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The Challenge of Job Creation in Asia

Jesus Felipe and Rana Hasan

April 2006

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With at least 500 million Asians conservatively estimated to be unemployed or underemployed and some 245 million new workers expected to enter the region's labor markets over the next decade, Asia faces the formidable challenge of creating large numbers of productive and better paying jobs to absorb its underutilized labor force. To meet this challenge, Jesus Felipe and Rana Hasan argue that Asian governments will have to make job creation a fundamental part of their economic agenda.

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This brief draws upon the volume, *Labor Markets in Asia: Issues and Perspectives* (edited by Jesus Felipe and Rana Hasan and published by Palgrave Macmillan). Some of the relevant material can also be found in the special chapter of ADB's Key Indicators 2005, *Labor Markets in Asia: Promoting Full, Productive, and Decent Employment*. The chapter is available at: http://www.adb.org/Documents/Books/Key_Indicators/2005/default.asp

With at least 500 million Asians conservatively estimated to be unemployed or underemployed and some 245 million new workers expected to enter the region's labor markets over the next decade, Asia faces the formidable challenge of creating large numbers of productive and better paying jobs to absorb its underutilized labor force. While economic growth is vital for generating jobs and improving standards of living, the links between economic growth, job creation, and earnings are complex. As pointed out in this policy brief, several dimensions of labor market outcomes in Asia indicate that economic growth has not been particularly inclusive. After discussing the factors that may be responsible for this, the policy brief provides an outline of some policy responses that hold promise in enabling the region's economies to generate many more productive jobs than they have been generating.

I. Labor Market Outcomes in Asia: Areas of Concern

An examination of labor market outcomes in the region reveals four main features. First, although many countries in Asia have achieved high output and productivity growth rates, corresponding employment growth rates have been far lower in recent years. As Table 1 shows, a one percentage point of growth led to a lower increase in employment in the 1990s than in the previous decade in most countries in the region.

Table 1
Employment Elasticities[a]

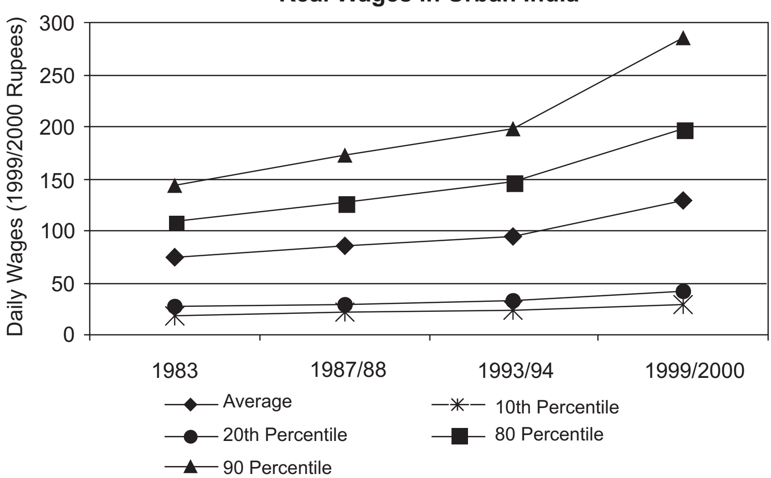
	1980s	1990s
Bangladesh	0.550	0.495
China, People's Rep. of	0.330	0.129
Indonesia	0.435	0.379
India	0.384	0.312
Rep. of Korea	0.223	0.225
Malaysia	0.683	0.406
Pakistan	0.406	0.553
Philippines	0.535	0.731
Singapore	0.375	0.711
Thailand	0.315	0.193
Taipei,China	0.242	0.139

Note: [a] Percentage increase in employment associated with a 1 percentage point increase in GDP.
Source: Felipe and Hasan (2006).

The case of the PRC—the world's fastest-growing economy year after year—is particularly telling. While in the 1980s it took a 3% growth rate of output to induce a 1% increase in employment, in the 1990s a growth rate of almost 8% was needed to achieve the same result. Estimates by the PRC's National Development and Reform Commission reveal the challenge that is involved: in 2006 the country will need to generate about 25 million urban jobs to accommodate new entrants into the labor market, workers laid off from state enterprises, and rural migrants. However, urban areas are expected to be able to generate only about 11 million jobs.

Second, the record of growth since the 1990s is disappointing as regards income/expenditure inequality, a variable tightly linked to the distribution of labor earnings. The PRC, for example, recorded an almost 13 percentage point increase in the Gini index[1] between 1981 and 2000 (Ravallion and Chen 2004). In India, inequality has increased between rural and urban areas and also within urban areas, as shown in Figure 1. The low growth of wages of those at the bottom of the distribution over a period of high economic growth indicates that growth can be associated with a slow pace of poverty reduction.

Figure 1
Real Wages in Urban India



Source: Adapted from Anant et. al. (2006)

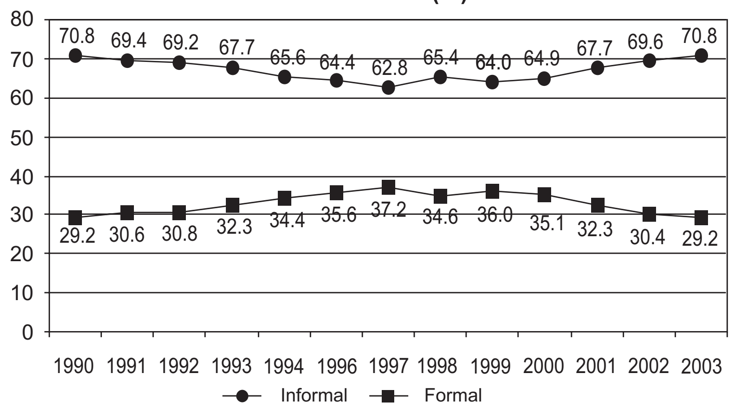
[1]The Gini index, or coefficient, is a commonly used measure of inequality. With perfect equality the Gini index would be equal to zero; with perfect inequality, it would be equal to one. Internationally, Gini indexes ranged from a low of 0.3 to a high of 0.7.

Third, employment in the informal sector—where production is typically carried out with very little capital, production methods are traditional, and productivity levels and earnings are correspondingly low—is either on the rise or remains persistent. There are two dimensions to this phenomenon. First, agricultural employment, which tends to be overwhelmingly informal, has been slow to decline as a share of total employment in a number of countries, especially in South Asia. In India, for example, agricultural employment—over 99% of which can be categorized as informal—continues to account for a majority of total employment. Second, many of the new jobs being generated outside of agriculture are in the informal sector. This is puzzling given that economic growth and expansion of employment in the formal sector have historically gone together. Continuing with the example of India, despite growth in GDP per capita close to 5% between 1993 and 1999, the share of the informal sector in total nonagricultural employment *increased* from 80.5% to 83.2%.

The informal sector also appears to be expanding in fast-growing transition economies such as the PRC and Viet Nam. In both countries layoffs in state-owned enterprises combined with some easing of rural-urban migration appears to be increasing the extent of informal sector employment (Amin 2002).

Where growth has been less robust, the extent of informalization may be even greater. A dramatic example is Indonesia. Figure 2 shows that since 1997, the year Asia's economic and financial crisis broke,

Figure 2
Share of Formal and Informal Sector Employment, Indonesia (%)

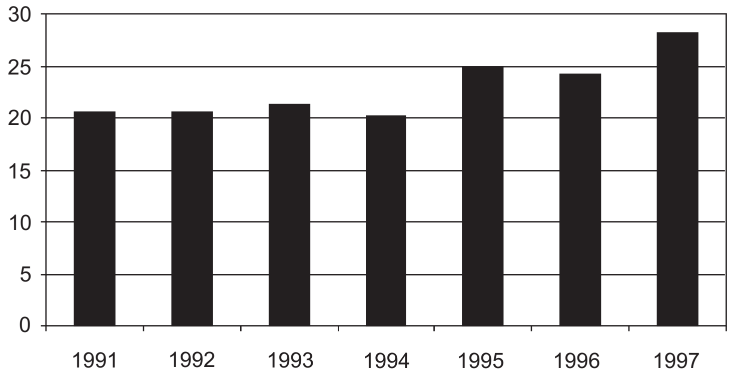


Source: Sugiyarto et. al. (2006)

employment in the economy has become markedly more informal. Something similar has happened in the Philippines and Thailand.

Finally, the nature of employment within the formal sector is changing. While previously formal sector employment was synonymous with "regular" contracts, which among other things offered considerable job security, this is increasingly not the case. A survey of formal sector establishments in the Philippines shows that the proportion of nonregular workers in total employment increased from about 20% in 1991 to about 28% in 1997 (Figure 3).

Figure 3
Share of Nonregular Workers to Total Workers (in establishments employing 10 or more workers), Philippines (%)



Notes: [a] Excludes agriculture, forestry, and fishery.
[b] As the Survey of Specific Groups of Workers was terminated in 1998, 1997 presents the latest available data.
Source: Felipe and Lanzona (2006)

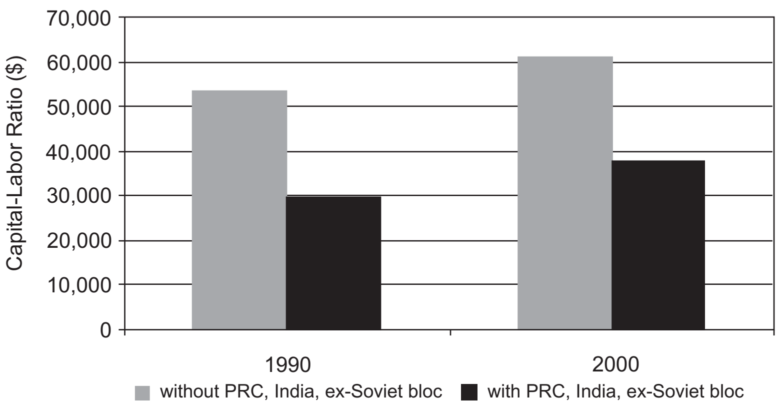
II. What is Driving Labor Market Outcomes?

There are a number of factors at play. The increasing inequality between rural and urban areas seen in many parts of Asia can be traced in part to the neglect of productivity-enhancing public investments in rural areas, where a majority of Asia's workers reside. Similarly, labor regulations, such as minimum wage laws or restrictions on laying off workers, may be playing a role in constraining job growth in the formal sector in some countries. In many others, limited investment in the face of a rapidly expanding labor force has led to slow growth in formal sector jobs.

More broadly, economies across the region are being influenced by the interplay of three factors, namely, globalization, technical change, and competition (ADB 2003). While there are many benefits to be had from these, they also present challenges in labor markets which need to be acknowledged and addressed.

First, driven in part by the integration of such economies as the PRC, India, and the ex-Soviet bloc, the effective global supply of labor has increased rapidly. Crucially, the increase in the effective size of the global labor force has not been accompanied by a surge in capital for investment. The result has been a steep reduction in the effective global capital-labor ratio from $53,500 in 1990 (excluding the large integrators) to $37,600 in 2000 (including them) as shown in Figure 4.[2] The decline in the available capital per worker globally combined with the fact that capital is more mobile than labor has generated anxiety at being able to attract the now more relatively limited pool of available capital and appears to have eroded the bargaining power of workers virtually everywhere. The changing nature of formal sector jobs discussed earlier is a direct outcome.

Figure 4
The Reduction of the Global Capital-Labor Ratio, 1990 and 2000



Source: Richard Freeman (personal communication, May 2005)

[2]These figures were provided by Richard Freeman, Harvard University (personal communication). His contribution is gratefully acknowledged.

Second, while the relative labor abundance of developing countries would suggest the use of more labor-intensive techniques of production in their formal industry and services sectors, in reality, the formal sectors of developing countries are not very different from those of industrial countries in terms of capital intensity.[3] The problem this creates is that given the supply of labor available, the more capital intensive the techniques the less employment will be required for any given rate of investment. Hence, unemployment will be the result of the use of "overly" capital-intensive techniques. At the same time, to the extent that some capital-intensive techniques are best utilized by skilled workers, the introduction of such techniques can raise the demand for skilled workers disproportionately. Since such workers are typically in short supply in developing countries, the result will be a sharp increase in wages earned by skilled workers and hence an increase in income inequalities.

The capital-intensive nature of new technologies can be seen at work in the retooling that is taking place at leading manufacturing firms in India, a country that is labor abundant by any definition. As reported in Merchant et al. (2005), 810 workers produced 244,000 motorbikes a year at a plant of one of India's leading scooter and motorbike manufacturers two years ago. By introducing greater automation, as well as improved shopfloor practices, the plant is producing nearly 3 times as many motorbikes with just 90 more workers. As executives at leading manufacturing plants explain, the introduction of labor-saving techniques is deemed essential for achieving "international competitiveness". This highlights a key challenge for the region: how to translate productivity growth into increases in employment and real wages in the formal sector.

III. Policies for Generating Productive Employment

What policies should governments implement? In what follows, some crucial elements of an overall policy package to address Asia's employment challenge are described.

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[3] At one level the forces of globalization and competition have enabled and compelled firms in developing countries to adopt productivity enhancing technologies. These technologies, however, are invariably generated in developed countries and tend to be increasingly capital-intensive.

A Big Push for the Rural Sector

The rural sector is where the majority of Asia's workers are employed. It is a sector characterized by a high degree of underemployment and low productivity. Yet it has suffered the neglect of policy makers. This is unfortunate since it is the productivity of work in the rural sector that is key for improving overall labor market outcomes.

Increased public investments in rural infrastructure and provision of agriculture extension services are vital for raising productivity in agriculture. Significantly, increased productivity on the farm will also bring benefits for the nonfarm rural economy. In the first place, rural roads and rural electrification will directly facilitate the expansion of the nonfarm sector as well. Second, increased incomes from improved farm productivity will raise demand for the output of the nonfarm sector.

Promoting Jobs in the Formal Sector

At the same time, significant increases in the demand for labor in the formal sector are required. Not only must the formal sector expand in terms of its contribution to aggregate value added, but also the expansion must be labor intensive. How can this be achieved? It is common to blame rigid labor laws for slow growth of jobs in the formal sector. Labor laws could be made more flexible in some cases but they are not the main drag on job creation, and more flexible labor laws alone would not spark a surge in new jobs.

Instead, the key to encouraging job growth in the formal sector will have to come from policies which promote diversification of production activities into new areas, facilitate restructuring of existing activities, and foster coordination between public and private entities to make all of this happen. Such policies—which is what "industrial" policies are at their core—need not be restricted to the industry sector. They also apply to the development of nontraditional activities in agriculture or services. Additionally, the use of industrial policies should not imply that governments make production and employment decisions. Instead, it requires that governments play a "strategic and coordinating role" in the development of nontraditional activities—activities where the underlying costs and opportunities are unknown to begin with and unfold only when such activities start (Rodrik 2004).

Consider the case of India's food processing industry—a labor-intensive sector and one that has strong direct linkages with the agriculture sector. Less than 2% of fruit and vegetable production in

India is processed, compared with 30% in Thailand and 80% in Malaysia (Sundaram and Tendulkar 2002). Several market analysts have identified food processing as an industry with significant potential to expand. What has constrained the expansion of India's food processing industry? A big part of the answer lies in the cultivation of traditional varieties of fruit and vegetables unsuitable for processing; weak infrastructure for postharvest preservation and quality control; and lack of modern storage, transportation, processing, and packaging facilities. While some of these constraints may result from misguided government policies, coordination failures abound in preventing the growth of a sector in which there are so many inputs and players.

Export Push

Exports can play an important role in expanding jobs in the formal sector, especially in countries with small domestic markets. An export push can be induced in one of two ways: lower wages or higher productivity. The second option is the one that countries should try to pursue. Ways to improve productivity include the introduction of competition policies and training and reorganization on the shop floor. Increases in the capital-labor ratio at the firm-level will also be required. For this reason, the expansion of exports should be driven by labor-intensive sectors for it have a large impact on employment.

IV. Concluding Remarks

It is important to recognize that the policies described above may alleviate some of the downsides from the adoption of new technologies and the intense competition firms are being faced with, but they will not eliminate them. In other words, it is quite likely that unemployment driven by the adoption of new technologies and heightened competition among firms will continue to be serious problems. Nevertheless, governments still have to act. In particular, they will have to devise human capital interventions which focus on enhancing the "trainability" of workers rather than providing formal degrees per se. A more trainable workforce will be better equipped to respond to the different skills required by new and changing technologies. Similarly, the growing inevitability of job losses will require the development of far more effective systems of social protection which help workers, in both formal and informal sectors, manage the risks they face in a fast-changing workplace.

In the final analysis, unless Asian governments make job creation a fundamental part of their economic agenda backed by time bound, feasible, and credible policies it is easy to conceive of a situation where the region, say 25 years from now, continues to grow but also continues to harbor most of the world's poor.

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