The Labour Market Regulations of the Doing Business Indicators

A critical assessment of the World Bank’s "Employing Workers Index"

Sandrine Cazes
EMP/Analysis
Employment Sector, ILO
Introduction

- Debate on EPL effect on economic & LM performances remains controversial
- Part of the problem may be due to the lack of satisfactory indicators, despite the innovative & rich work to measure hiring and firing rules
- Comparable datasets remain scarce
- Focus on the EWI of the DB Report (IFC, WB)
G1

GUEST17; 11/03/2009
The Case of the EW Index

• One of the 10 areas measured by the DB report
• Issue of labour regulations likely to be more controversial when the objective is to reduce costs; likely to undermine the purpose of labour law
• EW is a composite of 3 sub-indices: difficulty of hiring; rigidity of working hours; difficulty of firing; + firing cost indicator & non wage labour cost
• Countries are ranked according to their score
I-Methodological Issues

1. Restrictive assumptions about worker and firm
2. Arbitrary choices for weighting
3. Refer to a de Jure approach
4. Issues of Ranking procedures
5. Other concerns
1. Restrictive assumptions about the workers and the firms

- 20 years of job tenure
  - Only 17% of EU-15 workers meet this criteria
  - Average tenure is 6.2 years in Latin America and about half of the labour force had one or fewer years on the job.

- Firm with 201 employees
  - Most workers are in micro, small or medium firms
  - Employment in firms with < 50 employees: 53% Europe; 60% Chile; 74% Peru; 79% Pakistan
1. (cont.d)

- \( \Rightarrow \) Unrepresentative worker & firm

- \( \Rightarrow \) Long tenure has a large effect on dismissal costs

- \( \Rightarrow \) Omit exemptions from the application of labour legislation on SMEs (thresholds)
2. Arbitrary choices for weighting

- Choices of weighting scheme should be justified.
- Equal weights implicitly mean that each component has the same economic impact, although different numbers of workers are affected (regular employment/FT employment).
- Devising weights critical for composite indicators; thus use for policy recommendations should be done with great caution.
3. Focus on De Jure aspects

• Yet Enforcement matters
  • Given the increasing institutional complexity
  • The OECD indicator offering the closest approximation of judicial interpretation has the strongest correlation with the JOBLOSS variable and with the INFLOWS into U
• Important source of variation across countries & over time
• Neglect non-legislated forms of labour legislation
  • EP can for example be an outcome of a Collective Bargaining arrangement
4. Issue of ranking procedures

- “The main advantage of showing a single rank [is that] it is easily understood…and creates pressure to reform. As in sports, once you start keeping score everyone wants to win.” DB, 2006

- Ranking useful summary of complex & multidimensional issue; but provide information about relative positions only

- Over time comparability?

- Claim that ranking is an incentive to reforms, yet problems of moving target
5. Other Concerns

- **Subjective Indicators**
  - DB reports based on perception of respondents => Questionnaires allow room for interpretation & value judgements
  - Some partiality in the formulation of questionnaires, such as linguistic bias or choice of the vocabulary (du Marais, 2006)
- Mostly based on a binary coding
- Choices of threshold
II. Conceptual Problems

• Causality assumed to be from institutions to economic performance

• Regulations only seen as cost for (doing) business
  
  • Question 1: aren’t there any benefits from labour regulations above the sometimes narrow thresholds of the DB EWI?
  
  • Question 2: The design of a particular type of regulation decides on its effectiveness, can this be captured by a « cost only » approach?

• Collective bargaining not fully considered
Why focus only on (ex ante) costs?

- EWI do not consider the positive externalities of labour regulations. Many benefits, both social and economic, of labour regulations

- **Unemployment Benefits** scheme provides income protection to individuals and allows adjustment for business... adds employability if complemented by ALMP

- if well designed, moral hazard can be avoided and can improve matching in the LM thus benefiting firms. Act as a stabilizing mechanism for the economy
• **Working hours.** RHI does not reflect a proper grasp of the policy goals of working-time regulation – limit negative externalities associated with long working hours for individuals, firms and society.

• **Fixed term contracts.** Long term use of FT contracts associated with greater turnover, less skilled development, a greater prevalence of work accidents, etc.

• Management of **mass lay off**: EWI values unmanaged rather than managed retrenchments, while well managed retrenchment is a benefit to workers (better replacement score) and firms (lower adjustment costs in cases were public institutions co-finance).

  IFC’s “Good Practice Note: Managing Retrenchment,” (Aug 2005) more in the spirit of ILO convention 158

  • Advises early and on-going consultations with SP, government authorities and community leaders. Advises to look for alternatives to job losses and for outplacement

  • “a poorly executed retrenchment process can lead to loss of productivity, low morale and decreasing economic performance
Collective bargaining not considered in EWI

- Statutory provisions in the labour code are not the sole determinants of working conditions (or labour costs). In some cases, CAs mandate conditions of work (for ex. Working hours in DK)
- CB in some instances allow firms and workers to negotiate pay and working conditions that are below what is stipulated in the law
- Harmonious labour relations are an important factor for doing business
- Yet EWV methodology cannot accurately or fully capture the influence of collective agreements thus giving an inaccurate picture of what it is really like to do business in that particular country.
Conclusion:

• Room for improving EP measures; ILO probably a role to play in their construction.

• Potential benefits of regulation (not only for workers but also for firms) left to ex post assessments. But not easy to see how these could be conceptualized as an indicator.

• Need to be very cautious with policy recommendations.

• In particular ... since DB report is highly influential, used by academics, but also for the WB Country Assistance Strategies.

• Do we really know enough to get advices?