

## POLICY FRAMEWORK FOR INVESTMENT USER'S TOOLKIT

### Chapter 8. Human Resource Development

#### Introductory note

The PFI User's Toolkit responds to a need for specific and practical implementation guidance revealed from the experience of the countries that have already used or plan to use the PFI.

Development of the Toolkit has involved government users, co-operation with other organisations, OECD Committees with specialised expertise in the policy areas covered by the PFI and interested stakeholders.

Against this background, this document offers guidance relating to the Human Resource Development chapter of the PFI.

The PFI User's Toolkit is purposely structured in a way that is amenable to producing a web-based publication. A web-based format allows: a flexible approach to providing updates and additions; PFI users to download the guidance only relevant to the specific PFI application being implemented; and a portal offering users more detailed resources and guidance on each PFI question. The website is accessible at [www.oecd.org/investment/pfitoolkit](http://www.oecd.org/investment/pfitoolkit).



© OECD – 2012. A publication of the Investment Division of the OECD Directorate for Financial and Enterprise Affairs. OECD freely authorises the use of this material for non-commercial purposes. All requests for commercial use or translation of this material should be submitted to [investment@oecd.org](mailto:investment@oecd.org).

This work is published on the responsibility of the Secretary-General of the OECD. The opinions expressed and arguments employed herein do not necessarily reflect the official views of the Organisation or of the governments of its member countries.

This document and any map included herein are without prejudice to the status of or sovereignty over any territory, to the delimitation of international frontiers and boundaries and to the name of any territory, city or area.

## Human Resource Development

Human resource development (HRD) policies concern the quality of the labour force and the regulation of the labour market. Quality in turn is a function of basic and higher education, training programmes and the overall health of the population. The quality and adaptability of the labour force is a key driver in creating a favourable environment for both domestic and foreign enterprises to grow through new investment and to adapt quickly to changing circumstances. Their relative roles and the overall importance of HRD depend on individual country circumstances, particularly the economic structure.

Even more important than these individual HRD policies is the interaction among them. Attempts to boost workforce skills through vocational training without considering their interaction with basic educational attainment or flanking labour market policies are likely to be ineffective. Human resource development requires a comprehensive strategy that takes full account of the linkages between, for example, improved population health on educational attainment and, depending on employment policies, on labour productivity.

This chapter deals with how human resource development policies can contribute to an environment that is attractive to domestic and foreign investors and can enhance the benefits of investment to society. A premise of the chapter is the linkage between government and private investments in education, training and population health with physical investment: increased investment in human resource development attracts higher capital spending by enterprises, provided the general business environment is appropriate. The chapter examines and distils the lessons from how government HRD policies, including labour market policy, bear on business investment decisions and the key features that determine their success from a wider development perspective.

The 10 PFI questions on Human Resource Development relate to:

- HRD policy framework
- Basic schooling
- Higher education
- Training programmes
- Health

*Labour market laws and regulations:*

- Core labour standards
- Balancing multiple objectives of labour market regulations
- The role of foreign workers
- Labour market adjustment
- Labour market regulations and workforce adaptability

## **HRD policy framework**

*8.1 Has the government established a coherent and comprehensive human resource development (HRD) policy framework consistent with its broader development and investment strategy and its implementation capacity? Is the HRD policy framework periodically reviewed to ensure that it is responsive to new economic developments and engages the main stakeholders?*

### **Rationale for the question**

Human resource development has multiple dimensions, covering educational attainment, workforce skills, population health and the set of employment policies that provide businesses with workers with appropriate skills and the ability to adapt quickly to new challenges. Each of these areas is a key driver in creating a favourable environment for investment. Because HRD policies are all closely inter-related and must be consistent with a country's broader development and investment policies, they cannot be framed in isolation. Low human resource development needs to be tackled through a coherent and comprehensive strategy that takes full account of the policy linkages and a country's implementation capacity.

The policy framework needs to be flexible in order to respond to the new skill needs created by changing technologies and economic structures. The falling cost and rising quality of information and communication technologies, for example, is raising the demand for skilled workers, making low human resource development an increasing obstacle to inward investment. At the same time, these forces also offer an opportunity for emerging economies to integrate more quickly into the global economy, as businesses restructure their supply chain and operations to gain from regional comparative advantages.

HRD policies must therefore be adaptable and constantly fine-tuned in order quickly to respond to the changing skill needs created by new challenges and to ensure the contribution of investment for development. For this to happen, close co-operation between policy makers and the main stakeholders and periodic assessments of the impact of HRD policies on the business and investment environments are needed.

## Basic schooling

8.2 What steps has the government taken to increase participation in basic schooling and to improve the quality of instruction so as to leverage human resource assets to attract and to seize investment opportunities?

### Rationale for the question

Access to basic education for girls and boys is a human right and educational attainment at the primary and lower secondary levels is a minimum necessary condition for development. Broad access to basic education also underpins a healthy investment environment. Formal educational attainment also provides the foundations for further learning and safeguards the capacity to seize future investment opportunities. Despite positive trends in school enrolment, many countries under invest in human capital, due in part to a range of market failures and poverty. In these circumstances, without policy intervention, investment in early childhood, primary and lower secondary education will be suboptimal, feeding under-skilled workers into the labour market, disconnected with the requirements of business.

*Investment in human capital over two decades in 17 emerging economies has accounted for about ½ of a percentage point in their annual growth, and among OECD countries, one more year of schooling can increase GDP per capita by 4%-7%* OECD/UNESCO (2003), *Financing Education: Investment and Returns*, Paris.

*Human capital is one of the most important determinants of the investment location decision of foreign firms and its importance has grown over time, according to a study of 36 developing countries.*

Noorbakhsh, Farhad et al. (2001), *Human Capital and FDI Inflows to Developing Countries: New Empirical Evidence*, *World Development* 29(9).

*In Latin America and the Caribbean, a 1% decline in the illiteracy rate can increase FDI by 2.6%.*

Daude, C. et al. (2003), "Core labour standards and foreign direct investment in Latin America and the Caribbean: does lax enforcement of labour standards attract investors?" IADB mimeo, Washington.

*Roughly one in five firms in many developing countries rate inadequate skills and education of workers as a major or severe obstacle to their operations.*

World Bank(2005), *World Development Report 2005: A Better Investment Climate for Everyone*, Washington.

Formal educational attainment also provides the foundations for further learning and safeguards the capacity to seize future investment opportunities. Indeed, mastering core competencies of literacy and numeracy are pre-

requisites for effective training programmes later on. Countries with very low basic education thus risk, down the road, missing out on opportunities to move up the value chain by upgrading worker skills. Positive developments in schooling enrolment rates over recent decades have lowered this risk, though in many countries progress has been slow.

Too often families living in poverty and unable to access credit markets have no option but to withdraw their children prematurely from schooling, even though it is in their long term interest to continue. In these circumstances, without policy intervention, investment in early childhood, primary and lower secondary education will be sub-optimal, perpetually feeding under-skilled workers into the labour market, disconnected with the requirements of business. Sub-Saharan Africa and South Asia offer a stark example. According to the World Bank, in year 2000 more than 40 per cent of those aged 25 and over in these regions had not completed any formal education.

Basic education is especially prone to country-specific constraints. Moreover, successful basic education systems vary widely, making general policy guidelines hard to formulate, but certain general principles nevertheless apply. First, governments need to aim to extend access to all, not just the elite. Second, they should consider further development of basic education by, for instance, extending the length of compulsory education to at least the lower-secondary level. Better quality of basic education is also important. This can be facilitated through streamlining of learning objectives designed to impart core competencies and promote creativity, and by strengthening the relationships of accountability.

A strategy that tries rapidly to boost the level of access and quality of primary and lower-secondary level education runs the risk of encountering supply constraints, delaying the improvements to the investment climate that flow from better human resources. This risk can be reduced by better service delivery procedures, such as voucher schemes, and by giving schools and communities more autonomy for budget management, provided they meet pre-defined performance criteria.

## Higher education

8.3 *Is the economic incentive sufficient to encourage individuals to invest in higher education and life-long learning, supporting the improvement in the investment environment that flows from better human resources? What measures are being taken to ensure the full benefit of a countries' investment in its own human resources accrues, including the attraction of nationals who have completed their studies abroad? What mechanisms exist to promote closer co-operation between education institutions and business and to anticipate future labour force skill requirements?*

### Rationale for the question

Workers with higher secondary and tertiary education are essential to help secure the full benefits of business investment.

Unlike with basic education, graduates are usually able to internalise the benefits in the form of higher wages. There is a danger that the benefits to society and to the local business community are forfeited to the extent that skilled workers permanently emigrate. This risk is greater in small-sized economies than in the larger ones, where return migration is common. One way to lower the incentive for skilled workers to migrate and to reap the full benefit of a countries' investment in its own human resources is to pay attention to the size of the financial returns from higher education. Labour market policies that result in compressed wage structures and costly graduate programmes in terms of time taken and tuition fees can unduly crimp the size of the financial returns that subsequently accrue. More generally, a better business environment lifts the financial returns to investing in education, reduces the incentive to emigrate and favours return migration.

Higher education institutions themselves play a key role in equipping young people with the workforce skills needed by business. But these needs change quickly and often learning institutions are slow to respond. In this regard, stronger links between universities, businesses, trade unions and other stakeholders can help reshape course offerings to stay closely in line with evolving demands for specific skills. Co-operation can also bring other benefits favouring the investment environment, such as fostering an environment conducive to innovation and the quick diffusion of new knowledge.

## **Training programmes**

*8.4 To what extent does the government promote training programmes and has it adopted practices that evaluate their effectiveness and their impact on the investment environment? What mechanisms are used to encourage businesses to offer training to employees and to play a larger role in co-financing training?*

### **Rationale for the question**

While formal education equips individuals with the skills needed to learn, new recruits tend to lack the firm-specific knowledge that businesses require to unlock an employee's full productive potential. Transmitting these firm-specific skills is the domain of on-the-job training and specialized off-site training. As with basic education, market failures lead to too little training by businesses and the limited training that is undertaken is often concentrated within a narrow group of individuals. The shortage of trained workers is thus an obstacle to expanding investment and makes it particularly hard to attract high skill-intensive industries. The macroeconomic costs in terms of lost potential output can also be sizeable, given the productivity gains linked to training and because of the positive spillovers that multinational enterprises transmit to local firms. Policy instruments to support training are many and include co-financing arrangements, tax incentive schemes and subsidies. Evaluations of these instruments are likely to be country specific. What is important from the investment environment perspective is to ensure stable training programmes that are in line with business requirements and coupled with evaluations to favour those schemes with a proven track record of high rates of return.

## **Health**

8.5 *Does the government have a coherent strategy to tackle the spread of pandemic diseases and procedures to evaluate public health expenditures aimed at improving public health outcomes and, through inter-linkages, the investment environment?*

### **Rationale for the question**

Pandemic and epidemic diseases, such as malaria and HIV/AIDS, are a human tragedy, ravaging societies through the premature loss of lives and entrapping many others in poverty. They also discourage investment, risking a vicious cycle between poor health, lower investment, job creation and entrepreneurship and hence slower economic growth. At the same time, the links between health, education and economic growth can equally work in a virtuous way. Apart from the human benefit, better population health raises the ability and the incentive to invest in education, and promotes investment, because of the effect of good health on worker productivity and because domestic and foreign businesses tend to avoid sending employees into regions where their health could be damaged and where access to health care is limited. Designing the policies that favour a virtuous cycle between health, investment and sustainable development when faced with limited resources is hard to get right. The lessons from successful experiences underscore the importance of a coherent and comprehensive package of policies. Beyond ensuring broad access to essential medicines public health programmes need to be evaluated regularly to assess their effectiveness, since what works well in one country may not work equally well elsewhere.



## Core labour standards

8.6 What mechanisms are being put in place to promote and enforce core labour standards?

### Rationale for the question

Core labour standards are a series of rules and principles regarding the minimum standards recognised by the international community for treating workers humanely. Although many kinds of labour standards exist, the ones referred to as the four core labour standards are those that the international community has agreed are applicable to all countries because they protect basic human rights. Enforcement of these standards benefits a country as a whole, not only its workers, because the core labour standards are central to the healthy functioning of market economies. They create a level playing field for both foreign and domestic investors thereby improving economic performance.

Adopting the core labour standards serves countries' economic self-interest. A number of studies find no evidence to support the belief that multinational enterprises favour countries with lower respect for basic human and worker rights. On the contrary, evidence suggests that multinational enterprises are more likely to invest in countries with stricter safeguards and enforcement of basic human and worker rights than in those countries where such rights are absent or poorly enforced.

### Key considerations

The core labour standards are fundamental principles that protect basic human rights in the workforce. The international community, largely through the International Labour Organization (ILO)—a United Nations agency bringing together representatives of governments, employers and workers—has developed a consensus with respect to the definition of the core labour standards. As stated in the *ILO Declaration on Fundamental Principles and Rights at Work* (1998) the core labour standards aim to: (1) eliminate all forms of forced or compulsory labour; (2) effectively abolish child labour; (3) eliminate discrimination in respect of employment and occupation; and (4) ensure the freedom of association and the right to collective bargaining.

Specific definitions of these principles are spelled out in eight ILO core labour standard conventions, also known as the fundamental human rights conventions. These are:

- *Elimination of forced and compulsory labour* (Conventions 29 and 105) where forced labour is “all work or service which is exacted from any

person under the menace of any penalty and for which the said person has not offered himself voluntarily.”

- *Abolition of child labour* (Conventions 138 and 182). Aside from violating children’s basic human rights, sending children to work rather than to school perpetuates poverty and compromises economic growth. Each signatory, regardless of level of economic development, agrees to design and implement a course of action, effectively monitor implementation and apply appropriate sanctions.
- *Elimination of discrimination in respect of employment and occupation* (Conventions 100 and 111) is central to achieving greater social justice while also promoting development through a more efficient allocation of resources. Discrimination includes “any distinction, exclusion or preference” made “on the basis of race, colour, sex, religion, political opinion, national extraction or social origin, which has the effect of nullifying or impairing equality of opportunity or treatment in employment or occupation...”.
- *Freedom of association and collective bargaining* (Conventions 87 and 98). The right for workers and employers to freely create and participate in organisations to promote and protect their interests is a fundamental principle behind the ILO’s work. Signatories must give workers and employees the right freely to establish and join organisations of their choice, without any type of prior authorisation. Signatories further agree to establish mechanisms to ensure the right to organise and to encourage the practice of negotiating between employers and workers’ organisations.

## **Policy practices to scrutinise**

A country’s effective implementation and enforcement of each of the four core labour standards depends on the following criteria and indicators.

- *Ratification of the eight core labour standard conventions*. Is the government a member of the ILO and has it ratified the eight core labour standard conventions? While it is possible to respect all the core labour standards without ratifying any of the conventions, ratification sends a positive signal to the international community and foreign investors. This may in part explain why as of November 2007, over two thirds of the ILO’s 181 member states had ratified all 8 of the fundamental conventions. In addition, since the ILO’s 1998 *Declaration on Fundamental Principles and Rights at Work* made respect for the core labour standards an inherent requirement for all ILO members, a member country’s

ratification of these conventions is essentially an active affirmation of an obligation.

- *Laws and regulations enforcing and complying with the core labour standards.* Second, and more importantly, are laws in compliance with the four core labour standards? This means not only having laws and regulations that explicitly protect each of the human rights covered by the core standards, but also eliminating any laws or regulations that violate them. For example, regarding non-discrimination in respect of employment and occupation, it is not just a question of whether the law prohibits discrimination, but also of whether there are any discriminatory provisions already in force, such as a law that prohibits women from performing certain types of work. Has the government waived any components of the core labour standards within special export processing zones?

To be effective, laws and regulations must (1) be specific enough to cover clearly the intended violations without being so specific as unintentionally to exclude certain behaviour; (2) punish violations in a manner appropriate to the offence; yet at the same time (3) not render compliance with the law unnecessarily burdensome. For example, laws to combat forced labour should be specific enough to include a definition of forced labour that clearly covers newer forms of forced labour such as human trafficking. Those laws should also make violations such as human trafficking a criminal offence, not merely a civil offence. However, appropriate punishment may also include rehabilitation when it can help deter future violations. An example of an overly burdensome law might be an anti-discrimination provision that requires employers to file monthly reports with the labour inspection office detailing the race, gender and salary of all its employees. There are less burdensome and more effective means of fighting discrimination which ultimately are more likely to be respected.

- *Public outreach.* Third, what action has the government taken to ensure public awareness of the laws and regulations to defend the core labour standards? Does existing outreach communicate the necessary information in a manner that is clear and complete yet user-friendly, and which reaches its intended audience, *i.e.* workers, employers, potential local and foreign investors, and organisations representing each of these groups?

Effective forms of outreach include maintaining an easily navigable, regularly updated website which summarises legal protections and public resources in easily understood language. Websites have the advantage of being simple to update and accessible to anyone

anywhere, whether a local worker or an overseas investor. An effective website (1) summarises in plain language relevant laws and regulations defending core labour rights, (2) includes links to the texts of those laws and regulations, (3) provides a government hotline for reporting violations, and (4) indicates whom to contact for further information.

Although a website is a powerful tool, it alone is not enough. In countries where a significant segment of the population lacks ready access to the internet, additional forms of outreach are particularly important. What other means of public education has the government pursued, including the distribution of written material and cooperation with chambers of commerce and employer- and employee-representative groups to disseminate information?

Where violations of core labour standards are deeply rooted in a cultural acceptance of certain views, such as sexism or racism, it is particularly important to organise public education campaigns. Employers must be aware of their duties and workers of their rights. In some cases enduring success can only be achieved by changing pervasive attitudes. This is particularly important for combating discrimination.

- *Effective enforcement of the core labour standards.* Fourth, how effective is the enforcement of laws and regulations upholding core labour standards. Enforcement is effective when existing violators are consistently brought before the law, successfully prosecuted, and punished in a manner commensurate with the offence. Part of this assessment is to determine whether there is an effective way for private citizens to inform the relevant government agency of a breach. For example, is there a government-operated hotline to report violations? If, yes, are most people aware it exists? Has it been well publicised? Are reported incidents promptly and properly investigated? Are there government instruments in place to respond to an alleged breach? What protections are available to persons who report violations? Does the labour inspector's office have adequate resources to carry out effective inspections and properly sanction violations? How do independent measures of the level of incidence of actual violations, if any, compare with the number of cases investigated and prosecuted?
- *The role of non-governmental actors.* Fifth, have non-governmental actors, either in conjunction with or independent of the government, taken action? Examples of this are the inclusion of respect for the ILO core labour standards in collective agreements, public campaigns by NGOs to raise awareness of the core labour standards, and the introduction of codes of conduct by individual employers requiring compliance with the core labour standards. While a country should not

depend entirely on independent actors, the situation in a country can be better understood by taking into account the contributions of these independent players.

## Further resources

An excellent additional resource for better understanding the core labour standards is the [Core Labour Standards Handbook](#). The result of a collaboration between the ILO and the Asian Development Bank, it is a practical guide for policymakers and others, providing clear, in-depth explanations of all four of the core labour standards and the eight fundamental conventions.

The *International Labour Organization (ILO) website* ([www.ilo.org](http://www.ilo.org)) is the main resource for accessing information on core labour standards and the eight fundamental conventions. The main website includes a number of subsidiary sites within it. Some are listed below.

- ILOLEX, ILO's database on International Labour Standards ([www.ilo.org/ilolex/](http://www.ilo.org/ilolex/)), lists the texts of all ILO conventions and information on which countries have ratified each convention. The information is searchable both by convention and by country.
- NATLEX, ILO's labour law database ([www.ilo.org/natlex/](http://www.ilo.org/natlex/)) lists labour laws organised by both country and topic. Each of the four core labour standards is listed separately. This makes the web page a useful resource, first, to identify the relevant laws of a particular country and, second, to compare across-country laws on a specific topic.
- The NATLEX [Country Profiles Database](#) brings together information on a country's application of international labour standards and national labour law. The profiles include: information on a country's convention ratifications, ILO reporting requirements, comments of the ILO's supervisory bodies, and a link to the NATLEX database listing a country's basic laws.
- The ILO [Fundamental Principles and Rights at Work website](#) is dedicated specifically to the fundamental principles and rights at work. It features a link to the text of the *Declaration of the Fundamental Principles and Rights at Work* and includes a number of other resources, such as a page specifically dedicated to forced labour issues. Also of interest are the annual Global Reports accessible on the site covering on a rotating basis one of the four core labour standards. They provide in-depth explanations and detail the status of progress in securing compliance.

- *ILO International Training Centre in Turin* ([www.itcilo.it](http://www.itcilo.it)) provides training to governments and other organisations in the area of labour rights and compliance with labour standards, particularly the core labour standards.

The [US Department of State Human Rights Country Reports](#) cover a series of human rights issues, including core labour standards. It features useful headings such as “Discrimination, Societal Abuses, and Trafficking in Persons” and “Worker Rights”.

The *Human Rights Watch* ([www.hrw.org](http://www.hrw.org)) website covers a broad range of human rights issues, including core labour standards. Information on labour rights is not usually listed separately, but the site does include a page on labour and human rights – although not by country.

The *International Trade Union Confederation website* ([www.ituc-csi.org](http://www.ituc-csi.org)) provides information on issues related to the core labour standards such as forced labour, equality in the workplace, and trade union rights.

## **Balancing multiple objectives of labour market regulations**

*8.7 To what extent do labour market regulations support job creation and the government's investment attraction strategy? What initiatives have been introduced that support policy coordination, balancing social objectives, the goal of a competitive workforce and the incentives for business to invest?*

### **Rationale for the question**

Effective labour market regulation governing employment conditions sometimes needs to balance competing economic and social goals. Multinational enterprises are more likely to invest in countries with effective safeguards and enforcement of human and worker rights. But companies also look at other factors, including wage levels and non-wage labour costs. Through coordination of competing interests, intelligent policy design can often help balance social and economic objectives. Different countries may opt for different solutions, but crafting policy with an eye to balancing economic and social objectives is key. Poorly designed labour regulations can reduce opportunities and incentives for foreign and domestic businesses to make new investments and expand, which in turn can result in fewer jobs and lower employment rates.

Potential trade-offs between promoting social goals and attracting investment can be seen in two main areas of regulation. The first relates to wage formation methods—such as the setting of the legal minimum wage—that result in labour costs too high to spur job creation and in under-utilised labour resources, particularly female employment, thereby preventing economies from benefiting fully from their investments in Human Resource Development (HRD).

A second area where policymakers may face trade-offs is regarding regulations increasing non-wage labour costs that employers are not able to pass on to employees through lower monetary remuneration. Non-wage labour costs refer to social insurance expenditures and other labour taxes that an employer must pay for, but not to, each worker in addition to the worker's salary. These can include any employers' expenditures for legally-required employee insurance programmes, such as health or unemployment insurance and retirement pension plans. The mandatory payments may be to the government in the form of a tax, or to a separate entity such as an insurance company. Thus, overly burdensome non-wage labour costs can have the same dampening effect on job creation as wages that are too high. Policymakers face the challenge of creating policies that provide certain guarantees to workers, while at the same time keeping in check costs to employers.

The key question in both areas of regulation is how well interventions achieve policy goals without hurting economic performance. If wages or non-wage labour costs are too high and employers are unable to pass on those costs, businesses may

decide to hire fewer employees or risk becoming economically unviable. Foreign companies may choose to invest elsewhere.

Another possible consequence of overly burdensome regulation is that it gives both workers and employers an incentive to shift to the informal sector or to stay there. Employers turn to hiring informally when the expense or complication of hiring formally becomes too burdensome. Workers seek informal sector jobs when they cannot find employment in the formal sector. Informal employment is problematic on many levels. Informal workers do not receive the protections of the labour regulations intended to benefit them. These include the very minimum wage limits and social insurance programs discussed above but also, for example, the protection of laws securing the right to collective bargaining, guaranteeing a safe workplace and outlawing unfair firing. Informal employment can hurt state revenues, too. Governments have difficulty collecting taxes from informal employees and from employers with informal workforces, resulting in less funding for government programmes.

### **Key considerations**

Governments should set minimum socially responsible standards but avoid unnecessary regulation that could discourage investment. They should aim to create an environment of negotiation and communication between employers, employees and their representatives, and make sure that parties are able to bargain on equal footing.

**Set basic standards with minimal additional intervention** Governments play a crucial role in setting minimum and socially responsible labour standards. Certain labour and employment relation practices are simply unacceptable and it is the government's responsibility to define these limits. Laws and regulations that set key boundaries to insure fundamental protections, such as a safe workplace and humane working conditions, provide essential guarantees to workers. Beyond setting these basic standards, governments should leave other aspects of work conditions to negotiations between the interested parties—employers, employees and their freely elected representatives—rather than assuming a primary role.

A number of risks come with over-regulation. Excessive government regulation can unnecessarily tie businesses' hands by imposing rules that make it more difficult for them to operate successfully. Another danger is that regulations may simply be ineffective. Governments that attempt to micromanage work relations may discover that they are often not in the best position to determine what is most desirable for employers, employees, and as a result may impose rules that satisfy neither. Plus, overly burdensome and ineffective regulations can discourage investment and increase the motivation for employers and employees alike to operate outside the law. Across-the-board regulations can also become easily outdated and are not well-suited to all situations.



Regarding wage formation methods, for example, policymakers can play an important role in protecting workers from exploitatively low wages by setting a legal minimum wage. Setting the correct minimum wage is challenging: Policymakers need to keep in mind the delicate balance between the lowest wage for which a worker should be legally permitted to work, and the highest level at which this wage can be set without discouraging job creation and investment. Some governments have successfully set different regional minimum wages or given local governments the power to set local minimums. Others have set separate minimum wages for agricultural and non-agricultural work. However, more extensive government regulation of wages, such as setting salaries for specific professions or sectors is not advised. Wage levels are more likely to strike the best balance between social and economic goals when they are determined through fair negotiation and market forces. For that reason, beyond establishing a basic minimum wage, governments should turn their wage-setting efforts toward fostering an environment that favours effective bargaining between employees, employers and their representatives.

**Framework favouring effective collective bargaining** Governments should facilitate the creation of an environment where labour and management can bargain on equal footing. Governments can do this first and foremost through laws and regulations. As a starting point, governments need to put in place and enforce laws that guarantee the fundamental right to collective bargaining and freedom of association. Freedom of association means not only that workers and employers must be able to form organisations but also that membership must be optional. This helps ensure the organisations be truly representative of their membership. Also key are anti-discrimination laws that protect labour representatives and union members from workplace discrimination based on their activism. This way, workers cannot be unfairly punished for union membership or other affiliations. (These efforts overlap in part with enforcing the core labour standards discussed in Question 8.6.)

Second, governments need to make sure that people are aware of their rights and are able to exercise them freely. In countries lacking a tradition of collective bargaining, where unions do not have a significant presence, launching a public awareness campaign can be an important step. It could also help to educate people on the important roles unions and other organisations can play in the process of communication and cooperation between labour and management. Education may also include providing information on the basic functions of unions and other representative organisations, for example making sure people learn the importance of having organisation representatives that are freely elected by the organisation's membership to ensure their accountability. In addition, there should be channels through which the average worker can quickly and easily report violations without fear of retaliation, and laws that allow employees to take legal action against an employer who does not respect the law, with clear penalties for violators. One option is to have a government hotline employees can call to report violations of the law or simply to seek information on their legal rights.

Third, governments can play a role in encouraging a culture of cooperation and communication between labour and management by organising forums to bring representatives from both groups to the table. Effective communication and cooperation between these groups can help result in solutions to potential conflicts that can contribute positively to a country's investment attraction strategy.

**Alternative Dispute Resolution Institutions** Beyond protecting the right to collective bargaining, the government can play a role in creating forums for alternative dispute resolution in the context of labour disputes. Alternative dispute resolution (ADR) refers to methods of resolving disputes, other than through litigation, which involve a neutral third party and to which parties to the dispute agree voluntarily. In cases where parties cannot reach an agreement at the bargaining table, it is helpful for there to be an alternative to litigation, which can be expensive and time-consuming and which results in a solution that is imposed on the parties rather than one that is agreed to voluntarily by both. ADR can not only save time and money and is less formal, but some forms, such as mediation, serve to improve communication between the parties.

Mediation, arbitration and conciliation are among the more common forms of ADR. Mediation is where a neutral third party (the mediator) meets with both disputing parties together to help them create a dialogue and eventually work out a mutually satisfactory solution. Conciliation is where a neutral third party (the conciliator) meets with each party, usually separately, in a friendly, informal environment and tries to help them reach a compromise. Arbitration is more formal and one step closer to litigation. In arbitration, each party presents its case before one or more neutral third parties (an arbitrator or panel of arbitrators), whose decision the parties have contractually agreed in advance to follow instead of going to court.

Government involvement in promoting various forms of ADR can begin with drafting laws and regulations that provide a legal framework within which these alternative forums can be regulated. The framework should include answers to questions such as what is required for arbitration and mediation clauses in contracts to be enforceable by law, as well as rules on whether and when these decisions can be appealed through the court system, and how to legally enforce decisions arrived at through different types of ADR.

An organisational body should exist to deal with additional rules and professional and ethical standards for practicing and implementing various forms of alternative dispute resolution. The organisation may be governmental, independent, or some combination. In some countries, the government has established a single governmental body to deal with all ADR issues. In addition, a government may choose to create a section specifically dedicated to labour and employment law disputes. In other countries, certain standards are enforced through a professional organisation, serving a function similar to that of a bar organisation for lawyers. Important issues an ADR body should regulate include setting procedural and ethical rules for different types of ADR and setting certification standards for qualification as a conciliator, mediator, arbitrator or other type of neutral third

party involved in ADR to ensure a certain level of aptitude and professionalism. Another valuable service is to provide training and education on various forms of ADR.

**Policy coordination initiatives** Governments should consult various interests when drafting new laws to coordinate policies since new policies and programmes can have far-reaching effects beyond those initially envisioned. The able coordination of diverse policy objectives can frequently help lawmakers reach both social and economic goals and minimise the magnitude of any required trade-offs.

When it comes to labour and employment policy, tripartite consultation is key, which means bringing to the table representatives of labour, such as unions, and management, such as chambers of commerce, to present their perspectives to the government. It also helps to have the input of various government offices. Since different areas of the government are responsible for different policy priorities, each can present lawmakers with fresh perspectives. All these players can become involved in multiple stages of the drafting process.

In the area of non-wage labour costs, policymakers face the challenge of crafting policies that fulfil the social objective of providing important protections to workers, without compromising the economic goal of encouraging investment and growth by limiting the burden on employers. Since many governments require employers to fund programmes such as unemployment insurance, health insurance and retirement plans through additional payments for each worker employed, these additional services can translate into higher non-wage labour costs for employers. Policymakers will probably need to make some trade-offs, but consulting with representatives of all the interested parties will increase the likelihood that the law adopted in the end is an intelligent solution that strikes the right balance between various goals.

For example, when drafting legislation to provide unemployment insurance (payments that a worker may receive if downsized to help him cope financially before finding other employment) legislators need to take into account various policy objectives. These include not only how best to provide the benefits to recipients, but also how much funding to make available, what the source of funds should be, how to keep non-wage labour costs in check, and how to assist and motivate the unemployed to find new jobs. Consulting with various groups helps legislators understand all the relevant issues and ultimately design a balanced—and possibly creative—solution. For example, the unemployment benefits could gradually decrease over time and they could be made available only to workers who are actively seeking jobs. This would provide some assistance to the out-of-work, while limiting the burden on employers and motivating people to leave the ranks of the unemployed.

## ***Policy practices to scrutinise***

Based on these considerations and good practices, how do labour market regulations balance social objectives with those of market efficiency, such as the creation of jobs, a competitive workforce and incentives for businesses to invest? Key issues are how well laws and regulations balance social and economic goals, and how successful the country has been in establishing an environment where conflicts in these areas can be effectively resolved.

The following policy practices and criteria ought to be considered:

- Identify labour and employment laws and regulations and those affecting non-wage labour costs, which may involve trade-offs between social and market objectives, focusing in particular on the following areas:
  - The core labour standards (discussed in Question 8.6) – the right to freedom of association and collective bargaining, the elimination of workplace discrimination, the abolition of forced and compulsory labour, the abolition of child labour;
  - Work-place safety requirements (such as requirements that employees not be exposed to harmful or toxic substances or laws giving government inspectors access to workplaces)
  - Minimum wage requirements – one way to evaluate this is by comparing the minimum wage to the average value added per worker, as is done by the World Bank’s Doing Business project (see Further Resources)
  - Work hour limitations, which can include:
    - Maximum limits on the number of days in a workweek (six is common),
    - Prohibitions or limitations on working specific days in the week such as weekends or holidays, or certain times of the day such as at night
    - Required additional pay for overtime, night, weekend or holiday work, or any combination (for example, there may be a different premium for night work that is not overtime, and night work that is overtime)
    - Mandatory minimum limits on number of vacation days per year
  - Restrictions on hiring and firing, such as the types of work contracts (fixed-term, open-ended, and part-time) that exist and legal restrictions on firing. The laws governing each type of contract may set important limits such as on the maximum length of a fixed-term contract, and whether workers under different contracts receive different types of legal protections. Regarding restrictions on firing, key issues are rules governing firing for economic reasons (e.g., whether the employer is required to notify or gain approval from a government official or a trade union, whether the employer is

- required to fire employees in a specific order such as the least senior workers first or workers with families last);
  - The length of mandated notice periods, the amount of minimum required severance pay, and how each is calculated;
  - Requirements that contribute to non-wage labour costs, such as legally required contributions employers must make toward unemployment insurance schemes, workplace injury insurance, and retirement plans.
  
- How well do the laws and regulations identified guarantee the desired social objectives, while at the same balancing them with job creation goals and the government's investment attraction strategy? The balance to strike may differ from country to country as priorities vary. Flexibility is important. For example, compare a law requiring one day of rest per week, to a law requiring a day of rest on a specific day of the week such as Sunday. Both guarantee one day of rest, but the former is more flexible. The role of the government should be to set *mandatory minimum* standards. Thus even if the law requires one rest day per week, in practice two days may be more common and labour and management may negotiate more specific standards for a given workplace or industry.
  
- How well does the government foster an environment where labour and management can bargain on equal footing? This includes an evaluation of collective bargaining rights and practices and the level of communication between labour and management. More specifically:
  - Is there an even playing field between labour and management with regard to bargaining, and if not then what action is being taken to improve this?
  - How strong is the presence of unions or workplace representatives, what is the level of union membership? How common are workplace representatives and how influential are they?
  - How effective is communication between labour and management? Is there a culture of cooperation, and what action has the government taken to encourage communication and cooperation if improvement is needed?
  - How well are collective bargaining rights protected and enforced? How common is collective bargaining, and is there a right to strike? What limitations exist to this right?
  - Are workers aware of their legal rights, and if not, what efforts have the government or other groups made to remedy the situation, such as by mounting informational campaigns?
  
- What forms of ADR exist in the country, specifically in the context of labour disputes, and what types of structures are in place to ensure their

effectiveness? This includes an evaluation of the laws specifically governing different forms of ADR. For example,

- What is required for ADR clauses in contracts, such as arbitration clauses, to be enforceable by law?
  - Can ADR decisions be appealed through the court system and under what circumstances?
  - How can one legally enforce ADR decisions?
- Is there a government office or independent organisation that establishes additional rules and professional standards for various forms of ADR? If so, what are this body's functions? They may include setting procedural and ethical rules; granting certification for qualified arbitrators, mediators, etc. (similar to a bar membership for lawyers); offering training on how to become a qualified arbitrator, mediator, etc.; and educating the public on the availability of various forms of ADR. How commonly do parties turn to an ADR solution, and how effective is ADR as a tool to come to an agreement, increase efficiency, or cut costs?
  - It is important to evaluate what measures the government has taken to ensure the effective coordination of various policies, in particular of economic and social objectives.
    - Do law and policymakers consult with different government offices to better inform their policymaking decisions and make sure they have effectively coordinated various policy goals?
    - Do law and policymakers consult with labour and management representatives when passing laws that could affect either?
    - What is the consultation process? Is it through meetings, in writing, or both? Does the government circulate draft laws and regulations for comment and work to integrate comments in future drafts? How effective is it?

### ***Further resources and case studies***

The following resources provide information on labour market policy coordination:

The [World Bank's Doing Business project](#) includes a number of relevant indicators, such as Employing Workers, which examines labour laws and regulations such as the minimum number of vacation days required by law, and Paying Taxes, which includes information on non-wage labour costs under the heading 'labour tax and contributions'. The website also features a [free online collection of business laws and regulations](#).

The [International Labour Organization's website](#) features a wealth of labour-related resources, including several useful databases. The [Natlex database](#) is particularly useful by providing listings of national labour, social security and related human rights legislation and in some cases links to the full text of the law.

The World Bank provides guidelines for policymakers and reformers in the form of “toolkits” which are topic-specific handbooks giving practical advice and resources. Several are particularly relevant: the [Labour Toolkit](#) deals with labour issues in the context of infrastructure reform but gives advice that is helpful generally for all labour law assessment and reform. The [Public-Private Dialogue Toolkit](#) gives tips on effective dialogue between the public and private sector that can help governments shape their reforms in a way that responds to the concerns of the various stakeholders. The [Dispute Resolution Toolkit](#) provides a general overview of the various types of ADR and gives tips on how to build effective ADR programs.

The [OECD Employment Outlook](#) focuses on a different labour topic each year. While the work focuses mostly on OECD countries, much of the information is useful for policy-makers and reformers in non-member countries.

The [International Trade Union Confederation \(ITUC\) website](#) offers the perspective of an international workers’ organisation. The ITUC champions and defends the rights and interests of workers around the world. The ITUC’s [Annual Survey of Violations of Trade Union Rights](#) lists known violations of workers’ rights in over 100 countries. It is a useful resource for assessing how effective the government is in fostering an environment where labour and management can bargain on equal footing. [Reviewing Protest Letters](#), letters from the ITUC to government officials seeking to call attention to violations, may also be a useful resource.

[Federal Mediation and Conciliation Service \(FMCS\)](#) is an independent agency of the U.S. government that promotes sound and stable labour-management relations. Although the FMCS’s primary focus is on the United States, it provides extensive technical assistance outside of the U.S. to government, labour, and business representatives in topics such as negotiation skills and various types of alternative dispute resolution. It has also helped establish mediation agencies in other countries. In addition, the FMCS has set up an Institute for Conflict Management, offering a range of conflict management courses. Literature available on the FMCS website includes [Strengthening Governmental Conciliation Institution: A Practitioner’s Handbook](#), which describes the multitude of functions that a Governmental Conciliation Institution can perform, and [Responding to Change in the Workplace: Innovations in Labor-Management-Government Cooperation](#), a best practices toolkit describing some of the economic, social and political benefits of effective tripartite cooperation.

The World Bank makes available on its website a wealth of materials to assist policymakers to further explore the topic of labour reform. In conjunction with a Labour Market Policy course that the World Bank Institute offers each year to assist policymakers with labour reform, the Bank posts [case studies, evaluations of existing labour market policies, background reading, and exercises](#) useful even for those not participating in the training.

## **Labour market adjustment**

*8.9 Does the government support programmes designed to assist large-scale labour adjustment and indirectly the investment environment by better positioning firms to seize new investment opportunities? Do the incentive mechanisms in these schemes encourage broad support for change? What role is business encouraged to play in easing the transition costs associated with labour adjustment?*

### **Rationale for the question**

Every economy is prone to upheaval, often linked to new technologies that lead to different work practices, opening fresh business opportunities and making others no longer viable. As new firms establish themselves and grow, others downsize or close. This process whereby new technologies and know-how spread while old methods are abandoned is known as “creative destruction” and increases overall productivity in the long run. Those enterprises able to adapt to change quickly are better able to compete successfully and expand. Thus, to attract investment, the government must ensure an environment where businesses can transition swiftly.

At the same time, responsible governments must also put in place policies to assist displaced workers during transition periods, which can be costly and traumatic. Ideally, these mechanisms should cushion individuals from the effects of a sudden loss of income and position them to find other work. Effective policy curbs dislocation costs without hindering the adjustment process. Governments must also ensure these policies include incentive mechanisms to win the support of interest groups that may otherwise be resistant to their implementation, thereby encouraging broad support for change.

The business community can make a valuable contribution to easing the adjustment process, and it is in its own interest to do so, since a softer transition will reduce opposition to policies favouring swift labour adjustments. By keeping an open line of communication with the government, businesses can help the government effectively counter large-scale labour adjustments with policies that are responsive to the needs of those negatively affected during periods of transition. By maintaining a constant dialogue with employees and their representative, companies can foster a spirit of cooperation rather than mistrust that can help ease transitions, especially important in times of collective layoffs or dismissals.

### **Key considerations**

Key elements of programmes that successfully ease the labour adjustment process are (1) retraining and redeployment support, (2) temporary financial assistance, (3) built-in incentives for returning to work, (4) the capacity to implement additional support measures when necessary to respond to specific challenges, such as regionally concentrated labour adjustments, (5) incentive mechanisms that help build broad support for change, and (6) the active cooperation of business. The



policies each country chooses to implement will depend on its financial and organisational means as well as its policy preferences.

**Retraining and redeployment support** Retraining and redeployment programmes support large-scale labour adjustments by helping reintroduce unemployed workers into the workforce. There are essentially two elements of retraining and redeployment programmes: job search assistance and job skills training. The main objective of job search assistance is to provide job seekers with information about relevant job openings and put potential employees in touch with companies looking to hire. For this service to work well, it must provide up-to-date information on both the pool of job seekers and the positions available. The main objective of job skills training is to provide job seekers with the tools they need to find a new job. Programmes can help job seekers hone job hunting skills by, for example, offering workshops on drafting resumes and successful interviewing. Training can also extend to teaching job-specific skills that are in demand by employers, such as typing, operating a computer, sewing or welding.

Regardless of the type of programme, to succeed the aid provided must be well targeted, by offering services tailored to local circumstances and making them easily accessible to those in need. For example, for job skills training to be successful, it must be responsive to skills in demand, tailored to local circumstances and adapted as demand changes. While computer skills training may be helpful in one town, in another the need may be greatest for classes in basic reading and writing. And as needs change over time, the types of services provided must adjust promptly to shifts in demand. To make services easily accessible, offices should have opening hours and locations convenient for their users. Programmes that fail to meet these criteria risk failing to attract much demand or becoming an ineffective drain on resources. For all these reasons, operating successful retraining and redeployment programmes requires a certain level of infrastructure and funds.

**Financial Assistance** Providing temporary financial assistance to those who have recently become unemployed mitigates the growing pains associated with restructuring by easing the often difficult transition from one job to another. This, in turn, increases support for change and helps an economy adapt quickly to shifts resulting from large-scale labour adjustments. Ideally, financial assistance can be provided through a centrally-administered unemployment insurance or social security fund into which employers or employees or both gradually pay over time. This arrangement has the advantage of providing a safety net for workers who lose their jobs in a way that avoids placing additional financial strain on companies at the very time they are struggling to meet the challenges of a financial downturn.

In countries where operating such a system is not feasible, for example due to insufficient infrastructure or resources, employer pre-funded one-off severance payments are a reasonable alternative. The worker receives the payment from the employer in one lump sum at the time the person is let go. “Pre-funded” refers to the fact that the payment comes from money the employer has set aside gradually over time specifically for the purpose of making the severance payment. This is key,

because when a company's finances are tight, paying severance can be a very real strain on resources, in worst cases pushing businesses into bankruptcy or motivating others to skirt the law by not respecting severance pay requirements. The regulations governing the precise mechanism for putting the money aside can vary greatly from country to country. For example, employers, unions or even the government may manage the funds. The money set aside may be a percentage deducted from the employees' salaries or payments employers make directly into the fund. The formula for determining the minimum amount a company must pay a worker can also vary. In many countries the amount of severance pay is closely tied to the seniority of the worker. Regardless of the formula, there should always be a cap to prevent exorbitant costs.

**Incentives to return to work** Regardless of the combination of solutions a government chooses, aid programmes—financial assistance in particular—can sometimes have the unintended effect of encouraging people not to seek new jobs, since the programmes effectively pay people for being out of work. To offset this effect, aid programmes should include built-in safeguards and incentive for people to return to work. One approach is to tie receipt of aid to active participation in job-search programmes. The success of this approach depends on the careful monitoring of programme participants, to ensure they are indeed actively searching for work, and the programme itself, to ensure it provides meaningful and effective assistance to job seekers. Another approach is to discourage permanent dependence on government assistance by decreasing the level of assistance gradually over time. A third important safeguard in countries that require employers to pay severance is that the requirement not apply to workers fired for misconduct, so that there not be any economic motivation for trying to get fired.

**Additional support measures to respond to specific needs** In some cases a wider range of support measures may be necessary to address special challenges. A regional development programme may be the best response to a large regionally concentrated labour adjustment. A downturn in a key industry may require additional government intervention. Where the decisions of one enterprise dramatically affect the local employment rate, the government may seek to establish improved channels of communication with the company to better anticipate problems.

**Broad support for change/Incentive mechanisms** Governments may meet with resistance to the implementation of large-scale labour adjustment programmes from interest groups fearful of being adversely affected, even when those programmes increase overall welfare. This is why programmes need to include incentives mechanisms to draw in the support of a broad range of stakeholders. For example, a legal framework for hiring and firing that makes the process straightforward and predictable appeals to companies, even if the proposed changes may also involve an increase in their non-wage labour costs to help fund unemployment insurance. From labour's perspective, unions may initially resist

changes that make it easier to fire. But if combined with improved unemployment benefits, labour's support can be won.

Another way to build broad support is by giving a voice to key interested parties that would otherwise be under-represented. Although some groups are well organised—through, for example, chambers of commerce or trade unions—others like the non-unionised, the unemployed and informal workers may struggle to impact policy. If the government reaches out to these groups to hear their views, policies will be more likely to reflect the broader good than the limited interests of specific groups.

**Role of Business** Business has an important role to play in easing transition costs. By helping facilitate the transition for those adversely affected by economic adjustments, the business community can limit opposition to policies favouring smooth labour adjustments. The *OECD Guidelines for Multinational Enterprises* outline a number of ways that business can contribute positively to cushioning the effects of large-scale labour adjustments through responsible labour relations. Much of the advice applies not only to multinational enterprises but also to other businesses.

First, governments should encourage businesses to consult with employees, and their representatives when applicable, to promote dialogue and cooperation on issues of mutual concern, including the company's performance. Where a company has multiple branches, communications should cover both the performance of the company as a whole and that of the specific branch where the employees are based. When there is an issue to resolve, collective bargaining can be an effective mechanism for finding constructive solutions. Companies should strive to give employees and their representatives reasonable notice of the changes that could significantly affect employees' livelihood, such as collective layoffs or plant closings. Where appropriate, consulting with labour before making the final decision to let go a significant number of employees can give labour the opportunity to work with management to mitigate the effects of the layoffs through creative solutions, such as offering the possibility of part-time work as an alternative to losing employment. Full and early consultation and providing comprehensive information engages employees in the process of adjustment and helps limit opposition to change.

Second, governments should also encourage consultation between business and government, since governments can more effectively cushion difficult transitions when they have the cooperation of business. Under some circumstances it may be appropriate for businesses to consult with government authorities to better manage the negative effects of a planned plant closing or significant layoffs. If government agencies have advance notice, they will have the time to mobilise their resources and provide better assistance to those who become unemployed. Some government agencies may also be able to assist with mediation between management and labour. Regular communication between businesses and government agencies can help governments providing job skills training keep

abreast of what skills are most in demand, to help ensure that the programmes are responsive to current needs. Also, where there are government programmes to assist with job searches, businesses should keep the agencies abreast of current and anticipated job vacancies.

### ***Policy practices to scrutinise***

To what extent does the government supports programmes that effectively assist with large-scale labour adjustments without incurring disproportionate costs or overly burdensome regulation that risk discouraging FDI?

Key issues are how efficient and effective is the large-scale labour adjustment programme currently in place; how well does the programme balance the interests of business and labour; and what active role does business play in easing transition costs for those negatively affected by labour adjustments.

The following policy practices and criteria ought to be considered:

- What if any retraining and redeployment programmes are in effect and how well do they operate?
  - Exactly what services are being offered (retraining, redeployment, or both)?
  - Are the programmes government-run, operated privately or a hybrid? Regarding redeployment services there may exist both government and privately operated employment agencies. If this is the case, does the government agency provide a valuable service not already available elsewhere?
  - How responsive to the needs of the users are the services provided? For example, do retraining programs help people acquire skills that are in demand? Are there different services provided in different parts of the country depending on local needs? Do redeployment programmes provide job seekers with up-to-date and complete information?
  - How easily accessible are the programmes? Offices should be easily accessible and keep regular and adequate hours of operation. They should also have sufficient resources to service the volume of people seeking assistance. Using the services should not require navigating an unnecessarily complicated bureaucracy.
  - Do people know about and actually use the services provided? What percentage of eligible job seekers avail themselves of the services, and what is being done by the government to increase the number if it is not high enough?
  - Are the offices staffed by qualified personnel?
  - Are the programmes managed efficiently, without waste?
  - What role do the business community and labour organisations play in ensuring the programmes are responsive to their needs, for

- example, by advising on the types of training most in demand or providing information on job availability?
- What types of financial assistance are mandated through labour and social security laws and regulations? Do the laws and regulations:
    - Provide a meaningful cushion to those negatively affected by labour adjustments? What types of benefits are provided? Is there mandated unemployment insurance, mandated severance pay or both?
    - Balance interests of business and labour by providing protection that is both effective and not overly burdensome? This may involve a way to distribute the cost to employers across businesses and over time, for example, by having businesses pay gradually into a fund. In countries with well-functioning unemployment insurance programmes, severance payments play a less important role and therefore legally-required severance payments should be kept lower to ease the burden. In countries where offering comprehensive social security is not a viable option and severance payments play a more important role, there should still be a cap on the maximum amount of pay.
    - Are they clear and easy to follow?
    - Cover a meaningful portion of the population? For example, if assistance extends only to formal workers in a country where informal workers make up an important percentage of the work force, then many people are left unprotected;
    - Include incentives for benefits recipients to seek new employment, such as decreasing benefits over time, tying payments to reporting to a social worker on job search progress or to making use of retraining and/or redeployment services?
    - Include safeguards against employees purposely leaving work or trying to get fired in order to receive benefits?
    - Are they effectively enforced?
  - What role do businesses play in facilitating the transition process? How do businesses cooperate with both labour and government? What is the effectiveness of both the forms of cooperation required by law and the mechanisms in place to encourage voluntary cooperation, such as positive incentives and awareness campaigns? What mechanisms encourage businesses to:
    - Communicate regularly with labour to keep employees informed of the state of company affairs?
    - Consult labour early on to address financial difficulties that may result in layoffs? At what point do businesses consult labour? How complete is the information provided? And how effective are the

- consultations at engaging employees and limiting opposition to change?
  - Consult with government entities running skills training programmes for job seekers to make training more responsive to businesses' needs?
  - Consult with government entities operating redeployment programmes, to keep the government abreast of current and potential job openings?
  - Keep government entities abreast of projected large-scale firings so the government can mobilise to provide needed assistance? Are there any mandatory notice requirements for layoffs of a certain size and does this approach effectively meets the goal of assisting labour while not excessively burdening management, since overregulation can discourage investment?
- What mechanisms does the government have in place to respond to special challenges, such as a regional increase in unemployment? This may involve the ability to form a task force to respond to specific issues and should involve an inspection of how effective and efficient government responses have been in the past to specialised needs.

### ***Further resources and case studies:***

The following resources provide additional information on large-scale labour adjustment policies:

- The International Labour Organization's website features a wealth of labour-related resources, including several useful databases. The [Natlex](#) database provides listings of labour-related laws, including national labour and social security laws, which have information on collective dismissal procedures, severance pay and social security. In addition to relevant citation information, in some cases the site provides links to the full text of the law.
- The International Labour Organization's website also features a [Termination of Employment Legislation Digest](#), a database of laws and regulations covering termination of employment procedures in over 77 countries. It includes Profiles of National Legislation, which are concise and user-friendly summaries of termination legislation organised by country. Each profile is broken down into sections such as "sources of regulation", "scope of legislation", "dismissal" and "severance pay", and ends with links to sources of further information. The digest also provides comparative table for easy reference.
- The World Bank's [Doing Business](#) project seeks to provide objective measures of business regulations and their application in over 180 economies, with an eye to assessing the ease or difficulty of doing business in each economy. These include Employing Workers (information on third-party notification requirements for collective dismissals and required

severance pay and notice requirements for economic firing), and Paying Taxes (information on non-wage labour costs under the heading “labour tax and contributions”).

- The World Bank’s *Doing Business Law Library* features a free online collection of business laws and regulations, including labour and social security laws, many of them in the form of links to other websites where the texts of the laws are posted.
- The World Bank provides guidelines for policymakers and reformers in the form of “toolkits” which are topic-specific handbooks giving practical advice and resources. The Labour Toolkit deals with labour issues in the context of infrastructure reform but gives labour policy advice that is generally helpful. Specifically, Module 5 of the Labour Toolkit, “Key Elements of a Labour Programme” discusses severance pay, pensions and redeployment support.
- The World Bank makes available on its website a wealth of materials to assist policymakers to further explore the topic of labour reform. In conjunction with a Labour Market Policy course that the World Bank Institute offers each year to assist policymakers with labour reform, the Bank posts case studies, evaluations of existing labour market policies, background reading, and exercises useful even for those not participating in the training. For example, a presentation from the Labour Market Policies Flagship Course of 2003, “Socially Responsible Enterprise Restructuring”, outlines key issues to consider when evaluating policies to assist with labour adjustments.
- The OECD Guidelines for Multinational Enterprises make best practice recommendations for responsible business conduct. The *Guidelines* aim to help create a solid foundation for cooperation between investing enterprises and the countries in which they operate by giving advice that can improve relations and result in sustainable development. In particular, Chapter IV of the *Guidelines*, “Employment and Industrial Relations” advises on opening lines of communication between labour and business and on keeping those lines open during important changes in company operations.

## **Labour market regulations and workforce adaptability**

8.10 What steps are being taken to ensure that labour market regulations support an adaptable workforce and maintain the ability of enterprises to modify their operations and investment planning?

### **Rationale for the question**

Labour regulation that allows for efficient and flexible operations helps foster an attractive investment climate. The ability to respond efficiently to market forces is essential to staying competitive. Companies need to be able to modify quickly their operations and investment practices to be responsive to changes in demand and developments in technology.

The main policy issue is how to combine companies' need for adaptability with individuals' need for security. Question 8.9 focused on one aspect of this: worker protection policies that ease the difficulties faced by workers displaced during transition periods, an important counterbalance to policies that make hiring and firing easier. Question 8.10 focuses on another aspect: regulations that favour smooth workforce adjustments without losing sight of the need to provide people with security.

### **Key considerations**

*Efficient job protection regulation* Increasing the efficiency and predictability of job protection regulation is an essential first step toward making it possible for businesses to operate more effectively. This means creating rules that are :

- *Clear.* Laws and regulations should be easily comprehensible and unambiguous. Confusion over a law's requirements can lead to divergent interpretations, reducing compliance and possibly leading to costly legal disputes with unpredictable outcomes.
- *Not overly strict.* Protecting workers from unfair firing – such as on the basis of gender, ethnicity, age or other forms of unfair discrimination – should not imply that they cannot be dismissed for economic reasons.
- *With minimal red tape.* Minimising red tape increases efficiency by making compliance with procedures less costly and time-consuming. It also makes outcomes more predictable by decreasing the likelihood of administrative error and disagreement over proper procedures. Laws or regulations should be streamlined by removing unnecessary filing, approval and notification requirements, which can slow companies' operations and generate additional expense, and by reducing the number of government offices involved in the decision – which will also reduce the scope for bribery.
- *And with minimal judicial uncertainty.* Reducing judicial uncertainty increases efficiency by avoiding legal disputes which consume both time



and money. Keeping laws and regulations clear, their requirements reasonable, and their compliance procedures streamlined decreases the chances of ending up in court. Eliminating superfluous approval requirements by judicial bodies also reduces uncertainty.

*Flexicurity* Governments should focus their interventions on providing temporary income support and re-employment services to assist unemployed workers, while reducing legislative and regulatory obstacles to economic firing. This combination, called “flexicurity”, gives employers the flexibility they need to adapt and modify operations smoothly, while providing individuals with valuable protections.

Poorer countries with limited resources and organisational capacity may find some flexicurity measures a challenge to implement. Question 8.9 explores various income support and re-employment service alternatives, such as pooling risk through employment insurance and encouraging employers to create pre-funded severance pay accounts. Other options include reasonable dismissal notice requirements. If a country chooses to adopt a law requiring minimum notice before dismissal, the length of this notice should depend on individuals’ need for assistance in light of the other types of government support available and on how burdensome the requirement will be on companies.

*Flexible work schedules* Flexible work arrangements help to ensure an adaptable work force. Labour legislation that hinders the creation, through the mutual accord of employers and employees, of flexible work-time schedules should be eliminated. The law should allow for part-time work, fixed-term employment contracts, and flexible hours. These can create more employment options for companies, help people reconcile work and family life, and have other benefits such as helping older workers shift progressively from work to retirement.

At the same time, part-time and fixed-term employees should not receive inferior tax treatment or social security protections. The goal is to favour flexibility and give employers and employees more options, not to create a dual labour market, where some workers receive more benefits than others—a solution that can hurt labour market performance in the long run.

*Consultation with a wide range of stakeholders.* Labour market regulations should reflect the interests of employers and the entire workforce—employed and unemployed, union and non-union, formal and informal. When drafting new rules, governments should consult with a wide range of stakeholders, including those who can voice the interests of the unemployed and the disenfranchised.

### ***Policy practices to scrutinise***

Concerning the flexibility and efficiency of a country’s labour laws and regulations, key issues are the efficiency of economic dismissal laws and regulations, the degree to which they are combined with flexicurity-compatible protections, the degree of work schedule flexibility, and the range of stakeholders whose interests are represented.

- Considerations for economic dismissal laws and regulations are:
  - *The clarity of economic dismissal laws and regulations.* How straightforward and easily intelligible are the provisions? How likely are they to be subject to more than one interpretation due to vague or contradictory provisions?
  - *The barriers to economic dismissal under current laws and regulations.* What standards must the employer meet to proceed with economic dismissals? Are dismissals permitted or prohibited under certain circumstances? Must employers consult or obtain prior approval from government or other bodies (e.g., labour inspectors, courts, union representatives)? Are employers required to respect certain priority rules for dismissal (e.g., first in last out)? What is the amount of notice and severance pay required by law? Must the employer provide proof to justify an economic dismissal and if so what (e.g., specific balance sheet requirements)? How difficult is it to meet this standard, and how likely there is to be disagreement over whether this standard has been met? It may be that larger companies or collective dismissals of more than a threshold number of workers are subject to additional requirements. If so, are all sets of requirements appropriate and sufficiently flexible?
  - *The administrative steps involved in economic dismissal.* How many steps are involved in laying off employees for economic reasons and can any be removed? Is official approval required (which both slows down the process and makes the outcome less predictable)? Should more than one office be contacted? Are there any fees involved? How long does the entire process take? In countries where corruption is a problem, what is likely to be the additional cost incurred through paying bribes?
  - *The level of judicial uncertainty involved in economic dismissals.* What is the likelihood of ending up in court over a dispute? What share of layoff disputes end up in court? To what extent do existing laws and regulations require rulings or approvals by courts, trade organisations or other governmental or quasi-judicial bodies? Judicial uncertainty implies that more layoffs may occur outside the law.
  - *The effectiveness of economic dismissal laws and regulations.* In terms of compliance, how often is the law followed? How often it is circumvented or ignored? Low compliance could indicate weak enforcement due to inadequate government resources. But it may also signal rules that are difficult to enforce and which could be reformed to increase compliance levels. Low compliance may also signal rules that are in substance a poor fit,

overly severe or simply impractical, and which need to be reformed more fundamentally. Where compliance is high, do economic dismissal laws and regulations achieve desired outcomes or do they have adverse side effects (e.g., resulting in excessive expense or administrative delay or making employers reluctant to hire when business is good for fear of difficulty dismissing when business is bad)?

- Regarding flexicurity protections, has the country, within its means, successfully implemented laws, regulations and other programmes that provide income support and redeployment services to the unemployed, while reducing legislative and regulatory barriers to personnel restructuring? What types of support measures exist (e.g., direct financial support to the unemployed or other forms of unemployment insurance, severance pay from employers)? If so, how much is offered? How do these support measures relate to the existing barriers to economic dismissal? Is there a satisfactory equilibrium between low barriers to dismissal and meaningful support for individuals? Different countries may choose different formulas for striking this balance. What improvements are possible, keeping in mind that there are some programmes which, although effective, may not be within the means of every country to implement?
- Regarding flexible work schedules, what laws and regulations govern work schedules, including work-hour limitations and fixed-term and part-time work contracts? How well do they support an adaptable workforce by helping create flexible work schedules through the mutual agreement of employers and employees? Based on a review similar to that of economic dismissal laws, are such laws and regulations sufficiently clear, flexible, streamlined and ultimately effective? Regarding specifically fixed-term and part-time contracts:
  - Are there any limitations on contract lengths, number of renewals, and types of positions for which fixed-term or part-time contracts may apply? This is useful for evaluating flexibility. For example, if a fixed-term contract can last a maximum of only 24 months including renewals, this places a significant constraint on how it may be used.
  - Do those employed under fixed-term or part-time contracts receive equal tax treatment and social security protections? Where this is not the case, these types of contracts may be abusively used to withhold benefits from employees, rather than for their intended purpose of increasing flexibility.
  - Are fixed-term or part-time contracts used inappropriately to circumvent rigidities in other areas of employment law? For example, employers may try to hire workers using fixed-term

contracts to avoid dealing with economic dismissal procedures for full-time workers. This may signal economic dismissal procedures that are overly restrictive, and may result in a two-tiered system where employees doing the same work enjoy very different protections.

- Are the interests of any relevant stakeholders being neglected or under-represented through the current laws and regulations? Do current employment regulations protect more senior or full-time employees at the expense of newer employees, those with fixed-term contracts or the unemployed? Effective legislation should seek to reconcile employer and investor interests with those of the entire working age population.

### ***Further resources and case studies:***

The following resources provide information on labour market regulations that support an adaptable workforce and facilitate changes in operations and investment planning.

- An OECD report on [Boosting Jobs and Income: Policy Lessons from Reassessing the OECD Job Strategy](#) discusses creative ways of preserving labour market dynamism while at the same time providing workers with a sufficient security. The report is divided into four pillars: macroeconomic policy, removing impediments to labour market participation and job-search, tackling labour- and product-market obstacles to labour demand, and facilitating the development of labour force skills and competencies. Recommendations include ways of facilitating the adoption of flexible working-time arrangements and promoting transitions to formal employment.
- The [OECD Employment Outlook](#) is an annual publication focusing on a different labour topic each year concerning OECD countries – although much of the information is useful for policy-makers and reformers in non-member countries. For example, the 2006 Employment Outlook in chapter 2 examines the relationship between employment protection legislation and labour market flexibility. Chapter 3 of the 1999 edition discusses the impact of welfare systems and labour market programmes on participation and employment.
- The World Bank's Doing Business project ([www.doingbusiness.org](http://www.doingbusiness.org)) seeks to provide objective measures of business regulations and their application in over 180 economies, with an eye to assessing the ease or difficulty of doing business in each economy. A section on Employing Workers includes information on fixed-term contracts, work-hour restrictions, various types of limitations on economic dismissals, and required severance pay and notice requirements. A Paying Taxes topic includes information on non-wage labour costs. The World Bank's [Doing Business Law Library](#) features a free online collection of business laws

and regulations, including labour and social security laws, many of them in the form of links to other websites where the texts of the laws are posted.

- The International Labour Organization’s website ([www.ilo.org](http://www.ilo.org)) features a wealth of labour-related resources, including several useful databases. The [Natlex database](#) is particularly useful. It provides listings of labour-related laws (and sometimes links to the full text of the law), including national labour and social security laws and information on types of contracts, work-hour restrictions, collective dismissal procedures, severance pay and social security.
- The ILO website also features a [Termination of Employment Legislation Digest](#) which is a database of laws and regulations covering termination of employment procedures in over 77 countries. It includes Profiles of National Legislation, which are concise and user-friendly summaries of termination legislation organised by country. Each profile is broken down into sections such as “sources of regulation”, “scope of legislation”, “dismissal” and “severance pay”, and ends with links to sources of further information.
- The World Bank provides guidelines for policymakers and reformers in the form of “toolkits” which are topic-specific handbooks giving practical advice and resources. The [Labour Toolkit](#) deals with labour issues in the context of infrastructure reform but gives labour policy advice that is generally helpful, including on severance pay, pensions and redeployment support.
- In conjunction with a [Labour Market Policy course](#) that the World Bank Institute offers each year to assist policymakers with labour reform, the World Bank posts case studies, evaluations of existing labour market policies, background reading and useful exercises.