Coordinated macroeconomic, employment and social protection policies in Asia and the Pacific

Sukti Dasgupta and Kee Beom Kim
September 2011
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Preface

The International Labour Organization (ILO) is devoted to advancing opportunities for women and men to obtain decent and productive work. It aims to promote rights at work, encourage decent employment opportunities, enhance social protection and strengthen dialogue in handling work-related issues. As countries in the Asia and the Pacific region continue to recover from the global economic crisis, the ILO’s Decent Work Agenda and the Global Jobs Pact provide critical policy frameworks to strengthen the foundations for a more inclusive and sustainable future.

This paper by Sukti Dasgupta and Kee Beom Kim examines the important role of coordinated economic, employment and social protection policies in supporting a more sustainable and balanced growth in the Asia and the Pacific region. It was prepared as one of the background papers of the Report of the Director-General to the 15th Asia and the Pacific Regional Meeting.

This paper is part of the ILO Asia-Pacific Working Paper Series, which is intended to enhance the body of knowledge, stimulate discussion and encourage knowledge sharing and further research for the promotion of decent work in Asia and the Pacific.

Sachiko Yamamoto
Regional Director for Asia and the Pacific
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Acknowledgements

This paper benefited from very helpful comments and inputs provided by ILO colleagues including Duncan Campbell, Phu Huynh, Iyanatul Islam, Makiko Matsumoto, Muhammed Muqtada, Thetis Mangahas, Per Ronnas, Bill Salter and Gyorgy Sziraczki. Any errors are the sole responsibility of the authors.
Abstract

Coordinated global, regional and national efforts to support output, jobs and incomes have been an important factor behind the relatively swift recovery from the global economic crisis in Asia and the Pacific. Further strengthening such coordination of economic, employment and social protection policies is critical in supporting a more sustainable and balanced growth in the region. Ensuring that the macroeconomic framework, in addition to addressing economic growth targets, inflation and sustainable public finances, is employment-rich and inclusive provides an important anchor to such coordination. Such a framework needs to be underpinned by gender-sensitive employment strategies and sectoral strategies that integrate employment. Strengthening the tax and benefit system so as to finance a social protection floor while promoting productive investment and employment that generates future tax revenues contributes to both fiscal sustainability and inclusive growth.

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The responsibility for opinions expressed in articles, studies and other contributions rests solely with their authors, and publication does not constitute an endorsement by the International Labour Office of the opinions expressed in them, or of any products, processes or geographical designations mentioned.
### Abbreviations

<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Description</th>
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<tbody>
<tr>
<td>ADB</td>
<td>Asian Development Bank</td>
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<tr>
<td>APEC</td>
<td>Asia-Pacific Economic Cooperation</td>
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<td>ASEAN</td>
<td>Association of Southeast Asian Nations</td>
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<td>CCT</td>
<td>Conditional cash transfer</td>
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<td>FDI</td>
<td>Foreign direct investment</td>
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<td>GDP</td>
<td>Gross domestic product</td>
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<td>G20</td>
<td>Group of Twenty</td>
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<td>ILO</td>
<td>International Labour Organization</td>
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<td>IMF</td>
<td>International Monetary Fund</td>
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<td>NIE</td>
<td>Newly industrializing economy</td>
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<td>MDG</td>
<td>Millennium Development Goal</td>
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<td>NREGA</td>
<td>National Rural Employment Guarantee Act (India)</td>
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<tr>
<td>OECD</td>
<td>Organization for International Co-operation and Development</td>
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<tr>
<td>PKH</td>
<td>Program Keluarga Harapan (Indonesia)</td>
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<td>PNPM Generasi</td>
<td>Program Nasional Pemberdayaan Masyarakat Generasi Sehat dan Cerdas (Indonesia)</td>
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<tr>
<td>SAARC</td>
<td>South Asian Association for Regional Cooperation</td>
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<td>SME</td>
<td>Small and medium-sized enterprises</td>
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<td>UNDP</td>
<td>United Nations Development Programme</td>
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<td>WTO</td>
<td>World Trade Organization</td>
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1. Introduction

The global economic crisis has highlighted underlying structural imbalances in Asia and the Pacific and has brought to the fore the already existing employment challenge in the region. While the region’s dynamism before the crisis is currently enabling the region to lead the global recovery, its sustainable development in the future will depend to a large extent on the quality of that recovery and how Asia and the Pacific reorients its growth strategies. This will require a focus on growth that delivers quality jobs and decent work. It will also require an upward shift in productivity and a more egalitarian institutional basis for sharing productivity gains. For some countries in the region, it may require shifting away from a heavy reliance on export-orientated growth to a development path based on both exports and domestic demand. Crucial too is the need to put in place a social protection floor to support aggregate domestic consumption in a region that has too many working poor and workers in vulnerable employment. This calls for coordinated economic, employment and social protection policies, the focus of this paper. A starting point in this regard is revisiting the macroeconomic policy framework. It is essential that the framework, in addition to addressing the economic growth targets, inflation and sustainable public finances, ensures that growth is employment-rich and inclusive. A post-crisis macroeconomic framework that fosters a more inclusive and balanced growth in the region calls for a renewed commitment to full and productive employment as a core macroeconomic policy goal.

Gender-sensitive employment strategies, based on employment growth diagnosis, are important in underpinning an employment-friendly macroeconomic framework. Employment outcomes need to be mainstreamed in macroeconomic policy – monetary policy and fiscal policy. Furthermore industrial policy, where it exists, and trade policy, need to be oriented towards the employment outcome. In the wake of the global economic crisis, fiscal policies to foster growth and employment have in particular come to the forefront of the policy agenda in many countries in the region and around the world, as evidenced by the significant fiscal stimulus packages undertaken. This recent experience suggests that countries can better harness fiscal policies to address decent work deficits. Nonetheless, this potential is often constrained by public finances, highlighting the need to strengthen the tax and benefit system, including its redistribution function, while keeping in mind the need to promote investment and employment incentives.

As countries in the region re-examine taxation and fiscal sustainability, it is critical to incorporate into these considerations, the issue of a basic social protection floor. Governments in the region need to create fiscal space for investments in social protection, which in many instances will entail reprioritizing existing spending decisions, reached through social dialogue and national consensus. The 1997 Asian financial crisis and the recent economic crisis have starkly brought to the fore the issue of insecurity and vulnerability in employment and demonstrated the urgency of building and strengthening the “automatic stabilizers” of social protection.1

Realizing these opportunities and addressing the challenges will require increased policy coordination and coherence at global, regional and national levels. In coming together to adopt the Global Jobs Pact at the International Labour Conference in June 2009, the ILO’s constituents in the region have made a critical contribution to policy coordination and coherence: a sustainable recovery needs to be centred on productive investment, employment and social protection, rights at work and social dialogue.

1 See for example Lee, 2008 and Huynh et al., 2010.
2. Employment creation as a core macroeconomic policy goal

The design of macroeconomic policy frameworks, and macroeconomic policy objectives, are of critical concern, and is often a subject of ideological debate. There are divergent views on what constitutes an appropriate macroeconomic framework because this in turn is crucial for economic and social progress. Under the ‘Washington Consensus’, it was widely accepted that the main role of macroeconomic policy was stabilization, with a strong emphasis on low inflation and fiscal prudence (Williamson, 1999). Consequently, in Asia and the Pacific, as in developing countries in other regions, the primary objective of macroeconomic policy has been to adjust interest rates to control inflation, curb budget deficits for fiscal balance and manage current account surpluses. As a result of the crisis, such a policy framework has come under further careful scrutiny: “The crisis was not triggered primarily by macroeconomic policy. But it has exposed flaws in the pre-crisis policy framework, forced policymakers to explore new policies during the crisis, and forces us to think about the architecture of post-crisis macroeconomic policy” (Blanchard et al., 2010).

Studies have shown in particular that while the “pre-crisis” policies have been more or less successful in keeping inflation at low levels, and in maintaining economic stability, they often have had a negative effect on aggregate demand, and therefore on employment. In Asia and the Pacific, in spite of high growth rates and expanding exports, employment growth has lagged behind (see table 1). In China for example, whereas the economy expanded at unprecedented rates, by an annual average of 10.2 per cent between 2001 and 2008, employment grew by only 0.9 per cent per year during the same period. This led to a large jobs deficit in urban areas in China, and considerable surplus labour in agriculture. Furthermore, most countries in Asia and the Pacific have witnessed a decline in employment elasticity between 2001-2004 and 2004-2008.

In spite of relatively slow rate of growth in employment, unemployment rates have remained low in most developing countries in Asia and the Pacific, simply because in the absence of social protection policies the poor have to find an income through work – however inadequate that work, or income from that work, is. Therefore, low unemployment rates in Asia and the Pacific need to be considered together with other indicators that describe the quality of employment, be it underemployment, vulnerable employment (defined as the sum of own account workers and unpaid family workers) the ‘working poor’, and/or where available, estimates of employment in the informal economy. Indeed, in many cases, where employment did grow, its quality has been in question - much of it insecure and casual. The share of the region’s workers in vulnerable employment is estimated at around 60 per cent, or around 1.1 billion workers in 2009. In South Asia, the vulnerable employment rate is estimated to be 78.5 per cent while in East Asia, 50.8 per cent.

Furthermore, while unemployment rates are low in general, young women and men have borne the brunt of unemployment in the region, with unemployment rates for young people going up to over 20 per cent in some countries such as Indonesia, Mongolia and Sri Lanka. Many of these unemployed young people have completed secondary school or graduate school – implying perhaps, amongst other things, a skills mismatch.

In most countries in the region, reductions in poverty levels have been lower that what would have been desirable and income inequalities have increased in the region. While productivity and

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3 ILO, Trends econometric models, October 2010.
4 See for example ILO, 2008a.
wages in the formal sector have generally grown, real wage growth on the whole has been sluggish. In Thailand, for example, real wage growth for unskilled workers has been declining, even while productivity has been rising, and minimum wage adjustments have not kept pace with inflation since 1997. The dichotomy between productivity growth and real wage growth, even in the formal segments, has put industrial relations systems under stress.\(^5\)

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<tr>
<td>China</td>
<td>10.5</td>
<td>0.9</td>
<td>0.13</td>
<td>0.10</td>
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<tr>
<td>India(^*)</td>
<td>7</td>
<td>2.4</td>
<td>0.33</td>
<td>0.24</td>
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<td>Indonesia</td>
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<td>-0.1</td>
<td>n.a</td>
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<td>1.4</td>
<td>0.29</td>
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<td>Malaysia</td>
<td>5.7</td>
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<td>Mongolia</td>
<td>8.2</td>
<td>3.2</td>
<td>0.71</td>
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<td>Pakistan</td>
<td>3.3</td>
<td>3.7</td>
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<td>Sri Lanka</td>
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<td>Thailand</td>
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<td>Viet Nam</td>
<td>7.6</td>
<td>2.0</td>
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<td>0.28</td>
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Note: * refers to the period 2000 to 2005.

Yet, lack of productive employment opportunities and significant shares of vulnerable employment in some Asia and the Pacific countries (especially those caught in the so-called middle income trap such as Malaysia and Thailand) co-exist with current or forecasted labour shortages in specific sectors – with critical implications for their skill development system and wage policies.

While there is a positive relationship between economic growth and reduction in absolute poverty, how successful growth is in reducing poverty depends to a large extent on the sectoral composition of growth, and the changes it ushers in income distribution. ILO research over the years has highlighted that the critical link between growth and poverty reduction is productive employment – a view that is largely accepted today, even though macroeconomic policy frameworks do not always reflect this.

Mongolia is an example of the glaring discrepancy in recent years between high rates of GDP growth (average of 9 per cent per year between 2002 and 2008) on the one hand and continued high rates of income poverty on the other hand, reflecting a failure of growth to generate sufficient productive employment. The overall poverty rate in Mongolia declined slightly from 36.1 per cent in 2002/03 to 35.2 per cent in 2008, but the rural poverty rate actually rose from 43.4 per cent to 46.6 per cent during the same period. The failure of the high rates of growth to reduce poverty through the creation of and improved access to productive employment is all the more disconcerting as this development took place in a highly conducive demographic context – a sharp decline in birth rates after 1990 resulting in a favourable dependency ratio. The

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\(^5\) See ILO, 2011.
employment elasticity of growth fell sharply from 0.94 in 2000-2003 to a mere 0.26 in 2003-2007. The ranks of the working poor is estimated to have continued to increase from 343,000 to 376,000 between 2002/03 to 2008, and income inequality, as measured by the Gini coefficient, increased from 30 to 33 (Ronnas, 2009).

It is important to note that from a long term perspective, economic growth is essential for productive employment to be generated in a sustained manner, and indeed large parts of the region witnessed significant economic growth before the crisis. Nonetheless, the pre-crisis labour market situation in Asia and the Pacific was far from desirable, and the food and fuel crisis before the recent economic crisis undermined progress in reducing poverty (Islam and Buckley, 2009). The 2008-2009 economic crisis resulted in significant job losses in Asia and the Pacific countries, especially those that are export and FDI driven, leading to declining economic growth rates during the period. Since then growth has picked up, but labour market adjustment and recovery usually take longer. In the recovery and beyond, it is important to work towards economic growth, but it is now equally critical to think of productive employment as a development goal in its own right, and a cross-cutting objective that can help in the realization of other goals.
3. Employment strategies to underpin the macroeconomic framework

The success of macroeconomic policy in generating employment and reducing poverty would depend to a large extent on the circumstances of each country, and the appropriately assessed empirical realities. For a large number of developing countries in the region, poverty reduction will continue to be the main development objective, and macroeconomic policy would need to be oriented towards that objective. While there is no one strategy fits all, a common direction towards greater coherence between growth and employment is warranted. Indeed, this has been a factor contributing towards a greater focus on employment by initiating the process of formulation of Employment Strategies/Policies (such as in Cambodia, China, India, Malaysia, Mongolia, Nepal, Pakistan, Philippines, Sri Lanka and Viet Nam), or by mainstreaming employment in the national development framework (such as in Indonesia).

It is critical that these strategies are based on informed analysis – labour market assessments, employment diagnostic analyses and where possible, labour market and sectoral forecasts. The diagnostic framework enhances the understanding of factors responsible for inadequate employment growth and based on such an understanding, suggests policy responses to raise the employment content of growth to match a predetermined target that would address the country’s employment needs. ‘Employment targets’, like the commonly used national ‘growth targets’ set the employment goal as per the country’s requirements over a specific time period. It is important to stress that these employment targets need to be based on reliable empirical estimates and assumptions about employment elasticities, GDP growth and labour supply.7

Reliable labour market information, therefore, is essential for meaningful employment policy development. While some countries in Asia and the Pacific have excellent capacity in this regard, some others, especially the poorer ones, have no or irregular Labour Force Surveys, which poses a problem for policy formulation.

3.1 Consultations with key stakeholders

Effective stakeholder consultations are the basis of a well-designed employment strategy, as also noted in the Employment Policy Convention, 1964 (No. 122). Since employment outcomes depend on the policies and mandates of various ministries, coherence between different policy spheres is the basis of an appropriately designed employment strategy, and ideally require the active involvement of several ministries, particularly the economic, finance and sectoral ministries, coordinated by the ministry of labour. Critical to an employment strategy is consensus building through consultations with key stakeholders, especially relevant ministries, and workers and employers organizations. An important element of the employment strategy is centralizing employment in macroeconomic policies, in sectoral policies and in enterprise development policies to address the demand side of the problem. On the supply side, and equally important, are active and passive labour market policies, skill development policies, and effective labour market institutions. Depending on the country’s specific context, the employment strategy could focus on women, youth and vulnerable groups. Periodic reviews of this strategy are required, as also an appropriate monitoring mechanism.

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7 For a further discussion on employment targets, see Campbell, 2010.
3.2 Mainstreaming the employment outcome in economic policies

For desirable employment outcomes, it is useful to conduct employment impact assessments of current economic policies. Each of these economic policies has their own objectives, but employment generation could be included as another core objective.

The overall employment intensity of growth is influenced by the sector composition of growth in the economy, as different sectors are characterized by different employment intensities. Employment outcomes would need to be carefully considered in a country’s industrial and/or development policy, which could promote a structural shift in output and employment. Employment content analysis of key sectors and sub sectors, and value chain analysis are therefore important for strategizing and focusing on sectors that are most promising for both economic growth and employment growth in both the short and long term. The Philippines and Indonesia, for example are currently working towards integrating decent employment in industrial policies and sectoral strategies.

Public investment, especially in infrastructure, is critical to promoting employment in developing countries in the region as well as for crowding in private investment. Where there is a choice of technology in public works programmes, the use of labour-based technologies could enhance the employment content of investment and ensure a balance of employment intensity and long term sustainability without compromising on efficiency and quality. This is especially relevant for countries in the region where there is surplus labour and low wages. Well-designed public investment in infrastructure, carried out in a fiscally sustainable manner raises aggregate demand. Indeed stimulus packages in the aftermath of the economic crisis in some Asia and the Pacific countries, notably China, were focused on investment in infrastructure to create employment.

Macroeconomic policy needs to boost investor confidence as private investment is key to enterprise development and job creation. Current proposals for reforming the financial system could take into account the need to provide access to finance to SMEs and reduced rates of interest on loans to employment intensive sectors. Several central banks in Asia and the Pacific – for example in Bangladesh, China, India, Republic of Korea, Malaysia and Thailand reduced interest rates during the 2008 financial crisis to promote enterprise development and employment growth. On the other hand, while increasing tax revenue is the main objective of tax policy, it could be used to create incentive structures for better employment outcomes, by for example, not discouraging employment generation by levying higher taxes on enterprises that employ more workers, or by providing subsidies that distort factor prices in favour of greater capital intensity. A review of macroeconomic policies in India indicates that in the formal manufacturing sector, there are fiscal and monetary incentives (e.g. capital investment subsidy, interest subsidy, export proportion capital goods scheme, credit-linked capital subsidy for technological upgrading of small scale industries, etc.) that may have played a role in encouraging an excessive use of capital relative to labour.8

Studies in Viet Nam carried out as part of the background research for the development of the Employment Strategy finds that policies discriminate against non-state enterprises, (especially SMEs, which make up 95 percent of all enterprises and employ a large share of the non-agriculture workforce) vis-a-vis state owned, enterprises. As a result they earn much lower profit

8 A review of macroeconomic policies in India for example indicates that in the formal manufacturing sector, there are fiscal and monetary incentives (e.g. capital investment subsidy, interest subsidy, export proportion capital goods scheme, credit-linked capital subsidy for technological upgrading of small scale industries, etc.) that may have played a role in encouraging an excessive use of capital relative to labour. Some of these measures may have been conceived as instruments for encouraging investment and growth of industries, but an indirect effect of such measures has been to distort the relative prices of critical factors of production. The draft employment policy for India therefore calls for a careful review of these capital subsidies. See Chandrashekar, 2008.
in spite of very little differences in revenue per worker, which inhibits their growth and better quality employment generation.9

Trade openness has been a characteristic feature of many countries in the region, and indeed growth in Asia and the Pacific has been largely export-led. This process has been driven by manufacturing in many countries in the region, while some, such as Mongolia have relied on export of natural resources. This has implications for the level and structure of employment as well as for the economic and social impact of external shocks that affect exports. After the 2008-2009 economic crisis the overreliance on foreign markets is being questioned. Suitable policies would be required if a balance between the external and domestic markets is to be achieved. Trade openness is also a reason cited for high labour productivity in export sectors as technological progress is exogenously driven in the form of new products and processes required by developed country markets where most of these goods are destined. Under an export led regime, how successful developing countries from the region are in the creation of more and better jobs depend on the supply response of the economy to trade liberalization.10 As noted in a joint ILO/WTO study, trade policies have major impacts on employment and labour, and greater coherence between the two policy domains is necessary to ensure the there are significant positive effects on both growth and employment (ILO and WTO, 2007). The employment impact of foreign direct investment, (FDI) on the other hand, could be enhanced by subjecting FDI to a ‘national benefit test’, where its relevance to national development needs and productive and sustainable employment is assessed.11

3.3 A gender sensitive employment strategy

An important consideration for an employment strategy in many Asia and the Pacific countries is the gender dimension of growth and employment. Macroeconomic policies are likely to have gender differentiated effects because of women’s and men’s different access to and control over resources and economic opportunities and because the roles they play in the labour market and in the household are often different. Women’s perceived dominant role as care givers has influenced amongst others, the inequitable access of women to social security entitlements as it is assumed that women rely on men’s earnings or social security benefits; the widespread lack of child care support because women are assumed to stay home; and lower wages for women because they are assumed to be secondary income earners (King, 2010). There is an implicit assumption that women are passive recipients in need of assistance rather than being dynamic economic agents in their own right.

While women’s labour force participation differs across the region being higher in East Asia and South-East Asia, than in South Asia, women workers are increasingly found in some of the labour intensive export sectors such as garments, electronics and toys, in agriculture and in the informal economy (ILO and ADB, 2011). Indeed the region’s export-led growth model has largely been based on cheap and flexible female labour, and therefore, the recent economic crisis

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9 The most severe problem is the difficulty in accessing credit, according to a survey by the Central Institute of Economic Management in 2007, which forces them (nearly 80 percent of all SMEs) to resort to more costly informal credit markets. Under a special action plan introduced in 2008, provision for special access of SMEs to funding sources was made, but its coverage has been low as it is primarily meant for export-oriented and high value adding enterprises. There has also been international assistance for funding operations of SMEs. As a result, a larger proportion of them are now in credit relationship with banks, but their inability to provide substantial collateral, however, persists which has led to higher interest rates. It appears that a special window for funding of these enterprises with provisions, for example, of credit guarantee is necessary to ensure their better access to bank credit (Lim, 2010; Papola, 2010).

10 See Lim, 2010 for an analysis of relatively slow employment growth in the export sector in Viet Nam, explained in part by trade policies that sought to encourage FDI and capital intensive manufacturing.

11 For further discussion, see for example Islam, 2005.
which hit the export sectors has also affected women workers adversely. In Cambodia, where the garments sector which has a 90 percent female workforce led economic growth, but was also the most affected by the crisis – resulting in increased vulnerabilities for women workers in the country (Dasgupta and Williams, 2009). In some South Asian countries, there is huge potential of increasing women’s participation in the labour market. Often women’s employment in the formal sector is confined mainly in public sector jobs such as in central administration or in education and health. In spite of improvements over time, there is still a significant gender gap in wages - women still earn 54 to 90 percent of what men earn in Asia and the Pacific countries (UNDP, 2010). This reflects women's lower skills levels in general as also their lower access to assets, lower access to credit and socio-cultural norms that contribute towards labour market discrimination. In many Asia and the Pacific countries, the unemployment rate for women is higher than that for men, with the rate of unemployment for young women being the highest. The promotion of women’s productive employment would need specific policy recommendations which include creating an enabling environment for women’s work, through family friendly policies and equal opportunity legislation and action. Also social provisioning, such as investments in education and health, enhances capabilities of the poor and of women and should be viewed as an investment by economic policymakers rather than a cost.

Taking note of the lack of productive employment opportunities for women, the draft employment policy for India (2008) takes into account the special circumstances and problems of women, including measures aimed at shifting women from invisible to visible work, from low income employment in agriculture, to higher income sectors, and from low wage and no social security to higher wage with social security. More specifically it includes provisions for access to credit for women entrepreneurs both in the formal and informal sectors (including home-based workers), recommends an impact analysis of technology policies on women’s work and employment, identifies specific sectors that are women dominated for special measures to improve decent work and promotes strategies for women in the formal and informal sectors for skill development, access to information and child care.

3.4 Enhancing productivity and employment for sustainable growth

A critical issue in the process of centralizing employment in macroeconomic policies is the relationship between employment growth and labour productivity growth. In a majority of Asia and the Pacific countries, productivity remains low as a majority of the workforce are engaged in agriculture and in the informal segments of the economy which are characterised by low productivity. Workers in these sectors are typically vulnerable and many of them are ‘working poor’. Developing countries in Asia and the Pacific are therefore faced with the challenge of not only creating more jobs, but jobs that are more productive.

However, in general, often a negative relationship between productivity growth and employment growth is assumed as productivity is calculated as GDP or value added per worker. In that case, if the number of workers goes up, value added remaining constant, productivity falls. But for a growing economy where both GDP and the number of workers are rising, this assumption of trade-off between employment growth and productivity growth need not hold. In fact, given appropriate policies, both productivity and employment could rise. There may, however, be a trade-off between employment and productivity in the short run in particular sectors. Coordinated economic and social policies are needed to address the lack of productive employment in rural areas, both in agriculture and non-agriculture. This may require a structural

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12 See ILO, 2009a.
13 For a detailed discussion on this issue, see ILO, 2005.
shift – from agriculture into other more productive sectors, and wide ranging reforms in land holdings, in access to markets, skills and in agricultural services.

ILO research has shown that amongst ASEAN countries, there is a significant positive relationship between productivity growth and decline in vulnerable employment.\textsuperscript{14} While it may be counterproductive to opt for technology choice based on its labour-absorptive capacity alone, it is crucial that the right balance between technology and employment considers the sectoral context, the country’s industrial landscape, the country’s demographics and its development objectives.\textsuperscript{15}

\textsuperscript{14} See ILO, 2008b.
\textsuperscript{15} This argument has been elaborated in Auer and Islam, 2006.
4. Fiscal policies and employment

Fiscal policies (public spending, taxes and debt management) are an important part of the macroeconomic framework. Nonetheless, such policies in stabilizing and fostering growth and employment were largely underutilized previous to the crisis. Based on concerns over fiscal deficits and national indebtedness and influenced by structural adjustment programmes, the emphasis fell rather on monetary policy. In effect, fiscal policies were given little room to address decent work deficits.

In the wake of the global economic crisis however, there has emerged renewed commitment to the role of fiscal policies in fostering growth and employment. Countries around the Asia and the Pacific have undertaken significant discretionary fiscal stimulus packages to address the impacts of the crisis, with the size of those packages (as a share of GDP) in many countries in Asia exceeding the average of G20 countries (figure 1). Furthermore, these packages have included considerable measures to stimulate labour demand, protect jobs and the unemployed, extend social protection and promote social dialogue.¹⁶ A number of countries have committed themselves to reaching specific labour market targets, with Australia for example targeting to soften a rise in the unemployment level by 1.5 percentage points compared to a no-stimulus scenario. Some packages have also sought to promote longer-term goals such as green growth and jobs.

![Figure 1. Size of discretionary fiscal stimulus, 2009 (per cent of GDP)](chart)

There are significant variations on the size of countries’ fiscal stimulus package, with China’s exceeding 10 per cent of GDP and the Philippines around 2 per cent of GDP (World Bank, 2009). There are also large differences in the composition of those packages, with some countries such as Indonesia relying more on tax cuts while other countries such as Cambodia have tilted

¹⁶ Based on an ILO survey of 54 countries. See ILO, 2009b.
towards spending. Furthermore, some countries have been able to rely to a greater extent than others on automatic stabilizers compared to discretionary policies to deliver the stimulus.  

In many instances, the stimulus packages, combined with declining government revenues as a result of the global downturn, have contributed to increased government deficits, raising concerns at the global level about the sustainability of public debt (figure 2). In some countries, this has led to a debate on who will shoulder the burden of increasing budget deficits and rising government debt. It is critical that through social dialogue a balance is reached between the need to support the livelihoods of the current working age population and the burden that the future labour force will have bear.

Figure 2. Public debt as a proportion of GDP (%)

Source: IMF, World Economic Outlook Database, September 2011.

While many countries responded to the crisis rapidly by implementing fiscal stimulus packages, some lower-income Asia and the Pacific countries have struggled in this regard due to a lack of fiscal space. In many of these cases, the question of policy space to enact fiscal stimulus packages is a structural issue, as is their capacity to engage in counter-cyclical policies (Islam, 2009). Addressing these issues will require a renewed commitment to domestic resource mobilization, reorientation of policies and better preparedness to cope with global downturns to enhance both fiscal and policy space in sustainable ways. For countries undergoing decentralization in the region, such as Indonesia, it will also require close coordination between the centralized revenue collection and the decentralized management of expenditures.

All these challenges highlight even further the need to create decent work – fiscal balances will be further strained if high levels of unemployment and underemployment lead to lower tax revenues and higher unemployment compensation. Policies must be put in place to provide the older generation and the younger ones with decent work so that all are better placed to address debt and deficit concerns. Creating decent work contributes to better long-term fiscal performance.

17 Automatic stabilizers are cyclical features of the economy, such as tax revenues (which reduce in recessions) and safety net payments (which increase in recessions) that automatically dampen fluctuations in real GDP without explicit government policy action. When incomes are high, tax liabilities rise and eligibility for government benefits falls, without any change in the tax code or other legislation. Conversely, when incomes slip, tax liabilities drop and more families become eligible for government transfer programs, such as food stamps and unemployment insurance that help buttress their income.
The multiple approaches to fiscal policies and its potential burden on fiscal balances underscore the importance of having in place strong and effective tax and transfer systems. However, a key challenge for many countries in Asia and the Pacific is that these systems are often weak, which is often reflected on low tax-to-GDP ratios. Strengthening the tax and transfer system will require building capacities to collect taxes, including bringing the informal economy into the economic mainstream. It will also require broad agreement on appropriate levels and patterns of taxation that do not create undue obstacles to employment creation and productive investment in sustainable enterprises while ensuring that the gains from growth and productivity are more widely shared, including through the progressivity of the tax system. Such efforts however are complicated by globalization, which appears to have exerted a downward pressure on taxation levels. Levels of taxes on capital and high-income earners, the former which is more mobile than labour and the latter which is relatively more mobile than low-income earners, may have contributed to a decline in corporate tax rates and on the top marginal tax rates on personal income in region (figure 3). On the other hand, levels of indirect taxes, such as consumption taxes, have changed little in the past years. Such trends raise important implications on the progressivity of the tax system as consumption taxes weigh more heavily on the poor, given their higher share of income that is spent.

Figure 3. Average tax rates in Asia and the Pacific (%)

Note: Average of 15 Asia and the Pacific countries: Australia, China, India, Indonesia, Japan, Republic of Korea, Malaysia, New Zealand, Pakistan, Papua New Guinea, Philippines, Singapore, Sri Lanka, Thailand and Viet Nam. Indirect tax rate for 2003 not available.
Source: Author's calculations based on KPMG’s Corporate and Indirect Tax Rate Survey 2009 and KPMG’s Individual income tax and social security rate survey 2009.

Strengthening the tax and transfer system is all the more important as these systems may have indirectly contributed to the global economic crisis. The Commission of Experts of the President of the United Nations General Assembly on Reforms of the International Monetary and Financial System for example finds that the transfer of wealth from those with larger propensities to spend, such as the poor, to the wealthier weakened aggregate demand at the global level, thus contributing to the global imbalances that played an important role in the crisis (Commission of Experts of the President of the United Nations General Assembly on Reforms of the International Monetary and Financial System, 2009).
It is clear that countries can better harness fiscal policies, including the tax and transfer systems, to play an improved role in facilitating a more inclusive and balanced growth in Asia and the Pacific. Fiscal policies aimed at stabilization that do not address the needs of the poor not only weaken their stabilization objective and increases inequality and poverty, but also jeopardizes long-term growth (Ravallion, 2008). There is increasing awareness that governments should play an active role in facilitating industrial upgrading and that fiscal policy, in particular public spending on infrastructure and social safety nets, enhances growth potentials and in due course can generate enough tax revenues to cover the initial investment (Lin, 2010). As countries move forward on all these issues, it will be essential to take into account the financing and sequential implementation of a social protection floor.
5. A social protection floor

The global economic and financial crisis has further corroborated the argument that balanced economic and social development requires a solid foundation in the form of a social protection floor – including improved access to employment opportunities; affordable access to basic healthcare; social protection and education for children, income security for the elderly, and people with disabilities; social assistance for the poor or unemployed; and other features that vary according to country needs and stages of development. While some countries face clear challenges in relation to fiscal space and taxation, there is strong evidence that such a social protection floor can be made affordable in most countries in Asia and the Pacific. For example, providing a basic set of cash benefits to all elderly, families with children, and poor of working age in India would cost 2.2 per cent of GDP; in Pakistan, 2.4 per cent of GDP; in Viet Nam, 2.9 per cent; in Bangladesh, 4.6 per cent; and in Nepal, 5.7 per cent (ILO, 2008c and Mizunoya et al., 2006).

The recent global economic crisis has highlighted gaps in social protection systems in countries in Asia and the Pacific, including for the near poor who recently escaped poverty and faced the prospect of slipping below the poverty line as they lost their jobs in export-oriented industries. With a large share of women in export-orientated industries, women have been particularly vulnerable. In this regard, unemployment insurance can function as an automatic stabilizer that cushions the impact of the economic shock and help maintain aggregate demand.

The majority of countries in Asia and the Pacific however do not have unemployment insurance systems in place, although the crisis has prompted some countries such the Philippines to further explore the feasibility of introduction. Malaysia has recently launched its JobsMalaysia centres, aimed at supporting jobseekers secure employment. Furthermore, even where an unemployment insurance scheme exists, benefits are not often accessible to the unemployed due to contribution requirements (figure 4). Moreover, with large shares of the labour force employed in the informal economy, unemployment schemes are often not accessible to such workers.

**Figure 4. Share of unemployed receiving unemployment benefits (%)**

<table>
<thead>
<tr>
<th>Country</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Australia</td>
<td>80</td>
</tr>
<tr>
<td>Korea, Rep. of</td>
<td>70</td>
</tr>
<tr>
<td>New Zealand</td>
<td>60</td>
</tr>
<tr>
<td>China</td>
<td>40</td>
</tr>
<tr>
<td>Japan</td>
<td>30</td>
</tr>
<tr>
<td>Thailand</td>
<td>20</td>
</tr>
</tbody>
</table>

*Source: ILO-SECSOC database on the basis of national sources, latest available year.*
In addition to smoothing consumption, an effective unemployment insurance system can support countries’ efforts to rebalance the sources of growth, through for example freeing up excessive precautionary savings for consumption or investment or in facilitating the structural shifts that are bound to accompany the rebalancing process. Furthermore, unemployment insurance systems can provide a wealth of information on labour markets based on which constituents in the region can design, implement and monitor relevant policies (Scholz et al., 2009). As economies in Asia and the Pacific recover from the crisis, consideration could be given to putting in place unemployment insurance systems that could consequently be scaled up and expanded in the event of a crisis.

Previous to and in the aftermath of the crisis, countries in the region have undertaken various initiatives to sequentially build elements of the social protection floor and facilitate access to higher levels of social security. China is currently in the midst of an ambitious reforms to extend social protection, including old age pension and health insurance to the rural population. In 2006, Viet Nam introduced the Social Insurance Law, which stipulated the introduction of compulsory social insurance in 2007, introduction of voluntary social insurance in 2008, and the introduction of unemployment insurance in January 2009.

An alternative policy to provide income security and affordable access to healthcare is through non-contributory programmes. Thailand for example secured over several years nearly universal access to basic healthcare services when – in addition to existing (since 1991) social health insurance for formal economy workers – the country implemented the tax-financed non-contributory public health scheme. The scheme was known at the beginning as the 30-baht scheme, and has now been transformed into the national health scheme. Pacific Island States are budgeting for higher spending on health and education, in part to address the impacts of the global crisis (ADB, 2010). Another area where universal non-contributory social security provisions are being debated and gradually implemented and expanded is income security for old age. Asia and the Pacific is clearly ageing at an unprecedented rate. The region’s population aged 55 is projected to expand at the fastest rate compared to other age cohorts across all the sub-regions in Asia and the Pacific between 2010 and 2020, increasing the number of these persons by nearly 38 per cent, or an increase of 234 million. A large majority of the elderly in the region now have no entitlements to any pension, and a large majority of those who are now of working age and will be elderly in 2050 do not contribute to any pension scheme and have no prospect to do so in the foreseeable future. In this situation, the most effective way to avoid mass poverty in old age is to start building at least basic pension provisions on a non-contributory basis. Nepal has long provided basic pension to all residents over 75, and is now considering expanding it to all over 65 and to increase the amount. Thailand started recently to pay a very basic pension to all elderly, originally as an ad-hoc anti-crisis measure. Now the country is discussing making the pension a permanent solution as well as increasing the amount paid. Various forms of non-contributory pensions are also being implemented or considered in several other Asia and the Pacific countries such as Bangladesh, India, and Sri Lanka.

Countries in the region have also sought to enhance the reach of social assistance to the poor or needy households (minimizing the exclusion errors) while keeping targeting costs at an affordable level (there exists here a trade-off between perfection of targeting and the costs of targeting). In this regard, a promising approach is to strengthen the self-targeting component of existing programmes, a move which would encourage beneficiaries to enrol when in need and drop out when better opportunities arise in the economy elsewhere. Employment programmes and targeted cash transfers are generally regarded as the most effective way for governments to support the purchasing power of vulnerable households. Employment programmes can create much-needed employment opportunities in local public works projects and the fiscal cost of such measures automatically declines when the number of beneficiaries falls back. India’s National Rural Employment Guarantee Act (NREGA) is one such employment programme in the region.

For further discussion, see Hagemejer and Kim, 2009.
offering 100 days of work per household in rural areas at the minimum wage for agriculture to those that demand it.

Other countries have introduced social assistance programmes that seek to influence household behaviour by tying supplemental income to choices that improve their human capabilities in the long run. The Government of Indonesia, for example, has been implementing a conditional cash transfer (CCT) since 2007 known as the Program Keluarga Harapan (PKH), or Hopeful Family Program, that provides cash transfers to chronically poor households linked to certain mandated behaviors, including sending children to school and attending health clinics. The Indonesian Government is also in tandem implementing a CCT programme that targets communities rather than households. Launched together with the PKH but in different districts, the Program Nasional Pemberdayaan Masyarakat Generasi Sehat dan Cerdas (PNPM Generasi), or National Community Empowerment Program for a Healthy and Smart Generation, provides block grants to communities and enables them to decide how best to use the grants as long as they are used for improving health and education conditions. For example, grants have been used for education materials for children and roads to education and health services. Such community-targeted conditional cash transfers address one of the shortcomings of household-targeted cash transfers, which is that they do not address supply-side constraints such as lack of education infrastructure.

As programmes targeted at low-income households, CCTs cannot replace a universal basic social protection system. They can, however, contribute to expanding the coverage of existing systems and evidence from impact evaluations indicate that they have in general resulted in a reduction in child labour, have had positive impacts on education and health outcomes and no significant negative impacts on the labour market participation of adults (Fiszbein and Schady, 2009).

Figure 5: Public spending on social protection (percentage of GDP)

<table>
<thead>
<tr>
<th>Region</th>
<th>Percentage of GDP</th>
</tr>
</thead>
<tbody>
<tr>
<td>Western Europe</td>
<td>25.1</td>
</tr>
<tr>
<td>Central and Eastern Europe</td>
<td>18.9</td>
</tr>
<tr>
<td>North America</td>
<td>16.0</td>
</tr>
<tr>
<td>North Africa</td>
<td>13.6</td>
</tr>
<tr>
<td>CIS</td>
<td>13.5</td>
</tr>
<tr>
<td>Latin America + Caribbean</td>
<td>10.2</td>
</tr>
<tr>
<td>Middle East</td>
<td>9.8</td>
</tr>
<tr>
<td>Asia and the Pacific</td>
<td>5.3</td>
</tr>
<tr>
<td>Sub-Saharan Africa</td>
<td>5.3</td>
</tr>
<tr>
<td>Total</td>
<td>8.4</td>
</tr>
</tbody>
</table>

Note: Data are based on latest year available, weighted by population
Source: ILO-SECSOC estimates.

Building and strengthening a social protection floor is a critical issue for countries in Asia and the Pacific, which has an estimated 1.1 billion workers in vulnerable employment and 850 million workers living with their families on less than US$2 per day. Allocating more resources to social protection, which in many cases will entail re-prioritizing and reallocating existing resources, and spending resources more effectively, is all the more important as countries in the region seek to further integrate into and play a leading role in the world economy, thereby increasingly exposing
themselves to external shocks as evidenced in the recent economic crisis. A public-supported social protection system can also be instrumental in reducing excessive precautionary savings. Nonetheless, the region relative to others invests less in social protection, with expenditures on healthcare and cash social security transfers as a share of GDP averaging 5.3 per cent in Asia and the Pacific (figure 5).

With various economic integration initiatives underway in the region, including APEC, ASEAN, Pacific Island Forum, and SAARC among others, the issue of employment creation and social protection becomes all the more important. Trade and investment liberalization as part of integration initiatives drives structural transformations, resulting in increased labour market turnover and adjustments costs. Employment and social protection policies and institutions are required to provide adjustment assistance to workers and enterprises. In particular, if integration efforts include the mobility of labour, the social protection needs of migrant workers will need to be addressed and there will be greater pressure to reduce differences in social protection arrangements between countries. In recognition, ASEAN Member Countries for example are committed in reducing development gaps in the region, including in their social protection systems.

19 Chamon and Prasad (2010) for example find that health expenditure related risks largely explain the dramatic increase in saving rates among elderly urban households in China recently.
20 ASEAN Member Countries in their Charter have for example committed to the “movement of business persons, professionals, talents and labour”, ASEAN Charter, Article 1, Paragraph 5.
6. Policy coordination and coherence for inclusive and balanced growth and decent work

Asia and the Pacific includes a diverse set of countries – in terms of level of development, political charter, labour force size and structure, openness to trade and investment, size of rural sector and labour market institutions. The recent economic crisis has affected countries in the region differently. But the challenge of productive employment generation prior to the crisis and the need for a jobs-based recovery as highlighted in the Global Jobs Pact is a theme common to countries in the region.

While Asia and the Pacific has grown at a remarkable pace prior to the crisis, and continues to grow, the disjoint between economic growth and quality jobs has been stark, as has been the rise in income inequality. The crisis has exposed the structural imbalances in the region. As reflected in the statements of political leaders in Asia and the Pacific, and the leaders of the G20, it can no longer be ‘business as usual.’ There is now a commitment to focus on quality jobs and decent work, and on an effective social floor. This requires a reorientation of the macroeconomic policy goals towards the MDG 1 target of ‘full and productive employment and decent work for all, including young men and women’ and sustaining an effective social protection floor. While economic stability and price stability are extremely important objectives of macroeconomic policy, there is a need to move away from over-emphasis on these narrow targets at the cost of all else.

Coherence between economic and social policies and focus on quality jobs and social protection is required, which in turn calls for having in place employment strategies based on a participatory dialogue process, combined with basic social protection for all. The priorities identified in such employment strategies will differ as countries face different opportunities and challenges. Some countries in the region will continue to have labour supply pressures and challenges of youth employment, while others will need to cope with an increasingly ageing population and shrinking employment-to-population ratios in the near future. The incorporation of lessons learnt from the 1997/98 Asian financial crisis and the unprecedented global, regional and national efforts to coordinate fiscal stimulus packages to offset the deflationary effects of the economic crisis on output, consumption and jobs has been an important factor to a quicker and stronger recovery in Asia and the Pacific than originally anticipated. It is critical that the lessons from this crisis are also reflected. Moreover, while significant efforts at coordination were prompted by the severity and reach of the crisis, it should be borne in mind that such coordination is equally relevant and important in non-crisis periods in order to achieve the goal of full employment and decent work. The jobs crisis and decent work deficits that existed even before the crisis is multi-dimensional and requires coordinated macroeconomic, employment and social protection policies, at different levels.

Critically, ensuring coordinated macroeconomic, employment and social protection policies will require policy coordination at the national level, between ministries of labour, economic, financial, planning and sectoral ministries, central banks, statistical offices, and workers’ and employers’ organizations. This will require building the capacities of ministries of labour to take a proactive approach to employment generation in addition to welfare-related functions. Strengthening the capacities of workers and employers organizations to play a more effective role in the coherent policy-making process will also be critical. Social dialogue lies at the heart of achieving sustainable and meaningful policy coordination and coherence.

In addition to policy coordination and coherence at the national level, some form of regional and/or global coordination may be warranted. With increased global and regional integration, including trade and labour mobility, the economic and labour market policy actions in one country can bring benefits or costs to labour markets in other countries. Policy coordination can serve to maximize the positive spillovers and minimize the negative spillovers. For example,
coordination may be required to prevent lowering of regulations and taxes that excessively reduce the fiscal capacity and hence the employment support capacity of governments.

The G20, in which a number of developed and developing Asia and the Pacific countries are members of and which has risen as the prominent forum for coordination, is a reflection that the region’s economies are playing an increasingly important role in the global economy, and provides an important means through which regional priorities can be integrated at the global level. It is also clear that coordination at the global and regional levels will be essential to support country efforts in building their social protection floor. Many developing countries in the region lack the fiscal and policy space and supporting these countries to attain the goal of full and productive employment and decent work for all will require a combination of national commitment and international cooperation. In this regard it is worthwhile to note that the OECD Development Assistance Committee, in which several Asian countries are members, has for example noted the need to support national strategies to develop and implement social protections systems through a harmonized and coordinated financing mechanism (OECD, 2009).

The multilateral system also plays a central role in articulating and delivering a global and coherent response to the crisis. In this regard, the United Nations System Chief Executives Board for Coordination have for example committed to nine joint initiatives, including the Global Jobs Pact, aimed at “boosting employment, production, investment and aggregate demand”, and a social protection floor aimed at “ensuring access to basic social services, shelter, and empowerment and protection of the poor and vulnerable. 21 Stronger inter-agency coordination and stronger collaboration with other multilateral organizations and regional organizations, in particular the ADB, ASEAN, Islamic Development Bank, SAARC, IMF, Pacific Island Forum, World Bank, and WTO are also required to address the jobs and decent work crisis and build a stronger foundation for a more balanced and inclusive world economy.

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Coordinated macroeconomic, employment and social protection policies in Asia and the Pacific

Coordinated global, regional and national efforts to support output, jobs and incomes have been an important factor behind the relatively swift recovery from the global economic crisis in Asia and the Pacific. Further strengthening such coordination of economic, employment and social protection policies is critical in supporting a more sustainable and balanced growth in the region. Ensuring that the macroeconomic framework, in addition to addressing economic growth targets, inflation and sustainable public finances, is employment-rich and inclusive provides an important anchor to such coordination. Such a framework needs to be underpinned by gender-sensitive employment strategies and sectoral strategies that integrate employment. Strengthening the tax and benefit system so as to finance a social protection floor while promoting productive investment and employment that generates future tax revenues contributes to both fiscal sustainability and inclusive growth.