

Introduction: A World at Work

THE GLOBAL LABOR FORCE HAS GROWN massively in recent decades. In 1995 there are an estimated 2.5 billion men and women of working age in the world's labor force, almost twice as many as in 1965. Estimates project a further worldwide increase of 1.2 billion by 2025. This expansion, moreover, has been geographically skewed. Since 1965 growth in the labor supply has varied substantially across regions: from 40 percent in the world's high-income economies to 93 percent in South Asia and 176 percent in the Middle East and North Africa. And 99 percent of the projected growth in the labor force from now to 2025 will occur in what are today's low- and middle-income economies (Table 1.1).

Burgeoning labor force growth heavily biased toward the poorer regions makes the task of raising the living standards of the world's poor seem daunting—even impossible. Yet the evidence of recent decades does not support prophecies of doom and gloom—of overpopulation, mass unemployment, and deepening poverty. Despite these unprecedented increases in labor supply, the world's median worker is better off today than thirty years ago.

But there can be no guarantee that the poorest workers will see their living standards rise. Not everyone has shared in the rising prosperity of recent decades—indeed, many countries and even whole regions have seen little increase in their incomes per capita. Inequality, both across regions and within countries, remains a significant feature of the global economy. By one estimate, in 1870 the average income per capita of the richest countries was eleven times that of the poorest; that ratio rose to thirty-eight in 1960 and to fifty-two in 1985.

Will this pattern of rising prosperity, unequally shared, persist? Two systemic shifts in the world's economies are profoundly affecting labor's outlook into the next millennium. One is the changing role of the state, mainly in response to past failures by governments to improve welfare through state action. This shift is seen most clearly in the demise of Soviet-style socialism, but government activism has come under scrutiny in almost every country in the world. The second change is that markets have become steadily more integrated, both within and between nations. This globalizing trend has been driven by breakthroughs in transportation, communications, and industrial technology

Low-income countries represent an increasing share of the world's labor force.

Table 1.1 The world's labor force by country income group and region

Income group or region	Millions of workers ^a			Percentage of total		
	1965	1995	2025	1965	1995	2025
World	1,329	2,476	3,656	100	100	100
<i>Income group</i>						
High-income	272	382	395	21	15	11
Middle-income	363	658	1,020	27	27	28
Low-income	694	1,436	2,241	52	58	61
<i>Region</i>						
Sub-Saharan Africa	102	214	537	8	9	15
East Asia and the Pacific	448	964	1,201	34	39	33
South Asia	228	440	779	17	18	21
Europe and Central Asia	180	239	281	14	10	8
Middle East and North Africa	29	80	204	2	3	6
Latin America and the Caribbean	73	166	270	5	6	7
High-income OECD	269	373	384	20	15	10

a. Ages fifteen to sixty-four.

Source: ILO 1986 with ILO data updates.

The size and distribution of the working-age population differ with countries' incomes.

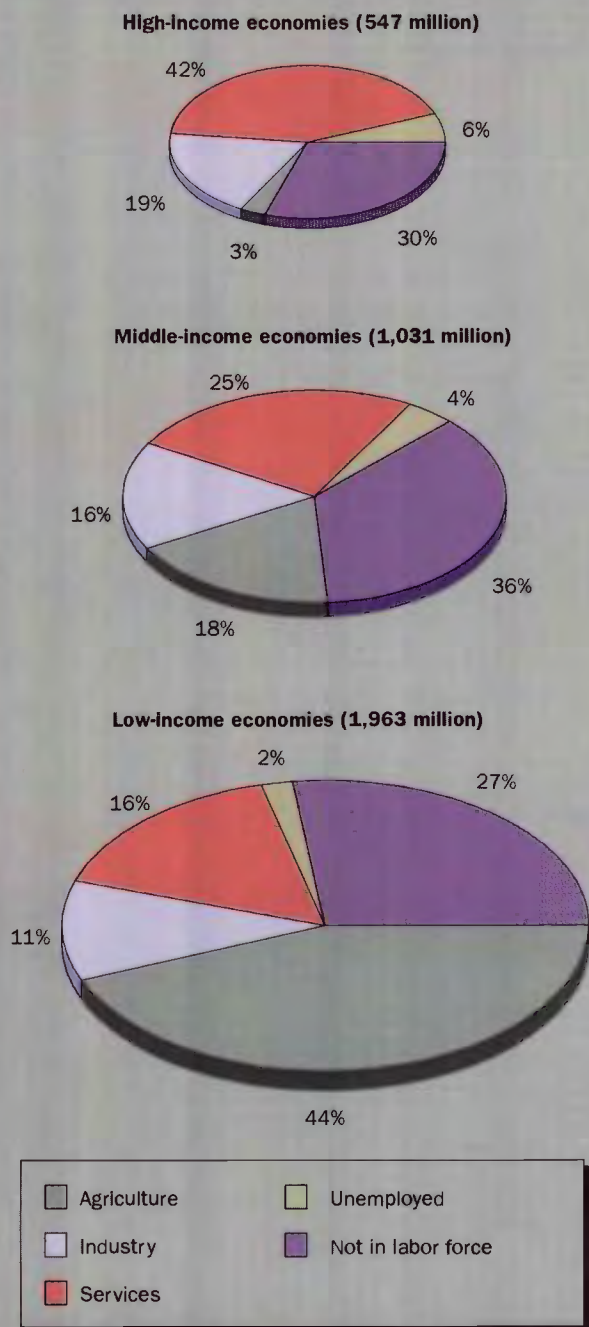


Figure 1.1 The world's working-age population by sector and country income group. Data are 1995 estimates for a sample of countries in each group. Percentages may not total 100 because of rounding. Source: World Bank staff estimates based on the following: EBRD 1994; ILO 1986 with ILO data updates; ILO, various years; and country sources.

and above all by the opening of national markets to international trade. The countries that have achieved the greatest gains for their workers are those that decided early on to take advantage of international opportunities, and to rely increasingly on market forces rather than the state in allocating resources.

This Report evaluates what a more market-driven and economically integrated world means for workers. We focus on four questions: Which development strategies are best able to raise the incomes and working conditions of workers? Does growing integration offer an opportunity or pose a threat to workers, especially those in the world's poorest regions? What should be the role of domestic labor market policy in improving labor market outcomes: efficiency of markets, equity of incomes, job and income security, and workplace standards? How can countries making the transition from central planning, or from a closed market to one open to international transactions, take account of the needs of labor? This chapter frames the discussion by outlining the wide variation in, and the impact of policy on, employment and wages for workers around the world.

Wage and employment outcomes

The economic objectives of households are similar everywhere: families seek to meet their basic needs, improve their standards of living, manage the risks they face in an uncertain world, and expand opportunities for their children. But the opportunities to achieve these objectives through work vary substantially across regions at different stages of development. Well over half of the world's working-age population, some 2 billion people, live in low-income economies where annual income per capita was below \$695 in 1993. Another 40 million elderly workers and a reported 50 million to 60 million children are at work. Because of widespread underreporting, child labor may actually involve tens of millions more.

About one-third of the working-age population in the low-income economies are not employed, some because they are attending school, raising children, or caring for their families, and others because they are unable to work or unable to find employment (Figure 1.1). But the majority are employed, and it is their low earnings at work, not unemployment, that are the main cause of their poverty. Of those at work, nearly six out of ten are engaged in agriculture. Of the remainder, almost 50 percent more are in the services sector than in industry (mining, manufacturing, construction, and utilities). Only about 15 percent of the labor force earn a living in the formal economy, defined as wage-paying nonagricultural private firms and the public sector.

The situation in the high-income economies is strikingly different. There, too, about one-third of the working-age population is outside the labor force or unemployed.

Nearly all the rest, however, about 350 million strong, work for wages. The services sector employs more than six out of every ten workers, more than double the number in industry. Agriculture employs 3 percent of the labor force. Some 30,000 children are estimated to be working. The situation in middle-income countries lies in between the low- and the high-income cases. Forty percent of all those of working age are not employed, about a third are in the formal economy (that is, working as regular, wage-earning employees in industry or services), about a fifth are in agriculture, and the remainder are in some type of informal employment. Over 7 million children in middle-income countries are reported as working.

Worldwide, unemployment—conventionally defined as those seeking work but unable to find any—is about 3 percent of the working-age population (about 5 percent of the labor force), although differences in national definitions and measurement difficulties make this estimate imprecise. Unemployment is often higher in high-income economies, but

with rising incomes, increasing urbanization, and sweeping economic transitions, it has become more prevalent in a broad range of low- and middle-income economies.

Just as employment opportunities vary substantially across countries and regions, so do wages (Figure 1.2). Adjusted for differences in their currencies' purchasing power, the earnings of engineers in Frankfurt, Germany, are fifty-six times those of unskilled female textile workers in Nairobi, Kenya (Box 1.1). Part of this gap can be traced to the occupational pay structure within each domestic economy—the pay ratio of engineers to female textile workers is eight to one in Nairobi and three to one in Frankfurt. And part is due to international differences in returns to similar work—the pay ratio of German to Kenyan engineers is seven to one, and that of German to Kenyan female textile workers is eighteen to one. The 40 percent of the world's working-age population who work on family farms and in the informal sector typically earn far less than even unskilled urban workers—if the returns to their labor were

Earnings differ tremendously across the international wage hierarchy.

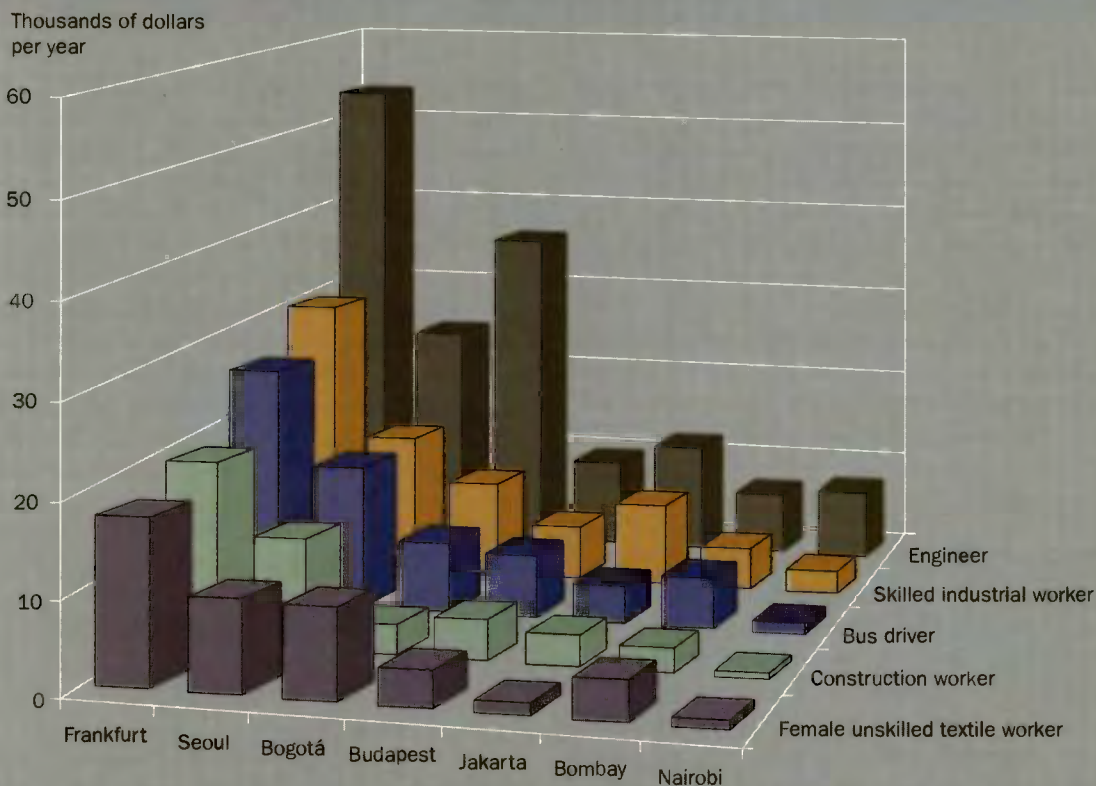


Figure 1.2 Earnings in selected occupations in seven cities. Earnings are adjusted to reflect purchasing power parity. Data are for 1994. Source: Union Bank of Switzerland 1994.

Box 1.1 How can we compare real wages across countries?

How much better off are workers in one country than their counterparts in another? This question often comes up in looking at cross-country data, but comparing the earnings of workers in different economies can be tricky because each is paid in domestic currency. The obvious solution is to convert wages into a common currency, usually the U.S. dollar. Until recently, the most common way of doing this was to use official exchange rates. However, dollar wages calculated in this manner do not adequately reflect workers' standards of living, because the prices of the goods they consume vary between countries. Prices of nontraded goods such as housing or personal services, in particular, differ widely, since they are determined by local demand and supply conditions.

To deal with such problems, wage comparisons in this Report use exchange rates adjusted for purchasing power parity (PPP), which equalize the price of the same bundle of goods and services across countries. For example, the Indian rupee PPP exchange rate measures the amount in rupees it would take in India to buy a selected basket of traded and nontraded goods that cost one dollar in the United States. This approach

does not take into account differences in the bundles of goods that workers in different countries are likely to consume; even so, wages converted into dollars using PPP exchange rates provide a better estimate of the quantity of goods and services that workers in different countries can buy. (Whereas PPP exchange rates thus offer a better basis for welfare comparisons, official rates remain more appropriate for judging countries' international competitiveness.)

Using PPP rather than official exchange rates significantly affects the results reported in Figure 1.2. Poorer countries generally have larger adjustments, since their nontraded goods and services are cheaper. For example, in 1994 a bus driver in Seoul, Korea, earned \$12,800 a year at the official exchange rate. A bus driver in Bombay, India, earned \$1,700, also at the official rate. Is the Korean really more than seven times better off than the Indian? Converting to PPP dollars, we find that their earnings were \$15,600 and \$5,590, respectively. The Korean, in terms of purchasing power, was less than three times better off than his Indian counterpart, because the prices of nontraded goods were much lower in Bombay than in Seoul.

added to the picture, the spread in earnings, domestically as well as internationally, would be even greater.

Besides these cross-country differences in wage and employment outcomes, *within* countries there are significant differences between men and women. In most societies women work more hours for lower pay. Women are engaged disproportionately in the home, looking after children and maintaining the household—activities that fall outside the market. In many countries women receive less education, often are underrepresented in good jobs, and usually get paid less than men even for the same work. These differences may flow from cultural norms, but they lead to gender inequality and to inefficient use of a society's human resources.

Why some workers have done better than others

Why are there such large differences in employment and earnings, and hence in standards of living, across regions? Why does agriculture occupy so few working men and women in the high-income economies, but over half the labor force in the low-income countries? And why is there so much dispersion in earnings, both across occupations within an economy and among workers performing similar tasks but living in different countries?

Differences in labor market outcomes can mainly be traced back to the productivity of labor—the quantity and value of labor's contribution to output. When output per

worker is high, a small fraction of the work force will be engaged in agriculture, because the economy's demand for food can be met by a small number of highly productive domestic farmers, or by the profitable exchange of goods made by highly productive industrial and service workers for food produced abroad. Across occupations, engineers earn more than textile workers because the market value of a year's work spent designing a machine that produces textiles is much greater than that of a year's supply of cloth produced by the worker operating it. Within occupations, pay differences across countries reflect the average level of *economy-wide* productivity. If a bus driver in Seoul earns three times as much as a bus driver in Bombay, it is not because the Korean is three times better at driving a bus. Instead, the higher level of labor productivity in the Korean economy overall, and hence the higher level of incomes there, mean that, on the one hand, the bus drivers must be paid enough to persuade them to drive a bus rather than do something else for a living, while on the other, consumers in Seoul are willing and able to pay more for a bus ride than consumers in Bombay.

In a market economy, differences in wages and employment are determined in the labor market, where households supplying their labor interact with employers who demand it. Where the market sets the price and quantity of labor, labor productivity must increase in order for wages to rise and employment opportunities to expand. This in turn

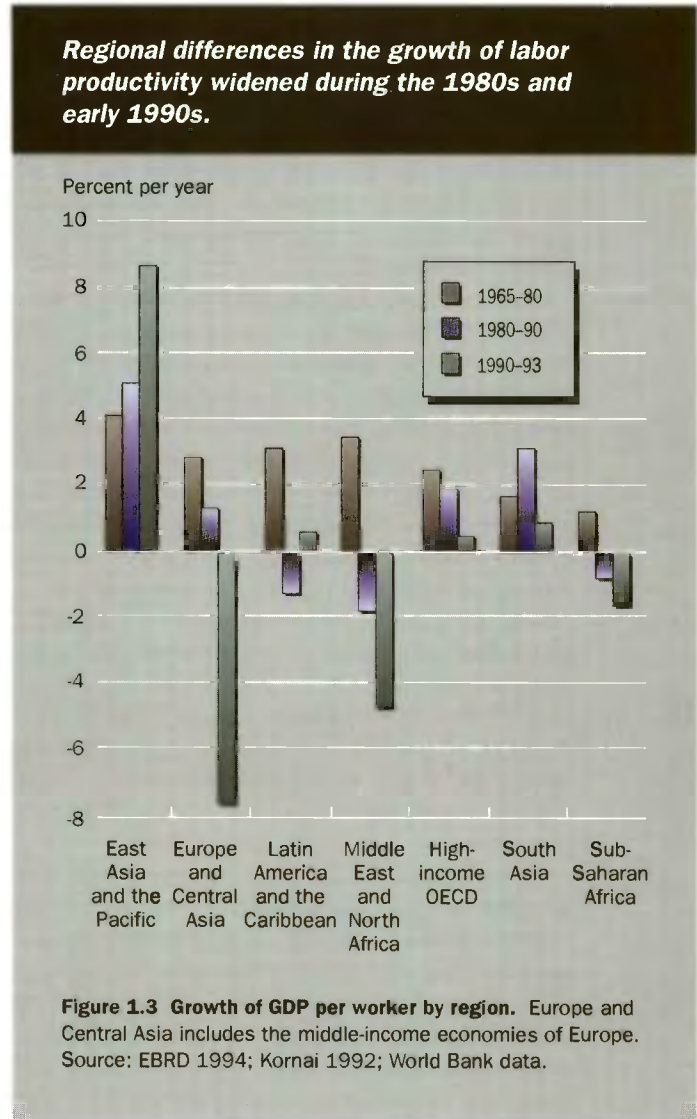
requires expansion in productive capacity; that is, employers and households must mobilize savings to finance investments in physical capital, new technologies, and worker skills. With increased productivity, employers are both able and compelled to pay higher wages: able because of the increased amount of goods and services each worker produces in return; compelled because employers must compete for labor that is becoming increasingly productive across a whole range of activities.

In the low- and middle-income economies, cross-country differences in today's earnings largely reflect changes over the past two or three decades. Thirty-five years ago, for example, the earnings of bus drivers in Seoul, Bogotá, Jakarta, Bombay, and Nairobi were more similar than they are today. Some of these cities are located in economies that have experienced rapid changes in the demand for their output and in the productivity of their work forces, permitting significant growth in labor incomes (Figure 1.3).

The greatest successes have occurred in East Asia, where GDP per worker more than tripled from 1965 to 1993, and in South Asia, where average labor productivity doubled over the same period. Approximately two-thirds of the working-age populations of the low- and middle-income economies reside in regions where labor productivity has risen since 1980. But in Africa, Latin America, the Middle East, and the transitional economies of Europe and Central Asia—which together account for about 30 percent of the world's working-age population—output growth has declined over the past thirteen years, and in many of these countries growth in labor productivity has turned negative. In fact, the rate of decline has accelerated during the 1990s in all of these regions except Latin America. Explaining why some countries have prospered and others have not is key to understanding how the world can productively absorb its growing work force.

Three patterns

Rapid growth in output per worker in countries such as the Republic of Korea, Indonesia, and, most recently, China has brought rapid growth in the incomes of wage workers and the self-employed, together with a swift influx of rural labor into higher productivity employment in industry and services. All of these East Asian economies invested heavily in physical and human capital—with special emphasis on developing human resources throughout the population. Effective engagement in international markets has been key to expanding higher productivity employment, whether in primary products or in manufactures. This strategy included strong support for agriculture, especially for family farms, and mostly avoided sharp divides between modern sector and rural workers. A strong export orientation reduced economic rents, and labor policy did not favor privileged groups of workers. East Asia's record in labor relations



is less enviable: many countries imposed restrictions on unions, and some have endured labor-related violence. However, there is no evidence to suggest that such restrictions were necessary for East Asia's economic success.

In Sub-Saharan Africa, Latin America, the Middle East, and South Asia most countries pursued, to varying degrees, inward-oriented development paths that protected certain industries and were biased against agriculture. These strategies benefited a limited number of "insiders"—capital holders and workers employed in the protected sector. Attempts to maintain these workers' privileged positions often were based on institutional interventions—prohibitions on firing in Latin America or featherbedding of public employment in South Asia and Sub-Saharan Africa—rather than on raising labor demand or improving productivity. The consequences were slow growth in labor demand,

especially in those industrial sectors that depended mainly on the domestic market, and a relatively large gap between workers in the formal sector and those working in the less privileged rural and informal sectors. A few countries, especially in South Asia, were able to achieve large gains for rural workers through effective support for family farms and adoption of new technologies. But even there labor's gains were substantially less than they would have been if industry had taken off.

The centrally planned economies, especially those of Europe and Central Asia, were for decades exemplars of an economic model antithetical to the market model of the high-income industrial countries. Regarding themselves as champions of labor, they delivered both rising wages and cradle-to-grave protection for their workers—and saw no need for free, independent trade unions. Like the East Asian economies they invested heavily in machines and skills, but unlike East Asia they weakened or destroyed family farming and pushed rather than attracted workers into industry—following a path dictated by a development strategy that was as disconnected from domestic economic reality as it was from international markets. Massive investments failed to offset severe resource misallocations and a lack of technological dynamism. Wage stagnation, shortages, a backward services sector, and some of the world's worst industrial pollution were all signs of the failure of central planning to improve workers' lives in a sustainable manner.

Two of these three divergent paths have reached their inevitable dead ends. Many workers are worse off than they were two or three decades ago. Today protectionist and centrally planned economies alike have been going through major changes toward greater reliance on international and domestic markets. These changes—in part forced by sharp macroeconomic shocks, in part driven by a radical turnaround in policy—have usually brought wrenching changes to workers in the transitional period before growth recovers.

The scope of this Report

This Report undertakes to explain how labor outcomes can be so extraordinarily different in different parts of the world, and how good policy choices can bring about desirable changes in the lives of workers. Part One reviews the long-run development experiences of different countries from the perspective of what they have meant for workers. It analyzes the relationship between the determinants of growth and policies influencing labor demand and human resource development. And it explores the relationship between inequality and the path of development. It concludes that high and broad-based investment in people and capital and reliance on markets can bring rapid and relatively equitable growth in labor incomes. The policy issue is not one of *laissez-faire* versus government intervention; rather it is

how to take effective public action that supports the efficient functioning of markets, encourages productive investment, and responds to the particular needs of workers who are discriminated against or otherwise disadvantaged.

Part Two assesses the consequences of ongoing international developments for workers, with an emphasis on their likely future course. Economic integration is creating a global labor market where wage and employment decisions in one country are increasingly influenced by interactions with other countries. Trade, migration, and capital flows all have the potential to improve the welfare of workers, especially in poorer countries, with trade by far the most important channel. But this potential will be realized only if domestic policy is sound. In a world of mobile capital, success is well rewarded but failure punished hard. With increasingly open trade, workers in countries that do not keep up with improvements in their competitors' productivity will reap smaller gains.

Part Three turns to the role of government policy in labor markets and assesses what types of policies make sense in an increasingly open and often more democratic world. For a market-based strategy to succeed, governments must establish labor policies to deal with basic worker rights, discrimination and inequality, income security, and the government's own role as an employer. Such policy must take market realities into account. Rather than dictate outcomes, public action and legislation should complement both informal sector solutions and the outcomes of negotiated solutions between workers and employers in the formal sector. Government policy should enable workers and employers to negotiate with each other and should avoid helping a few insiders at the expense of the vast number of poor outsiders.

Part Four explores the consequences for workers of major shifts from protectionism and central planning. Initial conditions and macroeconomic policies matter for the path of wage and employment outcomes. Inevitably there are winners and losers, but the sooner economies begin to grow, the fewer are those workers who suffer permanent losses. Labor market policies can facilitate restructuring by encouraging wage flexibility and labor mobility, by designing transfers targeted to the casualties of transformation, and by adopting certain measures designed to help workers find employment.

With effective policy, there is great potential for the world's expanding labor force to enjoy significant gains in coming decades. But this optimistic outcome is not guaranteed. If poor countries do not pursue market-based policies, or if the trend toward greater global integration is halted by protectionism, the future could instead witness slow growth and increasing global inequality. The Report's concluding chapter reviews the implications of the earlier chapters' analysis for workers in the twenty-first century.