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Regional Perspectives on World Development Report 1995

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**JOBS, POVERTY, AND
WORKING CONDITIONS
IN SOUTH ASIA**

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This report was prepared in conjunction with *World Development Report 1995: Workers in an Integrating World*. It was written by Hafez Ghanem under the direction of Michael Walton. Meta de Coquereaumont and Vince McCullough edited the report. Christian Perez laid out the text.

Foreword

World Development Report 1995: *Workers in an Integrating World* deals with labor and employment, issues that are important for South Asia. Expanding employment and increasing the remuneration of workers are crucial for poverty elimination, which is the overarching objective of all countries in the region. This summary presents the key messages of *World Development Report 1995* as they apply to the South Asian economies.

South Asian workers have made some gains over the past thirty years, but growth has been slow, poverty is still pervasive, and social and human indicators are too low. This performance reflects a development strategy that turned out to be biased against labor. High protection and inward orientation failed to achieve rapid growth in industrial employment, productivity, and wages. Most workers remained in the rural and informal sectors, where they are underemployed and poorly paid. Except for Sri Lanka, South Asian countries did not invest adequately in their workers to equip them with the skills needed to better compete in the world market and raise their living standards.

Faced with these outcomes, the countries of the region have changed development strategies. Reform programs focus on trade policies, the financial sector, investment regulations, taxation, and public enterprises. The objectives are to raise private investment, reduce reliance on the public sector, and promote exports. Liberalization should enable the region's economies to grow at rates closer to those in East Asia. Will the change in development strategy benefit labor? Yes. Market-based development, which encourages firms and workers to invest in physical capital, new technologies, and skills, is the best way to raise labor's living standards.

Changes in the global economy render this policy shift even more pressing. International flows of goods, services, capital, and people bring new opportunities and challenges for most workers. South Asia's labor stands to benefit from greater integration in the world economy. Evidence from the past two decades

indicates that countries that have opened to world markets, expanded exports, and attracted foreign capital have experienced rapid increases in real wages. However, some workers can be hurt if they are stuck in declining activities and lack the flexibility to change. Restricting trade is an inefficient way of dealing with this problem. A better strategy is to improve workers' skills or support their transition to new jobs.

Does the strategy of market-based development imply no role for governments in the labor market? No. Governments need to develop labor policies that define the rights of employers, workers, and labor unions and the framework for collective bargaining and the settlement of disputes. There are also cases where interventions are needed to complement informal and market solutions and protect vulnerable workers. But interventions that favor a few relatively well-off workers at the expense of those who operate in the rural and informal sectors should be avoided.

A consensus is gradually being built around a vision of a more dynamic South Asian economy, based on private initiatives and with stronger ties to the global economy. How should the transition to this new growth path be managed so as to minimize social costs and losses to workers? This report emphasizes the importance of credibility and of softening the impact of transitions on workers. Governments gain credibility by adhering to a consistent plan that sets out the main direction of reform. Government programs that compensate workers who are hurt in the initial phases of reforms are often necessary for social reasons, as well as to ensure support for reforms.



Joseph Wood
Vice President
South Asia Region

The Development Challenge

More than one-sixth (17.5 percent) of the world's labor force is in South Asia. For the purposes of this report, the region consists of three big and three smaller countries. India, with almost 900 million people, is the second largest country in the world; Pakistan (123 million) and Bangladesh (115 million) are the seventh and eighth biggest. Nepal (21 million), Sri Lanka (18 million), and Bhutan (2 million) are significantly smaller. Despite the huge differences in size, all six countries have low incomes, high population densities (except Bhutan), relatively low rates of urbanization, and poor health and education indicators (except Sri Lanka; Table 1).

The development challenge facing South Asia is formidable. Poverty is pervasive, and many South Asians face hunger and deprivation. Look at consumption. By this measure, South Asia is the poorest region in the world. In 1990 almost 59 percent of the population consumed less than \$30 a month (in terms of purchasing power parity). The equivalent share of the population was 53 percent in Sub-Saharan Africa, 28 percent in Latin America, and 15 percent in East Asia. Mean consumption in 1990 (also in purchasing power parity terms) was less than \$35 a month, compared with a developing country average of about \$67. Poverty is also reflected in social indicators. Average life expectancy at birth in South Asia is sixty years, compared with an average of sixty-four years for low- and middle-income countries. Adult literacy is 46 percent (the low- and middle-income country average is 67 percent). It is no surprise, then, that

sustained poverty relief and reduction are the overarching objective of economic policies in the region.

How can poverty be reduced? The answer is simple: by generating more productive jobs and investing in human development. The means of getting there is less straightforward. Low employment and low labor productivity are the main labor market problems facing the region. Low employment can take the form of high chronic unemployment (as in Sri Lanka, where almost 14 percent of the labor force is unemployed) or high underemployment (as in Pakistan, Bangladesh, and Nepal, where about 15 percent, 43 percent, and 45 percent of the labor force are not working as many hours as they would like). Low labor productivity implies low wages. Productivity differences partly explain why skilled industrial workers in Bombay earn 74 percent less than their counterparts in Jakarta, and yet Indonesian products remain competitive. Productive jobs for the underemployed or unemployed and the more than 7 million new entrants into the labor force each year would be the most effective poverty reduction program for South Asia.

Most developing countries are moving toward market economies, international markets are opening up, and goods, capital, and ideas flow more easily around the world. This report evaluates how the changing shape of the world economy and different policy choices by South Asian governments can affect the quantity and quality of jobs and so the living standard of the 430 million workers in the region. It concludes that:

Low incomes, high population densities, and poor social indicators are typical of South Asian countries

Table 1. Health and education indicators in South Asian economies, 1993

Country	GDP per capita (U.S. dollars)	Population density (per square kilometer)	Urban population (percentage of total)	Life expectancy (years)	Literacy (percentage of adult population)
Bhutan	180	32	6	48	38
Nepal	190	147	13	54	26
Bangladesh	220	800	17	56	35
India	300	273	26	61	52
Pakistan	430	154	34	62	35
Sri Lanka	600	271	22	72	88

Source: World Bank data.

- A market-friendly development strategy that encourages investment, human development, and growth is critical in improving labor market outcomes.
- Integration with the world economy, through a reduction in trade barriers and greater capital mobility, would provide a host of new opportunities for South Asian workers.
- Labor policies should complement, rather than substitute for, market mechanisms. Policies should be based on the respect of labor's right to bargain collectively in a competitive environment and avoid special privileges to small groups of workers at the expense of the majority, who are in the rural and informal sectors.
- The relative stability and large size of the agrarian sectors in South Asian economies provide flexibility in the pace of structural reforms, but reform agendas need to be credible and need to deal with the legitimate concerns of workers who may lose in the short run.

Growth, investment, and labor welfare

How can South Asia's economies generate the productive jobs necessary for poverty reduction? By growing faster. Rapid economic growth increases demand for labor, creates employment, and raises workers' incomes. Countries in the region can accelerate growth by adopting development strategies that encourage faster accumulation of physical and human capital, as well as their efficient use. Fast economic growth normally means dramatic changes in employment structure and enormous increases in productivity and real wages. Job opportunities expand in services and industry as employment in agriculture declines and workers move to urban areas and from informal to formal sectors. Those changes occur without specific government interventions. In fact, attempts by governments to force the pace by favoring industry and formal employment, at the expense of agriculture and the family farm, have proved an unsustainable and often counterproductive strategy, slowing economic growth, depressing labor demand, and encouraging informalization.

Economic growth, employment, and wages

Economic growth raises workers' welfare in two ways. First, it changes workers' employment status, bringing about a shift from informal to formal. Witness the contrasting experiences of Ghana and Malaysia. Ghana saw prolonged economic decline from 1960 to the late 1980s, when recovery began. Over that period, GNP per capita fell by 1.5 percent a year as the working-age population doubled from about 3.5 million to 7.8 million. As a result, the share of the labor force engaged in wage employment hardly changed—14 percent in 1989, more or less the same as in 1960. Self-employment in rural and urban areas continued to absorb more than half the working-age population. Malaysia's economy took off over this same period, with per

capita GNP growth of 4 percent a year. This led to a rise in wage employment, with a dramatic increase in industry and services and a decline in self-employment. In 1957 one in two employees worked on plantations; by 1989 wage employment had tripled, yet only one in ten workers was engaged in plantation agriculture.

Second, growth also raises the returns to work. Again, consider Ghana and Malaysia. Average real wages in manufacturing in Ghana collapsed; by 1984 they had plunged to 13 percent of their level a decade earlier. Agricultural wages also fell sharply. By contrast, real wages in Malaysian manufacturing have grown steadily, by 3.4 percent a year since 1973. Rural returns to labor have followed, with plantation wages doubling between 1971 and 1992. The sectoral transformation of employment intensified the gains from wage growth made by Malaysian labor. Between 1957 and 1989 the share of the work force in agriculture fell from 58 percent to 26 percent. Most entrants to the labor force joined the modern industrial and service economy, where average wages were almost double those in agriculture.

South Asia's growth performance in 1970–90 was mixed: not as disappointing as Ghana's or as brilliant as Malaysia's. Real per capita GNP growth in South Asia varied from a high of 3 percent in India and Pakistan to a low of around 2 percent for Bangladesh and Nepal. There was no radical transformation in the structure of employment. By the early 1990s as much as 63 percent of India's labor force was in agriculture, which is closer to the situation in Ghana (61 percent) than in Malaysia (26 percent). Agriculture's share in production in the other countries in the region varies from 47 percent for Pakistan to 73 percent for Bangladesh.

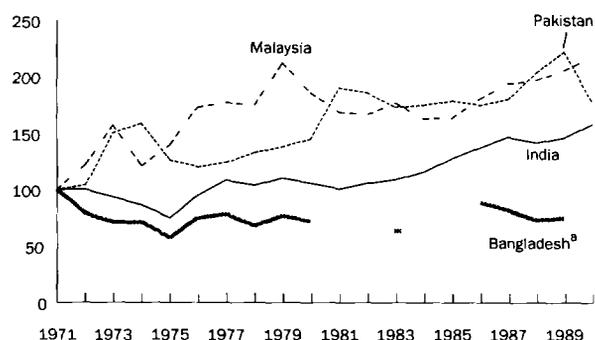
Those growth rates have been sufficient to bring about some real wage increases in the region's two largest economies. In 1971–90 real wages in agriculture rose at an annual average of around 2.5 percent in India and 3.0 percent in Pakistan (Figure 1). Urban wages in India grew more slowly. During the same period real wages in manufacturing rose almost 2 percent annually. Pakistan's urban workers did well, and manufacturing real wages rose by 5 percent a year.

In the slower-growing economies, Bangladesh and Sri Lanka, the outcome was different. In 1971–90 Bangladesh's real agricultural wages fell by about 1.5 percent a year, and its manufacturing wages by 3.0 percent. In Sri Lanka real agricultural wages fell by about 1 percent a year in the 1980s and manufacturing wages by 0.5 percent. This trend, however, seems to be changing in both countries: data for the 1990s indicate some increase in real wages.

India and Pakistan appear to be on a path that will lead to improved labor market outcomes, but they are proceeding at a much slower pace than the East Asian economies. The situation in Bangladesh and Sri Lanka is less promising. Workers in

Real agricultural wages grew rapidly in India and Pakistan, less so in Bangladesh and Sri Lanka

Figure 1. Index of real agricultural wages, 1971–90 (1971=100)



a. No data available for 1981–82 and 1984–85.
Source: ILO and country sources.

all four countries would benefit from an acceleration in growth that increases the demand for labor, lowers unemployment and underemployment, and raises incomes and living standards of workers.

The relationship between growth and labor market outcomes can be demonstrated through simulations using data for Bangladesh. Underemployment in Bangladesh is estimated as equivalent to having a quarter of the labor force unemployed. If real GDP in Bangladesh grows at the historical rate of around 4 percent or so a year, underemployment may rise and exceed the equivalent of 30 percent unemployment by 2000. Under those circumstances wages would continue to fall. Much higher growth rates are needed to expand employment opportunities fast enough to reduce underemployment and push wages higher.

Determinants of growth

How can growth be accelerated to achieve better outcomes for labor? By increasing investment in physical and human capital in a competitive environment. Evidence linking economic growth to increased accumulation of physical and human capital is overwhelming. At the microeconomic level, accumulation of human capital is strongly associated with increases in labor productivity and greater individual earning capacities. At an aggregate level, growth performance is best in countries that experienced rapid increases in their stocks of physical and human capital. For example, between 1965 and 1990 the high-performing economies of East Asia increased investment from an average of 22 percent to 35 percent. They also increased human capital. Over the same period, primary school enrollment rose from 92 to 102 percent, and secondary school enrollment from 27 to 37 percent.

In some other countries, however, growth was not as rapid, despite high rates of investment. China in the 1970s, the former Soviet Union, and Tanzania regularly invested more than 20 percent of GDP but did not experience anything near the impressive growth of, say, Korea or Malaysia. Many African countries expanded their education systems, substantially raising the average years of schooling of their labor force, but they have seen little corresponding aggregate growth. These experiences indicate that in the wrong economic environment accumulation of physical and human capital may yield unproductive or idle factors. Massive public investment in inefficient, loss-making enterprises will have little impact on growth, and educated workers will not contribute fully to economic development if they are not provided with opportunities to use their skills. Economic policies must encourage efficient private investment and provide an environment where capital and skills can be used effectively and efficiently to raise income.

Growth in South Asia in 1960–90 was slower than in any other developing region except Sub-Saharan Africa (Table 2). At 4.1 percent, it was similar to growth in OECD countries, which

South Asia's poorer performance stems from inefficient use of resources

Table 2. GDP growth and its sources, 1960–90 (annual percentage growth)

Region	GDP	Capital stock	Working-age population	Human capital ^a	Total factor productivity
South Asia	4.1	5.4	2.4	3.2	0.2
East Asia	6.1	6.4	2.5	4.1	1.5
Latin America	4.8	6.0	2.9	2.2	1.0
Sub-Saharan Africa	3.0	5.9	2.7	5.6	-2.1
OECD	3.9	5.3	1.2	0.3	1.3

a. Measured in terms of years of schooling.
Source: World Bank staff estimates.

was 3.9 percent; but the two groups of economies started from vastly different bases, and South Asia's working-age population grew at double that of OECD countries.

South Asia's lackluster growth is explained by inefficient use of resources and by low levels of accumulation of physical and human capital. Changes in total factor productivity—which measures the effects on output of variables other than accumulation—are used here as a proxy for efficiency improvements. The annual growth in total factor productivity in 1960–90 was close to zero—it was 1.5 percent in East Asia but –2.1 percent in Africa. This may be a reflection of policies that did not encourage the efficient allocation of capital and labor to maximize output. Present efforts aimed at liberalizing South Asia's economies and increasing their outward orientation should improve efficiency, and hence labor incomes.

Capital stock growth was even slower in South Asia (5.4 percent a year) than in Africa (5.9 percent), reflecting low investment. In the early 1990s, investment ranged from about 12 percent in Bangladesh to 23 percent in India and Sri Lanka. These are low when compared with 34 percent in Malaysia and 40 percent in Thailand. The average South Asian worker uses only \$2,513 of capital, compared with a developing country average of \$13,000 and an industrial country average of \$150,000. Under the circumstances, it is not surprising that productivity and wages are relatively low in the region. Increasing the stock of physical capital per worker is essential for raising productivity and wages.

Human development

South Asia's human capital—measured in years of schooling—grew more slowly than in either East Asia or Sub-Saharan Africa (see Table 2). This is particularly disturbing, because East Asia's experience indicates that accumulation of human capital is necessary for growth and development. Pervasive poverty accentuates the importance of human development in South Asia. From a national perspective, low levels of human development are likely to have a negative impact on growth and labor market outcomes. For individuals and households, better education and improved health are important ways of getting out of poverty.

Thus the importance of human development in South Asia cannot be overemphasized. Performance of the social sectors of most countries in the region has been disappointing, with negative consequences for worker welfare. To change this situation, South Asian governments will need to restructure public expenditures in favor of the social sectors and introduce reforms to improve the quality of services and the efficiency of delivery.

Human development and better outcomes for labor

Increasing the skills and capabilities of workers is critical for economic success in an increasingly integrated and competitive

global economy. Investing in people can boost the living standards of poor households by expanding opportunities, raising productivity, attracting capital investment, and increasing earning power. Better health, nutrition, and education also have value in their own right, enabling individuals to lead more fulfilling lives. Investments in human development are often highly complementary. Adequate nutrition and health increase the ability of children to learn. And, better-educated individuals tend to have better nutrition and hygiene habits, necessary for good health.

Worker productivity and income are clearly related to health. Better health services allow workers to live longer and lead more productive lives. Nutrition is also important. Lowering protein-energy malnutrition and increasing the consumption of micronutrients (such as iron and iodine) can raise labor productivity by improving mental and physical abilities. Analyses of farm households in Southern India found that increased weight for height (a measure of long-term nutritional status) and height alone (a proxy for childhood nutrition) are closely associated with greater output per adult worker. Better nutrition early in life appears to have a quantitative impact on future productivity that is at least as large as that often reported for primary schooling.

Education is essential for raising individual productivity and hence wages. General education gives children skills that will be transferable from job to job and the basic tools necessary for further learning. It augments workers' ability to perform standard tasks, to process and use information, and to adopt new technologies and production practices. Evidence on the adoption of high-yielding varieties of foodgrains in India illustrates this point. Areas with relatively few farmers with primary schooling at the onset of the Green Revolution experienced less growth than areas with the same technological opportunities but better-educated farmers.

Toward greater human development in South Asia

Despite some achievements over the past thirty years, social indicators in South Asia make grim reading. In India, 40 percent of the population have no access to basic health services, about half the children under five are malnourished and deficient in micronutrient intake, more than a quarter of the population have no access to potable water, and one in eight newborn babies dies before age one. The state of human development is equally depressing in Pakistan, especially in view of its higher per capita income. Pakistan's infant mortality rate is 30 percent higher than the average for all low-income countries, its adult literacy rate is 25 percentage points lower, and its gross primary and secondary school ratios are not much more than half the average for low-income countries. Pakistan's disadvantage is worse for women than for men. Bangladesh fares little better. Life expectancy at birth is around fifty-six years, and infant mortality is 110 per thousand live births compared with

64 per thousand for all developing countries in 1993. Diarrheal diseases, acute respiratory infections, and childhood diseases easily preventable by immunization (tetanus, diphtheria) are major killers. Bangladesh's education indicators are also discouraging: it has low adult literacy (35 percent), a very high rate of primary school dropouts (63 percent), and an unsatisfactory enrollment ratio (72 percent).

Sri Lanka has achieved a much higher level of human development than its larger neighbors. It has done very well in literacy and other basic education indicators, as well as mortality, fertility, and other health indicators. In 1990 Sri Lanka had a literacy rate of 88 percent overall (83 percent for women), compared with 60 percent for all low-income countries (48 percent for women). Its infant mortality was 19 per thousand live births, compared with 69 per thousand for low-income economies. Moreover, between 1960 and 1990 education and health indicators improved at much faster rates than in most other countries. A recent World Bank study ranked Sri Lanka eighth in a sample of forty-three developing countries in increase in net primary enrollment and nineteenth of seventy-one countries in decline in infant mortality. The larger South Asian countries could learn from Sri Lanka's success, a consequence of its past enlightened health and education policies. There has been a strong drive by the public sector to provide basic health services countrywide and universal primary education to boys and girls alike.

Governments in Bangladesh, India, and Pakistan need to change their spending priorities and reallocate resources to the social sectors. Indian data can be used to illustrate this point.

Public expenditures on education, health, nutrition, and population programs accounted for a meager 5.2 percent of GDP (and 16 percent of all public expenditures) in 1992–93, compared with an average of 6.4 percent for low-income countries and 10 percent for middle-income countries. By any standard, this level is too low. Per capita annual public expenditure on education in India is about \$30, while the average for low-income countries is roughly \$80, and per capita expenditure on health \$11 or so, while the average for low-income countries is around \$16. (All comparisons are in purchasing power parity terms.) To attain average social sector spending norms of low-income countries by 2000, India will have to increase its budgetary allocations to these sectors by more than 12 percent a year.

Even without increased allocations to India's social sectors, outcomes would be much better if efficiency were improved through quality inputs and effective delivery. In education, only sixty-three of every hundred children who enroll in grade one reach grade five. Only 37 percent of the age cohort completes the elementary schooling cycle. The quality of learning is so poor that a third of primary school graduates do not attain full numeracy and literacy. In health, medical supply and personnel shortages render many public health facilities almost useless. Some 55 percent of India's primary health centers lack antibiotics, and 46 percent of the nursing staff cannot properly sterilize a needle. Improving the quality of social services requires changes in the way governments act as employers, and reforms of employment, pay, recruitment, and promotion policies, as well as increases in spending on complementary inputs.

The Impact of International Integration on Workers

Countries with more open economies and closer links with world markets are generally the faster growers. Global integration is increasing rapidly, fueled by technological change and the continuous fall in communication and transport costs. In 1978 only a few developing countries, led by the newly industrialized countries of East Asia, were becoming deeply integrated in the world market. But conditions have changed quickly, and it is expected that by 2000 less than 10 percent of the world's workers will be sheltered from global influences.

How will globalization affect South Asian labor? Most workers will benefit from international migration, foreign trade, and capital flows, but a few, operating in inefficient protected sectors, will lose. Global integration provides workers with a larger and more stable market to sell their goods. Moreover, those who lose from greater integration can usually be compensated without jeopardizing the benefits that will accrue to the majority of workers.

Labor migration

Migration has had a large impact on South Asian labor markets as many workers sought jobs abroad, especially in Gulf countries. An estimated 1.2 million Pakistanis (4 percent of the labor force), 600,000 Bangladeshis (2 percent), and 300,000 Sri Lankans (4 percent) have jobs abroad. The effect on their balance of payments is stark. Worker remittances represented more than 40 percent of Bangladesh's export revenues in 1993. For Pakistan the figure is 24 percent, for Sri Lanka 22 percent, and for India 14 percent. Workers from South Asia have made tremendous contributions to economic growth and development in the Gulf region. Indeed, host countries would probably not have grown as fast without the relatively cheap migrant labor.

It is unlikely that migration will increase over the short and medium terms at rates fast enough to have a big impact on South Asian labor markets. Demand for migrant labor in the Gulf is slowing as economic growth stabilizes and as more nationals

enter the labor market in activities that were previously left to migrants. Moreover, political and social pressures are pushing some host countries into pursuing policies that limit migration.

But migration is not the only channel through which labor can benefit from international integration. South Asian countries can boost indirect exports of labor in the form of increased exports of goods and services. And if it is difficult for South Asian workers to migrate to countries with abundant capital, foreign investors can be encouraged to bring their capital to South Asia.

International trade

Increased trade benefits workers in three ways. First, it provides a much larger and generally more stable market for the fruits of their labor. Domestic markets, especially in countries with low per capita incomes such as Nepal and Bangladesh, tend to be very thin and volatile. Exports are the best way to expand production and achieve greater stability in demand. Second, free trade gives workers the choice of the cheapest consumption goods and access to equipment and technology that best complement their skills. The rapid industrialization in East Asia was built largely on massive imports of the West's best technologies and machinery. In South Asia, Pakistan's leather industry has developed fast and created thousands of jobs using imported machines and technology. Third, the global market allows workers to specialize in what they do best and to upgrade to the production of more valuable products at the speed at which their skills improve rather than at the speed at which these goods may come to be demanded at home. The newly industrialized countries of East Asia started by exporting primary products, then moved on to low-tech manufactures, and today are shipping increasingly sophisticated industrial products. India's entry into the world market for computer software is an example of this upgrading.

Clearly, the statistical correlation between long-term wage growth and exports is strong. In the past two decades, real wages rose at an annual average of 3 percent in developing countries where the growth of trade was relatively fast but stagnated in

countries where trade expanded least. Increasing exports raise the demand for labor, leading to more jobs and higher incomes for workers.

Most South Asian workers would benefit from free trade. Look at the likely impact of the Uruguay Round, the widest-ranging and most ambitious multilateral trade agreement ever negotiated. With many countries set to relax trade barriers at the same time, the pattern of international supply will gradually change. Snapshot estimates of full implementation of the Uruguay Round show that the real wages of South Asian workers could rise by around 2 percent (Figure 2). In general, the results indicate that workers in labor-abundant economies that specialize in labor-intensive goods—China, and the countries of ASEAN and South Asia—would benefit from trade liberalization because they could undercut producers in high-cost countries. They should be able to produce and export more, and employment and wages should rise. Trade liberalization will also bring dynamic gains that are likely to far exceed the one-shot impact. As the experience of the newly industrialized countries of East Asia shows, those able to expand domestic capacity by accumulating human and physical capital can grow by moving up the product ladder, shifting from primary and low-value products into higher-value exports.

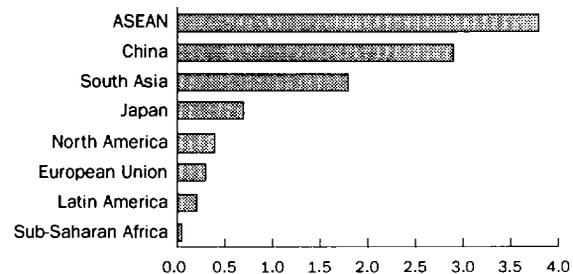
Not everybody will gain from more trade. The trend toward increased globalization may hurt two groups of South Asian workers. In the future, those working in export sectors that were receiving preferential treatment from OECD countries must compete with East Asian producers on an equal footing. And workers in heavily protected import-substituting industries may see some jobs disappear.

Workers in South Asia's booming garments industry, who have benefited in the past from OECD quotas on imports from East Asia, will have to deal with tougher competition. With increasingly competitive world trade, countries that do not keep pace with change can be hurt by improvements in the efficiency of rival exporters. For example, as China and Viet Nam become more effective exporters of garments, Bangladesh and Sri Lanka could lose market share, and jobs in those sectors would shrink. To remain competitive, South Asian exporters will have to lower costs and raise productivity through skill upgrading, more investment, improved technology, and backward linkages.

As trade is liberalized, the workers who stand to lose the most are those employed in import-substitution industries operating behind protective tariffs. Often, these are in the public sector—steel workers in India, for instance, or textile workers in Bangladesh. For decades these workers have been collecting huge rents—their wages are several times the earnings of workers in uncovered sectors. These rents were generated at the expense of consumers, who had to pay higher prices and accept goods of relatively low quality, and of taxpayers and bank depositors, who subsidized loss-making enterprises. With trade liberalization,

After trade liberalization South Asian workers will take home more pay

Figure 2. Impact of the Uruguay Round on real wages (percentage increase)



Source: World Bank staff estimates.

those rents will vanish and the sectors will contract. Eventually, excess labor from these sectors will be absorbed in booming and efficient export industries. But this will take time, and meanwhile those workers and their families will suffer. Labor, however, tends to be well organized and powerful politically and would likely use its political muscle to try to block reforms. Most reforming governments try to soften the blow and buy those workers' support for much needed reforms through generous severance pay and other safety nets.

International capital flows

International markets can also help finance investments that the South Asian economies need to grow faster and generate more jobs. Foreign resource inflows in 1993 represented around 3.5 percent of South Asia's GDP. Historically, most inflows have been official credits or grants. That is changing. In 1993 almost 26 percent of inflows were foreign direct investment and portfolio investment, up from only 9 percent in 1992. Most private flows have been concentrated in India and Pakistan, with little going to the smaller economies (Table 3). Even so, foreign inflows are small compared with other regions. South Asia has more than one-sixth of the labor force in developing countries, but it receives only slightly more than 1 percent of foreign direct investment going to those countries. By comparison, in 1993 Indonesia received \$2,004 million in foreign direct investment, Thailand \$2,400 million, and Malaysia \$4,351 million.

Economic policies in the region must aim at increasing foreign direct investment. This will accelerate capital formation, but it also has two other beneficial effects. Foreign direct investment usually brings with it new technologies and market access for exports. And increasing reliance on private sources of foreign financing shifts repayment risks from government to private entrepreneurs.

Of South Asian countries, foreign investors prefer India and Pakistan

Table 3. Foreign resource flows, 1993
(millions of U.S. dollars)

Country	Official debt	Grants	Net foreign direct investment	Portfolio equity	Total
India	3,894	560	273	1,840	6,567
Pakistan	1,493	250	347	185	2,275
Bangladesh	344	720	14	0	1,078
Sri Lanka	178	141	195	0	514
Nepal	149	150	6	0	305
Bhutan ^a	1	40	0	0	41
Total	6,059	1,861	835	2,025	10,780
Share (percent)	(56)	(17)	(8)	(19)	(100)

a. Data are for 1992.
Source: World Bank data.

How to attract private capital? Minimize production costs and raise labor skills. South Asian countries with low labor costs should normally be able to attract foreign investment and expand exports by undercutting more expensive established producers. Capital is first and foremost looking for good returns. So the key to a successful capital-attracting strategy is to have the fundamentals right—good infrastructure, abundant skills, and social and political stability. Many countries have tried granting special

favours or incentives to attract external capital and multinational corporations, but these measures are not sustainable in the long run. They distort the economy by discriminating against domestic producers. Attracting foreign capital requires more than good investments. Foreign investors also worry about macroeconomic stability and creditworthiness. Prudent fiscal and monetary policies, solid links with global markets, and the flexibility to handle external risks are also important for attracting those investors.

Domestic Labor Policies

Along with growth and integration with world markets, domestic labor policies are also important. Government labor policies and regulations are often needed to ensure the smooth functioning of labor markets, to avoid injustices, and to protect vulnerable workers. South Asian governments are heavily involved in formal labor markets. Most South Asian workers, however, operate in the informal and rural labor markets, which are beyond the reach of government regulations.

The available data may overestimate the importance of regulation in formal employment (Table 4). Administrative capacity is so weak that labor regulations are not enforced even in large urban firms that are usually considered part of the modern sector. Nevertheless, all governments in the region impose a vast array of labor laws and regulations ranging from minimum wages to laws governing collective bargaining, severance pay, and job security. Governments are also players in the labor market as large employers of civil servants and public sector workers. How do government labor market interventions affect workers' welfare?

Rural and informal labor markets

Formal employment can be defined as a contractual relationship subject to government laws and regulations. Informal employment relationships are unregulated. In fact, however, analyses of South Asian labor markets show that there are not two distinct or parallel labor markets but a continuum of markets. At one extreme are a few large firms and government enterprises to which labor legislation applies fully. At the other extreme are numerous wholly unregulated enterprises and family farms that employ most South Asian workers. In between are small and medium-size enterprises that, while formally subject to labor regulations, manage to circumvent most.

In Pakistan almost the entire rural labor market—which absorbs 71 percent of the employed labor force—is informal. Roughly 32 percent of rural employment is off-farm but still linked to agriculture. Many off-farm workers are engaged in services and repairs of agricultural implements, and rural small-scale manufacturing is dominated by food and beverage processing. This situation may be changing, however. Surveys of Pakistan's rural labor market indicate a rise in nontraditional activities, such as repair of electrical and transport equipment.

South Asian societies effectively use informal arrangements to deal with labor market issues, especially those related to the uneven power of employers and to risk and income security. In

South Asia's traditional societies, employers have to respect certain norms of justice and avoid exploitation, or face social sanctions. Most informal employment contracts involve some risk sharing. For example, share-cropping—in which landless peasants share output with the landlord—is common in South Asia. Informal arrangements can also provide income security. Private saving is an important mechanism for dealing with risks, such as unemployment, that are not easily insured against. For the poor with little or no savings, private transfers between households—within extended families or local communities—are often the recourse. A study of poor households in India found that 93 percent received private transfers, usually from members of their extended families.

An understanding of the behavior of wages in the rural and informal markets is crucial for policy analysis. Studies of rural markets in India indicate that many social and institutional factors enter into the determination of wages, which may explain wide variations in wage rates among different villages and the slow change in wages over time. At the same time, most studies show that real wages respond strongly to changes in demand and supply, especially over the medium and long terms. Empirical work indicates that the rural wage rate is positively associated with productivity-increasing factors, such as use of fertilizers, as well as with factors affecting demand, such as the availability of alternative off-farm employment. Higher yields in India's agriculture as a result of the Green Revolution, and the resulting

Most South Asian workers do not benefit from the protection of labor laws

Table 4. Employment and wages, late 1980s

Country	Wage labor ^a (percent)	Rural wage ^b (domestic currency/day)	Manufacturing wage ^b (domestic currency/day)
Bangladesh	25	33	65
India	..	19	70
Pakistan	30	33	102
Sri Lanka	47	64	80

.. Not available.

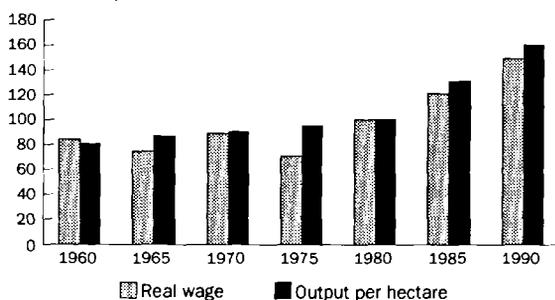
a. A large proportion of these workers (61 percent in Bangladesh) are casual day laborers who do not benefit from the full protection of labor laws.

b. For unskilled workers in 1990.

Source: ILO and country sources.

As yields rose in Indian agriculture, so did real rural wages

Figure 3. Indices of yields per hectare and real wages in India, 1960–90 (1980=100)



Source: Ravallion and Datt 1994.

increase in the demand for labor, were associated with a sharp rise in real rural wages (Figure 3).

Clearly, agricultural policies are important in improving the welfare of most informal workers. These include those employed off-farm as well as those directly involved in agriculture, since the demand for their products depends on agricultural incomes. East Asia’s experience provides useful lessons. Labor in these economies was well served by development strategies that supported agriculture—initially the major labor-intensive sector—through relatively light taxation, investments in rural infrastructure, and in some cases land reforms that supported family farming.

Setting workplace standards

Informal employment arrangements are intrinsically limited. They break down as the size of enterprises increases and as the communal links between workers and employers weaken. Although most South Asian workers are in rural and informal sectors and not often directly affected by regulations, there are two reasons why appropriate labor regulations are needed. First, formalization is important for development and growth, so labor market policies that discourage the expansion of the formal sector should be avoided. Second, labor policies could have an indirect impact on informal workers by affecting their access to better-paying formal jobs. Moreover, some labor policies, such as public works programs, could have a direct effect on informal workers.

Governments intervene in the labor market by setting workplace standards (such as minimum wages or maximum hours of work). They pass laws that define workers’ and employers’ basic rights and the framework for collective bargaining, wage determination, and dispute settlement. South Asian governments are

also large employers, and their policies affect the quality of public service and may have wider implications for the labor market. Finally, governments also play an important role in reducing income insecurity due to unemployment, disability, or old age.

Other than basic rights (freedom of association and organization), the most widely discussed workplace standards include bans on child labor, protection for working women and minorities, minimum wages, and health and safety regulations.

Banning child labor

All countries in the region have laws outlawing child labor. Yet millions of children under the age of fifteen are working in South Asia. Some child labor is considered more harmful than others. Most working children are unpaid helpers on the family farm, a practice unlikely to be condemned provided children continue to attend school. There is, however, a minority of child laborers engaged in casual wage work in urban areas—making carpets, for instance, or garments. Most people think of these children when they hear the term “child labor,” evoking disturbing images reminiscent of the “dark, satanic mills” of the industrial revolution.

Child labor has to be understood before policies can be designed to eliminate it. High rates of child labor are clearly linked to poverty and underdevelopment and to the poor quality or availability of education. Children in poor families work because the family needs the extra income, especially if the parents’ major source of revenue is uncertain. Surveys in rural India show that poor households, with no savings or current assets and unable to borrow, need to use child labor to minimize risks by reducing the potential impact of a parent’s loss of a job or a failed harvest on the family farm. Moreover, when the education system is costly and ill-prepared to provide children with marketable skills, parents take their children out of school and direct them to jobs in the informal sector.

The Indian state of Kerala shows how improved education facilities can lessen the problem of child labor. In 1992 around 25 percent of the budget in Kerala went to education—compared with an average of 17 percent for other Indian states. School retention through fifth grade is 100 percent of pupils entering first grade, and the state’s literacy rate is twice the national rate. Anthropological research in a Kerala fishing village indicates that school attendance does not eliminate child labor, but it does prevent the worst excesses found elsewhere in India. This research found that poor village children attend school but continue to work part-time to help support their families. Their paid out-of-school activities typically include looking after smaller children, foraging, petty trading, domestic chores, and fishing.

National legislation and international conventions banning child labor have symbolic value as an expression of society’s desire to eradicate this practice. But they cannot deliver results unless accompanied by measures to shift incentives away from child

labor and toward education. The most important ways for governments to help are to provide a safety net to protect the poor, to broaden opportunities for quality education, and gradually to expand the institutional capacity to enforce bans.

Protecting women and ethnic minorities

Children are not the only vulnerable group needing protection in South Asian labor markets. Governments also intervene to protect women and ethnic minorities. Protection takes two forms: maternity benefits and other privileges for working women, and antidiscrimination regulations to ensure equal access to formal jobs.

All countries in the region have standards relating to maternity protection and night work. By raising the cost to employers, however, these standards effectively discourage the hiring of women. They are also difficult to enforce even in the small formal sector and can sometimes have perverse effects. For example, some garment manufacturers in Bangladesh hire young women only on a daily, casual basis to avoid maternity benefits, and a survey of female garment workers found that few of them knew that they had a legal right to paid maternity leave.

Yet Bangladeshi garment workers are much better off than they were before getting jobs in the modern sector. Although low by formal sector standards, their wages are more than double what they could earn in the informal sector or in rural areas. Perhaps more important, having a stable source of income has entirely changed women's status within the household. Female rural workers in Bangladesh work 5 to 30 percent longer hours than do men, because they have household responsibilities in addition to their work in the fields. These women rarely have a say in the allocation of household expenditures. Their situation changes dramatically when they get work in the garment sector. Surveys indicate that the husbands of garment workers contribute 1.3 to 3.7 hours a day to household work, and that 57 percent of female garment workers determine how their wages are spent. It appears, therefore, that women gain much more from better access to modern sector jobs than from special standards to protect those who already have employment.

To provide women with special benefits without raising the cost of hiring them and discouraging employment, some countries finance maternity benefits from the government budget. But this approach may be problematic in South Asia. Administration requirements are high, and there are risks of abuse. Moreover, a general revenue-financed scheme would partly finance benefits for formal sector women at the cost of poorer men and women in rural and informal work.

Antidiscrimination policies usually aim at protecting ethnic minorities and women. India has a program favoring the employment of scheduled castes in the public sector, which appears to be achieving its objective of providing greater opportunities to

disadvantaged workers. It is facing difficulties, however, as other groups also demand preferential treatment, a common problem with affirmative action programs. Bangladeshi law reserves 15 percent of government positions for women, but the law appears to be inoperative. Women occupy only 6 percent of those jobs, although unemployment among educated women is around 17 percent, compared with 2.3 percent for men.

Setting minimum wages

Sri Lanka's legislation is representative of minimum wage policies in the region. Sectoral minimum wages are set by tripartite wages boards that determine minimum wages for each skill level in the different sectors of the formal economy. Typically, members of the board are chosen from among employers in the sector, trade union representatives, and officials of the Ministry of Labor.

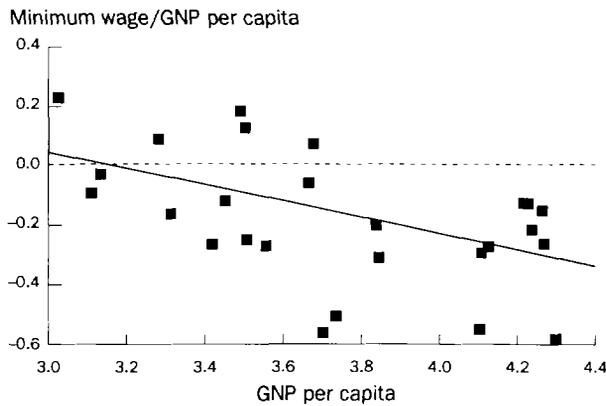
Minimum wage legislation remains one of the hottest topics in the debate on government-mandated labor standards around the world. Proponents believe that appropriately applied legislation can raise the income of the most poverty-stricken workers at little cost in unemployment. They view minimum wages as a desirable way to redistribute income. Opponents argue that minimum wages worsen income distribution. By raising production costs in the formal sector, they reduce employment. More workers are forced to seek jobs in the unregulated informal sector, pushing the wages of the working poor below their previous level.

It is unlikely that increases in minimum wages in South Asia could have a positive impact on income distribution. As in most developing countries, minimum wages in the region are already too high relative to national income and to other wages in the economy. So even a small increase in the minimum would have a negative impact on employment and income distribution. The relative level of the minimum wage tends to be higher in poorer countries and to fall as national income rises (Figure 4). For example, while some of the sectoral minimum wages are more than 2.5 times per capita GNP in Bangladesh, the minimum wage is only a quarter of per capita GNP in Canada. When enforced, minimum wages in South Asia affect only a small group of urban formal sector workers who earn much more than the less-favored majority that operate in the informal and rural sectors. Sometimes differences are extreme: for instance, an iron and steel worker in India earns 8.4 times the rural wage.

In South Asian countries, minimum wages are difficult to enforce even in the formal sector, where firms find many ways of avoiding them. Empirical work in Bangladesh and Sri Lanka suggests a great deal of formal-sector wage flexibility, despite the minimum wage regulations. The inability to enforce minimum wages is not specific to South Asia. For instance, household surveys in Mexico indicate that 16 percent of full-time male workers and 66 percent of female workers were paid below the minimum wage in 1988. In Morocco half the firms surveyed in 1986 paid unskilled

The relative level of the minimum wage tends to be higher in poorer countries

Figure 4. Relative level of minimum wage declines as income rises (logarithms)



Source: World Bank data.

workers below minimum wages. Few nations outside the OECD area have the administrative capacity to police minimum-wage regulations. This is especially so when minimum wages are set so high as to discourage hiring, which creates strong incentives for employers and workers alike to ignore the regulations. Employers clearly benefit from a lower minimum that reduces costs. Workers will also gain as long as the wage being offered is above what they could earn in informal-sector activities.

Setting health and safety standards

Since most South Asian workers operate in rural and informal markets, dealing with their health and safety concerns is a priority for many governments and civic organizations. The informal nature of labor arrangements in those markets, however, renders labor legislation useless. Attempts at improving health and safety conditions for agricultural and informal workers may be more successful if implemented through general policies aimed at the overall environment within which they work. For example, the use of dangerous chemicals in agriculture is usually best controlled by regulations covering the import or production of pesticides and fertilizers. Similarly, efforts at providing drinking water in rural areas and improving sanitary conditions in villages and urban slums could have a profound impact on the welfare of most workers in low- and middle-income countries.

Health and safety interventions in the formal sector are not as important as interventions in rural areas in terms of the number of workers affected. Nevertheless, almost all countries legislate minimum safety and health standards, usually justified on the grounds that employers will be aware of workplace dangers, but

workers might not. Even if workers are aware, they may accept dangerous jobs or hazardous working conditions because there is no alternative employment. Then, legislation may be necessary to prevent workers from consciously doing harm to themselves by accepting dangerous work. Legislated standards are also defended on the grounds that there are externalities to the risks that workers take—for example, when the costs of medical treatment for those who are injured or fall ill are subsidized by others (such as taxpayers). As with minimum wages, however, enforcing health and safety standards is difficult, unless monitoring is carried out by civic organizations or by trade unions.

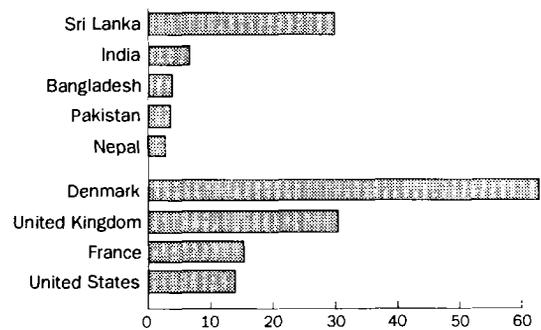
The role of labor unions

Trade unions are key players in South Asia's labor markets. They have a long history of contributing to political, social, and economic development. They were, for example, at the forefront of the movement seeking independence for India. More recently, they have been active supporters for democratization in Bangladesh and Pakistan. Unions and workers' collective action can also have positive socioeconomic effects. The Nari Mukti Samity, a women's group bringing together paddy laborers in Bahadurpur in Bangladesh, shows how worker organization can improve the lot of the rural poor. In 1989 women workers in the area were paid about 40 percent less than men. Supported by mens groups, womens organizations stopped working during the busy transplanting season and demanded equal pay for equal work. The landlords agreed to the demands and three years later continue to pay equal wages determined by annual collective agreements.

There are, however, some serious misgivings about labor unions in South Asia. The unions represent the interests of a very small proportion of relatively better-off workers (Figure 5).

In most countries unions represent only a fraction of the work force

Figure 5. Percentage of unionized workers



Source: ILO data.

They are also overpoliticized and fragmented. In Bangladesh, India, and Pakistan less than 4 percent of workers are unionized. Because of the organization of plantation workers, union coverage is higher in Sri Lanka (around 30 percent), but generally unions are not representative of most working men and women in South Asia. Nevertheless, they are an important political force, because they are organized in large urban centers and can exert pressure on government through agitation and unrest.

Union activities are sometimes seen as benefiting their relatively small membership at the expense of poorer informal and rural workers. The higher wages unions obtain for members either reduce business profits or get passed on to consumers in the form of higher prices. This leads unionized firms to hire fewer workers, increasing the supply of labor to the unorganized sector and depressing wages there.

There is a long tradition of ties between political parties and labor unions in South Asia, and weak, fragmented, highly politicized unions appear to be a characteristic of industrial relations in most of the region. A 1969 report of the Indian National Commission of Labor recognized the seriousness of the problem. Most disruptions in large public enterprises in Bangladesh over the past few years—including incidents at the Bangladesh Machine-Tool Factory in Joydepur, textile mills of BTMC in Tongi, and Adamjee Jute Mills at Adamjee Nagar—were caused by interunion rivalries. Disruptions in the workplace due to unions' political activities are hardly conducive to investment and growth.

Politicized unions are also viewed as obstructionists that wield their political power against socially important economic reforms that may hurt their members. India's unions continue to criticize the government's recent liberalization efforts, despite the apparent successes since 1991. The unions have organized nationwide general strikes to oppose the commercialization of state enterprises and industrial restructuring aimed in part at increasing India's outward orientation. India's unions are propping up that part of the economy most in need of reform.

The challenge facing policymakers is to create an environment that minimizes trade unions' negative effects and encourages them to increase positive contributions to growth and equity. Such an environment will usually include competitive product markets and regulatory and institutional frameworks designed to ensure trade union pluralism. Legislation in many countries also seeks to support collective bargaining in the private and public sectors.

Competitive product markets limit the ability of unions to act as monopolists and obtain overly high wages for members. Raising wages would force unionized firms out of business unless higher wages could be justified by increased productivity. In less competitive environments, unions will attempt to

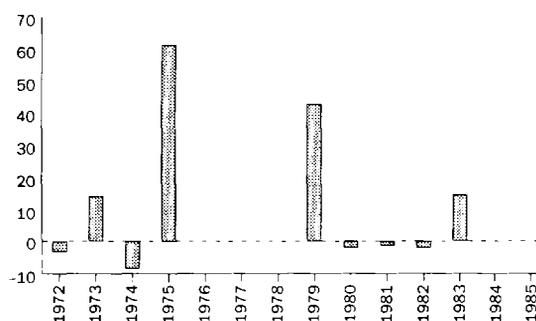
capture economic rents and will ally themselves politically with employers and politicians who promise to perpetuate those rents. Witness coal miners in India who have been shielded from competition ever since the government takeover of the industry in 1973. The highly unionized coal workers exert political pressure to obtain wage increases that are unrelated to productivity and market realities, without regard to the country's economic interests and development objectives. In the decade after 1973, miners' nominal wage increases matched inflation in most years, but real wages jumped noticeably in the years just before national elections (Figure 6). In a competitive environment coal miners would have had to moderate wage demands or face mine closures and job losses.

The structure of union organization and the coverage of collective agreements condition union behavior. Labor regulations in many countries also place a high value on pluralism in the labor movement and on the rights of individual workers, including their right not to join a union. This is often considered an extension of the basic human right of freedom of association, but it has important economic implications. Competition between free trade unions in a pluralist setting limits the ability of any single labor organization to exert pressure on workers and employers.

Except in countries where all workers are unionized, collective bargaining at the enterprise level is an appropriate framework for achieving positive economic effects. The union's ability to impose monopolistic wage increases is tempered by the strong competitive pressures on the firm from the product market, yet the union can still act as a participatory organization for the workers.

Real wages of Indian coal miners often jump before national elections

Figure 6. Year-on-year change in real wages of Indian coal miners, 1972–85 (percent)



Election years: 1974, 1977, 1980, 1984.
Source: Banerji and Sabot 1994.

Although many unions may represent workers in a single private sector enterprise, only one can act as the “collective bargaining agent.” Regulations also specify rules for the election of this agent at regular intervals from among all unions in the enterprise. This solution, however, has not been very effective because of interunion rivalries.

Industrial relations in South Asia’s public enterprises need to be restructured and depoliticized. Public sector workers are allowed to form unions but cannot bargain collectively with managers on wages and working conditions. In most countries, salaries and wages of civil servants and public employees are based on recommendations of government-appointed commissions. This has not stopped public workers from going on illegal strikes to exert political pressure on the government to raise wages and salaries.

The present system has helped strengthen the links between labor unions and political parties, especially since the public sector represents around a third of formal employment in the region and more than half of union workers are in public enterprises. Because of the direct involvement of central governments in wage setting and restrictions on collective bargaining, trade unions are unable to pursue their objectives through the normal machinery of industrial relations. They depend on central government, and hence on politicians, and the multiplicity of political parties is naturally reflected in the structure of the labor movement. The relative efficiency of different parties in satisfying union demands explains why unions affiliated with the ruling party tend to dominate the labor movement.

Reducing the role of central governments in the labor market is the key to strengthening and depoliticizing the labor movement. This can be achieved in two ways. First, privatization of state enterprises would automatically reduce government’s wage-setting role. Second, for enterprises that remain in the public domain, wage determination needs to be decentralized. This implies greater autonomy for enterprise managers, within a hard budget constraint, and extensive use of decentralized collective bargaining. Unions would have a nonpolitical means of pursuing their objectives, and politicians would be less able to influence managerial decisionmaking at the plant level. For this strategy to succeed, governments will need to impose a hard budget constraint on public enterprise management. If the costs of collective agreements are borne by taxpayers (through budgetary subsidies), the financial system (through loans that are often not repaid), or consumers (through higher prices), management and unions may end up colluding and agreeing on unrealistic wage settlements.

Government’s role as employer

South Asian governments need to improve their performance as employers of civil servants who provide public goods, such as

health and education. This requires a review of policies on the size of the civil service, remuneration, recruitment and promotion, and funding for materials and supplies.

The poor provision of essential public services is endemic to many developing countries, and South Asia is no exception. Demoralized school teachers do not provide students with a high-quality education. Doctors trying to supplement inadequate public salaries are unavailable for poor patients. Why are public employees, especially in developing countries, so likely to be inefficient? Most of the answers lie in the special character of public service. Measuring the quality and quantity of public service provision is difficult—as is evaluating workers on the basis of personal achievements. Providers of public services such as health care and education are encumbered by multiple objectives (ensuring equity, addressing poverty) that their private counterparts may not face. And like other street-level bureaucracies—the police force, courts, agricultural extension, and irrigation—these workers cannot be directly and continuously supervised because they interact with the public on a daily, individual basis.

Consider the experience of primary education in Bangladesh. The government is committed to improving the quality of education and has increased budgetary allocations for the sector. The full impact of higher expenditures on service delivery is yet to be felt, however, partly because of administrative weaknesses. Lack of qualified teachers is a big impediment. Teacher-pupil contact time in Bangladesh’s primary schools rarely exceeds ninety minutes a day, compared with international norms of around four to five hours and a national target of two hours. The situation is aggravated by irregular teacher attendance. Surveys show that as many as half the teachers are absent at a time, and it is not uncommon for schools to have a single teacher for more than a hundred children at different grade levels. (The international norm is one teacher for thirty pupils.)

Public wage and employment policies must reflect market realities. International experience indicates that government wage and employment policies are often at least partially responsible for such problems as lack of qualified public workers and widespread absenteeism. Many governments have let the size of the public service balloon, while limited resources have pushed real remuneration far below what a market-determined wage would have been. In some countries low pay has reduced the loyalty and dedication of many civil servants and lowered the incentives for talented and honest workers to move to or stay in public jobs. Salary compression has made matters even worse. The salaries of professional and skilled staff were allowed to fall more quickly in real terms than the earnings of those in lower grades, not because of any market evaluation of experience or education but because it was politically easier for governments. These changes in relative pay had significant consequences for the hiring, retention, and performance of senior civil servants and the

most skilled employees and, hence, for the productivity of those under their supervision.

Cutbacks in spending on materials and supplies also contributed to the deterioration in the quality of services. Civil servants cannot perform well if they are not provided with the tools to do the job. For example, many public hospitals in South Asia have excellent physicians but lack medicines and surgical supplies. Witness Pakistan's primary health care system. People avoid going to Pakistan's public hospitals because they lack adequate medicines, equipment, and supplies. Although a majority of the population is within reasonable reach of a public health facility, only 21 percent of patients first consult such a facility. Even very poor patients first consult a private service provider in 75 percent of cases.

To be fully effective in increasing the quality of services, reforms must include policy changes to ensure that the right people are selected for government jobs, and that employees are rewarded for hard work and held fully accountable for their actions. One way of attracting the best employees is to combine good salaries with objective, merit-based selection procedures, such as entrance examinations and interviews. In this area India does well. University graduates are recruited into officer ranks by national and state public service commissions that interview candidates and design examinations for different government departments. Although the large number of applicants means that some interviews take less than five minutes, using the examination and interview procedure nonetheless adds a merit-based element to recruitment.

Civil servants also need to be rewarded for their achievements and held accountable for failures. One powerful way of motivating workers is to link promotion to performance. The Indian civil service is typical. Promotion within the officer cadre is based solely on seniority. Officers are recruited in batches, and within each batch seniority is determined by the rank assigned by the public service commission on the basis of the initial examination and interview. Officers retain this seniority ranking for the rest of their careers, and it is rare for an officer to be promoted out of order. By contrast, promotion in the Korean civil service is based on a formula that weighs both length of service and individual merit. Merit is judged by subjective and objective criteria—test scores from training courses, performance assessments by supervisors, and other factors, including awards and special prizes for outstanding job performance or for other forms of public service.

Dealing with income insecurity

Public and private sector workers and their families worry about the consequences of drops in labor income, whether due to unemployment, disability, or old age. South Asian societies are concerned about income declines that push people into poverty or deepen poverty for those who are already poor. Both informal

and formal mechanisms are used to reduce these risks. Income transfers between households and assistance from the extended family are the most common informal ways of easing the impact of sharp falls in income. In the formal sector, contracts between workers and employers almost always have an insurance element.

Private strategies for providing income security do have significant limitations, however. Households may be unable to borrow to cover temporary declines in labor income. Community support mechanisms break down when there is a community- or economy-wide shock and weaken with urbanization and the diminishing importance of the extended family. Private insurance markets for unemployment, disability, and old age are limited or absent, in part because of perverse incentive effects such as adverse selection (only those likely to need insurance purchase it) and moral hazard (once insured, individuals are more likely to adopt behavior that results in their reaping the insurance benefits).

These limitations imply that governments may have a role to play in the provision of income security. In South Asia, governments provide income security to informal and rural workers through public works programs and other safety nets. Interventions in the formal sector are in the form of job security regulations and severance pay.

Public works programs are widely used in the region to complement private efforts that help the unemployed poor, provided they are willing to work for low wages. These schemes are especially appropriate during major recessions, when other job opportunities are unavailable. They are also well suited for rural areas in the slack season and can have a secondary benefit of building or maintaining important infrastructure assets. The level of wages can determine the success of such programs in targeting the needy. Wages need to be set low enough so that only the truly needy will accept the job. High wages may attract better-off workers and, given limited budgets, lead to fewer jobs for the truly destitute. Consider the experience of the Maharashtra program in India, which seeks to guarantee employment on demand. In its initial fifteen years the program maintained wages on a par with prevailing wages for unskilled casual agricultural labor. But in 1988 wages increased sharply, in line with the doubling of the statutory minimum wage. In the year after the wage increase, the program was no longer able to guarantee employment.

Although effective in dealing with unemployment and seasonality, public works programs can do little for disabled or older workers. People incapable of manual labor, often among the hard-core poor, cannot benefit from these programs. Hence, public works need to be supplemented by other types of public transfers and by non-work-related social safety nets. Bangladesh's Vulnerable Groups Development Program is an example of a successful intervention of this type in rural areas. It supplies grain to about half a million rural women and children and relies on local

leaders to identify the needy. Targeting is also improved by focusing the program's activities on at-risk regions.

Governments devote a large part of their efforts to providing income security for formal workers. Because unemployment benefits are complicated to administer, job security regulations and severance pay are used instead in South Asia. Job security legislation is often designed to discourage arbitrary dismissals by establishing a liability for employers who fire workers without just cause. Excessive job security, however, can discourage hiring. Sri Lanka's job security regulations may be doing just that. In addition to requiring employers to pay severance wages and contribute to provident funds, Sri Lanka's laws restrict a firm's ability to lay off workers. Firms with more than fifteen workers may not lay off workers on nondisciplinary grounds without their written consent. Firms usually must make large severance payments, beyond what is required by law, to obtain this consent. Not surprisingly, many firms hire workers on a casual or daily

basis or rely on subcontracting to circumvent these rules. India's situation is similar. An econometric study estimated that India's job security regulations reduced formal employment in thirty-five industries by 18 percent.

Since unemployment benefits are complex to administer and job security legislation discourages formal employment, many countries try to address the real concerns of formal-sector workers by requiring firms to make lump-sum severance payments. In Bangladesh severance payments are set at two months' basic wage for each year of service. If set too high, severance payments discourage hiring, driving employers and workers to rely on fixed-term or daily contracts to avoid the severance pay requirement. If set too low, severance pay will not provide socially desirable income security. There is no magic formula for determining the appropriate level of job security and severance pay, and governments will need to rely as much as possible on consultations and bargaining with trade unions and employers.

Lowering the Temporary Costs of Transition

Development strategies of the past that stressed the public sector and import substitution and that provided special privileges and protection to a small group of workers have not delivered results. As in most developing nations and the economies of Eastern Europe and Central Asia, the economies of South Asia are undergoing a deep transformation toward greater openness and market orientation. Some workers will experience temporary losses as jobs are destroyed and as once-protected wages and benefits adjust to market realities. South Asian countries are in a better position than most other countries undergoing this transformation. They do not face severe macroeconomic imbalances. The modern sectors that were protected and need reforms are a small proportion of the overall economy, which remains primarily agrarian and market oriented. And they have not experienced massive political and institutional upheavals. How fast should reforms be implemented? And, how can the social costs associated with the transition be minimized?

The speed of transformation

Should reform be gradual, with slow destruction of unviable jobs, or rapid? From labor's perspective, the ideal is to phase out jobs only as new jobs are created, and thus to minimize the drop in labor demand. This strategy of gradual transformation has been used successfully by China, which chose to protect unviable jobs to avoid social and political difficulties. Many Latin American countries and post-centrally planned economies chose to transform their economies more quickly.

Initial conditions can exert a powerful influence on the scope and pace of reform. The pace of job destruction, for example, can be managed only if the protected sector is small relative to the rest of the economy. Similarly, a gradualist approach to reform is easier in an economy that starts from macroeconomic equilibrium than in one plagued by high inflation or shortages of foreign exchange. A comparison of China and Russia illustrates the difference that initial conditions make. China chose a two-track approach: it continued state control of existing enterprises while permitting a new, nonstate sector to emerge largely outside of government control. This strategy was possible because the inefficient state sector accounted for a relatively small

share of the economy. That was not the case in Russia. And because China had a far larger informal agricultural sector than more heavily industrialized Russia, it had experienced less misallocation of resources.

These different initial conditions constrain both the path of transition and the strategic choices open to policymakers. China's large rural supply potential gave a powerful initial spurt to growth and allowed a gradual transition. Lacking such supply potential, the countries of Central and Eastern Europe and the former Soviet Union had to reform their state sectors and accept the destruction of state employment rather than postpone reforms as China did. As a general proposition, initial conditions are more advantageous when labor and capital are highly mobile and where there are viable sectors with a strong supply potential.

South Asian economies bear a greater resemblance to China than to Russia. The industrial sector, which has the most distortions, is a small part of the economy—only 25 to 27 percent of GDP in India, Pakistan, and Sri Lanka, and 18 percent in Bangladesh and Nepal (Table 5). The large agrarian markets could be an important source of growth and help absorb some of the labor that will need to leave inefficient industrial sectors. Moreover, South Asian economies are not facing severe macroeconomic imbalances or balance of payments and debt crises. Hence, they are not under pressure to act swiftly to achieve equilibrium and can afford to implement reforms gradually.

Gradual does not, however, mean a stop-and-go reform path that is hostage to interest group pressures. No adjustment can succeed without a credible commitment to move away from an old, undesirable equilibrium to a new one, following a basic plan that sets out the main direction of reform. The essential components of such a plan are straightforward: greater reliance on market forces, redefinition of the role of government, a stable macroeconomic framework, and increasing integration with the world economy through open trade. In South Asia credibility depends on dealing with the public enterprise problem. Large public enterprise losses have important budgetary implications, and public enterprise debts are a constraint on financial sector reform. Moreover, in some sectors the existence of large, inefficient public enterprises that receive special treatment and protection discourages private investment.

Industry is still a small part of South Asian economies

Table 5. Conditions affecting the pace of transition, 1993

Country	Share of industry in GDP (percent)	Average inflation (1980–93)	Reserves (months of imports)	Debt to GDP (percent)	Debt service ratio (percent)
India	27	8.7	3.6	29.1	28.0
Sri Lanka	26	11.1	2.9	41.9	10.1
Pakistan	25	7.4	1.4	39.1	24.7
Bangladesh	18	8.6	5.5	31.1	13.5
Nepal	18	9.5	6.8	25.6	9.0

Note: Debt is calculated in present value terms.

Source: World Bank data.

A credible and sustainable reform program also requires that government, capital, and labor perceive a common interest. Because unions in South Asia represent workers who were relatively privileged before the transition, they are a vocal force against economic modernization. Gaining organized labor's support is crucial. Making the long-term gains of reform explicit can help. So can mechanisms that precommit the government to follow through with the reforms and prevent it from renegeing on its promises.

Dealing with the social costs of transition

Regardless of the pace of reforms, the major changes needed in South Asia will have profound effects on some workers. Governments could play an important role in softening this impact. In times of major transitions, workers, especially those used to job security, fear losing their jobs and bear significant psychic costs. In South Asia workers in public enterprises, who enjoyed an implicit lifetime employment guarantee, are important losers. Workers in agriculture and in the emerging export sectors will generally gain. Government policies to support those who lose their jobs have often involved retraining, support for business startups, public works, and transfers to laid-off workers.

Retraining schemes seem to work differently for different groups of workers in different countries, though in general experience with retraining and support for business startups is not very encouraging. Strengthening the private sector as a provider

of retraining can improve its effectiveness. Chile shows that a system based on distributing vouchers to targeted groups, allowing them to buy training services in a competitive market, can work particularly well. By contrast, special credit programs in Sub-Saharan Africa and Latin America have rarely brought benefits. In the industrial countries these schemes have been shown to be of interest only to a small subgroup of the unemployed (about 3 percent) and have had significant displacement effects.

Public works can serve as a bridge between jobs during periods of major change, although they do not improve the long-term prospects of participants. Such schemes have been used successfully as antipoverty measures in rural South Asia—Maharashtra or food-for-work programs in Bangladesh and Nepal. In periods of massive transition they could also be extended to urban areas, as in Chile in the 1980s.

Boosting transfers to workers displaced during transition can also help. Permanent income security mechanisms—unemployment insurance and severance pay—may be inadequate in transitions because of huge (though temporary) increases in the number of unemployed or in the number of households in poverty. Governments may also be concerned about losing political support for reforms if income falls too much, especially among the politically influential. Many countries have adopted special provisions to deal with public workers who lose their jobs during transitions, including higher than normal severance pay. Clearly, the decision on the level of this compensation has to be based on social, political, and budgetary considerations.

The Outlook for South Asian Workers

Are the countries of South Asia poised for an East Asia-style take off and engagement in the international economy, or will their transition stall? At present South Asia is weakly integrated into international trade. Workers have seen average incomes rise slowly with labor productivity. The accumulation of capital and skills has also been steady though slow. But industrial labor absorption has been weak, and agriculture remains overregulated. The liberalization of agriculture and the takeoff in manufacturing must go hand in hand. In the absence of a strong pull of labor demand from manufacturing, there is a real risk of rising inequalities and stalled reforms.

Government policies could help workers seize the new opportunities provided by the global economy and minimize the risk of a stalled transition. In South Asia policies should aim at

encouraging private saving and investment (raising investment's share of GDP to at least 26 percent) and promoting exports (which need to rise by almost 9 percent a year in real terms). Concomitantly, governments should ensure that labor market interventions benefit all workers, not just the lucky few with modern sector jobs. The benefits to South Asian workers from good domestic and international policies could be enormous. Projections under assumptions of high investment and export growth show real wages increasing at more than 5 percent a year and the incidence of poverty falling rapidly. Good choices by governments, in the domestic and international realms, can lead to advances in the incomes of all workers, can address both their rights and their concerns, and can help bring back into the fold those who are unable to keep up or adjust on their own.

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This paper draws on the World Bank's *World Development Report 1995: Workers in an Integrating World* (New York: Oxford University Press, 1995). Additional data for South Asia were obtained from national statistical sources, from World Bank data collected for poverty assessments and public expenditure reviews, and from the papers and reports listed below.

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