World Development Report 1995

WORKERS *in an* INTEGRATING WORLD

WORLD DEVELOPMENT INDICATORS

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WORKERS *in an* INTEGRATING WORLD

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Foreword

WORK—SAFE, PRODUCTIVE, AND environmentally sound—is the key to economic and social progress everywhere. In the advice it gives governments and in the policies it promotes, the World Bank has long recognized the critical value of work. This is more than an economic issue; it is at the heart of human development. As such, work is a more than worthy subject for this, the eighteenth annual *World Development Report* It focuses on the incomes workers receive, the risks they face, and the conditions under which they work. Inevitably, work has almost as significant implications for those who do not work—children, the old, and those unable to work—as for those who do.

What makes the Report even more timely is the growing impact of two distinct global trends: reduced government intervention in markets, and the increased integration of trade, capital flows, and the exchange of information and technology. In such a climate of profound change, basic decisions about wages and working conditions are driven by global competitive pressures. The harsh reality of a global market is that policy failures are punished hard—through currency movements, shifts in market share, and, ultimately, through fluctuations in employment and wage levels.

Some see the new global marketplace as a source of opportunity, where industry and energy bring swift rewards; others regard the changes as a threat to security, and in parts of the industrial and the developing world the cause of protectionism is far from defeated.

This Report makes four key points:

First, building on earlier research—notably that of *World Development Report 1990*—it emphasizes the benefits to workers in all countries, and especially poor ones, of productivity-raising economic growth driven by sound investments in capital and in people's health and education.

Second, increased integration between countries, including through migration, can benefit workers in poor and rich countries at the same time. But governments have an important role in helping workers who are adversely affected by changes in trade patterns and capital flows. This can involve not just providing a social safety net, but also helping to equip workers for change.

Third, labor policies in many countries have been misguided in favoring those in good jobs at the expense of workers in the rural and informal sectors and the unemployed. Governments have a distinct role in setting the legal and regulatory frameworks within which trade unions and firms can operate and in ensuring that those frameworks encourage their positive contributions to development. Governments also need to define minimum standards and prevent exploitation and discrimination. Successful labor policies are those that work in harmony with the market and avoid providing special protections and privileges to particular labor groups at the expense of the poorest.

Fourth, workers eventually benefit from economic reform as states move from central planning to market systems and from protectionism to openness. The change, however, can be wrenching as employment and wages often decline temporarily and as workers have to move from old to new jobs. There remains a need for governments to provide strong support to workers and their families in such times of transition.

One goal of this Report is to spark a broad and informed debate on these often contentious issues. Another, more important, goal is to inspire policy changes that allow more of the right sort of jobs to be created. Work is, after all, the only foundation on which economies and people can build a success that lasts.

James D Wolfensohn
President
The World Bank

June 1, 1995

This Report has been prepared by a team led by Michael Walton and comprising Arup Banerji, Alejandra Cox Edwards, Ishac Diwan, Hafez Ghanem, David Lindauer, Ana Revenga, and Michal Rutkowski. The team was assisted by Vinod Ahuja, Deon Filmer, Praveen Kumar, Claudio E. Montenegro, Sarbajit Sinha, and Zhi Wang. Edward Balls was the principal editor. The work was carried out under the general direction of Michael Bruno.

Many others in and outside the Bank provided helpful comments and contributions (see the Bibliographical Note). The International Economics Department contributed to the data appendix and was responsible for the World Development Indicators. The production staff of the Report included Amy Brooks, Kathryn Kline Dahl, Geoffrey Eaton, Stephanie Gerard, Audrey Heiligman, Cathe Kocak, Jeffrey N. Lecksell, Hugh Nees, Kathy Rosen, Beatrice Sito, Tracey A. Smith, and Michael Treadway. The design was by Brian Noyes of the Magazine Group. The support staff was headed by Rebecca Sugui and included Daniel Atchison, Elizabeth V. de Lima, and Michael Geller. Trinidad S. Angeles and later Maria D. Ameal served as administrative officer.

Preparation of the Report was greatly aided by background papers and by contributions from participants in the consultation meetings. The names of the participants in the consultation meetings are listed in the Bibliographical Note.

Definitions and Data Notes

Selected terms used in this Report

The labor force and its components. The *labor force* of a country consists of all those in its *working-age population* (those fifteen to sixty-four years of age) who are employed or seeking employment. It includes the *unemployed* (those seeking work but unable to find it) but excludes *discouraged workers* (those who have given up looking for work) as well as others who are neither working nor seeking work (family members caring for children, as well as students, retirees, disabled persons, and others). *Underemployment*, although variously defined in the literature, is used in this Report to mean employment at fewer hours during a given period than the worker desires. The *labor force participation rate* is the percentage of the working-age population that is in the labor force. The *work force* consists of all persons who are actually working, whether in the formal or the informal sector—that is, the labor force less the unemployed. The *formal sector* consists of those enterprises, public or private, that hire workers under contract and are subject to labor laws and regulations. For purposes of empirical analysis, the formal sector is defined to include all nonagricultural enterprises that hire workers as wage-earning employees.

Active labor market policies. Policies aimed at helping the unemployed return to work or improving the opportunities of those now working; they include job search assistance, training, and job creation initiatives and are distinguished from *passive* policies, which seek to support the standard of living of those not working by providing cash or other benefits.

Affirmative action. The granting of preferences in hiring to persons deemed to have suffered from job discrimination in the past.

Collective bargaining. Negotiations between a union (or other representatives of employees) and employers to establish wage levels and other conditions of employment.

Export processing zone. A defined geographic area in which manufacturers producing for export are exempted from paying duties on imported inputs and, often, from certain domestic regulation.

Freedom of association. The freedom of workers to form and join unions or other organizations whose purpose is to increase their collective bargaining power.

Human capital. The skills and capabilities embodied in an individual or a work force, in part acquired through improved health and nutrition, education, and training.

Incomes policy. Any attempt by a government to restrain increases in wages and salaries, usually for the purpose of holding down inflation or maintaining employment levels.

Pension schemes are of two basic types. *Pay-as-you-go schemes* are state-operated arrangements in which payments to retirees are made out of current revenues, thus constituting a transfer from those currently working. In *funded schemes*, in contrast, benefits are paid out of funds accumulated from past contributions and are therefore an intertemporal "transfer" from one generation of workers to itself.

Purchasing power parity (PPP) adjustment. The adjustment for research purposes of data on the money incomes of workers to reflect the actual power of a unit of local currency to buy goods and services in its country of issue, which may be more or less than what a unit of the same currency will buy of equivalent goods and services in foreign countries at current market exchange rates. PPP-adjusted incomes are useful for comparing the living standards of workers in different countries. In this Report, data stated "in international prices" are PPP-adjusted.

Country groups

For operational and analytical purposes the World Bank's main criterion for classifying economies is gross national product (GNP) per capita. Every economy is classified as either low-income, middle-income (subdivided into lower-middle and upper-middle), or high-income. Other analytical groups, based on regions, exports, and levels of external debt, are also used.

Because GNP per capita changes with time, the country composition of each income group may change from one edition to the next. Once the classification is fixed for any edition, all the historical data presented are based on the same country grouping. The income-based country groupings used in this year's Report are defined as follows.

Low-income economies are those with a GNP per capita of $695 or less in 1993.

Middle-income economies are those with a GNP per capita of more than $695 but less than $8,626 in 1993. A further division, at GNP per capita of $2,785 in 1993, is made between lower-middle-income and upper-middle-income economies.

High-income economies are those with a GNP per capita of $8,626 or more in 1993.

World comprises all economies, including economies with sparse data and those with less than 1 million population; these are not shown separately in the main tables but are presented in Table 1a in the technical notes to the World Development Indicators.

The income criteria used in the World Development Indicators may differ from those used in the text of the Report.

Classification by income does not necessarily reflect development status. (In the World Development Indicators, high-income economies classified as developing by the United Nations or regarded as developing by their authorities are identified by the symbol †.) The use of the term "countries" to refer to economies implies no judgment by the Bank about the legal or other status of a territory.

Countries included in regional groupings used in the Report are listed in Appendix table A-1.

Data notes

Billion is 1,000 million.

Trillion is 1,000 billion.

Tons are metric tons, equal to 1,000 kilograms, or 2,204.6 pounds.

Dollars are current U.S. dollars unless otherwise specified.

Growth rates are based on constant price data and, unless otherwise noted, have been computed with the use of the least-squares method. See the technical notes to the World Development Indicators for details of this method.

The symbol / in dates, as in "1990/91," means that the period of time may be less than two years but straddles two calendar years and refers to a crop year, a survey year, or a fiscal year.

The symbol .. in tables means not available.

The symbol — in tables means not applicable. (In the World Development Indicators, a blank is used to mean not applicable.)

The number 0 or 0.0 in tables and figures means zero or a quantity less than half the unit shown and not known more precisely.

The cutoff date for all data in the World Development Indicators is April 30, 1995.

Historical data in this Report may differ from those in previous editions because of continual updating as better data become available, because of a change to a new base year for constant price data, or because of changes in country composition in income and analytical groups.

Other economic and demographic terms are defined in the technical notes to the World Development Indicators.

Acronyms and initials

ASEAN Association of South East Asian Nations (Brunei, Indonesia, Malaysia, the Philippines, Singapore, and Thailand)

CMEA Council for Mutual Economic Assistance (the trading system of the former communist bloc)

FDI Foreign direct investment

GATT General Agreement on Tariffs and Trade

GDP Gross domestic product

GNP Gross national product

ILO International Labour Office (or Organization)

NAFTA North American Free Trade Agreement

NGO Nongovernmental organization

NIE Newly industrializing economy

PPP Purchasing power parity (see "Selected terms used in this Report" above)

OECD Organization for Economic Cooperation and Development (Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Greece, Iceland, Ireland, Italy, Japan, Luxembourg, Mexico, Netherlands, New Zealand, Norway, Portugal, Spain, Sweden, Switzerland, Turkey, United Kingdom, and United States)

UNICEF United Nations Children's Fund

UNIDO United Nations Industrial Development Organization

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Overview

DUONG IS A VIETNAMESE PEASANT FARMER who struggles to feed his family. He earns the equivalent of $10 a week for thirty-eight hours of work in the rice fields, but he works full-time only six months of the year—during the off-season he can earn very little. His wife and four children work with him in the fields, but the family can afford to send only the two youngest to school. Duong's eleven-year-old daughter stays at home to help with housework, while his thirteen-year-old son works as a street trader in town. By any standard Duong's family is living in poverty. Workers like Duong, laboring on family farms in low- and middle-income countries, account for about 40 percent of the world's labor force.

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Hoa is a young Vietnamese city dweller experiencing relative affluence for the first time. In Ho Chi Minh City she earns the equivalent of $30 a week working forty-eight hours in a garment factory—a joint venture with a French firm. She works hard for her living and spends many hours looking after her three children as well; her husband works as a janitor. But Hoa's family has several times the standard of living of Duong's and, by Vietnamese standards, is relatively well-off. There is every expectation that both she and her children will continue to have a vastly better standard of living than her parents had. Wage employees like Hoa, working in the formal sector in low- and middle-income countries, make up about 20 percent of the global labor force.

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Françoise is an immigrant in France of Vietnamese origin who works long hours as a waitress to make ends meet. She takes home the equivalent of $220 a week, after taxes and including tips, for fifty hours' work. By French standards she is poor. Legally, Françoise is a casual worker and so has no job security, but she is much better off in France than she would have been in Viet Nam. Her wage is almost eight times that earned by Hoa in Ho Chi Minh City. Françoise and other services sector workers in high-income countries account for about 9 percent of the global labor force.

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Jean-Paul is a fifty-year-old Frenchman whose employment prospects look bleak. For ten years he has worked in a garment factory in Toulouse, taking home the equivalent of $400 a week—twelve times the average wage in Viet Nam's garment industry. But next month he will lose his job when the factory closes. Unemployment benefits will partly shield him from the shock, but his chances of matching his old salary in a new job are slim. Frenchmen of Jean-Paul's age who lose their jobs are likely to stay unemployed for more than a year, and Jean-Paul is encouraging his son to work hard in school so he can go to college and study computer programming. Workers in industry in high-income countries, like Jean-Paul, make up just 4 percent of the world's labor force.

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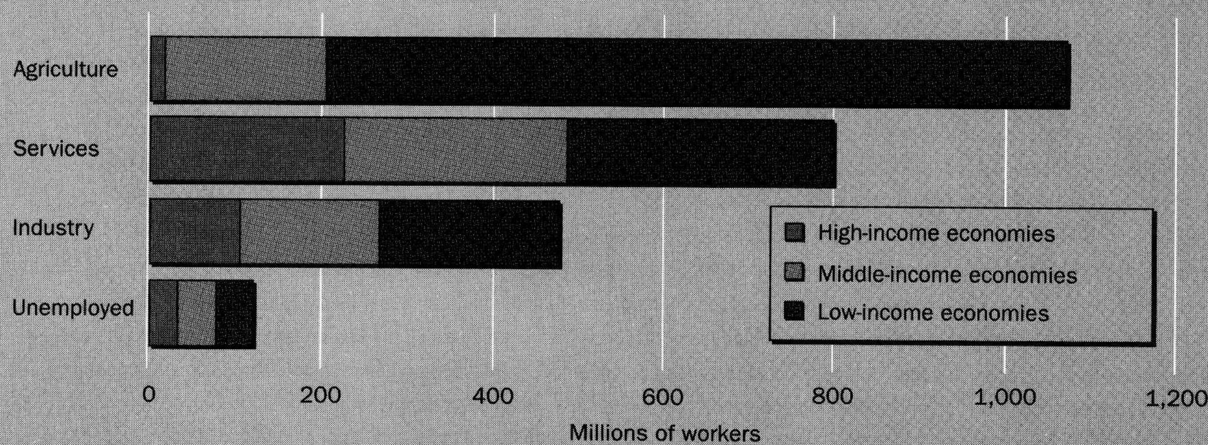
These four families—two living in Viet Nam, two in France—have vastly different standards of living and expectations for the future. Employment and wage prospects in Toulouse and Ho Chi Minh City are worlds apart, even when incomes are adjusted, as here, for differences in the cost of living. Françoise's poverty wage would clearly buy Hoa a vastly more affluent life-style. And much of the world's work force, like Duong, works outside the wage sector on family farms and in the informal sector, generally earning even lower labor incomes (Box 1). But the lives of urban workers in different parts of the world are increasingly intertwined. French consumers buy the product of Hoa's labor, and Jean-Paul believes it is Hoa's low wages that are taking his job, while immigrant workers like Françoise feel the brunt of Jean-Paul's anger. Meanwhile, Duong struggles to save so that his children can be educated and leave the countryside for the city, where foreign companies advertise new jobs at better wages.

These are revolutionary times in the global economy. The embrace of market-based development by many developing and former centrally planned economies, the opening of international markets, and great advances in the ease with which goods, capital, and ideas flow around the world are bringing new opportunities, as well as risks, to billions of people. In 1978 about a third of the world's work force lived in countries with centrally planned economies. At least another third lived in countries weakly linked to international interactions because of protective barriers to trade and investment. If recent trends continue, by the year 2000 fewer than 10 percent of workers may be living in such countries, largely disconnected from world markets.

But rapid change is never easy. In rich and poor countries alike there are fears of rising insecurity, as technological change, expanding international interactions, and the decline of traditional community structures seem to threaten jobs, wages, and support for the elderly. Nor have economic growth and rising integration solved the problem of world poverty and deprivation. Indeed, the numbers of the poor could rise still further as the world labor force grows from 2.5 billion today to a projected 3.7 billion in thirty years' time. The bulk of the more than a billion individuals living on a dollar or less a day depend, like Duong and his family,

Box 1 A world at work

For most households, poor and prosperous alike, income from work is the main determinant of their living conditions. Of the 2.5 billion people working in productive activities worldwide, over 1.4 billion live in poor countries, defined as those with annual income per capita below $695 in 1993. Another 660 million live in middle-income countries, and the remainder, some 380 million, live in high-income countries, with annual income per capita above $8,626 in 1993. There are vast differences in the patterns of employment across these three broad categories of countries. In poor countries 61 percent of the labor force works in agriculture, mainly tending family farms, while 22 percent work in the rural nonfarm and urban informal sectors, and 15 percent have wage contracts, mainly in urban industrial and service employment. In middle-income countries some 29 percent work on farms, 18 percent in rural and urban informal activities, and 46 percent in wage employment in industry and services. In rich countries the bulk of workers have jobs in the formal sector, with roughly 4 percent in agriculture, 27 percent in industry, and 60 percent in services. Some 120 million workers are unemployed worldwide. Workers in low-income countries dominate the world's agricultural work force but also, by their sheer numbers, account for nearly half of the world's industrial workers and about a third of its unemployed (see figure).



The world's labor force by sector and country income level. Data are projected for 1995 from a sample of countries in each income group. Source: World Bank staff estimates based on the following: EBRD 1994; ILO 1986 with ILO data updates; ILO, various years; and country sources.

on pitifully low returns to hard work. In many countries workers lack representation and work in unhealthy, dangerous, or demeaning conditions. Meanwhile 120 million or so are unemployed worldwide, and millions more have given up hope of finding work.

Yet fears that increased international trade and investment and less state intervention will hurt employment are mainly without basis. Workers have made great advances in many countries, especially those that have embraced these global trends, effectively engaging in international markets and avoiding excessive state intervention. Despite a doubling of the world's work force over the past three decades, the productivity of the world's median worker has doubled.

This Report concludes that problems of low incomes, poor working conditions, and insecurity affecting many of the world's workers *can* be effectively tackled in ways that reduce poverty and regional inequality. But to do so will require sound domestic policy and a supportive international environment. This means that governments must:

- pursue market-based growth paths that generate rapid growth in demand for labor, expansion in the skills of the work force, and rising productivity
- take advantage of new opportunities at the international level, by opening up to trade and attracting capital—but manage the dislocations that international changes sometimes bring
- construct a framework for labor policy that complements informal and rural labor markets, supports collective bargaining in the formal sector, provides safeguards for the vulnerable, and avoids biases that favor relatively well-off workers, and

- in those countries struggling with the transition to a more market-based and internationally integrated pattern of development, try to design the transition to make it as rapid as possible without excessive or permanent costs for labor.

Development strategy and workers

Manufacturing wages in a group of export-oriented East Asian economies rose 170 percent in real terms between 1970 and 1990, while manufacturing employment increased 400 percent. Wages of agricultural laborers in India rose 70 percent. But meanwhile industrial wages grew by only 12 percent in a group of Latin American countries and fell in many Sub-Saharan African countries.

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Economic growth is good for workers. This has long been true for those living in what are now the world's rich countries, and it has been spectacularly true for the newly industrializing economies (NIEs) of East Asia over the past few decades. Growth has reduced poverty through rising employment, increased labor productivity, and higher real wages (Figure 1). Growth also tends to reduce poverty and inequality, including inequality between men and women. For today's low- and middle-income countries, the fear that growth will primarily benefit capital, create few jobs, and fail to raise wages is unfounded. Viet Nam's workers are now some of the poorest in the world. If their country follows the path of other East Asian successes, they could enjoy a doubling of their labor incomes in a decade or so.

Market-based development, which encourages firms and workers to invest in physical capital, new technologies, and skills, is the best way to deliver growth and rising living standards for workers. Countries that have attempted to help workers by biasing investment against agriculture and toward industry, protecting the jobs of a favored few industrial workers against international competition, dictating wage increases, or creating unneeded jobs in the public sector have failed over the long run—whether in Latin America, the former Soviet Union, or elsewhere. What any nation's work force needs most is stronger demand for its services, together with high levels of investment in schooling, training, roads, and machines. This has worked best where, as in East Asia, governments made good use of international markets, especially for expanding exports, and gave strong support to family farming. The public sectors in these economies supported the efficient functioning of markets by providing a stable macroeconomic environment

Industrial wages have soared in East Asia but grown slowly or fallen elsewhere.

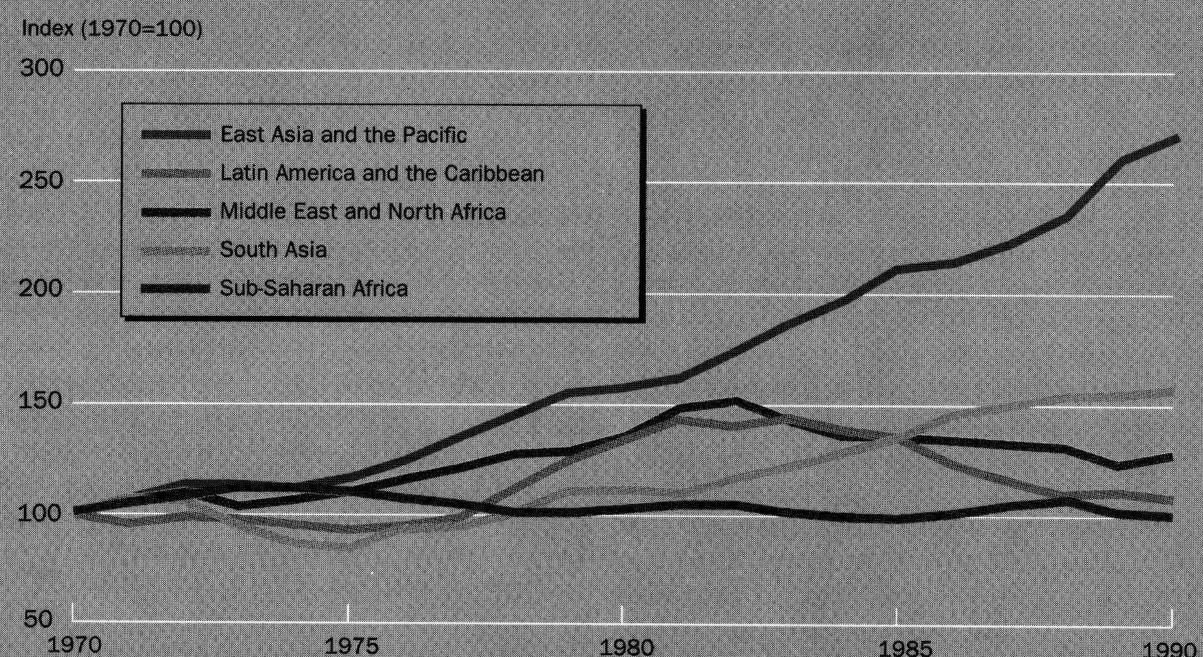

Figure 1 Real wages in manufacturing. Data are unweighted averages for a sample of countries in each region. Source: Wage data from UNIDO, adjusted for inflation.

for saving and investment and supporting the expansion of economic infrastructure and social services.

Investment in the skills, health, and nutrition of workers is key both to their welfare and to economic success. But some countries have performed badly despite investing in schooling. Investment—in physical or in human capital—does not guarantee growth (Figure 2). The former centrally planned economies of Europe and Central Asia represent an extreme case of high investment that led first to stagnating and eventually to collapsing labor incomes.

Market-based, labor-demanding growth also tends to reduce inequality—within countries and across regions—provided governments ensure broad-based investment in the capabilities of people and the complementary assets that determine their opportunities. It is true that the centrally planned economies achieved high degrees of equality and now generally face some rise in inequality. But the East Asian strategy—of supporting family farms, avoiding dualistic labor markets, and encouraging vigorous growth in formal employment through exporting—achieved rapid growth with declining poverty and lower inequality. By contrast, most Latin American countries have long had highly unequal income distributions, and most still do, with landholdings heavily concentrated in the hands of a few and growth paths biased against labor.

Inequalities between men and women, between ethnic groups, and between geographic regions are particularly tenacious. Women often work more but get paid less than men, because of a heavier burden of work in the home, less education, or weaker access to better paying jobs. Indian scheduled castes are confined to low-paying work. Poor regions, such as the state of Chiapas in Mexico, usually stay relatively poor even when the economy as a whole expands. Some of these groups do gain from development (in particular, wage differentials between men and women usually decline), but others miss out. Helping those left out is one of the toughest problems for policy, for poor and rich countries alike. From a hard-headed economic perspective, investing in such people may seem a poor risk, because many are old, socially ill adapted to work, or stuck in backward regions, but concern for their misery and for social cohesion demands that policy reach out to them. The longer people are left behind, the harder it becomes to break self-perpetuating intergenerational cycles of poverty.

Capital per worker has risen rapidly in all regions, while output growth has been slower.

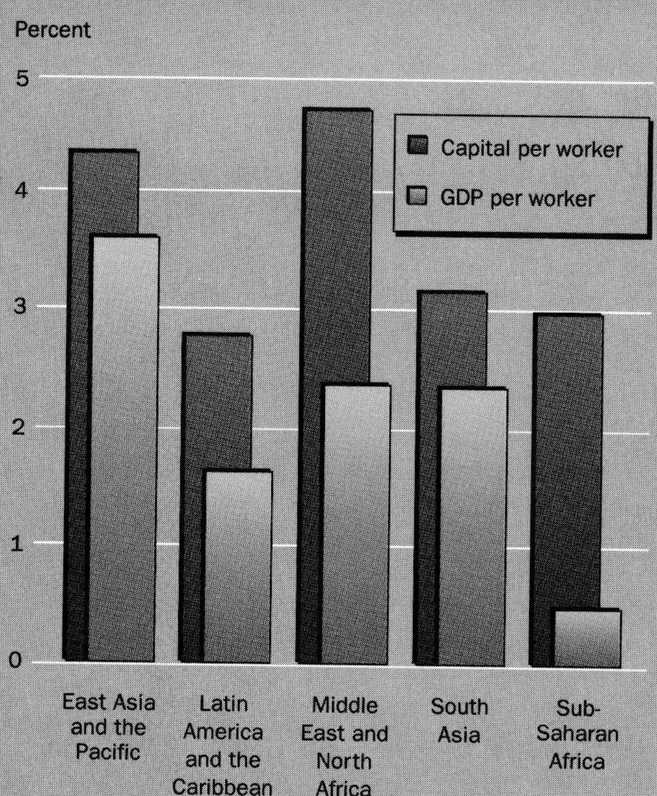

Figure 2 Growth rates of GDP and capital per worker. Data are annual averages for 1960-90. Source: ILO 1986 with ILO data updates; Nehru and Dhareshwar 1991; World Bank data.

Employment in an integrating world

The share of manufactures in developing country exports rose from 20 percent to 60 percent between 1960 and 1990. Low- and middle-income countries already account for almost 80 percent of the world's industrial work force.

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International flows of goods, services, capital, and people bring new opportunities for most workers. Where exports have risen fast, so have real wages—by an average of 3 percent per year (Figure 3). Foreign direct investment, which now accounts for 30 percent of capital flows to low- and middle-income economies, is creating many new jobs: 60 percent of worldwide growth in the payrolls of multinational corporations occurred in these countries between 1985 and 1992. International migration, although so far less of a force for change than either trade or investment, has usually brought income gains to those who move, higher remittances to those who stay, and increased production of goods and services in the host countries.

Many workers, especially in the farms, factories, and services sectors of Asia, have seen great gains from international engagement. But for some it feels as though international integration has increased their vulnerability to volatile international conditions; others—especially those living in Sub-Saharan Africa—remain largely disconnected from international market opportunities. And within industrial countries there is a small but vocal minority who fear they will lose from the introduction of new technologies, the growth of international trade, and movements of capital and people across national boundaries.

Some workers will indeed be hurt if they are stuck in declining activities and lack the flexibility to change. However, international trade, immigration, and capital flows account for only a small part of the problem faced by laid-off workers in France, or by unskilled men in the United States who have seen their wages decline for decades, even as the wages of college graduates continue to rise. More important, restricting trade or capital is not an effective way of dealing with this problem—a better strategy for any country is to improve the skills of its people or ease their transition to new jobs, while staying engaged with the world economy. International migration, in contrast, is always controlled to some degree. To the extent this is done to reduce conflict while preserving the basic rights of migrants, it can actually help sustain moderate levels of international migration.

In any case, capital now crosses borders ever more rapidly despite the best efforts of some national governments to control it. But far from rendering national governments impotent, international capital movements intensify the impact of domestic policy on labor outcomes, richly rewarding policy when it is sound but punishing it hard when it is unsound. Faster and broader capital flows and greater openness in trade are making domestic policy more important for workers. Success breeds success, because good macroeconomic and structural policies are key to attracting or keeping capital and achieving the productivity necessary to create competitive jobs at rising wages. But when policies fail, portfolio investment and local savings leave the scene, and labor suffers the consequences.

Wages rose in countries whose export orientation increased.

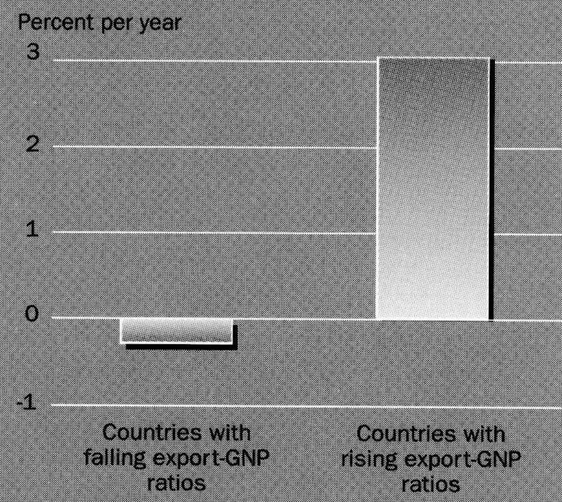

Figure 3 Real wage growth in manufacturing and export orientation. Data are annual averages for 1970-90 for a sample of thirty-seven countries with falling and thirty-two countries with rising export-GNP ratios. Source: UNIDO and World Bank data.

Labor policy

Although 90 percent of developing countries have some form of social security system, at best it covers only workers in the formal sector, who make up just 15 percent of the labor force in low-income countries, 45 percent in middle-income countries.

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Labor policies in low- and middle-income countries do not affect the majority of workers who, like Duong in Viet Nam, work in the rural or the urban informal sector. These are the poorest workers—often earning less than half what a formal sector employee earns—and therefore the most in need of protection. Moreover, labor regulations are often not enforced in many firms that are normally considered part of the modern sector (see Figure 11.2 in Chapter 11).

Does this mean that governments in low- and middle-income countries should not bother to intervene in the labor market, because their policies will not reach those who most need help and their regulations will not be enforced? The answer is no. Public action can complement community arrangements and enhance the welfare of informal workers by improving the environment in which they operate. In the formal sector public action is sometimes needed to improve market outcomes, enhance equity, and protect vulnerable workers.

Informal and rural workers often must work under more hazardous and insecure conditions than their formal sector counterparts. Improved working conditions are best achieved not by legislation but by direct public action affecting the working environment and the health of workers, in areas such as provision of water and sanitation, roads and drainage in and near cities, and environmental health. The eradication of onchocerciasis (river blindness) in large parts of West Africa brought immense reductions in human suffering and large increases in labor supply. Informal income security arrangements can be complemented by public transfer programs: public works are usually the best transfer method for able-bodied men and women. In India's Maharashtra State, for many years rural workers were guaranteed work in public works schemes at the local wage rate.

For the formal sector, collective bargaining between firms and independent unions is an effective way to determine wages and working conditions. Yet governments have often repressed unions, as in the Republic of Korea until the 1980s, or politicized the bargaining process, as in Bangladesh today. Sometimes, as in Indonesia, they have responded to pressures for independent unions by directly raising standards, such as minimum wages, potentially at the cost of employment. Governments do need to establish the rules for labor-management negotiations, spelling out the rights of workers and firms, establishing dispute resolution mechanisms, and promulgating basic health and safety regulations, which unions can monitor. Where unions cover only a small proportion of the work force, as they do in most low- and middle-income countries, decentralized bargaining under conditions of competitive output markets produces the best results. This precept has long applied in Japan and Hong Kong and applies now in Chile and Korea.

Direct government intervention makes sense in dealing with child labor and in other cases where the market may produce adverse outcomes, such as discrimination against women. But legislation alone has been ineffective. It needs to be complemented by other policies such as low-cost education and better access for women to formal sector jobs. India has sound child labor laws, yet millions of children are working, often in hazardous conditions. Child labor is partly a reflection of poverty. But it is not necessary to wait for a reduction in the poverty rate to tackle the most life-threatening and demeaning aspects of child labor. In the town of Pagsanjan in the Philippines, civic action dramatically reduced child prostitution. In Brazil, India, and the Philippines, local action, with public support, is improving the health status of working children and giving them greater educational opportunities.

Governments also have to set policy for public employment. Many public sector workers work hard and productively. But in many low- and middle-income countries, notably in Sub-Saharan Africa and the Middle East, the quality of public service has suffered as its ethos has been destroyed by a combination of overstaffing, inadequate pay, and weak governance. Restoring levels of pay and reducing the number of public workers are often essential reforms, to be combined with improvements in the recruitment, promotion, and accountability of civil servants, teachers, nurses, and policymakers. The redefinition of the role of the state makes it all the more important that governments be effective in those areas where they do stay involved.

If support for the rights of workers to form unions and to bargain collectively and support for the reduction of child labor make sense in a national context, should these principles be linked to international trade agreements, with sanctions for their violation? Advocates of linkage make a distinction between "core" standards, which for many would be akin to basic rights and do not directly raise labor costs, and other standards, such as minimum wages, that are a direct function of the level of development. Such a division is sound, and there is a case for international concern over core standards. However, it is best to keep multilateral trade agreements confined to directly trade-related issues, to prevent protectionist interests from misusing such links to reduce the trade that workers in low- and middle-income countries need if their incomes are to rise. As the history of trade reform illustrates, even well-intentioned and rationally designed discretionary trade measures can be captured by protectionist interests.

Managing major changes

Of the world's 2.5 billion workers, 1.4 billion live in countries struggling with transitions from state interventionism, high degrees of trade protection, or central planning.

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Many developing and transitional economies are struggling with one or both of two major changes in their development strategies: from protection to greater integration with international markets, and from massive state intervention to a market economy in which the state plays a smaller role in allocating resources. These changes can have a powerful labor market dimension. Their key characteristic is an acceleration in the destruction of unviable jobs and the creation of new ones. The process is often accompanied by macroeconomic decline and by a sharp drop in the demand for labor nationwide. In the short term, workers often feel the pain as real wages fall, unemployment rises, and employment shifts into informal activities. In Argentina, Bolivia, Chile, and Mexico, real wages fell by a third or more before recovering. In Bulgaria, the Czech Republic, Poland, Romania, and Russia, real wages fell between 18 and 40 percent in the first year of transition; in some countries, including Bulgaria and Poland, unemployment rose from negligible levels to 15 percent or more. But in Ghana and China wages rose during the adjustment process, and unemployment remained low.

Economic reform can create opportunities for some workers but have wrenching effects on others. Even the best-designed reforms produce gainers and losers in the short term. Moving the economy as quickly as possible to the new growth path is key to minimizing the pain and social costs of adjustment; macroeconomic stability and credibility of the overall reform package are therefore critical. Countries such as Chile and Estonia have done relatively well on these scores and have brought about—or are bringing about—recoveries in wages and employment. In contrast, Belarus and Venezuela have faltered and suffered declines or stagnation in wages and employment (Figure 4).

Is a strategy of gradual transition better for workers? Where initial conditions allow gradual job destruction without jeopardizing the reform that is needed to generate new jobs, gradualism makes sense. China exemplifies the truth of this proposition, but that country enjoyed a large margin for job expansion, first in agriculture and then in

Wages fall where the transition involves macroeconomic decline, but recover more quickly where reform is more credible.

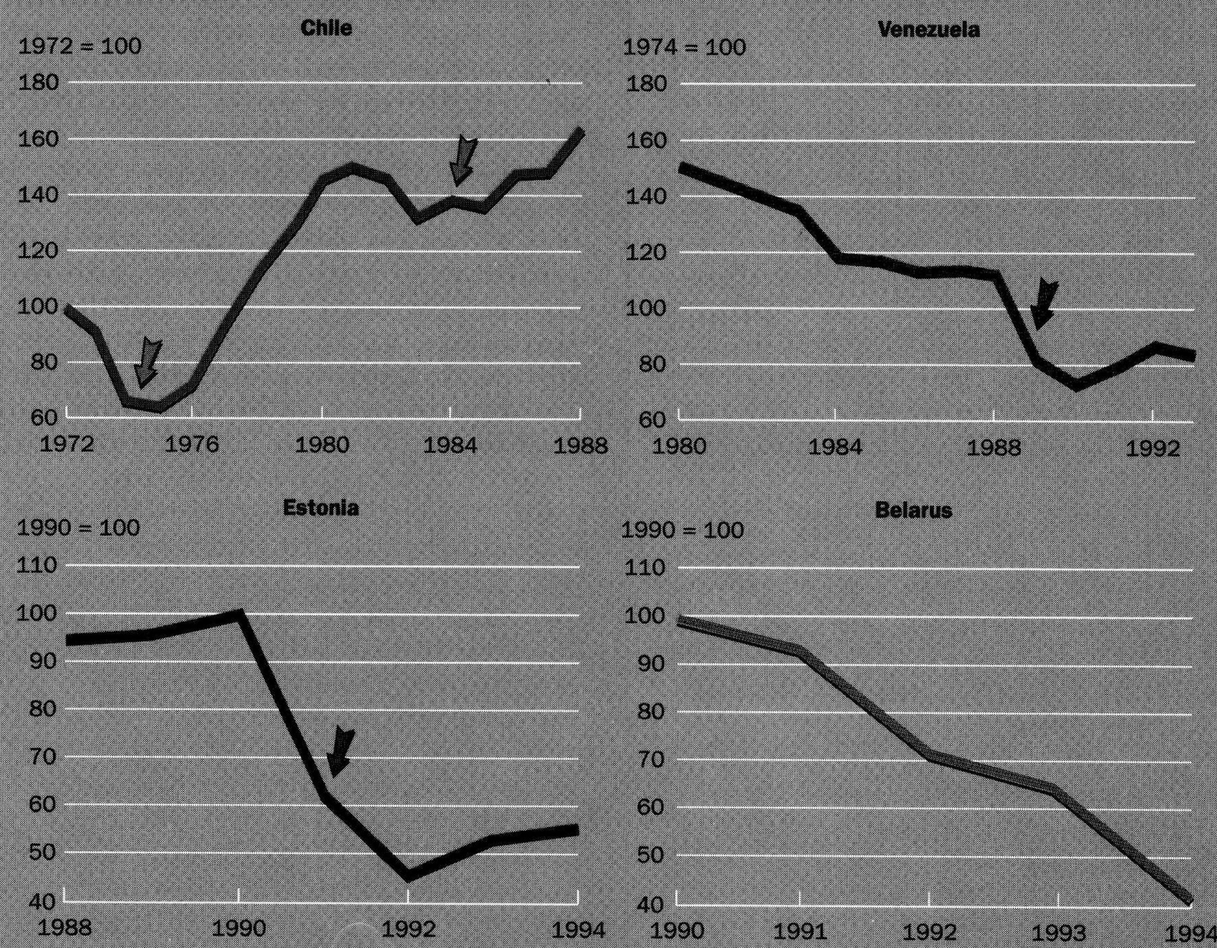

Figure 4 Real wage income per capita in four countries undergoing comprehensive reforms. Arrows indicate implementation of major reforms. Belarus has implemented partial reforms over the period since 1991. Source: World Bank staff estimates.

quasi-private industry, which could help finance the cost of the relatively inefficient state sector. In most other countries either macroeconomic imbalance or the costs of inefficient sectors make gradualism a nonstarter.

Microeconomic policies that affect the mobility and incomes of workers can play a major role both in influencing the overall pace of change and in safeguarding the welfare of workers over the transitional period. Good policy will generally involve action in three areas: enhancing mobility, reducing income insecurity, and equipping workers for change. These are highly complementary. Increased mobility will often involve measures to allow job destruction, including large layoffs from the public sector, to run its course. In many countries measures to separate entitlement to social services from employment and to liberalize housing markets are required. But it is also important to consider the needs of those at risk of steep income declines. Income transfers can play an important role here. Retraining can help certain groups of workers but is unlikely to provide a panacea.

Divergence or inclusion?

About 99 percent of the 1 billion or so workers projected to join the world's labor force over the next thirty years will live in what are today's low- and middle-income countries. Some groups of relatively poor workers have experienced large gains in the past thirty years—especially in Asia. But there is no worldwide trend toward convergence between