enabled by policy, characterized by efforts to discourage people from moving, unproductive use of land, people migrating in search of better health and education services, cities unprepared for fast population growth, and rapid divergence in living standards between town and country.

Urbanizing economies

For countries that are already rapidly urbanizing (particularly China, Indonesia, Mongolia, the Philippines, and Vietnam), the policy priority for boosting the quantity and quality of employment is to make cities work better. Anyone who has suffered a long spell in Jakarta or Manila's traffic will appreciate this argument. Somewhat counterintuitively in a discussion of well-being from work, the factor market that policy makers should pay the greatest attention to is the market for land. Since land is the least mobile factor of production, good urban planning becomes the key to increase the flexibility, efficiency, and thus the productivity of land use. Urban planning, including urban transportation planning, becomes the area of policy making with the greatest impact on the incentives of firms in towns and cities to form, to grow, to move up the value chain, and thus to create and sustain demand for labor and human capital. Also important are urban infrastructure and service provision, to ensure that growing cities create and attract plenty of skilled people to foster economies from agglomeration rather than incur burdening costs from congestion. Both Japan and Korea's examples are instructive in this regard and provide valuable guidance for East Asia Pacific's policy makers (World Bank 2008).

When they reach the top of the policy pyramid shown in figure 9.1, activist governments will need to correct remaining market failures proactively and capture externalities and social benefits that market forces would otherwise avoid. This may involve taking account of the special requirements of particular groups of people (women, young people, ethnic minorities, and older people). Even though countries in East Asia Pacific tend to have higher rates of female labor force participation than elsewhere (Fiji, Malaysia, and Timor-Leste are notable exceptions), persistent gender gaps in earnings and segregation in economic activity can limit the economic and development potential of countries. Also of concern is the disengagement of young people and, as people live longer, the needs of older workers. Human resources—whatever their gender, age, or ethnicity—are too valuable to lie unengaged. And if these groups were fully economically engaged, they could fuel further gains in productivity, living standards, and social cohesion.

Some of these problems may be the consequence of past biases in a country's fundamentals or factor market policies that require corrective action or that have left external benefits unexploited. This is the rationale for policy measures to address very high levels of youth disengagement and unemployment or substantial gender gaps in access to economic opportunities as well as to improve the incentives and increase the productivity of farmers. These policies address the externalities, market failures, and possibly past distortions that are not covered by the neutral policies proposed in the bottom two layers of the policy pyramid.

For example, in a country where most farmers may have had few real opportunities to gain ownership of their land and little incentive to apply new technology, the outcome of biased fundamentals will be low agricultural productivity. If this is aggravated by underinvestment in service provision in rural areas, people will have strong incentives to migrate to towns and cities for decent schools and health care as well as work. But this sort of migration—pushed by low agricultural output and a lack of rural services—is more likely to add to congestion than to contribute to agglomeration (World Bank 2008). This is precisely the problem described in last year's *Philippine Development Report* (World Bank 2013c).

A proactive policy package to increase land tenure, extend the use of fertilizers, support rural nonfarm industry, and ensure that people in rural areas have adequate schools and health care would be required to undo the damage of past policy biases. Similarly, proactive measures to encourage more women into market work, to lower the risk of scarring among young people, and to encourage business to lower the size of their carbon footprint are likely to be justifiable, due to either past policy biases or the externalities that would otherwise be left uncaptured.

Why should this approach to crafting employment strategies appeal to governments in East Asia Pacific?

As they face a future of moderating rates of economic growth, as well as pressure to respond to rising threats to well-being from work, why might the general principles presented in figure 9.1 appeal to policy makers in East Asia Pacific countries in particular? As a theoretical construct and description of a general approach, there is nothing especially "East Asian" about what has been described in the previous sections of this chapter. This said, we offer three specific reasons why the approach will be more appealing to policy makers in East Asia Pacific countries than to their peers in other regions. Among these lie the priority challenges to sustaining well-being from work in formalizing countries, the fourth country type from chapter 7 of particular relevance in East Asia Pacific.

First, the pursuit of a *neutral stance* (that is, neutrality with respect to the factors of production and to the ways in which people work), especially when it comes to policy fundamentals, might better appeal to policy makers' generally more conservative orientation in East Asia Pacific countries than activist governments elsewhere. Doing nothing and continuing with business as usual are not an option. Chapters 3 and 7 and the introduction to this chapter suggest that the consequences of a "do nothing" option will increasingly threaten social cohesion and, as growth moderates, constrain productivity and limit gains in living standards. Some governments in the region have started to intervene in the arena of labor regulations and social protection. But policy actions taken to improve employment outcomes by removing structural biases and taking a neutral stance toward all working people would look very different from what these governments have been doing.

Second, because the history of interventions in the labor market and social protection in East Asia Pacific countries is short relative to that of countries in Latin America and Southern and Central Europe, the costs of transitioning from an arguably biased stance that protects only workers in full-time dependent employment to a neutral stance that protects all working people are likely to be much lower.

For example, while technocrats serving in Latin American and Central European governments might find the idea of providing low, basic "noncontributory" forms of social protection appealing, instead of income-replacement benefits financed from employer and worker contributions, their already heavily indebted governments may consider the transition costs of such a move to be too high. Low "legacy costs" are an advantage that extends from the fiscal to the political arena: there are fewer social protection "sacred cows" in countries in the East Asia Pacific region.

Third, the risks of ignoring or aggravating biases in the current policy framework are higher for countries in East Asia Pacific due to their rapidly shifting demography. In chapters 2 and 7, we presented evidence of the speed at which the East Asian countries are aging. The pace of this demographic wave is likely to pick up in a couple of years and roll over the region faster than it has over any other. In China, the statistics authorities reported the first ever contraction of the working-age population in 2012. Korea already has the lowest population replacement rates in the world. And if the average longevity of people in Japan is a suitable benchmark, many people in East Asia can expect to live very long lives. Yet at the margin, most policy models currently in place in the region are likely to discourage longer working lives, constrain the productivity of older people, deprive all working people of the foundational skills they need to easily re-skill throughout their lives, or discourage formal forms of work that appeal to the elderly (part-time, irregular hours). Structural discouragements of longer working lives in East Asia Pacific are nowhere near as bad as they are in Latin America or Southern and Central Europe, where it often pays to withdraw from the labor force at an early age (Gill, Koettl, and Packard 2013). Today, people in East Asian countries work longer into old age because they do not have any other choice. But this is a poor, residual outcome, rather than the intended consequence of a coherent employment strategy. Better policy fundamentals, labor and social protection institutions, and proactive measures targeted at older people could create stronger incentives for people to remain productive longer. Across the region—particularly in the Pacific island countries that, despite a "younger" demographic profile, face a health and financial burden of noncommunicable diseases similar to that of much "older" countries—greater emphasis on better nutrition and prevention is likely to lengthen productive working lives and ease the burden of health care costs.

While preparing for the onset of aging, several governments in the region are also facing the challenges of "formalizing" more work, in part to increase the coverage of social protection, but also to sustain productivity and increase the tax base for financing public goods. As shown in chapter 7, in the region's most populous countries, the majority of people will soon live in towns and cities. The key principle for policy making in these countries is to avoid *segmentation*: cleavages in factor markets that impede competition, impair labor mobility, and limit the coverage of essential work risk and social protection. Segmentation is caused mainly by intended and unintended biases in countries' policy frameworks, including differences in how income from different sources is taxed, rules for providing credit that explicitly or implicitly exclude self-employed people, design and financing of nonwage social protection benefits, and recognition of only some types of work in the labor code.

Avoiding and eliminating biases and segmentation from factor markets are essential if countries of East Asia Pacific are to grow in wealth before they have to face the more difficult challenges of an aging economy. This is the current quandary of several middle-income countries in Central and Southern Europe and in the Southern Cone of Latin America that got old before they got rich. Their example should strike a note of caution for policy makers in East Asia Pacific countries, where the average age of the labor force and the share of elderly in the population are already rising quickly.

References

Andersen, Torben M., and Michael Svarer. 2007. "Flexicurity: Labour Market Performance in Denmark." Working Paper 2007-9, University of Aarhus, Denmark.

Baeza, Cristian, Fernando Montenegro, and Marco Nunez. 2002. "Extending Social Protection in Health through Community-Based Health Organizations: Evidence and Challenges." Discussion Paper, Universitas Program—Systems and Tools against Exclusion and Poverty (STEP), International Labour Organization, Geneva.

Development Committee. 2012. "Creating Jobs Good for Development: Policy Directions from the 2013 World Development Report on Jobs." DC2012-0011, Joint Ministerial Committee of the Board of Governors of the Bank and the Fund on the Transfer of Real Resources to Developing Countries, Washington, DC, September 21.

Furman, Jason. 2008. "The Concept of Neutrality in Tax Policy." Testimony before the U.S. Senate Committee on Finance Hearing on "Tax: Fundamentals in Advance of Reform," April 15, Brookings Institution, Washington, DC. http://www.brookings.edu/~/media/research/files/testimony/2008/4/15%20tax%20neutrality%20furman/0415_tax%20_neutrality_furman.

Gill, Indermit, and Homi Kharas. 2007. *An East Asian Renaissance*. Washington, DC: World Bank.

Gill, Indermit, Johannes Koettl, and Truman Packard. 2013. "Full Employment: A Distant Dream for Europe." *IZA Journal of European Labor Studies* 2 (19). doi:10.1186/2193-9012-2-19.

Gill, Indermit, and Martin Raiser. 2012. *Golden Growth: Restoring the Luster of the European Economic Model*. Washington, DC: World Bank.

Hansen, Leif Christian. 2010. "Flexicurity and Danish Labour Market Policy." Presentation given at the National Labour Market Authority.

HISRO (Health Insurance System Research Office). 2012. *Thailand's Universal Coverage Scheme: Achievements and Challenges: An Independent Assessment of the First 10 Years (2001–2010)*. Nonthaburi, Thailand: Health Insurance System Research Office.

OECD (Organisation for Economic Co-operation and Development). 2010. *OECD Employment Outlook 2010: Moving Beyond the Jobs Crisis*. Paris: OECD.

Pikkety, Thomas, and Emmanuel Saez. 2012. "Optimal Labor Income Taxation." NBER Working Paper 18521, National Bureau of Economic Research, Cambridge, MA.

World Bank. 2008. *World Development Report 2009: Reshaping Economic Geography*. New York: Oxford University Press.

———. 2012. *World Development Report 2013: Jobs*. New York: Oxford University Press.

———. 2013a. Doing Business Database. Washington, DC: World Bank. http://www.doingbusiness.org/.

———. 2013b. *Minimum Wage Policy: Lessons with a Focus on the ASEAN Region*. Washington, DC: World Bank, East Asia Pacific Regional Office, Human Development Sector Department.

———. 2013c. *More and Better Jobs for the Philippines: Philippine Development Report 2013*. Washington, DC: World Bank, East Asia Pacific Regional Office, Poverty Reduction and Economic Management Sector Department.

———. 2013d. "Paying Taxes 2014." International Finance Corporation, Price Waterhouse Coopers and World Bank, Washington, DC.

ECO-AUDIT

Environmental Benefits Statement

The World Bank is committed to preserving endangered forests and natural resources. The Office of the Publisher has chosen to print ***East Asia Pacific At Work*** on recycled paper with 50 percent post-consumer waste, in accordance with the recommended standards for paper usage set by the Green Press Initiative, a nonprofit program supporting publishers in using fiber that is not sourced from endangered forests. For more information, visit www.greenpressinitiative.org.

Saved:
- 16 trees
- 7 million British thermal units of total energy
- 1,332 pounds of net greenhouse gases (CO_2 equivalent)
- 7,222 gallons of waste water
- 483 pounds of solid waste

The unprecedented progress of East Asia Pacific is a triumph of working people. Countries that were low-income a generation ago successfully integrated into the global value chain, exploiting their labor-cost advantage. In 1990, the region held about one-third of the world's labor force. Leveraging this comparative advantage, the share of global GDP of emerging economies in East Asia Pacific grew from 7 percent in 1992 to 17 percent in 2011. Yet the region now finds itself at a critical juncture. Work and its contribution to growth and well-being can no longer be taken for granted. Labor's share of national income has been declining across most of the region. The challenges range from high youth inactivity and rising inequality to binding skills shortages and lagging infrastructure.

A key underlying issue is pervasive and persistent economic informality, despite rapid urbanization, which constrains innovation and productivity, limits the tax base, and increases household vulnerability to shocks. Informality is a consequence of both strict labor regulations and limited enforcement capacity. In several countries, de jure employment regulations are more stringent than in many parts of southern Europe. Even labor regulations set at reasonable levels but poorly implemented can exacerbate the market failures they were designed to overcome. Aggravating these failures further are underinvestment in transportation infrastructure and poor urban planning, limited access to finance for investment and growth, and the failure of the skills-supply system to keep up with the changing demands of modern market economies.

East Asia Pacific At Work argues that governments in the region will have to actively help markets sustain the well-being that people can expect from work. The appropriate policy responses to these challenges are to ensure macroeconomic stability and a regulatory framework that encourages the vitality and growth of, in particular, small- and medium-size enterprises, where most people in the region work. The countries that are still mostly agrarian will need to focus more on raising agricultural productivity, a vital but often overlooked step in the process of structural transformation. In urbanizing countries, effective urban planning becomes critical, and better management and functioning of land markets, transportation infrastructure, and delivery of services will loosen constraints on the demand for labor and human capital. The most important investment Pacific island countries can make is to provide their young people with the human capital needed to succeed abroad as migrant workers. And across the region, it is critical to "formalize" more work, thereby increasing the coverage of essential social protection and sustaining productivity. To this end, policies should encourage the mobility of labor and human capital, and not favor some forms of employment—for example, full-time wage employment in manufacturing—over others, either implicitly or explicitly. Policies to increase growth and well-being from employment should instead reflect and support the dynamism and diversity of work across the region.

ISBN 978-1-4648-0004-7
9 781464 800047 90000
SKU 210004

THE WORLD BANK