Enabling environment for MSEs – What roles do labour law play?*

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EXECUTIVE SUMMARY

The policy reviews of the ILO carried out in some 13 countries concluded that labour laws are often too complex in several countries for MSEs to be able to comply, thus creating a kind of ‘Growth Trap’ beyond which these enterprises are unable to grow. On the other hand, there is a growing pressure on developing countries for deregulation of their labour laws with the belief that such action will enable them to expand employment opportunities through growth of enterprises.

The question remains whether exemption from certain provisions in the labour law is a better option to provide incentives for creation of increasing quantities of jobs by small enterprises or simplification of compliance requirements would balance between the need for protecting workers’ rights and the enterprise performance. The country cases prepared by the ILO as well as its research findings were utilized in discussing the issues.

Tough and complex law is not going to ensure protection of the workers’ rights; as a matter of fact simpler law may be much better implemented. On the other hand, removing the provisions for workers’ rights for the sake of simplicity is not going to ensure greater incentives for business growth (as exemplified by the situations in Latin America, particularly in Peru and Uruguay). Many countries are reregulating the workplace with additional regulations as they find out that without regulation, situation tends to be worse for the benefit of the workers, as ILO internal review has found out.

Due to variations in the labour law provisions, varying degrees of enabling environments exist in the countries surveyed by the ILO. The findings from the survey illustrate the differences in the approaches of various countries in defining employment relationships, which highlight the difficulty in comparing them against one yardstick of enabling environment for MSEs. In other words, it is difficult to state merely examining the provisions of employment relationships whether there are constraints to the growth of enterprises, particularly when exemptions and inclusions tend to make each labour law different from another. But the attempts are being made to rank the countries by comparing them on the basis of the provisions of the labour law alone with regard to the application mechanisms.

The World Bank’s report titled, Doing Business in 2005, claims that the regulatory environment and its compliance requirements have resulted in high cost of doing business in many developing countries. The report advances the argument that the economically advanced nations have fewer procedures, least time required and low cost in doing business whereas the developing countries have the highest. Therefore, the report concludes that the enabling environment is largely determined by the compliance requirements of the countries.

*This paper draws on the research carried out for the global issues paper prepared by Colin Fenwick titled, ‘Labour law and MSEs,’ for the ILO Geneva, 2005.
When the least amount of governance is preferred as argued in the above World Bank report, government’s role is characterized as that of having negative influence in overall business environment. This view may hold true in certain developing countries where the bureaucracies and the politicians have established a nexus for renting seeking behaviour and have thus created obstacles for the growth of private sector investment. Where the government has not played a facilitating role and where the labour market institutions and BDS providers are weak, enterprises are bound to feel that they are operating in a negative environment with little institutional assistance.

However, such characterization of enabling environment tends to ignore the role of the government as a regulator, facilitator and promoter of MSEs. Governments do play important roles in the growth of MSEs. At the same time, the productivity and income of the MSEs are influenced just as well by the MSEs themselves as by the governments. MSEs’ efforts in improving job quality have the potential for building an overall environment of competitiveness and productivity.

Thus, enabling environment should result from the facilitative role of the government as well as the proactive measures on the part of the enterprises with active roles of the workers and employers’ organizations.

The conclusions reached from the discussions are:

a. Labour law vary from one country to another in terms of their formulation and application, thus making them less reliable parameter for ranking the enabling environments.

b. The effectiveness of the labour administration is far more important in the application of the labour law.

c. Labour market institutions and the capabilities of the trade unions and employers to deal with the application of the labour law are equally important in contributing to the effectiveness of the labour administration.

In a nutshell, simplistic explanation of the effect of the labour law on MSEs’ capability to job creation can be misleading. They are influential to the extent of their applicability.
1. Introduction

The ILO (International Labour Organization) has in the recent past carried out reviews of policy and regulatory environment in a number of countries around the world. In these reviews, it has become obvious that the labour and labour-related laws (alternately also referred to as labour law in this paper) are an important element in the overall policy environment for micro and small enterprises (MSEs).

Some countries (notably in Asia and Africa) exempt the MSEs from labour and labour-related laws, including social security and other benefit requirements. The issue remains as to whether the exemption of the MSEs from the labour-related laws has resulted in the MSEs opting to remain small and not expand beyond the statutory limit of workers (10 workers in many cases). On the other hand, it remains to be seen whether such exemption has resulted in poor job quality and absence of workers’ rights in MSEs, ultimately reflecting in productivity and competitiveness of the MSEs.

Other countries (notably in Latin America and China), on the other hand, have had the labour law applicable to all enterprises regardless of their size. However, the real application of the law may be a different matter; and the compliance to the law has not been as effective.

The question remains whether exemption from certain provisions in the labour law is a better option to provide incentives for creation of increasing quantities of jobs by small enterprises or simplification of compliance requirements would balance between the need for protecting workers’ rights and the enterprise performance. The country cases prepared by the ILO as well as its research findings are being utilized in discussing the issues. The discussion of these issues is expected to contribute to the better design and implementation of the labour-related legislations for small enterprises, particularly in relation to the following issues:

i. Has the growth of job creation by the MSEs been constrained or facilitated by their exemption from the labour and labour-related laws?

ii. Is there a scope for reducing the ‘cost of doing business’ for the MSEs by simplifying the compliance procedures?

iii. Would simplification of the compliance procedures likely to improve better protection of the workers’ rights and the overall job quality in MSEs?

Answers to the above questions rest on the main inquiry of this paper – What roles do labour law play in the enabling environment for MSEs?

2. The issues and findings

In addressing the above issues enumerated in the Introduction (Section 1 above), it is essential to assess what seems to be the preliminary impression of how does labour law affect job creation by MSEs. The policy reviews of the ILO carried out in some 13 countries\(^1\) concluded that labour laws are often too complex in several countries for MSEs to be able to comply, thus creating a kind of ‘Growth Trap’ beyond which these enterprises are unable to grow. On the other hand, there is a growing pressure on developing countries for deregulation

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\(^1\) The reviews were carried out during 200-2004. A summary of findings from most of the reports are available in Policies for small enterprises – Creating the right environment for good jobs, by Gerhard Reinecke and Simon white, ILO Geneva, 2003. The published and unpublished reports are available at SEED, ILO Geneva.
of their labour laws with the belief that such action will enable them to expand employment opportunities through growth of enterprises.\textsuperscript{2}

While the need for labour law reform in many countries may be acknowledged in removing the complexity and in streamlining the law for effective application, the above impression may lead to the erroneous conclusion that deregulation is the only way to improve the enabling environment for enterprises. It will be tantamount to concluding that since there may be widespread corruption, there should be least amount of governance without realizing that ‘good governance’ is the answer rather than ‘no governance’.

Labour law has been of little consequence for the most micro and small enterprises, as it would be seen in the discussion later, largely since either the application of the labour law is ineffectual or non-existent. However, those enterprises operating around the threshold established by the labour law do get influenced in their expansion decisions. In developing countries with widespread poverty, one is likely to find far too many survival oriented activities rather than the enterprises operating at the threshold levels. But reduction in poverty and such survival activities do require expansion of enterprises beyond the threshold levels.

But are the labour law solely influencing factors on the growth of MSEs? The conclusions reached from the discussions below are:

\begin{itemize}
  \item d. Labour law vary from one country to another in terms of their formulation and application, thus making them less reliable parameter for ranking the enabling environments.
  \item e. The effectiveness of the labour administration is far more important in the application of the labour law.
  \item f. Labour market institutions and the capabilities of the trade unions and employers to deal with the application of the labour law are equally important in contributing to the effectiveness of the labour administration.
\end{itemize}

In a nutshell, simplistic explanation of the effect of the labour law on MSEs’ capability to job creation can be misleading. They are influential to the extent of their applicability, which would be fully discussed in the sections below.

3. **Challenges in applying labour and labour-related laws to MSEs**

Ideally, any law of the land should be applicable to all barring a few exceptions. But when the exceptions turn into a majority, a dilemma is faced as to what was the intention of the law; and whether it is being legislated for a few only. Labour law administrations in many countries have avoided or are unable to apply labour-related laws to MSEs for the following reasons:

\begin{itemize}
  \item i. Most of the enterprises in many developing countries tend to be at the micro level economic activities operating in an informal environment.
  \item ii. Most developing countries have limited capabilities for enforcement of labour-related legislations.
  \item iii. Often, there is no employer-employee relationship in the MSEs. Industrial relations as it is known in the formal economy do not exist.
\end{itemize}

\textsuperscript{2} The World Bank reports on *Doing Business* for the years, 2004, 2005 and 2006 point towards such efforts in portraying that excessive, cumbersome labour regulations hinder growth of enterprises.
iv. Marginal level of economic activities and/or transient nature of operation make it difficult for the MSEs to comply with the legal requirements.

v. Due to the level of literacy and absence of information, voluntary compliance to the legislations is rare.

In order to improve compliance and to cover the subsectors with special features within the informal economy, several layers of legislations have been enacted in many countries (i.e., there are as many as 31 central legislations with many more state level legislations based on these to be complied with in India3) adding complexity and confusion in the labour-related laws. Many of the legal provisions have been conflicting in nature. Employer, worker, wages, social security, etc. are defined differently for different subsectors in addition to the sector specific provisions for labour law administration. Instead of redrafting the entire legislation in a simplified way, layers of new legislations have been added thus breeding confusion and potential for corruption. Such additional layers of legislations are also the result of hasty legislation in the past.

Additional layers of legislations as well as various labour-related laws (i.e., minimum wage, social security, etc.) have created different cut off points for applicability, admittedly from the practical viewpoint. MSEs are excluded from various provisions at various points. Does such exclusion from the provisions of the labour law provide an impetus for an enabling environment or does this constrain the creation of jobs by MSEs?

4. Protecting workers’ rights and providing incentives for business growth

Many of the complexities in the labour law were introduced over a period of time to protect the workers’ rights. Therefore, it is often perceived that the measures to protect workers’ rights have pushed up the cost of doing business brought on by the complexity of the rules. Complex rules are often the result of frustrations emanating from:

i. ineffective labour administration (as there are more difficulties in enforcing the rules, more rules are formulated);

ii. the patch work of formulation of the law in bits and pieces rather than well thought out simple law providing as wider coverage as possible; and

iii. inability on the part of the governments to clean up the antiquated law (labour law reform) by replacing them with new sets of law that would be relevant for the modern economy (i.e., as being attempted in Pakistan).

Tough and complex law is not going to ensure protection of the workers’ rights; as a matter of fact simpler law may be much better implemented. On the other hand, removing the provisions for workers’ rights for the sake of simplicity is not going to ensure greater incentives for business growth (as exemplified by the situations in Latin America, particularly in Peru and Uruguay4). Many countries are reregulating the workplace with additional regulations as they find out that without regulation, situation tends to be worse for the benefit of the workers, as ILO internal review has found out. But has the enabling environment been improved due to reregulation in these countries?

Due to complexities of the labour law and resultant high compliance costs, countries have tended to exclude (frequently, on the basis of the number of workers) the micro and small

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4 SRO ILO Lima.
enterprises from the provisions of the labour-related laws.\textsuperscript{5} Are the MSEs better off in terms of cost-of-compliance and the time required for the compliance when they are exempted from the requirements of the labour-related laws? Is it a short-term benefit at the expense of longer-term denial of workers’ rights and poor working environment resulting in low productivity and income resulting in all around depressed economic environment? Therefore, would enterprises be better off in complying with the labour law?

MSEs need to clearly see the linkage between compliance to labour law and economic benefits, in terms of reduced costs of informality. Many of the MSEs may realize the costs of informality only when information on such costs is made available to them. The immediate benefits of compliance tend to attract the business enterprises to comply with the labour law particularly when such benefits are evident in terms of access to credit and information and availability of the legal rights in terms of reduced harassments and enforceability of contracts and predictability in tax responsibilities. A major source of apprehension in compliance remains the uncertainty of the tax burden as exemplified elsewhere in this paper in terms of their concern regarding tax burden. There may also be other sources of burden of compliance, i.e., responsibilities for compliance to social security and other labour-related provisions. But the clear linkage in improvement in productivity and income and compliance may reduce the ambivalence towards compliance.

Compliance to labour law provisions has been linked to stability in employment and productivity gains. ILO’s \textit{World Employment Report, 2004-05}\textsuperscript{6} poses an issue as regards whether employment stability is essential for growth in productivity although a certain degree of labour and capital mobility may also be desirable. According to the report, the most convincing answer lies in the human capital theory. Much of how workers learn to do their jobs better comes from formal and on-the-job training. Employers may have less incentive to invest in their employees’ training if the workers may be required to leave any time either due to short run economic downturns or opportunities elsewhere. Workers, on the other hand, have no incentive for acquiring new, more productive ways of doing things in the absence of some employment security.

5. \textbf{Arguments for exemption vs. compliance}

All the exemptions do not emanate from the compulsions of the labour law administration and practical considerations. Countries have made deliberate decisions to exclude MSEs from the jurisdiction of the labour-related laws. Besides the administrative convenience, the arguments for exemption are rather economic. In face of the widespread poverty, creation of jobs may take precedence to compliance of the labour law by self-employed and micro enterprises. Exemptions from labour law requirements among many developing countries are often motivated by the desire for promoting self-employment and micro enterprises. At their nascent stage, MSEs are unable to bear the costs or spend time in meeting the compliance requirements. This may indeed provide opportunities for those who have little capital or skills to be able to generate self-employment for themselves and the immediate family member, although at the survival level.

But are such marginal jobs productive enough to provide sufficient incomes to the families to gradually rid of their poverty? Do the self-employment and micro enterprises lead to further

\begin{itemize}
  \item \textsuperscript{5} ILO: \textit{Informal Economy, Undeclared Work and Labour Administration}, Paper No. 9 prepared by José Luis Daza, Geneva, June 2005.
\end{itemize}
job creation that would be productive and remunerative? Long run prospects of the job creation through exemption of labour law have not been convincing enough since the countries that have exemptions have experienced proliferation of subsistence activities without expansion of market opportunities or productive jobs. A survey of MSEs in India concluded that exclusions based on the number of workers resulted in an unfair competition between those above and below the threshold levels, creating artificially low labour costs for the latter.\(^7\) On the other hand, most micro enterprises that came into existence, however, would not grow beyond the threshold level, although labour law may not be the only reason for their growth limitation. Does this, however, mean that the exemption of labour law from MSEs actually results in absence of workers’ rights and poor working conditions leading to low productivity and profitability? Has informalization of economic activities led to micro enterprises struggling for a share of the small market catering to the poor?

In the light of the above, compliance to the labour law has been thought of the best option for bringing the enterprises in the formality providing its benefits (i.e., legal status in case of claims and counter claims in business transactions, access to credit and incentives available to the formal enterprises, etc.). It has been generally believed that compliance enhances job quality, which actually contributes to improvement in productivity and competitiveness of enterprises due to its reliance on quality rather than cheap labour.\(^8\) International Labour Conference (ILC) of the ILO discussing on informal economy in 2002 argued that the best way to reduce the informality among the MSEs is to ensure that the compliance to labour law is improved and workers’ rights are respected as per the ILO’s Fundamental Principles and Workers’ Rights.\(^9\)

But the issue is often related to the extent and efficacy of compliance, which rely on the effectiveness of labour administration. There are numerous examples of well crafted labour law without having much effect on compliance.\(^10\) In the absence of compliance, arguments are forwarded to enhance the rigours of law and punitive measures. Wide scale compliance is like the adherence to ‘traffic rules’ by millions of motorists around the world. Compliance is not enhanced by the rigours of the law alone but through effective labour administration based on promotional strategies of awareness raising and dialogue. If the law and its compliance are simple, then compliance by legally aware enterprises would be much easier.

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\(^7\) Chandra and Parashar, Op.Cit.
\(^10\) Notes prepared by Dialogue InFocus Programme, ILO Geneva.
<table>
<thead>
<tr>
<th>Topics</th>
<th>Bangladesh</th>
<th>China</th>
<th>Iran</th>
<th>Nicaragua</th>
<th>Senegal</th>
<th>Tadjikistan</th>
<th>Tunisia</th>
</tr>
</thead>
<tbody>
<tr>
<td>Employment</td>
<td>Applies to all enterprises</td>
<td>All employers – workplaces, production, industrial, services and agricultural establishments</td>
<td>Regulate employment relationships and establish minimum rights and obligations</td>
<td>Any person/entity employing one or more workers</td>
<td></td>
<td>All – whether public, private, religious, secular, professional or charitable</td>
<td></td>
</tr>
<tr>
<td>Relationship</td>
<td></td>
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<td></td>
<td></td>
<td></td>
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</tr>
<tr>
<td>Enterprise/</td>
<td>Every shop or establishments to which the Act (1965) applies and industrial establishments with five or more workers</td>
<td></td>
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<td></td>
<td></td>
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<tr>
<td>Establishment</td>
<td></td>
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<tr>
<td>Special</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Special characteristics depending on the form of ownership – separate legislation</td>
</tr>
<tr>
<td>regulations</td>
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</tbody>
</table>

6. Applying labour and labour-related laws in practice (with country examples)

i. Different approaches of labour and labour-related laws and labour administration

ILO’s member countries have taken different routes in formulating and implementing labour and labour-related laws. In most instances, there are labour and labour-related laws, the latter relating to the minimum wage, social security, working conditions, women workers, hazardous chemicals and other environment related laws, registration and certification laws. While many of these laws have been enacted to address the specific issues, most of the laws are inspired by and confirm to the ILO standards, which are ratified by the member countries. Nonetheless, the major issue relates to the approaches to the labour law (categories of classification and coverage) and labour administration (ways of inspection and promotion).

Application of the labour law is dependent on determining the employment relationship and identifying the employer and workers. The state’s first problem is to detect, locate and identify enterprises and their owners, followed by the difficulty of identifying workers and the nature of their contracts or relationships.11

An ILO survey12 examined the labour law relating to employment relationships, occupational safety and health and social security in small enterprises. Matrix 1 (on the next page) provides a picture of scope of labour law in various countries, particularly in the areas of employment relationship and definitions of employer and establishments. For instance, labour codes in China and Senegal are applicable to all enterprises while it is meant to regulate employment relationships and establish minimum rights and obligations in Nicaragua. Iran and Tunisia have broadly defined the term of employer. Bangladesh includes all shops and establishments with more than five workers as employers. From the comparison of only a few countries, the matrix illustrates the breadth of coverage of labour law. However, employment contract is critical in determining existence of employment relationships, particularly among smaller enterprises. A matrix in Annex (Matrix 1A) provides comparison on employment relationships in various countries, particularly from the standpoint of existence of employment contract.

ii. Types of exemptions and expected results

Exemptions and inclusions of various kinds often provide better view of the scope of labour legislation. Such exclusions and inclusions are alternately used depending on the situations in the countries though. Thus, labour law in each country has its own special feature. Definitions of various terms tend to define the scope of the law and tend to act themselves as a sort of exclusion and inclusion rather than having a specific article in the law. Rather than how the labour law has described the employment relationships and extension of OSH and social security law to small enterprises, it is, therefore, more instructive to examine the extent of exemptions mentioned in the labour law. As shown in Matrix 2, exemptions in the labour law are often based on the following factors:

a. Autonomous work
b. Involvement of the members of the family
c. Membership in cooperatives

d. Religious, voluntary and charitable nature of work

f. Artisanal work

g. Size of enterprises

e. Place of work

Exemptions are generally in the areas of occupational safety and health (OSH), number of workers, definition of a worker, minimum wage, application of labour code, employment relationship and social security. Japan has the provision of limitation in the number of working hours extended up to 44 hours per week. Several countries (i.e., Bangladesh, Costa Rica, Kuwait, Nepal and S. Korea) have the threshold based on the number of workers for the application of labour law to MSEs.

In Viet Nam, although the labour code is excluded for the enterprises employing less than ten workers, the employer has to assure that workers’ fundamental rights and interests are adhered to and social security system is applied to even those enterprises employing less than ten workers through voluntary schemes. In Nigeria, Ireland and Jordan, members of the family are excluded from the definition of workers. Similarly, persons engaged in religious, voluntary or charitable work are excluded in Switzerland and South Africa.

Exemptions based on the place of work extend to home work, telework and domestic service. Casual work, work by students and part-time work are included in the precarious work category. Zambia and Botswana exclude casual work, which have been defined in their respective employment acts.

However, what does not seem to be certain is what effect such exemptions have had in the job creation capabilities of the MSEs. Even if one is to disregard the improvement in productivity and income among the MSEs, one would assume that employment creation in the MSEs has accelerated as a result of the above exemptions. It does seem that many countries with exemptions have experienced tremendous growth in micro enterprises but they are not necessarily due to the threshold limits of the workers. ILO’s studies in South Asia (India, Iran, Nepal and Pakistan) have revealed that micro enterprises with less than 5 workers seem to dominate the scenery. Differences in social security coverage also have not resulted in employment creation or formalization (i.e., Iran).

In addition, exemptions are also made on the basis of the subsectoral work (Matrix 2A in Annex); such as, agriculture, public sector, maritime and air transport. The latter exemption seems to be guided more by the practicality in dealing with a vast sector such as agriculture in developing countries or the subsector requiring specific regulation; such as, in the public sector.

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### Matrix 2: Scope of Labour law – Exemptions

<table>
<thead>
<tr>
<th>Types of exemptions based on</th>
<th>OSH application</th>
<th>No. of workers</th>
<th>Worker definition</th>
<th>Minimum Wage</th>
<th>Labour Code</th>
<th>Employment relationship</th>
<th>Social Security</th>
</tr>
</thead>
</table>
| Autonomous work             | Japan (40-44 hrs. to be observed) | S. Korea ≤5 workers  
Nepal ≤10 | Nigeria | Ireland | Jordan |
| Religious/charitable         |                  |                | Switzerland      
South Africa |          |            |            |                |
| Place of work               |                  |                | Lithuania        
Belgium        
Luxembourg |          |            |            |                |
| Precarious work             |                  | Botswana (< 12 months or <3 days /wk)  
Zambia (< 6 months) | Jordan (< 3 months) |          |            |            |                |
| Based on enterprise size    |                  |                  | Bangladesh <10 workers  
Kuwait < 5  
Agriculture only: Costa Rica <5  
Honduras < 10 |          |            |            |                |
| Artisans                    |                  |                  | Ecuador < 15 workers  
Cambodia <8 workers  
Iran < 8 |          |            |            |                |
|                             |                  |                  | Morocco - special law  
- 5 workers |          |            |            |                |

Varying degrees of enabling environments exist in all these countries due to variations in the labour law provisions. Both the above matrices illustrate the differences in the approaches of various countries in defining employment relationships, which highlight the difficulty in comparing them against one yardstick of enabling environment for MSEs. In other words, it is difficult to state merely examining the provisions of employment relationships whether there are constraints to the growth of enterprises, particularly when exemptions and inclusions tend to make each labour law different from another. But the attempts are being made to rank the countries by comparing them on the basis of the provisions of the labour law alone with regard to the application mechanisms.

### iii. Compliance requirements and cost of doing business

The cost of compliance to regulatory requirements tends to be disproportionately higher to MSEs in comparison to the larger enterprises, although the enterprises in general may recognize the benefit in operating in a formal environment conducive to investment and business. As cost of compliance includes both direct and indirect costs weighing heavily on thin resources of the MSEs, reforms aimed at simplifying and reducing the cost of registration, renewal and certification contribute to the enabling environment for the business enterprises. For creating an enabling environment to business growth, ILO’s Recommendation No.189 concerning General Conditions to Stimulate Job Creation in Small and Medium-sized Enterprises has called upon its member states to remove the constraints arising out of inappropriate, inadequate or overly burdensome registration, licensing, reporting and other administrative requirements, including those which are disincentives to the hiring of personnel.

The World Bank has been producing reports on ‘Doing Business’ in the years 2004, 2005 and 2006, all emphasizing the need to easing the burden of regulatory requirements on enterprises. Its report titled, Doing Business in 2005, claims that the regulatory environment and its compliance requirements have resulted in high cost of doing business in many developing countries. The report has contrasted the economically advanced countries and developing countries in three areas – number of procedures, time required in registering new businesses and the cost implications of such procedures and time required for complying with the procedural requirements (Tables 1 and 2). The report advances the argument that the economically advanced nations have fewer procedures, least time required and low cost in doing business whereas the developing countries have the highest. Therefore, the report concludes that the enabling environment is largely determined by the compliance requirements of the countries.

One may draw the conclusion as implicit in the above argument that the fewer the regulatory requirements, better the enabling environment. However, the question remains whether fewer regulations or consistent and better enforcement of regulations would contribute to an enabling environment for businesses to get started and prosper. Predictability in the policy and legal environment is associated with the consistent application of the law not in the absence of the legal provisions. It has been well documented, including in the World Bank report itself, that the safeguard of property rights along with the rights of the workers provide stable environment for growth of business enterprises.

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Table 1: Procedures and time required in business registration

<table>
<thead>
<tr>
<th>Fewest</th>
<th>Most</th>
<th>Least</th>
<th>Most</th>
</tr>
</thead>
<tbody>
<tr>
<td>Australia</td>
<td>2</td>
<td>Argentina</td>
<td>15</td>
</tr>
<tr>
<td>Canada</td>
<td>2</td>
<td>Bolivia</td>
<td>15</td>
</tr>
<tr>
<td>New Zealand</td>
<td>2</td>
<td>Greece</td>
<td>15</td>
</tr>
<tr>
<td>Finland</td>
<td>3</td>
<td>Guatemala</td>
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<tr>
<td>Sweden</td>
<td>3</td>
<td>Ukraine</td>
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</tr>
<tr>
<td>Belgium</td>
<td>4</td>
<td>Belarus</td>
<td>16</td>
</tr>
<tr>
<td>Denmark</td>
<td>4</td>
<td>Brazil</td>
<td>17</td>
</tr>
<tr>
<td>Ireland</td>
<td>4</td>
<td>Paraguay</td>
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<tr>
<td>Norway</td>
<td>4</td>
<td>Uganda</td>
<td>17</td>
</tr>
<tr>
<td>United States</td>
<td>5</td>
<td>Chad</td>
<td>19</td>
</tr>
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<td></td>
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</table>


Table 2: Cost (% of income per capita, and US$)

<table>
<thead>
<tr>
<th>Least</th>
<th>%</th>
<th>$</th>
<th>Most</th>
<th>%</th>
<th>$</th>
</tr>
</thead>
<tbody>
<tr>
<td>Denmark</td>
<td>0.0</td>
<td>0</td>
<td>Yemen, Rep.</td>
<td>269.3</td>
<td>1,404</td>
</tr>
<tr>
<td>New Zealand</td>
<td>0.2</td>
<td>39</td>
<td>Zimbabwe</td>
<td>304.7</td>
<td>140</td>
</tr>
<tr>
<td>United States</td>
<td>0.6</td>
<td>210</td>
<td>Rwanda</td>
<td>316.9</td>
<td>601</td>
</tr>
<tr>
<td>Sweden</td>
<td>0.7</td>
<td>257</td>
<td>Congo, Rep.</td>
<td>317.6</td>
<td>2,501</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>0.9</td>
<td>314</td>
<td>Niger</td>
<td>396.4</td>
<td>1,025</td>
</tr>
<tr>
<td>Puerto Rico</td>
<td>1.0</td>
<td>110</td>
<td>Cambodia</td>
<td>480.1</td>
<td>1,529</td>
</tr>
<tr>
<td>Canada</td>
<td>1.0</td>
<td>271</td>
<td>Congo, Dem.</td>
<td>344.2</td>
<td>1,086</td>
</tr>
<tr>
<td>France</td>
<td>1.1</td>
<td>368</td>
<td>Rep.</td>
<td>556.8</td>
<td>611</td>
</tr>
<tr>
<td>Singapore</td>
<td>1.2</td>
<td>262</td>
<td>Angola</td>
<td>884.6</td>
<td>6,621</td>
</tr>
<tr>
<td>Finland</td>
<td>1.2</td>
<td>417</td>
<td>Sierra Leone</td>
<td>1,268.4</td>
<td>1,663</td>
</tr>
</tbody>
</table>


In the interest of creating an enabling environment, the World Bank report also argues for greater labour market flexibility with the loosening of the legal provisions for hiring and firing of workers. Table 3 below provides the lists of countries with least and most difficulties in hiring and firing workers. The report has measured difficulty of hiring in terms of whether term contracts can be used and the ratio of minimum wage to the average value added per worker. Difficulty of firing is measured in terms of ease of dismissal at will of the employers without approval from the ministry of labour or labour unions. Table 4 below provides the rigidity of employment index as worked out in the World Bank report on the basis of a simple average of the difficulties of hiring and firing and rigidity of working hours. The report argues that least amount of difficulty and rigidity in hiring and firing workers lead towards more job creation.
Table 3: Difficulty of hiring and firing workers

<table>
<thead>
<tr>
<th>Least</th>
<th>Most</th>
<th>Least</th>
<th>Most</th>
</tr>
</thead>
<tbody>
<tr>
<td>25, including:</td>
<td>Romania</td>
<td>Canada</td>
<td>Cameroon</td>
</tr>
<tr>
<td>Israel</td>
<td>Mauritania</td>
<td>Costa Rica</td>
<td>Egypt, Arab Rep.</td>
</tr>
<tr>
<td>Slovakia</td>
<td>Central African Rep.</td>
<td>Hong Kong, China</td>
<td>Ukraine</td>
</tr>
<tr>
<td></td>
<td>Rwanda</td>
<td>Jamaica</td>
<td>Congo, Rep.</td>
</tr>
<tr>
<td>Denmark</td>
<td>Togo</td>
<td>Japan</td>
<td>India</td>
</tr>
<tr>
<td>Saudi Arabia</td>
<td>Congo, Rep.</td>
<td>Kuwait</td>
<td>Mexico</td>
</tr>
<tr>
<td>Botswana</td>
<td>Morocco</td>
<td>Saudi Arabia</td>
<td>Nepal</td>
</tr>
<tr>
<td>Russia</td>
<td>Chad</td>
<td>Singapore</td>
<td>Angola</td>
</tr>
<tr>
<td>United States</td>
<td>Burkina Faso</td>
<td>Uganda</td>
<td>Tunisia</td>
</tr>
<tr>
<td>Namibia</td>
<td>Niger</td>
<td>Uruguay</td>
<td>Uzbekistan</td>
</tr>
</tbody>
</table>


Although concrete examples of rise in job creation are lacking in the report, it provides several country examples. For instance, it gives the example of creation of 300,000 jobs in Colombia as a result of reforms broadening the definition of just causes of dismissal. However, it does not seem to be clear whether these jobs would have been created regardless of the reforms and were being created with uncertain terms of employment contract as a result of the reforms.

ILO’s own research indicates that the MSEs do not identify labour laws and regulations as a principal growth constraint whereas credit and markets are identified as the main obstacles to growth of business. Other studies (i.e., OECD’s 1995 survey and ILO’s country study in India) reach the similar conclusions. However, these conclusions have to be viewed in the light that: a) most MSEs in informal economy are already operating outside the purview of legal requirements; and b) survey methodologies have heavily relied on perception response.

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Simplification of registration requirements in Peru and Vietnam

In Peru, the Small Enterprise Law (Legislative Decree 705) 1991 simplified access to legal formality through the introduction of the Unified Registration System. This system embodied the principle of a ‘one-stop-shop’ for registration of a new enterprise. The Unified Registration System was eliminated in 1999 as its functions were subsumed under the general Tax-Payers’ Registry. The current system of registration for new enterprises involves registration in the Tax-Payers’ Registry, obtaining a Municipal Business Licence; the maintenance of a Payroll Record Book and, within 10 days of opening the Payroll Record Book, registration with the Social Health System.

These reforms have significantly reduced the hurdles faced by individuals seeking to register their businesses. In 1984, establishing a small industrial workshop in Lima required 11 steps, took an average of 289 days and cost around $US1321. In the late 1990s, the same process required 5 steps, took an average of 30 days and cost $US200.17

Whether these reforms have lowered the level of informality and thus improved job quality in the MSE sector is unclear. There has been no impact study on these regulations and some authors suggest that there have been no significant changes observed in the level of informality in Peru.18

In Vietnam, the introduction of the Enterprise Law in 2000 reduced the number of steps required to register an enterprise, the average time needed to register a business and the average monetary cost. The simplification of procedures and costs associated with business appears to have had a positive effect: during the first year of its enactment, 14,444 enterprises were newly registered, about two and a half times the number of registrations in 1999 under earlier legislation.19

The World Bank report makes the argument that the burden on individual businesses for having to maintain employment in the situation of economic downturn is too great. On the contrary, it could also be argued that extreme poverty and lack of employment render the workers in extremely poor countries vulnerable to extreme forms of exploitation especially under the conditions of high levels of illiteracy, unemployment and the presence of social exclusion. Hence, the report argues for the collective social protection for the workers based on economic prosperity.

Greater labour market flexibility may be advocated for enterprises to be better able to respond to the changes in the market demand. Extreme case of labour market flexibility can be witnessed in the casualization of the labour and subcontracting of the work to the workers without protection. As witnessed in many developing countries affected by globalization and consequent subcontracting, work is being increasingly done mostly by unskilled or semi-skilled workers in poor working conditions. As reported in a report titled, A Fair Globalization20, casualization and greater degree of underemployment are the likely results of

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18 Ibid 28.
globalization if the developing countries are not able to improve their productivity and competitiveness.

But the issues remain as to whether pursuit of price competitiveness based on driving down the labour costs has been beneficial for the long-term business profitability and survivability in the absence of regard for quality and consistency of the products and services. Besides, the question remains whether the labour cost is the highest component of the total cost of doing business. Discipline and the commitment to work among the workers based merely on fear factor of hiring and firing, perhaps as believed more in the early industrial era, may not be acceptable as the better motivational technique under modern management practice?

The argument for labour market flexibility is based on the assumption that the business enterprises hire workers depending on the business demands and allow the former to cut costs by doing so. There are certainly complex procedures and restrictions placed in many countries, which warrant urgent reforms to attain a measure of labour market flexibility with social protection. However, labour market flexibility is not only dependent on the labour law reforms but also on the capability and strength of the labour market institutions.

Labour market flexibility based on ease of hiring and firing of the workers presumes that social protection is available for the workers in the forms of advance notice, separation payout, continuation of unemployment benefits, opportunities for retraining and redeployment. Depending on how the countries have organized their social protection systems, individual businesses may feel higher burden even with the ease of hiring and firing of workers. In the spectrum of social protection systems, one may find the extreme cases of no social protection to other end with the availability of jobs in the market. Safety net is a term that is loosely used to describe minimum possible protection on one side of such spectrum while the ILO Conventions emphasize the importance of a system designed with involvement of the governments, workers and employers in the middle position along the spectrum moving, perhaps moving closer to other end, wherein the society has the responsibility for the protection of the workers for minimum socio-economic dislocations.21

7. Enabling regulatory environment and job quality

i. Requirements of an enabling regulatory environment

When the least amount of governance is preferred as argued in the above World Bank reports, government’s role is thus characterized as that of having negative influence in overall business environment. This view may hold true in certain developing countries where the bureaucracies and the politicians have established a nexus for renting seeking behaviour and thus created obstacles for the growth of private sector investment. Where the government has not played a facilitating role and where the labour market institutions and BDS providers are weak, enterprises are bound to feel that they are operating in a negative environment with little institutional assistance.

However, such characterization of enabling environment tends to ignore the role of the government as a regulator, facilitator and promoter of MSEs. Governments do play important roles in the growth of MSEs. At the same time, the productivity and income of the MSEs are

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influenced just as well by the MSEs themselves as by the governments. MSEs’ efforts in improving job quality have the potential for building an overall environment of competitiveness and productivity.

Arguing that the State (or other parties) may regulate more or less directly, Fenwick concluded that there is no simple dichotomy between regulation and deregulation. If ‘deregulation’ of labour market were to occur, it is generally assumed to be in favour of allowing the market to determine outcomes. In essence, the law of contract would regulate labour market exchanges. But what this means is that the ordinary legal system and courts, together with the ‘market,’ would be substituted as the regulatory mechanism, instead of the state-based law. It is immediately clear that this is not an absence of regulation, but a shift in types of regulation. A further crucial factor here is that markets themselves require regulation. Laws and legal institutions establishing and protecting property and transactional rights are the most important elements of market regulation.

Thus, enabling environment should result from the facilitative role of the government as well as the proactive measures on the part of the enterprises with active roles of the workers and employers’ organizations. In various traditional manufacturing clusters around the world (brassware and handlooms in India, wood products in Indonesia and handicrafts in Africa), ILO has assisted MSEs and their trade associations in improving their business practices, working conditions and productivity. Additionally, the ILO has linked its programme of work in Moradabad Brassware cluster in India to an action of organizing the informal workers and extending social protection with the cooperation of the local chapter of the national trade union organization. This is expected to not only enhance the awareness of the enterprises and workers’ organization towards job quality but also further the cause of adherence to the ILO’s Fundamental Principles and Workers’ Rights without much relying on the administration of the labour law. A social campaign is also being launched with the cooperation of all three parties – government, workers and employers – to increase the awareness of the community towards the advantages of decent job. Thus, the enabling environment is augmented through tripartite mechanism (meaning government, workers and employers’ involvement) rather than lessening of the role of the government.

ii. Role of job quality requirements in creating an enabling environment

The long term effectiveness of an enabling regulatory environment is tied with the state of job quality at the work place. Job quality means creating a working environment conducive to productivity and higher income, which are contributed by respecting the ILO’s Fundamental Principles and Workers’ Rights and pursuit of the ILO’s Decent Work Agenda. The concept of job quality springs from the ILO’s Decent Work Agenda, which articulates the need for creating productive, remunerative work with rights, protection and equality at work. Decent work provides the framework for creation of sustainable employment by enterprises while contributing to the economic growth. Rather than taking the view of job creation as a by

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23 Various reports on ILO’s work on clusters available at SEED, ILO Geneva.
24 Sources : MOU signed between ILO Subregional Office New Delhi and the local chapter of HMS (Hind Majdoor Sangathan), 2005 ; and Anil Bhardwaj, ‘Review of Policy and Regulatory Environment in Moradabad Brassware,’ an unpublished paper prepared for ILO Subregional Office New Delhi, 2005.
product of economic growth, the ILO considers creation of employment central to sustainable economic growth. Since last decade and half, many developing countries have experienced higher economic growth without corresponding growth in employment resulting in inequalities with socio-economic consequences.26

Organising in the informal sector: the experience of the Bakery, Confectionary, Manufacturing and Allied Workers’ Union in Kenya27

The Bakery, Confectionary, Manufacturing and Allied Workers’ Union (BCMAU) was registered in 1977 to represent the collective interests of workers employed in enterprises that produced bakeries, pastries, biscuits, cakes, confectionary, sweets and other types of food. The union is organised on a national basis with headquarters in Nairobi and branches in all major urban areas. The BCMAU traditionally targeted the formal sector. More recent efforts, however, have been focused on extending representation and protection to workers in the informal MSE sector.

The BCMAU has sought to extend protection to workers in the MSE sector through:

- Lobbying the Government to review all labour laws in Kenya, in order to enhance the rights and protection afforded to MSE workers, particularly women.
- Lobbying the Government for more effective enforcement of labour laws in the informal sector.
- Educating MSE workers on their rights at work through various education and awareness programmes, covering such areas as HIV/AIDS and the workplace, child labour and sexual harassment.
- Building strategic alliances with NGOs.

The BCMAU continues to face a range of challenges, including employer hostility to unionization, the ‘invisibility’ of informal sector enterprises, a restrictive legal framework which inhibits the ability of unions to organise within MSEs, poor access to justice for MSE workers and severe resource constraints.

Not only quantity but also quality of employment is important in creation of employment. Since quantity of employment may perpetuate the ‘working poor’ without prospects of Decent Work. Job quality emphasizes in building quality in the jobs being created thus improving prospects of higher productivity and income. Research has indicated that job quality in MSEs may have critical influence on their competitiveness. A World Bank survey of manufacturing enterprises in Malaysia has reported that the size of enterprises was not necessarily a limiting factor on enterprises to achieve higher efficiency or job quality.28 ILO’s global research on job quality in 2001 has concluded that disregard for working conditions and working environment in MSEs has resulted in a situation wherein productivity and income have remained consistently low.29 Low productivity has stunted the growth potentials of MSEs and has kept them at the marginal levels of operation with limited access to market. Investing in job quality has been traditionally seen as an avoidable business expense by the MSEs without realizing that the return on such investments tends to be immediate and dramatic in many cases. ILO’s work in Moradabad Brassware cluster has proved that job quality improvements by MSEs operating in traditional manufacturing cluster tend to have not only the productivity

improvement in the enterprises embarking on such improvement but also have ripple effect on other MSEs operating in the cluster.\textsuperscript{30}

### iii. Achieving growth with equity and quality

As pointed out in the report on social dimension of globalization,\textsuperscript{31} it has been well recognized that while globalization has fuelled growth in many countries, inequity in the socio-economic status, particularly among women, indigenous peoples and socially excluded and vulnerable groups has emerged as quite distinct and noticeable. Workers engaged in traditional manufacturing activities and the agricultural workers in the rural areas have experienced greater inequity as well. The challenge is whether it is possible to achieve growth with corresponding or greater increase in employment? Even more important question is whether such increase in employment will lead towards reduction in inequality and enhancement in quality of jobs?

The governments have been pressed for providing relief to the rising labour force by making work available to them. In many countries, over emphasis on quantity of jobs by the governments has led to proliferation of marginal activities leading towards expansion of informal economy rather than increase in productivity and incomes through improved prosperity and job creation capabilities of small enterprises. One way IFIs (international financial institutions) and developing countries have viewed the prospect of increasing the availability of jobs has been to improve the enabling environment for growth of small enterprises. Part of such effort has been to examine the extent to which the regulatory environment, including labour law, could be eased for encouraging private investment. But all evidences from the countries, which have both excluded and included the micro and small enterprises, indicate that:

\begin{itemize}
  \item[a.] most of the MSEs excluded from labour law requirements have not experienced growth; and
  \item[b.] the countries with extension of labour law to the MSEs as well have not experienced expansion in small enterprises either.
\end{itemize}

The common phenomenon being experienced is that despite the economic growth, job creation remains dismal with widening economic disparity. The reason for such disparity lie mostly elsewhere rather than on regulatory environment although the latter does play an important role as a part of the total environment. What are these other factors?

\begin{itemize}
  \item[b.] Absence of education and skills have kept the labour force incapable of fashioning anything larger than survival activities and unable to secure and utilize business information;
  \item[c.] Weak institutions and their business services support have made business start up and expansion difficult;
  \item[d.] General absence of entrepreneurial culture has made public jobs most sought after employment, which has been further perpetuated by various government programmes to provide jobs through public sector enterprises and infrastructure programmes; and
\end{itemize}


e. Rent seeking behaviour of the politicians and bureaucracy (often aided by complex regulations and procedures) has discouraged formal business startups and expansion.

Besides the above, the most important factor in disparity has been due to low productivity linked to poor job quality, which has been perpetuated by the above and existence of marginal activities in the informal activities. Traditional manufacturing and off-farm activities, in most of the developing countries, have remained as informal activities with low productivity and income. Even where such manufacturing activities have been linked to global supply chains, local skills are being gradually lost or forefeited by global supply chains as a result of the absence of business skills at the scale of global marketing.

Therefore in achieving growth with equity, the Globalization Report\(^\text{32}\) has advocated in strengthening of the local economic activities that mobilize the local entrepreneurial skills, workforce and resources in creating a competitive niche in a globalized economy. This requires enhancement of skills, business development services, credit and institutional support much more than merely simplifying the regulatory procedures. As a matter of fact, the latter without former conditions may further accelerate the negative effects of globalization at the local levels. An ILO internal review has found that its members are reregulating labour laws since a greater need for effective regulation has been felt. Predictability through consistent and effective application of the labour law in a transparent manner is desired by the workers and employers rather than the chaos resulting from the absence of rules. Several member countries of the ILO have sought to carry out the labour law reforms to streamline the application of the labour law for its effective application. Some countries have also begun considering separate labour legislations for MSEs.

State policies along with the labour legislation were reported to have a great deal of influence on the growth of MSEs. ILO’s survey of seven countries (Table 5) found that labour costs, labour regulation, government policies and taxation are perceived as the least conducive factors for employment generation.\(^\text{33}\) It is also noted that entrepreneurs in general view taxation and policies as detrimental to their abilities to improve working environment. However, these findings suggest that MSEs will not be significantly in a disadvantageous situation by the application of the labour law. Enterprises do make strategic decisions about which elements of the regulatory environment most affect their decisions about regulatory compliance with the implications that the state may need to develop the regulatory policies taking into account such strategic decisions.

8. Design of labour-related laws

From the above analysis, it can be discerned that the labour legislation emanating from the government policy will remain an important issue for the growth of business enterprises. Several approaches have been attempted in designing the labour and labour-related laws to meet the specific situations in various countries. Four broad variations in the approaches to labour-related laws exist:

a. providing no exemptions from labour and labour-related laws for MSEs;


b. providing specific exemptions for MSEs in the application of particular labour standards;

c. adopting a parallel and less onerous labour law regime for MSEs exempted from general labour law; and

d. exempting MSEs from all labour law and regulations.

Table 5: Ranking of factors influencing decisions related to working conditions

<table>
<thead>
<tr>
<th></th>
<th>Chile</th>
<th>Guinea</th>
<th>Pakistan</th>
<th>Peru</th>
<th>South Africa</th>
<th>Tanzania</th>
<th>Vietnam</th>
<th>All</th>
</tr>
</thead>
<tbody>
<tr>
<td>Markets</td>
<td>3</td>
<td>1</td>
<td>1</td>
<td>2</td>
<td>1</td>
<td>1</td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td>Exports</td>
<td>9</td>
<td>6</td>
<td>7</td>
<td>3</td>
<td>5</td>
<td>5</td>
<td>8</td>
<td>4</td>
</tr>
<tr>
<td>Premises</td>
<td>1</td>
<td>2</td>
<td>2</td>
<td>1</td>
<td>.</td>
<td>2</td>
<td>2</td>
<td>2</td>
</tr>
<tr>
<td>Finances</td>
<td>4</td>
<td>7</td>
<td>6</td>
<td>5</td>
<td>7</td>
<td>7</td>
<td>6</td>
<td>5</td>
</tr>
<tr>
<td>Resources</td>
<td>2</td>
<td>3</td>
<td>5</td>
<td>4</td>
<td>3</td>
<td>4</td>
<td>4</td>
<td>3</td>
</tr>
<tr>
<td>Labour costs</td>
<td>5</td>
<td>5</td>
<td>3</td>
<td>7</td>
<td>2</td>
<td>6</td>
<td>3</td>
<td>7</td>
</tr>
<tr>
<td>Labour regulations</td>
<td>6/7</td>
<td>4</td>
<td>4</td>
<td>6</td>
<td>4</td>
<td>3</td>
<td>5</td>
<td>6</td>
</tr>
<tr>
<td>Taxation</td>
<td>6/7</td>
<td>9</td>
<td>8</td>
<td>9</td>
<td>.</td>
<td>9</td>
<td>9</td>
<td>9</td>
</tr>
<tr>
<td>Government</td>
<td>8</td>
<td>8</td>
<td>9</td>
<td>8</td>
<td>6</td>
<td>8</td>
<td>7</td>
<td>8</td>
</tr>
</tbody>
</table>


Employment relationship is the foremost consideration in the design of the labour law. The narrow definition of employment tends to exclude many workers thus creating the exemptions that may or may not have been intended. Excessive exemptions may run counter to the intentions of the International Labour Conventions. Most of the labour law apply only to the formal economy workers with contract of employment leaving most MSEs in the informal economy uncovered by the labour law. This issue is to be examined by the International Labour Conference (ILC) in 2006. The ILO’s report titled, the Employment Relationship,\textsuperscript{34} which will form the basis of the ILC discussion in 2006, provides five possible options:

- a. redefine more precisely the employment relationship irrespective of the form of the contract;
- b. delineate more clearly the boundary between dependent and independent work;
- c. make provisions to deal with certain types of work, which had hitherto been inadequately defined in some countries;
- d. extend the protection of the employment contract to equivalent contracts; and
- e. delink certain rights from the employment relationship.

In attempting to create an enabling environment for the MSEs, governments in general carry out the regulatory reform based on the recognition and application of labour rights and standards. In addition to the adoption and promulgation of law that set out minimum labour standards and recognise basic labour rights, Fenwick\textsuperscript{35} has broadly identified three approaches that the state can take in creating a regulatory environment that is widely adhered to:


\textsuperscript{35} Colin Fenwick, Op.Cit.
a. educating and informing the regulated community as a key regulatory strategy;  
b. providing incentives to comply with legal or regulatory requirements; and  
c. utilizing innovative procedural regulation; e.g., through participation of private  
regulatory actions, including MSEs, workers and NGOs.

9. Labour Administration

i. Trade off between exemption and labour administration

Implementation of the labour and labour-related laws lies with the systems of labour  
administration, which may include various ministerial departments, public agencies, local  
authorities and institutional framework consisting of workers and employers. While  
exemptions of the MSEs from the labour law are partly due to inadequacy in labour  
administration and inability and unwillingness on the part of the governments to implement  
labour law, non-observance of minimum labour standards may also be facilitated by the  
discretion given to local authorities; for instance, in China and Southeast Asia. It may not be  
the complex rules that might be most troublesome for small enterprises but the absence of  
transparency in the implementation of the law is.

There could be three scenarios of exemptions of MSEs from the application of labour law in  
relation to the strength of labour administration:

a. MSEs are exempted largely due to impracticality in extending labour  
administration to cover them.  
b. MSEs are not exempted but the labour administration remains weak and  
ineffectual, thus making for all practical purposes tantamount to full  
exemption.  
c. MSEs are partially exempted in those areas that are not yet practical to cover  
with labour administration being implemented in the areas that are not exempt.

In the first scenario (a) above, governments seem to recognize the limitations of labour  
administration in attempting to extend the labour law to MSEs. On the other hand, the second  
scenario assumes that citizens would abide by the law regardless of the ability to implement  
the law. With a weak and ineffective labour administration, opportunities for corruption are  
also numerous since there would be countless episodes of violation of the law by the MSEs,  
who are oblivious of the requirements. Partial exemption of the labour law requirements with  
the effective implementation of the labour law seems to be a practical middle solution to the  
situation where it is not possible to extend the provisions to all MSEs.

There are plenty of examples of the exemptions and weak efforts of application of the labour  
law. An ILO/UNDP report (1999) concluded that the government at all levels (in Thailand)  
appeared to recognize, accept and allow the MSEs not to comply with all of its regulations.  
Practical deficiencies in the implementation of the law and regulations are often exacerbated  
by the weak status accorded to law. Labour markets in developing countries (i.e., in China  
and Viet Nam) often appear to operate with no reference to the formal legal system with  
general regulatory cultures tolerating non-compliance and corruption.

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36 ILO/UNDP : “Creating an Enabling Environment for Micro and Small Enterprise (MSE) Development in  

37 Sean Cooney, Tim Lindsey, Richard Mitchell and Ying Zhu (eds.) Law and Labour Market Regulation in East  
Lack of adequate resources to ensure inspection and enforcement mechanisms (e.g., in Kenya) have also resulted in widespread violations of minimum labour standards.\textsuperscript{38} Labour administrations in developing countries often lack the personnel, equipment, skills and training to ensure effective implementation of labour law and regulations. High levels of corruption may also undermine state systems of labour inspection. In China, firms are known to undermine the work of labour inspectors by producing false documentation and coaching workers to indicate compliance with the law.\textsuperscript{39}

The debate seems to be whether it would be strengthening of the labour administration that would close the loopholes of exemption or whether it is ease of formalization that would reduce the informality. There seems to be an argument in making for the latter from various quarters, particularly from the IFIs as evidenced from the World Bank reports on the cost of doing business. But the state of poverty and its manifestation in terms of subsistence activities are much more complex to be dealt with than through simple relaxation of the application of the labour law and thereby exacerbate absence of social protection and workers’ rights. As volumes have been written on poverty, it is influenced by a plethora of socio-economic factors, of course aided by political, legal, bureaucratic conditions that exist within the country. At the same time, it would be too simplistic to assume that effective labour administration alone would be sufficient in reducing the informality among the MSEs existing outside the legal framework.

\textbf{ii. Different approaches to labour administration}

Just as labour law provisions vary from country to country, different countries have taken different approaches to setting up their respective labour administrations, which have influenced the way labour market institutions have worked in these countries. Although some departments of labour have sought to adapt the administrative framework to the needs of MSEs by creating distinct structures or programmes targeted at MSEs (i.e., in Burkina Faso and Peru), they seem to be focused more on improving productivity rather than promoting compliance with labour standards among MSEs.\textsuperscript{40} However, some other countries (Chile, Peru) are focussing on developing inspection strategies more focused on MSEs. In Peru, the Micro and Small Enterprise (Promotion and Formalisation) Act 2003 (Law No. 2815) targets an annual inspection of 20 percent of registered MSEs.\textsuperscript{41}

The Labour Code in Chile has established a system of sanctions that are progressively more severe as the number of workers in an enterprise increases. In the Philippines on the other hand, MSEs with fewer than 5 workers are given a year to comply with labour standards if they are found to be breached.\textsuperscript{42}

The institutional framework plays a role in the implementation of the labour law to the extent it is possible given the labour union density, knowledge of the law and the effectiveness of the

\textsuperscript{38} Gregg J. Bekko and George M. Muchai, Op.Cit.
\textsuperscript{40} ILO: \textit{Informal Economy, Undeclared Work and Labour Administration}, Op.Cit.
\textsuperscript{41} Gerhard Reinecke: “Labour and Labour-related laws in Micro and Small Enterprises: Cases from Latin America,” ILO SRO Santiago, 2005.
\textsuperscript{42} Ibid. and ‘Philippines Informal Sector: Labour law and Industrial Relations,’ Assessment Report Series No. 6 prepared by Rene Ofreneo for the Interdepartmental Project on the Urban Informal Sector, 1994.
market based approaches in a given country. Low labour union density may weaken the role the unions can play in applying greater pressure on labour administration to inspect enterprises. Another important consideration is legal literacy among the workers and enterprises. In Nepal and China, it has been found that the MSEs as well as workers are unaware of the requirements of and protection provided by the labour standards.\(^{43}\) Here, the labour inspectors can play an important educative role rather than simple policing role. ILO projects and studies have demonstrated that where the labour inspectors have taken on an educative role, employers and workers have better understood the legal requirements and have benefited both.\(^{44}\) However, workers may be reluctant to report breaches in the labour law if the labour administration and its framework are not strong enough, particularly the workers’ organization, to prevent retribution to ‘whistle blowers’ as evidenced in China and Indonesia.\(^{45}\)

It is also being increasingly believed that voluntary compliance, particularly among the enterprises linked to a global supply chain, would greatly supplement the need for enforcement to the labour law. Self-regulation by enterprises also is expected to minimize the enforcement costs for the governments, and the regulation could be potentially adaptive to the subsector specific conditions and requirements. But it has to be recognized that market-based regulation tends to be limited to the interests of the individual firms not necessarily providing uniform interpretation and compliance. Even where a genuine attempt is made to implement codes of conduct, firms are found to be selective. A study\(^{46}\) on codes of conduct has revealed that they deal with three issues only:

- a. general commitment to working environment;
- b. compliance to local law; and
- c. protection against discrimination and harassment.

An additional problem could be that the firms are committed only temporarily to the cause of compliance to labour law. Once the production platform is transferred to another location, they will be less interested in workers’ welfare. Furthermore, the codes of conduct may be part of the bargaining tool in the hands of the lead firm in the supply chain and possibly make the MSEs dependent on one lead firm restricting the entry of other firms in the supply chain.

iii. **Balancing between the compliance and cost of doing business**

The final issue remains how to improve the compliance of enterprises to the labour law while keeping the cost of doing business at a reasonable level. Exemptions or non-exemptions, both do not seem to have improved the business performance of the MSEs in creating productive, remunerative jobs. On the other hand, strong arguments are being put forward to lessen and simplify the labour law requirements in a bid to reduce cost of doing business. But most of the MSEs in developing countries have been outside the purview of labour law, either by design or default.

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Nonetheless, it is true that once the MSEs cross the threshold of exemption, they are liable to comply with various laws, thus creating a sort of ‘growth trap’ beyond which they are not able to take a leap into the formality. Is it the psychological barrier of the ‘fear of unknown’ that keep them from making the transition from formality to informality or is it really ‘cost of doing business’ that frightens them away? As stated earlier, vast majority of micro enterprises never reach the threshold level to experience either of the situations. Those, who make it to the threshold level, may confront a bit of both, particularly when the law is confusing and labour administration weak. Actually during a survey of 636 MSEs in U.P. state of India, most of the MSEs stated that they did not find as much problem with the legislation as they dreaded the labour inspection or in other words labour administration. They ranked labour inspection second to tax inspection as a source of harassment.47

What the above indicates that labour law in itself may not be the source of difficulty in doing business as much as the labour administration may be. Confusion created by layers of legislations may be further exploited by the rent seeking attitude of bureaucracy. The World Bank’s latest report on Doing Business in 2006 acknowledges that ease-of-doing business may not necessarily mean less regulation and cites the examples of the nordic countries which have strict regulations but they are transparent and understood.48 The report argues that it is possible to have simple law and yet provide better protection for the workers.

Compliance with the labour law may not necessarily need to be contrary to low cost of doing business. But the complexity and extent of compliance requirements may have bearing on the cost of doing business. Compliance requirements are as much the product of labour administration and its framework as is that of the labour law. Therefore, a simplistic approach of labour law deregulation would not necessarily reduce the burden of compliance without strengthening labour administration and labour market institutions.

On the other hand, effective labour administration and its frameworks may lead towards simplicity in compliance and lower cost of doing business. However, cost of compliance and cost of doing business may converge where the law is complex, labour administration is ineffective and most of all legal literacy is low. Together with labour law reform and strengthening of labour inspection, there needs to be a great deal of emphasis on promotional activities for enhancing legal literacy and information about the law.

In a number of countries the reforms are still being hotly debated between the political parties and the social partners, so it is too soon to judge whether the new balance has been found. An ILO background report suggests that “flexicurity”, in which stronger reliance on collective bargaining and social dialogue reduces the need for extensive legal provisions, is a way forward to finding a new balance among flexibility, stability and security. 49

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10. Lessons learned

i. Lessons for improving the regulatory environment

The lessons for improving regulatory environment from the above discussion of various issues relating to the application of the labour law and labour-related laws on MSEs are based on failures of: a) exemptions of MSEs in the labour law to provide a boost in creation of productive, remunerative decent jobs in MSEs; and b) inclusion of MSEs without effective labour administration and its framework in keeping the compliance costs low for business enterprises. The solution, although it may lie in much needed labour law reform in many cases, cannot be simplistic solution of wishing away regulatory provisions for workers’ rights and protection.

There are cases of creation of separate legislations for the MSEs that take into account special situations under which these enterprises are created. But there is little evidence that such separate legislations have enabled the MSEs to make the transition from very small, marginal operations to larger ones creating more productive jobs. The goal cannot be that MSEs are encouraged to continue to operate in a secured cocoon of an environment, which insulates them from the rest of the economy. Therefore, the goal has to be in creating an enabling regulatory environment that encourages the MSEs to increasingly comply with the regulatory requirements, particularly concerning workers’ rights and protection and also achieve greater productivity and higher income.

The arguments regarding easing of the regulations that protect workers’ rights and protection for reducing the cost of doing business through greater labour market flexibility have been seen. It is true that many complex rules and restrictive provisions need to be dealt with, and greater labour market flexibility is required for encouraging job creation by enterprises, but without social protection, such jobs tend to be casual and exploitative without chances of being productive and sustainable in the long run. Social protection providing security from the work related risks and old age and adherence to basic labour standards are necessary counterpart to viable labour market flexibility. Effective social protection requires effective labour market institutions and social dialogue.

ii. Need for effective implementation

Labour law reforms streamlining labour and labour-related laws that create the conditions for the MSEs to comply with the legal requirements and respect the ILO’s Fundamental Principles and Workers’ Rights are possible provided the labour administration and its frameworks are also strengthened simultaneously. The countries (e.g., Denmark, Norway and Sweden) that have had high ease-of-doing business have transparent labour law and effective implementation mechanisms including the tripartism to have pressure from the workers’ organizations for administrative actions as well as social dialogue between the workers and employers to resolve the issues rather than letting the dissatisfactions fester.

Similar effective labour administration and social dialogue are essential for application of the labour law in the MSEs. The country cases from Asia and Latin America have adequately exemplified the need for such effective implementation. In Latin America although the labour law are extended to the MSEs, absence of such implementation mechanisms have largely hindered compliance. Similarly, Asian countries have expressed less reservation
towards the labour law in contrast to their views towards labour administration and of course, obvious lack of capabilities of the workers and employers’ organizations.

Effective implementation can not be considered only from legalistic view point of strengthening of labor inspection. Among millions of micro and very small enterprises, it would be practically impossible to undertake inspections on a regular basis and ensure that the law are complied with. Promotional activities and education remain the best option to spread the legal literacy among the workers and entrepreneurs of MSEs. Social campaigns have proved effective, as exemplified by the ILO’s efforts in Asia and Africa, in getting the entire community to bring about orderliness from chaotic manner in which informal economic activities are carried out and in improving working conditions and compliance by the MSEs.

iii. Effective labour market framework

It has been noted above that the capabilities of the workers and employers’ organizations to play active role in supporting the promotional activities, in prodding the labour administration to carry out monitoring and supervision and reporting when the violations do occur are most essential for compliance with the labour law by the MSEs. But even more important would be a framework under which social dialogue can take place between the workers and employers’ organizations and the working of dispute settling mechanism.

Although the workers’ organizations generally do not have wide membership and representation in the informal economy, there are growing examples of organization of informal workers in trade unions, which have illustrated the potentials of extending social protection and compliance by the MSEs through unionization. The ILO’s SYNDICOOP experiments in four countries in Africa and its assistance to the trade unions to extend micro health insurance in the informal economy in South Asia are such examples.

Thus, the roles of workers and employers’ organizations have to be seen in different perspectives than the traditional industrial relations, which are not perceptible in an informal economy. Workers and employers working with the MSEs in formation of the self-help groups, savings and credit and social protection can lead towards greater compliance to the provisions of the labour law.

iv. Conclusions

From the above discussion, two issues that are related to each other emerge as requiring consideration:

a. Would exemptions in the labour law create a ‘growth trap’ for MSEs by not allowing them to grow beyond certain threshold?

b. To what extent can the labour law be effectively extended and implemented for the MSEs?

Regarding the issue of the ‘growth trap’ referred to point (a) above, the evidence from various studies and country experiences point to the following:

i. Most micro enterprises come into existence and disappear well below the threshold provided for in the labour law.
ii. Surveys have indicated that the MSEs exempted from the labour law do not see the labour law as impediment to their growth while those that are covered under the law find themselves in a disadvantageous position.

iii. There are, however, instances of complex law and ineffective labour administration that have created an environment not so conducive for growth of small enterprises closer to and beyond the threshold.

Regarding the second issue in relation to the extent to which the labour law can be applied to the MSEs, the above discussion points to the following requirements:

i. Labour law reforms making the legal environment simple, transparent and responsive to the needs and requirements of the MSEs are required in many countries so that compliance can be improved.

ii. Simple labour law in themselves are not enough and need to be accompanied by effective labour administration, which needs to go beyond labour inspection to a promotional approach.

iii. Existence of effective labour market institutions is necessary to create conditions for the application of labour law to the MSEs.
**Annex**

**Matrix 1A: Scope of Labour law – Employment relationship and contract**

<table>
<thead>
<tr>
<th>Types of relationship/contract</th>
<th>Tacit or express agreement</th>
<th>Oral or in writing</th>
<th>Provision of services in return for remuneration</th>
<th>Any form of evidence, even without all requirements</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Employment relationship</strong></td>
<td>Brazil</td>
<td></td>
<td>Nicaragua</td>
<td>Guatemala</td>
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<tr>
<td><strong>Contracts</strong></td>
<td>Botswana</td>
<td>Slovenia</td>
<td>Spain</td>
<td>Singapore</td>
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<tr>
<td></td>
<td>Finland (+electronic)</td>
<td>Viet Nam</td>
<td></td>
<td></td>
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<tr>
<td></td>
<td>Zanzibar (in writing)</td>
<td>Zambia (employer</td>
<td></td>
<td></td>
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<tr>
<td></td>
<td></td>
<td>maintains a record)</td>
<td></td>
<td></td>
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<tr>
<td><strong>Evidence of Contracts</strong></td>
<td></td>
<td></td>
<td>Brazil, Cambodia (work card mandatory)</td>
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<td></td>
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<td></td>
<td>Bulgaria</td>
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<td></td>
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<td></td>
<td>Croatia (written certificate by employer)</td>
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<td>Haiti (work certificate mandatory)</td>
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<td></td>
<td>Lesotho (records by employer)</td>
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<td>Mexico</td>
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<td></td>
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<td></td>
<td>Spain (Personnel Reg. Book to be maintained by employers)</td>
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<td>Senegal (pay slip as evidence)</td>
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</tbody>
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<table>
<thead>
<tr>
<th>Exemptions</th>
<th>Benin</th>
<th>Brazil</th>
<th>Bolivia</th>
<th>Burundi</th>
<th>Cameroon</th>
<th>Jordan</th>
<th>Namibia</th>
</tr>
</thead>
<tbody>
<tr>
<td>State employees</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Specific regulations and provisions</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Agriculture, maritime work and air transport</td>
<td>Merchant marine and maritime fishing governed by Merchant Marine Code</td>
<td>Rural workers not employed in industrial/commercial activities</td>
<td>Special provision for agriculture</td>
<td></td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Certain categories of agricultural workers and enterprises</td>
<td></td>
<td></td>
<td></td>
<td>Agricultural operations in the modern sector not excluded</td>
<td></td>
<td>On the basis of the recommendation by the minister</td>
<td></td>
</tr>
</tbody>
</table>


Cooney, Sean; Tim Lindsey; Richard Mitchell and Ying Zhu (eds.) Law and Labour Market Regulation in East Asia, 2002, pp. 246, 253.


