MILES TO GO: A QUEST FOR AN OPERATIONAL LABOR MARKET PARADIGM FOR DEVELOPING COUNTRIES

Social Protection & Labor Sector
The World Bank

Abstract

Recent decades have witnessed mixed success of developing countries to improve their labor market outcomes through structural and other economic reforms. While the World Bank as well as other international and bilateral organizations have undertaken a number of initiatives over the last years to better integrate employment into development agenda, a comprehensive and operational labor market paradigm for developing countries is still missing to better guide policy decisions and to improve employment outcomes. To work toward an integrated, operationally relevant labor market paradigm for developing countries, the World Bank proposes a two-prong strategy consisting of (i) a policy relevant multi-sector policy framework – MILES – to help countries designing a comprehensive labor market strategy to create more and better jobs, and (ii) an extensive, in-depth and policy-relevant research agenda to better understand the functioning of labor markets and employment outcomes. The research agenda will be undertaken by leveraging on the international research community with financing by a multi-donor trust fund.

1 This note draws on various materials produced over the last few years to further the employment and development agenda inside and outside the World Bank. It wants to acknowledge the contribution to these notes by a number of World Bank staff, in particular (in alphabetic order) Arup Banerji, Robert Holzmann, Pirella Paci, Carmen Pages (now IADB), Stefano Scarpetta (now OECD), and Milan Vodopivec.

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Executive Summary

Past decades have witnessed mixed success of developing countries to improve their labor market outcomes through structural and other reforms. Even when economic growth improved, many countries have not generated enough jobs, and the jobs created have often been of low productivity and low pay. This note claims that these outcomes were not inevitable: They materialized with such strength in many countries partly because the labor market was not at the center of the structural adjustment policy agenda and policies lacked an operational labor market paradigm to guide the decisions. While the World Bank as well as other international and bilateral organizations have undertaken a number of initiatives over the last years to better integrate employment to development agenda, we believe that a comprehensive, operationally relevant labor market paradigm for developing countries is still missing to guide policy decisions and to improve employment outcomes.

To formulate such an integrated, operationally relevant labor market paradigm for developing countries, this note proposes a two-prong strategy of:

1. Building a policy relevant framework – MILES – to help countries designing a comprehensive labor market strategy to create more and better jobs, and, simultaneously,
2. Carrying out an extensive, in-depth, and relevant policy research on labor markets in developing countries to learn how efficient labor markets can contribute to growth and development goals, especially poverty reduction.

Recognizing the need to formulate a labor market paradigm for developing countries, the World Bank has been in the past years actively involved in building an operationally and policy relevant framework to help countries design a comprehensive labor market strategy to create more and better jobs – the MILES framework. The framework is multi-sectoral by its very design, focusing on five areas considered critical for employment creation (hence the acronym MILES): Macroeconomic policies, Investment climate, institutions and infrastructure, Labor market regulations and institutions, Education and skills, and Social Protection (social insurance and social safety net programs). Building on various diagnostic tools in areas central for job growth, the framework aims at identifying key constraints for job creation in an individual country, proposes policy priorities and required reforms, and helps implementing them. The implementation of MILES requires obtaining support from key stakeholders and close cooperation across different ministries, institutions, and social partners. The Bank is well-placed to carry out this task by using its AAA and ESW work to provide analytical content, and various loans and grants to provide necessary funding, and has successful piloted the MILES framework in more than 15 countries.

The second key component of developing an integrated, operationally relevant labor market paradigm for developing countries rests on implementing a parallel research agenda on “Employment and Development”. The agenda aims to generate knowledge necessary to close crucial gaps in our understanding of how labor markets in developing countries function and how employment outcomes can be improved to further development objectives, including achieving the MDGs and inclusive and sustainable globalization. The note describes the identified seven research priorities where obtaining further knowledge is deemed most important. The research agenda is broad and analytically rich, and its successful implementation requires collaboration of the World Bank with other multilateral agencies and the international research community (e.g. the joint work program with IZA). It hinges also on the support of donor countries (including the recently launched multi-donor trust fund “Labor Markets, Job Creation, and Economic Growth: Scaling Up Research, Capacity Building, and Action on the Ground”).
1. Introduction

Over the past two decades, many developing countries embarked on major economic and social transformations that often put them on higher, and more sustainable, growth paths. In too many cases, however, these transformations have not led to major improvements in labor market outcomes, with high or even increased unemployment, in particular among the youth or underemployment in low productivity jobs. Since labor is often the main – if not the sole – asset of the poor, a process of growth that was not associated with strong job creation also had a limited impact in reducing poverty and exclusion. Such unfavorable labor market consequences, besides being undesirable, have in many cases weakened popular support for needed reforms. In this context, it is not surprising that a recent report by the World Commission on the Social Dimension of Globalization (2004) called policy makers in developing countries – as well as donors and international organizations – to put employment at the center of their development strategy.

The unfavorable employment outcome observed in many developing countries is the result of a number of interacting factors. First and foremost, growth, while improving in many countries, has not been enough to generate enough jobs for a rapidly growing working age population in many countries. Growth and job creation should have been much stronger than those observed in order to accommodate the larger youth cohorts that have entered the labor market over the past decade. Second, the challenge for many developing countries is not only the creation of more jobs, but also the quality of these jobs. In many cases, the new jobs being created are of low productivity and low pay – such as those in subsistence agriculture or in the informal sector; these neither meet aspirations for a more skilled labor force, nor do they allow those who get them to escape poverty. Among the 2.85 billion people aged 15 and older who do have jobs, nearly half do not earn enough to lift themselves and their families above the US$2 a day poverty line – just as many as ten years ago.

Last but not least, labor market conditions in all countries have also been influenced by increased globalization. Greater integration in the global economy has increased opportunities for developing countries to have access to new markets and technologies, but has also exposed them to stronger competition from other countries. In particular, the full integration of China and India in the world economy has put pressure on wage rates world-wide. While globalization, with its stronger integration of the markets for goods, services, and factors of production has allowed firms in the developing world to choose their production technologies, these choices may not necessarily create more jobs or improve productivity of labor. Indeed, while early empirical evidence based on cross-country comparisons suggested little impact of globalization on wages and working conditions, more recent analysis of micro-data sets identified a stronger link with both negative and positive effects – and there is growing evidence that trade is increasing income disparities (Brown, 2007).

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2 A recent participatory study conducted in 23 countries, gathered the opinions of poor people, most of whom pointed to increased unemployment and decline in the availability of “regular” or “normal” work as the main cause behind the deterioration of livelihoods and income (see Narayan and Petesh, 2002). A recent study on ten African countries also revealed that creating more jobs is considered as the first priority for the respondents among all human development outcomes and the one where the was the largest gap between their preferred focus and the perceived current focus of the government (see “Africa in the New Century,” 2006).
Against this background, and in support of its mission of poverty reduction, **the World Bank has undertaken a number of initiatives over the last years to better integrate employment to development agenda.** Regional departments have undertaken in-depth reviews of labor market conditions in many client countries and have identified areas of specific policy interventions. Drawing from these country studies and several regional flagship publications on labor market, the Bank has also organized an international conference to consolidate the acquired knowledge on labor market conditions and identify areas for further research. Moreover, the Bank has launched a major study on “pro-poor growth” over the past years that has also contributed to our understanding of the links between labor market outcomes and poverty alleviation. In addition, the Bank has been actively involved a number of join initiatives with other international organizations. For example, the Bank participated in the creation of the **Youth Employment Network** (together with the UN and the ILO) and is contributing to the implementation of its agenda in several developing countries. Moreover, the World Bank has joined forces with the Institute for the Study of Labor (IZA) – the world’s largest network of labor market researchers – to create a new IZA research program on “Employment and Development.” The program is aimed at promoting policy-relevant research and foster cooperation between research institutions, donor organizations, and policymakers. Furthermore, the Bank has increasingly been engaged at country level in labor market and employment issues – from analytical studies to support of reforms and capacity building.

**Despite these initiatives and efforts, we believe that a comprehensive and operational labor market paradigm that moves employment back on the development agenda and better guides policy decisions for improved employment outcomes is still missing.** In particular, to contribute further to overall economic development and poverty reduction, we need to understand better how the different pieces fit together – for example: How do labor market policies and institutions contribute to a better investment climate while promoting decent working conditions and supporting workers affected by changes? How do labor markets function in the regulated and unregulated sectors, and how could policies be tailored to the needs of workers in the two sectors? Because economic reform does not happen in isolation, what are the costs of reforming some areas (i.e., product or financial markets) but not labor markets? Is there an optimal sequence for reforms? How can the Bank facilitate the political process of labor reforms? And what are the interactions between education and labor market policies that can promote human capital, enhance productivity and wages, and promote adaptability of workers?

**To formulate an integrated and operationally relevant labor market paradigm for developing countries, this note outlines the proposed two-prong strategy:**

- building a policy relevant framework – MILES– to help countries designing a comprehensive labor market strategy to create more and better jobs, and
- carrying out an extensive, in-depth policy-relevant research on labor markets in developing countries to learn how efficient labor markets can contribute to growth and development goals, specifically poverty reduction.

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3 This new research program was launched in May 2006 with a conference in Berlin. The 2nd research conference was held in May 2007 in Bonn, the 3rd will be held early May in Rabat, Morocco. These conferences also provided a major opportunity to discuss possible means of financing with donor countries, through a proposed trust fund initiative as a funding mechanism for the research program that is under implementation (see below).
The success of this endeavor requires an institution-wide effort – and beyond. Labor markets cut across the Bank’s traditional sectoral mapping. They are also far from uniform so regional and country-specific diversity must be recognized. And of course, there are many external partners whose resources and knowledge would be critical to achieving the objectives of the research strategy.

This note is organized as follows. Section 2 summarizes some of the main labor market challenges facing developing countries and discusses how the thinking about labor market issues has evolved within the World Bank. Section 3 highlights the main conclusions of a stock-taking conference conducted at the Bank in 2004 to assess labor market issues and policy challenges in different regions of the world. Section 4 proceeds with the description of the evolving MILES framework, the framework that focuses on several areas critical for employment creation and recognizes that successful policies must concentrate on key binding constraints to growth and job creation in each area. Section 5 describes key research priorities that have been identified by the Bank as areas where further knowledge should be generated so that the relevant labor market paradigm can be developed. Section 6 outlines the multi-donor trust fund that has been created in order to support the implementation of the research agenda and to support the capacity building on employment issues in client countries – the fund’s objectives, financing mechanism, and future steps.

2. Labor Market Imbalances and Evolving Bank’s View about Labor Markets⁴

The past two decades have witnessed major shakeups in the economic and social systems of many client countries. Some have gone through a fundamental transition from a centrally-planned to a market economy; others have implemented far-reaching structural adjustment packages, including financial-market and trade liberalization, privatization and product market deregulation. At the same time, all countries have been confronted with the growing challenges of a globalizing world. These changes have significantly reshaped the society itself, leading to stronger, and more sustainable, economic growth in many countries. But labor market outcomes, in many cases, have not improved, with rises in unemployment, inequality, and exclusion. We claim that these outcomes, which stand in sharp contrast to the poverty and development objectives of the Bank, were not inevitable and that they materialized with such strength in so many countries partly because the labor market was not at the center of the structural adjustment policy agenda. While the Bank has invested in its knowledge base on the labor market, this work has largely focused on the effectiveness of specific policies and has not been integrated into our broader development strategy. For such a strategy to spur growth and persistently reduce poverty and exclusion, we need a clearer paradigm about how the labor market functions and its interactions with other factor and output markets and institutions.

Labor market disparities have widened in many client countries

While the aggregate economic impact of structural adjustment programs have differed across countries depending on initial conditions and on the way such programs were designed and implemented, in many cases their implementation has been accompanied by rises in unemployment, underemployment, and inequality. For example, while unemployment was practically nil at the beginning of the 1990s in Central and Eastern Europe, it jumped to about 15 percent of the labor force in the early phases of the transition to a market economy and, despite general recovery in the second half of the 1990s and early 2000s, the unemployment rate often

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⁴ This note includes a number of references to Bank’s operational and analytical work. These should only be considered as examples and not as an exhaustive list of all relevant material.
remained well above 10 per cent (or even close to 20 percent in Poland, Slovak Republic, in some successor states of Yugoslavia, and Bulgaria) and labor force participation rates declined steadily, leading to declining employment rates (the shares of people of working age in employment – see Figure 1). Many Latin American countries, including those with sustained growth, have also seen major rises in unemployment and inequality together with falls in participation rates: for example, the unemployment rate doubled to more than 10 percent in Argentina, Brazil and Chile in the 1990s and the share of working poor in total employment has risen together with wage and income inequality in most countries. At the same time, while measured unemployment has remained relatively low in Sub-Saharan Africa and in South Asia, the share of working poor has reached more than 30 percent and more than 50 percent, respectively (Figure 1). A common pattern in many of client countries has also been a high incidence of joblessness, exclusion, or poorly paid jobs amongst vulnerable groups – young and old people, women, and the unskilled: often these vulnerable groups have benefited little from improvement in aggregate macroeconomic conditions or have borne most of the brunt of deteriorating conditions.

Figure 1: Employment Rate, Unemployment Rate, and $1 Working Poor 2006 (percent)

These labor market outcomes are obviously not what reformers had hoped for. Understandably, they have also weakened popular support for reforms. In this context, a natural question arises of what has been missing in the design and implementation of many of these reform

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5 A comprehensive WB review of how labor markets evolved during periods of structural adjustment programs confirm these observations. In a number of cases adjustment programs of the 1980s and early 1990s were associated with higher unemployment and under-employment with greater labor market segmentation. See Horton et al. (1994), “Labor Markets in an Era of Adjustment”, World Bank.

packages – the question underlying the current quest for a clearer understanding of the role of the labor market in the reform agenda.

*The Bank’ view of the role of labor markets for development has evolved over time …*

Understanding of the links between economic development and the labor market has evolved dramatically over the past decades. At the risk of over-simplifying, our thinking has evolved along the following lines. Back in the 1980s, a widely shared view was that stabilizing the economy and setting relative prices right would increase the demand for the abundant factor of labor and thus help workers and the poor. Adverse transitional effects were perceived to be short-lived and, at least in middle income countries, social safety nets were considered sufficient to protect workers affected by structural changes. Towards the end of the 1980s, it became clear that macro stabilization and trade liberalization did not lead, by themselves, to improvements in labor market conditions, especially for the most vulnerable groups. Such packages were often accompanied by tough fiscal austerity programs, which typically squeezed expenditures for social safety nets. In the 1990s, therefore, efforts to protect social expenditures and make them more effective in mitigating adverse effects of structural adjustments on the poor and other vulnerable groups became one of the main thrust of the Bank’s activities. In this context, the Bank’s work in the labor market area largely focused on the assessment of specific labor market policies and institutions to help the unemployed or those excluded from the formal labor market, a key element in our operational work with client countries.

…but further work is needed to assess how labor markets contribute to economic growth and empower poor people

Despite increased focus on the unemployed, underemployed and other vulnerable groups in the labor market, the need to formulate a clear paradigm of how labor markets fit into a comprehensive development strategy has now became obvious. In particular, the main challenge for the years to come is to understand how specific labor market conditions of developing countries affect economic growth, how the economy responds to structural reforms, and how the costs and benefits of such reforms are distributed among different social groups.

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7 A retrospective study of the Bank’s adjustment lending policy suggests that Bank’s policies have grown more long-term and developmental in nature over the past decade. However, it also recognizes the need for further improvements in several key areas, including the treatment of social aspects (see Operation Policy and Country Services, “Adjustment Lending Retrospective – Final Report”, June 2001). Results from a stocktaking exercise of World Bank lending and analytical work on labor markets, which reviewed development policy lending projects of the Bank during 2000-2007, confirm this point (Vodopivec et al 2008). For example, labor market conditions were infrequently included in these programs: of the 347 development policy loans reviewed for the 8 years, 38 projects had at least one labor market condition. The ECA region had the largest share of development policy lending projects with labor markets conditionality with 37 percent of the total. The LCR and AFR regions had 32 and 24 percent, respectively, of the projects with labor markets conditionality, while SAR had 8 percent. The EAP and MNA regions had none. In terms of lending amounts, 2.8 percent of total development policy lending over the period addressed labor market issues with ECA and LCR claiming more than 90 percent of the total. Moreover, poverty-reduction policies (including the Poverty Reduction Strategies) generally have significant impacts on the labor market – and in some cases include direct employment-creation programs. However, in many instances, the labor market does not explicitly feature as one of the key factors for these strategies and, consequently, an in-depth assessment of their potential effects on the labor market is lacking.
We believe that the labor market is critical for a sustainable and inclusive development strategy for at least three reasons: First, because it is in this market that the employment shocks related to (and often required by) structural reforms must be handled. Second, labor is most often the only asset of poor people, and a growth process that is not associated with sustained job creation may fail to reach them. And last but not least, a labor market that facilitates job creation and increases in productivity is a key ingredient in a business climate where new firms are created and private agents find the proper incentives to invest and innovate. So a well-functioning labor market is needed to guarantee the success of structural reforms, to maintain social support for these reforms, and to ensure that their benefits are widely distributed. All in all, moving towards a well-functioning labor market is likely to be crucial to a more effective implementation of poverty reduction strategies and hence progress against the MDGs.

This note is concerned with fostering the Bank’s vision of how labor markets function and what strategies work to spur growth and reduce poverty. Its ultimate goal is to develop an integrated and operationally relevant paradigm of the functioning of labor markets in client countries and to assess how efficient labor markets can contribute to the MDGs, specifically poverty reduction.

3. The Labor Market Stock-Taking of the World Bank

In an attempt to develop the labor market paradigm, an early research proposal developed by the Social Protection & Labor unit of the Human Development Network was discussed with a number of sectors, regional units, and DEC in the Bank in the early of 2000s. Two conclusions emerged from these consultations. First, the view was widely shared that a deeper understanding of how labor markets function would strengthen the Bank’s overall development strategy, validating the need for further research. Second, it became evident that considerable knowledge and practical experience on labor markets already existed within the institution.

To make sure that subsequent work takes advantage on the existing knowledge and experience, the World Bank organized a stock-taking conference on labor markets in November 2004, attended by Bank staff as well as external experts from academia and national and international institutions. The objectives of the stock-taking were three-fold: (1) consolidating existing knowledge on labor markets; (2) diffusing this knowledge across regions and sectors in an accessible manner; and (3) identifying areas where important knowledge gaps remain and where further research is needed. Five out of the six Bank’s regional units prepared stock-taking papers, and the East Asia paper was contributed by the Asian Development Bank. Because labor market analysis and experience has been less extensive in low-income countries, HDNSP also sponsored a workshop at the GDN annual conference in Dakar to focus specifically on a labor market stock-taking in South Asia and Africa.

The stock-taking conference and the follow-up workshop underlined the diverse experiences in different regions and produced the following main messages:

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8 The papers/presentations, thematic talks by external specialists, and a final summation are available at: [http://www.worldbank.org/sp](http://www.worldbank.org/sp). The terms of reference for regional papers included labor market trends and outcomes, a review of policy responses, major issues for the future, and knowledge gaps/research priorities.

9 The papers from this workshop are also available at [http://www.worldbank.org/sp](http://www.worldbank.org/sp).

(1) **The objective of employment creation and better jobs is an important but under-focused dimension of the development agenda.** As labor is often the only asset of the poor, providing jobs and making the market where this asset is exchanged more efficient must be a crucial aspect of poverty reduction. Yet, as there are many working poor, access to jobs is not sufficient for poverty reduction; this requires jobs with decent wages and, hence, higher productivity levels. However, the objective of more and better jobs will not be achieved by simply replacing growth with employment at the center of the development debate; rather, we need to think differently about the labor market and development, and how this contributes to employment, poverty reduction and economic growth.

(2) **The importance of labor market institutions for employment and growth differs substantially across regions and countries.** These institutions – comprising labor market regulations, active and passive labor market policies, and wage-setting rules – seem to have relatively little impact on the labor markets of some regions. This is particularly the case in regions where most of employment is in the informal economy (although regulations and institutions may be causing some informality). On the other hand, they are perceived as a binding constraint in other regions.

(3) **The labor market discussion seems to lack a conceptual framework to analyze labor market outcomes, partly because of lacking diagnostic tools and agree-upon labor market models.** There is a need to improve the diagnostic tools to assess labor market conditions in a given country, to identify vulnerable groups, and ultimately to provide better policy advice. Standard labor market indicators, including the unemployment rate, may not be appropriate in low-income countries where vulnerability often takes different forms than in middle- or high-income countries. Related to this is also a shared view that there is no labor market model that fits all countries. And there might be countries with no applicable labor market model at all. This model uncertainty may have consequences in the real world since it is not conducive to a rational policy discourse and may explain the lack of a clear-cut concept on the political economy of labor market reforms.

As an important outcome of stock-taking, a list of research issues relevant either universally or in a number of regions was formulated. This common research agenda, undoubtedly to be handled most effectively through a collaborative work program of researchers at the Bank, other multilateral agencies, and international research community, is presented in Section 5 of this note.

**4. Employment and Development: MILES to Go**

Recognizing the need to formulate an integrated and operationally relevant labor market paradigm for developing countries, the **World Bank has been involved in building an operationally and policy relevant framework to help countries design a comprehensive labor market strategy** to create more and better jobs, thus combating poverty, stimulating economic growth, and contributing to sustainable globalization – the **MILES framework**. Building on various diagnostic tools in areas central for job growth, the framework aims at identifying key constraints for job creation in an individual country, proposes policy priorities and required reforms, and helps implementing them. The implementation of MILES requires obtaining support from key stakeholders and close cooperation across different ministries, institutions, and social partners. The Bank is well-placed to carry out this task by using its AAA and ESW work to provide analytical content, and the multi-sector Development Policy Loans and
investment loans to ensure the necessary funding, and has successful piloted the MILES framework in more than 15 countries.11

The framework is multi-sectoral by its very nature. It focuses on the following five areas considered critical for employment creation (hence the acronym MILES):

- Macroeconomic policies.
- Investment climate, institutions and infrastructure.
- Labor market regulations and institutions.
- Education and skills.
- Social Protection (social insurance and social safety net programs).

The framework recognizes that successful policies must concentrate on key binding constraints to growth and job creation in each sector. Attempting to address all reform needs at the same time is neither politically feasible nor economically useful, as shown by the difficulties of across-the-board reforms, in particular in the labor market area. The framework relies on the following tools and methods to identify the most binding constraints:

- Reviews of existing studies on constraints to growth and job creation (such as effects of institutions on labor market outcomes).
- Opinion polls across the various economic agents (e.g., employers, workers, governments).
- Alternative methods that attempt to identify binding constraints, including microeconometric, structural, experimental, and institutional approaches (see the elaboration on these approaches below), as well as a scorecard approach, using diagnostic tools developed by the Bank and other institutions to prioritize reforms in each of the five MILES areas.

Moreover, given the extreme complexity of the task, a useful approach is to apply several methods simultaneously and compare their results, with binding constraints emerging as intersections among the constraints yielded by these methods (the "triangulation" method).

The implementation of the MILES framework on the country level involves three steps:

1. Review of the policy and institutional framework to identify the most binding constraints in the MILES areas.
2. Formulation of reforms in priority sectors, ensuring their internal consistency.
3. Implementation of reforms to overcome the binding constraints and to create a critical policy constituency.

Below we elaborate on key elements of MILES: its multi-sectoral nature that allows focusing on labor demand and supply; tools and methods which MILES relies upon; and implementation steps that bring MILES into being in the client countries.

4.1 Multi-Sectoral Nature of MILES

The main thrust of the MILES approach is the focus on both labor demand and supply factors. Traditional labor market studies tend to focus on the supply side of the labor market and concentrate on possible labor market and social policy reforms. Instead, the M and I components of the proposed MILES approach focus on demand factors affecting overall macroeconomic

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11 The countries which have applied the MILES framework include Armenia, the Baltic countries, Bangladesh, Bolivia, Brazil, Cambodia, Egypt, India, Madagascar, Morocco, Serbia, Tanzania, Thailand, Tunisia, and Turkey.
conditions as well as the business environment and job creation. While labor market policy and institutions (the L component) affect both demand and supply, the last two components of MILES – education and skill development and social protection – tend to work on the supply side. These five components are briefly reviewed below.

**M: macro-economics.** A sound macro-economic framework is crucial for the decision by entrepreneurs to expand their business and to create new jobs. And these conditions are likely to include macroeconomic stability as well as a supportive fiscal space and monetary policy. According to the recent Investment Climate Surveys (ICS) conducted by the Bank, macroeconomic and political instability are considered as one of the main concerns for the operation of businesses and their decision to enter the market, invest and create jobs. In general, those firms most affected by macro and political instability are small and medium enterprises that typically have the highest potential to invest, expand and hire more workers. This section of the MILES framework will focus on how reforming macro policy settings – by providing a more stable and predictable environment – can contribute to foster investment, growth and job creation.

**I: investment climate, institutions and infrastructure.** Firms will expand and create formal sector jobs when costs of doing business (from regulation, heavy tax burden and poor infrastructure) are low and predictable. But even when market costs appear to be low, the shadow costs for doing business – such as the lack of access to finance or to markets or corruption – can be very high. A poor investment climate often has disproportionately negative effects on small and medium sized firms. Many of them stay informal and fail to fully exploit their potential by expanding and creating more jobs. While selective interventions to target specific sectors or type of firms have seldom worked, empirical evidence suggest that improvements of the investment climate to create a level plain field tend to benefit the most small and medium-size firms (see World Bank, WDR 2005). This section of the MILES framework will make use of existing tools – Doing Business and ICS – to diagnose the status of the business environment and, in particular, how this affect those firms/sectors with the greatest potential to create more jobs, and then to develop the policy instruments to create a more employment-friendly climate for businesses.

**L: labor market regulations and institutions.** Labor market regulations and institutions affect different aspects of working conditions and the labor contract between workers and employers. Sound regulations are crucial for both the employer and the worker to engage in a productive and longer-term working relationship. But these regulations need to strike a balance between protecting jobs and enhancing working conditions with the need for firms to adapt to the evolution of demand. In many developing countries, current labor regulations provide a high standard of protection to a few workers but no, or minimal, protection for most of those in the unregulated economy. Labor market regulations and institutions also play an important role for working conditions and in the wage setting process, by mandating minimum wages and by setting rules for wage negotiations among the social partners. Recent and innovative empirical work in developing countries indicates that these regulations and institutions have a significant bearing on job creation and wage growth through their impact on sector choice and firm size. This section of the MILES framework will assess the status of labor market regulation, their degree of enforcement, and thus the impact of reforming such regulations on job creation and workers’ protection on the job. This analysis should also be conducted in conjunction with the one focusing on social protection schemes that provide income or active support to the unemployed.

**E: education and skills.** Decent jobs, i.e., higher productivity jobs, are invariably based on good formal education and require appropriate skills for all age groups. Then educated young people have a better chance of finding the type of jobs demanded by firms, and the elderly have a chance
to remain longer on the labor market, which in turn increases their incentives to engage in life-
long learning. According to the ICS, many employers consider skill shortages as a main 
constraint to the operation of their business and growth potential. Increasing the quality of the 
labor force is essential to increase the productivity and the earnings of workers. Yet, in many 
countries, state-provided training services have been inadequate and disconnected from the 
requirements of employers. Interventions in skill formation should take into account that (i) most 
training takes the form of on-the-job training; (ii) medium- and high-skill workers are more likely 
to be trained by firms than low-skill workers; (iii) larger firms are more likely to provide formal 
training their workforce than smaller firms; 12 (iv) many workers in developing countries are self-
employed; and (v) economic analysis has often shown that the returns to human capital 
investments in workers are highest when workers are supported in furthering their general 
(school-provided) education. This section of the MILES framework will review education 
attainment and enrollment rate, information on skill shortages and returns to education, and the 
policies of school to work transition and life-long learning. The objective is to characterize the 
potential impact for job creation of the potential education gap, but also to develop policies to 
address skill mismatches and redress factors that lead to low individual and/or social returns to 
investment in education.

S: social protection. A strong and balanced social protection scheme protects the income of 
workers from shocks to employment. In many developing countries, the task of cushioning 
adjustment costs for workers is hampered by a narrow tax base. But even within limited 
resources, improving the insurance component in income support schemes and the pooling the 
risks across individuals can go a long way to smooth adjustment costs for workers. Providing 
income support to the unemployed would not only smooth the cost of labor mobility for those 
directly affected but, by facilitating the matching process in the labor market, also improve 
the employment prospects of the unemployed and the overall efficiency of the economy. 13 
Moreover, if well designed and implemented, active labor market policies can also contribute to 
facilitate the matching of workers to jobs and support business incubators to generate productive 
self-employment. Many other social protection schemes also have a direct or indirect effect on 
job creation. 14 Social risk management programs, if well designed and implemented, can 
potentially enhance efficiency and the proper allocation of resources. First, social insurance 
schemes can stimulate the emergence of more risky, but more productive, jobs and industries. 15 
Second, uninsured transient shocks which reduce individual consumption below a threshold 
nEEDED to retain productivity can give rise to “dynamic poverty traps” and lead to chronic 
poverty. Third, uninsured risk also reduces efficiency through costly production and portfolio 
choices, such as the use of outdated but less risky production technologies, or holding livestock as

12 See among others Pierre and Scarpetta (2004).
13 The World Bank has done extensive work in the analysis of income support schemes for the unemployed 
(for the summary of existing programs offering income support for the unemployed, see Vodopivec 
2004, and for the analysis of employment disincentives, van Ours and Vodopivec 2006).
14 Among the strongest micro-based evidence showing that strict labor market regulations produce 
important efficiency losses are the results of Besley and Burgess (2004), who find that labor regulations in 
India had important adverse effects on output and employment, and Ahsan and Pages (2007), who – by 
distinguishing between regulations about labor disputes and job security – strengthen the above results by 
showing that stricter regulations of both types hurt registered sector workers and exert substantial costs on 
the economy. Moreover, Heckman and Pagés (2004) estimate that workers absorb between 52 and 90 per 
cent of the cost associated to non-wage benefits in Latin America. Gruber (1997) found that workers bear 
all the cost in the United States. Similarly, Mondino and Montaya (2004) for Argentina and Maclsaac and 
Rama (1997) for Ecuador suggest that compliance with labor regulations implies an increase in labor costs 
with possible dis-employment effects.
15 See, for example, Acemoglu and Shimer (1999).
a form of precautionary savings. Fourth, uninsured risk can adversely affect human capital accumulation, for example, when children are forced to drop out of school in the wake of an income shock in the household. This section of the MILES framework will review the options for social risk management programs given the administrative and resource constraints and assess the benefits and costs of different options.  

4.2 Tools and Methods

While the MILES framework will benefit from the ongoing and proposed labor market research in developing countries (see next section), its tools and methods rely extensively on various diagnostic tools that the Bank and other agencies have already developed. Rather than “re-invent the wheel”, the framework thus relies on recently developed diagnostic instruments, above all, in the area of growth and investment climate diagnostics. Moreover, the HDNSP is also involved in furthering other suitable methods the framework could use to identify binding constraints to job creation and growth. Below we review the existing diagnostic tools and discuss the potential methods and alternative approaches that can potentially contribute to the formulation of methods to identify binding constraints to job creation and productivity.

MILES draws on a rich set of existing tools…

Over recent years the Bank has reviewed and improved the diagnostic capacity in two areas which are crucial for employment: Growth diagnostics, and Doing Business/Investment Climate Assessments. A review of economic growth in the 1990s and the heterogeneous outcomes across its client countries helped Bank staff to draw broad policy lessons and improve its growth diagnostics (World Bank 2005). The thinking about appropriate growth diagnostics and policies was influenced by a proposed new approach to economic reform, which strongly suggests the identification of key binding constraints, and focusing the limited political capital to reforms in these areas (Hausmann, Rodrik, and Velasco 2005). The application of the approach identifying binding constraints in job creation has been successfully piloted in a number of countries, including Armenia, the Baltic countries, Bangladesh, Bolivia, Brazil, Cambodia, Egypt, India, Madagascar, Morocco, Serbia, Tanzania, Thailand, Tunisia, and Turkey.

The crucial importance of the investment climate for firm and job creation has let the Bank to develop a comprehensive diagnostic instrument which is updated (and extended) on a yearly basis: Doing Business (World Bank 2006). A detailed set of indicators of the regulatory and institutional setting is now available for over 140 countries. While there is room for improvement for each of this indicators and their interpretation, they create an important information base to help identify constraints for growth and job creation (see chapter 7 in WDR 2005). Moreover, the Bank has developed a new survey instrument – the Investment Climate Survey (ICS) – that provides detailed information on the performances of different types of firms – small/large, innovating, export-oriented etc. – in client countries and their perceptions of the constraints to their operation and prospect for growth. Together, the Doing Business and the ICS instruments provide a comprehensive picture of the status of the business sector in client countries, how it varies for firms of different characteristics and how specific constraints affect the prospect for job creation of firms. The interesting feature of the ICS is that it allows an examination of the specific constraints of different types of firms that may have different potentials for creating more and better jobs. In many countries, small and medium sized firms, as well as those that are innovating their products and processes, have high potential to expand and create more jobs. They face

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16 For guidelines about how to choose among income support programs for the unemployed in the context of developing countries, see Vodopivec (2006).
specific constraints that could be highlighted and guide a policy dialogue on how to promote job creation. The ICS also allows looking at the employment intensity of growth at the firm level and assessing how it may be affected by specific regulatory and legal frameworks. This again provides specific insights into the factors curbing job creation.

... and the development of alternative methods is also underway

Identification of the binding constraints to job and productivity growth on a country basis is an old but difficult issue. While many factors are undoubtedly relevant, it is all too easy to list the "101" requirements for a healthy, well functioning market economy rather than select the key binding constraints. Existing empirical work on the impact of the specific constraints yields mixed results in terms of relative and absolute importance. There is little disagreement that some combination of a large range of constraints matter but empirical identification of causal – even marginal – effects has proved difficult because of unresolved issues with model specification, endogeneity, identifying partial vs. industry vs. general equilibrium effects, and measurement error in both outcomes and constraints.

Nevertheless, there seems to be little disagreement amongst economist that one should think about employment creation in a multi-sectoral way, focusing on the main bottlenecks but taking into account the limitations established by the political economy. In this endeavor it is essential to bring together all the relevant policy makers and stakeholders in client countries. Below we review and discuss the available alternative approaches which could be used to identify binding constraints to job creation and productivity growth: (i) micro-econometric approach, (ii) structural approach, (iii) experimental approach, and (iv) institutional approach.

As the discussion below makes clear, rather than relying on a single method to identify the binding constraints to job creation and growth, we should rely on strengths of each of the multiple methods and explore their complementarities. Use of various methods not only helps to identify binding constraints, but the driving forces and the channels through which the constraints work. Moreover, given the extreme complexity of the task, a “triangulation” – the comparison of results of various methods – can be used to validate the results of individual methods and provide a consistency check.

(i) The microeconometric approach consists in exploring detailed micro (firm level) data to understand the differences in productivity and job creation (e.g., Bartelsman, Haltiwanger and Scarpetta, forthcoming). This approach is often presented as a strategy to circumvent the well established problems of the macro growth regressions (e.g., Levine and Ranelt, 1993). The findings using this approach have highlighted the importance of the improvement in allocative efficiency in recent years in some developing countries. Nevertheless, economists still need to examine efficiency and misallocation within countries where there is more meaningful variation.

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17 In December 2007, HDNSP organized a one day conference, bringing together World Bank specialists and top academics, to brainstorm on the implementation of the MILES agenda. The idea was to seek guidance from well know experts in the identification of the binding constraints to growth and job creation. During this conference, the different empirical approaches were presented and discussed. A summary of the topics discussed and highlighted points can be found at: www.worldbank.org/labormarkets.

18 Although the growth regression methodology helps painting a broad picture of the main determinants of country growth, economists must be cautious about establishing strong conclusions from these findings. In particular, the macro work suffers from severe specification issues, problems in measurement of variables and omitted variables, the problems which make it difficult to establish a causal relation.
Differences-in-differences approach is becoming increasingly popular in cross-country settings (e.g., Rajan and Zingales, 1998). The main advantage of this approach is that it allows for better measurement of the variables of interest (job flows, worker reallocation, total factor productivity) since it is based on micro firm data (e.g., Eslava, Haltiwanger, Kugler and Kugler, 2006). This is essential for the identification and understanding of the channels linking constraints to job creation. Moreover, it also allows one to explore within country variation in terms of binding constraints, usually across sectors, or across sectors and over time. This improves inference and possibly identification relatively to a more macro approach. However, also this approach faces some challenges. Specifically, (i) the micro heterogeneity with entry/exit frictions and non-convex adjustment costs yields a nonlinear behavior which can be very difficult to solve and aggregate; (ii) it is difficult to define precisely the distortions and to measure them, and (iii) it remains a challenge how to integrate the informal and the formal sectors, since most of the evidence explores large census data of formal firms.

(ii) The structural approach is can be motivated by the question of why there are such large and persistent differences in living standards across countries, which translate into large differences in average labor productivity. In this context, this approach is mainly useful to understand the key factors behind productivity differences on a country-by-country basis, attributing a special emphasis on the extent and nature of job creation. This approach highlights not only the identification of the key driving forces (i.e., differences in policy, regulations, and institutions) behind the variation in labor productivity, but also the economic mechanisms and channels that link these forces to outcomes, by linking economic ideas and data analysis. The biggest advantages of this method is that it allows us to check the consistency of the estimated regression coefficients with the economic story and to uncover secondary implications, enabling the consistency across stories and running controlled experiments. This approach also captures general equilibrium effects, which are difficult to quantify using alternative empirical methods since large scale experiments are still not very common.

However, structural approach is ultimately subject to important limitations. In particular, a long list of auxiliary assumptions need to be made in order to interpret the results, including, for example, assumptions about the nature of the heterogeneity at the firm and individual level, market structure, nature of equilibrium, the functional forms for production functions and utility functions, and the values of specific parameters. Moreover, if one has a negative finding about a particular story, it is hard to know if the story is wrong or if it is just that all of the auxiliary assumptions are incorrect. On the other hand, if one obtains a positive finding about the importance of a particular story, it is hard to know to what extent this depends on all of the auxiliary assumptions. Finally, this approach is limited in isolating definitive key factors in general, and less so, in particular countries. As the consequence of these limitations, it is

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19 The differences-in-differences methods are becoming increasingly popular in applied econometrics and they can also be applied in a cross country setting (see e.g., Ragan and Zingales, 1998). However, their validity hinges on the existence of relevant between and within country variation as well as on a plausible identification approach.

20 Another advantage of this approach is that it provides some structure to organize the data. For example, it has become common to use the structure of the neoclassical growth model as a way to view and organize aggregate data. This has lead to the development accounting tool. Some of this work has told us that the dominant source of differences in productivity is driven by differences in TFP, not in physical or human capital. (e.g., Klenow and Clare-Rodriguez, 1997 and Hall and Jones, 1999).
important to look for corroboration of findings across various methods. For example, if a reduced form analysis points to an important role for a particular factor, we should try to assess the importance of this factor in structural models. If structural methods suggest that a particular factor is important, then we should try to obtain better measures of it.

(iii) The experimental approach focuses in a particular constraint and designs an experiment that relaxes this constraint to determine its impact on growth and job creation when the constraint is relaxed. This approach usually requires the collection of micro secondary data sources, which can be quite costly for certain experiments. Nevertheless, the source of variation in this approach is usually very clear, allowing for a neat identification. There are there different approaches within this experimental approach: (i) Field experiments (ii) natural experiments, and (iii) policy experiments.

- **Field experiments** are most valuable in understanding small scale problems, especially those related with labor demand in the private sector (e.g., De Mel, McKenzie and Woodruff, 2007, Karlan and Valdivia, 2006). Indeed, most of the research in field experiments has been limited to the smallest firms (microfinance, micro enterprises) and agriculture. The main advantage of field experiments is that they allow to understand not only the outcomes but also the processes. They can also be customized to test specific theories (i.e., there is a strong interaction with micro theory and structural modeling when performed correctly) and they provide greater control over the research agenda. On the downsides, field experiments may be prone to corruption and face limitations in certain areas (for example, changes in infrastructure that cannot be easily simulated). There may also involve high costs, which limit their applications to larger firms and to scale up the findings.

- **Natural experiments** – as opposed to field experiments – are usually not “created” by economists (e.g., Burgess and Pande 2005, Banerjee and Duflo 2005, Van Ours and Vodopivec 2006), even though some are less natural than what they seem (e.g., Galiani and Schargrodsky, 2001). These experiments should be explored when it is possible as they are a promising way to examine the impact of constraints. However, they are rather difficult to find. Therefore, their scope as a general approach is potentially smaller since often data drives research (and not the other way around).

- **Policy experiments** involve randomized implementation of policy changes (e.g., Progresa program in Mexico). In comparison to the two other two types of experiments, policy experiments have a large potential to use administrative data and larger budgets. They often actively involve governments and quasi-governmental agencies to be major participants. They are also the most used experiments to understand the binding constraints for larger firms. However, they are often not randomly implemented, and are more politically driven.

In general, field experiments can be an important part of analyzing the constraints and potentials of small firms. Natural experiments, and especially natural policy experiments, also have a role to play, but need to be supplemented in other ways. Policy experiments are less suited for larger firms because of the costs involved. However, one must keep in mind that research must be driven by ideas and not merely by opportunities. Among the main advantages of the experimental approach is the ability of large scale experiments to capture general employment effects. Experiments may also explore multiple treatments and natural experiments where different policies affect different groups differently. This allows for the identification of channels through which binding constraints work.

21 For example, Galiani and Schargrodsky (2001) explore the decentralization of education services, from the federal government to the provincial governments, in Argentina in the early 90's, to evaluate empirically the effect of this decentralization on the quality of education.
(iv) **The institutional approach** places emphasis on the role of labor market institutions to explain differences in labor market outcomes across countries.\(^{22}\) The main advantage of this approach is that it helps specifying and defining exactly the binding constraints, like labor unions or the minimum wages. Nevertheless, a deep knowledge of the institutional and regulatory framework is essential in correctly measuring regulations and recognizing valid sources of variation for identification in the micro work. This approach has been implemented both at a macro (e.g., Botero, et al, 2004, Chor and Freeman, 2005) and at a micro level (Besley and Burgess, 2004, Micco and Pages, 2005). Within this approach, it is now consensual that the macro work suffers from several shortcomings, and that future work should explore micro data and changes in regulations either across sectors and/or over time. Nevertheless, the results that this approach has yielded to date are not consensual. For example, Richard Freeman highlights that some regulations/mandated benefits, although increasing labor costs, cut employment only modestly (e.g., evidence for Colombia or India) but that some institutions significantly alter distribution.\(^{23}\) On the other hand, some economists place more emphasis on the costs of labor regulations and on how binding they can be for job creation and for labor productivity. Actually, there is increasing evidence based on micro data that some regulations/mandated benefits do increase labor costs, cut employment, and eventually hurt labor productivity (Micco and Pages, 2005; Haltiwanger, Scarpetta and Schweiger, 2007).\(^{24}\) Moreover, there is also some evidence in the context of developing countries that different types of workers are differently affected by labor regulations (as employment protection laws).\(^{25}\)

There seems to be consensus that this line of research, although highly relevant, has so far paid insufficient attention to some important policy questions. In particular, it has focused too much on the costs of existing labor and social protection policies and too little on their benefits. It should also focus more on understanding which reforms are needed to construct institutions rather than merely focusing on the benefits and costs of deregulation. Moreover, one should find ways to compensate “losers” of reforms and to know more about the political economy of these reforms (in order to build broad consensus and a constituency for change). Finally, we should make a case for more experimentation and the implementation of a culture of trial/error in order to evaluate and correct approaches.

To reiterate, the above approaches are complementary to one another, as each has its own strengths and weakness. The implementation of MILES therefore relies on various methods to

\(^{22}\) One example is Richard Freeman’s work “Labor Regulations, Unions, and Social Protection in Developing Countries: Market distortions or Efficient Institutions”.

\(^{23}\) As puzzling facts in developing countries that future research needs to turn to, Richard Freeman highlights the increase in within country inequality and the rising informal employment. Future work must try to understand institutions as “insurance” rather than impediments and we must learn more about the informal sector as possibly a more permanent part of the economic world. We must also consider changes in labor as part of the transition to a true global labor market.

\(^{24}\) Micco and Pages (2006) show that employment and output share of more volatile sectors is smaller in more regulated countries; moreover, employment and output declines not because outcome per plant declines, but because of less firm entry. Similarly, using harmonized firm-level data from business registers and enterprise census data from 16 industrial and emerging countries, Haltiwanger, Scarpetta and Schweiger (2007) show that stringent hiring and firing costs reduce job turnover, especially in industries that require more frequent labor adjustment. Within each industry, medium and large firms are more severely affected by stringent labor regulations, while small firms are less affected.

\(^{25}\) Heckman and Pages (2004) report some evidence for Latin America that after an increase in the labor costs related with stricter labor regulations, the youth, women and the unskilled have a greater difficulty in transitioning from unemployment to employment.
achieve the goals of identifying the driving forces, binding constraints, and the channels through which they work. All the approaches contribute to providing increased credibility to the empirical findings. Moreover, note that sometimes there are advantages of focusing at one MILES area at the time, so as to be able to address a specific question and explore an empirical methodology to address it.

4.3 Implementation of MILES in Client Countries

The implementation of MILES involves three steps and depends crucially on strong, effective dialog with all stakeholders in the country.

The first step consists of analysis of the MILES areas and identification of most binding constraints to job creation and productivity growth. The identification of the key binding constraints should focus on those curbing economic growth as well as those that, given growth, reduce the potentials for job creation (that is, affect the elasticity of employment to growth). The tools and methods to be applied were reviewed above, and here let us just reiterate that a useful and effective approach, given the complexity of the task, is to use the "triangulation" method, that is, apply several methods (including reviews of existing studies on constraints to growth and job creation, opinion polls, and more rigorous methods described above) and identify binding constraints based on comparison of the results of these methods.

The second step is establishing minimum policy consistency across sectors. While having identified the binding constraints for employment creation in each MILES area is critical, these constraints need to be checked for policy consistency. Such has been the lesson from OECD countries, and undoubtedly this holds true also for developing countries. For example, if too strict labor market regulations in a country are identified as a binding constraint, their relaxation is likely to become effective only if concurrently the income support system for the unemployed is to be strengthened. Moving to such a “flexicurity” approach should also render the reform accounting to political economy considerations. Similarly, labor or output market reforms which benefit from accommodating fiscal and monetary policy may help overcome problems of nominal wage rigidities in a low inflation environment, and more generally political opposition when the economy is growing. Again what appears crucial is the identification of the most binding or critical policy constraints across sectors and thereby avoiding wholesale reform approaches which are difficult to conceptualize and impossible to implement in real life.

The third key step consists of the implementation of reforms to overcome binding, policy consistent constraints. In particular, three main factors have to be fully factored in the implementing: assessing the costs and benefits of each reform component; identifying trade-offs between possible components of a policy strategy; and identifying possible complementarities that could be exploited. This is easier said than done, as in many cases our knowledge about labor markets in low- and middle income countries is still limited – hence the research agenda proposed in Section 5 is critical. One other critical element of successful implementation of MILES is encompassing and effective policy dialogue and close interaction between the key policy makers, ministries and stakeholders (such as employers and trade unions) throughout the preparation of the reform and starting with early consultations. Often Doing Business indicators or even the results of the ICS do not fully depict the reality on the ground. The consultation process therefore has to provide an early reality check and the opportunity to hear “voices” from different interest groups, thereby also increasing the ownership of the process. It goes without saying that the effectiveness of governments’ actions on job creation, poverty and growth needs to be closely monitored and evaluated. This should allow for policy adjustments but also a learning process across countries.
It must be emphasized that the implementation of the MILES framework requires joint efforts and coordination by different ministries and agencies of the government, in addition to consultation with social partners and other stakeholders, from early consultations to their successful enactment. Effective reforms cannot be done by the labor ministry alone or by the finance ministry alone, and countries have to figure out how to move on a multi-sector approach involving players with government. Not only does the development of a successful strategy for job creation require a clear understanding of binding constraints in different markets and the interactions across them, but it should also recognize political constraints and the need for coordinated actions. Dialogue and consultation among relevant ministries but also involvements of key stakeholders thus facilitate both the identification of the most suitable strategy and its implementation.

In terms of practical procedure employed to operationalize MILES at a country level, the following ingredients can be envisaged:

- Producing a “Jobs Report” that would provide an in-depth diagnostics of labor market conditions, their evolution over time and the role of policy and institutions in driving both labor demand and labor supply, along the lines of the MILES components (perhaps as an outcome of the first two steps outlined above). The Bank is well placed to undertake this type of report and to provide technical assistance on how to approach specific policy issues in the MILES context. It is important to realize, however, that the Jobs Report should not be seen as another analytical report by the Bank. To be effective and lead to more operational activities it should draw from early consultations with policy makers and important stakeholders, as emphasized above.

- Launching a multi-sectoral Development Policy Loans (DPL) to support the job creation reform agenda. Reforms of the investment climate and of the labor market may be costly to implement and could involve transitional costs for those (both firms and workers) involved. A DPL may be a good instrument to support the policy reform effort. An example in this context is the 2007 Turkey Competitiveness and Employment DPL [World Bank 2007].

- Designing other supporting investment loans to address major structural issues affecting job creation. These loans can be underpinning infrastructure development in countries (such as the poorest ones) where inadequate transport or energy supplies are primary constraints to firm growth and job creation. In the social sectors, again, education and skills generation reform projects are of great importance. Moreover, designing effective safety nets – including unemployment benefit and pension reform, as well as transfers targeted to those in transitional poverty – would also be of clear importance.

Given the multi-sectoral nature of the MILES approach, the implementation of the different steps discussed above requires the involvement of specialists cross many sectors inside and outside the World Bank. To capitalize on the experience of the different implementation of MILES in specific countries it will be important to draw on the support of an external review group consisting of academics and policy makers, and to ask the team to elaborate a final assessment of the lessons learned in the process and how these could be used to refine the approach and the details of its implementation.

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26 The Bank organized two international conferences on job creation – in Cairo for the MENA region in November 2005, and in Istanbul for the ECA in June 2006. Policy makers from different ministries and social partners were invited to discuss how to promote job creation in their countries and engaged in lively discussion. Participants praised the organizers for having given them not only to listen to the experience of other countries but also to engage in a open debate among themselves.
5. Research Priorities

The second key component of developing an integrated, operationally relevant labor market paradigm for developing countries requires a successful integration of the knowledge obtained from policy relevant research on labor markets in developing countries. This section describes seven research priorities that have been identified by the stock-taking initiative described in Section 3 as areas where obtaining further knowledge is deemed most important. The priorities were identified according to the following criteria: (i) they address a knowledge gap; (ii) they were raised in several regional papers; and (iii) further knowledge on these issues would yield potentially large development gains. The resulting research agenda is very broad and requires further research well beyond the World Bank, to be best implemented with the support of donor countries and in collaboration with the international research community (see next section about the contribution of newly established World Bank multi-donor trust fund dedicated to job creation and employment in the next section).

Let us stress that despite their broad coverage, these seven topics do not exhaust the list of factors determining labor market outcomes. First and foremost, these outcomes are influenced by macroeconomic policy and the broad range of policies influencing the investment climate at the national, sectoral, and local levels.27 They all contribute to promote higher sustainable growth, create more and better jobs, and ultimately reduce poverty. Labor market policy and institutions in turn contribute to the investment climate and job creation prospects by promoting the reallocation of labor towards more productive and rewarding jobs and by supporting workers affected by shifts in labor demand. The seven topics discussed below explore these interactions and how labor market policy can better promote economic efficiency, equity and social inclusion, and poverty reduction.

A. Improve labor market diagnostics and identification of vulnerability

Improving our assessment of labor market conditions and policy challenges requires more and better information. In many low-income countries, standard labor market indicators are inappropriate. Most workers cannot afford to be unemployed and may well be engaged in full-time employment, while remaining in poverty. Better diagnosis is particularly needed to identify vulnerability in the labor market. In many countries, the traditional dichotomy of formal/informal employment may not characterize well the vulnerability of workers (more on this below). Vulnerability may also be the result of misguided policies or social norms that lead to social exclusion and discrimination. While in some countries, social exclusion is entrenched, we only have rough and incomplete measures to identify this phenomenon. A more complete set of labor market diagnostics needs to be developed in order to assess labor market performance and to identify vulnerable groups and design effective policies to improve their welfare.

Further required work

- Reviewing diagnostic tools to assess labor market conditions in countries at different stages of development and with different economic and social structures. In which cases would

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27 See the World Development Report 2005 on “A Better Investment Climate – for Everyone” for a detailed discussion of how improvements in the investment climate can improve long-term sustainable growth, job creation, and ultimately poverty reduction. The 2006 WDR on “Equity and Development” focuses on the role of policy and institutions in determining the distribution of income, access to services, and more generally social and economic opportunities, and thus complements the previous WDR.
unemployment and employment rates be reasonable indicators of the labor market situation? In other cases, what indicators would be more meaningful to assess labor market conditions? What data are necessary in order to measure appropriate indicators? Diagnosis is particularly problematic in labor markets where employment is predominantly rural and/or informal. This must be a priority for development work on diagnostic tools.\(^{28}\)

- **Improving identification of vulnerability in the labor market.** Is “working poor” a useful concept to identify vulnerable groups? If so, what is the appropriate benchmark for the working poor? How should the definition of vulnerability be tailored for those groups who are more likely to combine paid work with other activities (education, family responsibilities, etc.)? Should the analysis of labor market vulnerability be based on an individual concept or should it be extended to the household level?

- **Improving identification of vulnerability among children and the youth.** In many developing and emerging economies, child labor prevents children from acquiring the required skills for a productive working life. In others young people are experiencing difficulties in gaining access to decent jobs. In some countries, youth unemployment is the main source of concern, while in others, the unemployed youth are not the most vulnerable. Instead, idle youth or young people working in very low-paid and unproductive jobs might be more at risk. Identifying these sources of risk, allowing for differences across countries and for children and youth of different family background and education levels, is a priority for assessing child labor and youth employment. An important dimension of this research is also the analysis of the **school to work transition**: Which schooling and/or labor market interventions can help increase successful transitions? Which interventions can help to level the playing field among girls and boys, or between youth of different family backgrounds? Significant knowledge gaps remain in this area in most developing countries.\(^{29}\)

- **Understanding the gender dimensions of vulnerability in employment.** In many countries, labor markets are segmented by sex, with women concentrated in low paying occupations. As female education increases, the question is how much segmented labor markets affects gains in productivity and earnings for women. Research needs to explore gender labor market segmentation, including gender differences in formality status. Questions include what drives men and women in and out of formality? What are the social protection alternatives for female informal workers in urban and rural areas? Which mechanisms can combat gender labor market segmentation?

- **Identifying and facing up to social exclusion.** Social exclusion is a deep and entrenched aspect of many societies that can run along race, caste, religion, ethnicity, age, gender or disability lines. Often, these dimensions interact with each other and the result is compound discrimination. In the labor market, exclusion affects access to work and all aspects of employment including earnings, promotions, dismissals, and working conditions. There is a need to identify the extent of social exclusion beyond traditional measures of wage differentials. In addition, there is a need to identify which policies yield better outcomes to deal with exclusion. Are non-discrimination or preferential quotas appropriate policies, or do

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\(^{28}\) In 2007, a draft diagnostic tool – including a guide on how to construct improved labor market indicators using existing data sources – for assessing labor market outcomes in low-income countries with large informal employment and own-account jobs has been developed and piloted in nine countries (Brazil, Bangladesh, Senegal, Ghana, Madagascar, Morocco, Jordan, Egypt) and the results presented at a workshop.

\(^{29}\) HDNSP together with the HDNED and the Children & Youth Group is preparing a research proposal for a cross-sectoral study of the school to work transition in different client countries.
they have unintended effects? What other types of policies might increase the labor market inclusion of traditionally excluded groups.

B. Understand the linkages between investment climate, labor demand, and poverty

The challenge of creating more and better jobs largely relies on improvements in the investment climate in which firms find the incentives and opportunity to invest productively, grow, and hire workers.30 Existing bottlenecks in the investment climate affect the three main channels through which growth can affect poverty reduction: i) the sustainable growth path; ii) the employment content of growth (i.e. the elasticity of employment to output growth); and iii) poverty-reduction effect of employment growth (the poverty elasticity to employment). Moreover, different reforms of the investment climate may affect these three channels in ways that may affect the short-term and long-term effect of growth on poverty reduction. In many developing countries dominated by traditional economic production, two other important issues relating to labor demand concern rural, non-agricultural activity and the efficient migration of rural workers to urban areas where employment opportunities are growing. These have direct and potentially powerful implications for poverty reduction.

Further required work

• Assessing labor demand in countries at different levels of development and with different investment climates. Aggregate data would enable the analysis of differences in the employment content of growth across countries and regions. This analysis needs to be complemented by a more in-depth assessment of the sources of economic growth, productivity and job creation at the sector and firm level using available data in many developing countries.31 What are the sectors and types of firms that play an important role in productivity growth and job creation? Are those the same across countries, or are there differences? Do small firms play an important role in net job creation? What are the links between technological progress (through innovation and adoption of technologies) and the level and composition of labor demand? Are these links mediated by policy and institutions?

• Understanding the role of labor in the link between growth and poverty, especially in low-income countries. The impact of growth on poverty alleviation depends not only on the employment content of growth, but also on the location and quality of jobs created by stronger growth. In many low-income countries, improvements in agricultural productivity are often associated with major labor shedding and mobility towards urban areas. The creation of non-agricultural jobs in rural areas coupled with a smooth migration towards urban areas seems to be of foremost importance to reduce poverty. How can labor-intensive, non-agricultural activities in rural areas be encouraged in order to create earning opportunities for rural workers and to absorb the surplus labor in agriculture that has become so large in many developing countries? How much of an impact can education and training have for encouraging this type of job creation? Are there other policy interventions that matter? What factors determine decisions of rural workers to migrate to urban areas? What do we know about rural-urban migration patterns and about the post-migration employment outcomes? What role is there for policy to improve the transition?

30 The WDR – 2005 identified four areas as representing the basic pillars of a sound investment climate: i) political and economic stability and security; ii) regulations and taxation; iii) finance and infrastructure; and iv) workers and labor markets.

31 Sector level data are available for a large number of countries from UNIDO and national sources. Firm-level data are available for a growing number of countries from the Bank’s Investment Climate Surveys (ICS) as well as from enterprise surveys and business registers of many countries (see Bartelsman, Hativanger and Scarpetta, 2004, “Microeconomic Evidence of Creative Destruction in Industrial and Developing Countries”, Policy Research Working Paper No. 3464.)
C. Identify the benefits/costs of structural reforms and globalization for workers

This is closely related to the previous topic. The international evidence suggests that macro, trade, and structural reforms can involve large reallocations of resources – including labor – across firms, sectors, and locations, often with adverse effects on labor markets. In ECA, these reforms were accompanied by persistent open unemployment, declining participation, and sometimes, by stagnating real wages. In LAC, the impact of reforms on jobs has been much smaller but often at a cost of substantial wage losses. In many low income countries, increased trade openness is exposing them to greater opportunities but also more exposure to fluctuations of international markets.

Further required work

• Identifying the channels by which different types of reforms affect labor market outcomes. There are various hypotheses to explain cross-country differences in labor adjustments to reforms. One is that, in some countries, labor market regulations prevent labor reallocation, reducing the effects of reforms on employment but concentrating the effects on wages. Another hypothesis is that in some countries, the effect of trade reforms on employment has been ameliorated by real exchange rate depreciation, while in others it has been aggravated by real appreciation. A better understanding of the transmission channels will make it possible to (1) design structural adjustment programs conducive to greater welfare gains and (2) design income support and reemployment programs better targeted to the needs of affected firms and workers.

• Identifying the medium-term job growth prospects of structural reforms. Despite short-run costs, it is expected that successful integration into world markets will eventually bring large dividends to workers and firms. But is this actually the case and what does it depend upon? For example, recent evidence suggests trade liberalization has had large, positive effects on manufacturing employment in countries that are large FDI recipients, but small effect in countries that receive little FDI.

• Identifying the optimal sequencing of reforms for job creation. Is it better to reform labor markets and then open economies to trade, or vice versa? What about reforms oriented to improve the investment climate -- should they precede or follow labor reforms? Studying multiple experiences of structural reforms across the world can shed light on the sequencing that is best for job creation and poverty reduction, for a given set of initial conditions.

• Identifying the best mechanisms of income support and re-employment for affected firms and workers. Labor market adjustment to structural and trade reforms can be a complex and non-standard process. For example, while many income support mechanisms are targeted to displaced workers, some of the evidence for LAC points to the most important effects of trade reforms on wages. This suggests that is necessary to recognize the heterogeneity in country conditions in likely solutions. In some countries, income support mechanisms might need to focus on complementing the incomes of poor employed workers, in others on sustaining the incomes of the unemployed (more on this below). More and better knowledge of such country-specific factors is required to design effective labor market policies.32

D. Understand the different aspects of formality and informality

All labor markets include diverse types of employment in terms of “formal” jobs, “informal” jobs, and variations in between. In many developing and transition countries, informal

employment has been growing more rapidly than more formal employment. This has raised many
questions for labor market analysis and also for policy-making. It also has close links with the
earlier theme on diagnosis and vulnerability. It is obvious that the reality is more complex than
the traditional view of an informal “sector” where the poor, unable to find formal jobs, eke out a
subsistence living through very low productivity labor. While this characterization applies in
some cases, empirical studies in LAC have shown that some workers seem to be voluntarily
moving to the informal sector to improve their lot. Moreover, workers in sectors traditionally
considered as “formal” are increasingly employed in temporal, precarious jobs, blurring the line
between formal and informal employment. We know little about informality, what drives it, and
what its links are to formal labor markets.

Further required work

- Investigating the dynamics of the formal/informal economy. To what extent, and for which
  workers, is informality a launching pad, and for which others is it the only option available?
  In particular, do certain workers (e.g., parents of young children, youth, etc.) pursue informal
  jobs in order to combine work with other activities, or alternatively, do they do so because
  these are the only jobs available? Is informal employment the safety net of the poor and if so,
  how effective a safety net is it? What are the long-term, aggregate consequences of
  informality for productivity growth, human capital enhancement, and poverty?

- Re-thinking social protection for informal workers. While informal jobs may constitute a
  form of safety net, this is likely to be an imperfect or inefficient risk management strategy.
  What are the most efficient and cost-effective ways to improve the risk management
  strategies of vulnerable workers? What policies and interventions can be applied in the
  context of low-income countries with low capacity and limited fiscal resources?

- Identifying the effects of labor regulations and social protection programs on informality. To
  what extent is informal employment motivated by inappropriate regulations and costly social
  protection mechanisms? Do informal firms choose to remain small and unregistered to avoid
  regulations and payroll taxes? Does this behavior bring important aggregate costs in foregone
  productivity? And what, if any, regulations and social protection programs are most
  important in this decision process?

E. Identify appropriate labor market regulations and institutions

Research suggests that economic growth requires the capacity to reallocate resources, including
human resources, from declining to expanding sectors, and from low-productivity to high-
productivity activities. However, in many countries labor regulations appear to be ill-suited to
facilitate this process. In many developing countries, hiring and firing regulations are much
stricter than in high-income countries, hindering the reallocation of labor across uses; on the other
hand, few have adequate programs to support the unemployed (Figures 2 and 3). Yet it should be
recognized that labor market regulations, albeit imperfect, constitute a form of social protection
and cannot simply be dismissed. To move beyond a trade-off between labor market flexibility and
worker security is necessary (1) to identify the benefit/costs of existing regulations/social

Heckman and C. Pagés (eds.) Law and Employment: Lessons from Latin America and the Caribbean.
Cambridge, Mass.
34 See the Bank’s work by Canagarajah and Sethuraman (2001) “Social Protection and the Informal Sector
in Developing Countries: Challenges and Opportunities”; and Blunch et al. (2001) “The Informal Sector
Revisited: A Synthesis Across Space and Time” for a review.
protection mechanisms and (2) to identify potential alternatives, which yield higher benefits at a lower social and economic cost.

Further Required Work

- Identifying the impacts of labor regulations on total employment levels and growth, formal sector employment growth, informal-formal decisions, productivity growth, consumption smoothing, and risk management strategies. While all regional stock-taking papers, with the exception of Africa’s, refer to the apparent costs of existing labor regulations, it is necessary to identify and, more importantly, to quantify the benefits as well as the costs of existing regulations and also the benefits/costs of potential labor reforms. In addition, since not all firms and sectors are equally affected by regulations, this analysis needs to be complemented by further work on the heterogeneity of impacts on firm decisions and economic outcomes.\(^{35}\)

- Identifying the effect of labor market regulations on particular groups of the labor force. Heterogeneity of impacts also applies to workers. Recent evidence suggests that some labor market regulations (employment protection, minimum wages) are detrimental to the employment of youth, women, and unskilled workers. Some labor market regulations set to protect particular workers, for instance youth, women or disabled workers, may end up restricting their job opportunities. To what extent are inappropriate regulations behind the persistently high youth unemployment rates observed in LAC, MENA or ECA? To what extent do they slow down the entry of women and ethnic or racial minorities in the labor force? Are there regulatory regimes that offer some protective benefits to these groups while not hindering their access to employment?

\(^{35}\) See, for example, Montenegro and Pagés (2003), “Who Benefits from Labor Market Regulations?: Chile 1960-1998” WB Policy Research WP, 3143. An excellent example of work showing that strict labor market regulations produce important efficiency losses is a recent study of Ahsan and Pages, who distinguish between regulations about labor disputes and job security and show that labor regulations in India had important adverse effects on both output and employment (Ahsan and Pages, “Are All Labor Regulations Equal? Assessing the Effects of Job Security, Labor Dispute and Contract Labor Laws in India.” World Bank, Human Development Network, SP Discussion paper No. 0713, 2007.
Figure 2. Comparison of the stringency of employment protection legislation between developing and industrial countries

Source: Own calculations from World Bank Rapid Response Database.

- Labor standards. The role of international labor standards in trade and development has become an important issue for assessing conditions in the labor market and promote improvements. In recent years, the Bank has undertaken some research on policy to combat child labor and, in particular, its worst forms, and to assess whether and how multinational enterprises enforce or even promote core labor standards. The incidence of child labor had declined over the past decade, but in low-income countries many children in between 10 and 14 years of age are working (Figure 4). But there is a need to extend this effort and build a stronger and more operationally-relevant view of how the promotion of core labor standards can contribute to poverty reduction in client countries. Under what conditions can promotion contribute most to these goals? What are the precise links in the chain between respect for the core labor standards and poverty reduction? How can the standards be adapted to maximize their impact in labor markets where employment arrangements are typically informal and where compliance is weak? How can employers, unions, and NGOs contribute to the awareness, monitoring, and supervision that are critical to core labor standards? These are questions where cooperation with the ILO would be important.

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36 These include effective abolition of child labor; elimination of forced labor; equal opportunity and non-discrimination in the labor market; and freedom of association and collective bargaining.
Figure 3. Developing countries, particularly low-income ones, offer a much weaker and less diverse protection against unemployment risk than developed countries.


Figure 4. The incidence of child labor is still high in many countries (percent of 10-14 years old working)

- Understanding the political economy of labor reforms. A number of political economy issues have to be taken into consideration while reviewing labor market policy settings and potential reforms. In general, two considerations are particularly relevant. First, labor reforms often take time to produce positive effects in the market (especially if done in piecemeal fashion) and the time required may well be longer than the political horizon of elected governments. Second, such reforms are perceived to weaken (and often do weaken) the position of certain groups of workers (often referred to as the “insiders”) who oppose them fiercely. Thus it is often politically difficult for governments to embark on far-reaching labor market reforms,
even when the economic case exists. These considerations must be understood in the broader context where reforms in other markets, by increasing the demand for greater flexibility in labor adjustment, may create strong pressure for changes, even in the absence of a direct policy intervention. Not surprisingly, labor reforms in most client countries have been fairly infrequent and when they have occurred, they have most typically reformed “at the margin” -- for example, by easing regulations on temporary contracts while leaving in place stringent regulations for permanent workers. However, the existing evidence suggests that this type of reform has adverse effects on the labor market, and that it is not a substitute for comprehensive reform. Which elements drive a successful labor reform? Are there ways to design compensatory packages that allow potential losers to accept change?

- **Identifying alternative protection mechanisms with lower economic costs.** Finding suitable alternatives to existing social protection mechanisms is not an easy task. It is often mentioned, for instance, that mandatory severance pay should be replaced with some form of unemployment insurance (UI). Yet, OECD-style UI systems can be very expensive and have limited effectiveness in developing and transition countries where administrative capacity is limited and where opportunities to work informally are widespread. To reduce moral hazard, LAC countries are designing unemployment protection systems that rely on self-insurance. While such systems may be effective in countries with limited administrative capacity, preserving risk-sharing may be appropriate in middle-income countries with higher capacity. An additional complication stems from the aggregate adjustment consequences of income support programs. To what extent do income protection mechanisms reduce wage flexibility and increase unemployment (thus further increasing the need for unemployment insurance mechanisms)? To what extent do income protection mechanisms funded with labor taxes contribute to unemployment? What are the estimated financial costs of such programs? What is most appropriate for low-income countries? Finally, active labor market programs (ALMPs) are also an important consideration in designing policies to protect workers. These programs can potentially play a useful role in reducing frictions in the labor market, in addressing structural imbalances, and in providing short-term employment. However, the international evidence raises questions about the real impacts of these programs and their cost-effectiveness. What is the role of ALMPs and how can they be designed to have the most positive effect on labor markets?

- **How to promote social dialogue.** The experience of many countries that have undergone major reforms suggests that social dialogue is very important to improve the acceptance on the reform promote change in attitude of private agents and maintain momentum for the reform to bear its fruit. There are two dimensions to social dialogue that seem especially

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37 Political economy considerations can also partly explain why labor market conditionality is largely absent in structural adjustment programs: such conditions are likely to face strong opposition from interested groups delaying the approval of the overall adjustment package.


39 Evidence on the application of income support and active labor market programs to developing and transition countries is summarized in Vodopivec, Income Support for the Unemployed: Issues and Options (World Bank, 2004) and Betcherman, Dar, and Olivas, Impacts of Active Labor Market Programs: New Evidence from Evaluations with Particular Attention to Developing and Transition Countries (Social Protection Discussion Paper No. 0402, 2004).
relevant to developing a comprehensive view of the labor market. The first concerns the identification of the most effective ways to use social dialogue (employers, labor, other constituencies) to develop and implement policies that best support overall poverty reduction. The second concerns what models of collective bargaining should be encouraged to enhance economic and employment growth, while protecting the basic rights of workers. These two issues require additional research that is soundly rooted in country experience. By their very nature, they will also be key issues in our partnership activities, especially with the labor movement.

**F. Identify best practices in skills development and skills upgrading**

The stock-taking papers identified important skill shortages in most developing countries. In many countries of South Asia and Sub-Saharan Africa, illiteracy rates are still very high (Figure 5), and enrollment in secondary education is still fairly low in many low and middle-income countries. Not surprisingly, many employers in these countries consider skill shortage as one of their main constraints in the operation of their business and potential for growth (Figure 6). Increasing the quality of the labor force is essential to increase the productivity and the earnings of workers. Yet, in many countries, state-provided training services have been inadequate and disconnected from the requirements of employers. Interventions in skill formation should take into account that (i) most training takes the form of on-the-job training; (ii) medium- and high-skill workers are more likely to be trained by firms than low-skill workers; (iii) many workers in developing countries are self-employed; and (iv) economic analysis has often shown that the returns to human capital investments in workers are highest when workers are supported in furthering their general (school-provided) education. With all of these considerations, it remains unclear what the best models are for skills development and skills upgrading of the labor force. For example, what are the best training models to build a skilled labor force? What are the appropriate public and private roles? How should the training system interact with the education system, facilitating the entry of young people into the labor market?

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40 Amongst others, the WB study by Middleton, Ziderman, and Adams, “Skills for Productivity: Vocational Education and Training in Developing Countries” (1993) discusses different options.

41 This has become critical issue in a number of client countries, but not much expertise is available in house. A recent OECD study discusses pros and cons of specific youth programs developed in some OECD countries (“Giving youth a good start: The experience of OECD countries”) and this material could be a start in the identification of suitable programs for client countries.
Figure 5. Youth illiteracy rates still loom large in many low income countries

Further Required Work

- **Identifying efficient government interventions in training programs and policies.** There are a myriad of interventions that have been adopted to stimulate workforce training and skills upgrading: publicly provided training, adult education, fiscal incentives for firms that train workers, earmarked payroll taxes to fund training, labor force certification programs, lifelong learning competencies, technical assistance to SMEs and technical assistance to self-employed workers. What are the impacts of such programs and which programs are more effective to foster skill upgrading of unskilled workers? Which are more effective to foster growth in SMEs? What is the most appropriate role for government in terms of setting the policy framework, financing training, delivering training, providing training “infrastructure” (i.e., information, standards, monitoring and evaluation, etc)?

- **Identifying the role of labor force skills in determining economic outcomes in a context of globalization.** Many developing countries have an unclear strategy regarding the role that training and workforce skills investment should play? On the one hand, a more skilled labor force is often seen as a way to attract investment and to move up the value chain in terms of exports. On the other hand, the attractiveness of keeping labor costs down might suggest that skills development and upgrading should be a less important consideration at certain stages of development. What is evidence from the international experience? To what extent does a lack of suitable skills constrain investment decisions of firms? To what extent do they constrain innovation or FDI?
Figure 6. Share of firms reporting skill shortage as a major constrain in their operation, selected countries


G. International migration

The demographic development between the main regions of the world is characterized by large disequilibria as a result of differences in the timing and scope of fertility and mortality trends. As some of these differences will get more pronounced in the decades to come, this will accentuate the divergence in labor force growth between regions (Figure 7). Europe and Japan will have low or even negative growth, and other regions, such as MNA or India, will have continued high growth. For the rich countries in the developed world, a constant or declining labor force implies lower GDP per capita growth, unless a declining labor supply is fully compensated by higher productivity growth. But the latter risks to be negatively impacted by an older and less entrepreneurial population. Labor force stagnation also implies a higher burden through social security programs such as pension and health, which is largely independent of how these programs are funded. On the other hand, the developing countries with continued strong labor force growth will be extremely hard pressed to create the millions of additional jobs needed to accommodate the new entrants. This disequilibrium calls for demographic arbitrage and ideas on how to structure capital as well as labor flows as a win-win-win situation (for sending country, receiving country, and migrants). This includes managed temporary or permanent migration, the better use of remittances in labor-sending countries, and appropriate social policy programs which make return migration individually attractive and fiscally sustainable for the sending country.
Figure 7. Growing demographic imbalances across regions of the world, changes in population by age group and region for 2005-2050 (in millions)

Source: UN 2005 Population projections; EU25+ includes Iceland, Norway, Switzerland and Channel Islands; The projections are those of the zero migration scenario.

The World Bank has recently launched a research program on the development impact of migration. The objective of the research is to identify policies, regulations and institutional reforms that will lead to improved outcomes for developing countries. The research focuses on developing countries – sending countries – but also looks at the impact of migration on developed countries, as well as on migrants themselves, because the effect on both sets of countries (sending and receiving) will also depend on the degree of success of the migrants themselves. In short, a main objective is to identify “win-win-win” policies for the three groups: developing countries, developed countries and the migrants. The research program includes six main topics, including one on “Social Protection for Migrants”. The following paragraphs elaborate on labor market related issues within this broad topic.

Further required work

• Understanding demographic disequilibria and skill gaps. What are the consequences of insufficient adjustment to the demographic disequilibria for low- and high-labor force growth countries/regions? For the slow labor force growth countries the consequences are likely to include lower economic growth and an increased burden for dealing with population aging in pension and health programs. For the fast labor force growth group, the consequences are likely to include sustained high unemployment, in particular among the young. Moreover, what are the skills requirements for labor market “balancing” while maximizing mutual economic gains? What skill types and levels are required in low-labor force growth (i.e.,

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receiving) regions? Can these be provided by the high-labor force growth (i.e., sending) regions, while keeping distortions in both regions low? Questions to be investigated include analyzing the needed skills, their availability, and the effects of skill formation in both sending and receiving countries.

- **Assessing migration policies in receiving countries.** Comprehensive migration policies are required in receiving countries to promote integration and win-win-win outcomes for both sending and receiving countries: What is the access of migrants to social programs/services such as education, health, income support, etc? What are the needed policy changes for a productive absorption of migrants, in particular in output and factor markets? What are the gender differences in labor migration trends and levels and how gender informs migration policies? What are the budgetary effects of migration for the receiving countries? What are good practices of social integration policies such as outreach, language skills and code of conduct?

- **Assessing migration policies in sending countries.** Effective policies to stimulate job creation in sending countries have major implications for emigration patterns. The other components of the labor market research discussed in this note will all contribute to the assessment of how demographic pressures will translate into migration flows from sending countries. Furthermore, there is little knowledge how migration effects the local labor market and its segments of skilled and unskilled. In addition, the Bank is already working on the effects of migration on human capital formation and on remittances. Implications for brain drain, brain gain or brain circulation in sending countries awaits further investigations.

- **Understanding the role of portability of social benefits.** Greater coordination is required in the area of portability of social benefits and entitlements. Governments of sending countries have an interest in their citizens being protected by social services such as health care, education, unemployment insurance, and pension systems while living and working abroad. At the same time, receiving countries are not always prepared to offer full social protection to migrant workers and their families. Also, migrants may not have spent enough time in a particular country to be entitled to claim certain welfare provisions. How can the portability of benefits in the areas of pensions and health care for migrants among host countries and back to sending country be improved? Are bi-lateral agreements enough or are there better solutions through changes in benefit design?

6. **Implementing the Research Agenda: The World Bank Multi-Donor Trust Fund**

As mentioned above, the research agenda presented above is very ambitious and requires commitment and joint action by the World Bank, other multilateral agencies and international research community. As a significant development toward carrying out this research agenda, in October 2007 the World Bank obtained support from donors to launch a multi-donor trust fund (MDTF) “Labor Markets, Job Creation, and Economic Growth: Scaling Up Research, Capacity Building, and Action on the Ground.” Current donor commitments exceed $3 million, with several other donors likely to join very soon.

The objective of the MDTF is to improve understanding of how labor markets in developing countries function, offer new evidence about policies that create more good jobs as well as reduce inequality and social exclusion, and promote effective labor market policy-making in developing countries. Its main activities will consist of:
• Filling the knowledge gaps: supporting cutting-edge research by the global academic and research community on key policy issues related to the creation of more and better jobs, as well as the reduction of inequality and social exclusion.

• Overcoming the capacity gaps: building the capacity of developing country’s policy-makers and researchers on labor market analysis, evaluation techniques, and good practices in labor market policy.

• Bridging the experience gaps: catalyzing country-level activities aimed at the analysis of local labor market conditions and piloting of promising approaches.

Below we describe these activities in more detail, and provide also the fund’s governance structure and guiding principles.

6.1 Description of Activities

(i) Filling the Knowledge Gaps
The Trust Fund will be used to mobilize the international research community to produce high quality research on labor issues in developing countries, with direct application in the technical assistance and lending/granting operations of the World Bank and other multilateral and bilateral development institutions. The research results will be regularly presented at conferences and seminars.  

Sample deliverables under the research component include:

a. Toolkits. In a number of areas such as labor market diagnostics and assessment of specific policy, what could emerge are user-friendly toolkits to help frame labor market analysis, identify appropriate indicators and contextualize a particular policy issue.

b. Research papers The research products supported by the Trust Fund will be presented as research papers. Their objective is to provide a coherent, operationally relevant and empirically-based analysis that can guide policy interventions.

c. Non-technical notes. These will provide a framework to think about a particular policy issue. They will also distill the main policy challenges and possible trade-offs of different choices, and provide a list of best practices, depending on country circumstances.

d. Flagship reports. The main findings of research papers in any given area will be summarized in Flagship Reports providing a comprehensive vision on how to assess labor market outcomes, identify policy options while taking into account the complementarities and interactions between different policies – within the labor market and across different markets.

(ii) Overcoming the Capacity Gaps
Capacity building will be a major priority throughout the project and will be actively pursued in several areas. A broad range of stakeholders will benefit, including researchers from client countries, policymakers from a range of ministries (particularly in African countries), as well as other stakeholders such as trade unions, employers organizations and other civil society groups. As in previous trust fund efforts such as the German Trust fund on Job Creation, Core Labor Standards, and Poverty Reduction in Africa, a close cooperation with bilateral agencies and

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43 An example of such a conference was Employment and Development Conference organized by the Institute for the Studies of Labor (IZA) and the World Bank, Bonn, June 8-9, 2007.
donors on the ground will be assured. The experience and expertise of partners such as GTZ has proven to be instrumental and the continuation of previous fruitful cooperation is planned.

Experience from recent training and capacity building activities, primarily in Africa, has helped to identify the following successful models that could also be pursued also through this MDTF:

a. **Intensive labor economics training.** The new MDTF project could replicate the successful experience of the June 2006 course on labor economics taught to PhD students from the Africa Economics Research Consortium. In this model, a two-week course on labor economics is conducted by a research institution or university. Following the course, the students complete labor-related research projects under the continued guidance of the instructors. Based on their progress, two or three promising researchers are selected to serve as fellows at the institution organizing the course.

b. **Developing strategies to accelerate job growth in Africa.** Policymakers from a range of ministries in interested African countries could be engaged in an intensive multi-year effort to conduct labor market analysis and develop multi-sectoral employment strategies. The effort could include a series of distance learning events, face to face conferences, and ongoing mentoring at the country level. This model is based on experience of the World Bank Institute and Social Protection and Labor Unit in a 3-year project to mainstream the Social Risk Management (SRM) framework into operations. The SRM project has eventually helped eleven countries to conduct analytical work on risks and vulnerabilities, six of which have already incorporated SRM concepts and programs into their Poverty Reduction Strategies (the remaining five countries have not yet completed a new PRS since the program began).

c. **Developing and applying a core labor standards toolkit** designed to assist WB staff and stakeholders in client countries to analyze the implementation of these standards.

d. **Other capacity building efforts** employed by the MDTF include distance learning and face to face courses. Among others, training efforts could focus on improving capacity to analyze labor data, for example through targeted instruction of data analysis and associated computer programs such as STATA or E-views. Experience from Ethiopia shows that considerable interest and capacity can be developed with relatively short training interventions and the provision of software. Research findings and country experiences will also be incorporated into the World Bank’s two-week “Labor Market Policy Core Course,” thus benefiting a broad audience of policymakers and Bank staff.

(iii) Bridging the Experience Gaps

Many developing countries have employment strategies, but often they are insufficiently grounded in economic and social analysis, and their formulation is considered exclusively the responsibility of the Ministry of Labor. In fact, for these strategies to be successful, not only other ministries and actors need to be involved, but these strategies must also be based on solid

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44 The course was offered as part of the *Job Creation, Core Labor Standards, and Poverty Reduction in Africa* project funded by the German government.
45 The project was funded by the Finnish and French governments. More information is available at the WBI Social Protection Website.
46 The training of Ministry of labor staff in labor market data analysis using STATA software was another successful experience from the *Job Creation, Core Labor Standards, and Poverty Reduction in Africa* project funded by the German government.
analytical underpinnings—and, moreover, countries should be willing to try innovative approaches. This component of the MDTF will thus seek to support country-level innovations in economic analysis and policies. Calls for proposals will be issued to Bank staff willing to complement existing operational work in line with Country Assistance Strategies and PRS. Such activities might include:

a. **Innovative ways to assess and address key bottlenecks of job creation** and better labor market outcomes—putting to work the MILES framework. The steps of such an analysis could involve (i) the review and assessment of the policy and institutional framework of the countries (among others, using existing diagnostic tools developed by the Bank—see above); (ii) based on such an assessment, the identification of policies that create key bottlenecks; (iii) the verification/validation of these bottlenecks, among others, by opinion polls among businesses and workers and by checking how aligned the identified bottlenecks are with findings from existing country-level studies; and (iv) the formulation of the policy response, taking into account both the cross-consistency of the proposed initiatives as well as political economy considerations.

b. **Studies that focus on sub-topics within the labor market** such as analysis of the incidence and effectiveness of training activities of enterprises; the dynamics of the employment in urban informal sector, and prospects for non-farm employment growth in rural areas.

c. **Pilot projects.** These projects will provide opportunity to test innovative programs to addressing poverty within the labor market context and will include, as a rule, a rigorous, scientific monitoring and evaluation component. Possible pilots include:

- Enhancing self-employment and family business via entrepreneurship training and services (possible services include assessment of business ideas, technical assistance, classroom training, and one-on-one counseling, provided by local firms). Such programs have been identified, besides skill training programs, one of the two key labor market priorities in Africa by the World Bank.
- Special youth employment pilots, with similar self-employment and training services as above but with the inclusion of non-cognitive training (for example, life skills training which would address risky behavior such as consumption of alcohol, drugs and tobacco; unprotected sex; participation in gangs; and criminal behavior). Such programs would also benefit from lessons learned by the recently completed Youth Employment Inventory project, undertaken by the World Bank under the YEN.
- Pre-departure training of migrants. To enhance the benefits of migration, migrants would be trained for jobs in demand in destination countries, as well as given practical information about the conditions and risks they are likely to face.
- Policy pilots. Key national stakeholders would form a national employment/social policy task force with the objective to develop an employment strategy for their country. Their work would be supported by country level studies, including those generated under the MDTF activities, as well as PRSPs and CASs. The development of labor market statistics and capacity building efforts to train stakeholders to use labor market databases would be part of such activities.

Except for policy pilots, other pilots will be rigorously evaluated, preferably via randomized designs that assign candidates randomly into program and control groups. Random assignment ensures that on average, the program group and control group will have the same observable and unobservable characteristics, and thus differences in outcomes between the program and control groups can be directly attributed to program
participation. The proposed pilots could consist of relatively small groups (for example, they could start at about 600 participants, if possible representing both rural and urban areas).

Pilots will be implemented according to the following guidelines. In target countries, project collaborators will develop terms of reference for proposed projects, and the project executing agency will be selected via competitive process. Priority will be given to proposals which include a broad range of stakeholders (including trade unions and employers organizations in implementation). (Countries will likely hire part-time project coordinators who will provide technical assistance, monitoring, and supervision). Pilot projects would run approximately one year. A final joint country workshop will be held at the end of the pilot project phase to synthesize lessons learned.

6.2 Governance Structure and Dissemination

A Donor Steering Committee will meet annually and upon request to review progress of all ongoing and completed activities, and to provide strategic guidance in all three areas of the project. The Committee’s membership will consist of all MDTF donors. Individual members of a Technical Advisory Group will provide technical advice on Terms of Reference, Concept Notes, and Pilot Funding Proposals, as prompted by the Donor Steering Committee, Selection and Review Board, or Project Management Team. The Group will consist of widely recognized experts, including members of respected international institutions, academia, trade unions and employer associations, as well as staff members of the ILO and World Bank. Finally, a Selection and Review Board will review and approve Concept Notes for proposed research studies, and Pilot Funding Proposals for recipient grants. The Board will consist of World Bank Regional and Network staff. The MDTF will be managed the Project Management Team that will issue calls for proposals for research and for country level activities; manage contracts; coordinate dissemination; and provide overall project management.

Dissemination. Project outputs and results as well as information about project ongoing activities will be disseminated through both, web and hardcopy publications; a series of international conferences and seminars; and various working paper series and newsletters. The project’s research findings will also be incorporated into the Bank’s annual two-week Labor Market Policies Core Course.
REFERENCES


