

Doing Business

Employing workers

In the 1970s symphony orchestras in the United States started using “blind” auditions—where the performer plays behind a screen so the evaluator can hear the music but not see the person. The result: the share of women among new hires shot up by 75%.¹

Bias against the hiring and promotion of women still exists in some countries. In a few, it is explicit in the regulations. In the Democratic Republic of Congo, the United Arab Emirates and Yemen women are forbidden to work at night. In Lao PDR women are prohibited from performing certain types of manual work. In others, bias is simply the prevailing practice. The example of symphony orchestra hiring is telling—nothing in the rules discriminated against female musicians.

To protect workers from discrimination and other unfair employment practices, countries turn to regulation. The International Labour Organization has estab-

lished a set of fundamental principles and rights at work covering the right to collective bargaining, the elimination of forced labor, the abolition of child labor and the elimination of discrimination in hiring and work practices.²

Beyond these regulations and principles, governments struggle to strike the right balance between labor market flexibility and job stability. Many countries err on the side of excessive rigidity, to the detriment of businesses and workers alike. In Sierra Leone, for example, it costs an employer 189 weeks in severance pay to dismiss a worker. Venezuelan laws ban firing any low-paid workers. These are among the countries with the most rigid employment regulations (table 4.1).

In these and other countries laws created to protect workers often hurt them—especially women, youth and unskilled workers. Their employment opportunities vanish (figure 4.1). They end up in the informal economy. Women are 3 times as likely as men to be hired informally. In these jobs they receive no social benefits. And if they are abused by their employer, they have fewer protections.

More flexible labor regulations boost job creation. And they don't mean giving up protections. Georgia has some of the most flexible labor regulations in the world and it has ratified all the core labor standards of the International Labour Organization. Few can argue that workers are exploited in Denmark, another of the top 10 on the ease of employing workers. Workers in these countries have the best protection—flexible labor regulations that give them the opportunity for a job in the formal sector and easy transitions from one job to another.

TABLE 4.1

Where is it easy to employ workers—and where not?

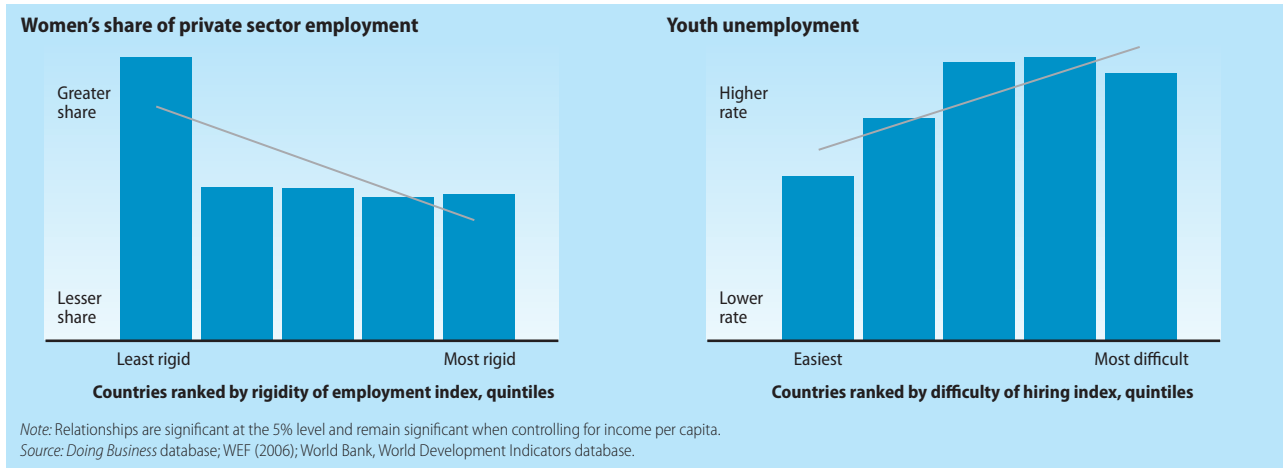
Easiest	Rank	Most difficult	Rank
United States	1	Sierra Leone	169
Singapore	2	Panama	170
Marshall Islands	3	Congo, Dem. Rep.	171
Georgia	4	Angola	172
Brunei	5	Paraguay	173
Tonga	6	Guinea-Bissau	174
Maldives	7	Equatorial Guinea	175
Australia	8	São Tomé and Príncipe	176
Palau	9	Bolivia	177
Denmark	10	Venezuela	178

Note: Rankings are the average of the country rankings on the difficulty of hiring, rigidity of hours, difficulty of firing and cost of firing indices. See Data notes for details.

Source: Doing Business database.

FIGURE 4.1

Women and youth lose out from rigid employment laws



The collection of data on the flexibility of labor regulations has spurred significant new research: 112 studies have used these *Doing Business* data. One set of studies finds that rigid labor regulation reduces jobs. In the Indian state of Maharashtra, for example, a study finds that rigid labor laws have resulted in 15% fewer jobs being created in the retail sector. Instead, store owners buy expensive computer equipment so they can run their operations with fewer workers.³

A second set of studies analyzes the effects of trade openness on the economy in the presence of flexible

labor regulations. A study of 90 developing countries finds that exporting businesses grew faster where labor regulations were flexible.⁴ Another study shows that this growth is due in part to the ability of these exporters to operate in industries with high volatility in demand. For example, textile exporters, whose business is driven by changes in fashion, thrive in countries with flexible regulation.⁵ A third study estimates that in an open economy, flexible labor regulation can increase annual growth by up to 1.5%.⁶

Who is reforming?

Twelve countries made significant changes to their labor regulations in 2006/07. Eight increased flexibility; 4 made regulations more rigid. Eastern Europe and Central Asia had the greatest number of positive reforms, followed by Western Europe and Africa (table 4.2).

The Czech Republic was the top reformer, adopting a new labor code that replaced its 1965 code. The new law provides for more flexible working hours. It also eases restrictions on dismissals. Before the reform an employer could dismiss an employee for economic reasons only if the employee could not be reassigned to another position or retrained. The new law eliminates this requirement. It also reduces notice periods for dismissals from 3 months to 2. Firing costs remain the same, however, because severance pay rose by a month.

Latvia extended the maximum duration of fixed-term contracts from 2 years to 3, making it easier to hire new workers when demand is high without imposing high costs for dismissal if demand declines.

Labor laws in rich countries, already among the most flexible, continued to evolve (table 4.3). Both Switzerland and the Netherlands made working hours more flexible. Switzerland eased restrictions on weekend work. And a new law in the Netherlands increases allowable overtime hours and extends the period for averaging them.

Reforms in Spain made it easier for employers to convert workers' contracts from fixed term to open

TABLE 4.2
More flexible working hours—a popular reform in 2006/07

Made working hours more flexible Czech Republic, Netherlands, Pakistan, Switzerland, Uganda
Extended limits on temporary work Bhutan, Latvia, Togo
Offered incentives to make temporary workers permanent Spain
Made firing more difficult Bhutan, Czech Republic, Latvia, Moldova, Venezuela
Increased restrictions on fixed-term employment Slovenia, Togo

Source: *Doing Business* database.

TABLE 4.3
Who regulates employment the least—and who the most?

Rigidity of employment index (0–100)			
Least		Most	
Hong Kong, China	0	Equatorial Guinea	66
United States	0	Guinea-Bissau	66
Singapore	0	Romania	66
Maldives	0	Angola	69
Marshall Islands	0	Congo, Rep.	69
Australia	3	Panama	69
Uganda	3	Niger	70
Canada	4	Congo, Dem. Rep.	74
Jamaica	4	Bolivia	79
Palau	4	Venezuela	79

Firing cost (weeks of salary)			
Least		Most	
Denmark	0	Ecuador	135
New Zealand	0	Argentina	139
United States	0	Mozambique	143
Puerto Rico	0	Sri Lanka	169
Afghanistan	0	Ghana	178
Iraq	0	Zambia	178
Marshall Islands	0	Sierra Leone	189
Micronesia	0	Zimbabwe	446
Palau	0	Bolivia	not possible
Tonga	0	Venezuela	not possible

Nonwage labor cost (% of salary)			
Least		Most	
13, including:		Hungary	34
Bangladesh	0	Czech Republic	35
Botswana	0	Slovakia	35
Cambodia	0	Brazil	37
Comoros	0	Italy	37
Eritrea	0	Ukraine	38
Ethiopia	0	Belarus	39
Lesotho	0	China	44
Maldives	0	France	47
West Bank and Gaza	0	Belgium	55

Note: "Not possible" indicates a full ban on firing low-paid workers for economic reasons.
 Source: *Doing Business* database.

ended. The reforms lowered nonwage labor costs and some types of severance payments and offered incentives to make temporary workers permanent. Businesses and workers welcomed the more flexible arrangements: 126,901 conversions took place in July and August 2006, a 204% increase over the same period the previous year.

In Africa, Uganda and Togo adopted new labor laws. Uganda's employment act removed restrictions on weekend work. Employers and employees are free to set the legally required rest day anytime they choose. And there is no required premium for working on a rest day, except for overtime. But the law also requires employers to notify unions and the labor commissioner before dismissing 10 or more redundant workers. Togo's new law extends the maximum duration of fixed-term contracts from 24 months to 48. But it limits fixed-term contracts to temporary tasks, reducing the ease of hiring overall.

In South Asia, Pakistan extended overtime limits for retail workers from 150 hours a year to 624 and made working hours more flexible. Bhutan went much further, implementing its first labor code. The law removes the 12-month limit on fixed-term contracts, eases restrictions on night work and does away with mandatory pay premiums for daytime overtime.

Bhutan's law also prohibits forced labor, discrimination, sexual harassment and child labor. And it replaces protections that hurt workers with ones that make sense. For example, before the reform it was illegal for a pregnant woman to work past 9:00 p.m.—even a woman just 1 month into her pregnancy. Now a pregnant employee can work past 9:00 p.m. if she chooses. More important, the new law prohibits firing a woman on the grounds of pregnancy.

Some countries made their employment regulations more rigid. Venezuela extended its prohibition on redundancy dismissals to workers earning up to 3 times the minimum wage. Moldova increased its severance pay requirements from 20 weeks to 28.7. And Slovenia reduced the maximum duration of fixed-term contracts to 24 months.

What to reform?

Since 2004, 35 countries have made their labor laws more flexible (figure 4.2). Another 15 have made them more rigid. Here are 4 reforms that create job opportunities—especially for women, youth and the unskilled—by making it easier for businesses to operate:

- Allow flexible working hours.
- Introduce apprentice wages.
- Lower dismissal costs.
- Raise and equalize mandatory retirement ages.

Allow flexible working hours

In Ukraine overtime is allowed only under exceptional circumstances—such as to respond to natural disasters or avoid the destruction of property. In Côte d'Ivoire employees cannot work more than 75 hours of overtime a year—even if they want to. In Panama only specially designated businesses can operate on Sundays. In Algeria a woman can work at night only if she has a special exception granted by a labor inspector. These laws were created to protect employees. But they usually backfire—and take work away from willing workers.

Businesses sometimes need longer workweeks to respond to seasonal increases in demand. Reformers in the Czech Republic and Serbia have responded by allowing businesses to shift their work schedules with rising demand. Hours worked can be averaged over a 6-month period—a year in the Czech Republic, if established by collective agreement. Bhutan's new Labor and Employment Act provides for more flexible night work schedules by removing the previous 7-hour cap on night shifts and replacing it with extra pay for overtime at night.

Seventy-five countries permit flexible night work and allow employees to work up to 50 hours a week for 2 months a year to respond to a seasonal increase in demand—for example, to serve as a lifeguard at the beach in the summer or to sell Christmas trees in the winter.

Introduce apprentice wages

Apprentice contracts exist in nearly all rich countries along with about 25 others, including Burkina Faso, Chile, Madagascar, Thailand and Tunisia. These allow businesses to hire first-time employees for a portion—typically 75%—of the mandatory wage for a short period. The workers can get training and the opportunity for a job, and the businesses have an incentive to keep the workers once they have invested in their training. This is an easy reform to introduce: beneficiaries are easy to target and political opposition is unlikely, especially in countries with high youth unemployment.

Lower dismissal costs

In the Republic of Congo an employer who wishes to dismiss redundant workers must first write to the workers' representatives, seeking their guidance. Then the employer must obtain the authorization of a commission headed by the labor inspector. If the dismissal is approved, the employer must choose whom to lay off according to the order set out in the law, taking into account seniority and other factors. And the workers can choose to appeal the decision to the minister of labor.

Zambia has no third-party notification requirements. But a worker with 20 years of service is entitled to 40 months' severance pay. In Sri Lanka the law mandates 39 months' severance pay when the layoff is due to economic downturn. These rules hit businesses at the worst possible time—when layoffs are needed because of falling demand for their products.

Some of these requirements were created with good intentions. But high firing costs scare employers away from creating jobs. Women and youth are affected most. One study shows that tougher regulation of dismissals in Chile increased relative employment for middle-aged men at the expense of women, youth and unskilled workers.⁷ In Peru reductions in dismissal costs in the 1990s brought more women into the formal sector. And wages for women rose relative to those for men.⁸

Another way to ease dismissal costs is to offer unemployment insurance rather than severance pay. This is a viable reform in middle-income and rich countries.

FIGURE 4.2

More labor law reforms in Eastern Europe & Central Asia



In Austria employers contribute to a fund from which they may withdraw if a worker is made redundant after 3 years of employment. In St. Kitts and Nevis severance payments are made from a government-administered fund that employers pay into over time. In Italy employers deposit a portion of each employee's salary into a designated fund over the course of the employment relationship. In these countries employers do not have to pay additional severance when dismissing workers because of redundancy.

Raise and equalize mandatory retirement ages

Every country with an aging population faces a choice: raise the mandatory retirement age or face the collapse of the pension system. Pension systems have not kept pace with changing demographics. Most Western European countries introduced their 65-year retirement age before World War II. Life expectancies have risen by a decade, but the retirement age stands unchanged. Requiring more years at work would reduce the burden on social security and make it easier for governments to reduce taxes on business.

When raising retirement ages, reformers can take the opportunity to equalize them. In Russia women live 12 years longer than men on average. But they must retire at age 55, while men retire at 60. Worldwide, women live 4 years longer than men on average. But half of countries force women to retire earlier than men. The retirement age gap is largest in Eastern Europe and Central Asia (figure 4.3). The idea may be to benefit women. Instead, earlier retirement reduces their pension pay and career opportunities.

FIGURE 4.3

Equality in retirement age—lowest in Eastern Europe



The European Union has obliged members to adopt identical retirement ages. Germany just revised its labor law: starting in 2029, both men and women will retire at 67. Other countries should follow. Women will see higher retirement pay. And businesses will be able to keep their productive workers longer.

Notes

1. Goldin and Rouse (2000).
2. ILO (1998).
3. Amin (2007).
4. López-Córdova (2007).
5. Cunat and Melitz (2007).
6. Freund and Bolaky (2007).
7. Montenegro and Pagés (2003).
8. Saavedra (1998).