
FAST TRACK BRIEF

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The IEG report “Earnings Growth and Employment Creation: An Assessment of World Bank Support in Three Middle-Income Countries,” was discussed by CODE on June 29, 2009

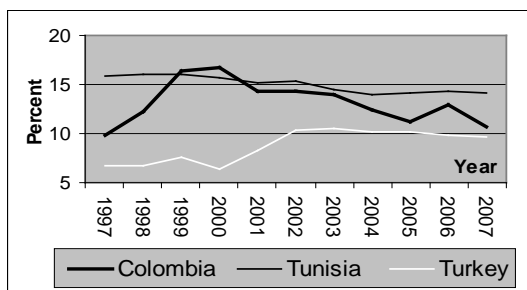
Earnings Growth and Employment Creation: An Assessment of World Bank Support in Three Middle-Income Countries

- ◆ This assessment reviews earnings and employment outcomes in Colombia, Tunisia, and Turkey during 1998-2007, as well as five policy areas (the MILES framework) likely to affect those outcomes: macroeconomic conditions, investment climate, labor regulations, education, and social protection. The three countries had very different experiences during the period: a deep recession during 1998-99 that increased cyclical unemployment in Colombia to unprecedented levels; a high unemployment rate that resisted efforts at reducing it for decades in Tunisia; and a sharp rise in structural unemployment in Turkey as it implemented structural reforms.
 - ◆ Employment-related outcomes in the three countries were mixed, with notable progress in economic growth, earnings and poverty reduction, but not in the employment-to-population ratio or unemployment rate. This underscores the desirability of focusing on the full set of employment-related variables—GDP, poverty, employment, unemployment, and earnings—in an integrative fashion rather than just on employment when setting the objectives of Bank support. This focus will need better employment-related statistics, an area where the Bank can help further.
 - ◆ Bank objectives in the three countries focused more on MILES components than on employment itself. This suggests that employment issues, which straddle three Bank Networks (PREM, HD, and PSD), may fall by the wayside unless the Country Partnership Strategy serves as a vehicle for diagnosis, priority setting, and programming cross-sector work. Employment-related issues in particular—such as structural unemployment—are largely cross-sectoral in nature. From this perspective, the Bank could usefully strengthen its role as knowledge provider, broker, and facilitator of knowledge creation.
 - ◆ Bank support in the three countries achieved differential progress in the individual MILES components, with the most progress on macro stabilization, followed in approximate order by progress on the investment climate, education, social protection, and labor taxation and regulations. The experience of the three countries illustrates how analytic and advisory activities can be the main instrument of support in those areas (such as labor regulations and taxes) where progress in reform is difficult and the need for building engagement and consensus is critical.
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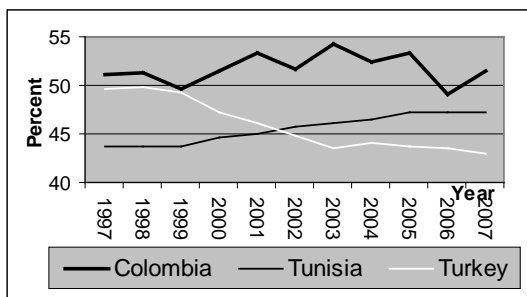
During 1998-2007, Colombia, Turkey, and Tunisia faced difficult employment challenges, as shown in the figure below. Over the first half of the review period, Colombia and Turkey experienced sharp increases in unemployment rate as deep recessions reduced employment demand, with Colombia's unemployment declining and Turkey's remaining higher as these economies recovered. Despite Tunisia's economic stability, it had the highest unemployment rate of the three countries, although unemployment declined moderately during the review period (Panel A). Furthermore, the employment-to-population ratio ceased growing in Colombia during the review period after many years of increases in female participation, and continued declining in Turkey. Tunisia's employment-to-population ratio increased by a few percentage points (Panel B) because female participation increased from a very low level. Earnings declined and poverty increased during the recessions in Colombia and Turkey, but these improved toward the end of the review period. Earnings in Tunisia increased and poverty declined.

Employment Performance in Colombia, Tunisia, and Turkey

A. Unemployment Rate: 1997-2007



B. Employment-to-Population Ratio: 1997-2007



Sources: The World Bank (World Development Indicators); Colombia Statistical Office (DANE); Turkey Statistical Office (Turkstat).

This report evaluates World Bank support for employment and earnings growth in Colombia, Tunisia, and Turkey during 1998-2007. It aims at drawing findings that may help guide the Bank's work in this area, including its response during the cur-

rent global crisis. The review looks at Bank support for the five areas embodied in the MILES framework developed by the Human Development (HD) and Poverty Reduction and Economic Management (PREM) networks: macroeconomic, investment climate, labor market, education, and social protection policies. These areas cover the key factors that affect the demand for labor, the workings of the labor market, and the supply of skills. While the demand for labor is expected to respond positively to economic growth, the two need not move in tandem, as the sources of economic growth include growth in skills, in physical capital and in total factor productivity, in addition to growth in employment.

Although the MILES framework was not explicitly used in formulating the objectives of the country programs reviewed in this report, the framework can be used to identify binding constraints to employment creation and earnings growth. It thus offers an organizing device for the evaluation, into which the three country programs can be retrofitted and assessed. This approach thus differs in some (though not all) respects from the standard approach in many IEG evaluations of "evaluating against objectives," where the outcome of the Bank program is assessed relative to objectives stated at the outset. In this case, although the programs in the three countries sought to help increase employment, the employment-related objectives were not always formulated and unbundled into more proximate objectives.

The table below shows that the largest amounts of lending support in the three countries were for macroeconomic policies (including financial sector policies) followed by investment climate.

Bank Lending (US\$ million) and AAA (number of tasks) by MILES Area: 1998-2007

Country	Colombia		Tunisia		Turkey	
	Loans	AAA	Loans	AAA	Loans	AAA
Macro conditions	1,235	9	562	11	4,988	6
Investment climate	1,100	4	436	17	1,961	7
Labor regulations	857	6	0	11	500	7
Education policy	662	3	385	10	704	2
Social protection	341	4	0	3	1,715	1
Total	4,195	26	1,383	52	9,868	23

Source: Appendices D, I, and N.

The following paragraphs briefly present the Bank's support and its outcome.

Colombia

Throughout the period, the Bank was engaged in the five areas of the MILES framework in varying degrees. Following the 1998-99 crisis, the Bank supported the government's efforts to strengthen fiscal performance (revenue collection,

efficiency in the provision of health services, contingent liabilities, public administration, and public expenditure and debt management) and the financial system. These improvements were critical in redressing growth and earnings and in dampening a surge in cyclical unemployment. They did not, however, achieve a reduction in structural unemployment, which remained high due, *inter alia*, to an excessive minimum wage and high payroll taxes.

Beginning in 2002, reflecting the government's priorities and concerns that the economic recovery was slow to yield better employment and social outcomes, especially for the poor, there was increased emphasis by the Bank on improving competitiveness (through investment climate strengthening and labor market reforms) and on improving the social risk management system.

Bank-supported objectives in the MILES areas were largely achieved, although the Bank over-promised on the elimination of fiscal structural rigidities given the political economy constraints, and did not adequately factor in the fiscal implications of the conditional cash transfer program. Nonetheless, Colombian counterparts acknowledged the contribution of the Bank in several areas, such as tax administration. In some areas the Bank missed certain opportunities to use its convening power. A number of consultations suggested, for example, that the Bank (as well as the IMF) had been too timid in pressing the policy implications of its labor market diagnostics (particularly on the minimum wage and labor taxes), which were of good quality. In general, the Bank's interventions were relevant and AAA, technical assistance, and lending operations adapted to the government's changing priorities.

Bank-supported policies improved employment performance. The improvements in macroeconomic policy and in the investment climate helped increase average yearly GDP growth from 0.5 percent during 1997-02 to 5.6 percent during 2002-07, primarily through an increase in total factor productivity (TFP) growth. This allowed the unemployment rate to decline and earnings to grow despite a slowdown in employment growth.

IEG rates the outcome of the Bank program in Colombia with respect to progress in employment and earnings growth as *moderately satisfactory*. Key achievements can be summarized as follows:

- *Higher-order outcomes:* increased earnings growth and lower poverty with stable employment growth and mitigation of cyclical unemployment, particularly during the second part of the review period.

- *Intermediate outcomes:* the restoration of fiscal stability, substantial progress in the investment climate, gains in the coverage and financing of education, and broader coverage of the safety net.
- *Bank interventions:* significant Bank contributions in tax administration, bank restructuring, business climate improvements, labor market diagnostics, coverage and financing of education, and design of the conditional cash transfer (CCT) system. There were shortfalls in resolving Colombia's revenue and expenditure rigidities, as well as in lowering the minimum wage and the burden of non-wage costs, relative to objectives. There was also lower growth and higher structural unemployment.

Tunisia

In Tunisia, the Bank was also engaged in the five pillars of the MILES framework, though there were important differences of emphasis. In macroeconomic policy, where performance was the best among the three countries, the Bank's role was positive, albeit marginal on the fiscal front. It was most important on trade liberalization and facilitation and financial sector reform, both of which benefited from AAA and lending, including high-quality diagnostic financial sector work undertaken jointly with the IMF. Regarding the investment climate, Bank support addressed important reforms, including a reduction in the regulatory gap that favored the offshore over the onshore economy, improving competition law, opening the information and communications technology sector, and developing the regulatory framework in infrastructure.

The Bank had little impact on policies governing the labor market. The Bank conducted AAA of good quality, but the government did not adopt any of the Bank's key recommendations. In education, a great deal was achieved at the primary and secondary levels, and the Bank played a major role in this. The results of Bank support were more muted at the tertiary level, where there was less-than-full agreement on some key policy issues (such as financing and cost recovery reforms) and it is believed that aggressive expansion in coverage has been responsible for a deterioration of quality.

The key policies that improved GDP, employment, and earnings growth in Tunisia were macroeconomic stabilization and trade integration with the EU, the latter largely established before the review period. Improvements in the investment climate may have further contributed to the growth in earnings suggested by rising formal sector wages through improvements in productivity growth. These improvements have not yet had a discernible effect on investment levels. While education has contributed to rising productivity and earnings, it has also led to increased unemployment among the educated due to both skills mismatches and low invest-

ment levels. Unemployment has been persistently high, but declined moderately during the review period. Inadequate skills appear to be behind the high level of unemployment. The latter may also reflect the effect of minimum wages.

The outcome of the Bank program in Tunisia relating to employment and earnings growth is rated *satisfactory*. Key achievements can be summarized as follows:

- *Higher-order outcomes:* increased earnings growth and lower poverty with stable employment growth, lower structural unemployment, and increased GDP growth.
- *Intermediate outcomes:* sustained macroeconomic stability, significant progress in trade facilitation and the business environment, substantial progress in the investment climate, and gains in coverage of education.
- *Bank interventions:* significant Bank contribution to trade, the investment climate, and coverage in education. However, there were shortfalls in making labor markets more flexible, in improving education quality, and in strengthening public sector governance.

Turkey

In Turkey, the Bank was heavily engaged in the five areas of the MILES framework to varying degrees. In the earlier years, the Bank concentrated on macroeconomic stabilization and accompanying structural reforms. Bank support was delivered primarily through policy advice and development policy lending. Following the 2001–02 crises, the Bank supported reforms to strengthen fiscal performance and the financial system. This set of reforms was critical in redressing economic growth and earnings growth in Turkey. But they did not help reduce unemployment, which in fact increased. In later years, greater attention was devoted to employment and competitiveness issues. Within the scope of the MILES framework, the remaining problem areas are labor market regulations, education, and the investment climate.

Bank-supported objectives were largely achieved. Stabilization and related structural reforms were achieved, although the support was initially unsuccessful because weak macroeconomic stabilization undermined financial sector reforms. On investment climate matters, active Foreign Investment Advisory Service (FIAS) participation supported important changes in foreign direct investment legislation. The more recent Investment Climate Assessment (ICA) has, however, been less successful thus far and would benefit from stronger client engagement and dissemination. On labor policy issues, the Bank provided high-quality advice, although this did not translate into policies to ease the rigid regulations and high labor taxes that had been diagnosed. On education, the first operation was unfocused and suffered from procurement problems, but follow-on lending fared better. Despite these operations and several pieces of AAA, the Bank’s engage-

ment in the education sector was less successful than that in the other areas relating to employment.

Bank-supported policies, particularly those in the macroeconomic area, helped reignite growth and the demand for employment, with the employment ratio stabilizing somewhat after a long-term decline. Higher productivity triggered by some of the supported reforms helped increase earnings of the poor. On the other hand, structural adjustment, particularly migration away from agriculture, continued to decrease labor participation, while increasing productivity. On balance, average earnings declined until about 2003 and then recovered.

The outcome of the Bank program in Turkey with respect to employment and earnings is rated *moderately satisfactory*. Key achievements can be summarized as follows:

- *Higher-order outcomes:* increased earnings, lower poverty, and higher GDP growth.
- *Intermediate outcomes:* the restoration of fiscal stability and gains in the coverage of education.
- *Bank interventions:* significant Bank contributions towards macroeconomic stability and the CCT program. There were shortfalls in the effectiveness of support on the business climate, in lowering non-wage costs, and in relaxing labor regulations (though some progress was achieved the year after the end of the review period). Effectiveness in contributing to education gains was also limited. Employment growth declined and unemployment increased.

Findings

Three sets of findings are worth highlighting. The first set concerns outcomes. In the three countries, progress in economic growth and earnings was notable but not in the employment-to-population ratio or the unemployment rate. This finding underscores that higher economic growth does not always lead to lower unemployment. It also underscores the need to consider the full set of employment-related outcomes, not just employment, wherever employment objectives feature prominently in Bank strategies and programs. The full set would cover employment growth, the employment-to-population-ratio, the unemployment rate and earnings growth, as well as the impact of these on poverty and the uncertainties of that impact. This means that policies and programs need to be understood in terms of their possible joint effects on those variables. As monitoring employment-related outcomes requires adequate data, the Bank can provide a valuable service by continuing to help client countries to reduce the long lags with which critical data on employment performance (for example, earnings) are produced and disseminated.

A second set of findings refer to Bank country strategies and programs. In the three countries covered in this evaluation, the Bank primarily targeted multiple objectives with a bearing on employment (for example, objectives relating to MILES components) rather than explicit employment outcomes. This points to the usefulness of situating Bank support for employment and earnings growth within an integrative framework. For client countries where employment-related objectives underlie Bank support, the Country Partnership Strategy takes on added importance as a vehicle for diagnosis, priority-setting, and cross-sector work on employment issues, which straddle three networks (PREM, HD, and PSD) and may not otherwise get the requisite attention.

AAA has been an important component of the Bank's assistance on employment and earnings. Although the impact that it had is unclear, the Bank's AAA was generally of good quality, addressing the right employment issues competently, and it was well appreciated by the three clients. This experience suggests that where it is judged that employment-related outcomes are central to country strategies, it would be advisable to deploy AAA in the critical areas, including: understanding and addressing the roots of unemployment, including its cyclical, classical, frictional, and structural components; and assessing labor market regulations and institutions and their effects. In particular, the Bank can help improve and extend the coverage of estimates and cross-country comparisons of labor rigidities and labor taxes.

In some cases the Bank was not sufficiently engaged on labor market issues. The experience of the three countries shows varying degrees of engagement, which in turn are likely to be driven by differences in the political economy of labor reform and in Bank proactivity regarding engagement on such issues. Where labor reform issues are deemed important to its country strategy, the Bank would be well advised to conduct the required AAA and find the right windows of opportunity to support the government (as was the case in Turkey).

All in all, sustained macroeconomic and financial stability in Tunisia and stabilization in Colombia and Turkey as well as higher education levels explain increased or recovered economic growth and earnings in the three countries, with some additional role attributed to improvement in the investment climate. However, progress in these three areas did not reduce unemployment rates in Colombia and Turkey and reduced them only moderately in Tunisia. High remaining unemployment is likely to reflect skill mismatches, rigid wages, or other structural conditions.

A third set of findings concerns the specific areas of support. Bank support for *macroeconomic policies* contributed effectively to country efforts on macro-financial crisis resolution in Co-

lombia and Turkey and to trade and financial development in Tunisia. These efforts were the main factor that helped restore GDP growth in the first two countries and also contributed to sustaining higher growth in the third. Restored GDP growth increased the demand for labor, resulting primarily in the higher earnings growth documented earlier. Bank support for *investment climate* reforms covered the three countries and contributed to improvements in specific policy areas that helped raise investment or total factor productivity to varying degrees.

Support for labor market regulations and institutions occurred primarily through AAA that was relevant and technically competent, but that had unclear impact. Labor rigidity and labor taxes remained a constraint to employment, particularly formal employment, in the three countries. Support for *education* contributed primarily to extensions in access and to an increased supply of the skills needed to raise output and earnings growth, but the impact on quality was more limited. And finally, support for *social protection* arrangements contributed successfully to conditional cash transfer (CCT) programs in Colombia and Turkey and less so to the unemployment insurance programs that are needed to move from job protection to worker protection. The three countries' experiences attest to the difficulties of setting up unemployment insurance systems.

From a more general cross-cutting perspective, the Bank could usefully strengthen its role as knowledge provider, broker, and facilitator of knowledge creation. The Bank is in a good position to exercise leadership on employment issues as it has demonstrated capacity to use research for developing operationally relevant policy. In this regard, AAA, not lending, is often the best instrument to deal with the more sensitive policy issues that affect employment outcomes. As with the three countries reviewed in this report, the Bank can contribute to understanding employment issues where those issues are a central concern. This would include advising countries how to use available resources judiciously to address various employment challenges (such as unemployment insurance) while ensuring macroeconomic stability. It would also include looking at education quality, possibly with greater emphasis on addressing skills mismatches, which may be behind much of the structural unemployment observed in countries like the three reviewed in this report.

The Current Global Jobs Crisis

The findings presented in this report suggest ways in which the Bank can strengthen its response to the current global economic crisis. The crisis has reduced output growth from 5.2 percent in 2007 to -1.3 percent in 2009 and increased the world unemployment rate from 5.7 percent in 2007 to 6.8 percent in 2009, with the higher increases in developed econ-

omies, Central and South Eastern Europe (non-EU) and CIS, and Latin America and the Caribbean. The findings suggest the following three directions:

Country programs can respond by focusing on both employment and earnings outcomes, which determine poverty outcomes. Country Directors are well positioned to deploy the Bank's multisector capacity to engage with client countries on how policies and adjustments to Bank programs can help improve the full set of employment-related outcomes, not just employment. Such engagement will require an understanding of how policies in different areas (including macro, labor market) can redress both employment and earnings in specific countries, presumably through increased demand for labor and skills and through higher labor productivity. Many governments have made adjustments to their policies in response to the financial crisis and/or may need well-tailored advice in these areas. Diagnoses and recommendations are likely to differ according to specific country circumstances, such as the degree of openness of the economy.

The Bank's effectiveness will be stronger as it integrates across networks to focus on those issues that are likely to be relevant during crises. Examples include improving employment and earnings monitoring; assessing the impact of global recession on structural unemployment; developing strategies to promote job flexibility and worker protection; finding the right balance between macroeconomic stability and the fiscal cost of other employment-related policies; strengthening the interaction between macroeconomic and microeconomic conditions affecting growth and employment demand; understanding the interface between quality of education and absorption of labor services; and assessing the possible effect of differential changes in employment and earnings on migration.

Country programs will be more effective as they focus on areas where progress in the enabling conditions has been slow but where windows of opportunity for reform surface. The area where progress has typically been slow is on making labor regulations more flexible and lowering labor taxes. Conversely, the Bank can also help countries maintain progress where it has been achieved, as was the case with macroeconomic stability in the three countries reviewed. In this regard, the Bank can deploy its multisector capacity to help countries avoid conflicts among employment policies (for example, ensuring that stimulus packages or extended social protection are affordable).

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