

# INTRODUCTION

1. The objective of this report is to analyze the important roles of labor markets, employment, productivity and labor income in facilitating shared growth and promoting poverty reduction in Bangladesh. At first, the report provides a background discussion of poverty, reform and growth in Bangladesh. Following this, an overview of the labor market is provided, describing the country's demographics, the institutional structure of the labor market, and the labor market indicators. Then, a poverty profile of the labor market is developed. A discussion of the income sources, and a decomposition of poverty reduction follow. A number of selected issues are discussed in the final section, including rural versus urban conditions, men, women and children in the labor market, self-employment and household employment, and socioeconomic inequalities.

2. The present study is part of the World Bank's broader PRMPR program on employment and shared growth, and is linked to the Bangladesh Poverty Assessment 2007.

3. The focus of the report is on the period 2000-2005, because this was the period in which Bangladesh witnessed a spectacular decrease in the extent of poverty, in which the labor market, employment and productivity played an important role. In addition, relatively good data were available for this analysis.

#### **4. The followings are the main findings of this report:**

- Urbanization and the associated expansion of the services sector have recently taken over as key factors shaping the development process in Bangladesh. This brings new challenges to the poverty reduction effort.
- The relatively flexible and gradually broadening labor market should facilitate the economic transition for the country.
- Although job creation has been an important factor, recent increases in income per capita and the recent reduction in poverty, have been linked predominantly to rising productivity in employment, rising wages and rising labor income. Most of this poverty reduction has taken place within the economic sectors.
- Nevertheless, the main determinant of labor market and poverty outcomes is endowment in productive assets – both physical capital and human capital. Additional investment in these assets is necessary, as is an environment conducive to higher returns to these assets.

- It is important to note that women are playing an increasingly significant role in the Bangladesh labor market. Nevertheless, their contribution remains small because of traditionally very low levels of participation.

**5. *Urbanization and the associated expansion of the services sector have recently taken over as key factors shaping the development process in Bangladesh. This brings new challenges for the poverty reduction effort.***

(i) Despite the robust overall population growth, the rural population is nearly stagnating while the urban population is growing at a rate triple that of the national average. At the same time, the shift away from agriculture is ongoing, with daily labor in agriculture migrating to urban areas to take up non-agricultural work (usually as daily workers or the self-employed).

(ii) The service sector is now the fastest growing sector, which marks a change from the 1990s, when the manufacturing sector (mainly ready-made garments) was responsible for pushing up incomes and expanding employment (it still does, but to a lesser extent).

(iii) Among the new challenges posed by this trend are the following. The absolute number of the urban poor has increased despite the overall country-wide reduction in the extent of poverty. As the migration of the landless poor to rural areas is likely to continue, the time might be ripe to consider special programs for the urban poor (until now, most anti-poverty programs were addressed to rural areas).

**6. *The relatively flexible, and broadening, labor market facilitates the economic transition.***

(i) Firms do not report particular problems with the hiring and firing of workers. The labor market dimension of the Doing Business environment in Bangladesh compares favorably with that of its neighbors. The minimum wage does not constrain employment growth.

(ii) More transactions are market based. There are more salaried jobs, particularly in the private sector; more wages and land rents are paid in money rather than in kind; and the use of formal financing for household enterprises is gradually improving.

(ii) As regards segmentation, the returns to labor are surprisingly similar across job categories, except for daily labor, which is clearly the least desirable option. Self-employment does not seem to be particularly inferior compared with salaried employment in the private sector. Nevertheless, some long-standing segmentation is visible between public and private employment and between rural and urban areas. In addition, women are at a significant disadvantage in the labor market.

**7. *Although job creation has been important – recent increases in income per capita and the reduction in poverty have been linked predominantly to the rising productivity of employment, rising wages and rising labor income. Most of the poverty reduction has taken place within the economic sectors.***

(i) The results from decompositions suggest that productivity improvement and wage growth were key factors in income increases and subsequent poverty reduction. The lack of contribution of employment rates reflects in part the fact that unemployment is not an option for many in Bangladesh, so the scope for further increases in the employment rate (at least for men) is limited.

(ii) If we look beyond the aggregate and into the sectors – we find that within agriculture, the growth was related to rising productivity and an outflow of people to other sectors. As regards

manufacturing, productivity was a key factor in the growth of income. The potential of manufacturing to further boost employment (as was the case in the past) should not be overestimated, not least because Bangladesh's garment export will face increasing competition owing to the expiration of favorable MFA quotas. Regarding services, the expanding employment in this sector has greatly contributed to increases in GDP per capita. Thus it appears that the services sector, particularly in urban areas and in the private sector, has the potential to provide employment and income opportunities for many poor people in the future.

(iii) However, it should be noted most of the poverty reduction has taken place within economic sectors rather than through intersectoral flows. The same principle applies to rural versus urban areas. Therefore, taking into account that there still are five times as many of the poor in the countryside as in the cities and given that the majority of the new entrants to the labor market would need to find their jobs in rural areas, the thrust of poverty reduction efforts may need to remain in areas where the poor are to be found, and concentrate on promoting productivity growth where productivity and wages are low – while simultaneously trying to facilitate job creation in and inflows to sectors where productivity is high (such as services in urban areas, but also manufacturing). In rural areas, non-farm employment and diversification into higher value added crops have performed well for the past several years in this regard, and they hold considerable potential for the future.

**8. *Still, the main determinant of labor market and poverty outcomes is endowment in productive assets – both physical capital and human capital. Additional investment in these assets is necessary, as is an environment conducive to higher returns to these assets.***

(i) For the waged workers, education is a key determinant of whether a person finds a decent job. For the self-employed, the importance lies in productive assets (although education is also important). Land ownership is closely linked to poverty in rural areas, and landless workers usually end up as poor daily workers.

(ii) Despite very great increases in micro-credit over the past several years, a lack of capital remains the issue for household enterprises. Ninety percent of entrepreneurs finance their businesses from own savings or from families, or friend's savings, while half of them report credit and capital as the main problem.

(iv) In addition, a conducive environment for the returns to human and other assets is crucial. Considerable evidence supports this: enterprises benefit significantly from better access to infrastructure; the deficiencies in the rule of law are at the top of the list of growth constraints for firms. On a positive note, a stable macroeconomic environment and trade openness are believed to have decisively contributed to the current growth acceleration.

**9. *Women are playing an increasingly important role in the Bangladesh labor market. But their contribution remains small, because of traditionally very low levels of participation.***

(i) Women's participation rates, working hours, levels of education and income levels have all increased at a much faster pace than those for men. Moreover, an increasing share of women's income derives from salaried employment as well as from household enterprises, often with more formal sources of financing.

(ii) Although women's income is non-negligible, their labor market participation is too small to make a significant dent in poverty. Furthermore, growth in their activity has been concentrated in the middle range and at the higher end of the income distribution.

(iii) The current urban shift is important, as it provides an opportunity for women to take part in productive employment on better terms.

10. The structure of the report is as follows: Chapter 1 describes the nature of economic growth in Bangladesh during the past three decades, focusing on the reforms that led to the recent growth acceleration, and discusses the poverty reduction record up to the present. It also introduces the data used in this report to analyze the links among employment, earnings and shared growth. Chapter 2 presents the main features of the Bangladesh labor market, including demographic developments, the institutional underpinnings of the labor market, the investment climate for firms, and the sectoral composition of employment, as well as the general trends of the key indicators.

11. In Chapter 3, the links between poverty and the labor market are explored. The chapter looks into the sources of income and develops a labor market poverty profile. By decomposing income growth and poverty reduction into components, it attempts to find which sectors were growing and whether poverty reduction took place as a result of sectoral shifts in employment or through growth within sectors. Finally, Chapter 4 discusses several topics important to a better understanding of the functioning of the labor market in Bangladesh and its link to poverty reduction. These issues are multiple income sources, labor market segmentation, self-employment and inequality, as well as rural/urban issues and issues concerning men/women in the labor market, and child workers.