Doing Business Employing Workers Consultative Group

Final Report

April 25, 2011

I. Consultative Process

A. Background

In September 2009, a consultative group, chaired by the Financial and Private Sector Vice Presidency, was convened by the World Bank Group with the objective of reviewing the Employing Workers indicator, and providing comments on the Paying Taxes indicators, two of the regulatory areas measured by the *Doing Business* report. *Doing Business*, one of the World Bank Group's (WBG) flagship publications, presents 11 quantitative indicators that measure business regulations and compares them across 183 economies.

Since their first publication in 2003, the *Doing Business* indicators have become widely used in World Bank country-level reports and policy advice and came to be a catalyst for policy dialogue in many countries. Concerns emerged that the Employing Workers indicator (EWI) presented a measure of flexibility in employment regulations but was excluding other key dimensions of employment policies, such as worker protection. The Independent Evaluation Group (IEG) conducted an evaluation of the Doing Business report in 2008 that included views on the Employing Workers indicator.[1]

In the context of the economic crisis it was deemed that a more comprehensive approach on labor market policies was needed and that the right balance between measuring regulation and flexibility needed to be achieved. In response to these concerns the World Bank Group (WBG) announced in April 2009 that it would make changes to the EWI and that for this purpose it would consult with a wide group of stakeholders representing a broad range of views and experience. This was followed by a Guidance Note to all World Bank Group staff removing the EWI, during the consultative process, as a guidepost to the World Bank Country Policy and Institutional Assessment questionnaire, and directing that the EWI was not to be used as a basis for policy advice.[2]

The work of the Consultative Group, formed as a result of the above, commenced in September 2009. As the process was incomplete as of the publication of the *Doing Business 2011* report, the World Bank Group determined that the EWI data would be provided in an annex to the report, but that the data would not be scored nor would the indicator be taken into account in the calculation of the overall ease of Doing Business ranking.

[1] The 2008 Independent Evaluation Group's report on Doing Business can be found here: http://web.worldbank.org/WBSITE/EXTERNAL/EXTOED/EXTDOIBUS/0,,contentMDK:21645387~pagePK:64829573~piPK:64829550~theSitePK:4663967,00.html

[2] http://www.doingbusiness.org/methodology/employing-workers

B. Objective of Consultative Group

The original terms of reference of the Consultative Group (CG) were as follows:

1. Advice concerning possible modifications to the EWI and research based on the EWI, including on information to be gathered and evaluated in the context of labor markets.

2. Advice concerning a possible worker protection indicator (WPI) that would address countries' adherence to core labor standards. It is expected this indicator would examine domestic labor laws, regulations and other instruments of government to ensure that workers are adequately protected, including in the event of unemployment.

3. Comment on the broader labor market, employment and social protection issues, including providing comments to a special forum to be convened to examine the Doing Business Paying Taxes Indicator (PTI).

Members of the CG were selected from international organizations, labor and employer organizations, academia, civil society, and related professionals; composing a multi-stakeholder group. Specific care was also taken to represent the views of developing countries and regional diversity. The terms of reference and list of the members of the CG are included in Annex 1 and Annex 2 respectively.

A preliminary teleconference was held on September 2, 2009 during which rules of procedure were agreed to (see Annex 3). A series of physical meetings and teleconferences were held between October 2009 and July 2010. Discussion on the various elements of the terms of reference ensued during each meeting. A complete and detailed list of the presentations and meeting minutes can be found in Annexes 4 - 10.

II. <u>Discussions and Outcomes</u>

A. EWI Methodology and changes recommended by CG member consensus

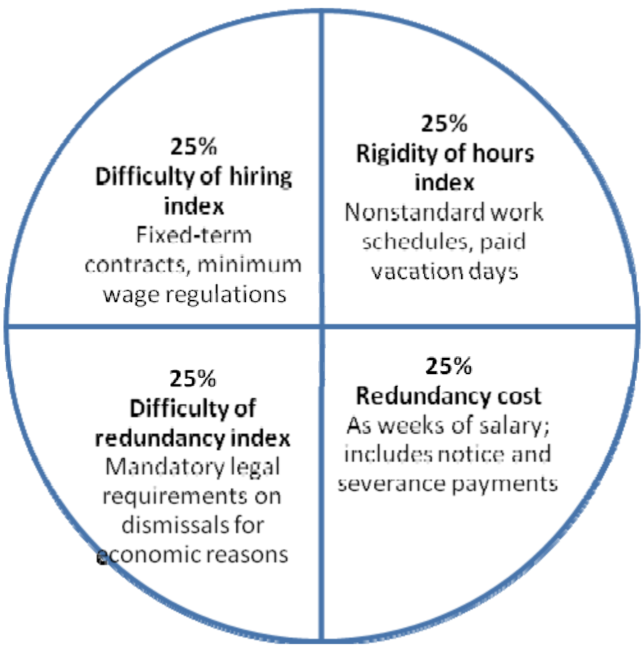
The Employing Workers Indicator (EWI), in line with the standard *Doing Business* methodology, bases its measurement on a hypothetical case study. The EWI case study is set out below (Box 1). Four areas of employment regulation are measured and scored: the difficulty of hiring, the rigidity of hours, the difficulty of redundancy and the redundancy cost (see Figure 1). All of these areas were open to discussion and review by the CG.

Box 1: Employing Workers case study as reflected in *Doing Business* 2010

Assumptions about the worker
Is a 42-year-old, nonexecutive, full-time, male employee.
Earns a salary plus benefits equal to the economy's average wage during the entire period of his employment.
Has the pay period that is the most common to workers in the economy being measured.
Is a lawful citizen who belongs to the same race and religion as the majority of the economy's population.

Resides in the country's largest business city. Is not a member of a labor union, unless membership is mandatory. **Assumptions about the business** Is a limited liability company. Operates in the economy's largest business city. Is 100% domestically owned. Operates in the manufacturing sector. Has 60 employees. Is subject to collective bargaining agreements in economies where such agreements cover more than half the manufacturing sector and apply even to firms not party to them. Abides by every law and regulation but does not grant workers more benefits than mandated by law, regulation or (if applicable) collective bargaining agreement.

Figure 1: Employing workers: rules on hiring, work schedules and redundancy
Rankings are based on 4 subindicators



An essential aspect of the CG's mandate revolved around assessing potential methodology changes to the EWI. The following areas of the Employing Workers methodology[3] were focused on: the tenure of the worker analyzed in the case study, mandatory paid annual leave, the maximum number of working days and working hours per week, and the minimum wage.

The guidance of the CG as detailed below has been the basis for methodology changes being considered by the WBG, which, if implemented, will focus attention on not only those

[3] Details of the EWI methodology can be found at www.doingbusiness.org/MethodologySurveys/EmployingWorkers.aspx

economies with excessive rigidity in employment regulation, but also those with inadequate labor regulations including those that do not meet ILO set minimum standards of worker protections in such areas as minimum wage, annual leave, and maximum working hours per weekIt should be noted that this represents a departure from the basic cost measure of a representative firm approach used in *Doing Business*. This departure is designed to consider the potential social costs associated with non-compliance with minimum labor standards.

The scope of what is measured by the Employing Workers Indicator relates to four areas of standards among the several themes covered by the ILO conventions; it does not measure aspects of the ILO core labor standards— effective recognition of the right to collective bargaining, the elimination of forced labor, the abolition of child labor and the elimination of discrimination in respect of employment and occupation.. EWI covers the areas relating to employee termination, weekly rest and working hours, holiday with pay and night work. The *Doing Business* methodology has made efforts to be consistent with the conventions identified in these areas, making it possible for an economy to receive the best score on the ease of employing workers and comply with these ILO conventions. However, the CG, as one of the three elements of its terms of reference, focused on aligning the EWI methodology with the basic minimum standards set out in the ILO Conventions in these areas.

1. *Tenure of the worker*

In this context, the calculation of employment rules applicable to the worker was measured with regards to a worker with 20 years of tenure. The tenure is relevant in the measures of annual leave and redundancy cost.

The CG was of the view that 20 years tenure was not an adequate reflection of the reality of tenure in the manufacturing sector around the world. The proposal was to change the basis for the calculation of the cost of redundancy by considering tenure years other than the presently assumed 20 years.

Simulations for 9 months, 1, 5, and 10 years were presented by the *Doing Business* team. Overall, the results for all years were highly correlated. However, looking more into detail, shorter tenures displayed lower levels of correlation with the 20 year tenure scenario.

It was also noted that providing the data for 9 months would also be useful, however, given that in a number of countries these rights are accrued only when the worker has been in continuous employment for one year, **the consensus recommendation was to consider the average of tenures with 1 year, 5 years and 10 years in the calculation of the redundancy cost** so as not to distort the results. It was also recommended that 9 month tenure data should be presented on the Doing Business website along with data relating to 1, 5, 10 and 20 years tenure.

2. *Annual leave*

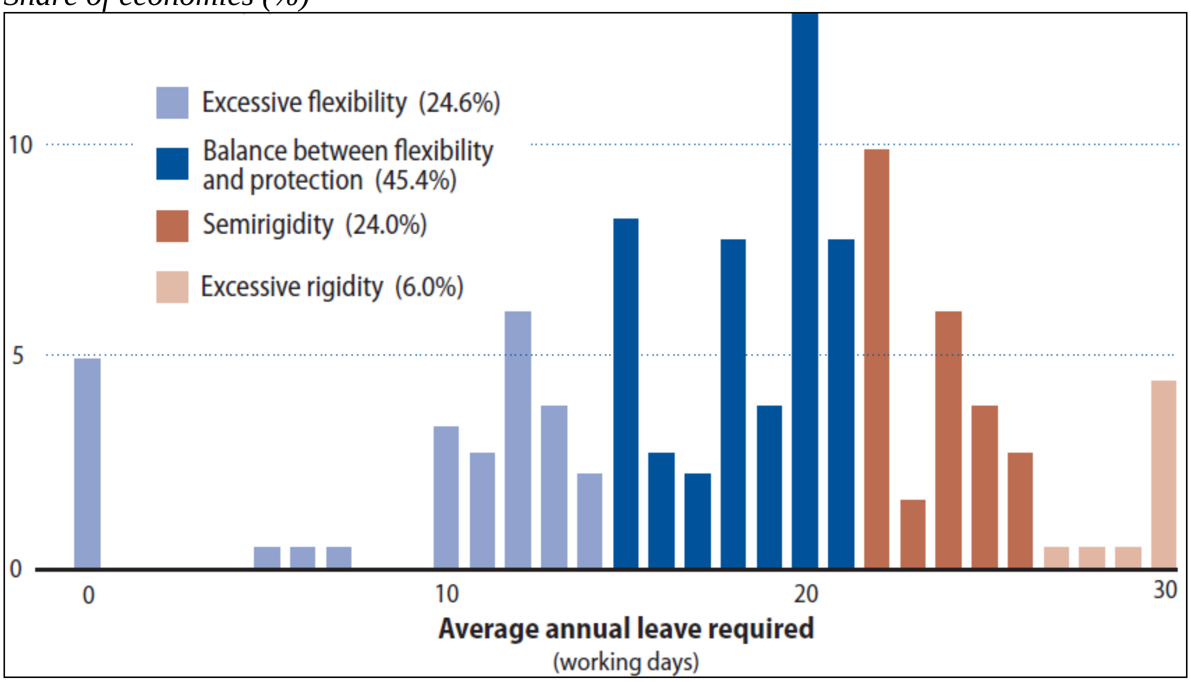
The rigidity of hours index of the EWI has 5 components. One of these measures the number of working days of paid annual leave that a worker can legally benefit from. The question measured was whether paid annual leave is 21 working days or fewer. As the methodology stood prior to any changes, a score of 1 was assigned if the answer was No, otherwise 0 was assigned.

During the consultative period **it was the consensus recommendation that the EWI subindicator on paid annual leave should be modified to set a floor at 15 working days below which an economy would score a 1 indicating excessive flexibility**. The rationale of such a change was to make the EWI methodology coherent with the relevant ILO Convention 132 – Holidays with Pay Convention (Revised), 1970, which states in its article 3.3: "*The holiday shall in no case be less than three working weeks for one year of service*". A score of 0 would be assigned to countries with annual leave of between and including 15 to 21 working days.

Additionally, there was discussion on whether economies with annual leave in excess of 21 working days (22 working days and above) should be scored a 1 indicating excessive rigidity. The group was of the view that a 2-step range should be set to distinguish between rigidity and excessive rigidity. Thus, **it was the consensus recommendation that annual leave between and including 22 – 26 working days should score 0.5 and annual leave of 27 days or more would score 1 for excessive rigidity**.

Figure 2 displays how countries would be distributed among different scoring classes according to the suggested amendment to the EWI methodology.

Figure 2: Distribution of economies by average annual leave
Share of economies (%)



Note: Sample includes all 183 economies measured in the *Doing Business* report.
Source: Doing Business database.

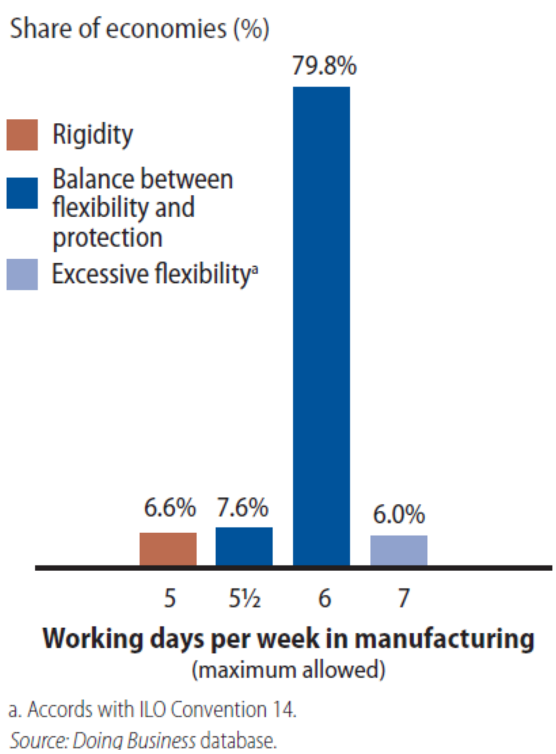
3. Maximum number of working days per week

The rigidity of hours index also measures the maximum number of working days per week. The question measured was whether the work week can consist of 5.5 days or more. A score of 1 was assigned according to the former methodology when the answer was No, otherwise 0 was assigned.

The CG acknowledged that the EWI scoring did not impose a minimum threshold for rest days per week. This was not in line with ILO Convention 14 on Weekly Rest (Industry), reading in its article 2.1: "*The whole of the staff shall enjoy in every period of seven days a period of rest comprising at least twenty-four consecutive hours*". The proposal to introduce a lower threshold was therefore recommended. Accordingly**, the consensus recommendation was that economies with less than one day (24 hours) per week as rest time should be assigned a score of 1 for excessive flexibility**.

Figure 3 displays how countries are distributed among different scoring classes based on an application of the amended EWI methodology.

Figure 3: Distribution of countries by number of working days per week
Share of economies (%)



Source: Doing Business database

4. *Minimum wage*

The difficulty of hiring index has three components, one of which looks at the mandated minimum wage. Scoring is based on the ratio of the minimum wage for a trainee or a 19 year-old employee to the overall economy's average value added per worker. Based on the EWI methodology under review, a score of 1 is assigned if the ratio of the minimum wage to the average value added per worker is 0.75 or more; 0.67 for a ratio of 0.50 or more but less than 0.75; 0.33 for a ratio of 0.25 or more but less than 0.50; and 0 for a ratio of less than 0.25.

Following the requests of the CG, the *Doing Business* team conducted further analysis regarding countries with no minimum wage according to *Doing Business* data.

From the minimum wage variable data, it was observed that 38 out of 183 countries (20.7%) are considered as 'no minimum wage countries' according to the methodology used in *Doing Business* 2010. However, a more detailed analysis of these 38 countries enabled the *Doing Business* team to observe a good degree of heterogeneity among them. The 38 countries could be divided into two categories:

i) Countries where there is no minimum wage at all, the mechanisms to fix it are ineffective or there is one minimum wage but it is just customary or applied only to the public sector.[4]
ii) Countries where the minimum wage is set by a collective bargaining agreement which applies to less than half the manufacturing sector or does not apply to firms not party to it - or countries where the minimum wage is set by law but does not apply to workers who are in their apprentice period.[5]

The results indicated that the adoption of a new scoring criterion would better represent such diversity, and this was the consensus of the CG. The rationale consisted in penalizing countries for excessive flexibility when they do not provide any minimum wage in the private sector or when they lack a legal basis to enforce a certain minimum wage in practice.

It was the consensus recommendation, therefore, that the calculation of the minimum wage ratio should change to ensure that economies in group (i) would not receive the highest score, while economies in group (ii) would still receive the highest score, as per the following.

Accordingly, it was recommended that a score of 0 be assigned if the minimum wage is set by a collective bargaining agreement –which applies to less than half the manufacturing sector or does not apply to firms not party to it- or if the minimum wage is set by law but does not apply to workers who are in their apprentice period. A ratio of 0.251 (and therefore a score of 0.33) would

[4] This group includes 29 countries, namely: Afghanistan, Bahrain, Brunei Darussalam, Cyprus, Djibouti, Eritrea, Ethiopia, Gambia, Guinea, Hong Kong, Kuwait, Malaysia, Maldives, Namibia, Saudi Arabia, Singapore, Suriname, Tonga, Iraq, Kiribati, St. Lucia, United Arab Emirates, West Bank and Gaza, Qatar, Nigeria, São Tomé and Principe, Cape Verde, Guinea Bissau, Kosovo, Timor-Leste.

[5] This group includes 8 countries, namely: Denmark, Italy, Sweden, Switzerland, Chile, Marshall Islands, Côte d'Ivoire, and Trinidad and Tobago.

automatically be assigned in 4 cases: if there is no minimum wage, if the law provides a regulatory mechanism for the minimum wage that is not enforced in practice, if there is no minimum wage set by law but there is a wage amount that is customarily used as a minimum or if there is no minimum wage set by law in the private sector but there is one in the public sector.

B. Other areas of discussion and research on EWI

5. Definition of minimum wage floor for the minimum wage indicator

The Group also explored alternative bases for calculating the floor for the minimum wage. The current floor is defined by the World Bank's global poverty level floor calculated as $1.25, using PPP exchange rates. If the ratio of the minimum wage to value added in the manufacturing sector is below this floor, economies score low (ie excessive flexibility). Some members were of the view that the floor should be in line with the ILO's guidance that minimum wages should reflect the cost of living. Other members cautioned that such guidance was nonspecific and would result in differing floors across the set of economies covered in the report, making comparison difficult.

It was suggested to use the value added per worker in the manufacturing sector, instead of the value added per worker currently used by *Doing Business* (ratio of an economy's GNI per capita to the working-age population as a percentage of the total population).

However, the analysis showed that such replacement would not be possible for two main reasons: (i) regarding the Manufacturing Value Added in USD in 2008, there is only information for 102 countries, 87 of which are *Doing Business* economies (less than half of the *Doing Business* sample), and (ii) neither the data for the value added in the manufacturing per worker, nor the data that breaks down employment for the manufacturing sector in each country is available.

6. Working hours per week

Discussions on the rigidity of hours index further revolved around the question on the maximum number of working hours per week. The question measured is whether the workweek can extend to 50 hours or more (including overtime) for 2 months a year to respond to a seasonal increase in production.

Two proposals were made and discussed by the CG:

i. To lower the threshold currently used by *Doing Business* to a floor of 48 hours a week and place a ceiling of 56 hours a week on average for continuous operation. The proposed floor is based on article 2.1 of ILO Convention 1, while the ceiling is based on article 4 of the same convention.

   It was noted that the setting of the ceiling may impose certain measurement challenges as the Convention does not clarify in what period the 56- hour average should be attained. **It was a consensus recommendation to request the *Doing***

***Business* team to collect systematically relevant data on maximum weekly hours, overtime in normal and exceptional circumstances, etc and subsequently conduct further analysis of this proposal**.

ii. The proposal to introduce a measurement of the overtime premia (penalizing excessive rigidity), given that it affects the cost for the employer. The idea presented was to combine this measure with the current measurement of number of working hours, so both of them would be equally weighted for this question.

Discussion revealed different views of the validity of this proposal. It was decided that the team should include questions in the *Doing Business* survey to collect data more in-depth on this issue, and analyze the results prior to deciding whether to include in the actual indicator.

C. Measuring worker protection

In line with the terms of reference of the CG, discussions were held on the development of a Worker Protection Indicator (WPI) in both the January 15, 2010 meeting as well as the July 12, 2010 meeting. A note defining the possible starting point for development of Worker Protection Measures (WPMs) was presented to the CG on January 15, 2010 (see Annex 11). The note was a combined effort of the World Bank's Financial and Private Sector Development and Human Development Networks. A further presentation on WPMs (see Annex 12) was made to the CG on July 12, 2010.

The proposed approach was a tentative first step as a foundation for a WPI and to identify aspects of labor law and regulations that are critical for worker protection. The note proposed starting with the ILO Core Labor Standards and also included other areas of interest that could serve as "building blocks" for WPMs. The group recognized the ILO's mandate in monitoring labor protections, and sought guidance from ILO on the information and indicators which it could provide in this area, now or in the future.

The following areas were tentatively proposed by some CG participants: (1) Worker Protection, (2) Maternity, Paternity and Personal Needs, (3) Access to Social Security (including benefits in case of job loss), and (4) Safety and Health. Using the *Doing Business* standard methodology each block would be comprised of a series of questions with a simple yes or no answer or quantitative information, enabling scoring.

The note further identified possible areas of contention and highlighted the challenges of building such an indicator. These consisted of the difficulty to establish a universal standard and to construct an adequate scoring system based on international standards that can be vague or leave room for interpretation due to the nature of the right that is protected. Other practical issues were identified such as whether or not to adopt the standard *Doing Business* methodology of applying a case study to ensure comparability amongst countries, as well as the need to distinguish between the law and practice. Finally the proposal raised the issue of how special standards in domestic legislation could be addressed.

D. Relationship between EWI and WPIs

The relationship between the EWI and the WPIs was discussed. In particular, members inquired how the WPI-WPMs effort would relate to *Doing Business'* EWI and the *Doing Business* report.

After discussions, the following alternative views were put forward:

i. One view emphasized that employing workers was a considerable cost to doing business, and thus a DB measure that ignored this aspect would be incomplete, and a DB publication that omitted this aspect would fail to provide the necessary information users require. This view emphasized that it was important to include the EWI in the DB indicator set and rankings whether or not information on worker protection was also added to the report in some way.

   Recognizing the many methodological changes that have resulted from the deliberations of the CG over the past year, these members expressed the view that the amended EWI was much more solid as a measure of the cost of employing workers while also balancing this against a minimum level of worker protections as expressed in the relevant ILO conventions. This view maintained that the modified EWI now embodied thresholds that identified countries with no legislated or effective minimum wage mechanisms, or with legislated annual leave below ILO conventions levels, or with no ILO convention standard applied to maximum working days per week. This view also held that the EWI chapter of the DB report could be complemented by information on worker protection so that a more holistic view of labor market regulation could be assessed while retaining the focus of the Doing Business indicator set on costs to firms. However, it was noted that Doing Business and EWI offered a quantitative measure of the cost of regulation from the perspective of the firm, while defining such a quantitative approach and maintaining the perspective of the firm to measure worker protection posed technical difficulties and methodological inconsistencies.

ii. A second view noted that EWI did not adequately reflect worker protections even after the amendments made, and that the Doing Business report should reflect labor regulations holistically, or not at all. It was also noted that while the design of a WPI posed certain technical and methodological challenges, similar challenges were faced by the EWI. To include only descriptive material about WPMs in the DB report could give the impression that DB country scores and rankings reflect compliance with core labor standards or social protection measures when in fact they do not. This view held that the modified EWI should only be included within the DB indicator set and rankings if the WPMs were also included in a quantifiable manner so that results across the labor measures could be aggregated in a WPI. Otherwise, this view held, countries would be given a biased view of the impact of labor regulations since only the costs and not the benefits of appropriate labor market standards and regulations would be reflected in DB indicators. Rather, this view held, both the modified EWI and the new WPMs could be included in the report as an annex with no impact on rankings or in a separate report.

E. Discussion on Paying Taxes

The CG reviewed the proceedings of the parallel ongoing consultations with the International Tax Dialogue (ITD) on the *Doing Business* Paying Taxes Indicator (PTI), and provided input in line with the CG Objectives. See Annex 13 for more details on the discussions between the *Doing Business* team and the International Tax Dialogue.

The primary issue discussed, with respect to the areas measured in the PTI, was the measurement of the total tax rate in general, and the inclusion of labor taxes and social security payments in the calculation of the total tax rate (TTR) more particularly. With respect to the labor taxes and social security payments, CG members commented on the proposal to include either the entire labor tax wedge (both the firm's and workers' contributions) or just a share of it (i.e. 50%), so that there would be no policy bias to encourage governments to reduce the firm's contribution.

The following views were expressed:

i. A view was expressed that the tax burden, as measured by the Total Tax Rate (TTR) component, was an important aspect of doing business for local firms and should be maintained within the PTI. This view also held that including the entire labor tax wedge would be a departure from the *Doing Business* approach of focusing on costs from the perspective of the firm.

ii. Other members, however, noted that including the entire labor wedge in the TTR would be a more appropriate approach from an economic perspective.

iii. A third view expressed that it was preferable to remove the total tax rate (TTR) from the PTI since there was no economic or business rationale for encouraging countries to eliminate all taxes paid by firms and instead increase taxes from other sources or reduce government services and social provisions..

iv. A further view held that even if the TTR is maintained, the entire labor tax wedge should be removed from the measure on the basis that this would remove any incentive for governments to lower labor taxes or social security to improve on the ranking.

III. Conclusion and suggestions for further work

The amendments recommended by the CG on the EWI methodology, as described in section II.A, were arrived at through consensus of the members. If adopted, these amendments would focus attention on not only those economies with excessive rigidity in employment regulation, but also those with inadequate labor regulations that do not meet ILO set minimum standards of worker protections in such areas as minimum wage, annual leave, and maximum working hours per week. Some members were of the view that this sent a clear message on the need to ensure a certain level of worker protection is transmitted to governments and stakeholders involved in labor policy.

The consensus recommendations for amendments to the EWI methodology are summarized as follows:

- *Tenure of the standardized case worker*: the average of tenures for 1 year, 5 years and 10 years should be used in the calculation of the redundancy cost. See page 4 for details.
- *Annual leave*: the EWI subindicator on paid annual leave should be modified to set a floor at 15 working days below which an economy would score a 1 indicating excessive flexibility, and annual leave between and including 22 – 26 working days should score 0.5 and annual leave of 27 days or more would score 1 for excessive rigidity. See page 4 for details.
- *Maximum working days per week:* economies with less than one day (24 hours) per week as rest time should be assigned a score of 1 for excessive flexibility. See page 5 for details.
- *Minimum wage*: Calculation of the minimum wage ratio should change to ensure that economies in group *i* (countries where there is no minimum wage at all) would not receive the highest score, while economies in group *ii* (countries where minimum wage is effective but not set by law) could still receive the highest score. See page 7 for details.

As described in sections II.D and II.E, there was not consensus among the members of the CG that these amendments met the concerns of all the members with both the EWI and the PTI.

The CG also held discussions on some conceptual issues involved in measuring worker protection. It identified areas of worker and social protection that could be pursued and touched on some the challenges for measurement.

Some members of the CG were of the view that work towards the design of Worker Protection Measures should be pursued by the World Bank Group, in collaboration with the ILO and interested stakeholders. These CG members encourage the World Bank Group to take this work forward through technical and research work in consultation with interested stakeholders including members of the CG in a transparent (including formal meetings and minutes) and inclusive process. These members were also of the view that the inclusion of the amended EWI in the Doing Business aggregate rankings should also be coupled with the inclusion of quantitative worker protection indicators, or both should be left outside of the Doing Business aggregate rankings.

Other CG members did not share this view, and do not see the utility or value in any further work on measuring worker protection arising from the CG process. These members also highlight substantial methodological and normative difficulties they consider are likely to make any further work by the Bank on measuring worker protection protracted and unproductive, and that are likely to compromise the validity of any outcomes. This view held that the changes made to the EWI methodology as a result of the CG process adequately measured the cost of employing workers while also balancing this against a minimum level of worker protections as expressed in the relevant ILO conventions.

Some members recommended that the World Bank Group implement work towards modifications of the Total Tax Rate component of the PTI through further consultations with interested stakeholders including members of the CG in a transparent (including formal meetings and minutes) and inclusive process.