SOCIAL PROTECTION AND JOBS
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Social Protection & Jobs

Balancing regulations to promote jobs

From employment contracts…
…to unemployment benefits

Labor Market Institutions & Social Dialogue
November 1, 2019

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World Bank

Jobs, Labor & Migration Course

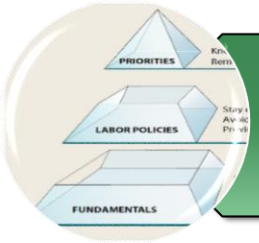
Why Labor Regulations?

establish the right balance between

- workers' rights and protection against abuse, unsafe work & emp. risks
- firms' flexibility in the management of human resources

correct imperfections in labor markets resulting from

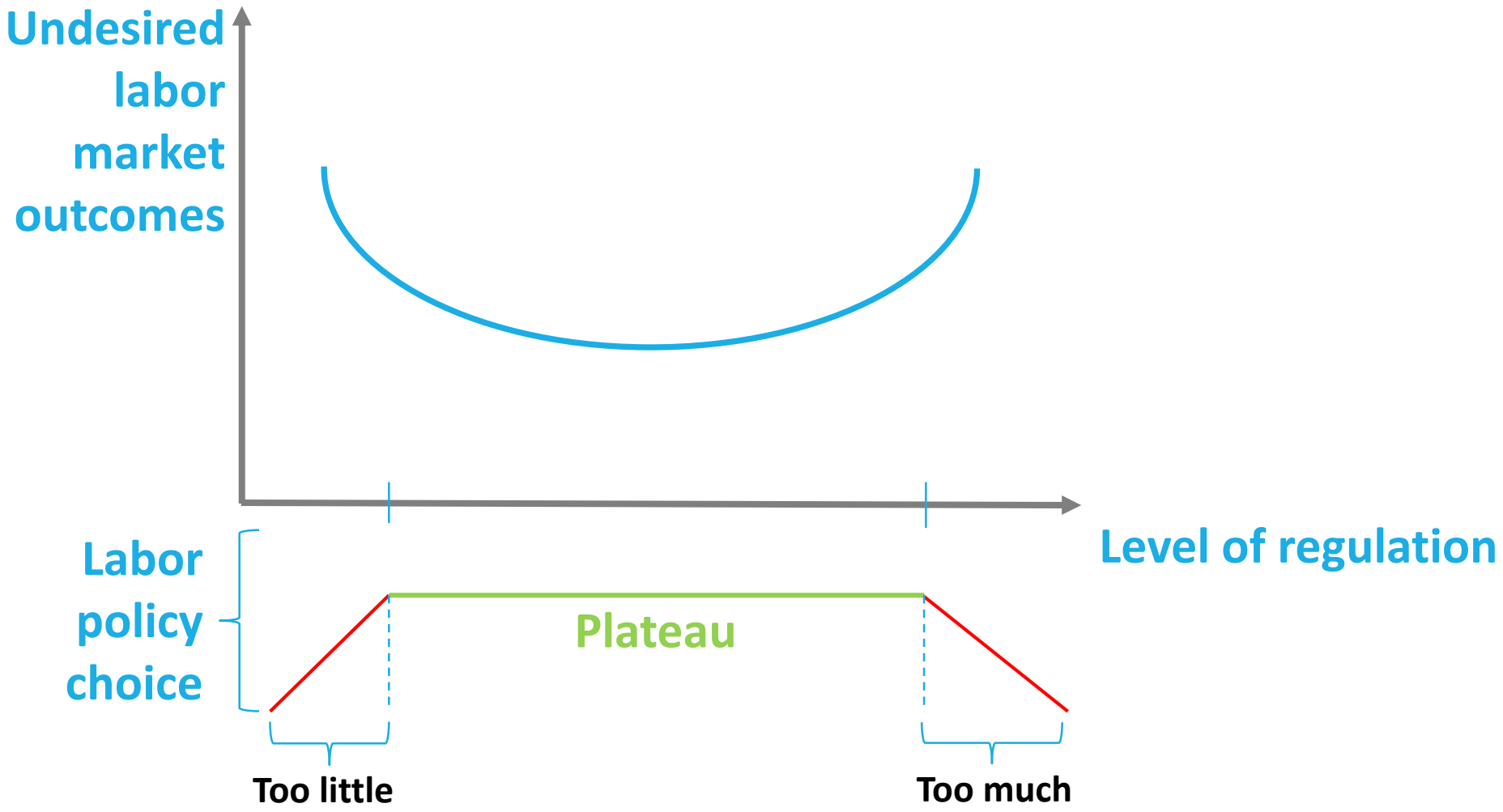
- inadequate information,
- uneven bargaining power,
- limited ability to enforce long-term commitments, and
- insufficient insurance mechanisms against employment-related risks



possible to achieve a workable balance,

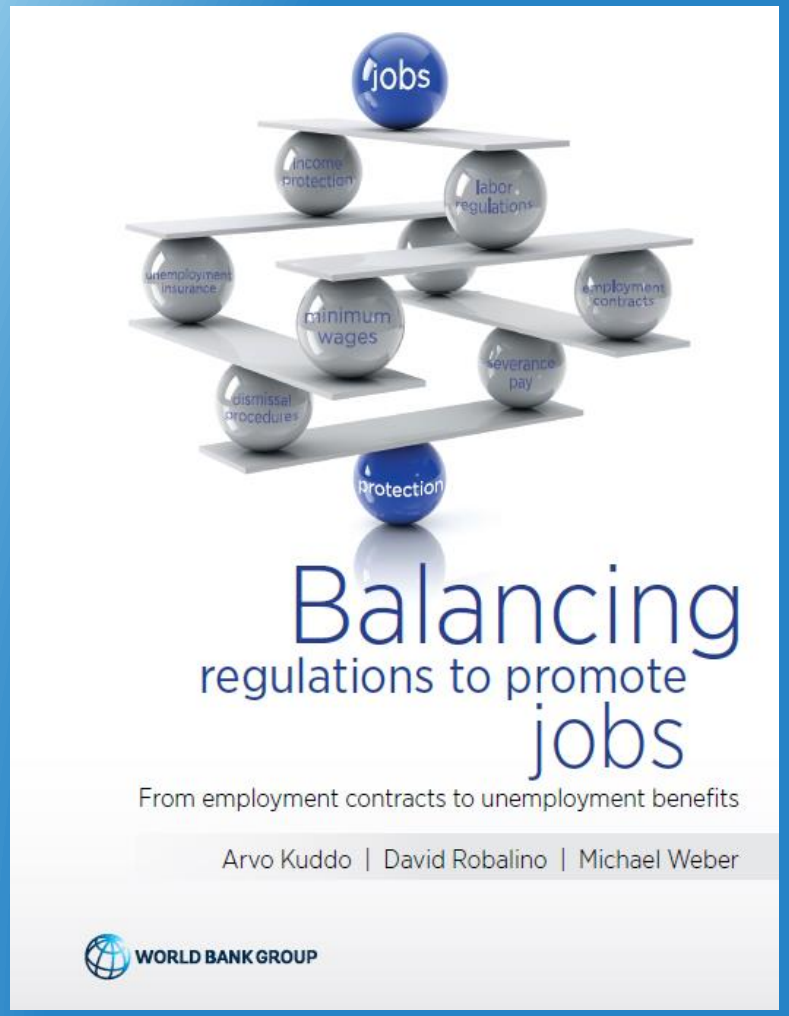
avoiding both: over- and under-regulation.

Labor Regulation "Plateau":
To lower adverse employment outcomes, avoid the extremes.



Source: Adaptation from WDR 2013: Jobs by T. Packard

Balancing regulations to promote jobs: From employment contracts to unemployment benefits

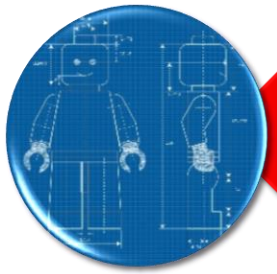


- provides general principles for the design and implementation of labor regulations in four areas:
  (i) employment contracts,
  (ii) minimum wages,
  (iii) dismissal procedures, and
  (iv) severance pay and unemployment benefits
- WBG report written in consultation with the ILO, ITUC, and IOE
- Click here for the document

General Findings I

Social dialogue can help develop and implement labor regulations

- promotes consensus building and ensures involvement of the main stakeholders



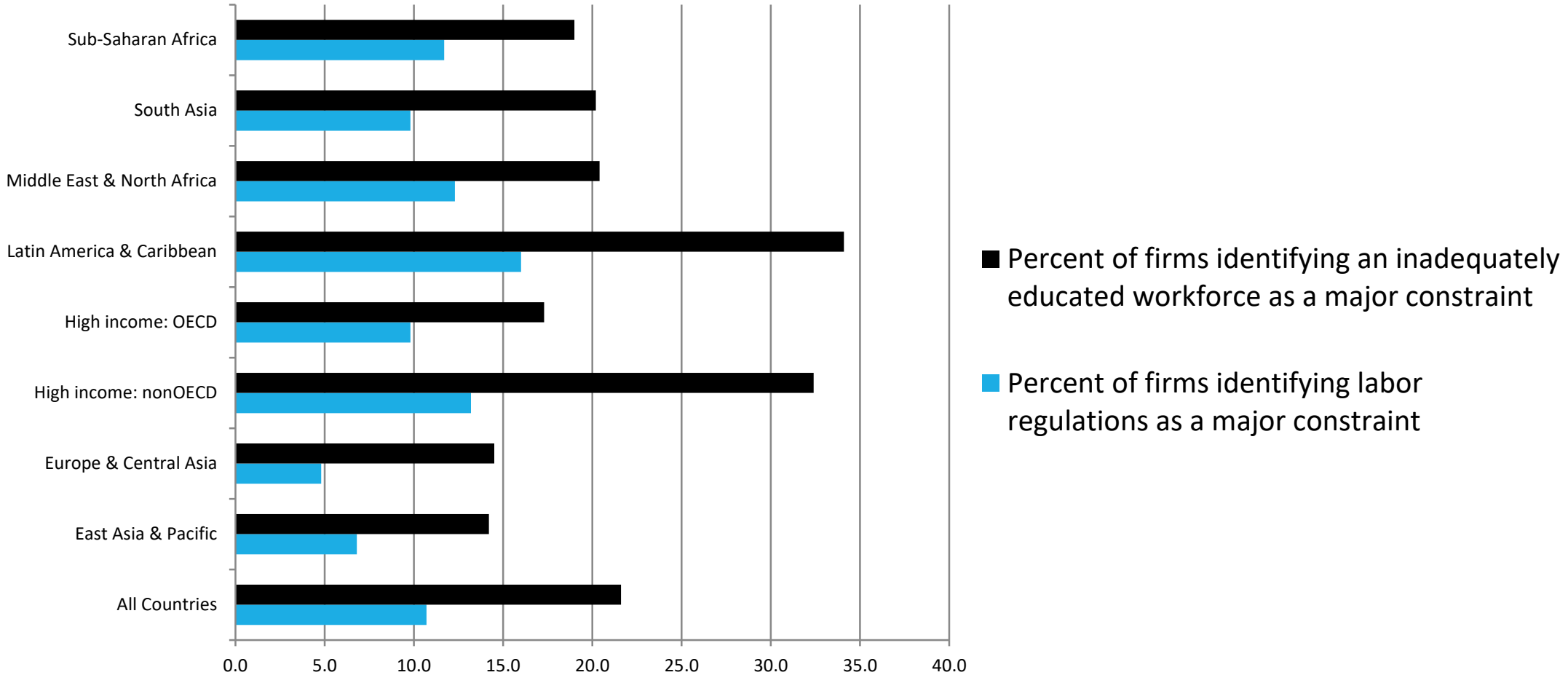
However: NO blueprint to design or adapt labor regulations

There are limits to what labor laws and policies can accomplish

- labor regulations primarily benefit employees in the formal sector

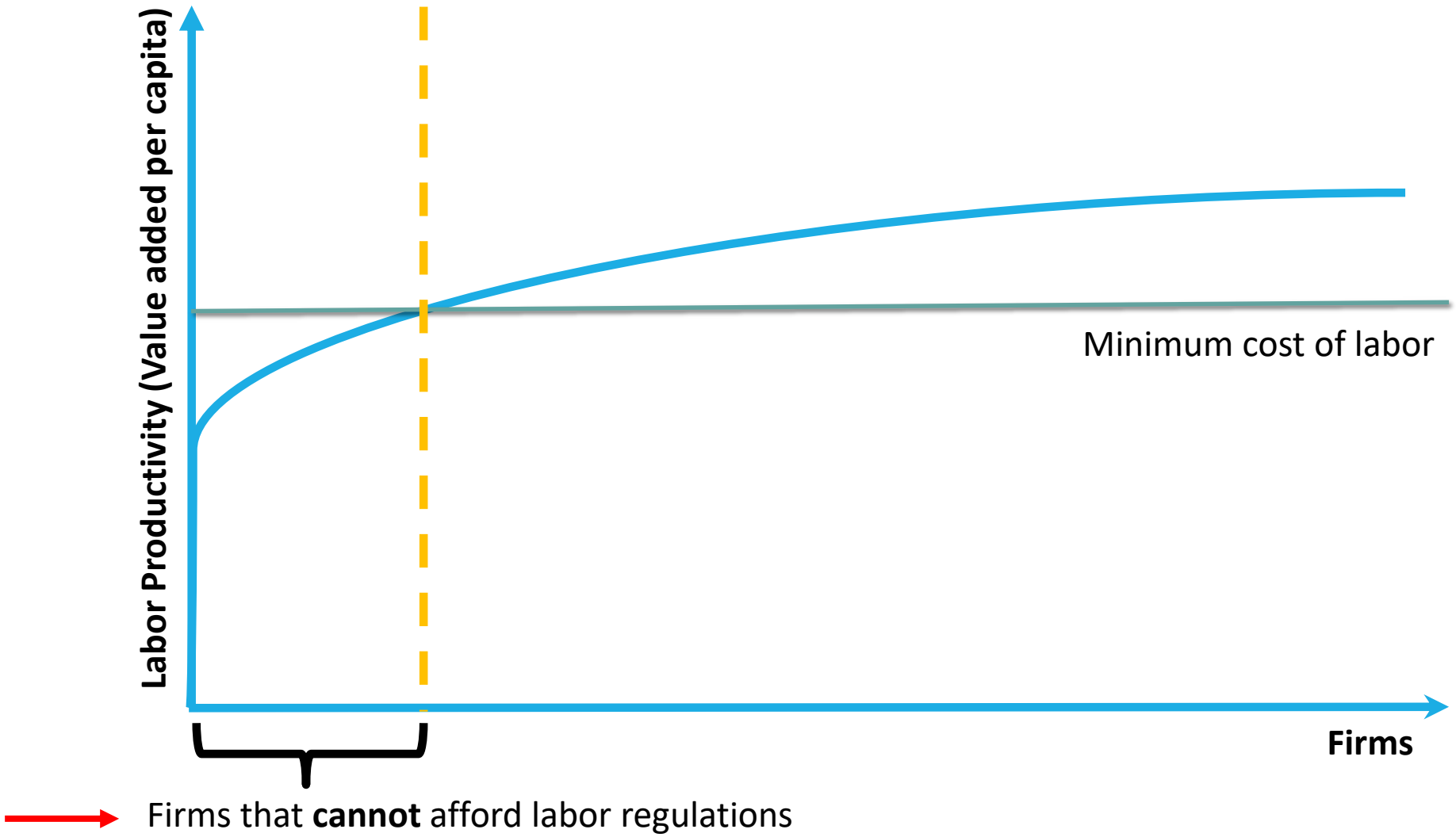
As the vast majority of jobs in LIC/MIC are in the informal sector

Only a small share of firms has issues with Labor Regulations



Source: World Bank Enterprise Surveys

But they can constrain low productivity, informal firms



General Findings II

Employment laws are often ineffective due to evasion and weak enforcement, even for workers with formal employment

Recommendation: reform labor regulations in a systematic and comprehensive manner.

- In the past, several countries narrowly focused on selected labor regulations without considering their complexity

Employment contracts

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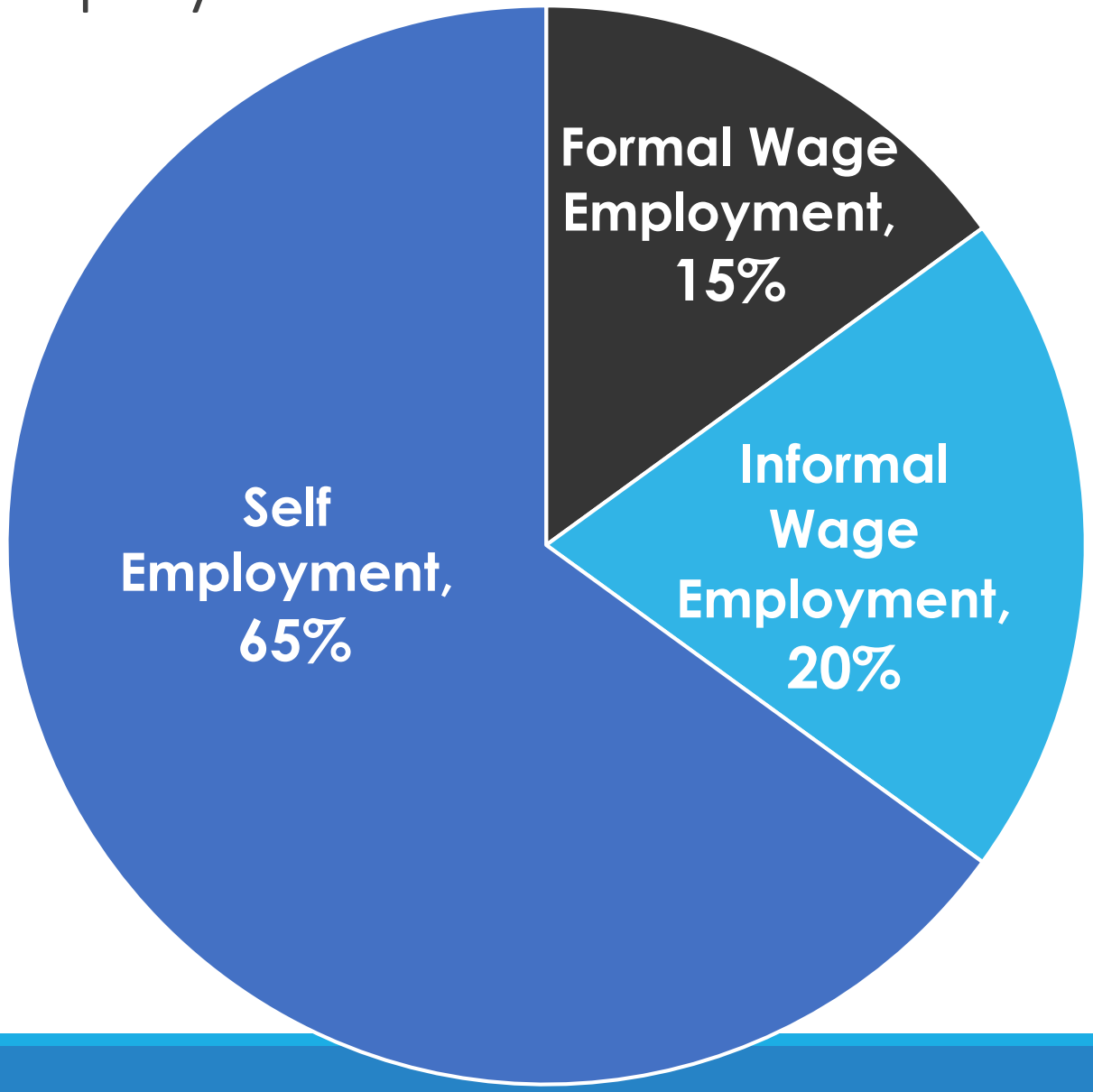
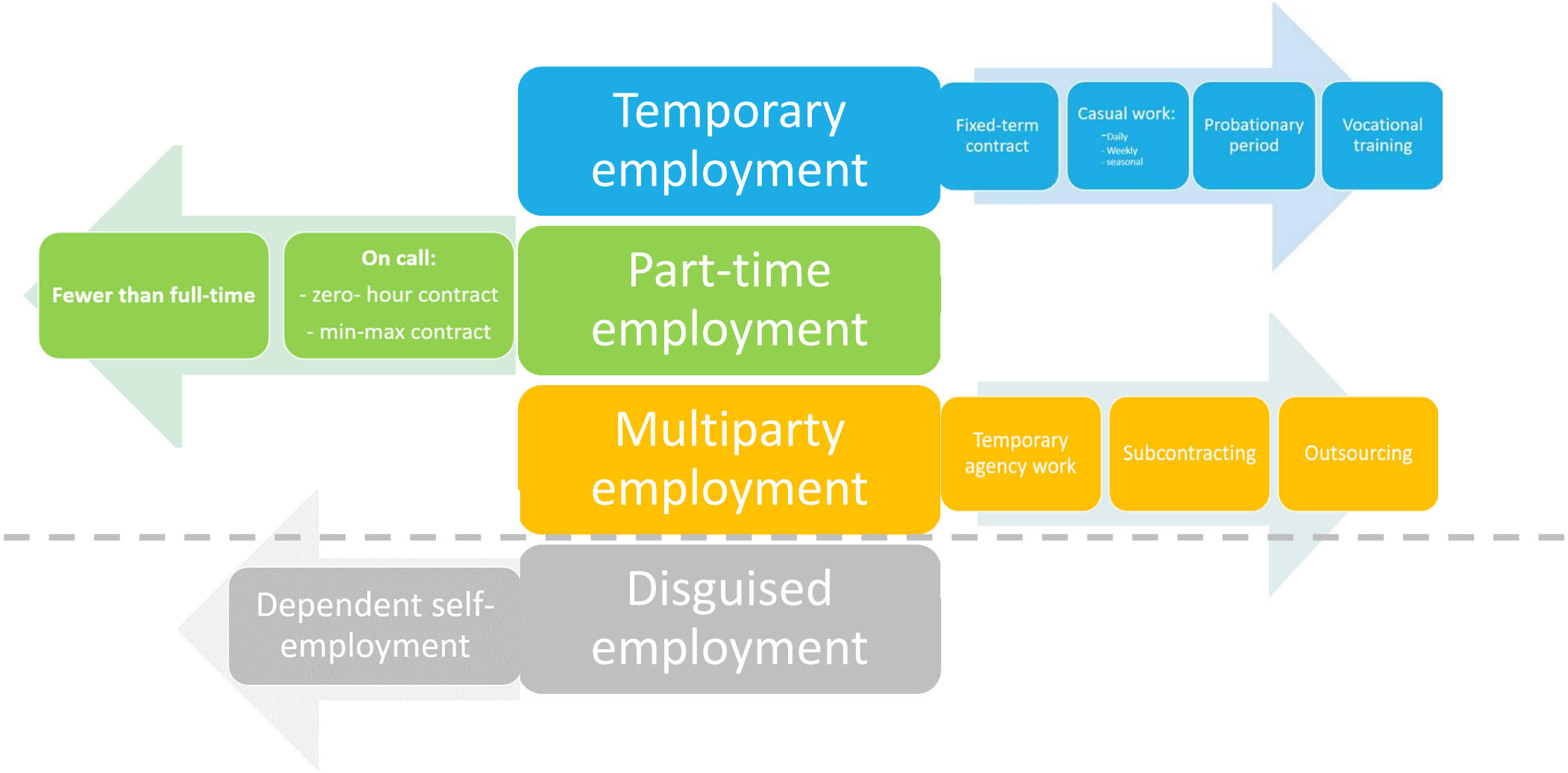
Why do we need to regulate labor contracts?

- Contracts exist because of asymmetric information and the need to enforce them
- In principle,
  - two or more parties should be able to agree on any type of contract and
  - courts should simply guarantee these contracts
- Typically not the case for labor contracts
  - as the bargaining power of employees and employers differs
- Basic standards are required to ensure that
  - workers have access to adequate working conditions, a fair remuneration, and access to social insurance
  - employers can better plan and manage their human resources

Who has employment contracts?



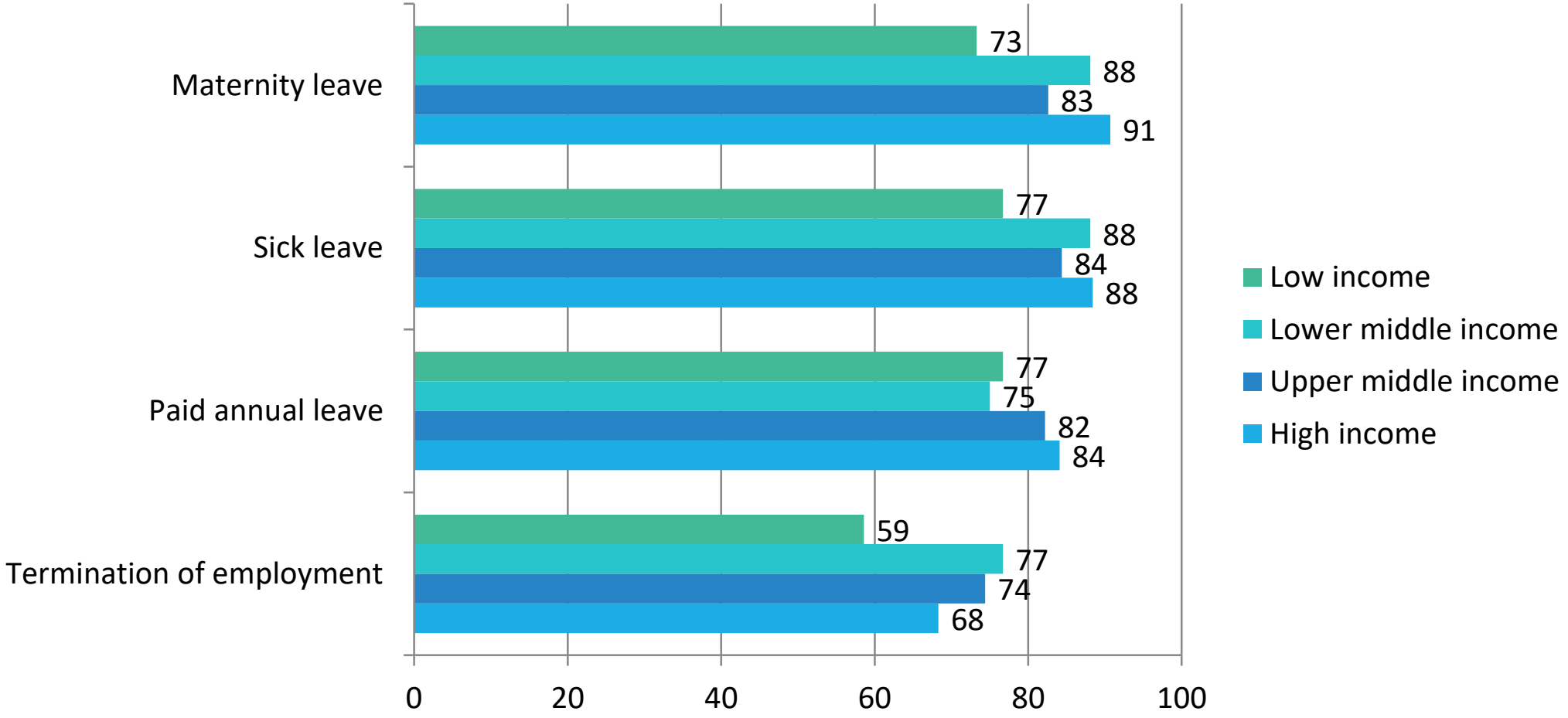
Non-standard work arrangements are on the rise



Examples of new forms of employment contracts

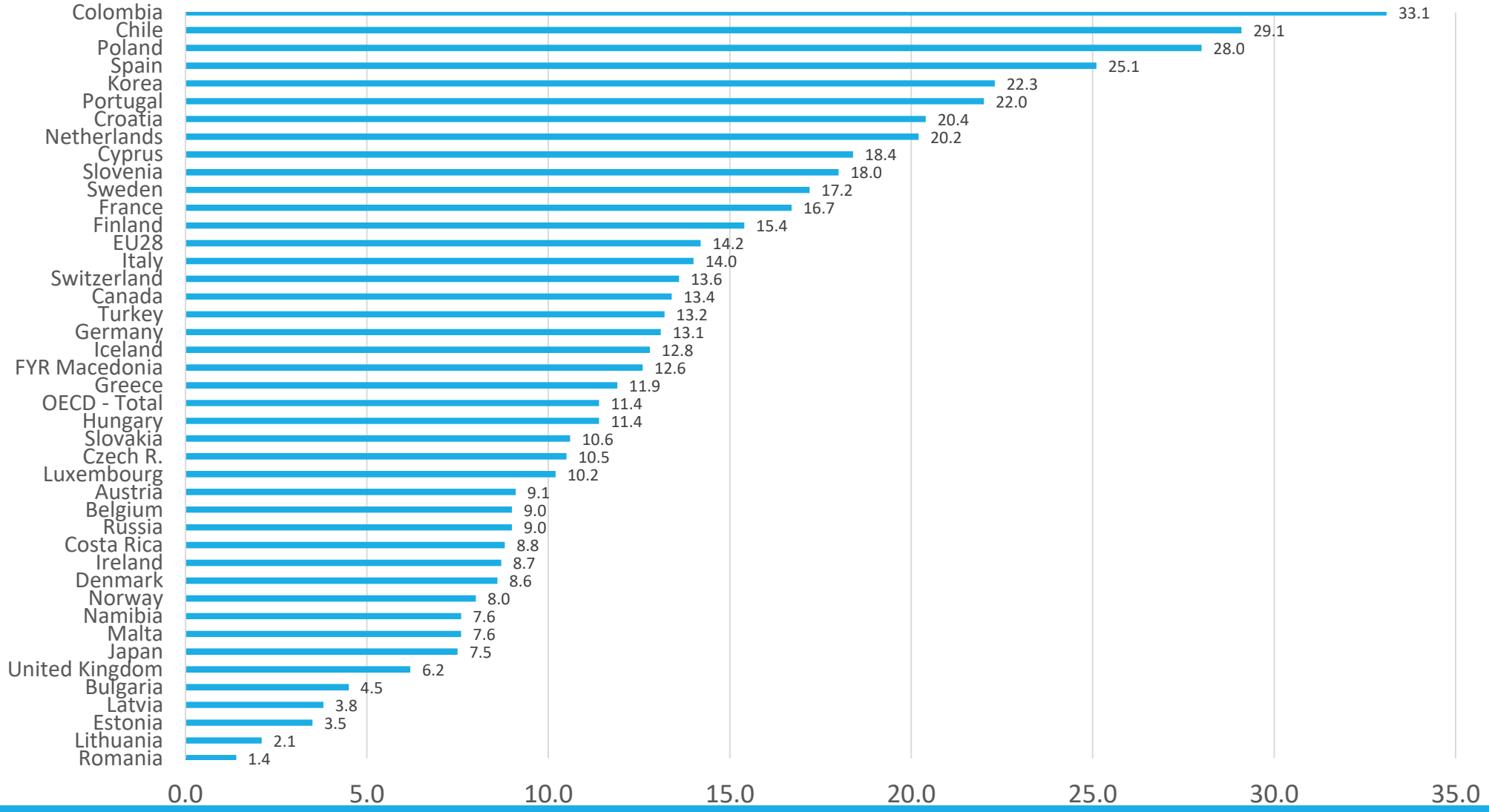
- Platform work (“gig economy”; digitally matched work)
- Crowd employment (task splitting)
- Collaborative employment (freelancers, self-employed, micro-enterprises)
- Job sharing
- Employee sharing
- Interim management

Economies in which the law requires that temporary workers enjoy conditions equivalent to those of comparable full-time workers, percent

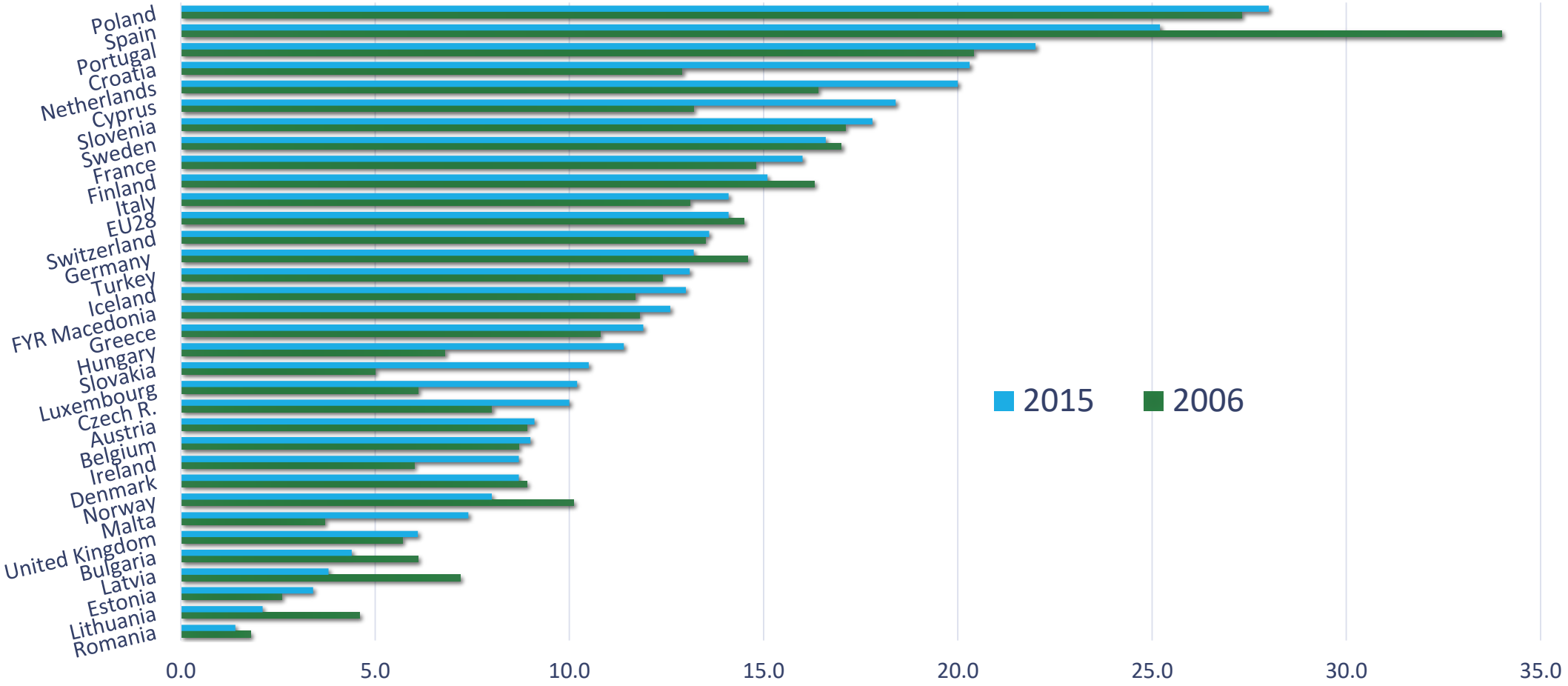


Data source: Doing Business

Temporary employment in selected countries, % of dependent employment, 2015



Fix-term contracts have proliferated as a way to provide flexibility to employers



Temporary employees as percentage of the total number of employees in the EU28 and in selected other countries in 2006 and 2015

What has been the impact?

- There is no evidence that flexibility increasing reforms raise overall employment;
  - instead, they appear to have encouraged substitution of temporary for permanent work
- Fixed-term jobs are less secure and pay lower than average wages
  - in the EU, temporary workers earn on average 14 percent less than workers with open-ended contracts
- Temporary workers tend to have reduced access to training
- Fixed-term workers are subject to higher turnover
- Labor market segmentation increased

Recommendations

- Let employers and employees agree on different types of contracts of different duration
- Term contracts can
  - provide an entry point into the workforce and an opportunity to gain experience and skills, while
  - allowing firms to cope with unexpected fluctuations in demand or replace permanent staff on leave
- Impose the same basic standards in all contracts:
  - Equivalence principle (‘pro-rated’) along measures of work intensity and extent
    - for working conditions, social insurance contributions, benefits incl. severance pay (e.g. based on the number of days of service)

Minimum wages

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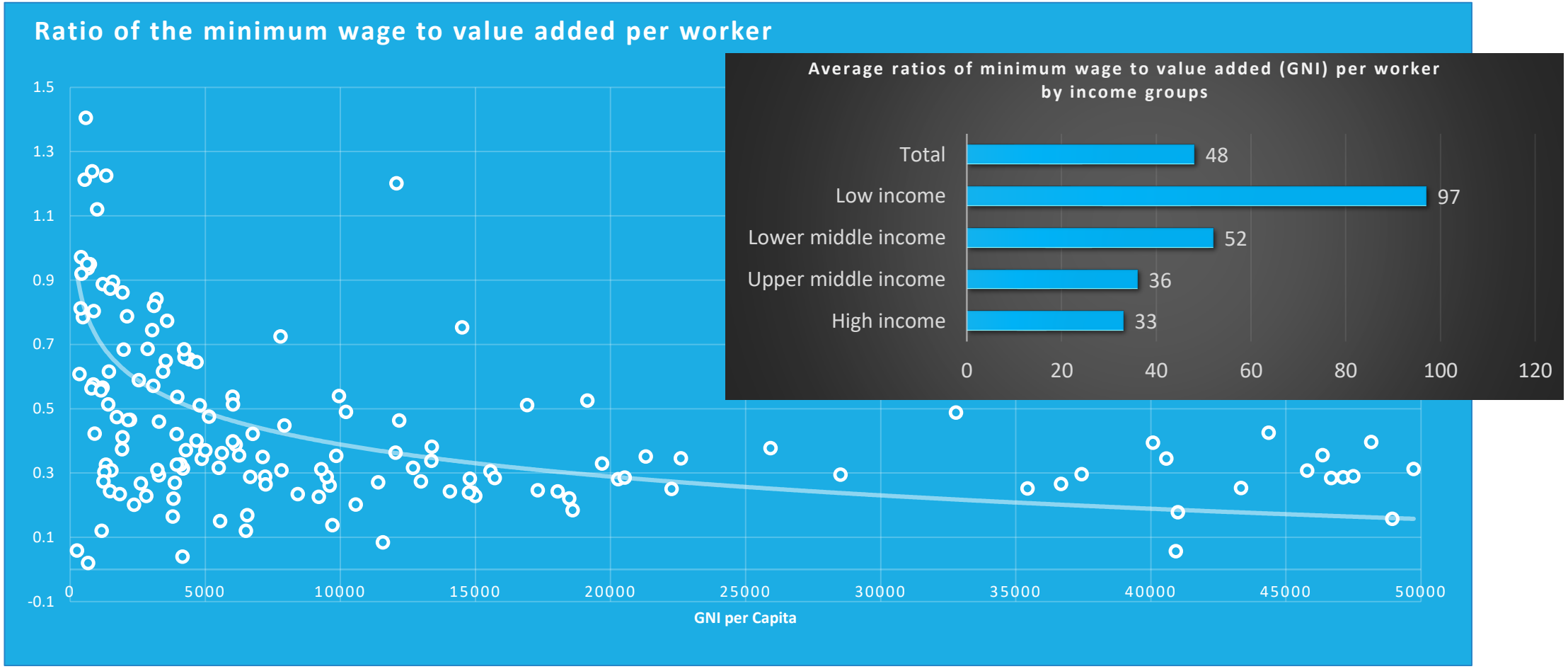
Why do we need minimum wages?

- The primary purpose of minimum wages (MW):
  - protection for wage earners against ‘unduly low wages’
  - justified due to asymmetric bargaining power
- MW
  - can contribute to reduce wage inequality and
  - under special conditions: reduce or prevent poverty

In developing countries, minimum wages are high relative to the value added per worker



Note:
Capped at 50,000 GNI PC and the ratio of 1.5
MW for a regular worker (adult cashier, age 19, with one year of work experience in the food retail industry)

Data source: World Bank, WDI

What has been the impact?

- LM and social impacts of minimum wages depend on
  - the level at which the MW are set (moderate levels are better for employment),
  - coverage of workers
  - enforcement
- Empirical results are mixed:
  - in some cases MW can increase employment (through higher labor supply), but
  - most studies show no or – small - negative impacts
- No strong findings that higher MW induce shift from formal to informal employment
- Evidence that MW can reduce poverty is weak
- Likewise, little evidence that MW can increase productivity (one study for the UK)

Recommendations

- Reduce political discretion:
  - Set a fix date to review the minimum wage
  - Set an independent body to recommend adjustments to the MW in consultations with social partners
  - The government can approve or veto but should not set the level
- Set the level based on an assessment of economic and social impacts:
  - A simple formula can be used to "anchor" the adjustment
  - But technical analysis should be used to asses impacts and recommend the final level
- Have a system that is simple:
  - Avoid different MW by sector – too complex
  - Maybe have a different minimum wage for first time job seekers
  - Maybe by geographic region

Dismissal procedures

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Why do we need regulations on dismissal procedures?

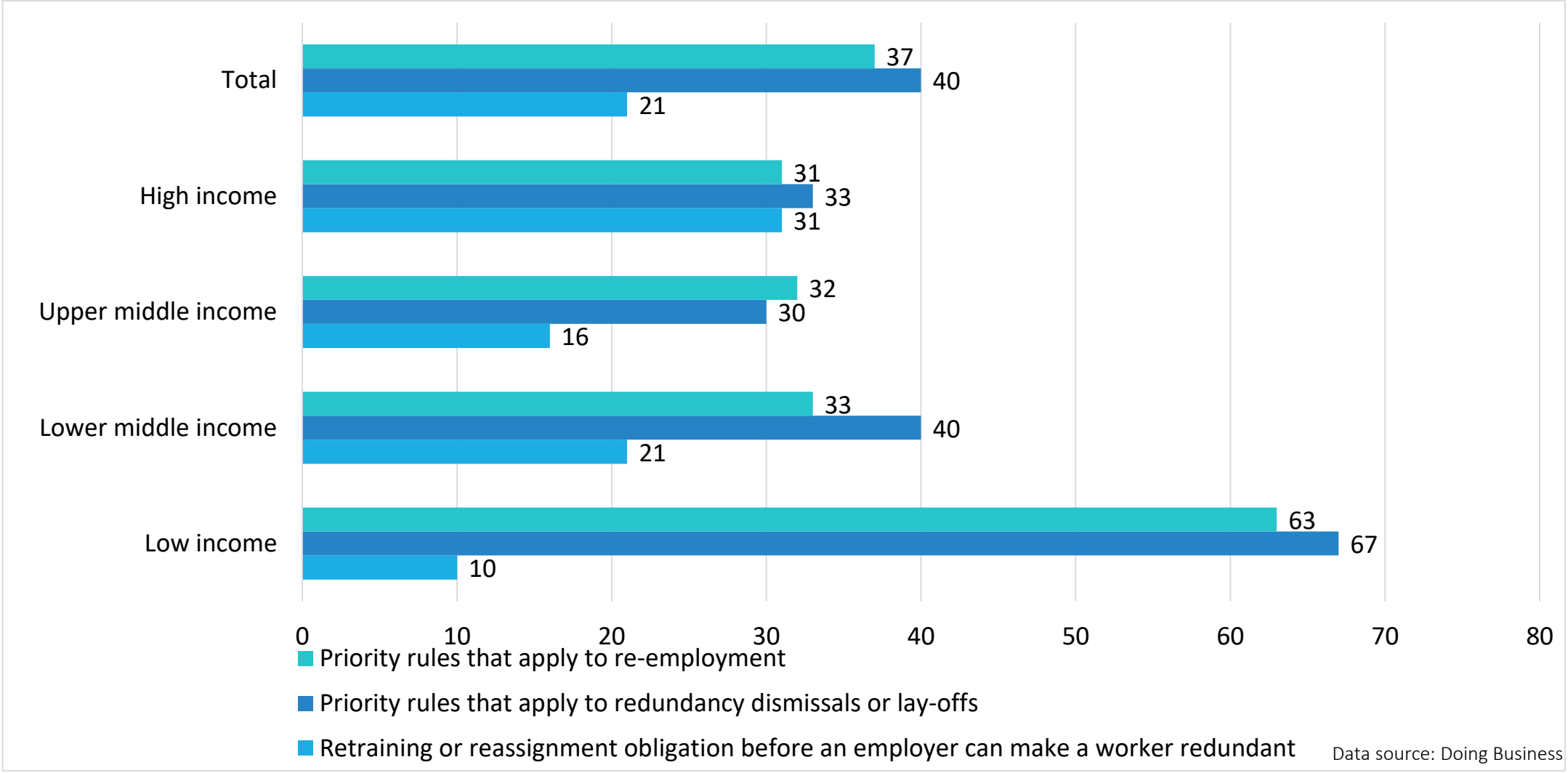
Mainly to mitigate the adverse effects of any termination on the workers and on their communities when dismissals affect large groups at once, and…

…to protect workers from abuse and discrimination.

Menu of requirements for employers

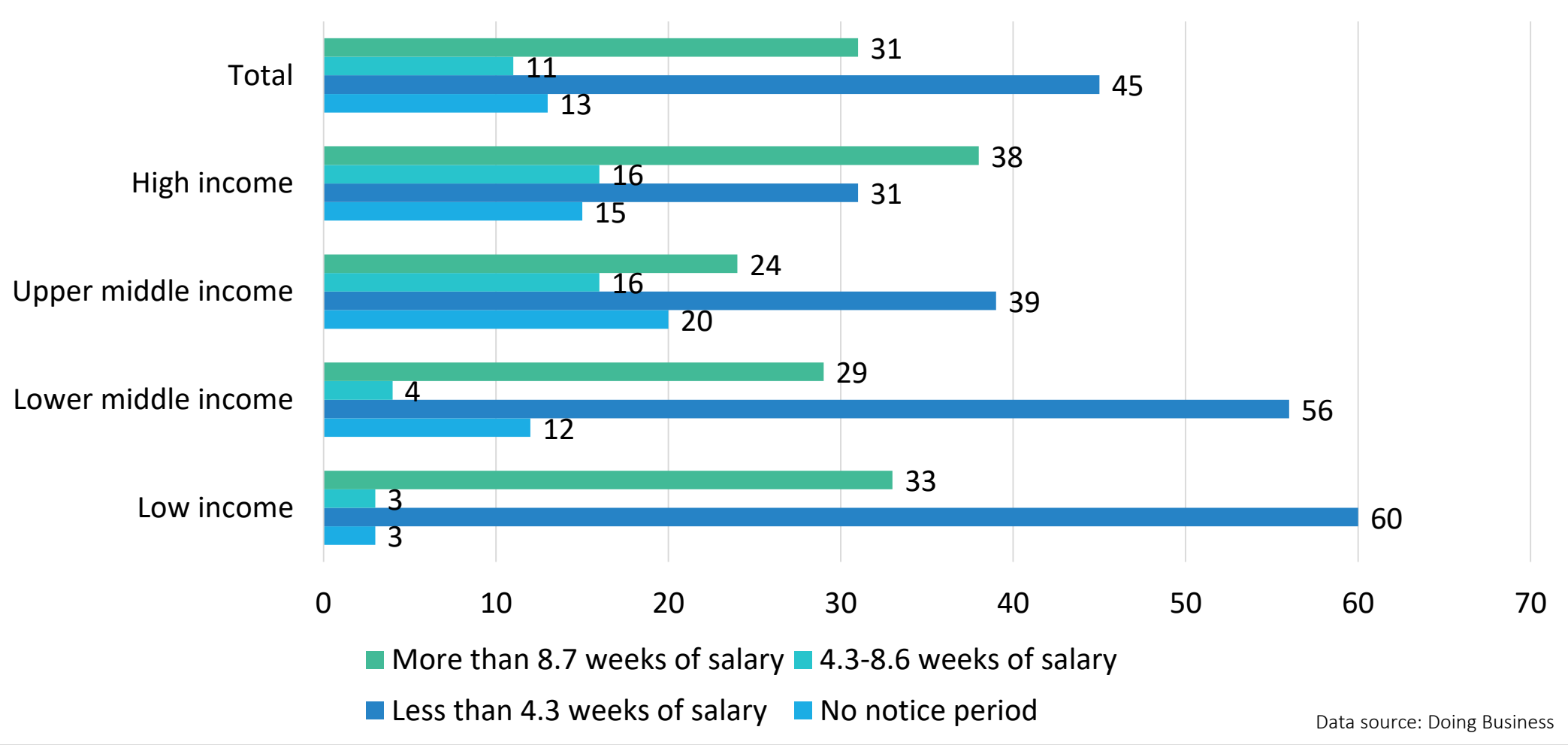
- Prior to initiation: preventive measures to avert or minimize the need for dismissals
  - may include retraining or reassignment obligation
- Priority rules
  - for selection of affected workers
  - can later apply for re-employment
- At initiation of dismissal
  - third party notification, or, in some cases,
  - third party approval
- Safeguards for ensuring
  - valid reason to terminate the employment contract;
  - no discrimination against workers;
  - advance notice; and
  - income protection and activation measures are in place
- Special provisions, common in case of mass redundancies

Requirements before dismissal

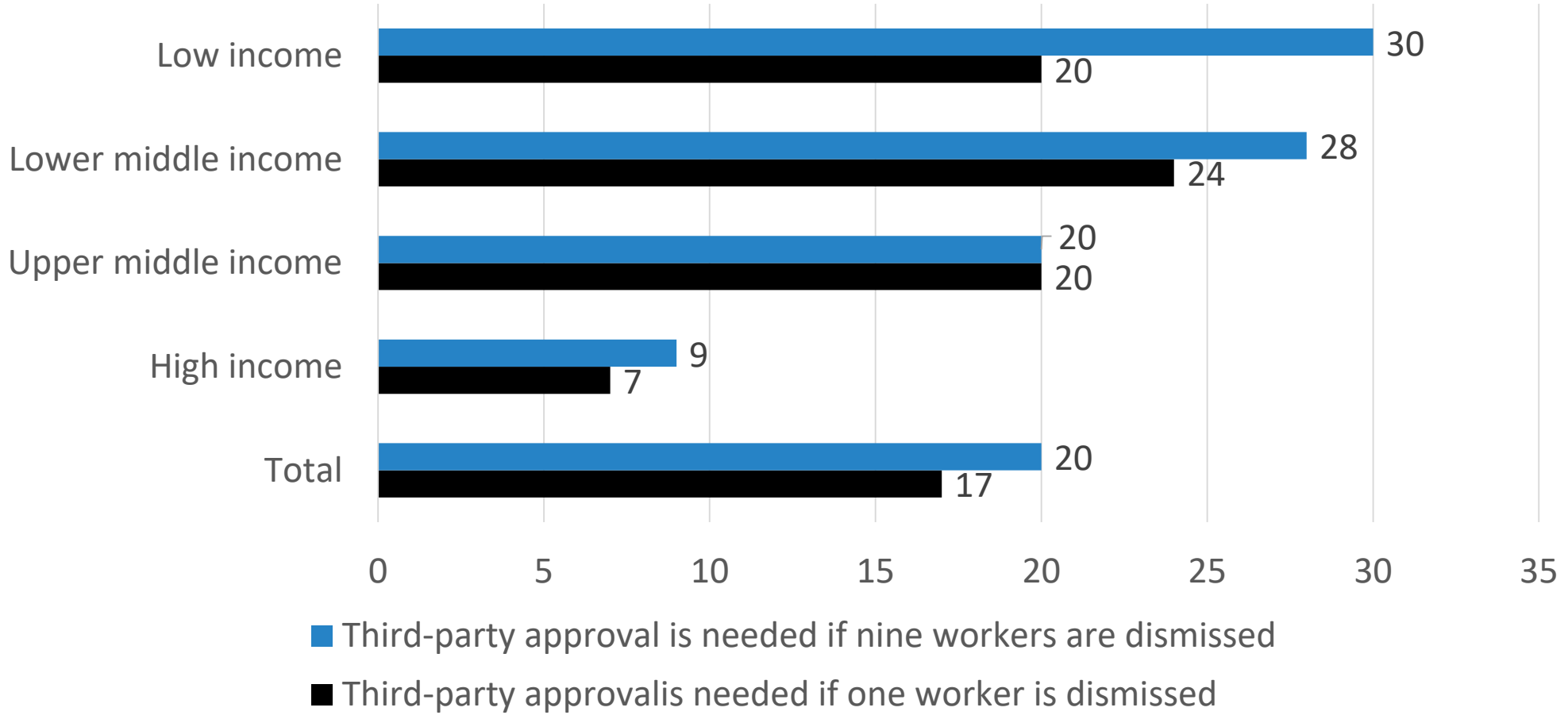


Data source: Doing Business

Notice period for redundancy dismissal after 10 years of continuous employment in weeks of salary; percent



Several countries restrict dismissals and require the approval of third parties



Data source: Doing Business

What has been the impact?

- Employers may be reluctant to hire if constraints inhibit future dismissals for technical or economic reasons
- Evidence that dismissal procedures
  - lengthen job tenure and
  - reduce turnover of those who are already employed
- Stringent employment protection:
  - sizeable negative effect on labor market flows and
  - some evidence for hindered productivity growth
- However, countries with more protective dismissal regulations have more durable or stable jobs,
  - can contribute to investments in training

Recommendations

- Employers should be allowed to manage human resources without third party approval, conditional on:
  (a) Proper advance notice
  (b) Effective and efficient unemployment benefits and ALMP
  (c) *Ex-post* controls and severe penalties for employers who abuse or discriminate against workers.
- However, special provisions needed for mass redundancies

Severance Pay and Unemployment Benefits

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Why Income Protection for the Unemployed?

- Help manage the risk of unemployment (consumption smoothing)
- Unemployment benefit systems can also act as automatic stabilizers
- Failures in insurance markets.
  - "Myopia“ – individuals failing to buy sufficient insurance,
  - Adverse selection, and
  - Cost of managing covariate risks (paying unemployment benefits in the case of recessions and mass-layoffs)

Basic options for income protection of the unemployed

Severance pay:

- Lump sum payment to a worker who has been involuntary laid-off
- Payout: wide variation re. coverage, eligibility conditions, vesting period and generosity
  - Payment usually depends on type of separation
  - Generosity often based on length of service

Unemployment Insurance:

- Risk-pooling among workers
- Labor wage based monthly contribution by formal wage workers
- Benefit Payout varies depending on eligibility requirements, vesting period, replacement rate,
- Can be linked to conditionalities

Unemployment Individual Savings Accounts

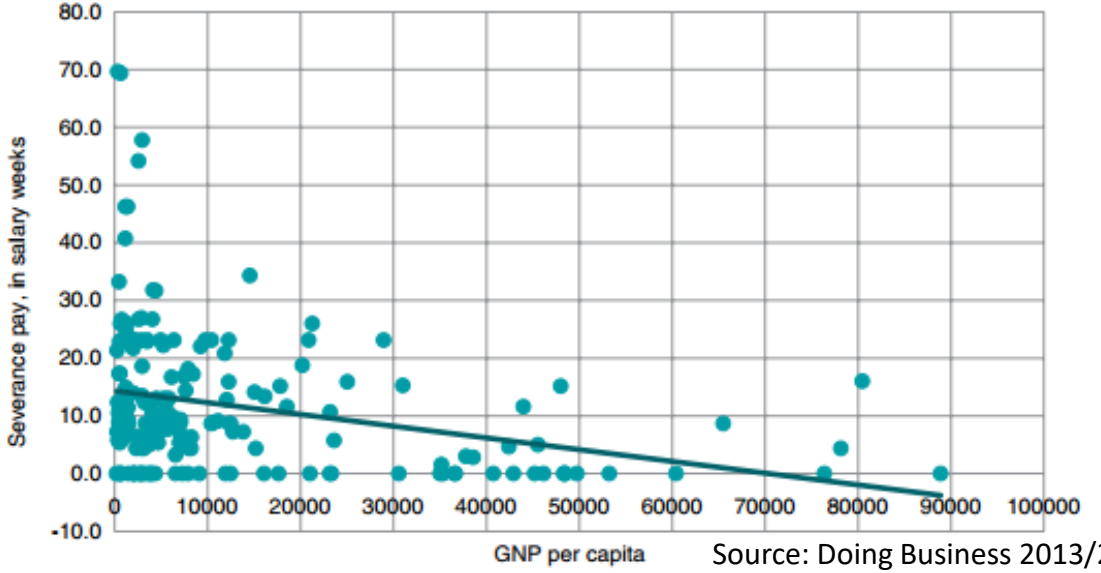
- Mandated savings for risk of unemployment
- Otherwise often similar parameters as for unemployment insurance but no conditionalities

Most LICs and MICs provide only severance pay

Average Severance in Countries with or without an Unemployment Benefits Scheme

Income Group	Countries with No Scheme		Countries with Scheme	
	Total Number of Countries	Average Severance Pay	Total Number of Countries	Average Severance Pay
High Income	10	10.3	46	6.7
Upper-Middle Income	26	8.2	24	13.3
Lower-Middle Income	35	17.0	12	12.5
Low Income	31	15.7	3	8.4
Total	102	13.7	85	9.7

Severance Pay for Redundancy Dismissal



Source: Doing Business 2013/2014

What have been the impacts? Part I

Severance pay:

- Employers often default
- Litigations are expensive and delay the payouts
- Increases cost of dismissals and there is evidence that it reduces flows into unemployment
- set too high: negative implications for job creation and efficient labor reallocation
- tend to discourage employers from undertaking necessary restructuring

Unemployment insurance (risk pooling):

- Higher solidarity and more redistribution (can be regressive)
- Lower cost for the same level of benefits
- Can increase the duration of unemployment spells, albeit
- May lead to better job "matches" (as workers can search longer)

What have been the impacts? Part II

Unemployment Individual Savings Accounts (UISA):

- High cost for a given level of benefits (8.33% contribution for one month of salaries per year)
- Workers are on their own; more vulnerable workers might not be able to save enough
- Better incentives to find and take jobs (lower moral hazard)
  - Although UISAs could increase turn over as workers try to cash savings
- May work best in combination with UI (risk-pooling)

Recommendations

- Replace generous severance pay with an unemployment benefits systems (current social security agencies can manage the new programs).
- Key policy choices for an unemployment benefit system:
  - The level of protection (replacement rate, duration, minimum benefit, cap, etc.)
  - The types of taxes needed to finance redistribution within the system (taxes on labor, savings, consumption, property/real estate)
  - Involvement of individual savings accounts for unemployment to reduce risk for moral hazard → consider mixed system: unemployment individual savings and insurance
  - Conditionalities to prevent abuse by increasing the opportunity cost of collecting unemployment benefits (mandatory participation in ALMP, e.g. training)
- Severance pay could remain in the form of a smaller "dismissal" tax – not as a payout to workers but help finance redistribution

Thank you for your attention

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