

An Overview of Labor Markets World-Wide: Key Trends and Major Policy Issues

Gordon Betcherman

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I. INTRODUCTION

The purpose of this paper is to provide an overview of key labor market trends world-wide. This is a daunting task. Most obviously, the sheer scope of the issues that deserve to be covered in any review of this type is immense. But there are two other complicating factors that, in effect, represent the central themes of this overview.

The first is the apparent pace of change. Globalization, the revolution in information and communication technologies, shifting macroeconomic orthodoxies, population patterns, and the changing role of women are just the most visible of a host of dramatic developments that have altered employment and work over the past quarter-century. Whether or not labor markets are actually changing more rapidly than was the case in the past is a complex (and largely unverified) proposition. But there is no doubt about the widespread perception of enormous change – including the accompanying risks and opportunities -- and the challenges this poses for policy-makers.

The second complicating factor is the diverging nature of labor market experiences. Developments such as those listed above are affecting different countries and different types of workers in very different ways. For example, a number of nations in the developed world in recent years have experienced very low unemployment rates and, within these countries (and in some developing countries), highly-skilled “knowledge” workers enjoy unprecedented earnings and employment opportunities. At the same time, many developing countries are witnessing a deterioration in their labor market situations with real wage declines, shrinking formal employment sectors, and worsening working conditions.

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Within this context of dramatic change and divergence in experiences, there are a number of key issues and difficult questions facing policy-makers:

- What can be done to make greater progress against unemployment and poverty among workers? According to ILO estimates, about 160 million workers worldwide are unemployed. This figure does not include the millions who may not be officially unemployed but are working in informal sectors because they cannot find a job in the formal sector. About a half billion workers around the world cannot earn enough to raise their families above the \$1US a day poverty line. Improving the labor market prospects in developing countries will be made more difficult given the exploding supply of young workers.
- What can and should be done about reversing inequality, both within and between countries?
- What can countries do to mitigate the hardships workers experience in the wake of major financial market crises? As the examples of East Asia (1997), Russia (1998), and Brazil (1999) have shown, these crises can have serious and persisting consequences for labor markets.
- How can the competitive pressures of globalization be managed in order to avoid downward pressure on wages (especially in developing countries) and a “race to the bottom” in terms of human resource practices and social and labor policies?
- How can public policy most effectively address issues of gender and ethnic discrimination in the labor market?
- What are the best approaches to meet the massive labor adjustment required as a result of technological change, globalization, industrial restructuring, and the downsizing of public sectors?
- How can all countries, but especially developing countries, meet the challenge of educating and training their workforces to realize the potential productivity and income gains of new technology and international markets?

This is not an exhaustive list but is illustrative of the issues facing labor policy-makers around the world.

Countries everywhere are grappling with the question of how to encourage employment and earnings growth and how to provide social protection for workers. Strategies involve some mix of relying on market mechanisms, worker representation and collective bargaining, and government intervention. In recent years, developed countries seem to have agreed (to some extent) on the benefits of encouraging labor market flexibility, investing in human capital, and “making work pay.” These principles form the basis of the OECD Jobs Strategy report (1994, 1999b). However, a great deal of variation remains in labor policy frameworks, even in developed countries, and the evidence about a single “best way” is not compelling. The real challenge everywhere is to find a balance between flexibility and protection.

One point of consensus concerns the limitations of traditional policy interventions. At a domestic level, conventional instruments have been under increasing scrutiny. To cite a few examples: Concerns have been raised about the incentive effects of passive income support programs like unemployment insurance. Training and other active labor market programs often have not fared well when judged against rigorous cost-benefit standards. The labor market effects of strong employment protection legislation have been questioned. Moreover, the reach of traditional public policy approaches is limited by the expansion of informal forms of employment in many parts of the world. Another consideration is the growth of labor issues that transcend national boundaries and the inability to this point to build consensus about how the global community should respond. Yet most people would agree that simply allowing market forces to operate is not the solution.

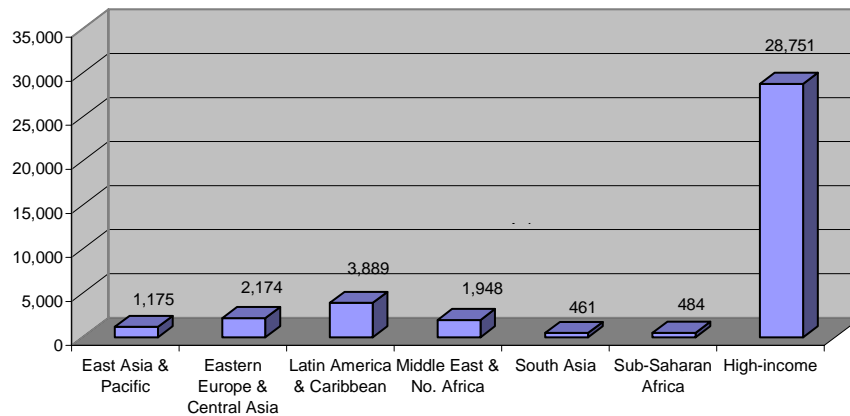
These constraints and the difficult issues raised earlier have led to great interest in exploring new ideas about employment and labor markets. This includes innovations in public policy – private-public partnerships in service delivery, new instruments for funding unemployment benefits, lifelong learning accounts, and alternative dispute resolution mechanisms are just a few examples. But it also includes new ideas from business about social responsibility and voluntary self-regulation, from trade unions and NGOs about building networks that reach informal sector workers, and from international organizations about disseminating best practice across borders and integrating labor concerns into comprehensive development approaches.

The remainder of this paper is organized as follows. In Section 2, we provide a statistical review of recent labor market developments and key employment indicators by region. Section 3 reviews four key trends affecting global labor markets: the changing industrial structure; globalization; technological change; and the informalization of labor markets. In section 4, we turn to three key policy challenges that are relevant for all countries, regardless of stage of development: investing in human resources; providing social protection for workers; and regulation, including addressing working conditions in a globalizing world. Conclusions are briefly drawn in section 5.

II. LABOR MARKET DEVELOPMENTS AND INDICATORS

Various factors including natural endowments, comparative advantages, population, cultural factors, and long-run economic performance contribute to dramatic differences in labor market conditions across regions. These differences are reflected in labor supply, the structure of employment, unemployment, productivity and wages, and working conditions.¹

Figure 1: GDP per capita (\$US) by region, 2000



Source: World Bank (2002a)

Aggregate economic performance

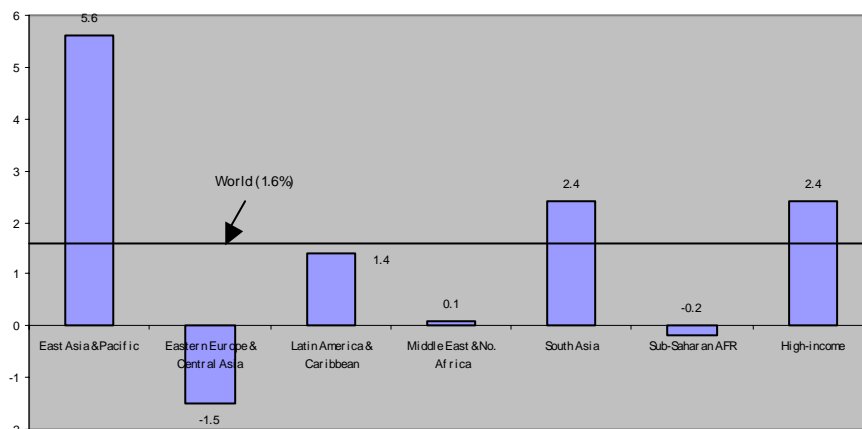
Economic performance is the primary determinant of labor market conditions. Figure 1 shows the variation in gross domestic product per capita (\$US) across regions in 2000. The

¹ Where possible, data are organized according to the following regions: high-income countries, East Asia and the Pacific (EAP), South Asia (SA), Eastern Europe and Central Asia (ECA), Middle East and North Africa (MENA), Sub-Saharan Africa (AFR), and Latin America and the Caribbean (LAC).

difference between the developed and developing countries is the most striking feature of this chart. GDP per capita in the high-income countries ranges from more than 60 times greater than the corresponding figure for the poorest developing region (South Asia) to 7 times greater than the level for the richest (Latin America and the Caribbean).²

With the exception of East Asia, the developing regions have not narrowed the gap over the past few decades (Figure 2). Between 1965 and 1999, GDP per capita in the high-income countries grew at an mean annual rate of 2.4%, above the world average of 1.6%. South Asia's per capita growth matched the OECD rate but the other four developing regions did not. Three of these -- the Middle East and North Africa, Sub-Saharan Africa, and Eastern Europe and Central Asia -- either had virtually no per capita growth or even declines over this 35-year period. This does not mean the economies of these regions did not expand during these years but whatever growth there was did not match population expansions.³

Figure 2: GDP per capita, average annual % change by region, 1965-1999



Source: World Development Indicators, 2001

² Conversion into \$US in this figure and elsewhere in this paper is based on official currency exchange rates. An alternative conversion method is to use purchasing power parities (PPPs) which provide a comparison of real price levels between countries. The PPP method reduces the gaps between regions, however they remain very large. For example, PPP gross national income per capita in 1999 in high-income countries was about 4 times greater than in Latin America and the Caribbean and 17 times greater than in Sub-Saharan Africa, the poorest region according to this method (World Development Indicators, 2001).

³ According to the World Development Indicators, 2001, average annual GDP growth on an aggregate basis was 7.4% in East Asia, 4.7% in South Asia, 3.5% in Latin America, 3.0% in the Middle East, and 2.6% in Africa. Only in Eastern Europe and Central Europe did aggregate growth decline (-0.7%).

Focusing on more recent trends, during the 1990s annual per capita GDP growth in low- and middle-income countries was 1.6% compared to 1.8% in high-income countries. East Asia (6.0%) and South Asia (3.3%) led the growth while Eastern Europe and Central Asia declined by 2.5% (World Bank 2002a).

Poverty

Economic growth and the distribution of income (discussed below) determine the incidence of poverty. As Table 1 indicates, there has been some decline in extreme poverty rates (living on less than \$US1 per day) in the 1990s. This was largely accounted for by East Asia where poverty rates were reduced by almost half and, to a lesser degree, by South Asia where rates – though still very high -- were cut by 7 points. Sub-Saharan Africa, the region with the highest incidence of poverty, experienced virtually no progress during the 1990s.

Table 1: Extreme poverty (living on less than \$US1 per day) by region, 1990 and 1999

	Percentage of population		Number (millions)
	1990	1999	1999
East Asia and Pacific	27.6	14.2	260
Eastern Europe and Central Asia	1.6	3.6	17
Latin America and the Caribbean	16.8	15.1	77
Middle East and North Africa	2.4	2.3	7
South Asia	44.0	36.9	490
Sub-Saharan Africa	47.7	46.7	300
Total	29.0	22.7	1,151

Source: World Bank (2002a)

Labor force

A number of dimensions are central to developments relating to labor supply: the global distribution, overall growth rate, age composition, female participation, the education and skill level workers, and international migration patterns. The first four are reviewed here while the last two will be covered in section 3.

The global working age population (conventionally defined as 15-64 years of age) is now approaching four billion (Table 2). Over half (54%) is in Asia. The developed countries account for just 16%. The world-wide labor force is estimated at 2.9 billion, representing a labor force participation rate of 77% -- the rate in 1980 was virtually the same (78%).

Compared to 1980, women now account for a slightly larger share of the global workforce (1.5 percentage points higher). As Table 2 indicates, increases in the female share have occurred in East Asia, Latin America, the Middle East, and the high-income countries. Note that a great deal of variation remains in terms of the quantitative importance of women in regional labor forces.

Labor force growth also has varied significantly across regions over the past two decades (Table 2). Population growth has been the principal factor. The developing regions, except Eastern Europe and Central Asia, have had annual labor force growth of 1.9% or greater. The transition and high-income countries, on the other hand, have had much lower growth rates.

Table 2: Labor supply trends by region, 1980-2015

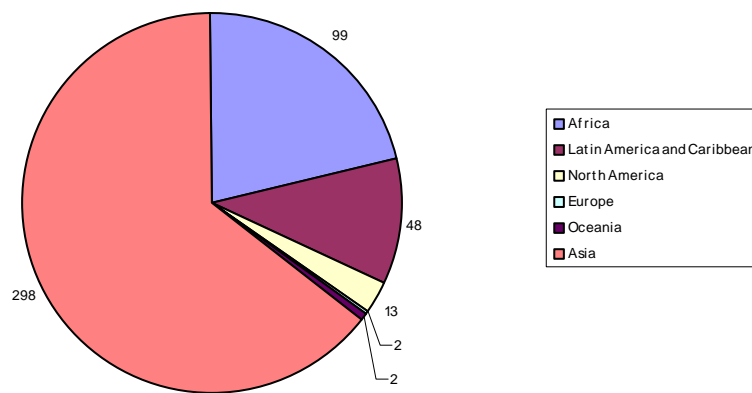
	Working age (15-64) population (millions)		Average annual labor force growth (%)	Projected Annual Population Growth Rate (%), 1999-2015 (age categories)			Female % of LF	
	1980	1999	1980-1999	0-14	15-64	65+	1980	1999
East Asia & Pacific	820	1220	1.9	-0.6	1.2	2.5	42.5	44.4
Eastern Europe & Central Asia	274	318	0.5	-1.2	0.4	0.7	46.7	46.2
Latin America & Caribbean	201	319	2.7	-0.1	1.7	2.8	27.8	34.6
Middle East & North Africa	92	172	3.0	0.5	2.5	2.8	23.8	27.3
South Asia	508	797	2.2	0.1	2	2.5	33.8	33.3
Sub-Saharan Africa	195	340	2.6	1.6	2.7	1.8	42.3	42.2
High-income	505	595	1.0	-0.6	0.2	1.8	38.4	43.1
World	2595	3761	1.9	0.1	1.4	2.1	39.1	40.6

Source: World Development Indicators, 2001

Over the next 15 years, the working age population will continue to expand very rapidly in most of the developing world (Table 2). Sub-Saharan Africa, the Middle East and North Africa, and South Asia are all projected to grow by at least 2% per year. At the same time, in much of the world, countries will have to deal with rapid increases in older age groups. In the high-income countries, the only substantial growth will be in this segment of the population.

Labor force projections provide an indication of the magnitude of the future job creation challenge. The flow of new entrants is expected to lead to a net labor force increase of almost half a billion over the first decade of this century. Figure 3 shows how unevenly this increase will be distributed world-wide. Almost 300 million of the new jobs required (65%) will be in Asia, with another 100 million (21%) in Africa and about 50 million (10%) in Latin America. Less than 4% will be in the developed countries.

Figure 3: Net increase in labor force by region (millions), 2000-2010



Source: ILO(2001a)

Unemployment

The concept of unemployment is difficult to apply on a uniform basis around the world. According to the standard (ILO) definition, unemployment refers to individuals of working age who are not working (paid or unpaid; employee, employer, or self-employed) but are actively searching for work. While not a perfect measure, this concept is generally accepted as the best single indicator of involuntary inactivity and aggregate labor market slack in developed countries.⁴

In developing countries, on the other hand, the meaning of unemployment, as defined above, is less clear. For various reasons, unemployment rates in developing countries often

⁴ Even in these countries, however, a range of alternative indicators are calculated.

understate the true level of labor market slack and worker hardship.⁵ Many workers cannot afford to be unemployed because family incomes may be close to or below subsistence levels and because social protection instruments like unemployment insurance often do not exist or have very limited coverage. Under these conditions, workers must have very low reservation wages, with little choice but to search for alternate earning opportunities in informal activities, if needed. As well, while the probability of being unemployed tends to be negatively correlated with family income and education in developed countries, this is not always the case in developing countries where better-off and higher-educated workers often queue for good jobs.

Having noted these qualifications, Table 3 presents unemployment rates by region for the past decade. There is less variation than is the case with many other labor market indicators – in large part, for the reasons noted above. In the developed countries, the aggregate unemployment rate in 2000 was 6.2%, with Japan and the United States having much lower rates than Europe. Among high-income countries, unemployment generally rose in the early years of the 1990s, then declined later in the decade and, subsequently, have risen again in 2001 (not shown). This pattern corresponded to the timing of the recession and recovery in most countries. However, in a number of countries, the non-cyclical component – “structural” unemployment – appears to have declined since the beginning of the 1990s (OECD 1999b).

Table 3: Unemployment rates by region, 1990-2000

	1990	1995	2000
Developed countries	6.1	7.4	6.2
Europe	7.7	11.0	8.5
Japan	2.1	3.2	4.8
United States	5.6	5.6	4.1
Latin America & Caribbean	5.7	7.2	7.1 ¹
Asia & Pacific	4.0	4.1	4.5 ¹
Transition economies		8.5	11.9
Middle East & North Africa	7.1	10.9	n/a

1. Figure for 1999.
Source: ILO (2001b)

⁵ While this is the case especially with unemployment rates calculated on the basis of survey data, some countries measure unemployment according to registrations at state employment offices. Depending on incentives associated with registering, unemployment rates calculated on this basis may understate or overstate inactivity and labor market slack.

Developing countries do not always calculate unemployment rates, especially where informal and rural sectors are large. Data are especially incomplete in Africa and South Asia. In Latin America countries, rates are sometimes calculated for urban labor markets only. In some countries, as well, unemployment is measured by registrations at state employment offices and not according to standard ILO methods. Turning to the data that are available, Asia has the lowest official unemployment rates in the developing world -- lower, in fact, than almost all developed countries. However, Latin America, the transition countries, and the Middle East all have rates near or above 10%. As Table 3 indicates, unemployment increased throughout the 1990s in all developing regions.

Earnings and inequality

It is difficult to paint an accurate and complete international picture of earnings. There are data gaps in many developing countries, especially for workers employed outside manufacturing. Naturally, there is virtually nothing where these activities are carried out in the informal sector. Table 4 presents three labor compensation series for a selection of countries.⁶ These series, compiled from World Bank and ILO sources, are fairly complete for manufacturing but, as is clear from the first column, wage data for agriculture are available for only a few countries. It is also not advisable to compare across earnings indicators (e.g., agricultural wages vs. labor costs in manufacturing) since these series have been obtained from different sources using different methodologies.

That most international profiles of wages and labor compensation are limited to manufacturing is problematic: this sector covers only a minority of employees in most countries and its wages are often unrepresentative of the overall labor market. Even where data are available, there are methodological issues associated with comparing earnings across countries and over time. Different approaches to handling exchange rates and inflation rates can lead to different figures.

The second column of Table 4 shows average labor compensation (wages/salaries, other benefits, and employer contributions to social security programs) in manufacturing. The strength of this indicator is that it measures all payroll costs to the employer. However,

⁶ The selection of countries has been based on data availability and on ensuring all regions and major countries in each region are covered.

Table 4: Selected wage indicators for selected countries, 1990s

	Annual agricultural wage (\$US) 1990-94 ¹	Annual labor cost per worker (\$US) in manufacturing 1990-94 ¹	Real manufacturing wage index (1990=100)
<i>Sub-Saharan Africa</i>			
Botswana	1,223	2,884	76 (1997)
Kenya	568	94	50 (1997)
South Africa	N/A	8,475	102 (1993)
Zambia	N/A	4,292	104 (1994)
Zimbabwe	N/A	3,422	71 (1996)
<i>East Asia</i>			
China	325	729 ²	130 (1996)
Indonesia	N/A	1,008	131 (1996)
Malaysia	N/A	3,429	125 (1995)
Thailand	N/A	2,705	125 (1997)
<i>Eastern Europe & Central Asia</i>			
Belarus	410 ²	754 ²	72 (1997)
Hungary	1,776	2,777	96 (1997)
Kyrgyz Rep.	168 ²	687 ²	44 (1997)
Poland	1,301	1,714	135 (1997)
Russia	659 ²	1,528 ²	60 (1997)
<i>Latin America & Caribbean</i>			
Argentina	N/A	7,338	100 (1997)
Bolivia	N/A	2,343	112 (1996)
Brazil	N/A	14,134	110 (1996)
Chile	N/A	5,822	67 (1997)
Colombia	N/A	2,507	109 (1997)
Jamaica	N/A	3,655	74 (1992)
Mexico	908	7,607 ²	99 (1997)
<i>Middle East & North Africa</i>			
Egypt	N/A	1,863	87 (1995)
Jordan	N/A	2,082 ²	93 (1995)
Syria	N/A	4,338	110 (1995)
Tunisia	968	3,599	N/A
<i>South Asia</i>			
Bangladesh	360	671	N/A
India	245	1,192	75 (1995)
Sri Lanka	264	604	98 (1997)
<i>High-income</i>			
Germany	N/A	33,226	111 (1997)
Japan	N/A	31,687	114 (1996)
United Kingdom	N/A	23,843	113 (1997)
United States	N/A	28,907	99 (1997)

1. Includes wages/salaries, other remuneration paid to employees, and employer contributions to social security programs on behalf of workers. Conversion into \$US using average exchange rate for the year.

2. Figures for 1995-99.

Sources: World Development Indicators, 2001; ILO, *Key Indicators of the Labor Market 1999*; World Bank (2000a).

since some of its components may not offer direct benefits to workers (e.g., some social security benefits, insurance program contributions), comparisons based on labor compensation are not necessarily the best way to capture earnings. The third column of the table shows the trend in real wages in manufacturing during the 1990s. The consumer price index has been used as the standard deflator.

The situation in the developing regions varies considerably, both in terms of wage levels and trends over time. In terms of the latter, the East Asian countries all had substantial increases in real wages over the period covered (25-31%). The other regions had less favorable records and, in the case of the two poorest regions – Sub-Saharan Africa and South Asia, negative trends clearly outnumbered positive ones.⁷ Latin America and the Caribbean experienced diverse trends, with Bolivia, Brazil, and Colombia showing growth of 9-12%; Argentina and Mexico reporting no change; and Chile and Jamaica having serious falls in real wages. With the exception of Poland, trends have been negative in the transition countries and, in some cases, real wage declines have been very large. Note, as well, that the ILO series on which this table is based ends before the financial crises in East Asia, Russia, and Latin America. Generally, real wages fell – often substantially -- during these periods.⁸

The distribution of earnings within countries is an important feature of labor markets. In all countries, wage differentials exist by gender, ethnicity, age, and other variables. These reflect both market forces and discrimination. Unfortunately, lack of data make it difficult to provide a comprehensive picture of these differentials. Even in the aggregate, earnings dispersion data are not available in most developing countries. As a result, evidence on income distributions provides the best insight into the question of wage inequality. Fortunately, labor market earnings represent the primary source of income in all countries. There are many different measures of income distribution – each with relative strengths and weaknesses in terms of the aspects of inequality it captures. But all measures essentially tell the same story: inequality varies dramatically across countries; developing countries tend to

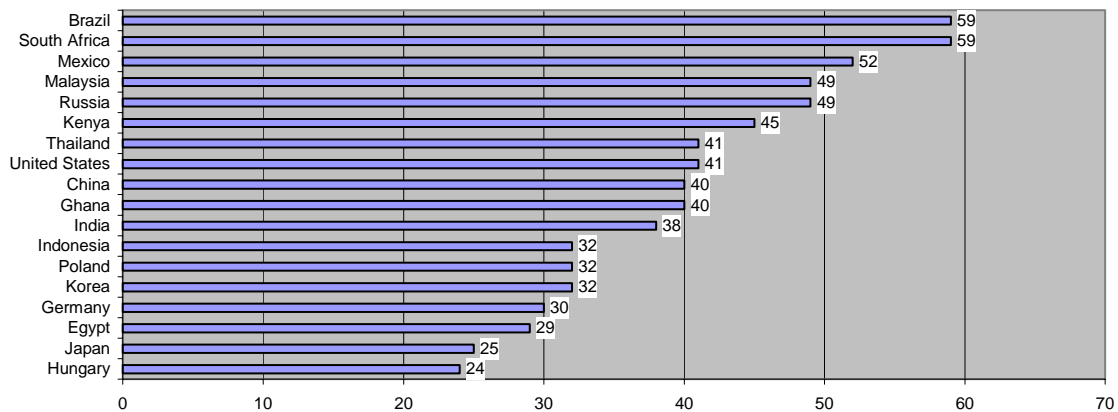
⁷ The other South Asia country, Pakistan, had a real wage index of 75 in 1994 (latest date available).

⁸ Taking the East Asia example, declines in real wages during the first year of the crisis ranged from 1% in Malaysia to 41% in Indonesia (Betcherman and Islam 2001).

have (much) higher levels of inequality than developed countries; and, while the time trends are far from uniform, inequality appears to be increasing in many developing countries.

Figure 4 presents inequality levels in the mid-to-late 1990s for a selection of countries at different stages of development. The measure used here is the Gini coefficient.⁹ The highest levels of inequality are in Brazil and South Africa, followed by Mexico. At the regional level, Latin America has the most inequality. Developed countries have relatively low Gini coefficients although, as Figure 4 shows, the United States is in the middle of the distribution. Even though some developing countries have very high inequality levels, others do have relatively low levels (e.g., Egypt, Korea, Indonesia, transition countries in Figure 4).

Figure 4: Income inequality (Gini coefficient), selected countries, mid-to-late 1990s



Source: World Development Indicators, 2001

The UNDP compared income distributions in 36 countries for the 1980s and 1990s. The measure used was the ratio of the income share held by the top quintile (i.e., highest 20% of all earners) to the share held by the bottom quintile. To appreciate the range, this ratio was 3.4 in Japan in the 1990s; in Brazil it was 25.5 (as cited in ILO 2001a). The UNDP's analysis over time found that the income distribution became more unequal in only one out of the eighteen developed countries in the sample. Developing countries were roughly split in terms of the direction of the trend.

⁹ This coefficient varies from 0 to 1. At the lower bound, the national income would be equally shared by everyone – i.e., there would be no inequality. At the upper bound, all of the aggregate income would be held by one person, with everyone else having zero income – i.e., complete inequality.

III. FOUR KEY TRENDS AFFECTING LABOR MARKETS

In this section, we review four trends that are shaping labor markets around the world: the changing economic structure; globalization; technological change; and the expanding informal sector. These trends are all closely linked. Together, they are affecting the structure and content of employment, the possibilities for employment and earnings growth, and the nature of the employment relationship between capital and labor. They are also shaping the priorities of public-policy makers.

Changing economic structure

With development, the structure of economic output involves a progressive shift from agriculture to industry and, subsequently, to services. Urbanization is an accompanying process. Technological change and national comparative advantages in a liberalized global regime are closely linked with how countries can most efficiently allocate resources across different types of economic activities. This largely explains the observed patterns in sectoral output. The resulting structural changes in economies have important implications for labor demand, skill requirements, and other aspects of the employment.

GDP data shows how the structural composition of output differs dramatically, depending on a country's level of development (Table 5). Moreover, it also shows that, for each income grouping, agriculture's share of GDP declined during the 1990s (except for high-income) while the share accounted for by services increased.

Table 5: Composition of GDP by economic sector by country income grouping, 1990-99

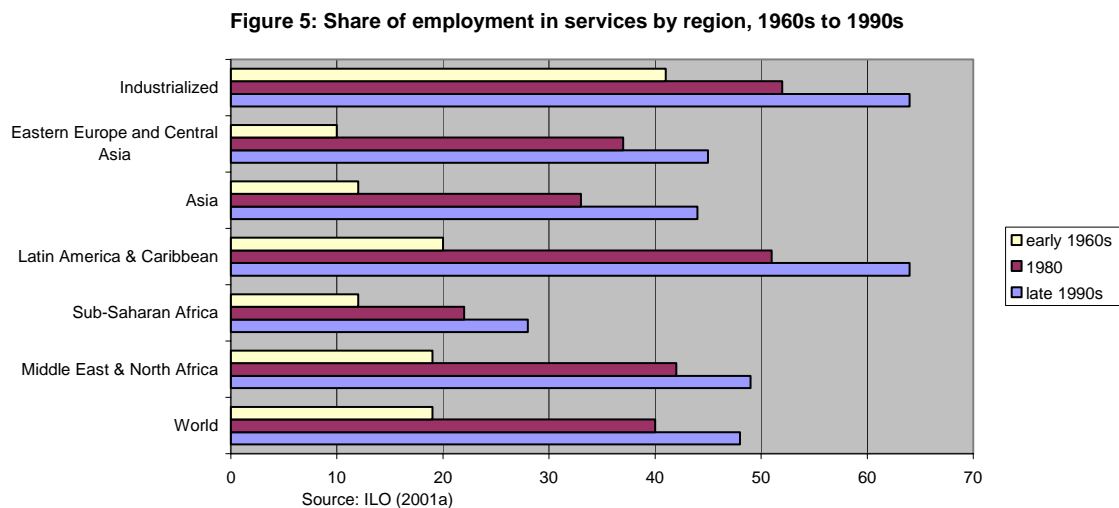
	Agriculture		Industry		Services	
	1990	1999	1990	1999	1990	1999
	% share of GDP					
Low income	29	26	31	30	40	44
Lower-middle	21	14	39	39	40	46
Upper-middle	8	6	40	33	52	60
High income	3	3	33	30	64	67
All countries	6	5	34	31	59	63

Source: World Development Indicators, 2001 and calculations by the author

These patterns are reflected clearly in the labor market. While there can be considerable variation at a national level because of natural endowments and policy, a general pattern emerges from the data (World Bank 1995). On average, agriculture's share of

total employment ranges from about 90% in the poorest countries to less than 5% in the richest. Industry's share (manufacturing, construction, mining) varies from about 5% to about 35%; here, however, the richest countries often have lower shares in industry than middle-income countries. This is primarily because the service sector now dominates employment in these countries, accounting for over 70% in the U.S., Canada, France, and a number of northern European countries.

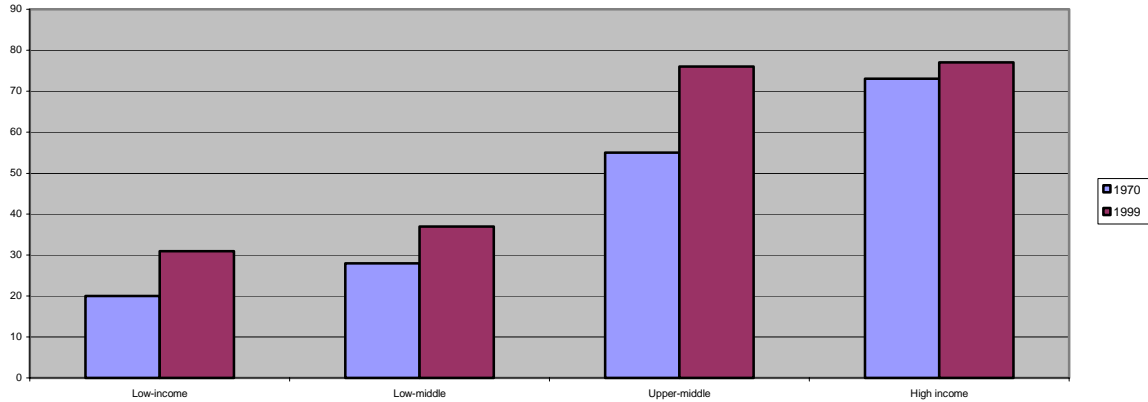
Figure 5 shows trends in the share of total employment in services by region between the 1960s and the 1990s. It confirms two observations made above. First, the relative proportion of jobs in services has increased over this period in all regions. Globally, it has risen from just below 20% in the 1960s to almost 50% in the late 1990s. Second, the magnitude of service sector employment shares largely reflect aggregate income levels; however, note that Latin America and the Caribbean and the Middle East and North Africa also have high shares, primarily reflecting the large public sectors in these regions.



As noted, urbanization accompanies these industrial shifts. The proportion of total population living in cities is highest in the high-income countries and declines as we move down the country income distribution (Figure 6). However, note the large jump in urbanization in upper-middle income countries (21 percentage points in three decades). This has been an important trend in all developing regions, except Eastern Europe and Central Asia. The pressure on urban labor markets in many developing countries is building rapidly,

with huge inflows of young workers looking for employment. Box 1 highlights the enormous recent growth in large cities in developing countries and the expected acceleration of this trend over the upcoming two decades.

Figure 6: Urban share of total population by country income group



Source: World Development Indicators, 2001

Box 1: Exploding urban labor markets in developing countries

A century ago, just 10% of the world’s 1.6 billion inhabitants lived in cities. Now 50% of the 6 billion people on the planet do. By the middle of this century, two-thirds of a total population of 10 billion will be in cities. This urban growth is concentrated in developing countries. Seven of the world’s 10 largest cities are now in developing countries and by 2020, nine will be. More than half of the urban inhabitants of Asia, Africa, and Latin America live in poverty.

The 10 largest urban areas

1980		2000		2020	
	mill.		mill.		mill.
Tokyo	21.9	Tokyo	26.4	Bombay	28.5
New York	15.6	Bombay	18.6	Tokyo	27.3
Mexico City	13.9	Mexico City	18.3	Lagos	26.5
Sao Paulo	12.5	Sao Paulo	18.0	Dhaka	24.0
Shanghai	11.7	New York	16.7	Karachi	21.7
Osaka	10.0	Lagos	14.1	Sao Paulo	21.3
Buenos Aires	9.9	Calcutta	13.2	Mexico City	19.6
Los Angeles	9.5	Los Angeles	13.2	Jakarta	19.4
Calcutta	9.0	Shanghai	13.0	Calcutta	18.8
Beijing	9.0	Buenos Aires	12.7	New Delhi	18.5

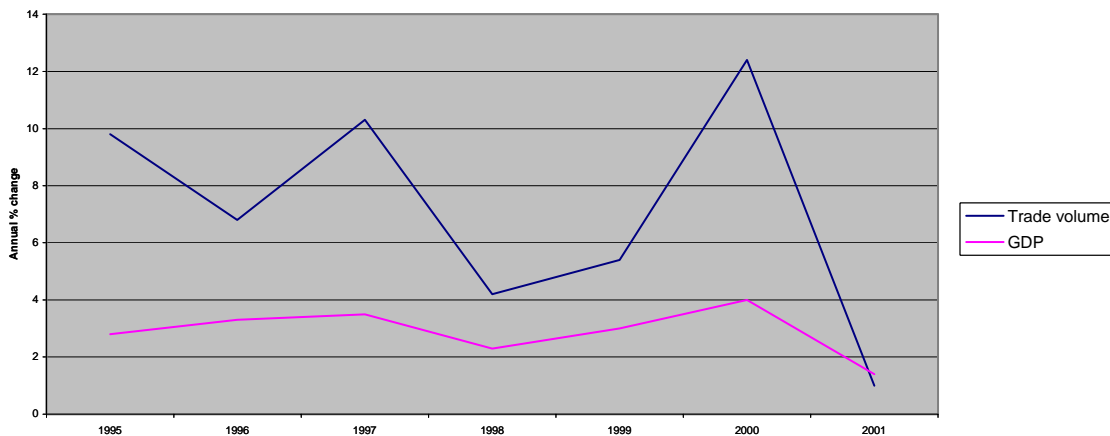
Source: The Population Institute; Population Reference Bureau.

Globalization

Globalization has been a much discussed and debated phenomenon over the past decade. While the term is used in many different ways, the most widely agreed definition at least among economists is that it refers to the growing economic interdependence of countries primarily through increasing flows of goods and services, international capital, and technology. Increased global integration has important implications for labor markets and employment policy.

Evidence documenting globalization is typically based on increasing flows of international trade and foreign direct investment.

Figure 7: Real annual growth rates of GDP and trade in goods and services



Source: IMF World Economic Outlook Tables, Dec. 2001

- As Figure 7 indicates, trade volumes during the past decade have generally outstripped aggregate economic growth, often by substantial amounts. Between 1990 and 1999, exports of goods and services as a share of world-wide GDP increased from 19% to 27%. Growth in trade volumes has generally been higher in low- and middle-income countries. However, flows between developed economies still account for most international trade. While the overall picture from Figure 7 is one of increasing trade, the volatility of flows evident from the figure reinforces the fact that ongoing liberalization is not a smooth (or even guaranteed) trend.
- Gross foreign direct investment as a share of world-wide GDP increased from 1.9% in 1989 to 4.6% in 1999. The increase in gross private capital flows over this period

was from 8.5% to 18.3%. Again these flows are dominated by developed countries. Foreign investment into developing countries also suffered a setback with the financial crisis but started to grow again in 1999 and 2000.

Globalization provides opportunities for economic growth and, thus, the potential for employment and rising incomes. In a recent study, the World Bank (2002b) found that developing countries that had been “globalizers” since 1980 had experienced per capita growth rates in the 1990s of 5% annually compared to –1% for the others.¹⁰ However, globalization also raises concerns about downside labor market risks in the form of unemployment, downward wage pressures, and a “race to the bottom” in working conditions and public policy. Despite all of the popular attention globalization has received, there is a need for more rigorous analysis of these sorts of impacts. One reason for the lack of conclusive evidence is that it is difficult to sort out the effects of globalization from other developments. We will see this again when we turn to technological change, which is often closely linked with globalization forces. Key issues to understand include the relationship between globalization and wages, skill requirements, employment, labor migration, and working conditions.

Globalization is associated with higher wages. The growth of wages between 1980-2000 in countries classified by the World Bank (2002b) as “globalizers” has been twice the wage growth observed in less globalized developing countries and substantially higher than in rich countries, as well. The distribution of wages also has been affected. As trade and investment liberalization has occurred, there has been a trend towards increasing returns to education, with the wage differential between skilled and unskilled workers widening. Much of this analysis has been undertaken in high-income countries (OECD 1997). While there has been much less analysis of this elsewhere, earnings differentials between skilled and unskilled workers have widened in a number of developing countries (World Bank 2002b; Patrinos 2001). The fact that these changes occurred while the supply of skilled workers was growing in most countries (developed and developing) suggests that the demand for skilled

¹⁰ This classification was based on the extent to which countries increased trade relative to income over the period. The top third were placed in the “globalizer” group, with the remaining two-thirds in the “less globalized” group.

labor has been increasing even faster. It is not clear, though, that globalization is primarily responsible for the shifting relative fortunes of skilled and unskilled workers. This trend – especially in the case of developing countries -- runs counter to what would be expected on the basis of international trade theory.¹¹ Moreover, the general view based on empirical studies is that international trade has accounted for about 10-20% of the increasing wage inequality (generally on the basis of U.S. studies). As we will discuss in the next sub-section, most economists attribute greater significance to the role of technological change.

There is no consensus, and little definitive research, on the impacts of globalization on aggregate employment and unemployment levels. There does appear to be a positive relationship between economic openness and variability of output and employment growth rates. As a consequence, it seems likely that globalization can increase both labor and job turnover.¹² To the extent that liberalization affects formerly protected sectors, then significant job destruction can occur. Policies to assist affected workers are a priority. On the other hand, by stimulating improvements in productivity and output, liberalization of trade and investment (including in export processing zones) can play an important role in job creation as well. The ability of countries to take advantage of these opportunities depends on many things including (among other factors) labor force skills.

While discussions of globalization tend to focus on flows of goods, services, and capital, the movement of workers is also part of the phenomenon. International migration, of course, is not new. In fact, the number of migrant workers as a percentage of total population is no higher than it was in some earlier decades. In absolute terms, however, it has increased – there are now about 120 million people living in a country in which they were not born, compared to 65 million in 1965. In theory, the liberalization of trade and investment – and the expected equalization of factor prices -- should reduce incentives to migrate. However, as Stalker (2000) argues, globalization also appears to create incentives in the other direction. The increased variability and attendant restructuring creates more displaced workers who are then motivated to look for work elsewhere. Also, reduced transportation and communication

¹¹ Increased international trade should lead to more intensive use of – and thus rising prices for -- the abundant factor which is unskilled labor in the case of developing countries.

¹² Labor turnover refers to the all hirings and separations. Job turnover relates to the creation and destruction of jobs through firm births/expansion and firm deaths/contraction.

costs both increase the likelihood of relocating and returning, as well as making it more feasible to emigrate without losing contact with one's home country. And, at an empirical level, it is not clear that price equalization across countries is actually occurring, as the theory predicts. (Recall Table 4 which suggests that real wages in manufacturing have been diverging.)

The current international migration of workers includes both unskilled and highly-skilled labor. In the former case, migration may contribute to poverty reduction and economic growth but there are also a host of policy issues including illegal trafficking, undocumented entry, "sweatshop" working conditions, and the social protection of these workers. The movement of skilled labor has been most visible recently with respect to efforts by developed countries to address shortages of high-tech workers by tapping into foreign supplies – often from developing or transition countries. This raises concerns about "brain drain" in the sending countries.

A more qualitative aspect of globalization relates to its effect on working conditions. This has attracted a great deal of attention in recent years with concerns that increased world-wide competition is leading to a "race to the bottom" in terms of a deterioration of working conditions in developing countries. These concerns are driven by the argument that rich-country multinational enterprises and domestic suppliers in developing countries are responding to competitive pressures by encouraging exploitative human resource practices that cut costs at the expense of decent working conditions. The use of child labor, unsafe workplaces, managerial harassment, and the abuse of basic worker rights are examples of practices cited. This also involves the concern that domestic governments are willing to accept such abuses in their pursuit of needed foreign investment. It is true that many developing countries are actively promoting export processing zones and other arrangements where foreign investors can benefit from special incentives, including relief in some cases from certain labor regulations. Counter to these concerns is empirical evidence that, on average, multinational enterprises have higher wages and better benefits than domestic firms. More needs to be known about the magnitude of the problem and the precise role that globalization is playing.

Technological change

Dramatic technological innovations, especially with respect to information and communication technologies (ICT), have occurred in the past two decades. These changes have included both “process innovations” – i.e., that alter how goods and services are produced – and “product innovations” – i.e., new products and services. The development and application of microelectronics has taken on the significance of an “all-purpose technology” which, in effect, has become a platform for technical innovation across the industrial spectrum. It is at the heart of current thinking about the “knowledge economy.” It is also seen in the industrialized countries as the key to spurring output and productivity growth (OECD 1996). Technological innovation also holds great promise for developing countries – first, by offering these countries the possibility of becoming important locations for emerging ICT and related products and services; second, by providing the possibility of “leapfrogging” earlier stages of development (convergence); and third, by creating opportunities to alleviate poverty through, for example, improved aggregate growth, access to information, and collective voice (ILO 2001a).

Consideration of technological change, and particularly the latest wave based on ICT, must incorporate a broad definition to include the important organizational changes that have accompanied purely technical innovation. As ICT has penetrated more deeply into economies and enterprises, the structure, strategies, and human resource practices of firms have changed as well. This includes increased contracting out, growth of small enterprises and self-employment (in some countries), and more emphasis on “numerical” and “functional” flexibility in labor deployment (OECD 1996). Indeed, research is showing that these organizational factors play a key role in shaping the impacts of ICT on employment levels, skills, and productivity.

Economists and others may debate whether the advances in ICT constitute a “post-industrial” revolution, whether they are spurring a “new economy,” and whether they are creating a new development paradigm. But, there seems to be consensus that these and related technological changes are having – and will continue to have -- major impacts on labor markets around the world. This includes (but is not restricted to) where employment is located, in what industries and occupations, the nature of the employment relationship, skill

requirements, wages and their distribution, the organization of work, and human resource and industrial relations practices. ICT offers considerable upside benefits to workers and labor markets but substantial risks as well.

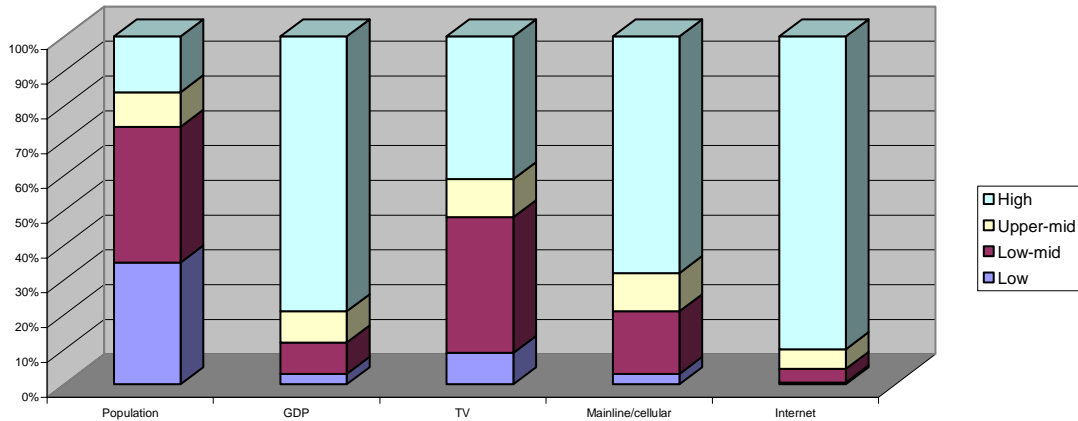
From its earliest days in the 1960s when large-scale mainframes were introduced in a handful of major western corporations, microelectronic technology is now pervasive. In the 1980s and early 1990s, researchers often documented the diffusion of the technology by “counting computers.” Now, because key aspects of the most recent developments in ICT involve network applications, diffusion statistics tend to focus on internet usage and the relevant infrastructure in place, as well as the incidence of computers. Not unexpectedly, the data indicate that growth in ICT has been tremendous. In mid-2000, for example, traffic on the Internet was doubling every 100 days (ILO 2001a).

However, adoption of ICT and access to these technologies is very uneven. The gap between rich and poor countries is often called the “digital divide” (World Bank 2000b). This divide also exists within countries with some groups (generally already advantaged) enjoying much greater access and benefits than others. Moreover, empirical analysis indicates that this divide may well be widening (ILO 2001a). While ICT may have potential to stimulate development and reduce poverty in low-income nations, current diffusion patterns suggest that its effect has been to widen gaps both between and within countries.

Figures 8 and 9 illustrate the uneven global diffusion of ICT. Figure 8 shows how the world-wide distribution of communication technologies varies by country income group, using population and GDP as frames of reference. The critical telephone infrastructure is heavily concentrated in high-income countries; their share (68%) is four times greater than would be expected on the basis of population (16% share). Only 3% of the telephone infrastructure is in low-income countries and 18% in low-middle income countries, while their shares of world population are 35% and 39%, respectively. Tokyo and Manhattan each have more phone lines than all of Africa (World Bank 2000b). Internet access is even more tilted towards high-income countries (in part because of the telephone infrastructure), with about 90% of all Internet hosts. Developing countries provide only a tiny share of Internet

content; Africa creates less than one-half of one percent and, excluding South Africa, this figure is only one-fiftieth of one percent (World Bank 2000b).¹³

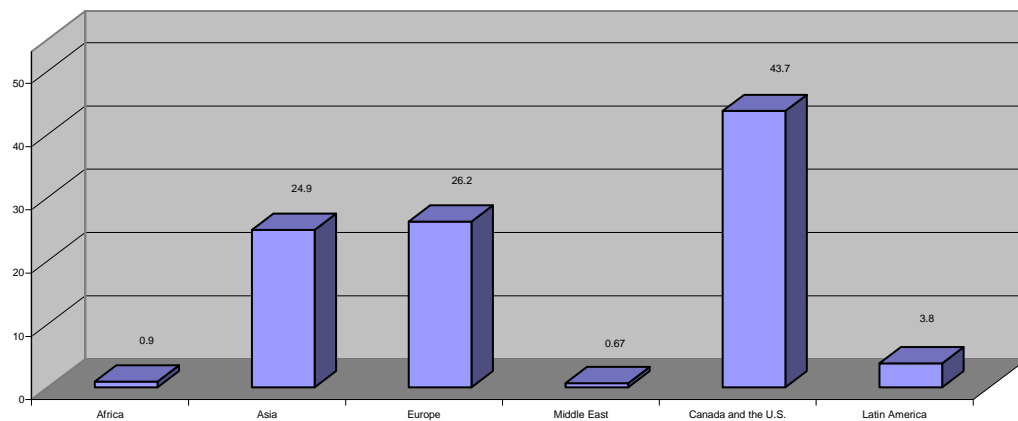
Figure 8: Distribution of ICT world-wide by country income group



Source: World Bank (2000b)

Figure 9 illustrates how Internet usage varies by region. As of mid-2000, North America had by far the highest rate, followed by Europe and Asia and the Pacific (including Japan). Note the very low usage figures for Latin America, Africa, and the Middle East.

Figure 9: Internet users by region as percent of total population, July 2000



Source: ILO (2001a)

While the gap between developed and developing countries is the most dramatic aspect of the digital divide, there are also major differences within countries in terms of ICT

¹³ Personal computers are also far more prevalent in high income countries. The number of PCs per 100 people in mid-1999 was 22.3 for high-income countries, 2.9 for upper-middle, 1.3 for lower-middle, and 0.2 for low-income countries (ILO 2001a).

access and usage (at home or on the job). These are significantly correlated with income and education. They are also higher for men and urban residents. These findings are best documented in industrialized countries but they appear to be valid in developing economies as well (World Bank 2000b; ILO 2001a).

Much of the (popular) debate about technological change has focused on its implications for aggregate employment. On the one hand, a longstanding view has argued that the primary labor market effect of new technologies is to eliminate jobs, replacing people with machines. The potential of these disemployment effects with ICT has been seen as very large by some observers (e.g., Rifkin 1994) since these technologies can affect not only physical but also cognitive activities.¹⁴ On the other hand, by creating new products and services and by making production more efficient (and thereby reducing prices and increasing consumer demand), technological change has been seen (especially by economists) as necessary for long-run employment growth (e.g., OECD 1996).

The ultimate employment effect depends on the relative weight of these two forces of technological change. It has been very difficult to measure this effect because of difficulties associated with measuring technological change and with isolating it from other factors (e.g., trade, market competition). Almost all of the empirical work has been undertaken in industrialized countries. The general findings, drawn from the OECD (1996) analysis, include:

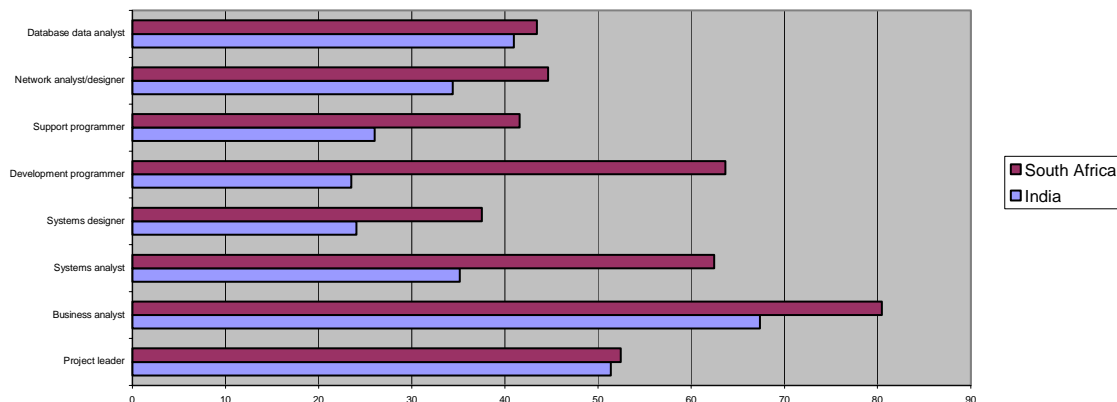
- In manufacturing, employment growth has been correlated with level of technology. Jobs have increased in high-technology science-based industries, stagnated in medium-technology sectors, and declined in low-technology manufacturing. At the level of the individual firm in manufacturing, the evidence is mixed – Canadian and U.S. studies have found that technologically-advanced firms had higher rates of employment growth while some evidence for Italy has drawn the opposite conclusion.
- Less research has been done on the employment impacts of technology in services. However, research by the OECD (1996) suggests that, at least during the 1980s, employment gains in services were larger in countries that had the greatest investments in ICT.

¹⁴ ILO (2001a) breaks displacement down into obsolescence, automation, and disintermediation.

While the evidence (at least from industrialized countries) offers more support for the net employment gains, ICT – like all technological change -- clearly alters the composition of employment through the processes of job creation and destruction. We have already seen how the industrial distribution of employment has been changing, at least in part because of technological change. Related to this, white-collar occupations have increased their share of total employment in both industrial and developing countries.

The OECD evidence cited above demonstrates how industrialized countries are increasingly involved in high-technology industries while shedding lower-technology ones. However, as the ILO (2001a) points out, developing countries – with their lower cost structure -- can accelerate up the value chain. Figure 10 shows how two developing countries (India and South Africa) with promising IT sectors can offer labor cost advantages compared to the U.S. in various ways. However, exploiting comparative advantages such as this requires a strong local skill base and infrastructure, and an appropriate regulatory framework.

Figure 10: Labor costs (\$US) for software personnel, India and South Africa, 1999 (US=100)



Source: ILO (2001a)

The employment debates surrounding ICT also have considered its impacts on skills. Here, too, there are two dominant strains – that technological progress requires increasingly sophisticated workers and, thus, is “upskilling” and, alternatively, that technological change may create some very highly-skilled personnel but that, for the most part, it routinizes work and, on balance, is “deskilling.” Sorting out this debate has been very complicated and some researchers have emphasized that workplace organization is often the deciding factor. For example, Autor, Levy, and Murnane (2000) show how the same technological change

introduced into two departments of a commercial bank had a labor substitution effect in one case and an upskilling effect in the other.

On balance, however, complementarity appears to exist between ICT and skills in the sense that the adoption of these technologies is associated with the employment of more skilled workers. This likely reflects a number of factors: the new technologies require highly skilled workers; firms upgrade their workers to complement the technology they adopt; and highly-skilled workers are more likely to be chosen by employers to use ICT. This notion of “skill-biased technological change” – i.e., that the technologies shift labor demand to higher-skilled workers – is widely accepted as a key factor in the increasing returns to education that have been observed in many developed and developing countries.¹⁵

The implications for public policy are clear in reinforcing the importance of human resource development, from basic education to lifelong learning. These investments are increasingly the most effective personal strategy for individuals and the best collective strategy for nations. Data on two key indicators, school enrollment and literacy, offer a mixed picture for developing countries – optimism because there is clear evidence of improvement but pessimism because they remain far behind developed nations.

Table 6 presents gross enrollment rates by region for 1980 and 1997.¹⁶ Looking first at the primary level, it is clear that all regions (except Sub-Saharan Africa) now have nearly universal enrollment. Significant gains have been made regarding secondary enrollment but each of the developing regions remains far behind the high-income countries. Finally, there are huge gaps in tertiary enrollment.

¹⁵ While much of the direct evidence on skill-biased technological change is based on industrialized countries, there is some corroborating evidence at least for middle-income developing countries (Tan 2000; Berman 2000).

¹⁶ Gross enrollment rates are calculated as the ratio of total enrollment (regardless of age) to the population of the age group that officially corresponds to the level of education. Overage students in primary education account for ratios that exceed 100. While these data are the principal source of information on participation in education, there are problems with them. The duration of primary education is not uniform across countries. Also the reliability of enrollment figures has been questioned.

Table 6: Gross enrollment rates by region, 1980-97

	Primary as % of relevant age group		Secondary as % of relevant age group		Tertiary as % of relevant age group	
	1980	1997	1980	1997	1980	1997
East Asia & Pacific	111	119	44	69	4	8
E. Europe and Central Asia	99	100	86		31	32
Latin America and Caribbean	105	113	42	60	14	17
Middle East and N. Africa	87	95	42	64	11	16
South Asia	77	100	27	49	5	7
Sub-Saharan Africa	81	78	15	27	1	
High income	102	103	87	106	36	62

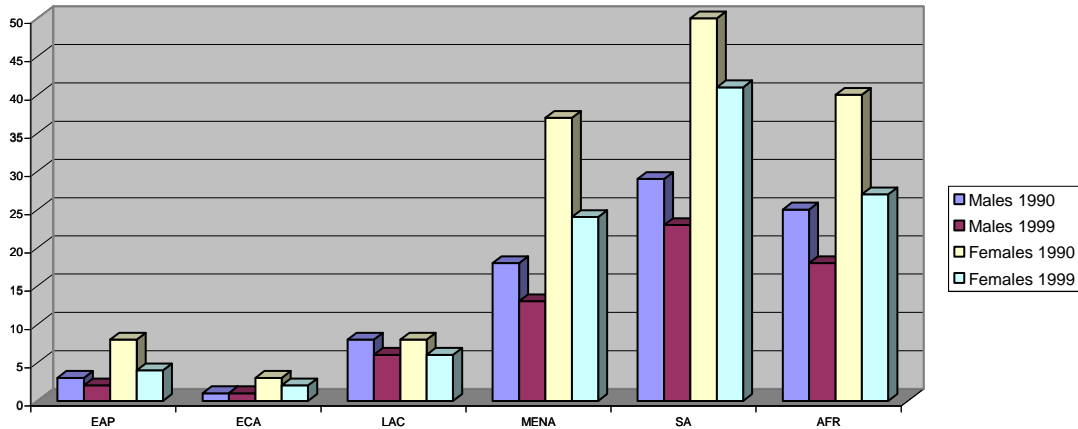
Source: World Development Indicators, 2001

Education participation rates offer little direct information about outcomes and, as a consequence, policy-makers are paying increasing attention to measures such as literacy. The International Adult Literacy Survey has provided new insights into the role of literacy skills (prose, document, quantitative) and how well different countries perform. The most recent survey gathered data between 1994 and 1998 in 20 countries; the sample is heavily weighted to high-income countries but does include four transition countries (Czech Republic, Hungary, Poland, and Slovenia) and Chile. Two key findings (for our purposes) emerge from the survey. First, the results demonstrate how important literacy skills are for reducing unemployment and for finding skilled work. Second, although the sample is small for developing/transition countries, all but the Czech Republic were at the bottom of the distribution in terms of aggregate literacy scores (OECD and Government of Canada 2000).

The links between literacy and employment performance have not been explored as fully in developing countries. However, all of the evidence suggests that a labor force with a solid basic skills foundation will be essential for these countries to exploit the opportunities of technological change. Future prospects are bound to be difficult for individual workers who are not literate. Figure 11 summarizes trends in illiteracy for the six developing regions.¹⁷ It presents youth rates (15-24 years of age) because these offer insight into how well labor forces will be prepared for the future. The trends reflect the gains in primary

¹⁷ The illiteracy rate is the percentage of people who cannot, with understanding, read and write a short, simple statement about their everyday life.

Figure 11: Illiteracy rates for males and females, 15-24 years of age, by region, 1990-99



Source: World Development Indicators, 2001

education documented in Table 6. All regions have shown improvements over the 1990s, with some impressive gains occurring for young women, in particular. Illiteracy remains a major problem, however, in the Middle East, Africa, and South Asia. Clearly, this poses formidable challenges for basic education in order to ensure that subsequent generations have better prospects in a world increasingly shaped by information and communication technology.

Expanding informal sector¹⁸

The informal sector has become a pervasive phenomena in the developing world. This trend is complicated, challenges many traditional notions of development and social protection, and is difficult in many ways to fully capture: What is the actual size of informal sectors? What factors are behind its apparent growth? What are the social and economic contributions of the informal sector and what are the problems? How should governments respond to informal labor markets?

The traditional development perspective has been a dual-labor market view of the informal sector as the disadvantaged low-paying and unprotected sector where workers go if they are unable to find work in the superior, formal sector. This undoubtedly applies to some extent; as we will see below, informal employment and poverty are strongly correlated.

¹⁸ Amit Dar, Dhushyanth Raju, and Sudharshan Canagarajah contributed to this sub-section on informal labor markets.

However, the traditional view overstates the dualism: there are many gray areas between a purely informal and purely formal employment arrangement and linkages between the two sectors. It also does not adequately recognize the fact that informal-sector activities contribute significantly to employment, incomes, and economic development and growth. In many economies, the character of the informal sector as a dynamic and growing sector is sharply accentuated when juxtaposed against a stagnant and shrinking formal sector. The informal sector also acts as a “shock absorber” by providing employment to a large number of displaced formal sector workers during times of crisis.

Policy-makers and economists initially assumed that the informal sector in developing countries would diminish over time as countries became industrialized. However, this has not happened. Some alternative hypotheses that have been put forward to explain this include: (a) The “no-growth” hypothesis – the modern industrial/formal sector has not grown fast enough to absorb the growing labor force and hence the informal sector has continued to expand. (b) The “jobless growth” hypothesis – the technology used in the formal sector has not been conducive to the absorption of labor in the formal sector. (c) The “growth from below” hypothesis – small and micro-enterprises themselves represent a vibrant sector and some entrepreneurs may choose to operate in this sector. (d) The “regulatory disincentive” hypothesis – employers and, in some cases, workers choose the informal sector because it is too costly to operate in the formal sector.

The concept of the “informal labor market” relates to the notion of non-participation in tax systems, in social security systems, and meeting regulatory requirements. This non-participation can be the result of legitimate exclusion (e.g., by size of firm) or from non-compliance. The informal sector is typically seen to include three types of people: microentrepreneurs, self-employed, and employees operating in informal-sector firms or in informal employment arrangements within registered firms.

Measuring informal employment is difficult, due to different definitions and data limitations. As a consequence, it is often not possible to get a good handle on the size and the growth of the informal sector. Many establishment surveys also often overlook small informal sector operators leading to a downward bias in the measurement of the sector. Furthermore, more reliable indicators are often available only on the urban informal sector –

the rural informal sector is more difficult to capture. Data on the size of the urban informal sector is presented for several countries in Table 7. It should be noted that due to different definitions used, cross-country comparisons should be drawn with caution. In most of these countries, the informal sector constitutes a significant proportion of total urban employment. Furthermore, consistent with the disadvantaged position of women in the labor market, the proportion of females employed in this sector is frequently higher than the proportion of males.

The informal sector is a primary source of employment for those workers who are relatively disadvantaged in the labor market (e.g. unskilled and low-skilled, women, disabled). For example, data from some Latin American countries show that the mean education level for males in the formal sector was 25-50% higher than the mean education level for those in the informal sector (the difference for females is even greater).

Informal sector enterprises tend to be small operations. For example, surveys in Bangladesh and Pakistan show that the average firm size is about 1.6 and 3.3 persons, respectively. Similarly, in Thailand, Indonesia and the Philippines, informal sector operations traditionally employ less than four workers. The scope of informal sector activities in urban areas remains heterogeneous, including trade, manufacturing, services, construction, and transportation. The majority of informal sector workers in rural areas are still engaged in agricultural activities.

Table 7: Share of urban employment in the informal sector, selected countries, 1990s

Country	Year of most recent data	Urban Informal Sector % of urban employment		
		Total	Male	Female
<i>Sub-Saharan Africa</i>				
Cote d' Ivoire	1996	52.7	37.3	73.3
Ghana	1997	78.5	Na	Na
Uganda	1993	83.7	67.6	80.5
Tanzania	1995	67.0	59.7	85.3
<i>Asia</i>				
India	1993	44.2	Na	Na
Pakistan	1992	67.1	65.9	80.6
Indonesia	1995	20.6	19.1	22.7
Thailand	1994	47.6	46.1	49.4

**Table 7: Share of urban employment in the informal sector, selected countries, 1990s
(contd.)**

Country	Year of most recent data	Urban Informal Sector % of urban employment		
		Total	Male	Female
<i>Latin America and Caribbean</i>				
Argentina	1995	45.7	Na	Na
Brazil	1995	48.2	Na	Na
Ecuador	1997	40.0	39.0	41.6
Jamaica	1996	23.5	26.2	20.0
Peru	1997	51.9	47.7	57.5
<i>Eastern Europe and Central Asia</i>				
Kazakhstan	1996	17.3	Na	Na
Lithuania	1997	8.5	11.9	4.8
Poland	1995	12.8	14.3	11.0

1. Definitions vary according to country. See source for details.

Source: Blunch, Canagarajah, and Raju (2001).

Data show that informality and poverty are highly correlated. Evidence from India shows that 43% of those in the informal sector are poor as compared to 6% in the formal sector. In Bangladesh, 48% of informal enterprises workers operated below the poverty line. Similarly, in most Latin American countries, a significant proportion of the urban poor work in the informal sector. This raises important questions for social protection.

IV. KEY POLICY ISSUES¹⁹

An effective policy framework supports well-functioning labor markets and helps workers manage risks of unemployment and low income. The details of such a framework depend on the country's stage of development and its history and culture. However, there are policy areas that are universally applicable including human resource development, social protection for workers, and labor market regulation.

Investing in human resources

Human capital is a crucial factor in taking advantage of the opportunities of globalization and technological change as well as minimizing social costs associated with adjustment. The growing importance of skills can be linked to the following factors: (a) rapid

¹⁹ Amit Dar has provided inputs to this section.

technological change calls for a richer cognitive content in education and training and the continued enhancement of workforce skills; (b) education and skills generation are crucial in ensuring that economies remain competitive and productive in an era of globalization; (c) education and skills development play a major role in mitigating social and economic vulnerability; and (d) reducing skill bottlenecks has a significant impact on enhancing the efficiency of the labor market (ILO 1998). For these reasons, there is increasing emphasis on lifelong learning.

Effective skills training requires a solid education system. Basic competencies are necessary in order for workers to develop further through advanced education, job experience, and skills training. The results of the International Adult Literacy Survey have highlighted the virtuous cycle that is triggered by strong basic skills (OECD and Government of Canada 2000). The most cost-effective use of public resources to improve the productivity and flexibility of the labor force is thus investment in general education at the primary and secondary level.

Given a sound basic education system, policy-makers then face the challenge of making training systems and institutions responsive to the changing demands for skills in the labor market. Here we briefly lay out some of the key aspects of this challenge:²⁰

- *Enhancing the effectiveness and efficiency of public training.* The record of public training in many countries is poor. This is often because governments expect their training systems to achieve a myriad of objectives – e.g., addressing structural unemployment; reducing the fiscal burden on higher education; and as an anti-poverty intervention. Furthermore, often faced with tight budget constraints, governments find it difficult to provide adequate financing to institutions, which results in low levels of training quality and further reduces the impact of training on productivity. However there is evidence of public training being cost-effective when the objectives are clear and the training is responsive to labor demand. Some keys to enhancing the effectiveness of public training include clarifying objectives; establishing links with employers/industry to improve responsiveness; and developing

²⁰ These points are largely drawn from Middleton, Ziderman, and Adams (1993); OECD (1999a); and Gill, Fluitman, and Dar (2000).

innovative financing mechanisms to ensure sustainability through greater cost-recovery and industrial participation in the financing of training. A prerequisite for all this is building capacity in government for policy-making and implementation of training programs.

- *Increasing the role of government in provision of information.* A preoccupation with delivering, regulating, or financing training has often resulted in governments neglecting their role as providers of information about the availability and effectiveness of vocational training programs. Good information about programs helps policy-makers design interventions to effectively reach target groups and wide access to information on the availability and quality of training supply can inform prospective trainees about their choices. An expansion of this role may be one of the most effective ways for governments to foster the development of a relevant and cost-effective training system.
- *Increasing possibilities for private training delivery.* International experience shows that when public policies are designed to encourage rather than replace private sector delivery (through private providers, NGOs, or public-private partnerships), a vigorous supply response that is attuned to labor demand can be forthcoming. Fostering competition can lead to better performance of both public and private training institutions. Issues that need to be addressed in this regard include developing clear and balanced legislation that encourages private provision by reducing barriers to entry into the training market; designing funding mechanisms that require public providers to compete on approximately equal terms with private trainers; and ensuring information and standards are in place to ensure that consumers make informed choices. Employer-based, in-service training should be encouraged by policy-makers through ensuring strong basic education, good labor market information, and, in some cases, credit tools for workers. However, with a few exceptions, the record of using taxes and financial incentives is not too favorable.

Social protection for workers

A sound labor market framework has a central social protection function of helping workers manage risks associated with unemployment, lost income, and poor working

conditions.²¹ Strictly speaking, all of the issues raised in this section, including human resource development and labor market regulation, contribute to this social protection function. However, here we deal with the two most directly related instruments – active and passive labor market programs. In recent years, the social protection of workers has been strained by major financial crises and we conclude by briefly addressing some of the particular social protection issues for workers that have arisen in these situations.

1. Active programs

Active labor market programs (ALMPs) include a wide range of activities intended to increase the quality of labor supply (e.g., retraining); to increase labor demand (e.g., direct job creation); or to improve the matching of workers and jobs (e.g., job search assistance). The primary objective of these measures is to increase the probability that the unemployed will find jobs or that the underemployed will increase their productivity and earnings. In many countries, ALMPs are targeted at vulnerable groups such as the long-term unemployed and the working poor. Scientific evaluations of these programs (involving control groups) often show that they have had modest or no impact on increasing employability and earnings (Dar and Tzannatos 1999).

However there are several reasons why policy-makers should not necessarily avoid this area in the future (Betcherman, Dar, Luinstra, and Ogawa 2001). First, active labor market programs can serve social objectives, as well as economic. Second, workforce development, social and economic integration of marginalized and at-risk groups, and the situation of unemployed workers are inevitable concerns for policy-makers and ALMPs are obvious instruments to address these. Third, the disappointing performance of these programs in the aggregate masks the fact that some program designs do seem to lead to positive outcomes for some types of workers. Policy-makers must learn from existing experiences and innovations and direct future programming along lines that appear to work – while being realistic about what ALMPs can do.

A number of issues need to be considered in the design and implementation of active labor market programs:

²¹ Risk management is the motivating concept for the World Bank's social protection strategy. See World Bank (2001a).

- *Priority setting.* It is important to identify the main objectives of these programs, since these should determine program choices and program design.
- *The roles of the public and private sectors.* In many countries, possibilities have opened up for the private sector to play important roles, at least in the delivery of services. This can lead to more diverse, innovative, and cost-efficient services and to programs that are more closely oriented to labor demand. The challenge for the government is to foster the role of the private sector while ensuring public priorities are addressed.
- *Promoting partnerships and dialogue.* The identification of priorities for active labor market policy and program choices can benefit from ongoing dialogue between government, business, labor, and other relevant organizations (e.g., service providers).
- *“Infrastructure” for the labor market.* This includes labor market information, a viable and complete network of employment service offices, and certification and accreditation systems.
- *Policy and administrative/operational capacity.* Designing and implementing ALMPs requires considerable capacity within government and capacity needs differ significantly by program.
- *Financing ALMPs.* Policymakers need to find the appropriate balance between public and private financing. Clearly, the rationale for public spending is strong: market failures exist with respect to human capital investments and there is a public good element to ALMPs. However, there are also private gains afforded to employers and governments need to think about how this can be reflected in financing.
- *Monitoring and evaluation.* This is a key part of capacity and deserves special mention. Policy-makers should ensure that the capacity to monitor and evaluate programs is developed at the same time as these programs are being designed.

2. Passive programs

While active programs are designed to reintegrate workers back into employment, passive programs provide income support for the unemployed. There are overlaps between

these two policies and some interventions fall under both (e.g., public works). Family- or community-based support for unemployed workers (private transfers) is important in some countries. However, such informal mechanisms incompletely address problems faced by the unemployed, especially when shocks are of a “covariate” or widespread nature. Government income support programs, then, are key interventions, especially in developed countries.

There is a range of passive instruments sponsored by governments: most prominent are public works, severance pay, and various systems for providing payments contingent on the state of being unemployed (which includes being available/searching for work). These include unemployment insurance (UI), unemployment assistance (UA), and individual savings accounts (ISA). The main differences among these relate to eligibility, funding, and risk-pooling.²²

Many countries, both developed and developing, have some form of severance payment arrangement. The existence of unemployment insurance, on the other hand, depends a great deal on the level of development and region (Vodopivec 2002). Virtually all developed countries have UI plans as do most transition countries in Eastern Europe and some countries in Latin America. Elsewhere, UI systems are not common. Unemployment assistance is prevalent in many European countries as a second-tier for UI exhaustees; however, as a primary income replacement program, it only exists in a few countries (including Australia). Individual savings accounts exist in some Latin American countries (e.g., Colombia, Brazil) where they have tended to evolve as funded severance pay systems (de Ferranti *et al.* 2000). Finally, public works programs exist in most countries and, along with severance pay, they are the main formal instruments in developing countries.

While unemployment insurance is the most prevalent system in the industrialized world, it may or may not be the best option for all countries – especially those that currently do not have a UI system in place. Concerns in the industrialized countries (especially in

²² In terms of eligibility, UA depends on meeting some minimum income test; the others do not. In terms of funding, there are many arrangements world-wide. However, the usual arrangement is that UI is financed by contributions to a dedicated fund or general revenues by one or more of employers, employees, and governments; UA by general government revenues; and ISAs by individual contributions. UI and UA involve social risk-pooling while ISAs do not. Note that individual savings accounts for unemployment do not exist widely and, relative to the other options, it is less clear what the basic program parameters look like. For more details, see Vodopivec (2002) and de Ferranti *et al.* (2000).

Europe) exist about the effects of UI systems, particularly with respect to their job search disincentives. In developing countries where informal sectors are large, added questions are raised about all unemployment benefit systems (including UI, UA, and ISAs) in terms of covering the labor force and identifying and verifying benefit eligibility.

It is important to carefully evaluate the strengths and weakness of all options for providing income support to unemployed workers. Vodopivec (2002) identifies two main classes of performance criteria: distributive effects and efficiency effects.²³ The former includes coverage, adequacy of support, and income redistribution. In terms of efficiency effects, the following are included: job-search efforts; post-unemployment wages; equilibrium labor market outcomes (employment, unemployment, labor force participation); restructuring and overall economic adjustment; labor supply of other family members; taking jobs in the regular vs. informal sector; and aggregate output and growth.

For any given country, an assessment of options along these lines must be made according to various considerations. First, the objectives of policy-makers are key. Is the priority to temporarily replace the lost income of formal-sector workers and thus support consumption smoothing and their job search? Or is it primarily to alleviate poverty for the most vulnerable workers? Second, the particular national context matters. How is the labor market regulated and how strong is the employment protection regime? Is the country susceptible to major economic shocks? How large is the informal sector? What is the administrative capacity? What are the cultural attitudes regarding income redistribution and social insurance? What programs are already in place?

Table 8 presents summary assessments made by two recent World Bank studies. Neither attempts to rank options according to their universal appropriateness because of the importance of the national context. Note that Vodopivec (2002) reviews options for developing countries while de Ferranti *et al.* (2000) focused on Latin America.

²³ De Ferranti *et al.* (2000) use four dimensions in their assessment of options in Latin America: coverage, cost, incentives, and insurance aspects. These are somewhat different but overlapping with Vodopivec's framework.

Table 8: Two World Bank assessments of the strengths and weaknesses of different passive options

	Vodopivec (2002)	De Ferranti <i>et al.</i> (2000)
Unemployment insurance	Performs well where labor market institutions encourage flexibility; informal sector small; strong administrative and political capacity	Good option where labor market reforms have been made; disincentives minimized by keeping benefits frugal; politically popular; strong administrative capacity
Unemployment assistance	Anti-poverty incidence; disincentive effects similar to UI; strong administrative requirements	
Individual savings accounts	Avoids search disincentives; good self-monitoring features; poor distributional features; largely untested	Option for countries where labor market functions poorly; low efficiency costs; welfare reduction for poorer workers
Severance payments	Limited coverage; reduces labor market dynamism	Little risk pooling; entails labor market inefficiencies; contentious; administratively complex
Public works	Can be effective in reaching poor; suitable where informal sector large and administrative capacity weak; but entails large non-labor cost	Can reach informal sector and the poor; leakages through non-labor costs; advantages in permanent schemes

3. Responding to crises

In recent years, a series of financial crises in East Asia, Russia, and Latin America have had serious consequences for workers. Research on the social and labor market aspects of these crises have improved our understanding of what happens when major shocks like this occur (e.g., Betcherman and Islam 2001; World Bank 2001b). In East Asia, for example, unemployment rose, real earnings fell, and workers' rights were endangered in some situations. Households responded by cutting back on consumption and resorting to informal safety nets. Governments responded by implementing safety net programs and attempting to protect spending in key social areas. However, governments in the region were hampered by their lack of preparedness, a weak social policy infrastructure, and poor information and a lack of coordination.

The lessons learned from the East Asian crisis raise important issues that should be dealt with as governments and households attempt to put in place sound social policies that will better enable them to deal with future crises. Some of the labor market aspects include:

- *Responding to mass layoffs.* Formal sector layoffs will be an inevitable result of slackening labor demand. In many cases, these will be mass layoffs of a magnitude that makes them major economic, political, and social events. Some of these are likely to involve government or state-sector employees. The layoffs themselves may be unavoidable, but their consequences can vary depending on factors such as advance notice and consultation, resettlement opportunities, and severance arrangements. While various forms of support can assist downsized workers, it is important to consider affordability and to avoid special treatment.
- *Delivering labor market programs.* Naturally, there will be considerable demand for new labor market programs or the ramping up of existing ones. This applies to both passive programs that provide income and active programs, such as retraining and job creation, that are intended to support reemployment. While governments should be responsive to these demands, they also need to make considered assessments of the available financial and institutional capacity in order to ensure the integrity of design, targeting, and delivery. Some of these issues have been highlighted in the previous discussion on ALMPs.
- *Better information, institutions, and coordination.* Effective social and labor policies in general and crisis management in particular require better information systems, more responsive institutions, and better coordination across agencies and programs. Ongoing monitoring of labor market and social developments and interventions is a crucial element in this whole process. Priorities in terms of policy interventions can change as a crisis and its impacts evolve. Tracking take-up rates, expenditures, operations, and outcomes will help to ensure that policy responses are in the right direction. Furthermore, qualitative monitoring at the community level will offer important information about informal risk management mechanisms and how they are bearing up under the demands of the crisis.

*Labor market regulation*²⁴

There are many aspects involved in the regulation of the labor market. These range from how employers contract for the services of labor to the nature of the exchange – including the rights and responsibilities of the parties, the terms and conditions of work, and the resolution of disputes. There are three modes of regulation: statutory (through laws and decrees); collective or “voice” (through bargaining between representatives of the parties); and market-based (Standing 1999). Not only does each have its strengths and weaknesses, but these can vary a great deal depending on the country context. In any labor market, all three modes will co-exist to some degree though different societies clearly exhibit different mixes. Regardless of the particular mix, however, public policy underpins the choice and provides the legitimacy for ongoing practices. This is most obvious in the case of statutory regulation. However, even where the “rules of the game” are determined by collective bargaining or market processes, public policy establishes the enabling framework.

What is critical is the link between labor market regulation and economic and social outcomes. How the labor market is regulated (in reality rather than simply “on paper”) can affect the rate of job creation and destruction; levels of employment and unemployment; productivity, wages, and profits; and the degree of social protection afforded workers.

How do differences in labor market regulation affect employment outcomes? This is a controversial question with two very different perspectives – what Freeman (1993) has called the “institutionalist” and “distortionist” views. The “institutionalist” view sees job security arrangements, minimum wages, and collective bargaining as providing important social protection for workers, as instruments for encouraging productivity growth (through training and the accumulation of firm-specific skills), and as means of moderating the effects of downswings in aggregate demand. The “distortionist” perspective emphasizes the advantage of market processes and is concerned that these institutional forms of regulation impede adjustments to economic shocks, discourage hiring, and favor “insiders” (i.e., regular workers).

It is difficult to draw a complete picture of the employment impacts of differences in labor market regulation. National contexts (history, culture, institutions) vary a great deal and

²⁴ This section is drawn from Betcherman, Luinstra, and Ogawa (2001).

labor market impacts of a given law or practice in one country may be quite different from another.

It is generally true that statutory forms of regulation have become less interventionist, although there clearly are exceptions. Much of the international evidence has focused on the labor market impacts of employment protection rules and minimum wages. The actual research, itself, requires complicated methodologies and has often led to uncertain conclusions. Nonetheless, keeping these caveats in mind, the international evidence – largely based on the experience of OECD countries -- does lead to some conclusions in these two areas:

- *Employment protection legislation.* Rigid hiring and firing rules typically reduce employment levels somewhat but may not lead to higher unemployment because they also tend to reduce labor force participation. Stronger job security protection tends to benefit “insiders” (e.g., prime-age males) while reducing for “outsiders” (often women and young workers). It does increase job stability but also tends to increase unemployment duration (OECD 1999a).
- *Minimum wages.* Not surprisingly, the labor market impacts of minimum wages depend heavily on the level at which they are set. The overall disemployment effect tends to be relatively small for prime-age groups though it increases for younger workers. Since minimum wages tend to support earnings for low-income individuals, they can have modest impacts on poverty; however, interactions with other policy areas including the tax system matter a great deal (OECD 1998).

What about “voice” regulation through the voluntary negotiation of wages and other working conditions? This form of regulation has been associated with a number of employment effects – for example, on wages, employment, productivity, and dispute resolution.²⁵ At the same time that many countries have moved towards reducing statutory regulation, collective bargaining appears to have weakened somewhat as well. This is evident in the general trend of declining union memberships. The ILO (2000) has analyzed unionization data from the mid-1980s to the mid-1990s for a sample of 58 countries. In 42 of

²⁵ For a review of the effects of unions and collective bargaining, see Aidt and Tzannatos (2002) and ILO (2000).

these, union membership rates fell, while increasing in just 12.²⁶ There are many hypotheses for this declining trend; however, it is generally agreed that technology and globalization are important factors. These forces have reduced employment in occupations and industries that have traditionally had high unionization rates; they have been associated with the expansion of “non-traditional” employment forms (e.g., part-time and contingent work, home-work) that are difficult to unionize; and they have sparked changes in organizational and human resource strategies that either discourage unions or make them less attractive for workers.

Globalization has added an international dimension to labor market regulation. It has led to questioning regarding the effective reach of traditional national policy and the possible need to consider new approaches. There are various factors driving this. First, traditional national-level regulatory instruments such as laws or collective agreements do not always match the realities of global production and commerce. Second, there are concerns that globalization is intensifying competition and pushing producers in a “race to the bottom.” Third, various groups (including workers) in industrialized countries are experiencing dislocations as a result of trade and foreign investment and are lobbying not to be “undercut” by low labor standards. Finally, consumers in these countries are becoming more aware of and, in some cases, feeling more responsible for the conditions under which goods they consume are produced.

The result of these forces is that various proposals are being put forward to assure some international regulation of labor market conditions. Most prominent are the international core labor standards. As defined in the ILO Declaration on Fundamental Principles and Rights at Work, these include the freedom of association and the right to collective bargaining, the effective elimination of harmful child labor, the prohibition of forced labor, and the elimination of discrimination. Currently, there are no real enforcement mechanisms regarding these labor standards although pressure is being exerted from some quarters to link these with trade through sanctions (for violations) or incentives (for improvements). In addition, there is considerable experimentation in alternative approaches to regulation using enterprise and industry-level codes of conduct and other instruments.

²⁶ Of the 12 countries where unionization rates rose, 6 are in Europe (5 of which are developed), and two from each of Latin America, Africa, and East Asia (ILO 2000).

V. CONCLUSION

This paper began by identifying two themes: the rapid changes that are affecting workers and labor markets everywhere and the diverging capacity of countries to manage these changes. Rapidly evolving technological changes and globalization present opportunities for employment and improvements in incomes and working standards. However, our review of the evidence underlines the gaps on almost all dimensions between the labor market situations in developed and developing countries. This is evident in the quantitative data on earnings and poverty, and more qualitative information on working conditions. Moreover, various indicators suggest that further divergence is likely in the absence of significant reversals.

Labor market policies have been undergoing changes as well. Traditional forms of regulation and intervention have been questioned. This has resulted in some notable policy developments in industrialized nations. Many OECD countries have increased the flexibility of their labor markets. Longstanding approaches to training and active employment programs are being reformed, with greater emphasis on responsiveness to labor demand, on flexible delivery methods often involving private partners, on opportunities for life-long learning, and on a results-based orientation. Innovations in financial instruments (e.g., for human capital investment) and labor market information have been introduced to improve the functioning of markets. Incentives to participate in employment have been strengthened. While aggregate labor market indicators have been relatively favorable in many developed countries, policy-makers must now focus on the situation of the less-skilled whose position has been deteriorating in terms of employment and/or earnings.

The challenges facing developing countries are much more formidable. While some success stories can be told, many underlying trends are troublesome – for example, slow technology adoption, continued low educational attainment and high illiteracy rates, and growing informal sectors. Moreover, labor force growth concentrated in very large urban areas will place great pressure on job creation. Many key responses will need to be taken outside the labor policy envelope. However, policy-makers in the labor must address the core questions of how to develop human resources, how to offer effective social protection to workers, and how to regulate the labor market in order to support the growth of employment

and earnings while protecting the fundamental rights of workers. The experience of the developed countries and their cutting-edge practices can offer a useful guideline. A great deal can be learned from the OECD experience in these key policy areas and collaboration “across the development divide” will be essential. However, the unique “initial conditions” in developing countries must be factored in as well.

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