

A photograph showing a worker inside a large, circular industrial pipe. The worker is silhouetted against a bright light source at the end of the pipe. Sparks are flying from the worker's position, creating a dynamic and industrial scene. The pipe's interior is visible, showing its circular structure and some mechanical components in the background.

South Asia Development Matters

**OVERVIEW**

# More and Better Jobs in South Asia



THE WORLD BANK

South Asia Development Matters

OVERVIEW

# More and Better Jobs in South Asia



THE WORLD BANK  
Washington, D.C.

This booklet contains the Overview as well as a list of contents from the forthcoming book, *More and Better Jobs in South Asia*.

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**The manuscript for this overview edition disseminates the findings of work in progress to encourage the exchange of ideas about development issues. It is unedited and is not for citation.**

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# Acknowledgments

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The report was prepared by a team co-led by Reema Nayar and Pablo Gottret, under the direction of Kalpana Kochhar, Chief Economist of the South Asia region. The core team comprised Pradeep Mitra, Yue Man Lee, Indhira Santos, Gordon Betcherman, Mahesh Dahal, and Maheshwor Shreshtha. Mark Schaffer, Wendy Carlin, Amit Dar, and Toby Linden made significant contributions to specific chapters.

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# Messages

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## **Message 1: South Asia has created many, mostly better jobs.**

- Job creation in South Asia averaged just fewer than 800,000 a month between 2000 and 2010. The rate of employment growth broadly tracked that of the working-age (15–64) population. Open unemployment is low.
- Real wages rose for wage workers, and poverty declined for the self-employed, as well as other types of workers. Wages and poverty are the primary criteria for improved job quality that guide the analysis. A reduced risk of low and uncertain income for the most vulnerable group of workers is a secondary criterion for improved job quality. It could be monitored only in India, where it is satisfied.
- The improvement in job quality has been associated with accelerating economic growth in Bangladesh and India since the 1980s. In Nepal, where growth has been slow over several decades, it is massive out-migration in response to limited opportunities at home that has improved labor market prospects for those who remain. Workers' remittances have reduced poverty across a wide swath of households.

## **Message 2: The region faces an enormous employment challenge, but its demography can work in support of the reforms needed to meet it.**

- An estimated 1.0–1.2 million new workers will join the labor market every month over the next few decades—an increase of 25–50 percent over the historical average. The employment challenge for the region is to absorb them at rising levels of productivity.
- Aggregate productivity growth in South Asia over the last three decades was driven by an extraordinary surge in the growth of total factor productivity (TFP)—a combination of changes in efficiency with which inputs are used and changes in technology—the contribution of which was larger than in the “miracle” growth years of high-performing East Asian economies (excluding China). Going forward, rapidly growing countries in South Asia need to sustain and slow-growing countries to ignite growth by easing constraints to physical and human capital accumulation. Higher rates of factor accumulation, alongside more typical rates of TFP growth, which will vary according to country circumstances, will allow the region to absorb new entrants to the labor force at rapidly rising levels of labor productivity.
- With higher TFP growth in industry and services compared with agriculture,

aggregate TFP growth should also increase, through a faster reallocation of labor from agriculture to industry and services. Reallocation across sectors needs to be complemented by moving labor out of lower-productivity firms in manufacturing and services, where the overwhelming majority of South Asians who are employed in these sectors work, into higher-productivity firms within those sectors. But reallocation across and within sectors will require physical capital accumulation, for example, in electricity, the inadequacy of which inhibits firms from expanding and creating jobs. It will also require investment in human capital to provide those workers with the skills necessary to access better jobs.

- The “demographic transition”—the period during which the number of workers grows more rapidly than the number of dependents—can provide a tailwind in support of policy reform for the next three decades in much of South Asia, because the resources saved from having fewer dependents provides a “demographic dividend.” This dividend can be used for high-priority physical and human capital investments necessary to absorb the growing number of entrants into the labor force at rising wages and more productive self-employment. This will happen only if there is a policy framework that can channel the extra savings into such priority investments, such as an efficiently intermediating financial sector and a business environment conducive to firms’ carrying out those investments. In the absence of such a framework, productivity will be growing slowly or remain stagnant and the dividend will go uncashed. The window of demographic opportunity is expected to close around 2040 for all countries except Sri Lanka, where it closed around 2005, and Afghanistan, where it will stay open beyond 2040.
- The policy reforms required to boost job quality are desirable irrespective of the demographic transition. But the window of demographic opportunity lends urgency to the agenda, especially given that policies take time to bear fruit.

**Message 3: Creating more and better jobs for a growing labor force calls for a reform agenda that cuts across sectors.**

- Investing in reliable electricity supply is critical. South Asian firms of all types—rural and urban, formal and informal—rate electricity as the top constraint to operations. Reported outages are consistent with reported severity: Afghanistan, Bangladesh, and Nepal have some of the highest reported outages. The gap between demand and supply of electricity is large. Reforms need to manage the needed expansion of capacity efficiently and improve the financial and commercial viability of the power utilities. They



involve a combination of investment and reform of governance in the sector—both are critical.

- Formal urban firms cite corruption in interactions with the state, especially in transactions involving tax administration and utilities, as an important constraint to their operations.
- In addition to electricity, informal urban firms in India report inadequate access to land among their leading constraints. Rural-based industry and service firms in Bangladesh, Pakistan, and Sri Lanka report inadequate transport, which inhibits their access to markets that would make them less dependent on local demand, as important.
- Agriculture will continue to be the largest employer compared to industry and services in much of South Asia in the foreseeable future. Boosting productivity growth in the sector through accelerated diversification into cash crops and high-value activities will require investment in key public goods. Investment in agricultural research and development has much higher returns than power, fertilizer, and credit subsidies.
- Education reform is key. But this calls for action before children enter school. Poor nutrition in early childhood, where South Asia has the weakest indicators in the world, impairs cognitive development before children get to school, thus reducing the payoff from subsequent educational investments. Policy makers must strengthen the quality of learning at all levels, to equip tomorrow's workers, not only with academic and technical skills, but also the behavioral, creative, and problem-solving skills employers increasingly demand.
- Moving away from protecting jobs to protecting workers is essential for formal sector job creation in India, Nepal, and Sri Lanka, where enterprise managers in the urban formal sector report labor regulations as being a more severe constraint to the operation and growth of their business than is the case for countries at their levels of per capita income. Reforms to encourage job creation in the formal economy must go hand in hand with strengthening labor market institutions and programs that formal and informal sector workers can use to help them adjust to labor market shocks and improve their future earnings potential. Building incrementally on existing schemes is likely the best way forward.

# Overview

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This study investigates how more and better jobs can be created in South Asia.<sup>1</sup> It does so for two reasons. First, this region will add nearly 40 percent to the growth of the world's working-age (15–64) population over the next several decades. It is important to ask what needs to be done to absorb them into employment at rising levels of labor productivity. Second, creating more productive jobs—with jobs defined to include all wage work and self-employment—is the most reliable route out of poverty for a region that is home to more than 40 percent of the world's absolute poor.<sup>2</sup>

The report addresses three major questions.

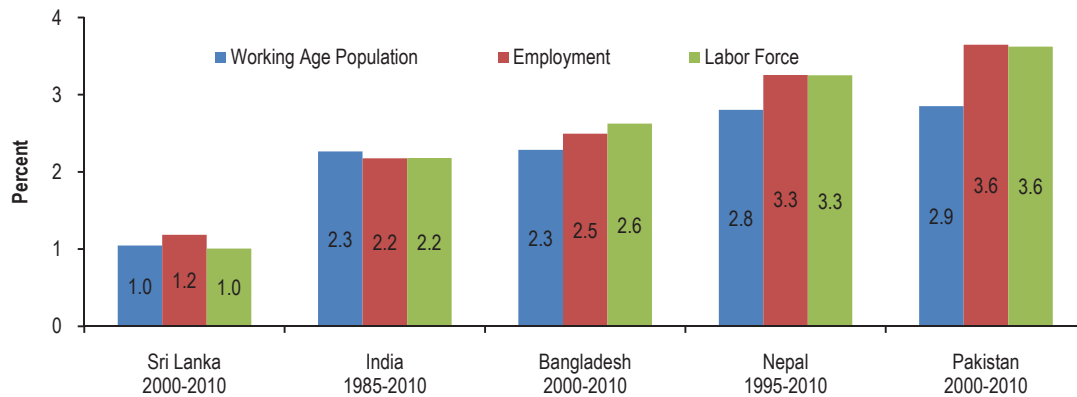
- Has South Asia been creating an increasing number of jobs and better jobs?
- What determines the quality of job creation, and what is the employment challenge going forward?
- What demand- and supply-side bottlenecks need to be eased to meet South Asia's employment challenge in the face of intensifying demographic pressure?

## South Asia's Track Record

This section examines South Asia's track record in creating jobs. It looks at the quantity of jobs, the quality of jobs, and workers' ability to move across categories of jobs.

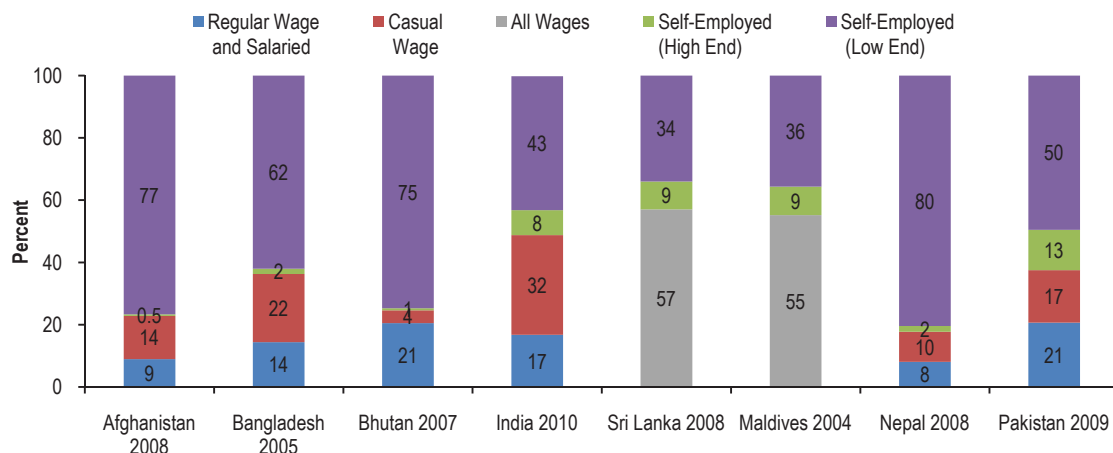
### *Job Quantity*

Employment grew in South Asia over the past decade, broadly tracking growth in the working-age population (figure 1.1). Lack of safety nets precludes high rates of open unemployment, which averaged a little over 3 percent in the region. Thus employment growth tends to broadly mirror growth in the labor force. As the proportion of the working-age population that is in the labor force changes slowly, the growth of the labor force tends to track that of the working-age population.

**Figure 1.1 Annual Growth in Working-Age Population, Employment, and Labor Force in Selected South Asian Countries**

Source: Authors, based on data on working-age population from UN 2010 and data on employment and labor force from national labor force surveys.

Among the five large countries in the region, employment growth since 2000 was highest in Pakistan, followed by Nepal and Bangladesh, India, and Sri Lanka. Total employment in South Asia (excluding Afghanistan and Bhutan) rose from 473 million in 2000 to 568 million in 2010, creating an average of just under 800,000 new jobs a month. In all countries except Maldives and Sri Lanka, the largest share of the employed are the low-end self-employed (figure 1.2).<sup>3</sup> Nearly a third of workers in India and a fifth of workers in Bangladesh and Pakistan are casual laborers. Regular wage and salaried workers represent a fifth or less of total employment.<sup>4</sup>

**Figure 1.2 Distribution of Employment by Type in South Asia, by Country**

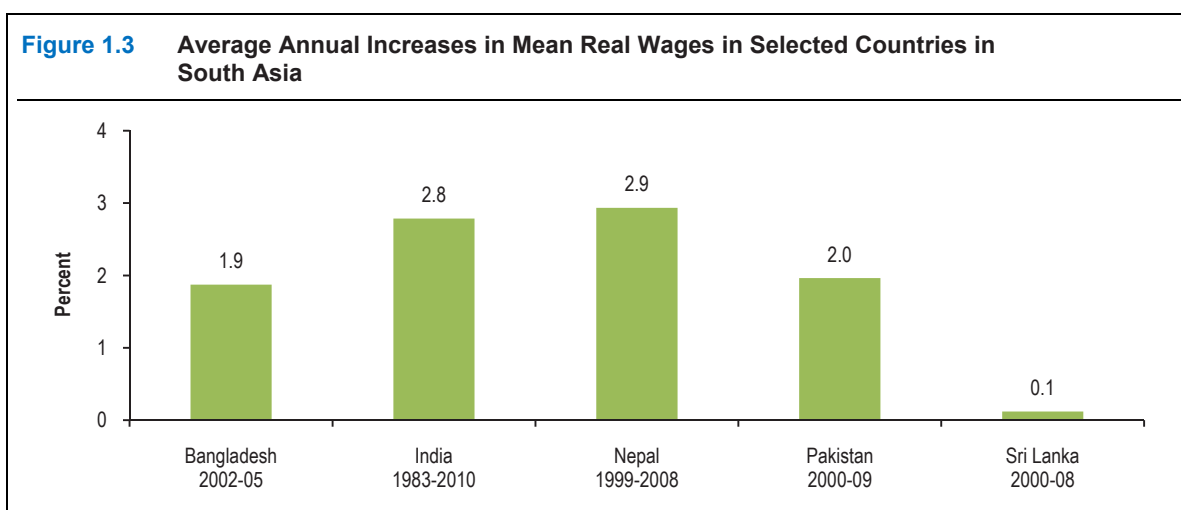
Source: Authors, based on data from national labor force and household surveys.

Note: The data for Maldives and Sri Lanka do not allow the separation of wage employment into regular and casual laborers.

## Job Quality

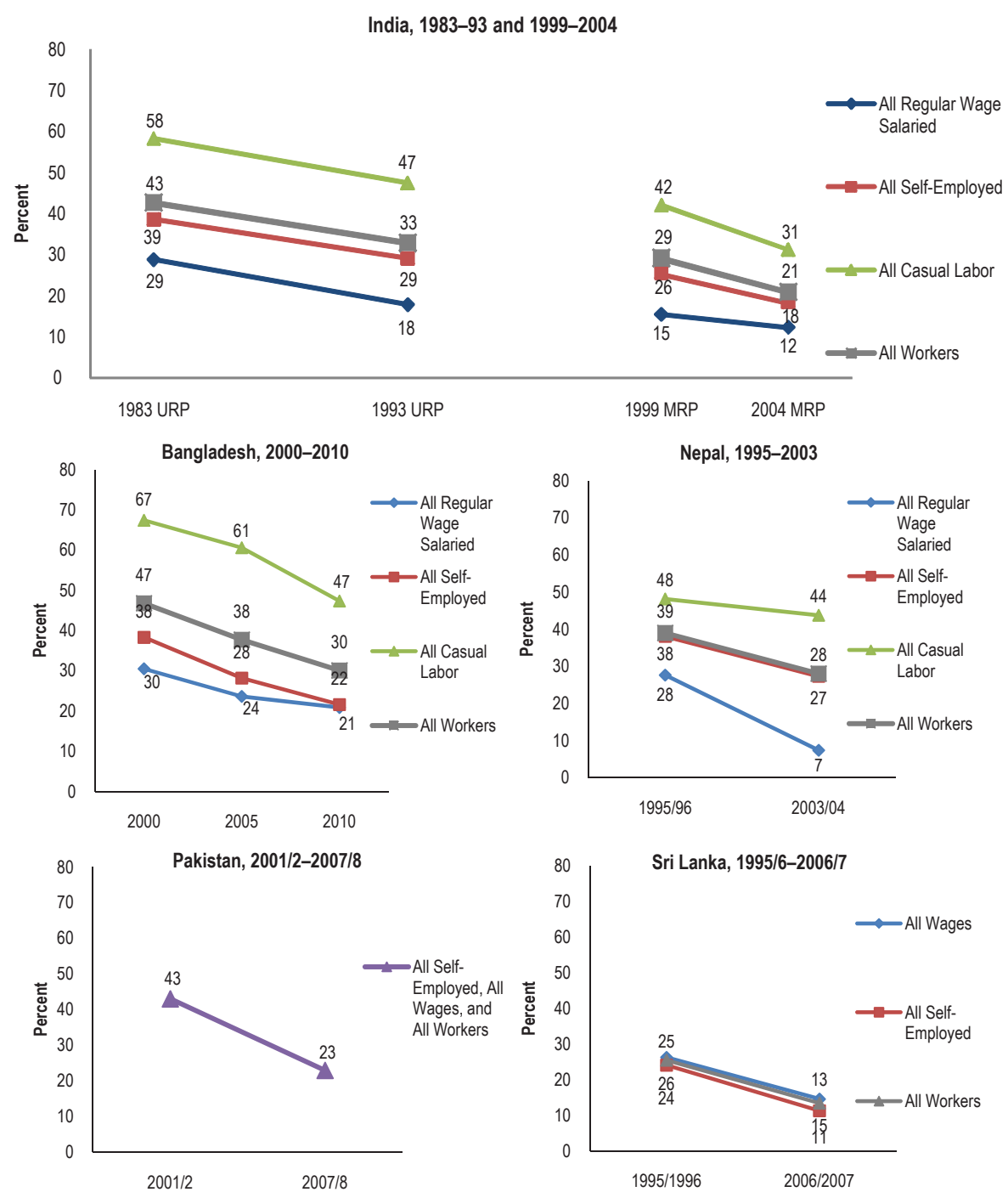
South Asia has created better jobs, defined primarily as those with higher wages for wage workers and lower poverty levels for the self-employed and, secondarily, as jobs that reduce the risk of low and uncertain income for the most vulnerable group of workers. By these measures, results have been positive:

- Real wages for wage workers—both casual and regular wage or salaried—grew 2–3 percent a year during various subperiods between 1983 and 2009–10 for which comparisons can be made (figure 1.3).



Source: Authors, based on data from national labor force and household surveys.

- A higher proportion of self-employed workers (on whom information on earnings is not available) are now in households above the national poverty line in Bangladesh, India, Nepal, Pakistan, and Sri Lanka. This figure is used as a proxy for improving job quality for this segment of the labor force (figure 1.4). It is not possible to rule out reasons other than improving job quality for falling poverty rates in these households. Such factors include the flow of workers' remittances in Nepal, which bring in close to a quarter of gross domestic product (GDP) and are estimated to account for half of the decline in national poverty rates, or an increase in hours worked by household members in situations of low wage growth. Increasing proportions of casual and regular wage or salaried workers in Bangladesh, India, and Nepal and all wage workers in Pakistan and Sri Lanka are also now in households that are above the poverty line. Indeed, poverty rates for all types of workers during all time periods show a decline when the data are disaggregated by location (rural or urban) or gender. Thus the primary criterion for better jobs is broadly satisfied.

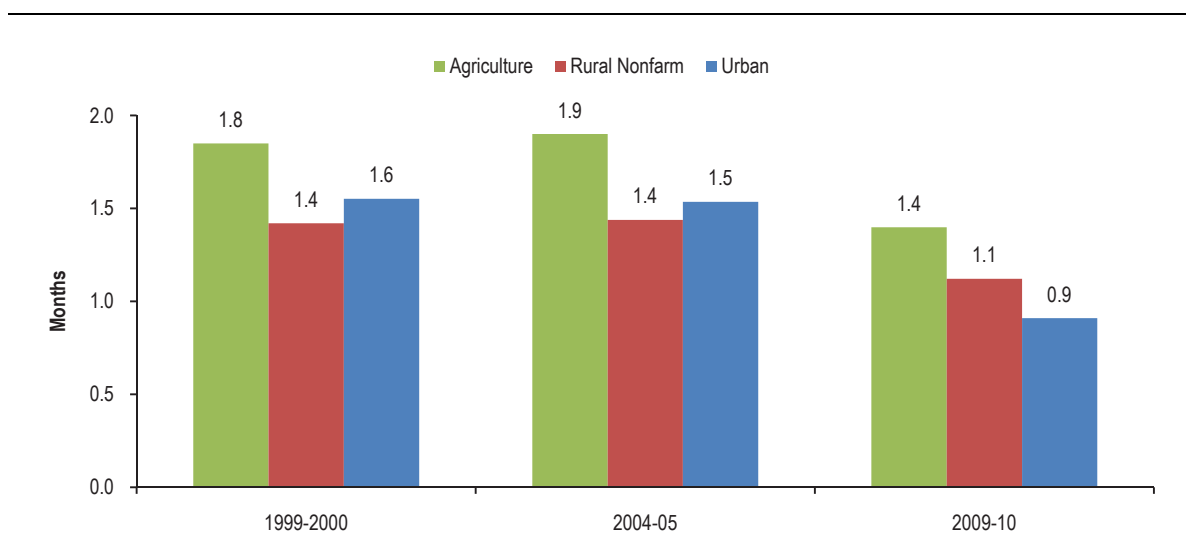
**Figure 1.4 Percentage of Workers in Households below the Poverty Line in Selected South Asian Countries, by Employment Status**

Source: Authors, based on data from national labor force and household surveys.

Note: URP denotes uniform recall period (the period in which respondents were asked to recall all consumption items over the same recall period [for example, 7 days]). MRP denotes mixed recall period (the period need not be the same for all items, [for example, 7 days for some and 365 days for others]). Figures are for workers 15–64.

- In India over the periods 1999–2000 and 2009–10, there was a decline in the average number of months for which all casual laborers were without work despite looking for it (figure 1.5). Thus the secondary criterion for better jobs—that they should reduce the risk of low and uncertain incomes for the most vulnerable—appears to have been met in India. This is not necessarily the case in other countries in South Asia. (For a discussion of these criteria and the way in which they are used to rank jobs by quality, see annex 1C.)

**Figure 1.5** Average Number of Months without Work in the Past Year, Casual Laborers in India, 1999–2010, by Sector



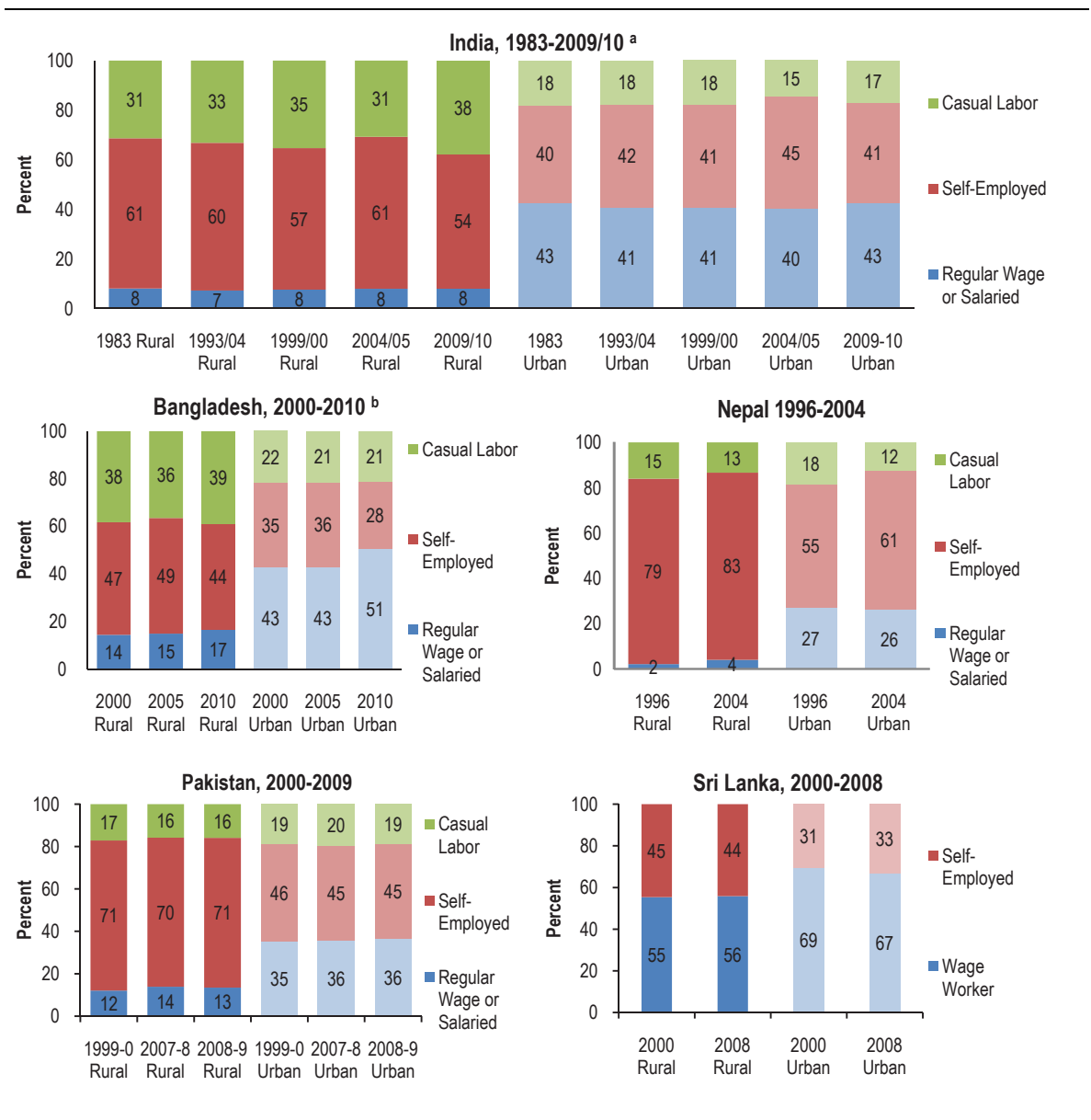
Source: Authors, based on data from Indian labor force and household surveys.

Note: Figures are for workers 15–64 who were available for work during at least part of the month.

Notwithstanding the variation in wages and poverty rates across employment types and their changes over time, there is a stable pattern of association between poverty and the type of employment that has been maintained over time. Regular wage or salaried workers have the highest wages and lowest poverty rates; the self-employed have higher poverty rates; and casual labor, especially agricultural casual labor, is associated with the lowest wages and the highest poverty rates (see annex 1C).

The proportion of workers in different employment types has remained largely unchanged over time (figure 1.6). At this level of aggregation, better jobs have thus been created mainly as a result of increasing quality within jobs rather than reallocation of the labor force across employment categories.



**Figure 1.6 Share of Rural and Urban Workers in Selected South Asian Countries**

Source: Authors, based on data from national labor force and household surveys.

Notes: a. Although there is variation in the shares of casual labor and self-employment in rural areas in India, there is no persistent increase or decline in the shares throughout the whole period (for example, the increase in casual labor between 2004/05 and 2009/10 mostly reversed the decline between 1999/2000 and 2004/05); the share of regular wage or salaried workers remained constant throughout the 25-year period.

b. Data from the Bangladesh Household Income and Expenditure Surveys (HIES) were used to calculate worker poverty rates. The share of workers by employment type in the HIES differs from the share in the Bangladesh labor force surveys. The difference is likely to be partly driven by how female employment is captured in the two surveys, with the female participation rates in the HIES less than half those reported in the labor force survey. Therefore, the changes in the share of workers by type in Bangladesh from the HIES should be interpreted carefully. For example, between 2005 and 2010 the significant increase in the share of regular wage or salaried work in urban areas was driven largely by changes in the female urban workforce reported in the HIES 2005 and HIES 2010.

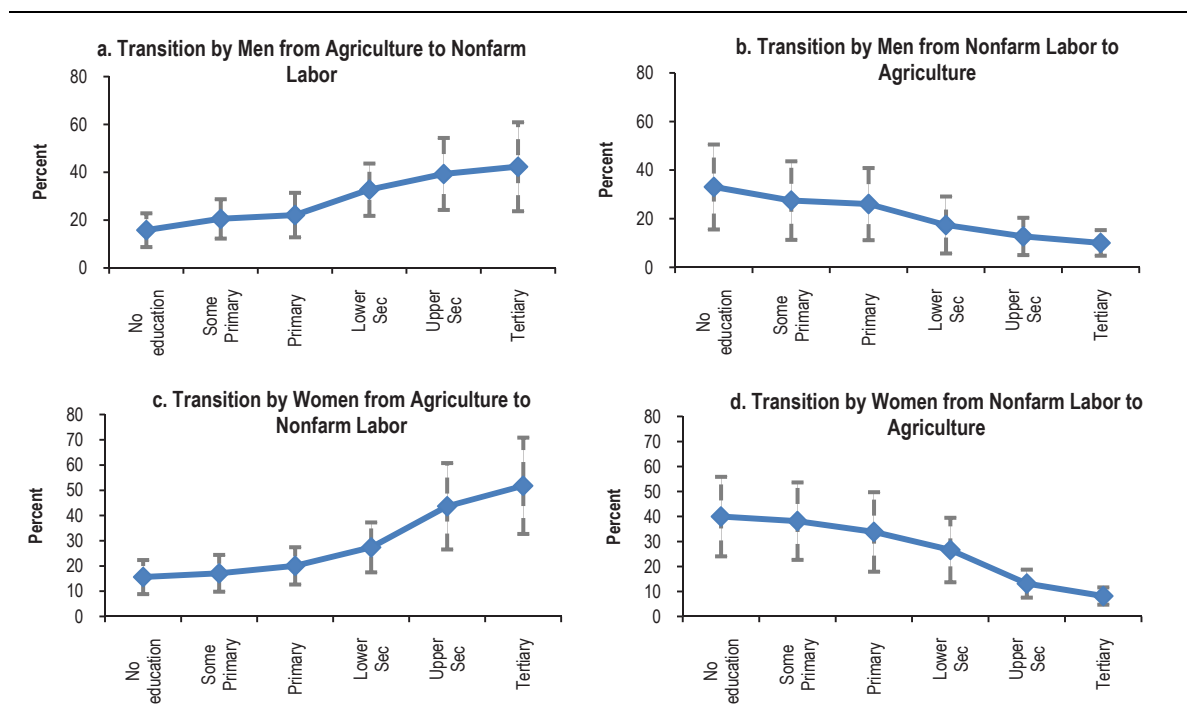
Looking across broad sectors, wages in industry and services are higher than in agriculture. Thus the rural nonfarm economy offers better jobs than agriculture. Improvement in job quality has been associated with increasing shares of industry and services in employment, which includes a growing share of the rural nonfarm economy in rural employment.

### Labor Transitions

The broad constancy in the share of workers across employment types masks labor mobility at the level of individual workers. Many rural workers in Bangladesh, India, and Nepal (the three countries studied in the labor transition analysis in chapter 5) have moved from agriculture to the rural nonfarm economy and vice versa.

Education is closely tied to labor mobility. Secondary and higher levels of education increase the ability of workers to move out of agriculture, casual wage jobs, and low-end self-employment to better jobs. Although the analysis was conducted for both rural and urban Bangladesh, India, and Nepal, in the interest of space only the results for rural India are shown (figure 1.7).

**Figure 1.7** Conditional Probability of Moving into and out of Better Jobs in Rural India, by Education Level and Gender, 2004/05–2007/08



Source: Authors, based on data from national labor force and household surveys.

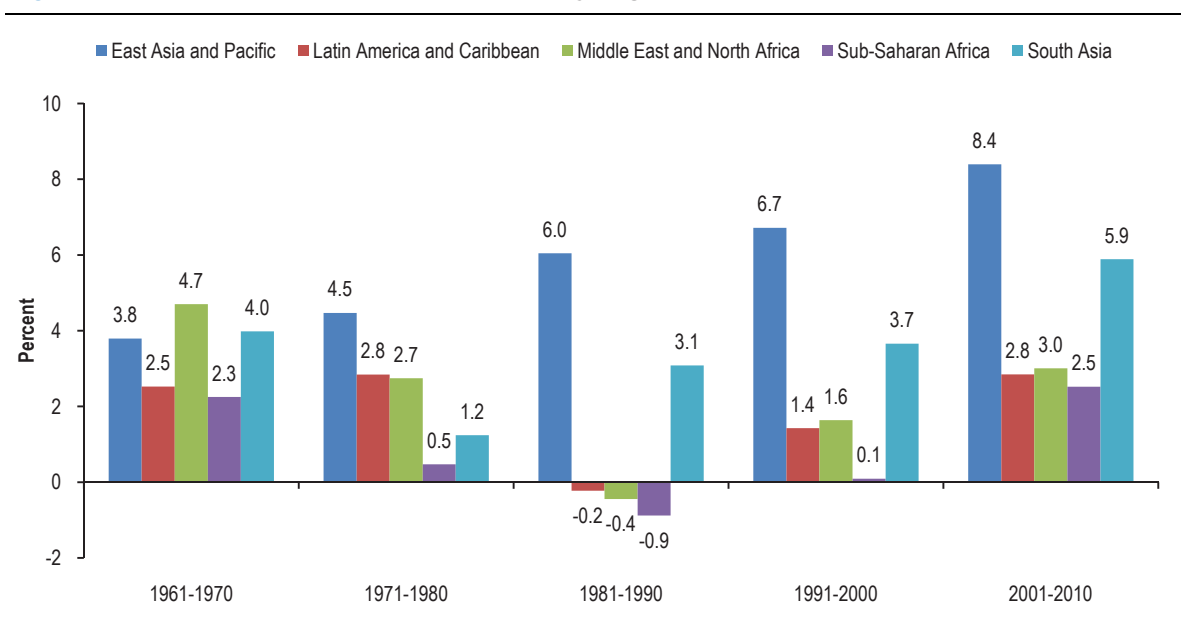
Note: Results provide upper- and lower-bound estimates of the share of rural workers in different types of transitions. The lines are drawn through the midpoints of these bounds and should not be interpreted as the true point estimates.

Rural workers who were in agriculture in the first period were more likely to make the transition to a better job if they had secondary or higher levels of education. Better jobs in rural areas are typically in the nonfarm economy. This higher mobility is typically greater for workers with completed upper secondary education. Conversely, workers with less education were more likely to experience a transition in the opposite direction—for example, from nonfarm work to agriculture. Workers with lower levels of education are more likely to lose better jobs than they are to secure them, as shown in the higher levels of transition bars for lower levels of education in the right-hand panel compared with the left-hand panel. On the other hand, workers with higher levels of education are more likely to move to better jobs than they are to lose them.

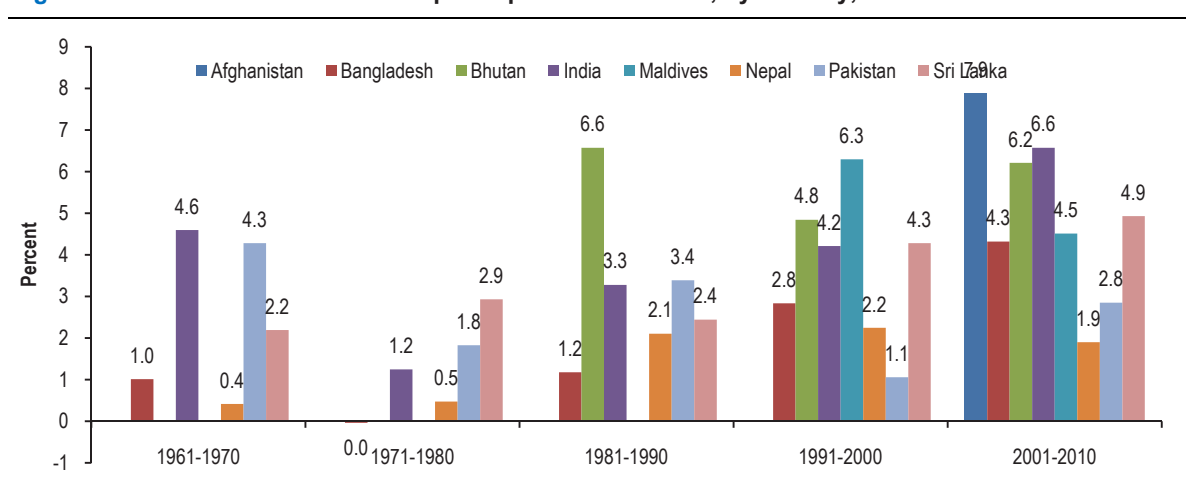
## Determinants of Job Quality and the Employment Challenge

Improving job quality for most segments of the labor force can usually occur only in a growing economy. South Asia has seen an acceleration of growth over the three decades since 1980 that is second only to that of East Asia (figure 1.8). But growth experiences have varied within South Asia (figure 1.9). Growth in GDP per capita has accelerated, particularly since the 1980s, in Bangladesh and India. It has stagnated in Nepal and been marked by volatility around a broadly declining trend over the last four decades in Pakistan. Sri Lanka witnessed an acceleration of growth over the last five decades, except for a dip in the 1980s, and it managed to avoid the slowdown or stagnation of the 1970s that affected the other countries in the region.

**Figure 1.8 Annual Growth in GDP per Capita, by Region, 1960s–2000s**



Source: Authors, based on data from World Bank 2011b.

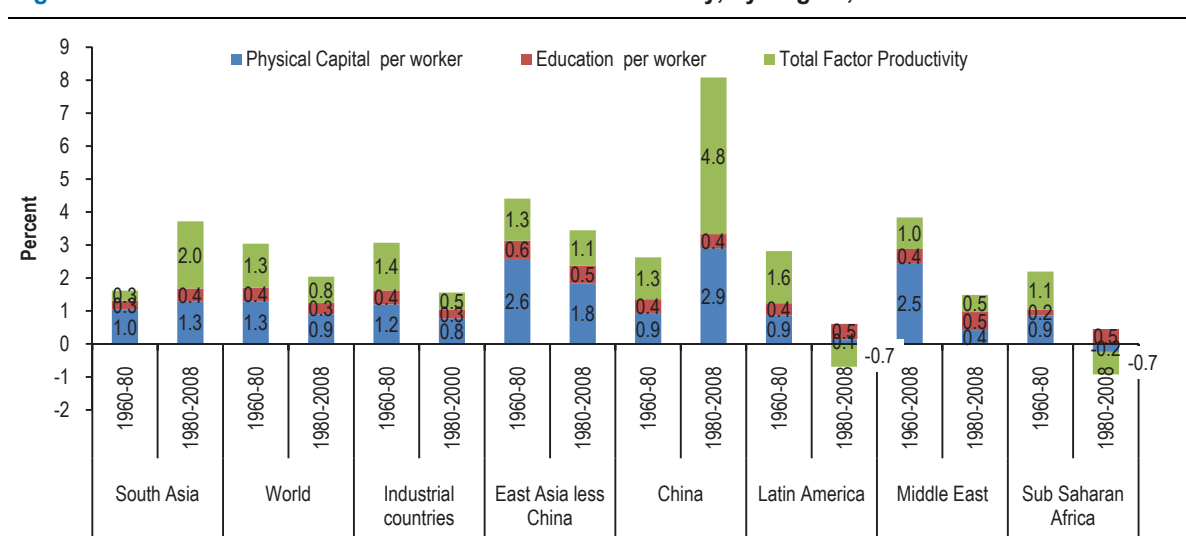
**Figure 1.9 Annual Growth in GDP per Capita in South Asia, by Country, 1960s-2000s**

Source: Authors, based on data from World Bank 2011b.

Note: Growth in the earliest available decade for Afghanistan, Bhutan, and Maldives is not based on data for the entire decade because data for the entire decade were not available. Thus Afghanistan 2001–10 is based on 2003–09, Maldives 1991–2000 on 1996–2000, and Bhutan 1981–90 on 1982–90.

### Sources of Growth

The marked acceleration in growth in South Asia has allowed better jobs to be created. Among industrial and all developing regions except China, aggregate labor productivity (GDP per worker) grew fastest in South Asia, at 3.7 percent a year, between 1980 and 2008 (figure 1.10). This performance represents a striking turnaround from the preceding two decades (1960–80), when aggregate labor productivity in South Asia grew just 1.6 percent a year—more slowly than any other region, including Sub-Saharan Africa.

**Figure 1.10 Sources of Annual Growth in Labor Productivity, by Region, 1960-80 and 1980-2008**

Source: Bosworth 2010.

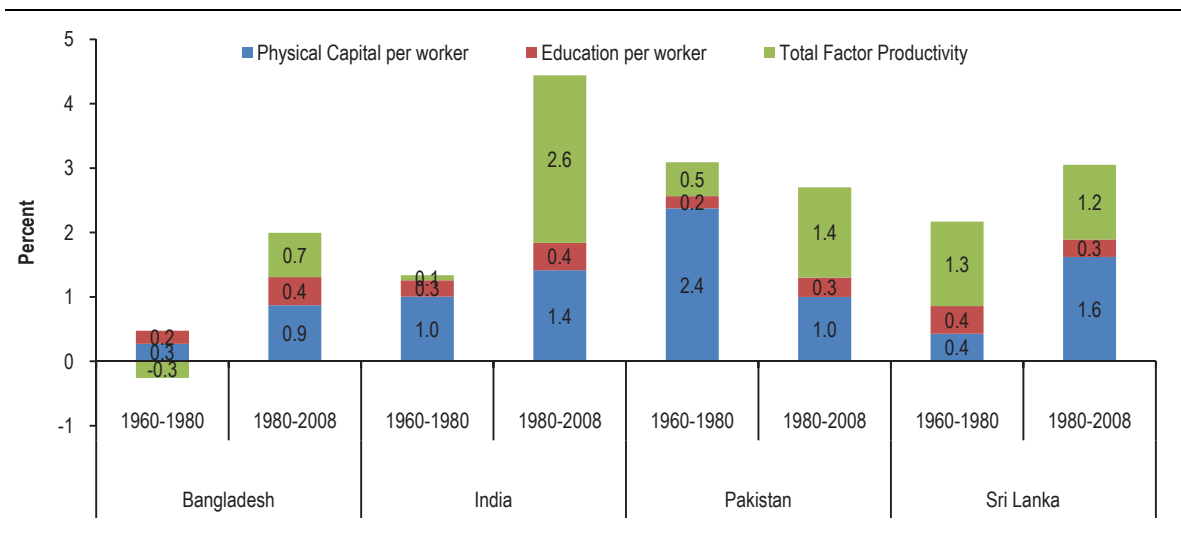
Growth in aggregate labor productivity can be decomposed into two factors:

- “Extensive” growth, comprising the growth in physical capital per worker (capital deepening) and the growth of human capital per worker (education)
- “Intensive” growth, comprising growth in total factor productivity, a measure of the efficiency with which inputs are combined to produce output.

This decomposition indicates that growth in TFP made a larger relative contribution to the growth of aggregate labor productivity in South Asia during 1980–2008 than did physical and human capital accumulation (figure 1.10). In fact, the contribution of TFP growth was higher than in the high-performing East Asian economies excluding China during their “miracle” growth years.<sup>5</sup>

The sources of growth varied across countries (figure 1.11). In Bangladesh education accounted for a fifth of the growth in aggregate labor productivity. Growth of TFP was more important in India, reflecting its increased exposure to external and internal competition brought about by trade liberalization and deregulation. Capital deepening played a significant role in India and Pakistan. But whereas its contribution rose in India after 1980, it fell sharply in Pakistan, accounting for the relative importance of TFP growth there. Capital deepening has been more important in Sri Lanka, where the share of investment in GDP nearly doubled following its “big bang” opening up in 1977.

**Figure 1.11 Sources of Annual Growth in Labor Productivity in South Asia, by Country, 1960-80 and 1980-2008<sup>1</sup>**



Source: Bosworth 2010.

The heterogeneity of the countries in the region is a reminder that job quality has not been associated with accelerated economic growth everywhere. In Nepal, for example, growth in GDP per capita remained at about 2 percent a year during the last three decades. It was the massive out-migration of workers—estimated at at least a third of all working-age men—that contributed to the reduction in labor supply and led to rising real

wages for those left behind. Declining poverty, which is used as a proxy for improving job quality, owes less to growth in Nepal than to an inflow of worker remittances, estimated at nearly a quarter of GDP.

### *The Employment Challenge*

The pressure to create better jobs will intensify very substantially over the next few decades. In its medium-fertility scenario, the United Nations projects that the region's current population of 1.65 billion will increase 25 percent by 2030 and 40 percent by 2050. Given the region's generally youthful population, the working-age population is projected to increase even more (35 percent by 2030 and 50 percent by 2050).

Two scenarios reveal the job creation implications of these demographic changes. In the first, there is no increase in the rate of female labor force participation from current levels. In this scenario, South Asia adds 1 million entrants a month to the labor force between 2010 and 2030. The proportionate increases are largest in countries with the youngest populations (Afghanistan, Nepal, Pakistan) and smallest in the single aging country in the region (Sri Lanka).

Under the second scenario, female labor participation rates increase 10 percentage points by 2030 in Bangladesh, India, and Pakistan, which together account for 95 percent of the region's working-age population and have the lowest rates of female participation (31 percent in Bangladesh, 30 percent in India, and 22 percent in Pakistan). (This phenomenon would be consistent with observed behavior in Indonesia, the Republic of Korea, Malaysia, and Thailand between 1960 and 2000.) Participation rates remain unchanged in the other countries. Nearly 1.2 million entrants a month are added to the labor force between 2010 and 2030, intensifying labor market pressure in Bangladesh, India, and Pakistan. South Asia saw an average of just under 800,000 entrants a month to the labor force between 1990 and 2010. These projections thus imply a huge increase over historical levels.

Can high economic growth, which has been the major driver of improving job quality in some South Asian countries, be expected to continue over the next few decades? The historical evidence from around the world shows that growth rates are highly unstable over time: the cross-decade rank correlation of growth rates per capita for 94 countries across five decades is a mere 0.1–0.4—and correlations with time periods more than two decades apart are typically negligible.<sup>6</sup> The rarity of sustained growth is underlined by the fact that since 1950, GDP per capita has grown at a rate of 7 percent or more—the rate required to double living standards every 10 years—in only 13 countries, 9 of them in East Asia (World Bank 2008c).

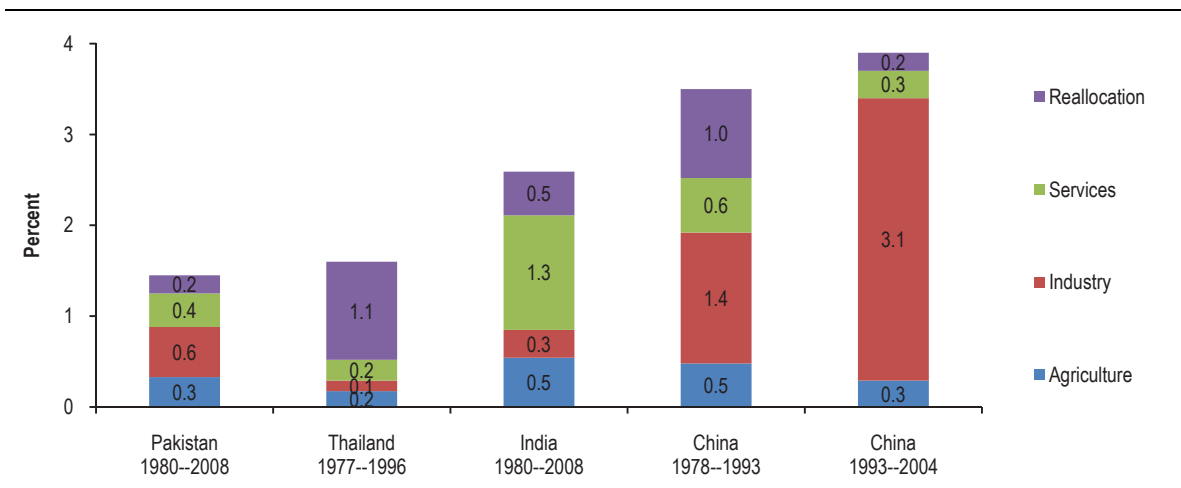
Looking forward, productivity growth in the region will need to rely more on factor accumulation (physical capital deepening and human capital accumulation) and less on the extraordinary growth of TFP seen in the last three decades.<sup>7</sup> As the region has become more open to the international economy, it is importing better-quality capital and intermediate goods at world prices and using standard technology to produce goods that are either sold domestically or exported in competitive world markets. Inasmuch as the



technology is widely used internationally, the increases in TFP arising from it will be limited to what it is in global best practice. Furthermore, even with acceleration in “second generation” structural reforms, TFP growth is not likely to continue at the rates triggered by the reforms of the 1990s. Hence a key task for policy makers will be to create an improving enabling environment for factor accumulation (physical capital deepening and human capital formation), which, alongside TFP growth, can deliver rising wages and declining poverty.

Aggregate TFP growth could also be increased as a result of a faster reallocation of labor out of low-productivity agriculture. The contribution of reallocation to TFP growth has been substantially greater in East Asia than in South Asia (figure 1.12). Reallocation accounted for two-thirds of aggregate TFP growth in Thailand between 1977 and 1996, a period during which the share of agriculture in employment fell by nearly a third. The contribution of reallocation to TFP growth in China between 1978, when reforms started, and 1993 was nearly one-third. During this period, the share of agriculture in employment fell by more than a fifth.<sup>8</sup> In contrast, reallocation contributed 15 percent to aggregate TFP growth in Pakistan and 20 percent in India between 1980 and 2008, during which time the share of agriculture fell by 15 percent in both countries.

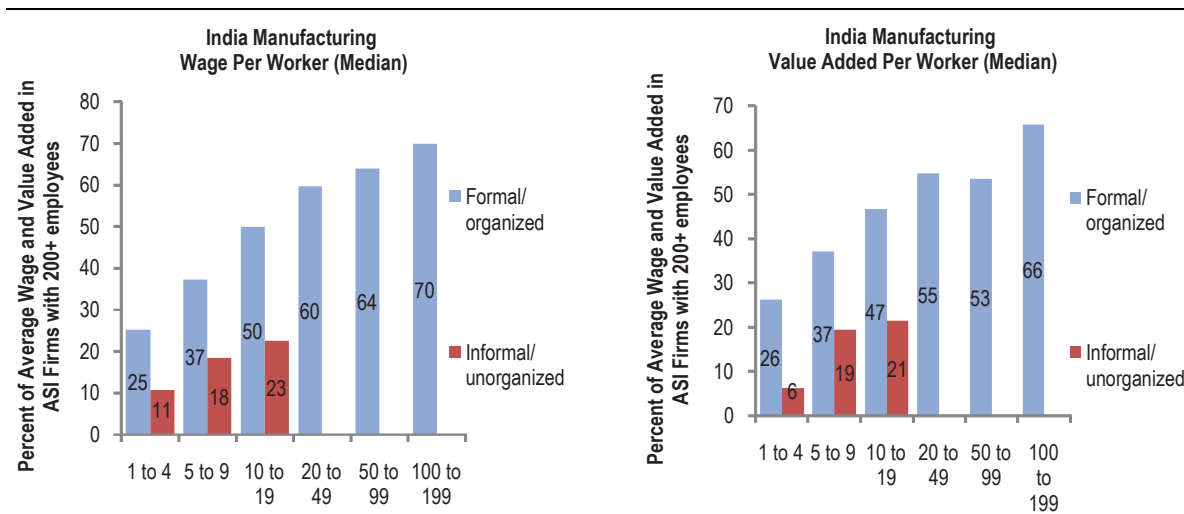
**Figure 1.12 Sources of Annual Growth in Total Factor Productivity in China, India, Pakistan, and Thailand**



Source: Authors, based on data from Bosworth 2005, 2010; Bosworth and Collins 2007.

The creation of better jobs also requires that labor be moved more rapidly not only out of agriculture into industry and services but also out of lower-productivity firms within industry and services into higher-productivity firms within those sectors. Wage differentials between smaller and larger firms are particularly marked in India’s manufacturing sector, where both output and wages per worker in formal firms employing one to four workers average one-quarter the levels of firms employing more than 200 workers (figure 1.13).<sup>9</sup>

**Figure 1.13** Average Wage and Value Added per Manufacturing Worker in India, by Firm Size and Type, 2005



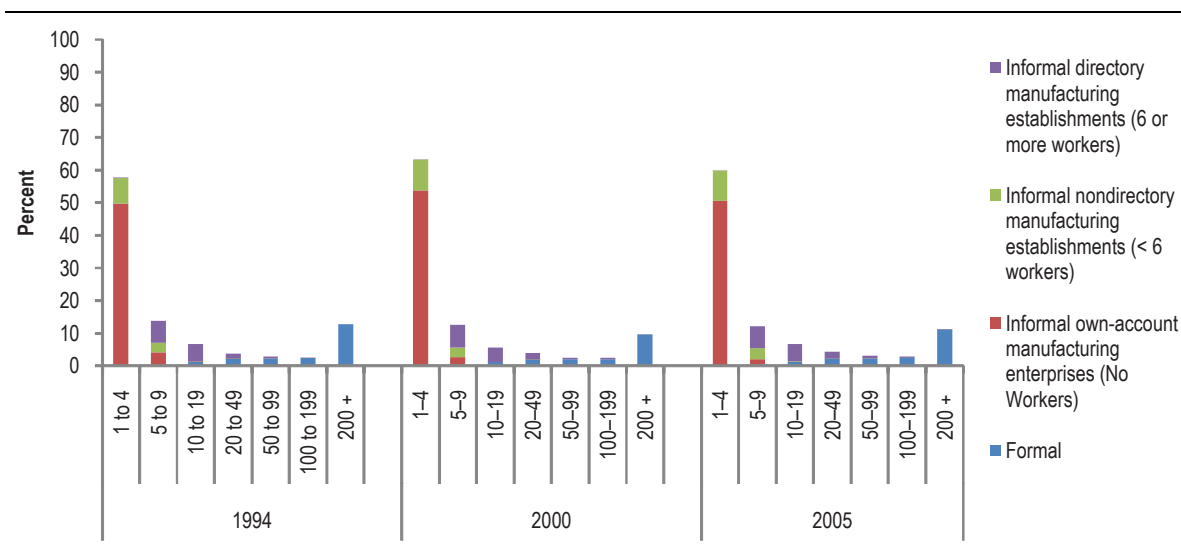
Source: Authors, based on data on organized firms from the Annual Survey of Industries and data on unorganized firms from the National Sample Survey manufacturing surveys.

Note: Organized/formal firms with 200 or more employees = 100 percent.

Output per worker and wages are also much lower in informal firms than in formal firms the same size class. In informal firms with one to four workers, these measures are just 25–50 percent of those formal firms the same size. The difference probably reflects both the higher capital intensity and the higher skill levels at larger firms versus smaller ones and at formal firms versus informal firms the same size. Firm-size productivity differentials exist in other countries, but they are particularly high in India compared with East Asia.

Although output per worker and wages at larger, formal firms are higher, more than 80 percent of employment in manufacturing in India is in microfirms (firms with 1–4 workers) and small firms (firms with 5–49 workers), a situation that has persisted over time (figure 1.14). In fact, half of employment is in own-account manufacturing enterprises that do not employ any wage workers. The concentration of employment in micro and small firms is even higher in services, where 96 percent of workers are in firms that employ fewer than 50 people. As in manufacturing, the size distribution of firms did not change between 2001 and 2006.

Notwithstanding its declining share of employment, agriculture will continue to be the largest employer among the three broad sectors in most of South Asia for some time. For this reason, it is important that agricultural productivity be increased to ensure that the quality of jobs be improved for workers in the sector (box 1.1).

**Figure 1.14** Share of Manufacturing Employment by Firm Size and Type in India, 1994–2005

Source: Authors, based on data on organized firms from the Annual Survey of Industries and data on unorganized firms from the National Sample Survey manufacturing surveys.

### Box 1.1 Increasing Productivity in Agriculture

The exit of workers from agriculture to industry and services, whether rural or urban based, is an important correlate of economic development. It is nevertheless critical to ensure that total factor productivity (TFP) in agriculture—the key driver of economic growth over the long haul—continues to grow. Increasing agricultural TFP is important for two reasons. First, it can provide better jobs for workers who remain in the sector. Second, it allows workers to transition more rapidly from agriculture to industry and services, where TFP growth is higher.

Notwithstanding South Asia's transformation from a food deficit to a food surplus region, the productivity of agriculture remains low. India and Pakistan have improved their agricultural productivity over the years; elsewhere in the region, improvements began only in the 1990s, after decades of relative stagnation. There is some room to expand area under cultivation in selected rain-fed parts of the region (Afghanistan, Bhutan, Nepal, eastern Sri Lanka). There are also some unexploited opportunities for expanding area through watershed development and irrigation (in Afghanistan, Bhutan, India, Nepal, and Pakistan). But the bulk of future growth will have to rely on boosting TFP growth, which has lagged international best practice.

The key to accelerating TFP growth lies in diversifying into cash crops (tea, sugarcane, cotton, spices, and rubber) and high-value activities. Cash crops have traditionally been important sources of agricultural growth and employment in many parts of South Asia. They are more labor intensive than food staples (mechanization options are limited) and well suited for small-scale production. Improved technology, together with a reduction of implicit taxation, could boost the yields of such crops.

(Box continues on next page)

**Box 1.1 (continued)**

Rising incomes, urbanization, and changing consumer preferences are creating strong demand for high-value commodities in most South Asian countries. The shift has increased incentives to diversify, to which farmers across the subcontinent are responding. Agricultural diversification has proceeded most rapidly for fruits and vegetables in Bangladesh, Bhutan, and Nepal; horticulture, fishing, and livestock in India; and livestock in Pakistan. These developments have occurred despite the disincentives created by policies that favor food security crops (rice and wheat), as India, Pakistan, and Sri Lanka do. A shift from cereal-based to high-value agriculture requires substantial farm-level investment, as well as greater exposure to risk. It is necessary to widen access to financial and insurance services for many smallholders in order to enable them to participate in the high-value supply chains.

Core public goods are particularly important in agriculture. Only the public sector can invest in much research and development, because private investors are not able to appropriate rents, except in a few cases, such as hybrid seed. Public investment in agriculture has been an important driver of growth and poverty reduction in India and can provide high returns to investment in South Asia. The highest returns to public spending in the last two decades were in research and development, roads, education, and irrigation (box table 1.1.1). Although marginal returns have diminished over time, they remain significant. In contrast, returns to input subsidies (fertilizer, power and credit) are low.

**Box Table 1.1.1 Returns to Agricultural Growth from Investments in Public Goods and Subsidies in India, 1960s–90s (percent)**

Type of public good	1960s	1970s	1980s	1990s
Road investment	8.79	3.80	3.03	3.17
Educational investment	5.97	7.80	3.88	1.53
Irrigation investment	2.65	2.10	3.61	1.41
Irrigation subsidies	2.24	1.22	2.38	—
Fertilizer subsidies	2.41	3.03	0.88	0.53
Power subsidies	1.18	0.95	1.66	0.58
Credit subsidies	3.86	1.68	5.20	0.89
Agricultural research and development	3.12	5.90	6.95	6.93

Source: Fan, Gulati, and Thorat 2008.

Note: — Not available.

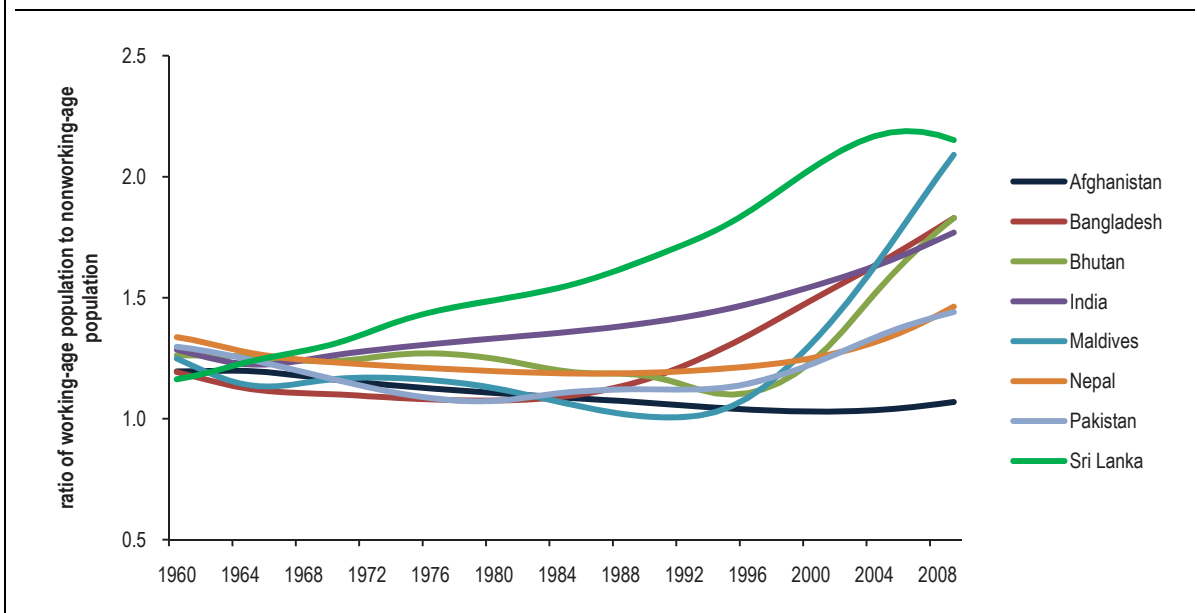
Institutional weaknesses such as thin land markets, suboptimal water-use arrangements, and regulatory restrictions on marketing arrangements also constrain productivity growth in agriculture. There is thus a substantial agenda of institutional reform.

Accelerating the exit from agriculture to industry and services and enabling industrial and service sector firms to expand, become more productive, and thus pay higher wages requires urgent action on a number of fronts. The limited educational attainment of the labor force, inadequate infrastructure, and low capital intensity of most firms imply that realizing higher TFP growth through the intersectoral and intrasectoral reallocation of labor will require substantial investment in human and physical capital.

### *Cashing the Demographic Dividend*

South Asia's changing demographic profile can help it meet the enormous employment challenge it faces.<sup>10</sup> All South Asian countries are undergoing a process, known as the "demographic transition," by which high fertility and mortality rates are replaced by low ones. A key indicator of where a country is situated in the transition is the inverse dependency ratio, which is the ratio of the working-age population to the dependent population. Typically, there is an initial decline in this ratio, reflecting a fall in the infant mortality rate that precedes a fall in the fertility rate. The ratio subsequently increases as the baby boom caused by the lagged decline in the fertility rate becomes part of the working-age population. The resulting rise in the share of the working-age to the nonworking-age population implies that there are fewer dependents to support (figure 1.15). The resources saved as a result—the "demographic dividend"—can be used for high-priority investments.

**Figure 1.15** Ratio of Working-Age to Nonworking-Age Population in South Asia, by Country 1960–2008



Source: Authors, based on data from UN 2008.

Although the inverse dependency ratio has followed the same broad pattern in all of South Asia, there are country differences. Afghanistan's ratio started increasing only in 2005. Bangladesh's ratio rose sharply, catching up with India's in 2003 and exceeding it thereafter. The improvement reflected, among other things, a very rapid decline in fertility that was supported by the country's reproductive health program. Maldives saw the fastest increase in the ratio, thanks to its plunging fertility rate. Pakistan's ratio began a gentle climb in the 1980s and Nepal's in the 1990s.

In its medium-fertility scenario, the United Nations estimates that the inverse dependency ratio will peak for most South Asian countries around 2040. The exceptions are Sri Lanka, where it occurred around 2005, and Afghanistan, where it will still be rising in 2040. Bangladesh, Bhutan, India, and Maldives are already experiencing the demographic transition and therefore have the potential to benefit from it. Nepal and Pakistan, where the demographic transition started later, have yet to see a dividend.

The demographic dividend grows when the inverse dependency ratio rises more rapidly and peaks at a higher level. This will be the case if the fertility decline occurs soon after the decline in infant mortality and is rapid. Policies such as creating an effective reproductive health program and expanding female primary and secondary education, which reduces family size, can help bring this about.

The resources made available by the demographic dividend can be used for physical capital deepening (electricity, transport) and human capital formation (education, skills) if the business environment is conducive to such investments being made. It is also important that policy focus on improving the quality of financial intermediation, so that the increased private savings of households find their way into the investments in physical and human capital that have the highest returns. The increased factor accumulation would then increase aggregate labor productivity, which would help absorb entrants into the labor market at rising wages and more remunerative self-employment.

Without policy reform, however, the demographic dividend cannot be increased or used to boost growth and living standards. In that event, entrants into the labor market will be absorbed at stagnant or slowly rising levels of productivity, and the potential of the demographic dividend will remain untapped. Policies to improve the environment for factor accumulation and raise the quality of physical and human capital formation are necessary to create better jobs whether or not there is a demographic dividend. But the fact that for most of the region, the window of demographic opportunity will be open for only another three decades lends urgency to the need for policy reform.

Because of volatile economic growth, an uneven policy framework, and armed conflict in a number of countries, there is only a broad correspondence between per capita GDP growth and the demographic transition. The acceleration in India's economic growth started in the 1970s, when its inverse dependency ratio started its climb (figures 1.9 and 1.15). Bangladesh's acceleration began in the 1980s; during the middle of the decade, its ratio began to increase as well. With the exception of a slowdown in the 1980s, Sri Lanka has seen an acceleration of economic growth over nearly five decades since the 1960s, when its inverse dependency ratio started rising rapidly. Pakistan, where economic growth has been volatile across the decades, and Nepal, where growth has been low and stagnant, have yet to see a demographic dividend. With better policies, their growth performance could improve in the future as the demographic transition takes hold.

Except in Nepal and, to a lesser extent Bhutan, the female employment rate (that is, the ratio of female employment to the female working-age population) in South Asia is among the lowest in the developing world. This reflects primarily the notably low female



labor participation rate in South Asia. Participation rates are particularly low in the three largest countries: Pakistan, where almost four out of every five women do not participate in the labor force, and Bangladesh and India, where slightly more than two out of every three do not do so. Nonparticipation does not imply inactivity: household duties were cited as the most important reason for nonparticipation. An increased proportion of working-age women in employment in the near future would raise the inverse dependency ratio and boost the demographic dividend in countries such as Bangladesh and India, which are going through the demographic transition. While the demographic transition is less advanced in Pakistan, the situation is no less urgent there, where the female participation rate in the country is the lowest in the region. (For a comprehensive discussion of options to improve economic opportunities for women, see World Bank 2012.)

The employment challenge in South Asia is one of improving job quality rather than quantity, as job growth over long periods tracks the growth of the working-age population. The challenge will be to find better jobs for a workforce whose size will increase 25–50 percent in the coming decades. In the presence of policy reform, the demographic transition can provide a favorable tailwind in support of economic growth and improving job quality. Policy will be needed, however, to address the main demand-side constraints to job creation, discussed in the next section.

## Improving an Unconducive Business Environment

What constrains the demand for labor in South Asia? What types of policy reform would facilitate firm expansion and the demand for labor? How do the business environments of individual South Asian countries compare with the rest of the developing world?

Enterprise surveys can be used to uncover such information. These surveys ask firms to rate the severity of inadequacies in the various elements of the business environment for their ability to operate and expand their business. These elements, which are external to the firm and resemble public goods, include regulation, physical infrastructure, the availability of skilled labor, macroeconomic conditions, the quality of the judiciary, and crime and corruption. The question takes the form: “How much of an obstacle is X to the operation and growth of your business?” The firm’s response regarding its severity—rated on a five-point scale, with 0 being no obstacle and 4 being a very severe obstacle—is a measure of the marginal reported cost imposed by the constraint on the operation and growth of its business. These data can be interpreted as the difference between the firm’s profit in the hypothetical situation in which the business environment poses a negligible obstacle to the firm’s operations and the firm’s actual profit, given the existing quality of the business environment.

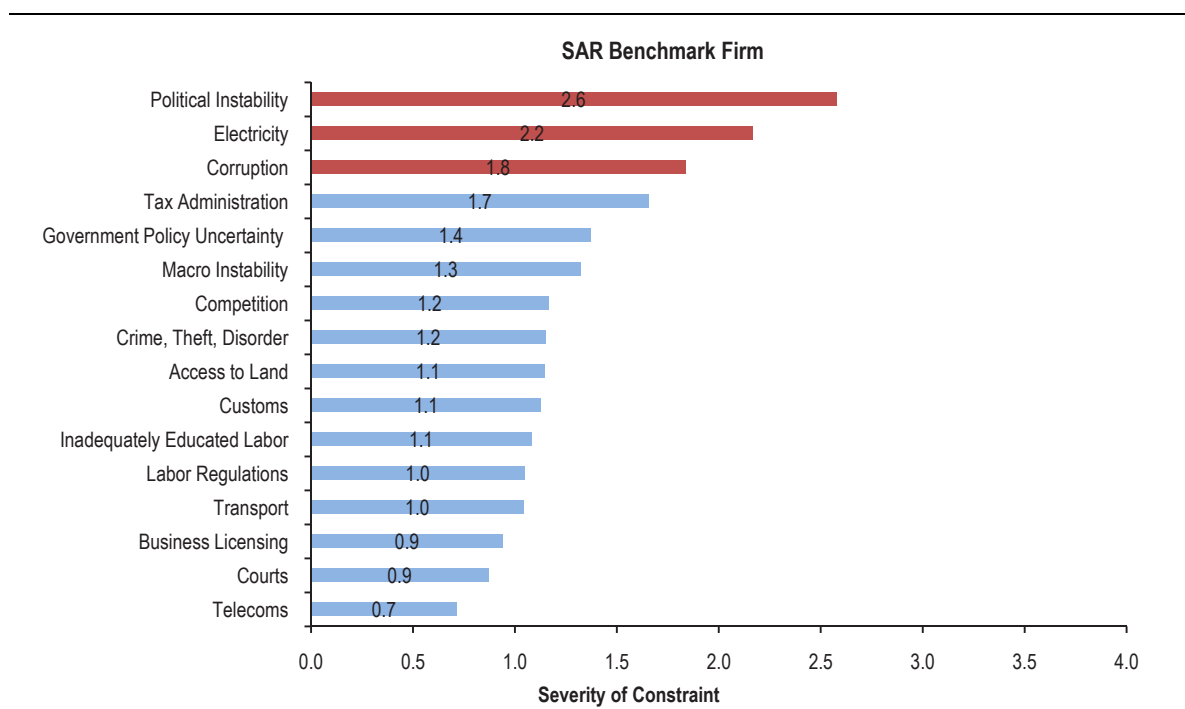
### *Power, Payments, and Politics*

The three most common binding constraints for medium-size urban formal firms in South Asia are electricity, corruption, and political instability (table 1.1 and figure 1.16).<sup>11, 12</sup> Although there are some variations, the top three constraints facing formal, urban firms

are common to most countries. In every country except Bhutan and Maldives, electricity is one of the top two constraints; it is the top constraint in India and Sri Lanka. Except for Bhutan, political instability is among the top three constraints in all countries where it was included in the survey instrument. In five of the eight countries studied, corruption is among the four highest-ranked constraints cited by a benchmark firm in the urban formal sector.

Table 1.1 and figure 1.16 show the severity and ranking of constraints for a benchmark firm in the urban formal sector. A benchmark firm is a medium-size manufacturing firm with 30 employees that is domestically owned, does not export or import, is located in a large city, and did not expand employment in the preceding three years. A comparison across countries and regions requires that these firm characteristics, which are distributed differently across countries, be controlled for. For instance, if a country has a dominance of skill-intensive firms, the answer to the question on labor skills (“How much of an obstacle are labor skills to the operation and growth of your business?”) might be more important than it would be in countries that do not have firms requiring such skills. That said, although the severity of constraints differs for nonbenchmark firms (for example, firms in the service sector), the ranking of the top constraints is very similar across types of firms within the urban formal sector across countries in South Asia.

**Figure 1.16** Severity of Constraints Reported by South Asian Benchmark Firm in the Urban Formal Sectors



Source: Authors, based on Carlin and Schaffer 2011b (from World Bank enterprise surveys).

Note: A benchmark firm is a medium-size manufacturing firm with 30 employees that is domestically owned, does not export or import, is located in a large city, and did not expand employment in the preceding three years

**Table 1.1 Top Five Constraints Reported by South Asian Benchmark Firm in the Urban Formal Sector, by Country**

	South Asia	Afghanistan	Bangladesh	Bhutan	India	Maldives	Nepal	Pakistan	Sri Lanka
Electricity	2	2	1		1		2	2	1
Political Instability	1	1	2		n.a.	n.a.	1	3	n.a.
Corruption	3	3	3		2	3	4		
Tax Administration	4		5	5	3			1	
Labor Regulations				3	4		5		5
Labor Skills				2	5	2			
Access to Land		4	4			1			
Transport				1			3		
Gvt Policy Uncertainty	5							4	2
Courts						4		5	
Crime Theft Disorder		5				5			
Business Licensing				4					
Macro Instability									3
Competition									4

*Ranking: 1 = Top ranked constraint*

*Source:* Authors, based on Carlin and Schaffer 2011b (from World Bank enterprise surveys).

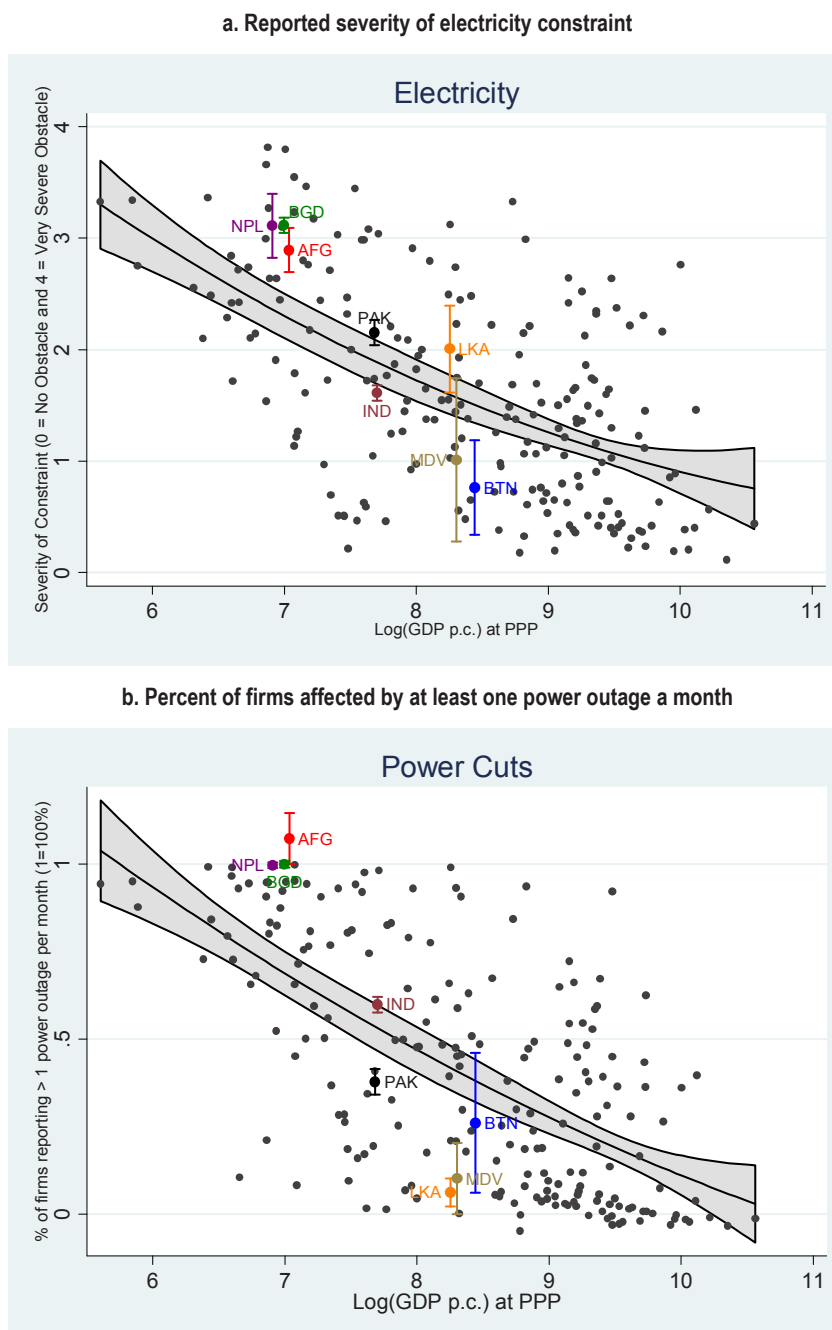
*Note:* A benchmark firm is a medium-size manufacturing firm with 30 employees that is domestically owned, does not export or import, is located in a large city, and did not expand employment in the preceding three years. n.a. Not applicable (question was not asked).

## Electricity

In most South Asian countries, the cost imposed on firms by the electricity constraint is among the highest in the world; in Afghanistan, Bangladesh, and Nepal it is higher than in other countries at similar levels of GDP per capita. Moreover, the severity of the constraint has increased over time in India, Nepal, and Pakistan (figure 1.17). The downward slope in the figure implies that although firms in richer countries can be expected to make more demands on the electricity grid, which would lead to rising severity of complaints, richer countries can more than offset those demands in the provision of electricity, resulting in lower levels of severity at higher incomes per capita. (For details, see chapter 4.)

The high frequency of power outages in South Asia is consistent with the reported severity of the electricity constraint. Indeed, Afghanistan, Bangladesh, and Nepal have some of the highest reported outages in the world, with virtually 100 percent of firms experiencing them. Predictably, the use of generators to mitigate the effects of uncertain power supply is higher in South Asia than elsewhere, with 87 percent of firms in Afghanistan, 52 percent in Sri Lanka, and 49 percent in India having generators.

**Figure 1.17** Cross-Country Comparisons of Reported Severity of Electricity Constraint and Power Outages for a Benchmark Firm



Source: Carlin and Schaffer 2011b (based on World Bank enterprise surveys).

Note: The log of GDP per capita in purchasing power parity is on the horizontal axis. A conditional mean is the marginal cost of the constraint for the benchmark firm. The vertical bars shown for South Asian countries are confidence intervals of 95 percent. The regression line shows the relationship between the conditional mean for each country and the square of log GDP per capita for the rest of the world. The shaded area is the 95 percent confidence interval band around the regression line.

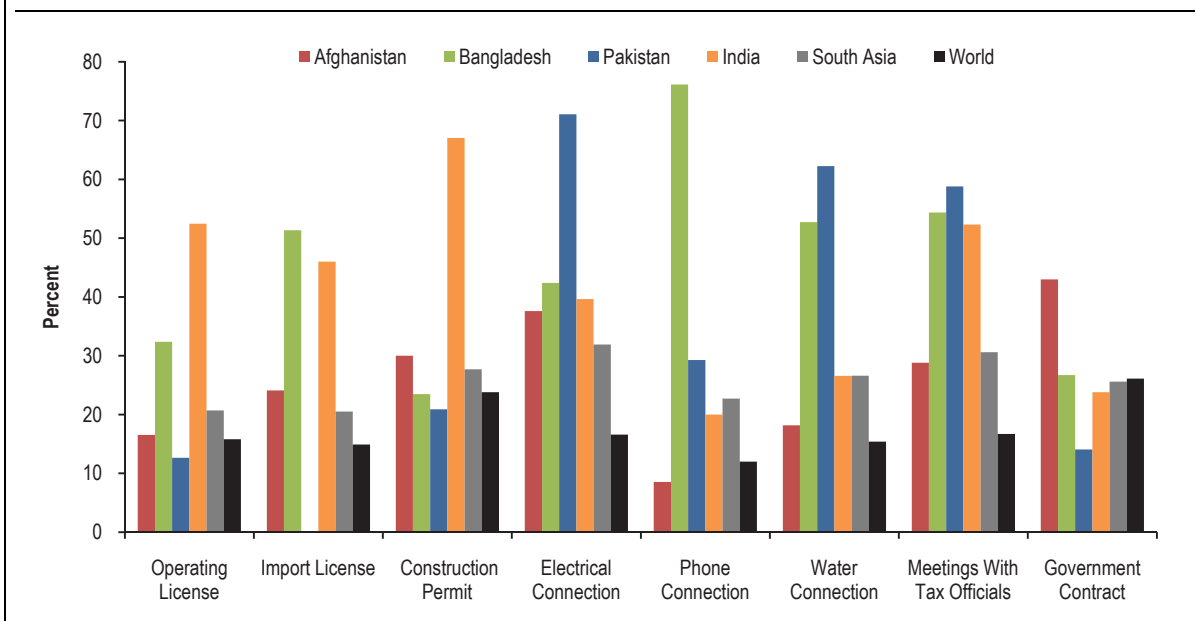
## Corruption

Corruption is among the top five constraints in five South Asian countries (see table 1.1). Firms face high levels of corruption in a range of interactions with public officials, particularly for utilities and tax inspections (figure 1.18). Government interactions that have the highest frequency of bribes vary by country:

- Afghanistan: Government contracts (43 percent), electrical connections (38 percent)
- Bangladesh: Utilities (42–76 percent), tax meetings (54 percent), import licenses (51 percent)
- India: Construction permits (67 percent), tax meetings (52 percent), operating licenses (52 percent), electrical connections (40 percent)
- Pakistan: Electrical connections (71 percent), water connections (62 percent), tax meetings (59 percent)

The high frequency of bribes faced in connecting to power supply is another dimension of the issue of access to electricity and could be related to businesses having to compete to secure much needed power (World Bank 2008b). More than half of firms in Bangladesh, India, and Pakistan are expected to pay bribes during tax inspections. The tax systems in these countries are complex and create not only high costs of compliance but also opportunities for corruption. (Chapter 4 compares the severity of corruption as an obstacle to doing business and the prevalence of bribes in individual South Asian countries and countries outside the region at similar levels of GDP per capita.)

**Figure 1.18** Percent of Firms Expected to Give Gifts to Public Officials, by Type of Interaction



Source: Authors, based on data from World Bank enterprise surveys.

Note: Figures show percent of firms in South Asian countries citing corruption as one of their top three constraints.

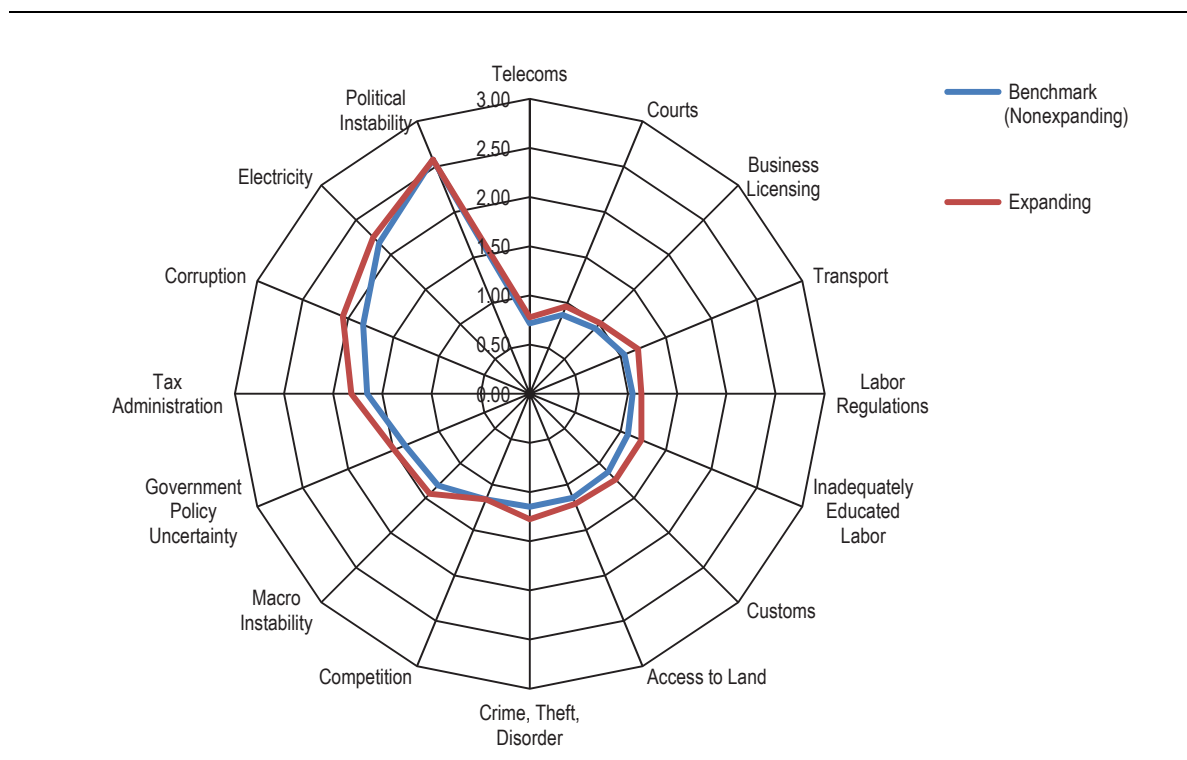
## Political instability

The reported costs of political instability are high in Afghanistan, Bangladesh, and Nepal; in all three countries, it is the most or second-most severe constraint (see chapter 4 for details). These three countries have some of the highest reported costs of political instability in the world. (Chapter 7 examines the nature of political instability and the cost it imposes on firms and workers.)

## Constraints Facing Job-Creating Firms in the Urban Formal Sector

Firms that expanded permanent employment in the preceding three years report higher costs than the benchmark firm across virtually the entire range of external constraints. Job-creating firms, which are similar in all respects to the benchmark firm except that they expanded employment during the preceding three years, report significantly higher severity in 14 of the 16 business constraints (figure 1.19 and table 1.2). They also report higher levels of mitigation activities, such as using generators as a response to unreliable electricity supply and paying bribes to navigate a corrupt environment.

**Figure 1.19** Severity of Constraints Reported by South Asian Benchmark (Nonexpanding) and Expanding Firm in the Urban Formal Sector



Source: Authors, based on Carlin and Schaffer 2011b (based on World Bank enterprise surveys).

Note: A point farther away from the origin indicates that the business constraint is considered more severe. Only statistically significant differences in reported severity between benchmark and nonbenchmark firms are shown. Survey does not make clear what firms mean by "competition."



**Table 1.2** Top Five Constraints Reported by South Asian Benchmark (Nonexpanding) and Expanding Firm in the Urban Formal Sector, by Country

Constraint	South Asia	Afghanistan	Bangladesh	Bhutan	India	Maldives	Nepal	Pakistan	Sri Lanka
Electricity	2 2	2 2	1 1		1 2		2 2	2	1 1
Political Instability	1 1	1 1	2 2		n.a   n.a	n.a   n.a	1 1	3 1	n.a n.a
Corruption	3 3	3 4	3 3		2 1	3 4	4 4	1	
Tax Administration	4 4		5 5	5 5	3 3			1 4	
Labor Regulations				3 3	4 4		5 5		5 5
Labor Skills				2 2	5 5	2 2			
Access to Land		4 5	4 4			1 1			
Transport				1 1			3 3		
Gvt Policy Uncertainty	5 5							4 3	2 2
Courts						4 5		5	
Crime Theft Disorder		5 3				5 3			
Business Licensing				4 4					
Macro Instability								5	3 3
Competition									4 4

Ranking: 1 = Top ranked constraint. **Blue**= Benchmark Firm. **Red**=Expanding Firm

Source: Authors, based on Carlin and Schaffer 2011b (based on World Bank enterprise surveys).

Note: n.a. Not applicable (question was not asked).

Job-creating firms in the urban formal sector perform well in other respects, too. They engage in R&D, introduce new processes and products, sell to multinational companies, offer in-firm training, and have better-educated managers. The increase in the cost of constraints for expanding firms compared to the benchmark firm is highest in India and Pakistan.

Although the level of severity is different, job-creating firms rank constraints in much the same way that benchmark firms do, ranking electricity, corruption, and political stability as the top three constraints (see table 1.2).<sup>13</sup> The severity of the electricity constraint facing urban formal firms—as well as urban informal firms and rural nonfarm enterprises—prompts a discussion of the problems facing the sector and the policies and other initiatives being undertaken to address them (box 1.2). The need to make substantial investment in electricity is an example of the point made earlier that a rapid reallocation of workers to more productive sectors will require accumulation of physical capital.

### Box 1.2 Options for Reforming the Power Sector in South Asia

South Asia is characterized by low levels of access, low consumption per capita, and wide demand-supply gaps. Some 600 million people in the region lack access to electricity—more than 40 percent of the world total. Access rates range from 44 percent of the population in Nepal to 77 percent in Sri Lanka. The average annual per capita consumption for the region is 500 KWh, lower than anywhere else in the world except Sub-Saharan Africa.

Supply has not kept pace with demand, resulting in shortages at peak times ranging from 1 GW (gigawatt) in Bangladesh (13 percent) to 12 GW (10 percent) in India. The toll on the economy is enormous: in Pakistan the cost of industrial load shedding is 400,000 lost jobs; in India 17 percent of total capacity is based on expensive diesel generation.

Countries have responded through massive investment in expanding generation capacity. India added 50 GW of capacity between 2006 and 2011 and initiated a series of “ultra mega” (4 GW) generation projects based on competitive bidding by independent power producers. Bangladesh plans to develop 9.4 GW of new generation capacity by 2015. Bhutan has successfully established public-private partnerships for a large export-oriented hydropower project.

Significant institutional reforms have also taken place since the 1990s. Most countries have unbundled their power sectors or corporatized previously vertically integrated power utilities. The sector has been opened to private entry and greater competition in generation, transmission, and distribution, and new regulatory frameworks and independent regulatory bodies have been established. The degree of reform varies across countries and across states in India.

Sector financial losses across the region are large, resulting from the misalignment of tariffs, the high cost of power procurement, and high transmission and distribution losses. In India the combined cash loss of state-owned distribution companies is more than \$20 billion a year, compared with \$300 billion of investment needs in 2010–15. The sector deficit in Pakistan is estimated at about \$2 billion a year, compared with \$32 billion of investment needs in 2010–20.

Several challenges need to be addressed to alleviate power shortages and improve service delivery. Each is addressed briefly below.

#### ***Improving the Financial and Commercial Viability of the Power Sector***

Policymakers can choose from a range of options to improve the financial and commercial viability of the power sector:

- Increase the level of tariffs to reflect the cost of supply, and rationalize tariffs to address cross-subsidization. Some countries have not revised tariffs. Others have made progress toward achieving cost-reflective tariffs, primarily to reduce fiscal pressure. All countries offer “lifeline” rates to residential consumers to enable the poor to access at least a minimum quantity of electricity as well as nominally priced electricity to agriculture consumers to support irrigation and food security. The burden of cross-subsidization falls on industrial and commercial consumers. Any tariff increases will need to ensure that adequate safety nets are in place to minimize the impact on the poor. Innovative initiatives such as the separate provision of heavy-duty agricultural feeders for agricultural needs and regular feeders for domestic and industrial purposes in the Indian state of Gujarat has allowed transparency of agricultural consumption and, by providing reliable supply to both farmers and rural domestic consumers, spurred the growth of rural productivity.

*(Box continues on next page)*

**Box 1.2 (continued)**

- Reduce losses by improving collection, curbing theft, and improving overall efficiency. India has initiated incentive schemes such as the Restructured Accelerated Power Development Reform Program (R-APDRP), which aims to limit losses to 15 percent. The program focuses on achieving demonstrable and measurable performance in reducing distribution losses.
- Improve the capacity and independence of regulatory agencies to ensure transparency and accountability in tariff setting, which continues to be driven by political exigencies. New initiatives in regulation have been put in place, such as the implementation of multiyear tariffs in India, which provide certainty regarding the costs for which utilities can be held accountable and reduce day-to-day regulatory interference.

***Enhancing the Business Environment for Private Investment in Power Sector***

The generation sector has attracted substantial private interest, but obstacles remain in the form of procedural bottlenecks (for example, land acquisition, environmental and forest clearances, provision of water for thermal plants); limited technical and financial capacity to implement large projects; and the shortage of fuel (both domestic and imported) to ramp up capacity utilization. The region also needs to improve the operating environment to attract private players in transmission and distribution.

***Exploiting the Significant Potential of Intraregional Energy Trade***

One of the most cost-effective options for alleviating shortages in the region is increasing intraregional energy trade. Such trade has increased in recent years, particularly in the form of hydro exports from Bhutan to India and, to a limited extent, between Nepal and India.

***Improving the Governance of Utilities and Strengthening Institutional Capacity***

Steps are being taken to develop strong boards and high-quality, professional management. Doing so is necessary to transform an organizational culture of risk-averse top-down bureaucratic control to one more suited to commercialization. Some states in India (such as Andhra Pradesh and West Bengal) have adopted technology initiatives, particularly in metering, and accountability frameworks to improve sector performance.

***Constraints Facing Rural Firms***

Improving the business environment can spur development of the rural nonfarm economy, which accounts for an increasing share of rural employment in many South Asian countries and, therefore, the creation of better jobs within it. Doing so requires an understanding of the constraints firms in this sector face.

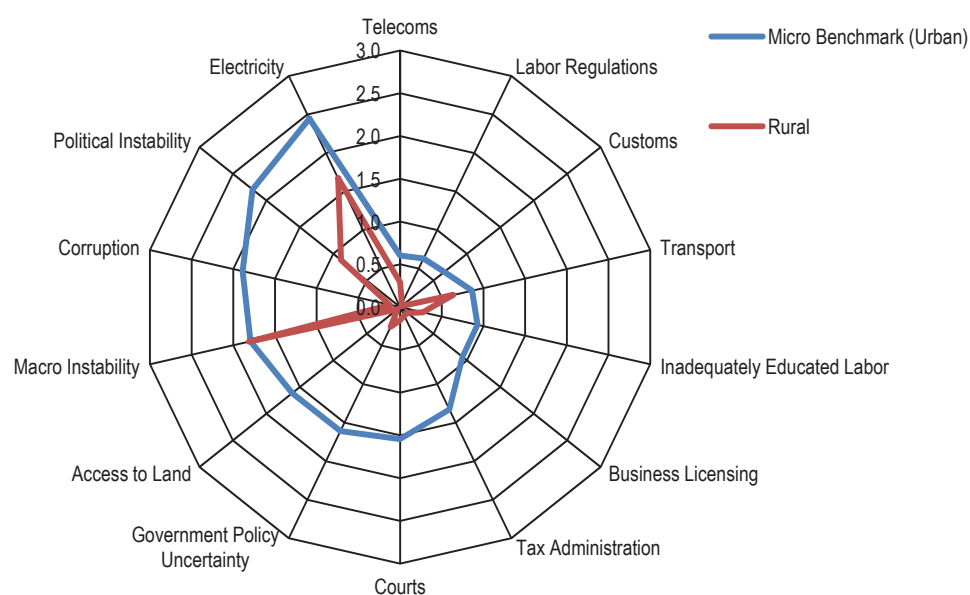
The severity of constraints reported by rural firms in results of enterprise surveys in Bangladesh, Pakistan, and Sri Lanka are compared with those reported by urban (formal) firms in the same countries.<sup>14</sup> As rural firms typically employ far fewer than 30 employees, the comparison is with a micro benchmark firm—a benchmark firm with 5 employees. The results are as follows:

- Rural firms report less severe constraints to their operations than urban firms do (table 1.3 and figure 1.20). This pattern is not unusual in developing countries, where larger urban firms are typically more productive and, during the course of

their expansion, place more demands on publicly provided services than their rural counterparts.

- Rural firms identify electricity as one of the most binding constraints to their operations. They report levels of power outages similar to those for urban firms and use generators more intensively than urban sector firms. In Sri Lanka, shortages and unreliability of power are severe in rural areas, where less than 70 percent of enterprises use electricity from the national grid. In Bangladesh 73 percent of nonmetropolitan nonfarm enterprises have an electricity connection, with 99 percent of them reporting power outages.
- Unlike their urban counterparts, rural firms cite transport as one of their top four constraints. Firms in Bangladesh and Sri Lanka complain about the poor conditions and inaccessibility of rural roads. Rural enterprises sell predominantly to local customers, which limits the size of the market for their products and goods. Poor transport limits access to larger, urban markets.<sup>15</sup> Rehabilitating and maintaining existing rural roads as well as building new roads would open up opportunities to rural firms.

**Figure 1.20** Severity of Constraints Reported by Micro Benchmark Firm in Urban and Rural Sectors of Bangladesh, Pakistan, and Sri Lanka



Source: Authors, based on Carlin and Schaffer 2011a (based on World Bank enterprise surveys).

Note: Results are based on pooled sample of firms in Bangladesh, Pakistan, and Sri Lanka. Macro instability was asked only in Bangladesh. A point farther away from the origin indicates that the business constraint is considered more severe. Only statistically significant differences in reported severity between the micro benchmark firms in different sectors are shown.

**Table 1.3** Top Five Constraints Reported by Micro Benchmark Firm in the Urban and Rural Sectors of Bangladesh, Pakistan, and Sri Lanka

Constraint	Bangladesh, Sri Lanka, Pakistan	
Electricity	1	2
Political Instability	2	3
Corruption	3	
Macro Instability	4	1
Access to Land	5	
Transport		4

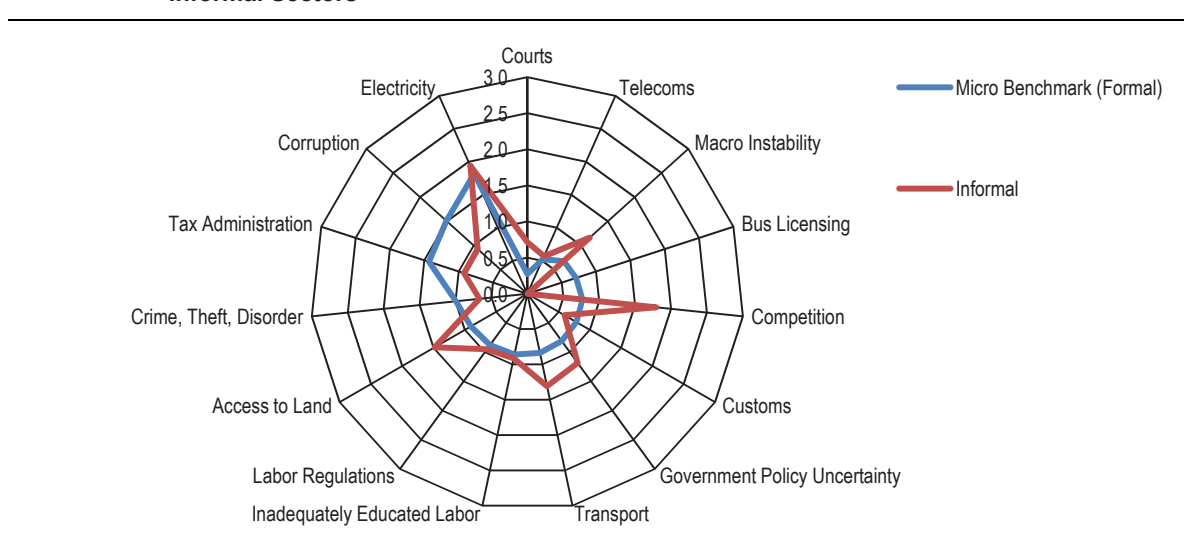
Blue= Urban/Formal. Green= Rural

Source: Authors, based on Carlin and Schaffer 2011a (based on World Bank enterprise surveys).

### Constraints Facing Informal Urban Firms

Enterprise surveys in the informal and formal urban sectors in India make it possible to compare the constraints encountered by informal firms with those facing formal firms. The comparison is between a formal and informal urban benchmark firms. As the median firm in the informal urban sector has fewer than 30 employees, the benchmark firm size is 5 rather than 30.<sup>16</sup>

There are both similarities and differences between formal and informal firms in the ranking of business constraints (figure 1.21 and table 1.4). Both types of firms cite electricity as an important constraint. Informal firms are more likely to cite access to land and transport and less likely to cite corruption and tax administration.<sup>17</sup>

**Figure 1.21** Severity of Constraints Reported by Micro Benchmark Firm in India's Urban Formal and Informal Sectors

Source: Authors, based on Carlin and Schaffer 2011b (based on World Bank enterprise surveys).

Note: A point farther away from the origin indicates that the business constraint is considered more severe. Only statistically significant differences in reported severity between the micro benchmark firms in different sectors are shown.

**Table 1.4** Top Five Constraints Reported by Micro Benchmark Firm in India's Urban Formal and Informal Sectors

Constraint	India	
Electricity	1	1
Corruption	2	
Tax Administration	3	
Crime, Theft, Disorder	4	
Access to Land	5	3
Competition		2
Transport		4
Government Policy Uncertainty		5

*Blue= Urban/Formal. Orange = Urban/Informal*

Source: Authors, based on Carlin and Schaffer 2011b (based on World Bank enterprise surveys).

Informal firms report access to finance as the most severe constraint to the operations of their business. However, this finding does not necessarily have implications for policy, as “access to finance” is not a dimension of the business environment that, unlike the judiciary or tax administration, is a public good. The firm’s response regarding the inadequacy of finance could simply reflect the fact that some firms do not have bankable projects. Other indicators of access (for example, the proportion of firms using external finance) suggest that finance may indeed be an issue for micro and small firms in some countries.

The concern regarding access to land expressed by urban informal firms may reflect the impact of regulations that shape the operation of land markets in India. Density regulations, which limit the ratio of floor space to plot area, lead cities to expand outward instead of upward. Together with limited accessibility of public transport, such expansion can make it more difficult for informal manufacturing units to be located where they should be—close to buyers and suppliers. Relaxing density regulations, improving urban transport, and increasing the supply of property might help reduce the severity of the land constraint for informal urban firms (World Bank 2011a).

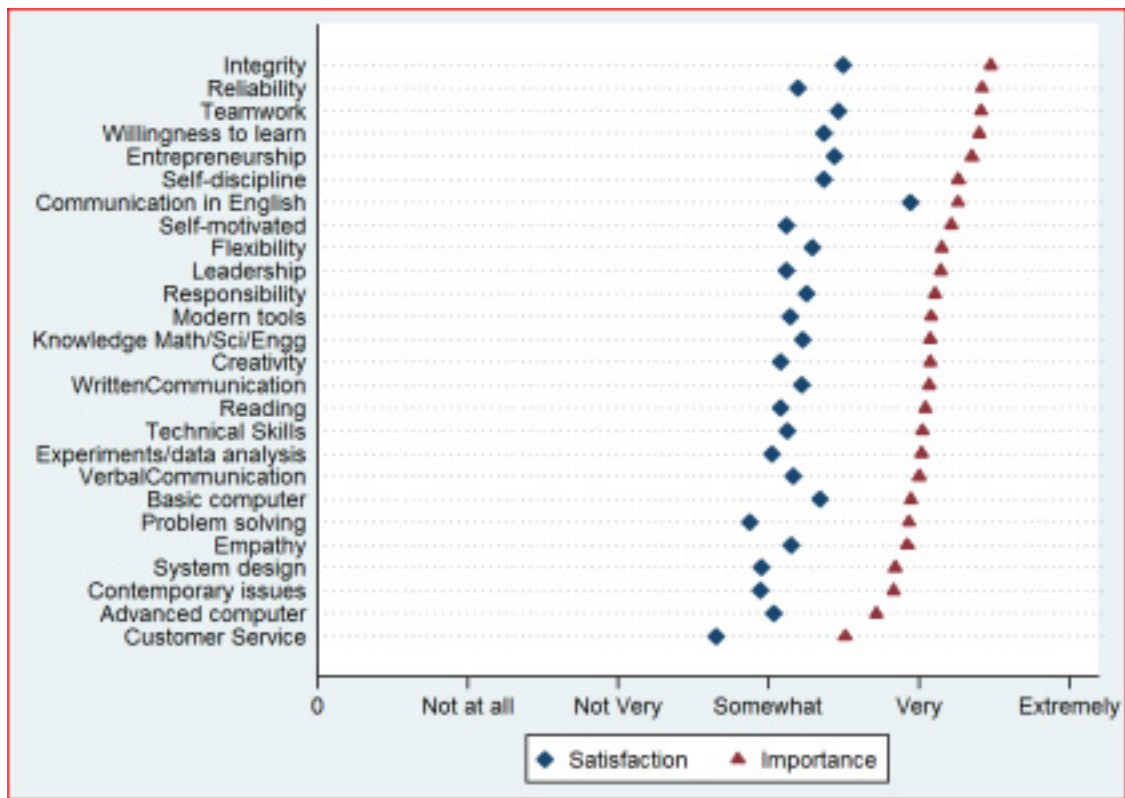
## Improving Workers’ Skills

Enterprise managers in the urban formal sectors in Bhutan, India, and Maldives report inadequate skills of the labor force among the top five constraints to the operation and growth of their firms (see table 1.1). In Bhutan and Maldives, inadequate skills of the labor force are among the top two constraints; in India they rank 5th out of 14 constraints. Firms in Afghanistan and Pakistan rate skills constraints among the least problematic.

Focused employer surveys in India and Sri Lanka highlight concerns with the skills of tertiary education graduates. Employers hiring fresh engineering graduates in India evaluated the degree of importance of a broad range of skills and their level of satisfaction with recent hires. They rated behavioral skills (teamwork, reliability, leadership, willingness to learn); creative thinking and problem-solving skills; and specific

knowledge and technical skills needed for the job. Two out of three employers reported that most of these skills are “very” important but that they were only “somewhat” satisfied (at best) with the graduates’ skills (figure 1.22). (Similar concerns are echoed by Sri Lankan employers in a survey of the information technology workforce [Sri Lanka Information Communication Technology Association 2007].) The foundation for many of these skills is established well before graduates enter the world of work—in primary and secondary education and indeed even earlier.

**Figure 1.22 Employers’ Perceptions of Engineers’ Skills in India**



Source: Blom and Saeki 2011.

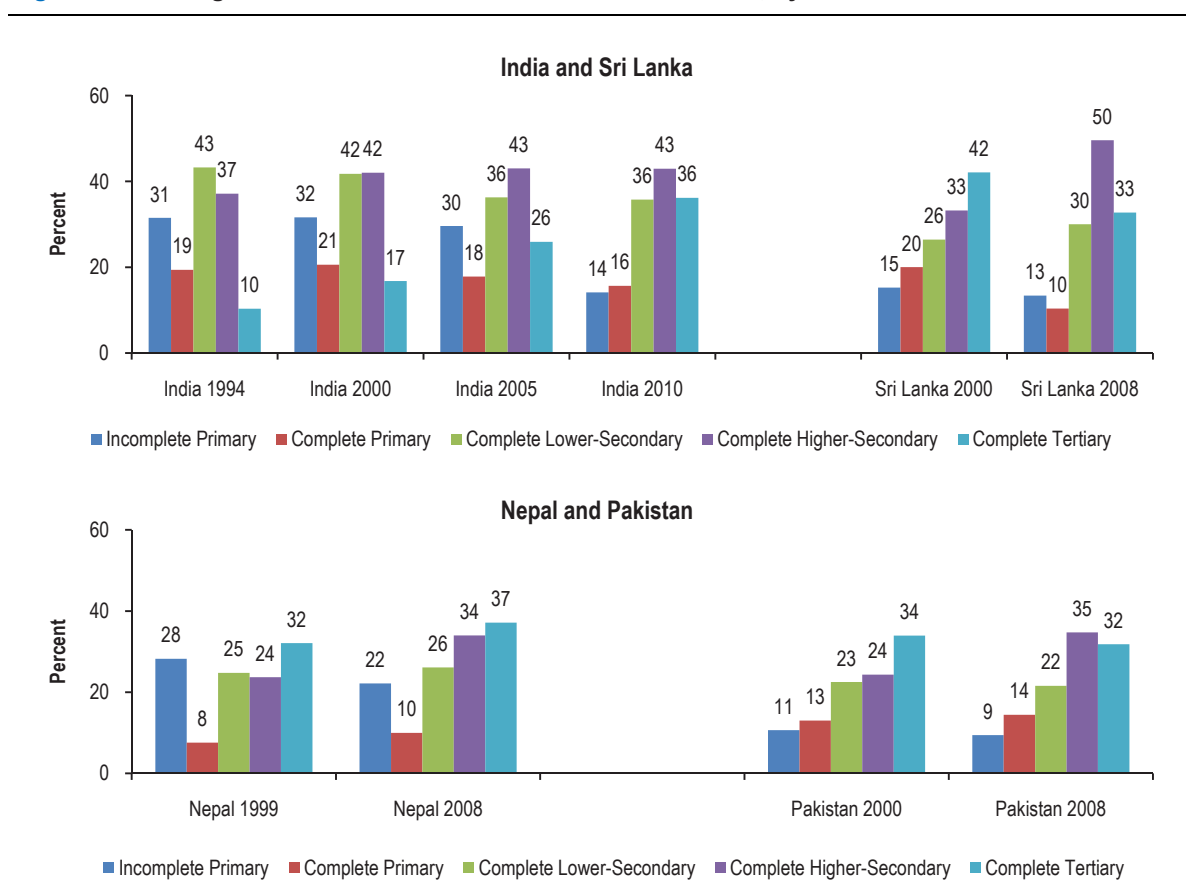
The wage premium has been rising for higher levels of education in all countries, even as the supply of educated workers has increased. Figure 1.23 presents trends in wage premium for different levels of education in three South Asian countries between about 2000 and 2008 and a longer period for India. The premiums reflect the differential between the average earnings of a worker with a particular level of educational attainment and the average earnings of a worker with the level of attainment just below (for details, see chapter 5). The pattern over time has been that the premium to lower levels of education has been falling while those for upper-secondary and tertiary education have been increasing. These changes have been taking place in a context in



which the educational attainment of the labor force has been rising, with an increase in the share of workers with primary, secondary, and tertiary education. The pattern is thus consistent with a situation in which the supply of workers at lower levels of education is increasing faster than demand, whereas the demand for workers with secondary or tertiary education is outpacing the increased supply.

The heterogeneity of the region is reflected in variations across countries. India and Nepal have seen increases in premiums to both upper-secondary and tertiary education. Indeed, the wage premium for tertiary education more than doubled in India between 2000 and 2010, despite a large increase in the share of the labor force with tertiary education. In Nepal the largest relative increases in wage premiums were at the upper-secondary level, suggesting that demand increases at this level were greater than the small increases in supply. In contrast, in Pakistan and Sri Lanka, the wage premium increased for upper-secondary education but decreased for tertiary education.

**Figure 1.23 Wage Premiums in Selected South Asian Countries, by Level of Education**

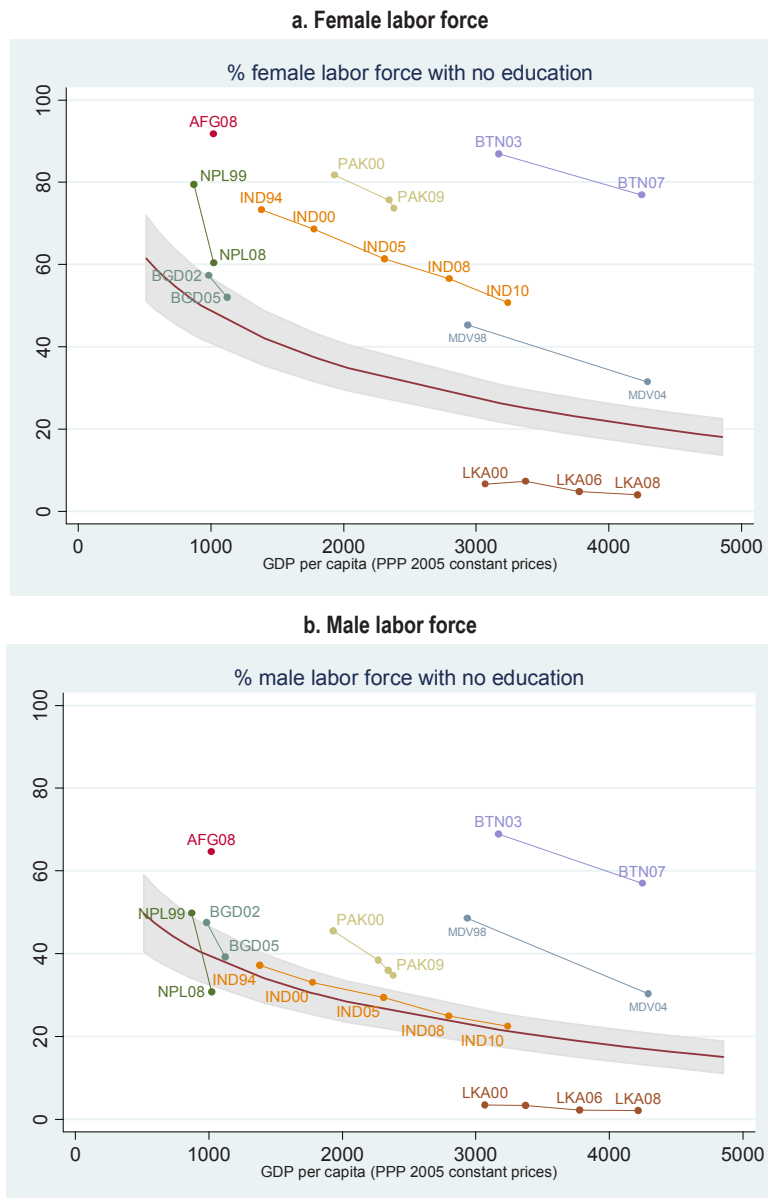


Source: Authors, based on data from national labor force and household surveys.

Note: The first bar for each country-year pair reflects the wage premium for even some primary education relative to no education; the last bar reflects the wage premium for completing tertiary relative to completing upper-secondary education.

Despite significant progress in recent years, the contrast between increasing demand for higher levels of education and the educational attainment of the labor force remains stark. Educational attainment remains low, particularly in secondary and tertiary education, and well over a quarter of the labor force in all countries except Sri Lanka lacks any education at all (figure 1.24). The average years of education of people 15–34

**Figure 1.24** Share of Labor Force with No Education



Source: Authors, based on data from World Bank 2011 and national labor force and household surveys.

Note: Predicted values of share of labor force with no education are based on a regression on the log of GDP per capita excluding high-income countries. A 95 percent confidence interval based on the standard error of the predicted mean is displayed.

increased in all countries between the late 1990s and early 2000, but it is still low in most countries, ranging from 2.5 years in Afghanistan to 7.1 years in India. (It is higher in Maldives [7.8 years] and Sri Lanka [10.2 years].) In many countries, the picture is considerably worse for women (see panel a of figure 1.24).

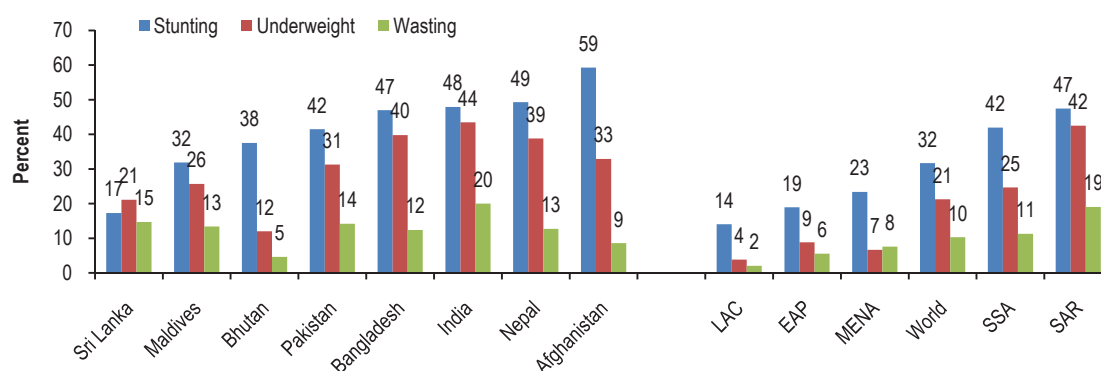
Success in school is affected by what happens to children before they enter school. In fact, the greatest payoffs may well come from addressing poor nutrition and other factors in early childhood, before children enter formal schooling (box 1.3).

### Box 1.3 The Critical Role of Nutrition in Early Childhood Development

The first years of life—long before formal schooling begins—are a key period for building human capital. The benefits of health and nutrition early on can have effects that persist through life; damage from childhood disease and malnutrition in terms of lost opportunity for learning can be difficult to undo. Low levels of cognitive development in early childhood are often strongly correlated with low socioeconomic status and malnutrition. In addition to protein-energy malnutrition, micronutrient deficiencies, which often begin before birth, can impair cognitive and motor development among children and therefore school outcomes.

South Asia has some of the highest rates of malnutrition in the world, as well as high levels of anemia and iodine deficiency. As measured by stunting, underweight, and wasting, it has the world's highest prevalence of malnutrition in children under five (box figure 1.3.1).<sup>a</sup> Indeed, malnutrition rates are higher than in Sub-Saharan Africa. South Asia also has high levels of anemia and iodine deficiency.

Box figure 1.3.1 Percentage of Children under Five with Malnutrition, by Region and Country



Source: Authors, based on data from World Bank 2011b.

In South Asia, as globally, rates of malnutrition, anemia, and iodine deficits improve with wealth, but only modestly. This means that (a) high malnutrition and micronutrient deficiencies are likely important contributors to developmental delays in low-income groups in South Asia, (b) they may also be important factors for overall cognitive development of the broader population, and (c) income growth alone will not eliminate malnutrition micronutrient deficiencies; focused attention is needed.

(Box continues on next page)

**Box 1.3 (continued)**

Most South Asian countries do not have integrated policy frameworks for early childhood development. Early childhood interventions—which include nutrition, hygiene, early cognitive stimulation, and preschool programs—are among the most cost-effective investments for improving the quality and efficiency of basic education, as well as labor market success.

In South Asia, India has the strongest enabling policy framework, with a foundation deriving from the constitution, among other sources. National nutrition policies and programs in Bangladesh and some aspects of public health campaigns related to nutrition in Pakistan have contributed to improvements in nutrition both countries, but neither country has a national policy on early childhood development.

There are very few programs at scale that seek to integrate early childhood interventions. Several pilot projects can serve as a laboratory for designing cost-effective programs, but many lack careful plans for evaluation. Potentially promising efforts are under way, however. For example, pilots run by the International Center for Diarrheal Disease Research (ICDDR) in Dhaka have stronger evaluation designs and have proven the feasibility of promoting better parenting and mother-child interactions through home visits. The lady health worker program in Pakistan—a community-based government preventive care program—holds promise for promoting nutrition and child care through scaling up of carefully evaluated cost-effective pilot designs.

a. Wasting, stunting, and underweight indicators refer to the proportion of children under five whose weight for height, height for age, and weight for age are more than two standard deviations below the medians of an international reference population recognized by the World Health Organization (WHO).

The education challenge facing South Asia is broad. It includes improving nutrition and other factors in early childhood, increasing attainment from primary to secondary and higher levels, ensuring equal opportunity for all groups, and equipping graduates with the skills necessary to succeed in the world of work. Country priorities will vary. In Afghanistan achieving universal primary education remains a priority. Afghanistan, Pakistan, and Nepal still have significant gender disparities in primary education. India, Maldives, and Sri Lanka are focusing on expanding upper-secondary school. A common central priority for all South Asian countries is to improve the quality of learning and skills of graduates at all levels.

Improving the quality of learning in primary and secondary schools requires strengthening incentives and capacity in the school system. To do so, governments could consider the following actions in the school subsector:

- Addressing information gaps, by developing national assessment systems that provide reliable feedback on learning
- Improving capacity and accountability at the school level, by devolving greater responsibility to schools while increasing their accountability to local stakeholders
- Improving the quality and performance of teachers, by engaging in transparent recruitment and development of career and pay systems that build capacity and provide incentives.

As more and more students enter higher levels of education, pressure to expand tertiary education will intensify. Priorities to ensure a focus on the quality and relevance of skills of graduates of both tertiary institutions and preemployment training systems include the following:

- Provide information on the quality of graduates and their employability, and strengthen quality assurance and accreditation.
- Increase the role of the private sector in provision and that of employers in the management of public institutions.
- Increase the autonomy of public higher education institutions and improve incentives for improved performance, such as those provided by moving from historically negotiated budgets to performance-based approaches.
- Increase contributions from students while protecting students less able to pay.

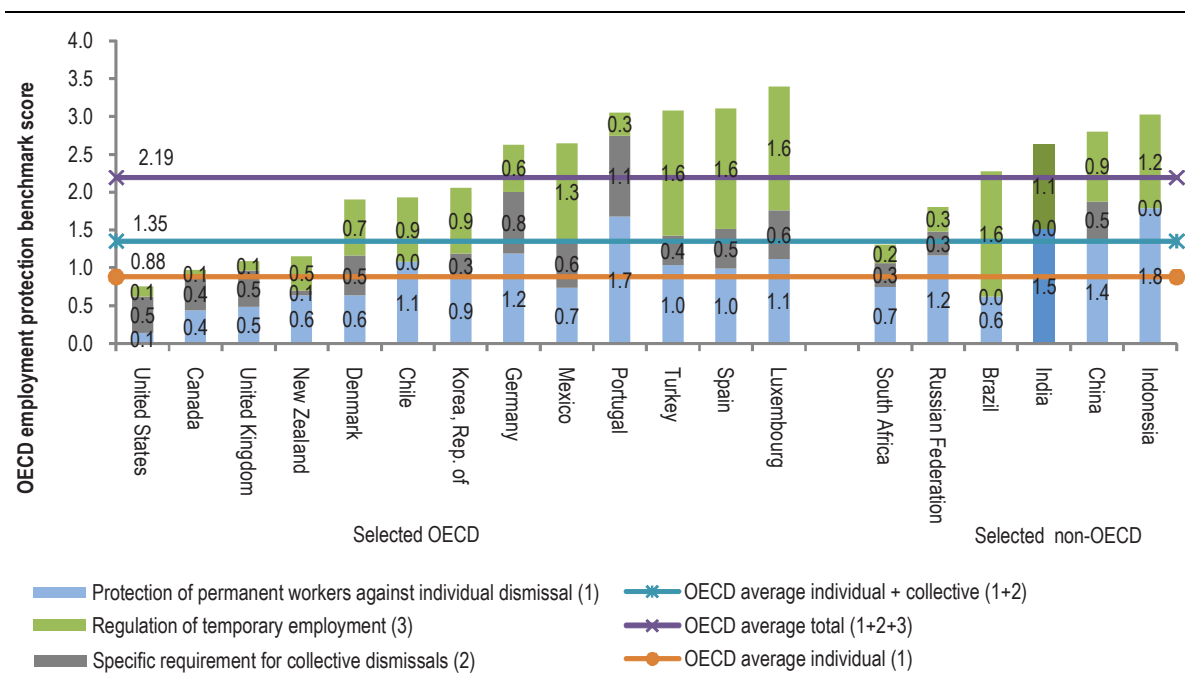
## Reforming Labor Market Institutions

Labor market policies in South Asia need to strike a balance between facilitating protection for the vast majority of workers, primarily in the informal sector, who are not covered by social protection instruments while enhancing their incentives for income generation. Efforts are needed on two fronts: (a) reforming statutory regulations and institutions that encourage job creation in the formal economy while protecting the fundamental rights of covered workers and (b) building on programs that can help informal workers adjust to labor market shocks and improve their productivity and future earnings potential.

Beyond protecting the basic rights of workers, labor market institutions have an important role to play in regulating the employment relationship, with potentially important implications for labor market efficiency and social protection. Employment protection legislation covers the kinds of contracts permitted and the conditions and procedures for termination. Restrictions on nonpermanent hiring and employer dismissal rights can increase employment security and provide protection to workers from arbitrary dismissal by employers. If excessively restrictive, however, they can discourage formal job creation, limit the efficient reallocation of labor, and fail to provide real protection, as employers find ways around the rules. The evidence suggests that, in some countries, notably India and Sri Lanka, the efficiency costs of employment protection legislation outweigh the benefits in terms of worker protection.

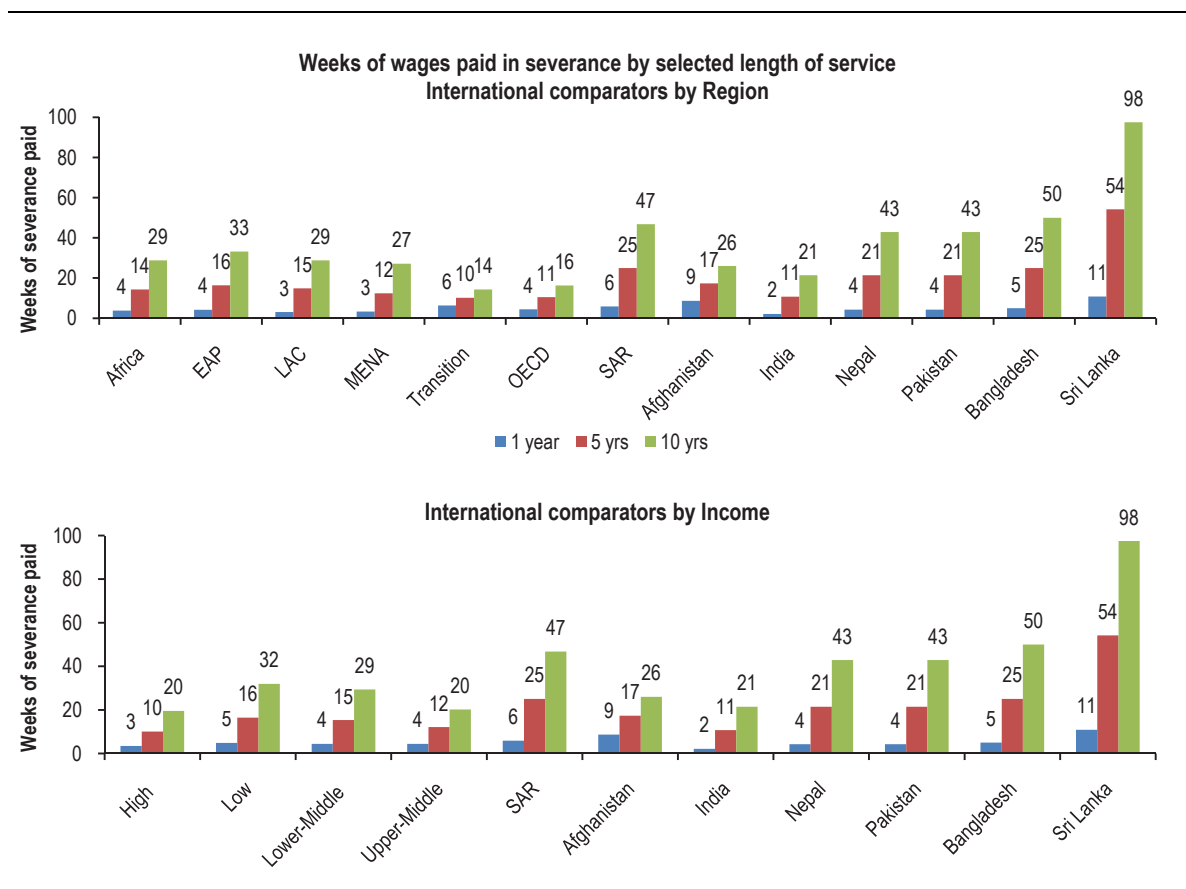
Labor market policies in India, Nepal, and Sri Lanka are oriented toward protecting jobs. India, for example, has employment protection laws that are considerably tighter than laws in Western countries and most other major emerging economies (figure 1.25). India, Nepal, and Sri Lanka require not only notification but prior approval by the state to lay off or retrench workers, individually or collectively. In Sri Lanka prior approval is necessary only when the worker's written consent for layoff cannot be obtained. This is different from India, where large firms need prior approval from the government before they can dismiss an employee even if the worker consents to the dismissal. Severance pay, which typically requires minimum tenure in the establishment and increases with seniority, is also high in most South Asian countries, particularly in Sri Lanka but also in Bangladesh, Nepal, and Pakistan (figure 1.26).

**Figure 1.25** Employment Protection Indicators in Selected Countries



Source: OECD 2009.

Note: The OECD employment protection indicators cover three different aspects of employment protection: individual dismissal of permanent workers, regulation of temporary employment, and specific requirements for collective dismissal. Each subindicator ranges from 0 to 6, with 0 the least restrictive and 6 the most restrictive. The overall indicator, which is the weighted sum of the three subindicators, weighted at 5/12, 5/12, and 2/12, also ranges from 0 to 6.

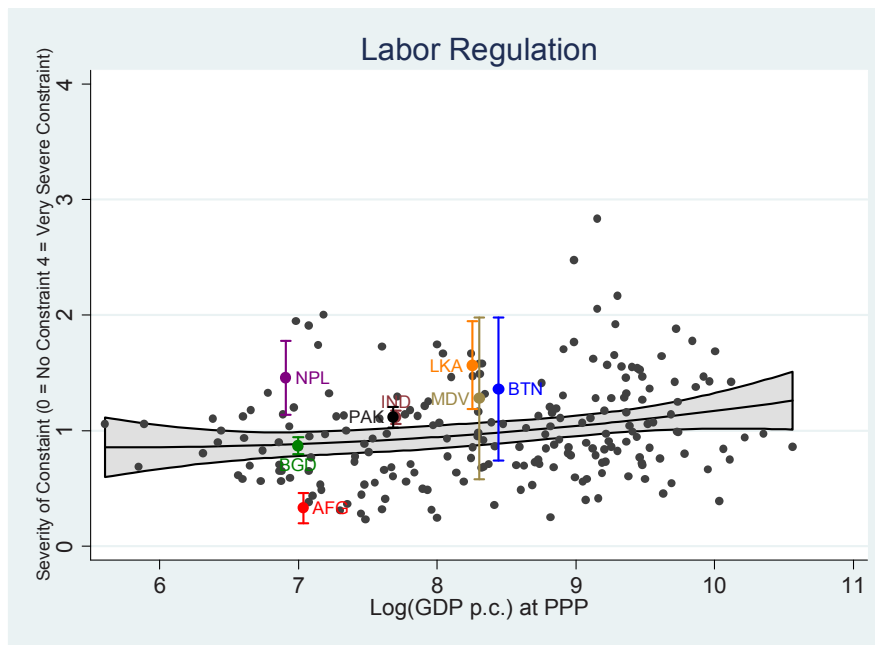
**Figure 1.26** Severance Pay Requirements in South Asian Countries and Regions

Source: Holzmann and others 2011.

Most countries have reasonably flexible contracting rules. Bangladesh, Nepal, and Pakistan place limits on the use of fixed-term contracts, however, and lack of clarity in India has led to widely varying interpretations, regulations, and practices across states.

Enterprise managers in India, Nepal, and Sri Lanka report labor regulations to be an important constraint to the operation and growth of their business. In contrast, formal sector firms in Afghanistan and Bangladesh rate labor regulations as among the least problematic. There is some evidence that labor regulations become more costly to firms as GDP per capita rises (figure 1.27). India, Nepal, and Sri Lanka report higher levels of severity of this constraint than other countries at their level of development, however. When asked which labor regulations most affected the operation of their businesses, nearly one in three firms in India for whom labor regulations were perceived as a moderate or severe constraint reported that restrictions on dismissal are a constraint to hiring. About one in four cited restrictions on casual work, and one in five cited constraints on temporary work.



**Figure 1.27** Cross-Country Comparison of the Reported Severity of Labor Regulation Constraint for a Benchmark Firm<sup>7</sup>

Source: Carlin and Schaffer 2011a (based on the World Bank enterprise surveys).

Note: The log of GDP per capita in purchasing power parity is on the horizontal axis, the reported severity of the constraint is on the vertical axis. A conditional mean is the marginal cost of the constraint for the benchmark firm. The vertical bars shown for South Asian countries are confidence intervals of 95 percent. The regression line shows the relationship between the conditional mean for each country and the square of log GDP per capita for the rest of the world. The shaded area is the 95 percent confidence interval band around the regression line.

In addition to creating disincentives for expanding the formal sector, labor market rules in South Asia have failed to protect workers, for two main reasons. First, rules cover much less than 10 percent of the labor force in most countries and less than a third even in Sri Lanka, which has the most formalized labor market. Second, the impact of labor market rules is weakened by noncompliance. As regulations become more costly, firms increasingly employ strategies to circumvent them, reducing de facto protection from labor market regulations. In India, for example, medium-size and large firms in organized manufacturing adjust employment levels through hiring and termination of contract workers. In Sri Lanka, where statutory severance rights are generous, workers often fail to benefit from them because of nonpayment or partial payment, particularly during periods of economic distress. Limited options for resolving disputes and grievances and lengthy and costly procedures for the resolution of disputes provide additional incentives for noncompliance.

Going forward, South Asian countries would benefit from reorienting their labor market policies from “protecting jobs” to “protecting workers.” As the region modernizes, an approach that moves away from protection through strong job security laws to encouraging more flexibility in the labor market while providing workers with better

tools to manage the fluctuations of the market will lead to more job creation and offer more protection.

This approach requires two coordinated strategies. The first involves realigning labor market regulations and institutions to relax the procedures and costs associated with dismissals; extending the legality of nonpermanent contracts; improving protection of fundamental worker rights; improving the efficiency of dispute resolution and the enforcement of employment protection legislation; and streamlining and clarifying regulations. The second involves strengthening the tools available to workers in both the formal and informal sectors to help them manage labor market shocks. These tools include income support in the event of unemployment and active labor market programs, including cost-effective training and employment services.

Over time, this strategy will create a more favorable environment for formal sector job creation. Less restrictive regulations, especially pertaining to dismissal, could create incentives for formal sector job creation; benefit certain groups, including women; and encourage compliance with the law.

In the long run, as the workforce becomes better educated and productivity rises, the formalization gains from such an institutional framework could be considerable. In the short run, however, this strategy would benefit only some informal sector workers who might be able to find formal sector jobs in a more favorable regulatory environment. The vast majority of workers would continue to lack social security benefits and disability and health coverage.

One way to close the gap between protected and unprotected workers would be to extend (statutory) social insurance to informal workers. India's Rashtriya Swasthya Bima Yojna (RSBY) is designed to provide hospitalization coverage to households below the poverty line. The new pension law in Maldives provides for matching pension contributions for informal sector workers such as fishers, in order to encourage informal sector participation in the pension scheme.

Any such plans need to take into account of financing, as well as the effect on the incidence of informality itself. Employers may be more likely to seek ways to opt out of formal contributory systems if they know employees can access social protection in other ways; workers themselves may prefer to remain informal, depending on how programs are financed. Thus the potential for social insurance to be extended into the informal sector will depend a great deal on financing and the scope to which individuals are able to contribute. Given the high prevalence of workers with very limited or no capacity to contribute, coverage can be expanded only if governments are willing to allocate significant subsidies. The level of subsidies would need to be determined not only in light of the mandate of the programs but also by other calls on budgetary resources. It therefore seems likely that protection will be built incrementally on numerous existing schemes and adjusted in light of lessons learned during their implementation.

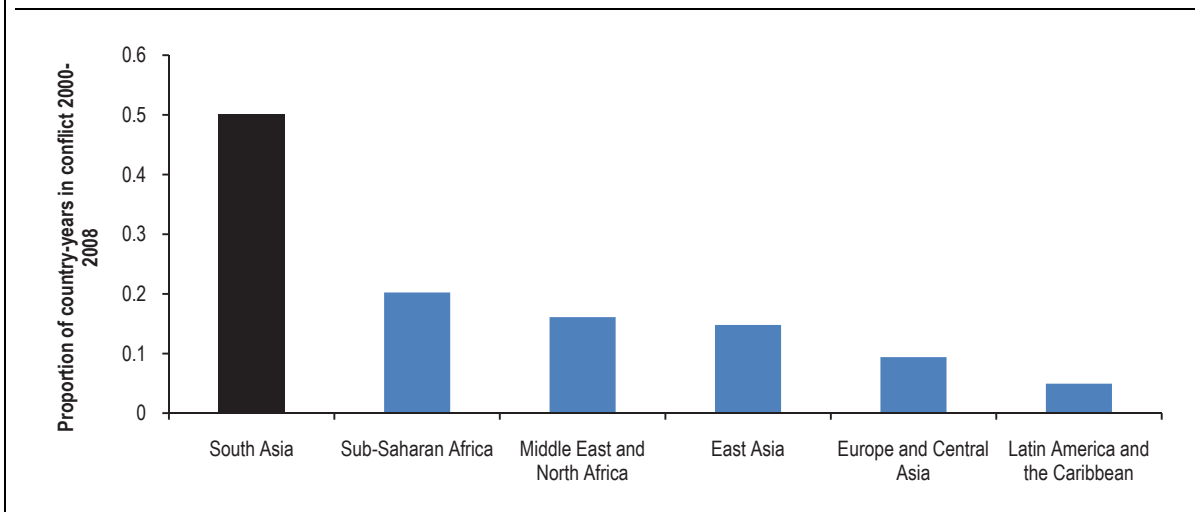
Well-targeted and well-designed programs can help informal workers smooth consumption and enhance their income-generating potential. Countries in the region have a variety of training, public works, and self-employment assistance programs, operated

by the government as well as by private and nongovernment sponsors. The effectiveness of many of these programs is not well understood because of the lack of evaluation evidence. However, if well targeted and efficiently implemented, such programs can incorporate both a safety net perspective (helping workers manage income-related risks) and an activation perspective (helping them improve their capacity to generate income). A priority is to encourage evaluation and expand programs that meet standards of targeting and cost-effectiveness.

## Creating Jobs in Conflict-Affected Areas

Measured by the proportion of country-years in conflict since 2000, South Asia is the most conflict-affected major region in the world (figure 1.28). Four of the top 10 countries in terms of direct deaths from armed conflict in 2008 are in South Asia (Afghanistan, Pakistan, India, and Sri Lanka). Ongoing conflicts affect all of Afghanistan and parts of Pakistan and, at a lower intensity, India. Nepal and Sri Lanka are in postconflict status.

**Figure 1.28** Proportion of Country-Years in Armed Conflict, by Region, 2000–08



*Source:* Authors, based on Gleditsch and others 2002; Harbom and Wallensteen 2009.

*Note:* Armed conflict refers to internal armed conflicts between the government of a state and one or more internal opposition groups that result in at least 25 battle-related deaths a year.

Conflict affects the demand for and the supply of labor. On the demand side, it affects both the incentives and the ability of firms to invest in conflict-affected regions and create jobs. In addition to concerns about security, disincentives to the operation of private firms arise from inadequate or confusing regulations and the poor quality of governance in areas affected by conflict. On the supply side, conflict reduces the capacity of the population to supply labor—because of security concerns and, over time, disruptions to education, increased mortality and morbidity, and the loss of job-related skills and training.

The impact of armed conflict on the labor market behavior of individuals living in conflict zones takes the form of higher labor force participation. Armed conflict seems to be associated with an increase (or a smaller reduction) in the share of the working-age population that is economically active and employed. Between 1996 (preconflict) and 2004, for example, the proportion of the working-age population in Nepal that was employed increased about 2 percentage points in low-conflict areas and by more than 4 percentage points in high-conflict areas. In India employment rates in conflict-affected areas fell less than in peaceful areas. In Afghanistan 56 percent of the working-age population was employed in low-conflict and 68 percent in high-conflict provinces.

These numbers usually reflect higher female labor force participation and a larger share of unpaid family workers in conflict-affected areas. Notwithstanding decreased labor demand as a result of pervasive insecurity, conflict is thus likely to increase labor supply from individuals, probably because of economic need and the absence of key income earners.<sup>18</sup>

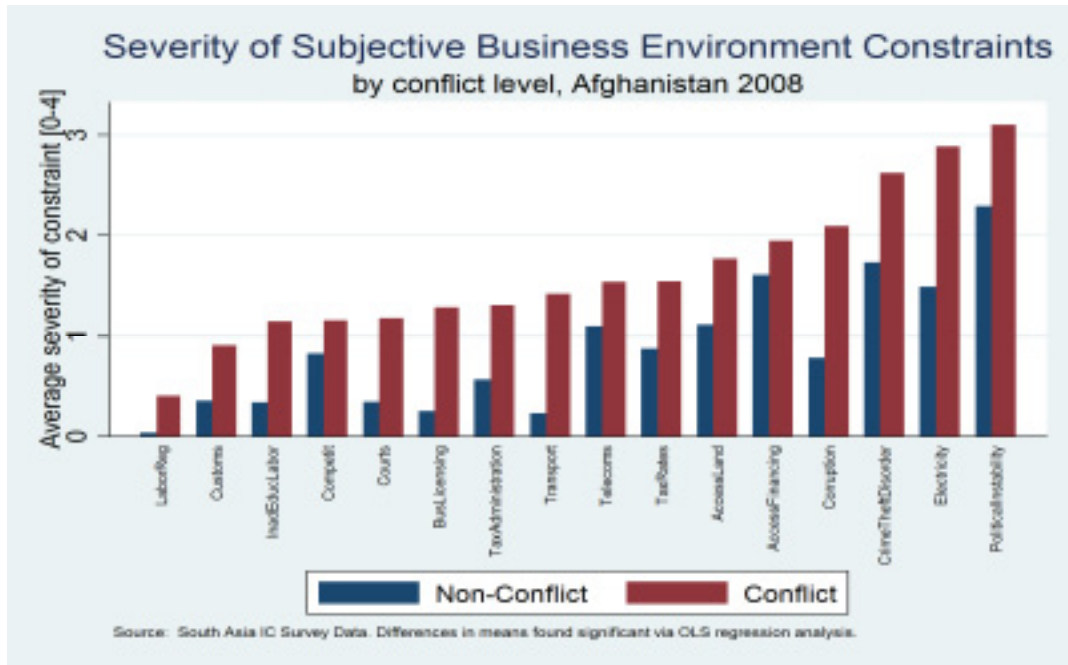
Labor markets in conflict zones differ from labor markets in nonconflict areas in several ways. First, except in Sri Lanka, jobs in high-conflict areas are more likely to remain rural and based on agriculture. One explanation for this tendency is that the terrain in rural areas makes them more favorable to rebellion. Another is that undiversified economies (like Afghanistan and Nepal) are more prone to conflict than diversified economies (Collier and Sambanis 2005). The conflict itself delays the structural transformation of the economy.

Second, there is a lower likelihood of moving out of “vulnerable” jobs in conflict areas, as the workforce is more likely to remain engaged in unpaid family labor or casual work, partly because of the higher concentration of employment in agriculture and related activities.

Third, the workforce is less likely to be well educated—although conflict in Nepal seems to have been associated with an improvement in school access—and therefore less able to access better jobs were they to become available. This outcome reflects both the negative impact of conflict on the demand for schooling and the destruction of schools and complementary infrastructure. In most cases, these features of the labor market are the result of both the conflict and conditions predating it.

Even when it is already over, armed conflict remains a serious obstacle to job creation in South Asia. Almost 60 percent of firms included in the enterprise surveys rank political instability as a major or severe constraint to doing business. In Afghanistan firms located in areas where conflict is most violent report that they are more severely constrained than their counterparts in more peaceful areas with regard to infrastructure, the regulatory environment, security, and skills (figure 1.29).

**Figure 1.29** Severity of Business Environment Constraints Reported by Firms in Conflict and Nonconflict Areas of Afghanistan, 2008



Source: Authors, based on data from the 2008 Afghanistan enterprise survey.

Note: Figure shows only differences that were statistically significant at least the 5 percent in an ordinary least squares regression, including firm size and industry fixed effects.

Governments can improve security in conflict situations and help restore livelihoods by implementing disarmament, demobilization, and reintegration (DDR) programs. Such programs, which target excombatants, are underway in Afghanistan and Nepal. They include three broad phases:

- Disarmament (collecting and disposing of weapons)
- Demobilization (disbanding military structures)
- Reintegration (facilitating the return of former combatants to civilian life, the armed forces, or the police).

In addition to providing a minimal level of security, without which economic recovery is virtually impossible, the public sector has a potentially important role to play as a direct provider of jobs in the early stages of a postconflict situation. One way to do so is by increasing the public sector payroll and providing employment directly, as DDR programs in Afghanistan and Nepal are doing. A second is through public works programs that target rural areas and build or rehabilitate community infrastructure, which can increase the productivity of agriculture and the rural nonfarm economy. Well-designed and well-implemented training and self-employment assistance programs are also important.

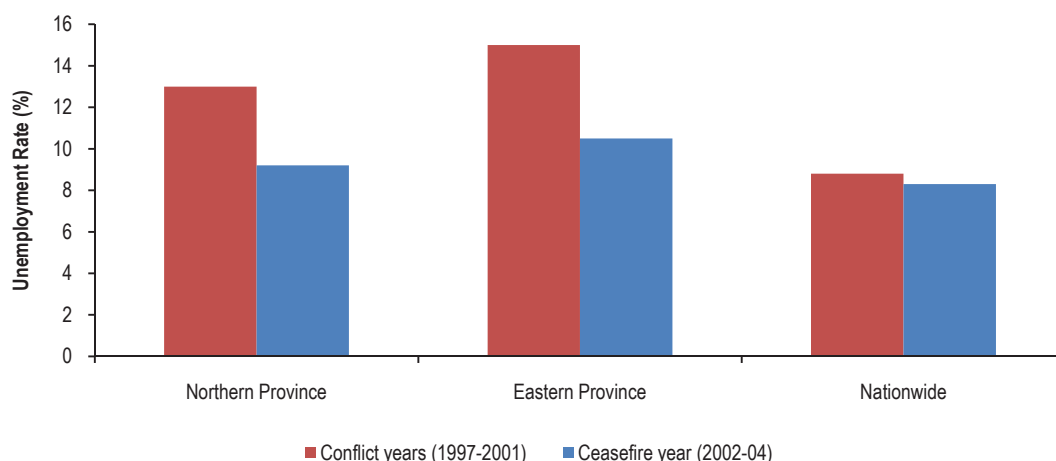
Priority is often initially given to segments of the population that are particularly vulnerable and sectors that have the potential to absorb large numbers of workers. Initially, labor market programs and policies in conflict-affected areas need to target three types of populations with special needs:

- Excombatants, who need to be integrated into the workforce and given incentives to refrain from violence
- At-risk youth and war victims (families who lost members, people with physical or mental disabilities, and households that are extremely vulnerable as a result of the lack of a steady stream of income)
- People displaced by the conflict, who may wish to return to their homes but need to be able to find jobs and feel secure there.

Labor market programs and public jobs are important, but fiscal and capacity constraints will limit the potential for direct job creation by the public sector in conflict environments. (Both constraints are likely to be most severe for nationwide conflicts, suggesting that the government is in a better position to directly provide jobs in conflict-affected areas in Sri Lanka, where conflicts are or were localized, than in Afghanistan or Nepal.) International organizations and foreign governments have key roles to play in providing funding and building capacity, particularly in cases of nationwide conflict.

The peace dividend for job creation is potentially large. A striking example is the unemployment reduction experienced in the Northern and Eastern provinces of Sri Lanka during a ceasefire that lasted from 2002 to 2004 (figure 1.30). Unemployment fell from 13.0 to 9.2 percent in the Northern Province and from 15.9 to 10.5 percent in the Eastern province, at a time when the national unemployment rate decreased much more slowly, from 8.8 to 8.3 percent.

**Figure 1.30** Unemployment Rates in Sri Lanka, by Region, 1997–2001 and 2002–04



Source: Annual Reports of the Central Bank of Sri Lanka.



Given resource constraints and the risks of the politicization of extended public sector involvement, policy makers need to plan a transition to make the private sector a more significant creator of jobs once a minimum level of security is achieved. Improving the regulatory environment is important in this regard, but true institutional transformation could take a generation. Governments could begin by reducing barriers to firm entry and tackling at least the most blatant pockets of corruption (World Bank 2011c). In addition, governments could facilitate private sector activities by creating “safe economic zones” that provide the needed security, services, and infrastructure in a focused manner and promoting “resource corridors” in areas rich in natural resources to better link them to the rest of the economy. Although much of the effort of job creation will initially be in agriculture and construction, the focus should shift over time from low-skilled agricultural jobs to higher-productivity nonfarm jobs and from targeted programs to broad-based job creation.

## Conclusion

This overview began by posing three questions. This section summarizes the answers to those questions.

### *Has South Asia Been Creating an Increasing Number of Jobs and Better Jobs?*

South Asia has created jobs at a rate that broadly tracks the growth in the region’s working-age population. Indeed, the ranking of the large countries in the region, in descending order of growth of employment (Pakistan, Nepal, Bangladesh, India, Sri Lanka) coincides with their ranking by growth of the working-age population.

But do workers have better jobs? This study uses two primary measures (increases in real wages for casual laborers and regular wage or salaried earners and decreases in poverty rates for the self-employed) and one secondary measure (mitigation of the risk of low and uncertain income arising from lack of work for the most vulnerable group of workers) to assess their well-being. Based on the primary criteria, South Asian workers are indeed better off than they were in the earliest period for which comparable data are available. Real wages have risen for wage workers, including both casual laborers and regular wage or salaried earners. Among all groups of workers—rural and urban workers, men and women—a higher proportion of the self-employed (for whom wage data are not relevant) belong to households that are above the poverty line. In India—the only country in which the data permitted this measure to be calculated—the risk of low and uncertain income arising from lack of work has been mitigated over the last decade for the most vulnerable segment of the labor force, casual workers.

### *What Determines the Quality of Job Creation, and What Is the Employment Challenge Going Forward?*

Improvements in worker well-being have been possible because of strong economic growth in the region since the 1980s, which has been second only to that of East Asia. Rising aggregate labor productivity has largely driven this growth. South Asia has seen



the fastest growth in total factor productivity in the world over the last three decades. But not all countries in the region have enjoyed rapid growth. Some countries that had stagnant or slow growth experienced massive international out-migration, which opened up job opportunities for those who remained behind. Together with a substantial inflow of workers' remittances, the tighter labor market has contributed to rising real wages and declining poverty.

Going forward, South Asia will have to accommodate 1–1.2 million new labor market entrants a month between 2010 and 2030—a 25–50 percent increase over historical levels. Finding jobs of increasing quality for this massive number of new workers represents an enormous challenge. With TFP growth likely to return to more typical rates for the region as a whole, policy makers have to create incentives for physical capital deepening and human capital formation to play a greater role in propelling the growth of aggregate labor productivity. Given South Asia's heterogeneity, the relative contribution of these factors to the growth of aggregate labor productivity will vary by country. A faster reallocation of labor from agriculture to industry and services, where TFP growth is higher, can raise aggregate TFP growth. Such a reallocation of workers will need physical capital accumulation in, for example, electricity and transport and investment in human capital. Reallocation across sectors needs to be complemented by moving labor out of low-productivity firms in manufacturing and services, where the bulk of workers in these sectors are employed.

### *What Bottlenecks Need to be Eased to Meet the Employment Challenge Given Intensifying Demographic Pressure?*

Accommodating new entrants into the labor force at rising levels of productivity will require reforms to ease demand- and supply-side bottlenecks to expanding employment. Investing in electricity to ensure reliable power supply is the most important and pervasive reform. But the reform agenda is not only about investment. Improvements in the regulatory framework and governance of the sector must go hand in hand. Firms consistently cited corruption in dealings between urban formal sector firms and the state—in particular utilities and tax administration—among the top demand-side constraints.

Improving the quality of education is a key supply-side priority. Doing so should start with interventions in early childhood to improve nutritional status and prevent cognitive impairment before children get to school. It should incorporate a sustained focus on the quality of learning at all levels once children enter the school system. Ensuring that graduates are equipped not only with academic and technical skills but also with the behavioral, problem-solving, and creative thinking skills increasingly required in the world of work is critical. Moving labor market institutions away from protecting jobs for a minority of insiders toward protecting the vast majority of workers in the informal sector who lack protection is essential.

### *A Challenging but Feasible Agenda*

The proposed reform agenda is challenging—but it is feasible, especially given the resources that will be freed up over the next three decades as a result of South Asia's demographic transition. The alternative of business as usual will be able to accommodate as many as 1.2 million new entrants to the labor force every month as well. But doing so at stagnant or barely rising levels of productivity would mean that the quality of employment will be poor. The vicious circle of poverty and low-productivity employment would then be drawn around another generation. That is the price of failure. It is a price that need not be paid.

## Annex 1A: Summary Economic Statistics of South Asian Countries

**Table 1A.1 Summary Economic Statistics of South Asian Countries**

Statistic	Afghanistan	Bangladesh	Bhutan	India	Maldives	Nepal	Pakistan	Sri Lanka	South Asia
GDP per capita (constant 2005 dollars at purchasing price parity)	1,200	1,286	4,643	2,993	4,972	1,049	2,369	4,333	2,698
Gross capital formation (% of GDP)	25	24	54	36	53	30	19	25	33
Gross savings (% of GDP)		39		35	35	38	22	24	34
Total population (millions)	30	162	1	1,155	0	29	170	20	1,568
<i>Sector share of GDP (value added)</i> <i>1980</i>									
Agriculture	—	32	44	36	—	62	30	28	35
Industry	—	21	15	25	—	12	25	30	24
Manufacturing	—	14	4	17	—	4	16	18	16
Services	—	48	42	40	—	26	46	43	41
<i>2008</i>									
Agriculture	32	19	19	18	6	34	20	13	18
Industry	26	29	46	29	18	17	27	29	29
Manufacturing	16	18	7	16	7	7	20	18	16
Services	42	53	35	54	76	50	53	57	54
<i>Sector share of employment</i> <i>Earliest year available</i>		2002	2003	1983	1998	1999	2000	2000	
Agriculture	—	51	80	63	25	77	47	37	60
Industry	—	14	3	16	25	10	19	25	16
Manufacturing	—	10	1	12	15	6	12	17	11
Services	—	35	18	21	49	13	34	38	24
<i>Latest year available</i>	2008	2005	2007	2008	2004	2008	2009	2008	
Agriculture	59	47	68	53	17	73	43	31	52
Industry	13	15	7	20	27	11	21	27	20
Manufacturing	5	11	4	12	20	7	13	19	12
Services	29	38	24	26	55	16	36	42	28

*Source:* Authors, based on data from World Bank 2011b; ILO KILM & LABORSTA databases 2010; Aggarwal 2010; and national labor force surveys.

*Note:* Totals may sum to less than 100 percent because of employment in unknown or unclassifiable categories. Employment and GDP shares for 2008 are based on most recent year available. — Not available.

## Annex 1B: Definition of Key Labor Market Terms

**Table 1B.1** Definitions of Key Labor Market Terms Used in This Report

Term	Definition
Employed	Person worked during at least part of the reference period (typically the last seven days), regardless of whether employment was formal or informal, paid or unpaid. Reference period in Bangladesh, Bhutan, India, Nepal, Pakistan, and Sri Lanka was reference week (generally past seven days). Reference period in Afghanistan and Maldives was past month.
Unemployed	Person did not work in the reference period but actively sought work.
Inactive worker (nonparticipant in labor force)	Person was neither employed nor unemployed during the reference period. This category includes discouraged workers—people who left the labor force because they believed no jobs were available or did not know how to search.
Regular wage or salaried workers	Person who receives regular wages or salary from a job in the public or private sector. These workers are usually on the payroll and usually earn leave and supplementary benefits. A significant proportion of these workers are in the public sector (ranging from 29 percent in Bangladesh to 67 percent in Afghanistan).
Casual laborers	Person who is paid on a casual, daily, irregular, or piece-rate basis. These workers typically do not have access to formal instruments of social protection. In rural areas, this category includes landless agricultural workers as well as workers in rural-based industry and services, such as construction.
Self-employed workers	Employers, own-account workers, and unpaid family enterprise workers. Except in Maldives and Sri Lanka, this is the largest group of workers in South Asia, where the majority of people work as own-account or family enterprise workers. In rural areas, this category comprises largely farmers working their own land, although many self-employed workers also work in the rural nonfarm sector.
High-end self-employed	Employers in all occupations, and own-account workers and unpaid family workers working as managers, professionals, technicians, and clerks.
Low-end self-employed	Own-account workers and unpaid family workers working as service workers, skilled agricultural workers, craftspeople, machine operators, and workers in elementary occupations.

Source: Authors.

## Annex 1C: What Is a “Better” Job, and Which Jobs Are “Better”?

Two main criteria are used to assess job quality. The primary criterion is higher average earnings. For wage workers, earnings can be assessed using information on average wages. This information is not available on the self-employed, whose earnings are in the form of returns to both labor and capital. As these figures are not available, poverty rates (the percentage of workers living in households below the poverty line) are used as a proxy for job quality for this segment of the labor force. Better jobs are thus those associated with higher (average) wage rates and lower poverty rates.

The second criterion of job quality looks beyond average income to its variance. Lack of stable employment and the associated variation in income and consumption are of concern for casual wage workers, who are typically the poorest segment of the labor force. Data limitations in all countries except India precluded a consistent analysis of this secondary criterion. The primary criterion for better jobs thus guides most of this book.

Various additional dimensions of job quality are often cited, including access to nonwage benefits, access to public social protection mechanisms, the ability to upgrade skills and receive training on the job, and the presence of a safe working environment. These factors are strongly correlated with wages, poverty, and job security.

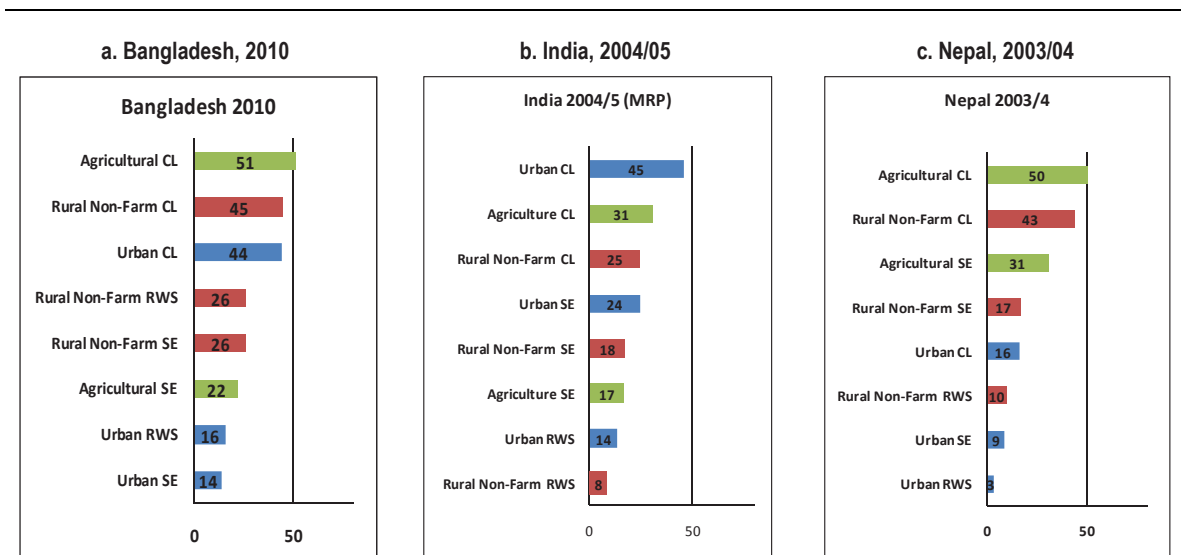
Based on the criteria of average wages or poverty rates and the risk of low and uncertain incomes, several observations can be made about where the “better” jobs are in South Asia (figures 1C.1 and 1C.2):

- Poverty rates are highest among casual workers and lowest among regular wage or salaried workers. Regular wage workers earn 23–59 percent more than casual workers and have poverty rates that are just a third or less than those of casual workers. The poverty rates for the self-employed are typically between those of casual and regular wage workers.
- In India and Nepal—the two countries for which data were available—casual labor is also associated with the least stability and regular wage work with the most stability. In India in 2010, for example, casual workers reported being out of work for 0.9–1.4 months the previous year. In contrast, the self-employed reported 0.2–0.7 months out of work, and regular wage or salaried workers reported virtually no time out of work.
- Among the casual labor force, workers in the agricultural sector have the lowest average earnings and the highest poverty rates. Casual workers in rural-based industry and services (the rural nonfarm sector) earn 10–50 percent more than casual workers in agriculture, even though the skills profiles are broadly similar. Urban casual workers earn up to 20–30 percent more than casual agricultural workers in Nepal and Pakistan. In India the risk of uncertain income arising from inability to find work is also highest for agricultural casual laborers, 49 percent of whom spent at least one month without work in the previous year, with an average of 1.4 months spent without work. In contrast, 40 percent of rural nonfarm

casual labor reported being without work for at least 1 month the previous year, with an average of 1.1 months spent without work. This risk is lower still for urban casual workers, 31 percent of whom reported being without work for at least one month, with an average of 0.9 months spent without work. Wage differentials between sectors and employment types partly reflect educational attainment. Workers in industry and services are more educated than workers in agriculture. Regular wage or salaried workers are more educated than casual workers. Almost all have some education, and a significant proportion have secondary education or above. The self-employed are more educated than casual workers. Even after accounting for higher skills, however, the majority of industry and service jobs still pay more than casual jobs in the agricultural sector.

In summary, less desirable jobs are found in casual employment, with the most precarious and lowest-paying jobs held by agricultural casual workers. Self-employment is in the middle, with high-end self-employed workers having consumption profiles and poverty rates closer to regular wage workers and low-end self-employed having profiles and poverty rates that are closer to those of casual laborers. “Better jobs” are held by regular wage or salaried workers in industry and services.

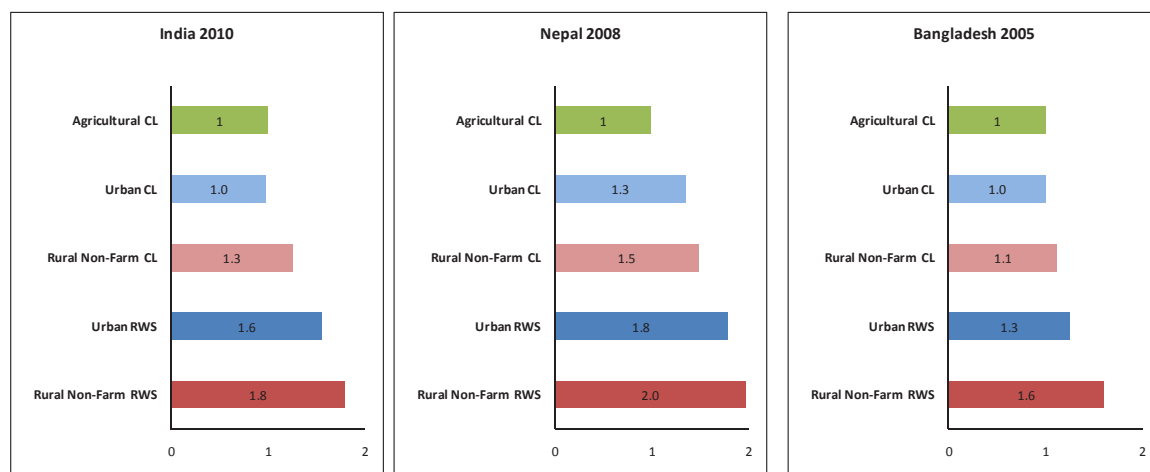
**Figure 1C.1 Percentage of Workers in Households below the Poverty Line in Bangladesh, India, and Nepal, by Employment Status**



Source: Authors, based on data from national labor force and household surveys.

Note: Figures are for workers 15–64. Poverty rates for India are based on pre-2004/05 official poverty lines. Using the new official poverty lines for 2004/05 would increase the poverty rates in rural areas, making the poverty rates of rural workers higher than those of urban workers for the same employment type. The hierarchy in terms of employment type would remain the same. CL=Casual Labor, SE=Self Employed, RWS=Regular Wage or Salaried Worker.

**Figure 1C.2** Ratio of Nonfarm and Urban Wages to Agricultural Wages in Bangladesh, India, and Nepal



*Source:* Authors, based on data from national labor force and household surveys.

*Note:* Figures are median wages for latest year available. CL=Casual Labor, SE=Self Employed, RWS= Regular Wage or Salaried Worker.



## Notes

1. See annex 1A for summary statistics on the eight South Asian countries
2. The absolute poor live on less than \$1.25 a day in 2005 purchasing power parity dollars.
3. See annex 1B for a definition of key terms.
4. See annex 1C for a definition of worker types.
5. Young (1994, 1995) notes the dominance of physical and human capital accumulation compared to TFP growth in East Asia. Rodrik and Subramanian (2005) note the overwhelming importance of TFP growth in India in 1980–99.
6. These data update the point made in Easterly and others (1993).
7. Bosworth, Collins, and Virmani (2007) emphasize this point in the context of India.
8. Reallocation contributed only 5 percent to TFP growth in China between 1993 and 2004 because of an extraordinarily high rate of within-sector TFP growth (more than 6 percent a year in industry).
9. The discussion of India's manufacturing sector uses the terms *establishments* and *firms* interchangeably.
10. The discussion draws on Bloom, Canning, and Rosenberg (2011), which is based on an analysis of the contribution of demographic change to economic growth at the global level in Bloom and Canning (2008).
11. Enterprise surveys provide information only about the constraints facing existing enterprises; they are not useful in understanding constraints perceived by potential firms that did not enter in the first place.
12. The question on political instability was not asked in India and Sri Lanka. Tax rates and access to finance constraints are excluded.
13. Only in Pakistan do the rankings by benchmark and expanding firms differ: for expanding firms corruption and political instability become the top constraints.
14. The samples for the investment climate for rural firms are pooled because of the limited sample size (500 firms) in each country.
15. The importance of urban-rural linkages for the nonfarm economy has been discussed in other studies. The World Bank's India poverty assessment (2010b) finds that the expansion of the nonfarm sector is more closely linked to urban than to agricultural growth. This finding is confirmed by a simple multivariate regression analysis using census data from Nepal.
16. To facilitate comparison, firms with more than 20 employees were dropped from the sample of formal firms.
17. Informal firms also cite "competition" as a severe constraint. The survey does not make clear what firms mean by competition.
18. The effects of conflict on the employment rate are likely to vary depending on the context and the subgroups of the population considered. The effects may also vary in the years following conflict. In Afghanistan data are available for only one point in time, so care needs to be taken in interpreting differences in labor market indicators between high- and low-conflict areas as reflecting the conflict.

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