THE FIGHT AGAINST GLOBAL POVERTY AND INEQUALITY: THE WORLD BANK'S APPROACH TO CORE LABOR STANDARDS AND EMPLOYMENT CREATION

HEARING

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THE FIGHT AGAINST GLOBAL POVERTY AND INEQUALITY: THE WORLD BANK'S APPROACH TO CORE LABOR STANDARDS AND EMPLOYMENT CREATION

Wednesday, October 3, 2007

U.S. HOUSE OF REPRESENTATIVES,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The committee met, pursuant to notice, at 10:02 a.m., in room 2128, Rayburn House Office Building, Hon. Barney Frank [chairman of the committee] presiding.

Members present: Representatives Frank, Waters, Maloney, Watt, Meeks, McCarthy, Scott, Green, Cleaver, Moore of Wisconsin, Davis of Tennessee, Ellison, Klein, Marshall; Castle, Jones, Hensarling, and McCarthy.

The CHAIRMAN. This Committee on Financial Services hearing will come to order. The topic today is the "Doing Business" report issued by the World Bank.

This committee does not have jurisdiction directly over the World Bank, and I often wish that we did, but the World Bank is an international organization. What we do have is jurisdiction over the relationship of the U.S. Government to the Bank. Funding requests come through us, and legislation that deals with the terms under which the United States executive directors—the voting members of the Bank board—should function also come through us.

One of the major concerns of this committee, particularly those of us on the majority side, is the dilemma we face in a world in which increased wealth has been accompanied to a distressing extent by increased inequality. There has been a history in judging the success of economic development policies to look at countries as if they were undivided wholes and to talk about the increase in percentages and gross domestic product of this or that country. That is important, but increases in gross domestic product which are overwhelmingly enjoyed by a very small percentage of the residents of that country are much less of a good thing.

We have this problem here in the United States, but it is a problem elsewhere in the world, where the way in which growth has gone forward recently—a combination of technology, of globalization—essentially what we have seen in recent years is a great freeing from constraint of capital, both technically and legally. Capital has been empowered to move very rapidly.

That has very good aspects. It can get to the point where it does the most overall good. But it has allowed the owners of capital to leave everybody else very much behind in the sharing of these benefits.

Now, that has been a particular problem in the United States. A couple of months ago, to the dismay of many in the business community and elsewhere, the immigration bill blew up. The President's ability to negotiate trade treaties was allowed to die. There is an effort now, led by Democratic leaders in the Ways and Means Committee, to put forward a treaty with Peru which accomplishes some of the goals the Democrats have long had in the areas of labor and environmental rights, but it is still controversial, including with many who had previously been advocates of that.

And the problems with trade, the problems with what I think is an excessive sensitivity to foreign investment, a skepticism about foreign investment that is unjustified as a general principle, the concerns with immigration, the objections we have in some cases to allow businesses fully to adopt more productive technology, it stems in the United States from the unhappiness that the fruits of these policies are so unfairly shared.

We did a roundtable on the paper put forward by Don Evans, President Bush's first Secretary of Commerce, documenting how badly wealth has been distributed, how much has gone to a relatively small number of people and how the great bulk of people have received nothing. This was a report put out by a former member of the current President's Council of Economic Advisers, the former Under Secretary of Commerce for Trade.

We have a serious problem. We are trying to deal with it here, but it is an international problem.

We have seen, I believe, some improvement in the orientation of the international financial institutions. It is fairly recent. During the Asian crisis, in particular, of 10 years ago or so, I believe the IMF in particular was playing a very retrograde role. It was imposing on countries a degree of repressive economic policies that were not responsive to the problem. You don't solve a liquidity crisis by cutting wages, and it had negative social consequences.

The World Bank has begun to address this on the one hand, but what I hear and from what I read in some of the testimony, there is a certain schizophrenia in the Bank. At least at the operational level on its own, the Bank talks about trying to pay attention to the distributional qualities. But the "Doing Business" report that the Bank puts out and some of the work of the IFC take a very different view.

Essentially what we get from the "Doing Business" report is that the nicer you are to your workers, the worse you are as a place to do business. It is an extraordinarily, I think, simplistic and regressive approach. And while the "Doing Business" report, they say, "Well, it doesn't have an actual binding effect," of course it is important or they wouldn't put it out. There is some evidence that it has some impact on some of the country assessment strategies, not on all of them.

It is simply wrong for the major international institution in the world, the World Bank, to be putting out a report in which the worse you treat your workers, everything else being equal, the better you are rated. That is not only wrong in and of itself, but I want to go back to this other point. We have a certain unhappiness in America at the rise of regimes with whom we disagree. It is not in the interests of the world, of the United States for, kind of, pro-Western democracy to be associated with unfair economic distribution. It is, in fact, not a good idea in general for people to get the sense that a free-enterprise system, a capitalist system, means that the rich get richer, the middle class get nothing, and the poor get poorer.

So we are not just talking here about a moral imperative to be fair, we are talking about what I believe is one of the most difficult obstacles to the kind of economic policy many in the business community and elsewhere would like to see. Yes, I think in the right circumstances an embrace of technology and of globalization can produce greater benefits for everybody, but only if we combat the natural tendency for these benefits to be so unequally shared.

And no one is talking about equalization—I shouldn't have said equally—less unequally. Inequality is a very good thing; it is necessary in a capitalist system. But excessive inequality can become politically dysfunctional, and to the extent that it begins to depress consumption, depress savings rates, it can become economically dysfunctional. I think we are at that point in the world. And it troubles me to see the "Doing Business" report of the World Bank reinforcing those tendencies, to the extent that it has an influence.

And I now recognize the gentleman from Delaware.

Mr. CASTLE. Thank you, Mr. Chairman, for holding this important hearing.

Mr. Chairman, we all agree that it is important to work to alleviate poverty, be it here in the United States or overseas, where the scenes we see are sometimes heartbreaking. And I am glad that today we will focus more on individuals or populations than when we often talk about the development banks or the International Monetary Fund.

Too often we talk about the success or failure of big infrastructure projects, such as dams or roads, or about the success of an IMF program in stabilizing inflation. It is easy to forget that we are really talking about people.

But for people to get ahead, individually or as a population, they really need jobs. And for that reason, I believe that the "Doing Business" report is important. It gives countries a good idea of what they need to do to attract new jobs, and companies a good idea of what sort of business climate they will face.

I know that the focus of this hearing is on whether some portions of the report somehow make it easier to make people work in conditions that would not be acceptable here in the United States or in Europe, and while I agree that no one should work in unsafe conditions, the amount of hours a person chooses to work, or if they choose to work on a weekend, might be more their choice than that of a well-employed Westerner. I hope we will hear a discussion of both points of view of that today.

Mr. Chairman, I have a unanimous consent request to insert into the record a paper expressing the views of the United States Council for International Business, who had hoped to be a witness at today's hearing but were not able to be accommodated. These views are submitted by the Council's executive vice president and senior policy officer, Ms. Ronnie L. Goldberg, who serves both as a U.S.

employer delegate on the ILO governing body and vice president of the International Organization of Employers, IOE, whose membership consists of representative employer organizations from 138 countries, the majority of which are in the developing world.

I regret that the important voice of employers, who constitute one-third of the constituency of the tripartite ILO, will be missing from the hearing. Inserting this paper will at least make those views part of the permanent record. I offer that statement.

The CHAIRMAN. Reserving the right to object, I would note that we did ask the minority to suggest two witnesses, and we have two witnesses who represent the minority. So, I think that we can't possibly get everybody, but two of the witnesses are here at the request of the minority.

Is there any objection?

Hearing none, the statement will be put into the record.

Mr. CASTLE. Mr. Chairman, thank you for the submission statement. But if I may just add, we are not complaining about it at all. It is just, as you said, a function of too many people who deserve to be heard.

The CHAIRMAN. I thank the gentleman. I am just not used to people not complaining, and I apologize.

Are there any further opening statements?

If not, we will proceed with the panel of witnesses. Before we begin, let me say that the Democratic leadership has scheduled a press conference for 11:15 on the subprime crisis, so I will be here until about 11:05, and then I will go to the Senate.

I hope I do not share the fate of many of the bills that we have sent to the Senate. That is, I hope I will not disappear and that I will be seen and heard from again.

But I will have to go over there, and the gentlewoman from New York will be available to chair—Chairwoman Maloney of the Subcommittee on Financial Institutions—and I will try to get back.

The first witness is Peter Bakvis, who is the director of the Washington Office of the International Trade Union Confederation/Global Unions and represents the international trade union movement. They, understandably, often focus on the international financial institutions themselves.

Mr. Bakvis?

STATEMENT OF PETER BAKVIS, DIRECTOR, WASHINGTON OFFICE OF THE INTERNATIONAL TRADE UNION CONFEDERATION/GLOBAL UNIONS

Mr. BAKVIS. Thank you, Mr. Chairman, and members of the committee. I thank you for the opportunity.

My organization, the ITUC, represents 168 million members in 153 countries, including 10 million members of the AFL–CIO. Two-thirds of our members, however, live in developing or so-called transition countries.

The U.S. Congress, I think it is clear, took the lead in urging the World Bank to pay more attention to the impact of its policies on workers when, 13 years ago, it instructed the U.S. representatives at the Bank to support policies and "guarantee certain internationally recognized worker rights." Even though it took several years, I am pleased that the Bank has taken some steps to ensure that its operations are in line with the core labor standards.

Starting in 2002, the Bank put itself on record as supporting them, after having done several years of research to determine if they were consistent with the Bank's development goals. In 2006, the Bank took the first step to ensure that the activities and finances don't violate the standards when its private-sector lending arm, the IFC, required that all borrowers respect them. And this year, the Bank began inserting the same requirement into contracts for infrastructure projects. Hopefully, this will put an end to child labor and other violations that were previously found on some Bank-funded sites.

These are important steps. But in the area of labor law reform, the Bank is going in a completely different direction. The main approach is being set by the department that produces an annual publication, which you mentioned, called "Doing Business." It includes an index on employing workers that gives the best scores to countries that have the least amount of regulations, whether they be minimum wages, notice for mass layoffs, payroll taxes to finance Social Security, and so on. It encourages countries to get rid of these so as to improve their "Doing Business" score, no matter what the impact is on workers.

The results of this flawed rating system have been observed. In past years, "Doing Business" gave the best performer ranking for labor to nations that were not even ILO members. In "Doing Business 2008," which came out last week, the ex-Soviet Republic of Georgia is praised as a top reformer because it did away with most of its worker protection rules. Any worker can now be fired without recourse, labor unions have been essentially marginalized and can be prohibited all together.

The World Bank gave Georgia this top rating at the same time that the ILO was criticizing the country's labor practices for contravening four of the eight core labor standards conventions, including the two child labor conventions. The European Union is currently investigating Georgia for possible violation of the E.U.'s GSP.

And which country in this vast region gets the worst "Doing Business" rating for its labor standards? Slovenia, which has the lowest unemployment of all of those countries and the best labor conditions of all of the bloc of ex-communist countries.

Let us take another example in our hemisphere. Haiti, which has almost no social program, 80 percent of its people in poverty, has had negative growth in the last several years, some very modest growth in the last couple of years, is among the best "Doing Business" performers for labor in Latin America.

Brazil, which enjoys stable growth and has considerably improved social protection, is ranked among the worst. Other countries that you might be surprised to find get relatively good ratings for their labor policies from "Doing Business" are China, Colombia and Belarus.

Now, it would be easy to dismiss all of this if "Doing Business" were not playing such an important role, but it is. The "Doing Business" labor indicators are used for determining countries' level of access to concessionary lending dispensed by the World Bank's IDA through a mechanism called CPIA. The indicators have been incorporated in the Bank's overall labor markets strategy. A growing number of World Bank and IMF country strategies have used the indicators to do away with labor regulations. The ITUC, my organization, documented 16 new cases in a report last week, and I have copies of it for those who might be interested.

The IMF told Jordan, where the ILO has been working with the government to combat abuse of workers in free-trade zones, that its "Doing Business" labor rating isn't good enough and it should make it easier to fire workers.

Several countries have been told to dismantle sector-level bargaining arrangements so as to improve their "Doing Business" scores, even though the Bank's own research shows that countries with centralized collective bargaining tend to have lower unemployment.

And in several countries, the Bank has included loans for labor regulations aimed at improving the "Doing Business" rankings, essentially made them into a conditionality for those loans.

I will conclude, Mr. Chairman, with a few suggestions.

If the Bank is to be involved in labor law reforms at all, which is a debatable question, I would submit, it should adopt the ILO's "decent work" agenda, which has the objective of maximizing employment but also pays attention to job quality, social protection and workers' rights.

"Doing Business" should be removed from the World Bank's labor markets strategy, and the issue of labor should be removed from the mandate of "Doing Business."

"Doing Business" should not be used in the Bank's CPIA mechanism to determine access to funds.

The Bank should develop tools for assessing the qualities of social and labor policies with the ILO and prioritize projects that improve labor conditions, as it has done in one case that I am aware of, the ILO-led Better Factories Cambodia project.

Finally, the World Bank should adopt an operational policy requiring that all the activities it finances conform to the core labor standards.

Thank you for your attention, and I look forward to your questions.

[The prepared statement of Mr. Bakvis can be found on page 34 of the appendix.]

The CHAIRMAN. Thank you.

I guess the acting ranking minority member and I do want to note we have a new member of the committee to fill the vacancy very regrettably left by the death of our dear colleague, Mr. Gillmor. So we welcome the gentleman from California, Mr. McCarthy, to the committee.

The next witness is Mr. Eric Miller, who is the president of Millers Rock Consulting. And he had previously worked for the Inter-American Development Bank, one of the IFIs.

Mr. Miller, please.

STATEMENT OF ERIC MILLER, PRESIDENT, MILLERS ROCK CONSULTING, LLC

Mr. MILLER. Thank you very much, Mr. Chairman, and members of the committee. It is a great pleasure to address you this morning.

As the chairman said, I have a background in working for the international financial institutions, both on the inside and as a consultant on the outside. So that is the basis of my comments today, and also my experience in working with numerous governments.

On employment-creation policies, the World Bank's view and my view is flexible labor markets create more jobs than rigid labor markets. Also, flexible labor markets tend to create more opportunities and better working conditions for women, young people and the low-skilled. Research suggests that the jobs created under rigid labor markets tend to go to men with years of experience. Meanwhile, the rest of the population is pushed into the informal sector, where they receive no social benefits and no legal protections.

Let us be clear that flexible labor markets do not mean the absence of labor law. However, flexibility does allow firms to readily change the composition of their labor force as market conditions evolve.

The World Bank's "Doing Business" report seeks to measure the effects of business regulations across 175 countries. One of its 10 categories is employing workers. Some observers have noted that, in certain cases, countries with more restrictive union-organization practices have scored better than those with less restrictive practices. This is the result of two factors: first, the focus of the study, which is the effect of government regulations; and second, the methodology employed for gathering the data, which is the standard survey practice of assuming what a typical worker in business looks like across countries.

In most countries, the majority of workers are not union members; therefore, the typical worker is not a union member. Without using the standard statistical techniques, the "Doing Business" report would lose its focus and swiftly become noncomparable across countries.

The important contribution of the "Doing Business" report is that it has made governments begin to think about the incentive structures inherent in their business regulatory regimes and how these can be improved.

For years, many countries have made it expensive and complicated for entrepreneurs to establish and operate firms in the formal sector. Everyone agrees that it is desirable to have more taxpaying firms that employ people. However, national regulatory regimes that make the formalization process long and expensive runs counter to this objective. The World Bank is a large bureaucracy that achieves uneven results. Despite its imperfections, the Bank does have an important role to play in the fight against global poverty. The IFC's contributions in putting together the Equator Principles, the voluntary initiative among the world's commercial banks to establish a universal framework for establishing social and environmental issues, was very important.

Undoubtedly, the Bank could do more on core labor standards. The important work of the Inter-American Development Bank in pulling together trade and labor ministers during the CAFTA process is a useful example. Ultimately, though, the fight against global poverty can only be won if large numbers of the poor are able to access and harness the power of the global economy. The wealthiest countries of the world are also the most globalized.

To bring the poor fully into the global economy, countries need three things: good policies, such as open trade and transparency; improvements to the basic plumbing of commerce, such as ports, telecommunications infrastructure, and financial systems that extend credit to nascent entrepreneurs; and improved education and training systems.

The World Bank has a role to play in this process. However, we need to examine ways in which the Bank should be restructured to achieve its mission more efficiently and effectively.

Ultimately, however, the impetus for the reduction of poverty and the improvement of labor standards will come at the country level. Having seen manufacturing jobs go to China, many developing countries now understand that low wages are neither a desirable nor a feasible strategy for long-term competitiveness. The only answer is to move up the value chain, where they can compete on the basis of factors other than strictly price.

Thank you very much.

[The prepared statement of Mr. Miller can be found on page 48 of the appendix.]

The CHAIRMAN. Thank you.

Our next witness is Sandra Polaski, who is a senior associate and director of the Trade Equity and Development Program at the Carnegie Endowment for International Peace.

Ms. Polaski?

STATEMENT OF SANDRA POLASKI, SENIOR ASSOCIATE AND DIRECTOR OF THE TRADE, EQUITY AND DEVELOPMENT PROGRAM, CARNEGIE ENDOWMENT FOR INTERNATIONAL PEACE

Ms. POLASKI. Thank you, Mr. Chairman, and thanks to the committee for this opportunity to comment on the World Bank's approach to core labor standards and employment creation.

I direct research and policy work on trade, employment and development at Carnegie, and previously had the pleasure to serve Secretaries of State Madeleine Albright and Colin Powell as special representative for international labor affairs, where I worked on many of the issues that are the topic of this hearing today.

I would like to briefly mention four recent developments in the World Bank Group that I think are very important, three positive and one negative.

On the positive score, first I would echo the comments that were made earlier, that the IFC recently adopted a new performance standard covering labor and working conditions in the businesses to whom it lends in the developing country. Previously, the IFC had standards on the environment, child labor and forced labor, but not on the core labor standards and not on broader workplace policies.

Adopting this new standard in 2006 was very important for the work of the IFC itself in raising the level and performance of the firms that it lends to in developing countries, but also because it has broader impact. It has been adopted by the Equator Banks, and we will be hearing more about that from a representative of one of those banks in a moment. And I believe it actually paved the way for the very recent adoption by the main World Bank Group of a new standard on procurement contracts, which requires that all firms signing on to do work that is funded by the World Bank must observe the core labor standards. These are both very positive developments.

Now, in the IFC, the new performance standard on labor is just now in the process of implementation. The Environment and Social Development Department has been charged with the responsibility for implementing this. It has done much to train the loan officers, whose ultimate responsibility it is to decide which firms get loans or not, and therefore to enforce the labor standards.

And I think that the department that is overseeing this process has done a very professional and serious effort, but it will need a lot of support if it is to change the culture of the IFC with respect to working conditions, employment creation and core labor standards. And I think that this is work that deserves the support and attention of the committee and the U.S. executive director.

That brings me to the negative point that I want to make, and that is on the "Doing Business" report, and specifically "Doing Business 2008," which was issued last week. I think it is probably the most glaring example of inconsistency within the Bank, in terms of promoting good workplace practices.

The "Doing Business" report, as you mentioned, ranks countries on how business-friendly they are, and it influences decisions by the Bank in funding and by outside investors. The report covers a number of appropriate topics, such as the ease of establishing a new business, licensing and registration requirements, for example, and access to credit and financial markets.

However, the section that deals with employing workers is seriously off-track. It creates an index made up of three components, labeled "difficulty of hiring," "rigidity of hours," and "difficulty of firing." A perfect score for a country means that it is a good place to do business. A low ranking suggests that investors should avoid that country and that the government should change its labor laws.

Let me comment on each ingredient of this index.

The "difficulty of hiring" index gives a perfect score to countries that allow the use of fixed-term—that is, temporary—contracts for workers who are hired to do permanent tasks, with no limitations whatsoever. It gives the worst score to countries that limit the use of temporary contracts to no more than 3 years for workers if they are doing permanent work.

It should be noted that temporary contracts are widely used and abused in many developing countries, notably in parts of Latin America, to avoid putting employees on regular payrolls despite the fact that they are doing permanent work. These contracts keep the affected workers in a precarious economic position, not knowing whether they will be employed at the end of their contract, which can often run for as short as 3 months, renewed again and again and again.

In some cases, the use of these temporary contracts means that the worker will not qualify for employment benefits, such as medical insurance and pensions. It discourages both the employee and the firm from investing in the temporary worker's training and skills because of the uncertainty of continued employment. It discourages workers from joining unions or organizing unions because of the fear that their contracts will not be renewed.

The effect is to create precarious employment and economic insecurity and to slow the workplace training that is so essential in developing countries.

The "difficulty of hiring" index also discourages the use of minimum-wage legislation or encourages extremely low minimum wages if they are set at all by governments. It assigns a perfect score to countries that set the minimum wage at less than 25 percent of the average value added per worker.

The "Doing Business" team ignores extensive research showing that carefully established minimum-wage policy can alleviate poverty and improve income distribution without, in any way, discouraging employment creation. Instead, it rewards countries that set minimum-wage rules that allow firms to capture the largest possible share of output and productivity gains. This encourages sweat shops, basically, where labor is paid the lowest possible wage, rather than encouraging increased productivity based on investment in workers' skills and technology.

The second ranking of the index, "rigidity of hours," implicitly advocates rolling back any restrictions on hours worked. It assigns a perfect score to countries that allow 50-hour work weeks and limit vacation time. If developing countries established the kind of limits that we in our country came to believe were sensible, such as a 40-hour work week, they are labeled bad places to do business.

In a world where unemployment and underemployment are major economic and social problems in most developing countries, the idea that workers already on payrolls should be worked to the maximum, rather than encouraging firms to hire additional workers, is going in entirely the wrong direction.

Finally, the "difficulty of firing" index rates countries that require advanced notice of termination or layoff or that require that the options of retraining or alternative placement be considered instead of doing layoff as bad places for business.

The index lists the firing costs in each country, which amounts to the cost of advanced notice and severance pay. This must be understood in the context that, in most developing countries, there is no unemployment insurance. Severance pay is the only buffer for households that lose the income of their wage-earners. To imply that this buffer should be eliminated by countries without unemployment insurance endorses an approach of shifting all economic risk from firms to households. This represents an extremist view of the balance—

The CHAIRMAN. Ms. Polaski, you are going to have to finish up.

Ms. POLASKI. —an extremist view of the balance that should be achieved.

I won't take time, then, to mention the fourth thing, which is positive, which is the establishment by the IFC and the ILO of the new program called "Better Work," which will attempt to replicate lessons that were learned by an innovative project between the United States and Cambodia, but it is included in my testimony.

And I thank the committee.

[The prepared statement of Ms. Polaski can be found on page 57 of the appendix.]

The CHAIRMAN. And we will get to it in the question period.

Next we will hear from Thea Lee, who is the policy director at AFL–CIO and is involved in research and strategy on domestic and international policy.

Ms. Lee?

STATEMENT OF THEA M. LEE, POLICY DIRECTOR, AFL–CIO

Ms. LEE. Thank you very much, Mr. Chairman, and members of the committee. I appreciate the opportunity to come here today. I would like to thank you for holding the hearing today on this important topic.

We believe that the fight against global poverty and inequality must include as an integral element the promotion of decent work, as the International Labor Organization has defined it. Both my colleagues, Peter Bakvis and Sandra Polaski, have spoken about the importance of decent work, which is not just about employment creation but also about the protection of workers' human rights. There is a growing body of research showing that observing fundamental workers' rights is good for growth, not an obstacle.

Some have tried to create a false dichotomy, insisting that we or workers or the government must choose between decent work and any work, between rights and a job. We disagree fundamentally with this premise. It is both bad economics and bad politics. A vibrant democracy and a strong middle class are essential to sustainable development, not an inessential luxury.

The subject of today's hearing is the World Bank and the World Bank's approach to core labor standards in its mission to reduce global poverty and raise living standards. The World Bank's record, as the chairman mentioned, is mixed on this issue. There has been much criticism of the conditionalities imposed by the World Bank in its mission to end poverty, and questions raised as to whether those conditionalities have been imbalanced toward undermining progressive government initiatives and undermining the rights of workers.

As other panelists have said, there has been some progress at the World Bank in recent years with respect to core labor standards, and we recognize and honor the progress that has been made, particularly with respect to the IFC and to some of the research that has been done.

However, we also would like to add our voice to the criticism of the "Doing Business" report as the most glaring example of inconsistency within the World Bank, and also as emblematic of the failure of the World Bank to engage in meaningful policy coherence dialogues with other international institutions. The United States belongs to both the World Bank and the International Labor Organization. We shouldn't be promoting one set of goals at the ILO and then allowing another institution to undermine those very same goals.

I would submit to you that the "Doing Business" report, particularly the most recent version, is an international disgrace. It might be appropriate for a business organization, let us say the International Chamber of Commerce, to put out a report that is so one-sided in its views about what a good business environment is. But it is not appropriate for an intergovernmental agency committed to ending poverty to send a message to both governments and to businesses that the way to attract business, the way to develop in a global economy is to undermine protections for workers.

The "Doing Business" report classifies most protections for workers as investment impediments. It ranks human-rights abusers as stars and downgrades democratic countries with strong labor institutions and protections. Contrary to what some World Bank officials have said, this is not a neutral set of indices. It is a powerful policy document that has been used to determine loan eligibility in important World Bank reports.

One of the key issues is whether the "Doing Business" report undermines the World Bank's own stated goals and puts the World Bank at odds with other international institutions.

The World Bank endorsed the Millennium Development Goal of eliminating extreme poverty. Yet the "Doing Business" report penalizes countries that have a minimum wage unless it is less than 25 percent of average value-added per worker. This comes to less than a dollar a day in most sub-Saharan African countries, which is the threshold for extreme poverty. So in this case, the World Bank is actually instructing countries not to implement minimum-wage provisions that would keep full-time workers out of extreme poverty, and in doing so, it is undermining the objective that the World Bank declared to be its overarching goal in 1999.

Let me sum up by saying that, in terms of the interactions between the ILO and the World Bank, there have been many high-level discussions about coherence, and meetings between the ILO and the World Bank. There have been many commitments to achieve better policy coherence between the ILO, the World Bank, the IMF and the WTO. And so far, we appreciate that meetings have been held, we appreciate that conversations have occurred, but we would like to see those conversations reach down into the mainstream of World Bank policy.

To the extent that a publication like "Doing Business" exists, and it is the flagship publication of the World Bank, the most-read, the most-cited publication of the World Bank, and it comes out with a contrary message, an undermining message to protections for workers, this is an enormous problem. We hope that the U.S. Congress, in its instructions to the U.S. executive director to the World Bank, will use all the influence it has to ensure that the World Bank sends a single set of messages in conjunction with its sister institutions, particularly the ILO.

Thank you very much for your attention, and I look forward to your questions.

[The prepared statement of Ms. Lee can be found on page 43 of the appendix.]

The CHAIRMAN. Thank you.

Our next witness has three very important qualifications. First, she was the finance minister and foreign minister of Nigeria, the first woman to hold those positions. Before that, she was the corporate secretary of the World Bank Group. And she was also my very delightful seatmate on our trip to Davos last January.

And in all three capacities, Dr. Ngozi Okonjo-Iweala, we welcome you. Please go ahead.

STATEMENT OF NGOZI OKONJO-IWEALA, DISTINGUISHED FELLOW, GLOBAL ECONOMY AND DEVELOPMENT PROGRAM, THE BROOKINGS INSTITUTION

Ms. OKONJO-IWEALA. Thank you, Mr. Chairman. I am very honored to be here today and to testify before you on this very important issue.

You have already done my task for me of explaining that I see this from different, multiple angles. But most of all, I think that the value I can bring to this hearing is speaking from the point of view of a policymaker who has had to struggle with the issues that are being discussed here and with the kind of recommendations being talked about in the "Doing Business" report.

And I must say that I am somewhat taken aback by the interpretations that I have heard about countries, this report instructing countries to do things in certain ways. Because that is certainly not the way on the ground that we saw this report when I was minister of finance in Nigeria and had to work with it every day.

First of all, as countries, we increasingly like to make our own policies in the context of our own circumstances. And therefore, I think we see these reports as providing additional information, and not instructions or conditionality, because that is not the best way to work with us, with our countries.

The "Doing Business" report has served as a very useful guide in terms of looking at those things that a country can do to enhance its position in terms of creating jobs. And I think that what has happened is that, looking at it perhaps from the World Bank side, is a struggle between protection of workers and flexibility for the labor market. This is an everyday struggle that we have. And the way we read the report is as a report that is trying to give information on balancing that very complex difficulty of: How do you ensure that you have an economy and a labor market that is flexible enough so that jobs are being created?

The biggest problem we face in our countries is the creation of jobs. More than 50 percent of our population are youths under the age of 25. And if we don't work hard to look at creating jobs for these youths, we will have trouble, even more serious problems of inequality, which the honorable chairman referred to.

But we do not see that we can create these jobs on the back of our workers. No country ever grew or will ever grow on the back of unhappy workers. So we have always paid attention to how can we improve the situation with our workers, making sure we applied the minimum codes and standards which my country has signed up to.

And I hasten to say that we are not there yet in Nigeria, that we have a ways to go, in terms of implementing. But, really, that is our objective. We don't see it as contradictory to creating jobs, but rather that we need to maintain this flexibility in the labor market, while also making sure that our workers enjoy the minimum standards and codes that we have signed up to at the international level.

I am, therefore, surprised from the point of view of a practitioner to hear that this is the way the “Doing Business” report is seen, because we certainly do not see it that way. We see it as an important guide which we factor as one more element in our decision-making. And we have to make our own codes and rules in the country and observe our own particular situation and decide what would be most favorable for our workers.

We also see that, in the report, there are many countries that observe high codes and standards for labor but are also tops, in terms of “Doing Business.” So we really don’t see this as contradictory. The United States ranks very high, Denmark ranks very high, many other countries rank very high in “Doing Business” and in treating workers well. So this is not a contradiction, for us.

What we have to do is what policies can we look at that are good for our country, that will both enable us to get workers employed so that we can attack poverty, so that we can deal with the increasing problem of inequality that the honorable chairman referred to, whilst at the same time making sure that our workers have the basic treatment that they need.

So I want to submit that the report is an ingredient in the decision-making of developing countries. We do not regard it as instructions to us to do one thing or the other.

And I think that, in the modern era, this idea of conditionality, you know, getting the Bank to make countries do things as a condition for getting its loans doesn’t work anymore. Countries have to believe in what they are doing. And we believe in decent standards for our workers.

And second of all, we don’t see a contradiction between being a good country that respects workers and creating jobs. And I think that this is what the report is trying to do.

Thank you very much, Mr. Chairman.

The CHAIRMAN. Our final witness has made reference to the Equator Principles, and one of the organizers and administrators of the Equator Principles is Suellen Lazarus, who is a senior advisor at ABN AMRO, here in Washington.

Please, Ms. Lazarus.

STATEMENT OF SUELLEN LAZARUS, SENIOR ADVISOR, ABN AMRO

Ms. LAZARUS. Mr. Chairman, and members of the committee, thank you for inviting me this morning. It is a pleasure to be here.

ABN AMRO is a Dutch bank with operations worldwide and a strong commitment to sustainable development. Prior to joining ABN AMRO, I worked for 23 years at the World Bank and the International Finance Corporation. My responsibilities included serving as advisor to the U.S. executive director of the World Bank, working as principal investment officer in IFC for major projects in Asia, serving as special assistant to IFC’s executive vice president, running IFC’s syndications department, and working with IFC’s vice president for operations on major policy issues.

In the fall of 2002, as director of the syndications department, I was asked by IFC’s executive vice president to structure a small meeting of banks to discuss environment and social issues in project finance lending. The origin of this meeting was at the request of the head of risk management of ABN AMRO.

The Bank had experienced some financial losses due to inadequate environmental controls in several projects. They were also finding that environmental and social risks were making projects increasingly complicated, but the Bank lacked a systematic way to deal with these challenges. Their approach of turning down projects on environmental grounds simply was not working. It neither improved the environment, nor was it good for business. Projects that the Bank would decline were readily picked up by the neighboring bank. There was a clear need to level the playing field.

Hosted by ABN AMRO and IFC, the first meeting of the banks was held in London in October 2002. Despite some initial denial that there was a problem, within a few hours the banks concluded that if they were to keep doing project finance business, they needed a better approach to environmental and social risk management. While they had expected appropriate environmental management from clients, the banks agreed that they often were unclear on what standards were applicable and did not enforce and monitor environmental covenants.

Eight months later, in June 2003, the Equator Principles were launched here in Washington, when 10 banks announced their adoption. The Equator Principles are a voluntary set of guidelines developed and adopted by banks to identify, assess, and manage environmental and social risk in project finance lending. These standards now also encompass the core labor standards.

The framework for the Equator Principles is based on the environmental and social standards of IFC. There are now, we are pleased to say, 54 financial institutions worldwide that have committed to using the Equator Principles. These include banks in such countries as Chile, Argentina, Brazil, and South Africa, as well as in the European countries and the United States. We estimate that 80 to 85 percent of the global project finance market is now covered by the Equator Principles.

In April 2006, IFC revised its social and environmental performance standards to incorporate the core labor standards, along with a range of other changes. The banks had to then determine if they would incorporate IFC's new standards in the Equator Principles.

How to implement the expanded labor policies was one of the more difficult issues during the revision process. Many of the banks were active in countries where the right to organize and collective bargaining were not allowed. Did this mean that they had to stop working in these countries?

The understanding that, in such countries, our clients instead needed to provide grievance mechanisms and ensure adequate working conditions and terms of employment provided a great deal of comfort.

Ultimately, at ABN AMRO, we concluded it was about risk management. Not addressing the human element is a risk for the project and for the bank lending to the project, regardless of the country we are working in. Companies that deal effectively with labor issues demonstrate good management. And good managers are good clients. To us, incorporating labor standards is conducting business responsibly, and prudently.

Today, environmental and social standards, including review of a company's labor standards, are an essential component of risk management at ABN AMRO. The Equator Principles have allowed us to have greater expertise in advising our clients and improving the risk profile of our projects. Our clients appreciate that there will be one standard assessment process and a focus on internationally recognized environmental and social standards. Through this transparent and consistent approach, their costs are reduced, and difficult issues are addressed up front.

The development and application of the Equator Principles has been a major step forward for the financial industry. We have concluded that the Equator Principles are, indeed, good for business.

Thank you.

[The prepared statement of Ms. Lazarus can be found on page 41 of the appendix.]

The CHAIRMAN. Thank you.

I would just say, Mr. Miller, you mentioned rigidity is a bad thing, but my problem is, as I read the report, it does not seem to differentiate between good and bad kinds of rigidity or legitimate protections and excesses.

Do you think that—I mean, it did seem to me that there was a sort of a—anything that made for any kind of protection became rigidity, and there really wasn't a differentiation between good and bad kinds. Do you think the report adequately differentiates between good kinds of protections and excessively rigid ones?

Mr. MILLER. Certainly the question of rigidity versus flexibility is a continuum. It is not an absolute that, if you have an absolutely flexible labor market with child labor and bonded labor, that it is better than having a situation like France, with a 35-hour work week, where it is very difficult to hire people.

I think that we need to look at the fact that most people want to be somewhere in the middle, where there is labor law. Most countries have labor laws, and those labor laws are enforced.

The CHAIRMAN. I appreciate that. But as I read the "Doing Business" report, it didn't seem to make the distinction you were just making. It seemed to me, that in their measurement, less was always better. Is that an inaccurate reading? I mean, that they did not take the more measured approach you are taking, but that, the less you had, then the less rigid you were, and more flexible you were, and the better off you were.

Mr. MILLER. Well, I think that it is important to look at where—at why the report is being prepared and how it is being prepared.

The CHAIRMAN. Well, no, it is important for me to look at what the report says. Do you think that the report accurately reflects that notion? Because it did seem to me that less was always better in that report.

Mr. MILLER. I think that the question is that, that is not the what report is focusing on. It is looking—

The CHAIRMAN. Well, excuse me, Mr. Miller. I understand that, but the fact that that is not what it is focusing on doesn't mean it doesn't also say that. And the focus consists of a lot of things. I guess I won't keep trying to get you to answer that one question, but when people don't want to answer the one question, I draw inferences. It may focus on that, but it does say what it says, as part of it.

Let me ask the other witnesses if they would have—that does seem to me to be the issue, that it is not a case of an intelligent discrimination about what is or isn't good labor protection, but rather a kind of, "if it is in there, it is no good."

Ms. Lee?

Ms. LEE. Thank you, Mr. Chairman.

Yes, I think that is exactly the problem with the report, that it makes no distinction between necessary social protections for workers and rigidities that might inconvenience or impede investment.

What we would like to see is that you start from a bottom line, which is to start with the work that the ILO has done to identify what are the basic protections that workers deserve, and never try to encourage any government to go below that, to work workers long hours without any day of rest, without any protections from arbitrary firings and so on.

Within that context, if you start with the base of the ILO protections, then it is legitimate for governments to make the kinds of trade-offs that Dr. Okonjo-Iweala was talking about, where governments do need to make trade-offs between trying to figure out how to attract investment to create jobs and how to protect their workers.

But we need a baseline, and that baseline is missing from the "Doing Business" report.

The CHAIRMAN. Well, I appreciate that.

I have a report here that we will put into the record, if there is no objection, and it does have the defect that I was hoping it wouldn't have, which is "less is always better," and if you don't have any protections, you just get more points in that report.

Yes, Dr. Okonjo-Iweala?

Ms. OKONJO-IWEALA. Thank you very much.

While I agree that perhaps the report would need to be more crystal clear in the future on this issue, I do point to the fact that, in a reading of the report, the report endorsed or made clear that the fundamental principles and rights of workers to all the basic things that has been agreed in the ILO conventions is important and should be respected. This is part of the report.

However—and it refers to the fact that excessive rigidity, so that is what we are looking at, things like excessive rigidity—

The CHAIRMAN. But, Doctor, that is not—you are making a case for the report that the report doesn't make. In the ratings, I don't see that distinction at all. In fact, while it says we like the ILO, when it does the ratings, the absence of ILO standards helps you in the ratings, and the presence would hurt you, in many cases.

Ms. OKONJO-IWEALA. That is why I say, Mr. Chairman, that the report needs to make crystal clear. Because in the discussion in the report itself, it talks about the issue that the fundamental core labor standards have to be respected.

The CHAIRMAN. I understand that. The rhetoric is there, but the rating system has to catch up. So I would say it doesn't have to be crystal clear; it has to not be internally contradictory. And I think that is a problem that—maybe it is cultural lag, but there still is this problem. You and Mr. Miller both say, "Well, okay, but don't look at what it says. Look at the focus. Look at the other things it says." But we can't not look at the things it says. And they ought to correct them and stop saying those things if they don't mean them.

Ms. Polaski?

Ms. POLASKI. Directly to your question, Mr. Chairman, the rating itself, if you look at the way it is constructed, absolutely does give higher marks for lower regulation. The less regulation, the higher the mark; the more regulation, regardless of how carefully—

The CHAIRMAN. With no balance. Less is always better.

Ms. POLASKI. Absolutely less regulation makes you a better place to do business. And that is the ranking, at the end of the day.

The CHAIRMAN. That would include if, in fact, you didn't follow some of the ILO standards, you would get a better ranking in that particular situation than if you did, correct?

Ms. POLASKI. That is correct.

The CHAIRMAN. All right. Well, then, if that is not what they mean, I have a simple suggestion: Write it better. Don't send very sophisticated people who are well-meaning here to say, "Oh, yes, but you have to read it in context," etc.

You know, I will tell you this. People say, "Oh, don't take it out of context." Every time I say, "Oh, well, I was quoted out of context," I really mean, "I wish I didn't say that, and next time I will say it better." So, next time, they should say it better.

The gentleman from Delaware.

Mr. CASTLE. Thank you, Mr. Chairman.

My question is going to be basically simple. It is going to be to all of you, but a couple of you have made comments that got my attention. Mr. Miller said something to the effect of national regulatory schemes that limit the establishment of business, for example. And Dr. Ngozi has been involved locally in Nigeria, as well as in international organizations, dealing with the issue of enforcement of various rules, laws, and regulations.

And I don't mean to speak for anyone here, but I think most of us would agree that most of those things that we are concerned about, in terms of employment practices, we could probably find agreement upon in this committee. But I worry about the intersection between the international institutions, the World Bank, and the other international institutions and the countries, and the enforcement of these principles.

I guess I need a one-on-one lesson on exactly how the international institutions actually go about enforcing some of the principles of which they are concerned. Is it the persuasion of rankings, or is it making or not making loans? Or what is it that is done that gives you the ability to influence some of the outcomes that you want?

Mr. BAKVIS. Sure.

Well, it is a publication of the World Bank and is used—you know, we have documented dozens of cases—in World Bank and IMF reports. These are institutions that lend monies to countries, so that gives them a very powerful incentive, compared to, for example, the ILO, whose power essentially is the power of moral suasion. The ILO can tell countries they are violating the core labor standards, as it did in the case of Georgia, as I mentioned. But beyond that, it can't use any pressure on them. However, the World Bank and the IMF, by bringing this into a vast number of their country reports, making them loan conditions in some cases that we cite in our longer report, they do have the possibility to impose these things.

Now, I would like to mention that one central tenet of "Doing Business" is the claim that you have to get rid of these labor protections because that will create more jobs. Now, they cite studies, and they actually miscite them. The basic methodology was developed in an article that was published a few years ago in the Quarterly Journal of Economics. And they quote that particular article as saying that countries that have more regulation, as they measure it, push people into the informal sector; so more people work in the informal sector, the informal sector is larger. If you actually read the article, the study they cite doesn't say that. It is misstated in "Doing Business," and I think that is important.

So it is not a surprise that you get the situation where "Doing Business" says that Afghanistan, Armenia, Georgia, Haiti, and Mongolia—which I don't think many people would consider economic success stories—get better rankings for their labor scores than Finland, Korea, the Netherlands, Norway, Slovenia, and Taiwan, which all have very low unemployment, high working conditions, and very good social protection measures.

So I think it is a thoroughly imperfect and flawed indicator to use to tell countries this is what you should be doing to create more jobs. It does not do that. They haven't proved it through economic research.

And if you peruse the rankings, you can see how ridiculous it is.

Mr. CASTLE. Ms. Lee, you had your hand up?

Ms. LEE. Thank you. I wanted to respond to your excellent question about how the different international institutions go about enforcing their principles.

Just to build on what Peter Bakvis said, if you start from the ILO, and you mentioned earlier the IOE, the International Organization of Employers, what is extraordinary about the ILO is the tripartite structure of employers, workers, and governments from 181 countries represented. The idea that those three groups from more than 180 countries were able to reach consensus on the core labor standards should give that tremendous weight. Yet, as Peter Bakvis said, the ILO has no enforcement power whatsoever. It can sanction, it can discipline, it can scold its members, but it doesn't have the capacity to impose any economic consequences, even for egregiously bad behavior.

If we are serious about the commitment that we made at the ILO to respect, promote, and realize the core labor standards, then we need to make sure that the other international institutions, like the IMF and the World Bank and the WTO, that do have economic power, are incorporating the principles of the ILO into their work. This will ensure that we put some economic consequences behind the commitment we have already made.

Thank you.

Mr. CASTLE. My time is up. I think Mr. Miller wanted to answer, Mr. Chairman, if we can get his answer.

Mr. MILLER. Thank you.

The process of actually implementing the core labor standards—and when we understand core labor standards, we mean prohibitions on child labor, prohibitions on forced labor, prohibitions on employment discrimination, and prohibitions on collective bargaining and the right to organize, all of which are included in the National Labor Relations Act here in the United States.

We have to understand that the process of developing loans, which is ultimately the most powerful mechanism that the World Bank has, is a dialogue between an institution and a government, which is long and requires a very extensive country bias. I think that, oftentimes, people begin to imagine that you can simply impose these things, but as was noted earlier, countries are sovereign, and they are making their own policy decisions, and they have a degree of skepticism about the effectiveness of the work of the international financial institutions.

So I think that, while it is important for the World Bank to look at getting people together to have a dialogue on how one can deal with child labor in the developing worlds as they have done, it is not as simple as simply saying, "Well, you must implement these things, or you must inform your labor ministry." That implies taking a loan, which oftentimes requires congressional approval, and I cannot imagine this Congress agreeing to increase the public indebtedness of the United States for something that it did not support.

Mr. CASTLE. Thank you.

Mr. GREEN. [presiding] The Chair recognizes subcommittee Chairwoman Maloney for 5 minutes.

Mrs. MALONEY. I thank the gentleman for recognizing me.

I thank all of the panelists for your statements today.

One indicator in the "Doing Business" report is the employing workers indicator. This indicator measures the extent to which country labor markets are flexible, the assumption that flexibility creates employment. However, the employing workers indicator gives more favorable employing workers ratings to Saudi Arabia, which systematically discriminates against women—women cannot even drive a car to work there—and Georgia, which continues to repress unions, than to Finland or to Sweden, high-productivity economies with fine worker protections. This indicator gives recurrent violators of fundamental workers' rights, including Belarus, China, Saudi Arabia, Swaziland, and Uzbekistan, a higher rating than most countries of Western Europe.

Can someone explain to me how a country that violates fundamental workers' rights, represses women or bans unions can be seen as a good thing for employment, earning a country a higher rating? I invite anyone to respond.

Mr. BAKVIS. I cannot justify that.

Mrs. MALONEY. Thank you.

Ms. Polaski.

Ms. POLASKI. I think that one of the fundamental problems with the "Doing Business" report is what you have just identified. There is not good research underlying the employing workers section of the report. The references cited, which have been mentioned here, do not say the things that they are credited as to saying, and to the extent that any sources are cited, they are very thin, and they lie at one extreme of the research spectrum.

There is a lot of labor market research which says that a sensible balancing of the rights of workers with those of firms is going to produce better results in terms of overall employment, in terms of poverty reduction, in terms of income distribution, and in terms of clear labor standards.

I think that a serious problem with the report is that it is not based on sound economics, it is not based on sound research, and I think that is one reason why the committee should think about instructing the U.S. executive director to work toward taking that section out until it can be reconstructed on a sounder basis.

Mrs. MALONEY. Well, I will talk to the chairman about achieving that result. Thank you.

I would like to ask about the paying taxes indicator. My understanding is that the paying taxes indicator quantifies the cost of total mandatory contributions in payroll tax, retirement, unemployment, maternity, housing or health insurance, and it encourages countries to have these contributions set as close to zero as possible.

"Doing Business 2008" highlights fining those countries that reduce pensions, maternity, and health insurance or compensation for workplace injury: Albania, Bulgaria, Mexico, Moldova, the Netherlands, Romania, Slovenia, South Africa, and Uzbekistan.

Why should we be rewarding countries that are reducing pensions, maternity leave, health care insurance or compensation for workplace injury? What does the paying taxes indicator use to include the possible benefits these items have?

Yes.

Mr. BAKVIS. Well, I think your question puts the finger on a very important issue, which is that there is definitely a bias against countries that adopt all of these kinds of social protection measures that are very important and that are part of what should be seen as development goals if they finance them through payroll taxes. In countries that shift the burden to consumption taxes, value-added taxe, or income taxes—as Denmark did, for example—it is not counted.

Now, we see this as a bias against developing countries because value-added taxes do not exist in developing countries. They do not have that option. Income tax systems are very undeveloped in developing countries. Payroll taxes are something that are simpler to implement; they can identify payroll, and it is possible to gain revenues from them. So, when you are telling a developing country, you can no longer finance these things through payroll taxes, you are, essentially, going to get rid of them—get rid of maternity leave, get rid of pensions, get rid of the health benefits or whatever that are financed by these taxes. So we think this is, really, a very nefarious message for the World Bank to be giving to developing countries.

Mrs. MALONEY. Can Mr. Miller respond? My time is up, but we look forward to your comment, Mr. Miller.

Mr. MILLER. Briefly, I think that—while one could read the report in that way if one chose to, I think it is an overstatement, and I think that it misses the focus of the report. I think it is important to see these things on a continuum; that lower taxes on businesses are generally better than higher taxes.

The unfortunate thing about the "Doing Business" indicators is that it was born as a process of trying to approximate the impact of business regulations across countries, and it has become something which has been demanded to be quantitatively perfect. It is not quantitatively perfect, and I think that one can make fair criticisms of the "Doing Business" report.

However, I think what is important about it is its impact on helping to begin the process of dialogue within countries on reducing business regulations, and so one can make a criticism about this particular submeasure or that particular submeasure, but I read it as being based on sound statistical practice.

Mrs. MALONEY. Thank you.

Can she comment?

Mr. GREEN. Of course.

Ms. OKONJO-IWEALA. Thank you very much for recognizing me. I just wanted to add to that, that, indeed, it is true that the improvements can be made, and it is not quantitatively perfect, but we do not also, in making policy, look at it as something that is a perfect report in which we have to, you know, go according to every single indicator. It is a report that lets us know where it is as countries they are having the greatest problems in terms of creating employment and improving the economy and getting access to jobs for the poor. And that is the way we read it, and I think it would be a shame if it is not read correctly in that light. That is certainly the way that we applied it.

Again, I hasten to say that countries have a great deal of autonomy. I want to come back to that. The idea that some institution can force you to do something, or you can load up conditionality on the back of a loan is a dated idea, and lots of studies have been done by Danny Roderick, David Dollar, and others to show this does not work. A country has to believe in what it is doing, not because some institution comes to impose it.

So I think we are looking and seeing that having proper labor standards and codes for workers is the right thing to do, and I think that this report is a guide. It is not an instruction.

Thank you.

Mr. GREEN. Thank you.

We will now recognize the current ranking member, the gentleman from North Carolina, Mr. Jones.

Mr. JONES. Mr. Chairman, thank you.

At this stage of life, the only way I can get here is to fill in for somebody else.

So I want to thank you for this presentation. I have a lot to learn; I have been in Congress for 14 years, and I have really found this to be very interesting and educational. So, from that standpoint, I want to thank you.

I want to ask—Ms. Lee, I will start with you because my concern as a Republican and as a conservative is what I have seen happening to not only this country, but—can we do a better job, when we pass these trade agreements, of helping the workers and the environment? Can we do a better job than we are doing now?

My reason for that question is from the World Bank report, but when you really come down to it—and I think the doctor said this just a moment ago—a Nation that is relatively strong—of course, many of us are concerned about the debt of this country, but that is another issue. I remember the Central American Free Trade Agreement debate. I remember meeting with several elected officials from the five Central American countries and some priests and some preachers and elected officials, and they were so concerned that we are doing nothing to help the low end of the population because we are not more forceful in the area of environment and labor standards.

Ms. LEE. Thank you so much, Congressman Jones, for the question.

Absolutely, we can do more, and we should do more to help workers and the environment through our trade agreements and also through our interaction with the international financial institutions. In representing American workers, we see every day that our members are impacted by unfair terms of competition. When workers in other countries cannot bargain collectively for their fair share of the wealth that they create, they are undermined; their lives are impacted, and our members lose their jobs.

So these issues are important in a moral sense, that we care what happens to workers in other countries, and they are important in an economic sense, because this is about the terms of competition. That is why it is so important that an institution like the World Bank should live up to its mandate, which is to reduce poverty and inequality and to raise living standards in the rest of the world. In order to do that, there has to be a lens which is broader than a narrow private investor's lens. We have to look at the world with a social dimension and try to figure out what it would take to empower workers, to build a strong middle class, and to build stronger democracies in developing countries. There is no question that the challenges the developing countries' governments face are tremendous. They are trying to attract foreign investment in a tough global economy. If the message that they get from investors, from financial institutions, and then from international intergovernmental organizations is, "The way you attract foreign investment is to undermine the bargaining power of your workers by weakening labor standards, and by making everything comfortable for foreign investors," that is a dead-end road. Ultimately, they are going to cheapen labor, but they are not going to be creating a strong, vibrant middle class that will allow us in the future, we hope someday, to have a stronger reciprocal trading relationship.

Thank you.

Mr. JONES. Is China an example?

When I look at the environmental conditions in China, which are so deplorable, and yet we have sent so many jobs to the Chinese—we have a $300 billion, roughly, I think, trade deficit—again, if the World Bank—and, Mr. Bakvis, I think you said it in your statements. Is it your responsibility, do you think, to be more assertive as it relates to some of these issues that we are talking about with the environment and with the labor standards? I think you mentioned that, at this point, you have not been that assertive as an organization. Excuse me.

Mr. BAKVIS. Yes.

Well, as I mentioned in the introduction, two-thirds of our members are in developing countries, and obviously we are very concerned. And I think Ms. Lee just explained some of the factors that motivate the AFL–CIO and also developing countries.

Now, you mentioned China. That is an interesting case. I am not an environmental expert, but I do work a lot on labor issues. Now, China, over the past 20 years, has evolved from a low-income and relatively equal, in terms of distribution of income, country into one of the most unequal countries—middle income, but one of the most unequal countries—in terms of income distribution today, to the point that the Asian Development Bank came out with a report last month calling attention to this and seeing it as something very alarming for the long-term development potential of China.

Now, why has China become so unequal? Well, one issue is the way they have treated the rural sector there. They have shut down services to the rural sector. Everything is going to the new upper and middle classes. Another major problem is that it is a country that does not respect the core labor standards. Trade unions, outside of a very strictly controlled, government-run body, are not allowed. Workers are put in jail when they try to found independent trade unions. Therefore, in effect, wages are being artificially pushed down by the fact that workers cannot exercise their full rights, and that is one of the reasons you have this terrible inequality now that has developed in China.

What has the World Bank done? Well, you know, we were somewhat shocked last year. The World Bank prepared a policy paper on social and labor policy where it told China the so-called "international labor standards"—and they called it like that and put it in quotation marks—are something you should not really pay attention to except to the extent that you have to abide by them to prevent protectionist measures. Now, for the World Bank to be saying that to China, which is one of their biggest client countries, "Do not pay attention to these standards," I think, comes out of the whole "Doing Business" approach. It is very serious.

The World Bank could make a positive contribution, as Mr. Wolfensohn did when he was president a few years ago—he said to China, "Improve your rights; improve your social policies." But to be telling China today, "Do not pay attention to these things," that is only going to make the situation worse.

Mr. GREEN. Yes. I have been informed that we have a series of votes that are imminent, and so as to avoid trying to have you come back at a later time, we are going to ask that the members stay within the 5 minutes, and that we move as expeditiously as possible.

With this said, we will now recognize the gentlelady from New York, Mrs. McCarthy.

Mrs. MCCARTHY. Thank you, Mr. Chairman.

This might be a little bit off the beaten path, but in the Budget Committee and even in Financial Services, when we had the World Bank in front of us, for a lot of the questions that I asked, I never really got a solid answer.

It seems to me that the World Bank has a trickle down, so they have the money on the top to the countries, and yet, from everything that I have seen, and certainly through documentaries and everything else, these microloans, actually, in many ways do a very good job. One of the documentaries I just saw over the weekend was of a leper colony in India. They had built a village. They had no income. It was all off the government. A private, inside organization in India started doing microloans. The village today is the most successful village out of all the areas around the leper colony. They started a barbershop. A woman had one cow; now she has five cows.

I mean, is the World Bank doing enough on the microloans to help from the bottom up? Because when you work with people from the bottom up, it gives them the respect; it gives them the opportunity to see what life could be like, you know, in, obviously, trying to move up to be middle-income families.

I was just wondering if anybody had—Mr. Miller.

Ms. LAZARUS. I can probably respond to that. I think that there are a couple of things I would say.

First of all, the World Bank funds a major organization called CGAP, the consultive group for action for the poorest, which is a resource on microfinance operations. It is funded by both the World Bank and other donors, and it fosters microfinance work globally.

I think it is important to remember that the World Bank, of course, lends to member governments. Most often microfinance operations are done by nongovernmental organizations or by the private sector. So much of the funding of microfinance lending is happening in the World Bank Group through the International Finance Corporation, the IFC, which does private-sector lending, and they have a very large microfinance operation where they are helping to develop microfinance institutions and lending to them. The policy work about the creation of microfinance institutions and helping governments set up frameworks for allowing the flourishing of microfinance institutions is happening through CGAP.

Mrs. MCCARTHY. But once we give money to "the government," how do we track that it is actually being used to do what it is supposed to be doing on the oversight?

Ms. LAZARUS. "We," meaning the World Bank, or—

Mrs. MCCARTHY. Yes.

Ms. LAZARUS. —once the World Bank lends to a government?

Mrs. MCCARTHY. Right.

Ms. LAZARUS. Oh. The World Bank requires that the government report. They have an audit function. There are checks and balances, so there is a country supervision program.

Ms. OKONJO-IWEALA. Maybe I can speak.

Perhaps to complement what Suellen said, on the ground, when you sign the loan agreement, you also undertake that you will receive missions from the World Bank that are cost supervision missions, you know, that will come to see how the loan is functioning. The government itself also has to—because the government implements the project, it has to set up a mechanism to track how the project is going and how the loan is being used or the credit. So, when the supervision mission comes, typically both the government officials and the officials in the World Bank go to wherever the project site is, and, of course, records are kept, and you have to show what has been disbursed, where it is going and all that.

That does not mean that, you know, projects are perfect and that you do not have issues, but there is a tracking mechanism you sign onto. Where the ability does not exist, they often provide technical assistance to help build it so that the loans can be properly tracked. And the government also has an interest in tracking actual—you know, when you borrow, you have to pay back that money, so you have to make sure that you have mechanisms to make sure the money is going where it is supposed to go.

Mrs. MCCARTHY. Mr. Miller.

Mr. MILLER. One of the things that, I think, would be useful for the World Bank to look at is to examine the lessons of the Multilateral Investment Fund at the IDB, which was set up to finance innovative projects for the private sector in Latin America and in the Caribbean, because I find often that the World Bank's approach is rather too rigid because dealing with entrepreneurs is very difficult.

When I was running a USAID project in Panama, I spent a lot of time working with entrepreneurs, and the process can be time-consuming, but you really have to get down to that micro level, and you find that people on the ground have a lot of really good ideas, but I do not find that there are really sufficient grant mechanisms in place to allow those ideas to be actualized.

Mrs. MCCARTHY. Thank you. My time is up.

Mr. GREEN. We will now recognize the gentleman from Georgia, Mr. Scott, for 5 minutes.

Mr. SCOTT. Thank you very much.

Let me start off by asking, how much of the World Bank's funding comes from the United States?

Ms. LAZARUS. As someone who worked at the World Bank, I can probably say, first of all, I do not know the exact number anymore, but the World Bank's share—I am sorry, the United States' share in the World Bank is somewhere around 16 to 17 percent.

I think that it is important to remember that the World Bank—and we are talking about the IBRD, the International Bank for Reconstruction and Development. The share capital for the Bank was paid in many years ago. The Bank now funds itself by borrowing in the capital markets. So the amount of money that the United States has actually put in is not significant. What the United States does do, as all member governments do, is they back up World Bank bonds in the market. So, if there were to be a default on the World Bank bonds, the member governments have guaranteed them. It is called "callable capital." So the actual contribution, in monetary terms, of the United States is quite small; it is the shareholding that is significant.

Mr. SCOTT. So the World Bank borrows from countries and charges an interest rate to countries?

Ms. LAZARUS. The World Bank borrows in the capital markets just like any other bank. It funds itself, and then it lends to governments, and the differential between its borrowing rate and its lending rate is how it funds its operations.

Mr. SCOTT. Okay. Then, with that understanding, as the World Bank plans to lower its interest rates, it charges middle-income countries. There is a plan to do that, to borrow money and then pledge to significantly increase the aid for the poor nations.

Do you believe there is a specific plan in place to ensure that these funds are used effectively in addressing employment strategies of some of the poorest nations?

Ms. LAZARUS. I just want to make a clarification. There are two separate arms of the World Bank. There is IBRD, the International Bank for Reconstruction and Development, which does lend to the middle-income countries and is talking about, as you said, lowering rates; and then there is the International Development Association, which lends to the poorest countries, and that is the money—the IDA replenishments that are under discussion now, the current IDA replenishments—that governments each contribute, and that is where there is scope for putting in the kinds of conditions that you are talking about.

Mr. SCOTT. I guess what I am trying to say is, is there a plan in place, though, to accurately account for these funds in relationship to their effectiveness in coming up with sound employment strategies?

Yes, Mr. Bakvis.

Mr. BAKVIS. Well, I think the short answer is "no."

The World Bank has adopted a labor market strategy recently which uses the acronym MILES, which stands for different elements of the labor market strategy. We were quite concerned when this strategy was adopted last year that the "I" stands for "investment climate," and it is stated in that document that the "Doing Business" labor market indicators will be used as the instrument to help countries develop a correct investment climate for employing workers.

You know, again, as several of us have tried to point out, this is an extremely imperfect, erroneous approach to developing employment. Economic literature does not back it up. The studies that have been invoked to justify the whole methodology have either referred to industrialized OECD countries that are not applicable—and, in fact, that have been discredited by studies done by the OECD itself—or in one case, the Bank cites an article which actually says the opposite of what it claims it says, namely, that the rigidity of labor markets, as they measure it, stimulates growth of employment in the informal sector; that is, unprotected jobs.

So, if this is to be part, and it is, of the overall labor market strategy, no, the Bank does not have a proper strategy for employment creation.

Mr. SCOTT. Thank you, sir.

Mr. GREEN. We will now recognize the gentleman from North Carolina, Mr. Watt.

Mr. WATT. Thank you, Mr. Chairman. I will try to be brief.

Ms. Lazarus, I was here for the testimony and had to leave, but I heard all of the witnesses, and you seem to be the only one who never really expressed an opinion about whether this "Doing Business 2008" report was constructive or counterproductive in the way it addressed the labor standards issue. I think I understand where everybody else has come from. Maybe you did not get on this panel with the intent of getting into that discussion. I am just wondering whether you had an opinion about that.

Ms. LAZARUS. Thank you for your question.

The point that I would make is that the "Doing Business" report, the audience of the "Doing Business" report, is in addition to countries looking at how they rank relative to one another, it is also private-sector companies looking to invest in developing countries, looking to go overseas. Companies do pay attention to that report, and the rankings make a difference for them.

So I would say to the extent that you are encouraging companies through that report to invest in one country over another, it is inconsistent with the way private-sector financial institutions and the IFC are looking at those countries or are looking at companies in those countries, because, within our lending, my bank's lending, to a particular company, we would require the company to meet certain labor standards that might be different than those required by the country in which they are operating.

There are ways to overcome that by the way the client itself manages the company, but there is an inconsistency between the way we are wanting to operate and the standards that we are going to be imposing—requesting our clients to meet—and the way that particular report ranks countries.

Mr. WATT. Now, that is the business side of it.

The gentlelady from Nigeria, whose name I cannot pronounce, made it pretty clear that sophisticated countries that deal with the Bank, such as Nigeria, the United States and other countries that have some experience with the Bank, probably do not view anything in this 2008 report as a conditionality.

In your experience, would some of the countries that did not have the experience and the knowledge of dealing with the Bank view this in a different way? Would they view this report as an invitation to drive down their labor standards to create a more business-friendly environment?

I am asking both Ms. Lazarus and Ms.—

Ms. OKONJO-IWEALA. Okonjo-Iweala.

Mr. WATT. Say it again.

Ms. OKONJO-IWEALA. Okonjo-Iweala.

Mr. WATT. Okonjo-Iweala. That is a beautiful name.

I would like both of your opinions about that.

Ms. OKONJO-IWEALA. Well, perhaps in the past I would have said—you know, in the 1980's and 1990's—the Bank had a very heavy weight in terms of the issue of conditionality and in making countries do things, you know. You know, some people call it "buying development" or "buying compliance." There was a very heavy weight on that because many countries did not have access to alternative sources of capital, and so they had to do whatever the Bank or the Fund said.

I think the world has evolved. I am not saying—

Mr. WATT. But isn't that true still for some—I mean, it is probably not true of Nigeria, obviously.

Ms. OKONJO-IWEALA. Yes.

Mr. WATT. Isn't it still true for a number of countries that deal with the Bank?

Ms. OKONJO-IWEALA. There are some countries that are poorer, you know, where the Bank and the Fund may still have that kind of weight. So I am not saying that does not exist.

What I am saying is the incidence or the ability of these institutions to do that, very frankly, in today's world is diminishing because the overall aid architecture is changing. There are so many foundations, funds, bilaterals, and other people who are coming in that the ability of these financial institutions to really work in that way with the countries has changed. But I want to say that does not mean that the Bank and Fund are not important. It is just that they are—and IDA is crucial for that reason. I am just saying that they are recognizing that it is counterproductive to force a country to do something, because the minute you turn your back, they will reverse it. So they are working differently to make countries understand and believe that this is important for them.

Mr. WATT. My time has expired, but I would welcome Ms. Lazarus' opinion on the same question briefly. I do not want to deprive the other members of an opportunity to speak.

Mr. GREEN. I am going to ask that the summary be very brief because we have other members who have not been heard.

Ms. LAZARUS. Well, I really do not have much to add. It would be difficult to speculate, from my position, on the impact of this report with governments.

Mr. WATT. Okay. That is fine.

I yield back.

Mr. GREEN. Mr. Cleaver from Missouri is recognized for 5 minutes.

Mr. CLEAVER. Thank you, Mr. Chairman.

The one disappointment—well, there were a number of disappointments, but one disappointment that I have to mention in the "Doing Business 2008" is the absence of the World Bank's supporting sustainable and renewable economic opportunities for developing nations. It is a little difficult for me to believe that a report, "Doing Business in 2008," could exempt, leave out, forget one of the most significant issues of our time, which is the climate change. And I believe that we are on the cusp of a new industrial era as companies begin to move toward green products, and so it seems to me in sub-Saharan Africa, and particularly where the desert is moving about a half a mile southward a year, and where people have been subjected to colonialism and neocolonialism and now just a number of "isms," that the World Bank is not trying to support sustainable and renewable economies, because what is going to happen is, you know, 25 years from now they will be where China is in starting a new coal-fired plant every week, producing 500 tons, each plant 500 tons, of sodium dioxide, which is going to push them further and further back economically, because by then we are going to have carbon taxes or cap and trade or whatever.

Was there intentionality in leaving that out, or did you forget?

Yes, sir.

Mr. MILLER. The report focused on business regulations, and it has a certain set of indicators, and I think the Bank does regard those issues as something that is very important.

For example, their antigas-flaring initiative has been something which has been very positive. But the "Doing Business" report looks at a certain snapshot. It acknowledges that there are many other issues which need to be incorporated, but you cannot put everything into one report, and I think it is important to see this as one contribution of many.

Mr. CLEAVER. Yes, except this is so significant now. I mean, 27 nations of the EU have already moved toward revamping their entire economy based on climate change, based on the greening of the world, and so if we are not going to address this issue with Third World nations, and particularly sub-Saharan Africa, we are pushing them further and further behind.

Ms.—

Ms. OKONJO-IWEALA. Okonjo-Iweala.

Mr. CLEAVER. I was going to say that.

Ms. OKONJO-IWEALA. I think that the honorable gentleman certainly has a very important point.

The climate change issue is crucial for sub-Saharan African countries, and I would like to say that, for this reason, you know, maybe the "Doing Business" report needs to look at how you can encompass that. But there is an arm of the World Bank that addresses the sustainable development and climate change issues, and believe me, we experience them, you know, in Nigeria, you know, in repeatedly trying to interject into the projects we are doing a consciousness for the environment. In fact, one of the things that—complaints that the Bank has encountered, you know, in many cases is, you know, how countries—you know, that there is quite a heavy presence on the environmental issues, and countries would like to have the ability to work better with the Bank to make sure these issues are integrated into what they are doing.

So they are there, but that does not mean that, you know, this report cannot also look at that. The only thing is that, you know, then if there is a report that looks at regulation, you might ask yourself is this the best vehicle, or should they sharpen the vehicle that is already existing to take charge of these issues? Otherwise this report will get all out of proportion.

Mr. CLEAVER. Thank you.

Mr. Chairman, this is the best this committee has run since I have been here.

Mr. GREEN. Thank you for your kind comments.

We will now hear from the gentlelady from Wisconsin for approximately 5 minutes as the vote is imminent. I think we have time if you have questions. The Chair recognizes you.

Ms. MOORE OF WISCONSIN. Well, thank you, Mr. Chairman. What a privilege.

Let me just get right to one of the series of questions that I had, in the interest of time. I guess I want to be the devil's advocate here, because many times, I believe, Mr. Bakvis, you have indicated that there is absolutely no research backing up the employing workers section. But we have seen it played out, at least here in America, that businesses continue to strive to pay no pensions, no health care, to jettison the minimum wage for workers, to try to provide part-time work so they do not have to pay unemployment compensation. We have seen no notices before layoffs, dismissals, because their interest is in that short-term capital, and while there might be some benefits, as you see it as organized labor, worker satisfaction, worker safety, the bottom line is that slavery worked in terms of providing people long-term wealth. Child labor works.

So, while you have said that they have no research to demonstrate that it does not, what strong, empirical data do you have that it works? Particularly when people put these hedge funds together, and they are in pursuit of short-term capital, quite frankly, they want to exploit the workers.

Mr. BAKVIS. Well, I think what is clear is that is not a long-term development strategy for any country to exploit workers, to prevent them from getting more education and being more skillful workers and, therefore, contributing to overall growth. The point I made earlier is that this is not a recipe for job creation even when you do not take account of the kinds of jobs that are being created.

Ms. MOORE OF WISCONSIN. But it sounds good to say you are creating jobs while you are making your big boom money.

I want to address a question to Dr. Okonjo-Iweala. I cannot say your name.

Yes, ma'am. Ms. Lee.

Ms. LEE. Can I add something quickly on that subject?

Ms. MOORE OF WISCONSIN. Yes.

Ms. LEE. It is an excellent question, and it is the difference between an individual company making short-term profit and achieving broader social goals. There is no question that companies want to have fewer labor market regulations and constraints, but the question is whether it is good for economic growth and for society and for the long-term picture, particularly in a developing country. I would say a couple of things.

One is in terms of the minimum wage. What the research shows is that a higher minimum wage leads to lower turnover, higher productivity, and more investment in workers. In fact, there is an offsetting advantage to companies when there is a higher minimum wage. There can be the higher productivity that offsets the higher wage.

It is also the case that if governments do not invest in education, health care and infrastructure, they do not have a healthy workforce, and they cannot have the productivity that they need over the long term.

So I just want to say that there is a difference between the narrow interests of a single company and the social interests that the World Bank should be trying to promote.

Thanks.

Ms. MOORE OF WISCONSIN. Precisely.

So that is why I am a little bit perplexed, Dr. Okonjo-Iweala, about your indicating that conditionality is not the rule of the day. It seems to me that this "Doing Business" report that the World Bank is putting out—I mean, I did not know about this report before this hearing. It is very distressing to me that they are using the proceeds and the resources of the World Bank to recruit people who literally are looking for opportunities to exploit people.

As to conditionality, I am wondering if these heavily indebted countries, of which we are now trying to look for ways to relieve that debt, are in debt because of the conditionalities that we have imposed upon them.

You can answer that, too, Ms. Lazarus, if you would like to.

Ms. OKONJO-IWEALA. Let me start. Thank you very much for pointing this out.

I would say that, first of all, on the report itself, this has never been presented to us. When I was in office for 3 years, as to, “Here are a set of conditions you have to obey,” no, that has never been the case, and that is the truth. The report was presented to us as a guide, you know, for us to compare ourselves to other countries to see where we are in terms of encouraging an environment in which both our domestic—this is not only for foreign investment, but what are we doing as a government that would encourage our own domestic sector to invest as well as those abroad.

Then secondly, on the issue of the—

Mr. GREEN. I am going to have to ask that you summarize very quickly.

Ms. OKONJO-IWEALA. Okay.

They have actually worked to help reduce debt. My country got some backing from them, and we got $10 billion written off, and I want to thank you and the U.S. Government for the role you played through your presence in the Bank for that.

Thank you.

Mr. GREEN. Thank you.

The gentlelady, I think, has about 5 minutes before the vote, 4 minutes.

Let me just close with these comments. Dr. King reminded us that life is an inescapable network of mutuality tied to a single garment of destiny; that what impacts one directly impacts all indirectly.

My suspicion is that, in this global economy, a slight modification or a tweaking of this premise may be necessary, because what impacts one directly now in some distant place can impact workers in this country directly. We are finding that capital seems to flow to the place where, to borrow a term that I am not exactly fond of, the market is flexible, and with that flexibility, we are finding that jobs are flowing along with that capital.

I sincerely hope that the asset test that the World Bank is continuing to project will at some point indicate that less is not always better, and that workers are human beings; that not only are they to be protected within this country but also without this country, because, in the final analysis, the global economy is looking at a single workforce as opposed to multiple workforces in various places on the planet.

I thank all of the witnesses for your comments. It has been very enlightening.

Without objection, the record will remain open for 30 days for members to submit written questions to these witnesses and to place their responses in the record.

The hearing is now adjourned.

[Whereupon, at 11:51 a.m., the hearing was adjourned.]

A P P E N D I X

October 3, 2007

Testimony of Peter Bakvis, Director
Washington Office of the ITUC/Global Unions[1]
Before the Committee on Financial Services
U.S. House of Representatives on
"The Fight against Global Poverty and Inequality: the World Bank's Approach to Core Labor Standards and Employment Creation"

October 3, 2007

Mr. Chairman, members of the Committee on Financial Services, I thank you for the opportunity to testify today on the World Bank's approach to labor standards and employment creation.

My organization, the International Trade Union Confederation (ITUC), represents 168 million working men and women in 153 countries around the world, including, in this country, the 10 million members of the AFL-CIO. The policies of the World Bank and the IMF have the most direct impact on the two-thirds of the ITUC's members who live in developing and transition countries. These policies also have indirect effects on U.S. workers, which I am sure the representative from the AFL-CIO will address.

I have been the ITUC's Washington representative for almost eight years, mostly working to make the Washington-based international financial institutions (IFIs) more aware of the need to put decent employment creation, including respect for basic workers' rights, in a central position in their policies, which include poverty reduction as their stated priority objective.

The U.S. Congress took the lead in urging the World Bank and IMF to pay more attention to the impact of their policies on workers when, in 1994, it enacted a mandate instructing the United States' Executive Directors to use their voice and vote at the IFIs "to adopt policies to encourage borrowing countries to guarantee certain internationally recognized worker rights." This was four years before the International Labor Organization (ILO), which has almost the same membership as the IFIs, made observance of the core labor standards a *de facto* condition for membership.[2]

I am pleased to say that, in my view, the World Bank has, in recent years, taken some important steps forward in terms of ensuring that its operations are in line with the core labor standards. But I am also disappointed to say that Bank has developed

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[1] The Global Unions group is made up of the International Trade Union Confederation (ITUC), which has 168 million members in 153 countries; the Global Union Federations (GUFs), which represent their respective sectors at the international trade union level (BWI, EI, ICEM, IFJ, IMF, ITF, ITGLWF, IUF, PSI and UNI); and the Trade Union Advisory Committee (TUAC) to the OECD.

[2] Core labor standards are internationally-agreed fundamental human rights for all workers, irrespective of countries' level of development, that are defined by the ILO conventions that cover freedom of association and the right to collective bargaining (ILO Conventions 87 and 98); the elimination of discrimination in respect of employment and occupation (ILO Conventions 100 and 111); the elimination of all forms of forced or compulsory labor (ILO Conventions 29 and 105); and the effective abolition of child labor, including its worst forms (ILO Conventions 138 and 182).

simultaneously an anti-labor standards approach in what has become the Bank's leading annual publication, and furthermore, has incorporated that approach into its overall labor markets strategy and used it as a template to pressure dozens of countries to dismantle worker protection rules. I would like to elaborate briefly on both points.

First, on the steps forward. After several years of encouragement from a number of countries including the U.S., and organizations such as mine, the president of the World Bank put himself on record starting in 2002 that the Bank supported the core labor standards and considered them to be consistent with and supportive of the Bank's development goals. The Bank did this after having carried out several years of research to determine the economic impact of the standards. The conclusion: each of the four standards – prohibition of forced labor, elimination of child labor, the elimination of discrimination in the labor market, and freedom of association and right to collective bargaining – either had positive, pro-growth economic impacts or, at the very least, did not hinder growth but did achieve a more equal distribution of income and thus less poverty. The latter was notably the conclusion of a book on *Unions and Collective Bargaining* published by the Bank in 2002.[3]

While congratulating the World Bank for having taken this important step in favor of the core labor standards, we also told it that acts are as important as words, and showed Bank officials evidence of at least three of the four standards being violated in World Bank-financed projects. The Bank's private-sector lending arm, the International Finance Corporation, was the first to acknowledge that it should ensure that its own house was in order. The head of the IFC told us in 2003 that he agreed that all companies borrowing from the IFC should be required to abide by the core labor standards.

It took until May 2006 before the IFC adopted and started implementing the requirement, but it finally did, and we have been cooperating with the IFC in meeting the challenges of implementation. The IFC has held meetings with the trade union organizations, employers and the ILO, and has responded to some of our suggestions. The IFC also created a labor advisory committee to give it regular advice on implementation. I am pleased to have been named as one of the members of that committee.

Last December, the president of the World Bank told us that a requirement to abide by the core labor standards would also be introduced into World Bank contracts for public-sector infrastructure projects. That language was indeed included in April of this year in a revised Standard Bidding Document for Procurement of Works, which lays down the conditions that contractors building Bank-financed projects must meet.

As with the IFC standards, the Bank obviously has some work to do in its verification and monitoring procedures to ensure that the requirements are being applied. There are questions about how the "country systems" approach, which could lead to the Bank eventually using national procurement systems for World Bank-financed projects instead of the Bank's own standards, will affect the requirement. There is also more that the

[3] Aidt & Tzannatos, *Unions and Collective Bargaining: Economic Effects in a Global Environment* (World Bank, Washington, 2002)

Bank could do in other areas that I will mention in a moment, but I think it is important to note that the Bank has taken important steps in the right direction, and these are encouraging.

That is what the World Bank is doing in terms of ensuring that the projects it finances don't violate the core labor standards. Then you have the World Bank's involvement in labor law reforms, which, unfortunately, is going in a completely different direction. Since 2003, the lead department which is setting the tone for the Bank's approach on labor market reforms is the Private Sector Development department, which produces an annual publication called *Doing Business*.[4]

Now, the Bank claims that the purpose of *Doing Business* is to identify and measure impediments to private-sector investment, such as delays in issuing business permits or laxity in enforcing contracts, with the intent of encouraging countries to reduce such impediments. We have nothing against this kind of exercise when it concerns matters such as these two examples. But when the Bank uses the same methodology on labor standards, identifying labor regulations as nothing more than a nuisance to investors and having no benefit, economic or other, then, I submit, there is a serious problem.

Doing Business includes an index on "Employing Workers" that gives the best scores to countries that have the least amount of regulations, whether they be minimum wages; maximum hours of work; advance notice for mass lay-offs; severance pay; rules concerning priority in hiring or firing, including some types of affirmative action rules; and payroll taxes to finance workmen's compensation, social security or health care. Countries that have the least of these get the best score, no matter how workers are treated or what success the countries have or have not achieved in terms of employment creation.

For two years in a row, in 2006 and 2007, *Doing Business* gave the global "Best Performer" ranking for "Employing Workers" to two tiny Pacific island states, Palau and Marshall Islands, that were not even ILO members. In *Doing Business 2008*, which came out last week, the ex-Soviet republic of Georgia is praised as the top reformer for its labor laws, because it did away with most of its worker protection rules in 2006. Many working conditions are now no longer subject to collective bargaining, any worker can be dismissed without valid reason, and trade unions have been effectively marginalized. Furthermore, unions can be prohibited altogether if they are judged to be stirring up "social conflict."

The ILO has criticized Georgia's 2006 reform and its overall labor practices as being in contravention of four of the core labor standards conventions, including the two child labor conventions. The labor law reform is also being investigated by the European Union for being in possible violation of Georgia's requirements to have access to the EU's Generalized System of Preferences (GSP). Yet this is a country that *Doing Business 2008* holds up as a country where "workers ... have the best protection."

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[4] World Bank, *Doing Business 2008* (Washington, 2007).

If you read what *Doing Business* says in its chapter about "Employing Workers," it actually implies that core labor standards are not a bad thing. However, what is important is that *Doing Business* does not take the core labor standards into account in determining its country scores. Georgia is not the only country that gets good marks from *Doing Business* even though it violates the standards. Countries like Belarus, China, Colombia and Saudi Arabia, that are recurrent serious violators of the standards, get better marks than most countries in Western Europe and several developing countries that do not have serious worker rights problems.

Doing Business asserts that the countries on which it confers better "Employing Workers" indicators create more and better jobs. The handful of economic studies it has cited to justify this assertion have been contradicted by more serious and up-to-date studies and, in one important case, *Doing Business* misstates the conclusion of a study which it says justifies its methodology. The ILO and the ITUC have recently completed, independently from each other, analyses that point out the serious problems in the methodology and lack of evidence to back up key assumptions.[5]

Nor do the anecdotal cases cited by *Doing Business* support its affirmation that elimination of labor regulations automatically translates into employment creation. Two earlier editions of *Doing Business* asserted that Colombia's labor reforms would produce "the largest payoffs" in reducing unemployment. A year after that statement, the World Bank did a special study on the employment impact of Colombia's labor market reforms, which concluded that the impact "seems to have been modest" and is in fact impossible to confirm at all.[6] In the country of Georgia, unemployment actually went up after it adopted the labor reform lauded by *Doing Business.*

Georgia gets the best score in all of Central and Eastern Europe for its *Doing Business* labor score, followed by Kazakhstan and Belarus, which lost its GSP status with the European Union because of labor rights abuses. Slovenia, which has the lowest unemployment, best labor conditions and best social programs among all the ex-communist countries, gets the worst *Doing Business* ranking in the region for its labor regulations.

Among *Doing Business*'s best performers in Latin America and the Caribbean for "Employing Workers" is Haiti, the poorest country of the hemisphere with the lowest wages, almost no social protection and 80 percent of the population living below the poverty line. Among the worst performers for "Employing Workers," again according to *Doing Business*, are the high-performance economies of Brazil and Peru, which have both enjoyed stable growth and, in the case of Brazil, has considerably improved social protection for the most vulnerable workers.

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[5] Berg and Cazes, *The Doing Business Indicators: Measurement issues and political implications* (ILO, Geneva, 2007) and ITUC/Global Unions, *The IFIs' Use of Doing Business to Eliminate Workers' Protection: Analysis of Doing Business 2008 and new country cases* (Washington, 2007).
[6] World Bank, *Colombia: Country Economic Memorandum* (Washington, 2005) and World Bank, *Colombia: Labor Market Adjustment, Reform and Productivity* (Washington, 2005).

It would be easy to laugh off the obviously flawed grading system that leads to these nonsensical results if *Doing Business* were not playing such an important role in the policy advice and loan conditions on labor issues put forward by both the IMF and World Bank. *Doing Business* is being used in the following three ways:

- The *Doing Business* labor indicators are used for determining the overall level of access to the concessionary lending and grants dispensed by the World Bank's International Development Association (IDA), through a mechanism called the Country Policy and Institutional Assessment (CPIA). Ironically, *Doing Business* is used as a "Guidepost," or measuring rod, in a section of the CPIA that purports to give better marks to countries that apply the core labor standards and have good social protection programs. If anything, *Doing Business* gives better marks to countries that do the opposite.

- The *Doing Business* labor indicators have been incorporated into the Bank's overall labor markets strategy, which is called by the acronym MILES, where the "I" stands for Investment Climate. The Bank's new labor markets strategy, which was designed in 2006 by the Bank's Human Development Network, states that it will use *Doing Business* "to develop policy instruments to create a more employment-friendly climate for business."[7]

- Not surprisingly, given the incorporation of the *Doing Business* approach on labor into important policy instruments, a growing number of country strategies, adopted not only by the World Bank but also by the IMF, have used the *Doing Business* labor indicators to drive down labor standards. Between October 2006 and July 2007, almost half of the Bank's new Country Assistance or Country Partnership Strategies (CAS/CPS) included recommendations to deregulate labor markets on the basis of *Doing Business* ratings. In contrast, only about one in ten CAS or CPS in recent years include the assessment of countries' compliance with core labor standards that was a recommendation in the IDA12 replenishment agreement of 1998. Between October 2006 and July 2007 about half of IMF Article IV Consultation reports, the Fund's annual country-level policy report, include labor market deregulation recommendations based on *Doing Business*.

These policy recommendations include the World Bank telling Macedonia in its CPS last March to eliminate certain worker protections in order to improve the business climate as measured by *Doing Business*, even though the country completely overhauled its labor legislation in 2005. The Bank never evaluated the impact of that reform and the CPS includes the results of a survey which shows that labor regulations come fifteenth and near last on the list of concerns mentioned by Macedonian business owners, well below several other concerns that the Bank's strategy does not address.

The IMF told the government of Jordan – a country where U.S.-based organizations have exposed widespread abuse of workers, particularly among migrants in export-processing

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[7] World Bank, *MILES: A Multi-Sector Approach to Foster Job Creation, Poverty Reduction and Growth* (Washington, April 2007)

zones – that there has been "slippage" in its *Doing Business* labor ratings and that it should make it easier for firms to fire workers. This would likely counteract efforts the ILO has undertaken, working jointly with the Jordanian government, to address abuse of workers in these zones, which send a large part of their production to the U.S. market.

Several countries, including recently Algeria and Mauritius, have been told by the World Bank or IMF to dismantle sector-level bargaining arrangements so as to improve their *Doing Business* scores, even though *Doing Business* does not purport to measure specific bargaining arrangements. Moreover, the previously cited Bank's own research on *Unions and Collective Bargaining* has concluded that countries with highly coordinated collective bargaining tend to have lower unemployment. In other words, *Doing Business* is being invoked by the IFIs to pressure countries to adopt policies that may even increase unemployment.

In some countries, labor market reforms based on *Doing Business* have been imposed as loan conditions by the IMF or World Bank. Examples include Burkina Faso, Colombia, Kyrgyzstan and Nepal. Several World Bank country programs have included financial assistance to carry out labor law reform specifically aimed at improving *Doing Business* labor market indicators; in one case the Bank called it a "*Doing Business* loan." A week ago, the ITUC released a new report documenting sixteen specific country cases on the use of *Doing Business* to drive down worker protection.[8] These add to seven other cases documented last year.

I would like to conclude by presenting you a few suggestions on how I think the World Bank could make useful contributions to improving compliance with the core labor standards and to employment creation:

1. It is certainly debatable whether the World Bank should get involved in labor law reforms at all, since this is clearly a mandate of another international institution, the ILO. If the Bank does get involved, it should endorse and adopt the ILO's Decent Work agenda, which has the objective of maximizing the total volume of employment, but also pays attention to the quality of jobs, including social protection coverage, and the possibility for workers to exercise their basic worker rights as expressed in the core labor standards. If it were to adopt the Decent Work agenda, the Bank would stop encouraging countries to get rid of all advance notice for dismissal requirements and reduce statutory severance pay, as it presently does using *Doing Business,* until countries have put in place adequate social protection such as unemployment benefits, which don't exist in most developing countries.

2. *Doing Business* should be removed from the World Bank's overall labor markets strategy, of which it is presently a central pillar, and the issue of labor markets should be removed from the purview and mandate of *Doing Business*. The basic premise of *Doing Business* that all labor standards are nothing more than impediments to investment is based on false economics, and four years of

[8] ITUC/Global Unions, op. cit.

its application by the IFIs in eliminating worker protection has created unacceptable social and economic damage. Instead, the World Bank should put the ILO's concept of Decent Work at the center of its employment creation and labor market strategies.

3. By the same token, the *Doing Business* labor market indictors should be removed as a "Guidepost" in the Bank's Country Policy and Institutional Assessment for measuring whether countries have good social and labor policies, since *Doing Business* actually favors their elimination. If the Bank retains the CPIA as a determinant for access to IDA funds, it should develop accurate tools for assessing the qualities of countries' policies. In the case of social and labor polices, it could collaborate with the ILO in determining the feasibility of such tools. Additionally, the World Bank should prioritize programs that work towards achievement of Decent Work objectives. Some examples would be supporting improved labor conditions in employment-intensive industries (along the model of "Better Factories Cambodia"), and supporting expanded social protection coverage, rather than privatizing social security, as has been the Bank's main focus until recently. Following up on the IDA12 recommendation of 1998, the World Bank should be required to include an assessment of compliance with core labor standards in *all* Country Assistance and Country Partnership Strategies. As part of the assessment, the Bank should make the links between the need to improve compliance with the standards and the Bank's specific programs in the country for reducing poverty and inequality.

4. Finally, the World Bank should adopt an operational policy requiring that all of the projects and activities that it finances do not violate the core labor standards. While some divisions of the Bank have taken important steps towards achieving this objective, the fundamental human rights for workers embodied in the standards are too important for their observance in Bank-financed projects to be left up to the whims of individual managers. Furthermore, some of the gains could be threatened by processes such as the "country systems" approach, unless precautions are taken by making it official policy that the World Bank cannot finance activities that contravene the core labor standards.

Thank you for your attention and the invitation to appear before you today. I look forward to your questions.

House Committee on Finance Services
Hearing on "The Fight against Global Poverty and Inequality: The World Bank's Approach to the Core Labor Standards and Employment Creation"
Statement of Suellen Lazarus, Senior Adviser, ABN AMRO Bank
October 3, 2007

My name is Suellen Lazarus. I am Senior Adviser and Senior Relationship Banker for ABN AMRO Bank in Washington, DC representing the bank to the international financial institutions and other agencies. ABN AMRO is a Dutch bank with operations worldwide and a strong commitment to sustainable development. Prior to joining ABN AMRO, I worked for 23 years at the World Bank and the International Finance Corporation (IFC). My responsibilities included serving as the Adviser to the US Executive Director of the World Bank, working as a Principal Investment Officer for major IFC projects in Asia, serving as Special Assistant to the Executive Vice President of IFC, running the IFC Syndications Department as Director for six years, and working with the IFC Vice President for Operations on major policy issues.

In the fall of 2002, as the head of IFC Syndications Department, I was asked by IFC's Executive Vice President to structure a small meeting of banks to discuss environmental and social issues in project finance lending. The origin of this meeting was at the request of the head of risk management at ABN AMRO. The bank had experienced some financial losses due to inadequate environmental controls in several projects. They were also finding that environmental and social issues were making projects increasingly complicated, but the bank lacked a systematic way to approach these issues. However, their approach of turning down projects on environmental grounds was not working either. It neither improved the environment nor was it good for business. Projects that the bank would decline were readily picked up by other banks. There was a clear need to level the playing field. The bank admired IFC's procedures and its neutral convening power.

At their first meeting in London in October 2002, the banks soon concluded that they needed to work together to address environmental and social risks in the projects that they were financing. While they had traditionally expected appropriate environmental management from clients, the banks agreed that they lacked consistent standards, a set of procedures to apply, and generally did not proactively enforce and monitor environmental issues.

From this modest initiative, eight months later the Equator Principles were launched here in Washington. In June 2003, ten banks, all competitors, announced their adoption of a uniform set of environmental and social standards for projects. The Equator Principles are a voluntary set of guidelines developed and adopted by banks to identify, assess, and manage environmental and social risk in project finance lending. These standards also include the core labor standards. The framework for the Equator Principles is based on the environmental and social standards of IFC.

There are now 54 financial institutions worldwide that have committed to using the Equator Principles. In addition, many of the world's export credit agencies have now aligned their policies to comply with the Equator Principles. It is fair to say that at least 80-85% of the global project finance market now meets the Equator Principles.

More than a declaration of intent, the Equator Principles have teeth. The signatories commit to "not provide loans to projects where the borrower will not or is unable to comply with our ... social and environmental policies and procedures."

Today, successful syndication of a project finance deal means that compliance with the Equator Principles is expected. Environmental and social standards, including labor standards, are not just seen as something that is nice to do. They are an essential component of risk management and good business. Clients appreciate that they will be using one standardized assessment process and internationally recognized environmental and social standards. Through this transparent and consistent approach, they have found that costs are reduced and difficult issues are addressed up front.

When IFC revised its environmental and social safeguard policies in April 2006, the Equator Principles were subsequently revised to incorporate these new standards. Through this process, expanded labor standards were incorporated in the Equator Principles. It is fair to say that consideration of the expanded labor policies was the most difficult issue for the banks in the revision process. Ultimately, at ABN AMRO we concluded that it was about risk management. Not addressing labor issues is a risk for the project and for the bank lending to the project. Companies that deal effectively with labor issues demonstrate good management and that is what we are looking for in our clients. To us, incorporating labor standards is conducting business responsibly and prudently.

The development and application of the Equator Principles has been a major step forward for the financial industry. The common standard promotes learning among the financial institutions. The principles have allowed us to have greater expertise in advising our clients on environmental and social issues and in improving the overall risk profiles of our projects. In other words, we believe that the Equator Principles are good for business.

Thank you.

Testimony of Thea Mei Lee
Policy Director
American Federation of Labor and Congress of Industrial Organizations
Before the
U.S. House of Representatives
Financial Services Committee on
"The Fight Against Global Poverty and Inequality:
The World Bank's Approach to Core Labor Standards and Employment Creation"

October 3, 2007

Mr. Chairman, members of the Committee, I thank you for the opportunity to speak to you today about the World Bank's approach to core labor standards and employment creation, on behalf of the ten million working men and women of the AFL-CIO.

We believe that the fight against global poverty and inequality must include as an integral element the promotion of decent work, as the International Labor Organization (ILO) has defined it. Decent work "involves opportunities for work that is productive and delivers a fair income, security in the workplace and social protection for families, better prospects for personal development and social integration, freedom for people to express their concerns, organize and participate in the decisions that affect their lives, and equality of opportunity and treatment for all women and men." The protection of workers' human rights, as outlined in the ILO Declaration on Fundamental Principles and Rights at Work, is an essential ingredient in building strong democracies, distributing the benefits of globalization more broadly, and ultimately creating the kind of world we all want to live in.

Nobel laureate Joseph Stiglitz, former chief economist at the World Bank, correctly contends that "workers have to be at the center of the development transformation, and workers' organizations can be a key institution in the development process."

Research shows that observing fundamental workers' rights is good for growth, not an obstacle, and that strong democratic institutions smooth economic transitions and aid in crisis management. Protecting workers' rights contributes to development by building popular institutions, decreasing inequality, and encouraging political participation. Labor organizations can bridge ethnic and religious differences in the workplace and push for greater public and private investment in education, training, and economic growth. Underestimating the role of unions in development ignores the history of the wealthiest countries, where unions proved critical to democratization and the growth of a middle class.

Labor is one of the few assets that the poor have around the world. Creating job opportunities for the poor that provide them with productive and dignified work is necessary to stimulate broad-based growth and reduce poverty. The first Millennium Development Goal – halving extreme poverty – cannot be achieved on a sustainable basis without more and better jobs for the poor.

Policies to eliminate child labor often go hand in hand with policies to increase school enrollment. Achieving the Millennium Development Goal of universal primary education requires an effective strategy for moving the 200 million children under the age of 14 that go to work every day around the world into the classroom.

The workplace can be a powerful site for health care and health education for the poor. Labor unions in Africa have played an important role in advocating for and implementing highly effective HIV/AIDS education and treatment programs based in the workplace.

The World Bank

The World Bank describes its mission as "global poverty reduction and the improvement of living standards." In order to achieve these goals, it "provides low-interest loans, interest-free credit and grants to developing countries for education, health, infrastructure, communications and many other purposes."

In recent years, the Bank has made some important progress in incorporating core labor standards into its own operations, especially through the loan conditions imposed by the Bank's private-sector lending arm, the International Finance Corporation (IFC). The Bank also published an important book by Aidt and Tzannatos on the role of unions and collective bargaining in the development process in 2002.

We applaud the steps taken by the Bank so far to recognize and honor the core labor standards. However, we are deeply troubled by conflicting messages from different divisions within the Bank, as well as by the Bank's failure to recognize the important connections between its work to combat poverty and inequality and the work of the ILO to protect the rights of workers. We have long called for our key international institutions – the World Bank, the International Monetary Fund (IMF), the World Trade Organization (WTO), and the ILO -- to work together to achieve genuine policy coherence through cooperation at the country level, through sharing of data and expertise, and through incorporating common principles and values into every aspect of work.

Peter Bakvis, who represents the International Trade Union Confederation (ITUC) here in Washington, has laid out the ITUC's concerns and experience with respect to internal coherence at the World Bank. The AFL-CIO shares the ITUC's concerns and concurs with the ITUC's policy recommendations with respect to the Bank. I would like to focus my testimony today on the policy coherence – or lack thereof – between the World Bank and the ILO, particularly with respect to the annual Doing Business report.

The ILO is unique among United Nation agencies, in that it is a tripartite organization, with representatives from governments, employers, and workers from all of its member countries. In 1998, the three ILO constituencies reached a remarkable consensus on the core workers' rights that every worker in the world is entitled to: freedom of association and the right to bargain collectively, and prohibitions on child labor, forced labor, and discrimination in employment. Every member of the ILO committed to "respect, promote, and realize" these principles, regardless of whether it had ratified the underlying conventions. These core conventions are considered a minimum floor. No intergovernmental institution should undermine the principles reached via tripartite negotiation and consensus at the ILO.

However, the Bank has not consistently upheld the core labor standards in its country-level conditionalities, its public statements, and its work with individual countries. The World Bank's "structural adjustment" conditions have invariably emphasized labor market "flexibility," deregulation, and privatization, without concern for the likely impact on workers. A typical World Bank project description includes the following "labor market reforms": "(i) making the hiring of contract labor more flexible; (ii) decentralizing implementation of labor regulations; (iii) streamlining and simplifying compliance of labor regulations; and (iv) liberalization of working hours for women and small shops."[1]

Since 2004, the most glaring example of the Bank's inconsistency with respect to the core labor standards has been its annual "flagship" volume, entitled *Doing Business*.

Doing Business provides criteria that are in principle supposed to rank countries' "ease of doing business," measured by ten separate indicators. Unions, NGOs, and academics have criticized *Doing Business* as a one-sided publication, focused almost exclusively on a narrow "private. investor" perspective, with little regard for social impact. *Doing Business* also relies on misleading use of research and empirical evidence, ignoring research findings by World Bank staff that do not support the "investor" lens of the report and mischaracterizing the findings of other academic reports.

Doing Business is an international disgrace. It classifies most protections for workers as investment impediments. It ranks human-rights abusers as stars, and downgrades democratic countries with strong labor institutions and protections. Contrary to the protestations from World Bank officials, *Doing Business* is not simply a neutral set of indices, but rather a powerful policy document, used to determine loan eligibility and to send a message, both to governments and to investors, about "desirable" regulatory reforms.

Doing Business is frequently cited in IMF Article IV consultation reports, as well as in World Bank Country Assistance or Country Partnership Strategies. TheWorld Bank also uses the *Doing Business* "labor market rigidity" scores in calculating its Country Policy and Institutional Assessment (CPIA), which is used to determine levels of aid or credit, debt ceilings, and the content of policy conditionalities. The CPIA is also used to determine aid allocation formulas by the Asian Development Bank and bilateral development agencies of several European countries. This is clearly a powerful policy document, not just incidental reading material.

The ITUC has documented 23 cases where the *Doing Business* report was used by the World Bank and IMF to push for labor market deregulation, in some cases backed up by loan conditions. World Bank officials have claimed that critics of *Doing Business* have "misinterpreted" the data. As the ITUC reports says, "Unless one is to surmise that hundreds of IFI staff members are systematically and deliberately 'misinterpreting' the Bank's highest circulation publication, it is not credible that the Bank never intended that *Doing Business* be

[1] World Bank, "The World Bank and the Social Dimension of Globalization," April 30, 2007.

used for that purpose, as those responsible for the publication have told trade union representatives."[2]

But perhaps most problematic, *Doing Business* undermines the World Bank's own stated goals, and puts the World Bank at odds with other international institutions, namely the ILO and other UN agencies.

For example, the World Bank has endorsed Millennium Development Goal number one, which is to eliminate extreme poverty. Yet *Doing Business* penalizes countries that have a statutory minimum wage, unless it is less than 25 percent of value-added per worker. This comes to less than $1 a day in most sub-Saharan African countries, which is the threshold for extreme poverty. So in this case, the World Bank is actually instructing countries NOT to implement minimum-wage provisions that would keep full-time workers out of extreme poverty, and is undermining an objective that the World Bank declared to be its overarching goal in 1999.[3] While the authors of *Doing Business* justify the penalizing of countries with a decent minimum wage on the grounds that eliminating or reducing the minimum wage will create more employment, this rationale ignores empirical evidence that higher minimum wages have offsetting employment benefits (with respect to productivity, turnover, and morale).[4]

In fact, if one were to use the *Doing Business* indices to construct a "perfect score" with respect to the "Employing Workers" index, the highest possible score would go to a country that had the following labor market features:

- ✓ Employers pay *zero contributions* for payroll tax, retirement, unemployment, maternity, invalidity, housing and health insurance.
- ✓ Short-term contracts can be used for more than 5 years for any category of work.
- ✓ Starting minimum wage is less than a quarter of average value-added per worker.
- ✓ There is no designated day of rest for any categories of workers, no more than 1 and a half day of rest per week is required, and the workweek (including overtime) can be more than 50 hours for 2 months a year. Night work is unrestricted, and annual vacation amounts to less than 21 days.
- ✓ Termination of employment for individuals and groups of employees alike can be carried out without previous notice to a third party and to the worker, without providing justification, and without the approval of any regulatory institution.

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[2] ITUC, ibid, p. 16.
[3] International Trade Union Confederation/Global Unions, "The IFIs' Use of *Doing Business* to Eliminate Workers' Protection: Analysis of *Doing Business 2008* and new country evidence," September 26, 2007.
[4] See, for example, D. Card and A. Krueger (1995) *Myth and Measurement: The New Economics of the Minimum Wage*. Princeton, New Jersey: Princeton University Press.

While the ILO has expressed concern to the World Bank about *Doing Business*, and has provided extensive documentation of problems with the report, there is little evidence of ILO input incorporated into the publication. The ILO and the World Bank have agreed to do intensive joint work in a limited number of countries, but ILO and World Bank country staff should be cooperating and sharing information across the board. It has often been our experience that World Bank country-level staff have no contact with ILO staff and no familiarity with ILO priorities or concerns.

While regular "Policy Coherence Initiative" meetings have been taking place for the last several years between World Bank, IMF, and ILO representatives, World Bank participation has been of varying levels of commitment, the agendas have often been limited to narrow or peripheral topics, and there has been limited follow-through with respect to the Bank's policy recommendations. These policy coherence meetings need to be accorded higher priority within the Bank, and staff need to be empowered to follow through with meaningful actions.

American workers have a strong interest in fighting poverty around the world and strengthening protections for workers' rights globally. In a dynamic and competitive global economy, our members are in competition with vulnerable and disenfranchised workers whose rights are not protected. At the same time, workers in developing countries who earn a decent living and have a strong and independent voice in a democratic system can potentially grow into a middle-class market for goods and services that we produce.

It makes a difference to American workers if our international institutions see their mission as fighting poverty by empowering and protecting workers, or as weakening worker protections in a misguided attempt to stimulate private investment and growth. We hope that the Congress and the Administration will ensure that the U.S. Executive Director to the World Bank conveys in the strongest possible terms that the World Bank must live up to its mandate, cooperate with its sister international organizations (particularly the ILO), and respect the international tripartite consensus that sustainable economic development can only be achieved if workers' human rights are respected. A first step should be eliminating the "Employing Workers" index from the *Doing Business* report, and reviewing the entire publication with a broader social perspective.

Thank you for your time, and I look forward to your questions.

Testimony of Eric T. Miller

President, Millers Rock Consulting, LLC
erictmiller@earthlink.net

to the

U.S. House of Representatives
Committee on Financial Services

Hearing on

The Fight Against Global Poverty and Inequality: The World Bank's Approach to Core Labor Standards and Employment Creation

October 3, 2007

Mr. Chairman, Members of the Committee, thank you very much for the opportunity to address you this morning.

My name is Eric T. Miller. I am currently President of *Millers Rock Consulting, LLC*, a trade and business strategy firm. Previously, I worked for nine years at the Inter-American Development Bank (IDB), the World Bank's sister institution for Latin America and the Caribbean, and for two years for an economic consulting firm developing business with the World Bank and other donor institutions. I have also run a major USAID trade development project in Panama and have prepared a number of detailed country-level economic and social reports for the Agency that draw heavily on the *Doing Business* report and other indicators. In short, I have seen the "development business" from many different perspectives.

Poverty, Inequality, and the Millennium Development Goals

This hearing is timely and of great importance. As we reach the halfway point in the timeframe established for meeting the Millennium Development Goals (MDG), it is important to have a broad-ranging discussion about where we are with their implementation. A key MDG is to "reduce by half the proportion of the world's population living on less than $1 per day". According to the World Bank's *World Development Indicators* 2007 report, the number of people in the world living on less than $1 per day is falling. In 2004, some 980 million people were suffering in this type of extreme poverty, compared with 1.25 billion people in 1990. The report indicates that the number of people living on less than $2 per day is also falling. However, an estimated 2.6 billion people – or almost half the population of the developing world - are still living below that level. In other words, while we are making progress in the fight against global poverty, we are not moving far enough or fast enough.

The continued urgency of the challenge is even more apparent when one considers where many of those coming out of extreme poverty reside. They tend to be in a handful of populous countries that have achieved high levels of growth as a result of ambitious market opening processes undertaken over the past 15-20 years, namely China and India. By contrast, many countries in the developing world have made scant progress in cutting their dollar-a-day rates. A principal cause for this lack of progress is that hundreds of millions of people in sub-Saharan Africa, the Middle East, and Latin America remain cut off from the global economy and its the economic growth potential. It is little wonder that most of the world's wealthiest countries are also, according to the Foreign Policy/A.T. Kearney list, the most globalized. By contrast, much of the developing world lacks even the basic "plumbing" for making globalization work. This includes quality infrastructure (ports, airports, primary and secondary roads), a wide dissemination of information and communications technologies, an openness to foreign direct investment, capital markets that include the poor, and governance structures that are conducive to private enterprise while providing complementary public goods. Many developing countries also have poor education and training systems, meaning that workers often lack the skills and technical knowledge needed to effectively participate in the global economy above the lowest rung.

Numerous developing countries also have large numbers of businesses in the informal sector that skirt their tax obligations and have a poor record in the treatment of workers. Many of these challenges are contemplated in the MDGs.

While the experiences of China and India in achieving solid growth patterns and large reductions in the levels of poverty should be carefully examined for lessons, the two countries share one thing in common – they are mega-states with large internal markets. By contrast, mid-size and smaller countries must produce for and sell to a global economy if they are to achieve economies of scale. The real success in meeting the MDG on poverty reduction should be measured outside of the emerging mega-states.

Although the MDGs do not establish explicit targets on reducing income inequality, the available evidence suggests that the gap between the rich and poor is increasing in many parts of the developing world. Growing income inequality matters for a variety of reasons, ranging from challenges to social cohesion to the decreasing purchasing power of consumers in internal markets. In addressing the challenges of growing inequality, one must understand its causes. Many economists have attributed the widening of the income divide to a divergence in the economic returns between those that are able and willing to participate in the global economy and those that are not. There is a great deal of truth to this assessment. However, growing inequality is not the result of a conscious decision to make the rich richer and the poor poorer. Rather, it stems principally from the technological changes that have resulted in cheap transportation, instantaneous communications, and the like. Rather than engaging in a quixotic attempt to reverse the technological developments that underpin the global economy or legislate impediments to the flows of global commerce, developing countries and donor institutions need to work together to widen the access of the poor and the lower-middle-class in the developing world to the global economy and to improve the skills and products that they can bring to the table. Widening the circle of wealth creation is the only viable way to reduce inequality. One must be very clear that open markets, open trade, open investment, open travel, the open flow of ideas, and transparency are essential tools for moving large numbers of people in the developing world out of poverty.

What are Core Labor Standards?

Internationally, core labor standards are understood to be the four principles set forth in the 1998 International Labor Organization (ILO) *Declaration on Fundamental Principles and Rights at Work.* While the ILO has Conventions dealing with a variety of topics, the 1998 Declaration established that the four principles were the basic standards by which members had to comply. The Declaration enjoyed wide support from the United States and many other countries. In the end, the 175 ILO member states as well as representatives of employers and workers supported the Declaration.

The four core labor standards are:

(1) ***The elimination of all forms of compulsory labor.*** This includes any work or service, paid or unpaid, that is performed involuntarily or under threat of penalty, such as indentured labor, bonded labor, or forced prison labor;

(2) ***The effective abolition of child labor, with priority to the worst forms.*** This includes both the traditional emphasis on limiting hours, times, and ages of work as well as more contemporary issues such as using children in illicit activities or activities that endanger the health, safety, and morals of children;

(3) ***The elimination of discrimination in employment.*** This includes the elimination of discrimination in access to employment, training, and working conditions on the basis of race, color, sex, religion, political opinion, national extraction, and/or social origin. It also includes a requirement for equal pay for men and women for work of equal value; and

(4) ***Freedom of association and the right to collective bargaining.*** This includes providing protection against interference of workers' and employers' efforts to organize and protects measures promoting collective bargaining. Additionally, it prevents employers from conditioning employment on workers pledging to not join or to relinquish membership in a union and from dismissing or otherwise punishing a worker due to union activities.

Core labor standards have also been widely discussed in the context of trade negotiations. Many analysts attribute this to the perceived institutional weakness of the ILO on the enforcement side as compared to the relatively strong dispute settlement provisions at the WTO and in regional trade agreements.

The World Bank and Core Labor Standards

The World Bank has not defined an official policy on core labor standards nor has it mandated full compliance with core labor standards as a condition for loans, grants, or technical assistance to client countries. However, it has undertaken a variety of initiatives to support the universal implementation of core labor standards in response to both the 1998 ILO Convention and the 12th and 13th Replenishments of IDA Resources. First, the Bank assembled a Core Labor Standards Toolkit, which is designed to assist staff in addressing these issues in the development of Country Assistance Strategies (CAS) – the basic strategy document with each country. There is evidence to suggest that the implementation of the core labor standards is finding a place in the CAS documents in numerous countries. For example, the 2005-2008 CAS for Cambodia establishes that a lack of compliance with core labor standards is a key impediment to productivity growth. Second, compliance with core labor standards has been incorporated into the Country Policy and Institutional Assessment (CPIA) documents that are used to assess the quality of IDA country policy frameworks with a view to informing the allocation of these resources. Third, the IFC and MIGA have policies forbidding harmful child or forced labor in investor projects. Fourth, the Bank undertakes ongoing policy dialogues, training programs, and initiatives supporting the implementation of the core labor standards.

Examples include the Bank's ongoing program on child labor and a pilot project strengthening core labor standards in three African countries.

The Doing Business Report

On September 25, 2007, the World Bank released the 5th Edition of the *Doing Business* report. The Bank states that the basic objective of this annual report is to investigate "the regulations that enhance business activity and those that constrain it. *Doing Business* presents quantitative indicators on business regulations and the protection of property rights that can be compared across 175 economies ... and over time."

Doing Business determines its rankings based on ten major categories: (1) Starting a Business; (2) Dealing with Licenses; (3) Employing Workers; (4) Registering Property; (5) Getting Credit; (6) Protecting Investors; (7) Paying Taxes; (8) Trading Across Borders; (9) Enforcing Contracts; and (10) Closing a Business. These categories are, in turn, comprised of a total of 42 sub-categories of indicators.

The data is collected on the basis of annual surveys, completed principally by law and consulting firms in the countries. While the *Doing Business* team has set forth its methodologies for collecting the data for each category in peer reviewed journals and have otherwise made efforts to ensure its accuracy and comparability, survey data of this nature is inherently imperfect. For example, in 2006, when I was preparing a country social and economic assessment for USAID, the Economic Growth Officer in the Country Mission told me that only four lawyers in his country had completed the surveys and the results for some categories were overstated. Nevertheless, the *Doing Business* results do appear to be sufficiently accurate to constitute a reasonable approximation of the regulatory environment for business within and across countries.

Employing Workers

The *Employing Workers* category, which includes six sub-categories – (a) Difficulty of Hiring Index; (b) Rigidity of Hours Index; (c) Difficulty of Firing Index; (d) Rigidity of Employment Index; (e) Non-wage labor cost (% of salary); and (f) Firing costs (weeks of wages) – has been the subject of some controversy.

The basic assumption of the Bank is that flexible labor markets are more conducive to job creation than rigid labor markets. There is wide evidence in the economic literature and in the experiences ranging from wealthy countries such as Germany to poor countries such as Burkina Faso that flexible labor markets lead to job creation. As the 2006 *Doing Business* report aptly explains:

> *With rigid regulation, common in developing countries, employers choose conservatively. Some workers benefit – mostly men with years of experience on the job. But young, female and low-skilled workers often lose out, denied job*

opportunities. Inflexible labor markets stifle new job creation and push workers into the informal sector. Three-quarters of informal workers are women. They receive no health benefits, no support for their children, no sick leave, and no pension. If abused by their employer, they have no recourse to the courts, because the employment relationship is not documented. Far from protecting the vulnerable, rigid employment regulations exclude them from the market.

Some have raised concerns about whether the Bank's methodology encourages countries to not fully comply with core labor standards by grading them higher if they do not. However, this assertion is unfounded. Nothing in the World Bank's approach suggests that they understand flexible labor markets to mean the absence of labor law. The Bank views practices such as child labor or forced labor as injurious to development. In addition, the Bank, like virtually every other development agency recognizes the importance of ensuring equal rights for woman and minority groups to the development process.

Doing Business and Unions

The World Bank has not taken a position on the effects of the role of unions in the *Doing Business* report or elsewhere. Some observers have raised concerns about certain cases where countries with more restrictive union organization practices score better than those with less restrictive practices. This result is due to the focus of the study and the methodology employed for gathering the data. This is also the case for countries such as Saudi Arabia, which are well known for their poor treatment of women, yet score well. The *Doing Business* report focuses on measuring the impact of regulations on business formation and operation across 175 countries. It does not focus on the impact of unions or the effect of tax incentives or any other type of measure that could have specific effects in specific countries. In order to make data comparable across countries, large and small, rich and poor, and with different legal traditions, the standard practice is to develop a basic typology for each category in the survey. In the case of "Employing Workers", the survey assumes, *inter alia*:

The Worker:
- *Is a 42-year-old, non-executive, full-time, male employee.*
- *Is not a member of a labor union, unless membership is mandatory.*

The Business:
- *Is subject to collective bargaining agreements in countries 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.*

Certainly most workers are not 42-year-old males, and many workers are members of unions. However, in order to obtain an average picture that is comparable across countries, one must make assumptions about what a "typical" worker and business look like. In most countries, the majority of workers are not union members. Therefore, the "typical" worker is not a union member. Were the World Bank team to begin to differentiate between male and female workers, union and non-union workers, and rural and urban workers, to name but a few, *Doing Business* would lose its focus and swiftly become non-comparable across countries.

The Uses of Doing Business

Some observers have expressed concerns that private investors and the Bank itself evaluate candidates for investment on the basis of the *Doing Business* report without fully understanding or explaining the assumptions in the methodology. Certainly the release of this annual report is accompanied by the plethora of media activity. However, the impact of the report, especially on private investors should not be overstated.

In my years of experience in working on foreign investment issues in the Americas, I have never observed an investor who would invest in a country solely on the basis of an international report. Firms invest outside their home countries for a variety of reasons. The typology advanced by the UN Economic Commission for Latin America and the Caribbean is helpful in this regard. It posits that there are three motivations for foreign investment:

- efficiency-seeking: looking to build products or provide services better and more cost effectively;
- raw materials-seeking: including sectors such as mining, oil/gas, and forestry;
- market access-seeking: looking to sell into less open markets or heavily regulated sectors.

Even after firms know why they are investing, the decision of where to invest tends to be made following an extended evaluation process. Most companies consider a variety of factors including the procedures for establishment in the country, the tax regime, the ability to repatriate profits, energy costs, and the quality of infrastructure for moving goods into and out of the country. Although labor costs and the labor regime are considered in the evaluation, they are but two of many factors. This is especially true outside of the Chinese manufacturing sector and the Indian services sector. While investors do look at many of the regulatory issues covered in the *Doing Business* report as part of their due diligence process, their examination is much deeper, more extensive, and sector-specific than that of the World Bank team. In short, investors are concerned about the particular regulatory regime in the particular part of the economy in which they are seeking to operate.

The most important contribution of the *Doing Business* report at the country-level is that it has made governments begin to think about the incentive structures inherent in their business regulatory regimes and how these can be improved. For years, many countries have made it expensive and complicated for entrepreneurs to establish and operate firms in the formal sector. Everyone agrees that it is desirable to have more tax-paying firms that employ people, help contribute to the social security coffers and the like. However, national regulatory regimes that make the formalization process long and expensive drive firms underground or kill them altogether before they ever get started.

The Equator Principles

The Equator Principles are the culmination of years of work by the banking industry to develop a universal framework for addressing social and environmental issues that arise in their projects. Banks now have a common framework for assessing such risks as well as a common terminology. The Principles were first launched in 2003 by ten commercial banks. Today, more than 50 banks representing well over 80% of global project lending have adopted them. The Bank's International Finance Corporation provided important advice and support to the process of putting the Principles together. Its most important contribution was to serve as the source for the environmental and social framework on which the Principles are based.

The Equator Principles are a welcome initiative. Importantly, participation is voluntary. Firms are required to notify that they have put in place the procedures to adopt the Principles. However, they are not required to sign a lengthy agreement and subject themselves to potential legal action in the case of disagreements about their level of compliance. Were compliance subject to such an agreement, one can posit that banks would be less inclined to join. Through voluntary standards and required annual reporting, the global financial industry is making important progress in addressing social and environmental issues in the projects they finance.

Unions in Developing Countries

There is no consensus about the economic effects of unions in developing countries. Classical economic analysis holds that unions interfere in the labor market price setting process, thereby creating market inefficiencies and reducing firm-level profits. Other economists hold that unions bring increased wages in their sectors and promote firm level investment. More broadly, there are certainly examples such as Solidarity in Poland and the Congress of Trade Unions in Zimbabwe where unions have and are playing a positive role in the democracy-building processes in their countries. Similarly, there are also numerous examples throughout the developing world of union corruption. Assessing the positive and negative effects of unions is ultimately the job of citizens and companies. However, in this debate, one must not lose sight of the fact that if firms cannot compete in the global economy, there are no jobs.

The World Bank, Poverty Reduction, and Labor Standards

The World Bank is a large, diverse organization offering its member states a range of tools including loans, grants, technical assistance, guarantees, policy analysis, and training. The Bank system has a diverse array of institutions and mandates that have been accumulated at the direction of the board over many years. In pursuing its many objectives, the Bank tries, in general, to incorporate approaches that are found through research and experience to "work" in achieving its goals. Like any large bureaucracy, the results are imperfect and uneven. The *Doing Business* report is a notable exception to this "bureaucratic" tendency. As part of the process of exploring ways to make the Bank better and more efficient at achieving its overarching mission of a world free of poverty, we must think about how to improve its capacity to work with entrepreneurs and businesses trying to innovate and make the leap to exporting and greater levels of competitiveness. This not to imply that Bank's continued work on infrastructure, education, and policy reform projects is not important. It certainly is. However, they must be understood as the necessary frameworks that support the creation of competitive firms, competitive products and services, and skilled workers.

On the issue of core labor standards, the World Bank should explore ways of doing more. Some of the regional development banks are more active in this area than the World Bank. For example, the Inter-American Development Bank played a very important leadership role during the CAFTA process in pulling together trade and labor ministers to focus on improving compliance with core labor standards and the enforcement of domestic labor laws. Anecdotal evidence suggests that the monitoring and transparency demanded by CAFTA has led to an improvement of labor conditions in the six countries. Likewise, the Asian Development Bank recently produced a handbook on incorporating core labor standards into its programming process that goes much beyond the earlier World Bank toolkit.

While the IFIs can look to do more in the labor area, the impetus for improvement of labor standards will come at the country level. Having seen numerous manufacturing jobs go to China, many developing countries now understand that low wages are neither a desirable nor a feasible strategy for long-term competitiveness. Thus, development agencies, government authorities, and firms are working together to assist the latter with moving up the value chain where they can compete on the basis of factors other than strictly price. With higher-value products and services come higher wages and improved working conditions. While this process takes time and challenges remain, large-scale poverty reduction will only come by providing the poor with the access and the tools to take advantage of the global economy markets.

Thank you very much for your time.

TESTIMONY SUBMITTED TO
THE UNITED STATES HOUSE OF REPRESENTATIVES
COMMITTEE ON FINANCIAL SERVICES

"THE WORLD BANK'S APPROACH TO CORE LABOR STANDARDS AND EMPLOYMENT CREATION: RECENT DEVELOPMENTS"

BY

SANDRA POLASKI
DIRECTOR
TRADE, EQUITY AND DEVELOPMENT PROJECT
CARNEGIE ENDOWMENT FOR INTERNATIONAL PEACE
1779 MASSACHUSETTS AVENUE, NW
WASHINGTON DC 20036

202-939-2252
SPOLASKI@CEIP.ORG

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The World Bank Group has recently taken several steps that have a significant impact on core labor standards, work place practices or employment creation. In my testimony I would like to call the Committee's attention to four key examples, three positive and one negative.

1. International Finance Corporation Adoption of Performance Standard on Labor

The most positive recent development was a step taken by the International Finance Corporation (IFC), which is the arm of the World Bank Group that lends to private firms in developing countries. In February 2006, the IFC adopted a new set of performance standards. These performance standards lay out requirements that must be observed by all firms that borrow from the IFC. The new standards adopted in 2006 included a labor performance standard, Performance Standard 2 or PS2, which for the first time required that the private firms borrowing from the IFC must comply with all core labor standards and certain other good workplace practices. The text of PS 2 is attached to this document.

The adoption of PS2 was an important step for the IFC and it also has a bearing on broader practices. It paved the way for the recent adoption by the main World Bank body of a new requirement that core labor standards be respected by firms that seek procurement contracts funded by the Bank, discussed below. It also led to the adoption of a new standard by the Equator Banks requiring borrowers to respect core labor standards and follow other good workplace practices. The Equator Banks are a group of leading commercial banks that decided earlier to adhere to a set of principles on environmental practices called the "Equator Principles". After the IFC's promulgation of PS2, the Equator Banks adopted the same standard. Together the IFC and these banks account for over 80% of international private sector project finance in developing countries, so the impact is potentially very large.

The IFC is now in the process of implementing PS2. The organization's Environment and Social Development Department, which shepherded the development of the standard, has been assigned the task of operationalizing the new standard, although loan officers ultimately have responsibility for implementation. The department provided initial training to loan officers to help them understand and apply the standard to all new loans. The department must also implement a process for ongoing oversight of the performance of borrowers and for prompt remediation where problems arise.

The department has made a very professional and serious effort to operationalize the standard. At the same time, it must be recognized that respect for core labor standards was not part of the culture of the IFC or the reward system for loan officers. The effective and full implementation of PS2 will require a significant change in the institution's orientation toward workers' rights and workplace practices. It will require continuing capacity building by the Environment and Social Development Department, adequate resources for the task, and the support of IFC leadership.

This positive work deserves the support, attention and encouragement of the Committee and the U.S. Executive Director.

2. World Bank Policy on Core Labor Standards

As mentioned, the World Bank recently revised its "Standard Bidding Document for Procurement of Works" to require that core labor standards be respected by the Bank's contractors. This will apply primarily to the infrastructure projects funded by the Bank. Implementation has not yet started. The Bank will undoubtedly face a steep learning curve in implementing this new requirement, as core labor standards have not been part of its procurement activities in the past and because respect for these standards is still contested in some parts of the Bank. It will be important that the leadership of the Bank and its governing body pay close attention to progress on implementation to ensure that the new requirement is fully operationalized. It would be advisable for the Bank to learn from its sister institution, the IFC, which has now accumulated at least come experience to share.

The Committee and the U.S. Executive Director should track the progress of the effort.

The World Bank more generally has not adopted a consistent stance of promoting core labor standards.

3. Doing Business Report 2008

The Doing Business Report is perhaps the most glaring example of inconsistency by the World Bank in promoting good workplace practices and respect for workers' rights.

The annual Doing Business Report ranks countries according to how "business friendly" they are. The rankings are used both inside and outside the Bank in decisions about investment. The report covers a number of appropriate topics, such as the ease of establishing and operating a business, including licensing and registration requirements, and access to credit in financial markets. It also deals with the topic "Employing workers". This is an area where the approach taken in the report is seriously off track in terms of good policy and specifically in terms of creating employment and promoting good labor practices.

The section on "Employing workers" creates an index of what it calls the "Rigidity of Employment". This index is made up of three components, labeled "difficulty of hiring", "rigidity of hours", and "difficulty of firing". A perfect score for a country means that it is a good place to do business in terms of employment matters. A low ranking suggests that investors should avoid the country and that the government should change its labor laws and labor market policy. I will comment briefly on each element of the index and its impact on employment and workers in the real world.

The "difficulty of hiring" index gives perfect scores to countries that allow the use of fixed term—that is, temporary—contracts for workers hired to perform permanent tasks, with no limitations whatsoever. It gives the worst score to countries that limit the use of temporary contracts for permanent work to less than three years. It should be noted that temporary contracts are widely used—and abused—in many developing countries, notably parts of Latin America, to avoid putting employees on regular employment rolls, despite the fact that they are doing work that is integral to the operation of the firm and that the firm considers permanent.

These contracts keep the affected workers in a precarious economic position, not knowing whether they will be employed at the end of the contracts, which often run for as short a period as three months. In some cases, use of temporary contracts means that the worker will not qualify for regular employment benefits including medical insurance and pensions. It discourages both the employee and the firm from investing in the temporary worker's training and skills because of the uncertainly of continued employment. It discourages workers from joining labor organizations or union organizing campaigns because of fear that their contracts will not be renewed. These effects are not consistent with the goal of creating employment and promoting core labor standards. Nor are they consistent with good labor market practices that encourage investment in human capital.

The "difficulty of hiring" index also discourages the effective use of minimum wage legislation and encourages very low minimum wages if they are set at all by governments. Despite extensive research showing that carefully established minimum wage policy can effectively alleviate poverty and improve income distribution without discouraging employment, the Doing Business team ignores that research and appears to assume that minimum wages should not be used or should be set at extremely low levels. It assigns a perfect score to countries that set the minimum wage at less than 25% of the average value added per worker. Minimum wages are used in many countries to provide a lower bound to the distribution of value added between labor and capital. In its' recent *World Economic Outlook 2007,* the IMF found a worldwide increase in capital's share of GDP and decrease in labor's share, especially marked in developing countries. The Doing Business Report encourages countries to set minimum wage rules that allow firms to capture the largest possible share of output. This is what used to be called "sweating", that is, extracting labor for the lowest possible wage, rather than encouraging increased productivity based on worker motivation, investment in workers' skills and technology.

The "rigidity of hours" index implicitly advocates the rolling back of any restrictions on hours worked, with a perfect score assigned to countries that allow 50 hour weeks at least part of the year and limit vacation time. Countries that establish what we in the US came to believe were sensible limits, such as the forty hour work week, are considered bad places to do business, according to this index. In a world where unemployment and underemployment are major economic and social problems in most developing countries, the idea that workers already on payrolls should be worked to the maximum rather than encouraging firms to hire more workers by keeping work time to a reasonable level goes in the wrong direction.

The "difficulty of firing" index rates countries as bad places to do business that require advance notice of termination or layoff or that require the options of retraining or alternative placement be considered instead of layoff. On other hand, Doing Business gives a perfect score to countries that have no restrictions on layoffs, no advance notice requirements, no obligation to consider the options of retraining or alternative placement, and allow no priority in the layoff process for considerations such as seniority or preserving balance in the composition of the workforce. The index lists the "firing cost" in each country, which amounts to the cost of advance notice and severance pay. This must be understood in the context that in most developing countries there is no unemployment insurance. Severance pay is the only buffer for households that lose the income of their wage earners. To imply that this buffer should be eliminated by countries without unemployment insurance endorses an approach of shifting all economic risks from firms to households. This approach represents an extremist view of the balance between firm and household interests; it should not be implicitly or explicitly foisted on developing countries.

The "Employing workers" section was even worse in the past, when it anointed policies that were directly at odds with ILO conventions. However it is still seriously off track. It ignores extensive contemporary research on labor market policies. To the extent that Doing Business references any empirical evidence rather than relying on what appears to be an ideologically pre-determined preference for labor market deregulation, it relies only on labor market research that lies at one extreme of the spectrum of such research. It favors an approach to labor market policy that shifts all risk from firms to workers and households and encourages countries to prioritize the short-term interests of firms over all other economic interests. This is at odds with the more sensible and mainstream approach that encourages governments to balance the interests of all economic actors and to take social and long-term interests into account. As development policy it is short-sighted and ignores lessons widely learned in already-developed countries. At worst it encourages countries to adopt policies that will hurt their employment generation and worsen income distribution and poverty levels.

The unbalanced and counterproductive approach to employment and labor market policy in the Doing Business Report cannot be ignored. It is used as an input to country level planning, poverty reduction strategies and loans by other parts of the World Bank Group. It is also used by private firms as a basis for decisions on where to invest. I believe that the "Employing workers" index should be removed entirely from the Doing Business Report until the Bank can come to terms with the wide array of labor market and social issues that are involved. I suggest that the Committee should instruct the U.S. Executive Director to work to eliminate this section until the Bank staff is able to provide an approach that can be approved by the Bank's governing body, which can bring to bear the experiences of the member governments in dealing with the economic, social and political complexity of labor market issues.

4. The "Better Work" Program of the IFC and the ILO

One recent initiative that deserves attention and support is the recently launched "Better Work Program". This is a joint project operated by the IFC and ILO that is designed to improve labor practices and productivity in global supply chains. The program will monitor workplaces in participating countries to determine whether national labor laws and core labor standards are observed. It will report the results of that monitoring and provide advice and assistance to the firms to improve their compliance.

The new program draws on experience gained by the ILO in a successful policy experiment in Cambodia. The ILO conducts ongoing monitoring of conditions in the apparel factories there and publishes the results in highly transparent reports that detail compliance or non-compliance by each factory with national labor laws and internationally agreed basic labor rights. Until the end of 2004, these reports were used by the US government as a key input for decisions under an innovative scheme that allowed increased access to the US market in response to improved working conditions and labor practices. An important element of the experiment that was largely unanticipated but has proven critical to its ongoing success is the use of the ILO reports by private foreign firms that buy from Cambodian producers. These buyers, conscious of their brand reputations, use the reports to determine whether their supplier firms comply with labor standards. The buyer then encourage remediation of problems, and if factories repeatedly fail to improve, the buyers shift orders to firms that run businesses able to comply with the national laws and core labor standards. The net effect has been to upgrade the quality of the industry while increasing apparel production, exports and employment very substantially. A fuller description and analysis of the Cambodian project is attached.

The new joint program of the IFC and ILO will draw on these lessons to achieve improvement in workplaces that produce for global supply chains elsewhere. Discussions are underway with the governments, private sectors and labor unions of Jordan, Vietnam and Lesotho to establish programs that draw on the lessons of the Cambodian success. This program will require external financial assistance and deserves the attention and support of the Committee and the U.S. Executive Director.

Conclusion

These four undertakings indicate both that progress is being made in moving the World Bank Group to address core labor standards and to improve workplace conditions, but that some serious problems remain and much more needs to be done. The active oversight of this Committee can contribute to further improvements.

International Finance Corporation
World Bank Group

Performance Standard 2
Labor and Working Conditions

April 30, 2006

Introduction

1. Performance Standard 2 recognizes that the pursuit of economic growth through employment creation and income generation should be balanced with protection for basic rights of workers. For any business, the workforce is a valuable asset, and a sound worker-management relationship is a key ingredient to the sustainability of the enterprise. Failure to establish and foster a sound worker-management relationship can undermine worker commitment and retention, and can jeopardize a project. Conversely, through a constructive worker-management relationship, and by treating the workers fairly and providing them with safe and healthy working conditions, clients may create tangible benefits, such as enhancement of the efficiency and productivity of their operations.

2. The requirements set out in this Performance Standard have been in part guided by a number of international conventions negotiated through the International Labour Organization (ILO) and the United Nations (UN).[1]

Objectives

- To establish, maintain and improve the worker-management relationship
- To promote the fair treatment, non-discrimination and equal opportunity of workers, and compliance with national labor and employment laws
- To protect the workforce by addressing child labor and forced labor
- To promote safe and healthy working conditions, and to protect and promote the health of workers

Scope of Application

3. The applicability of this Performance Standard is established during the Social and Environmental Assessment process, while implementation of the actions necessary to meet the requirements of this Performance Standard is managed through the client's Social and Environmental Management System. The assessment and management system requirements are outlined in Performance Standard 1.

4. Throughout this Performance Standard, the term "workers" is used to refer to employees of the client, as well as to certain types of non-employee workers described in paragraph 17. The application of this Performance Standard will vary depending on the type of workers, as follows:

- **Employees**: All the requirements of this Performance Standard, except for the requirements under paragraphs 17 and 18, apply
- **Non-Employee Workers**: The requirements of paragraph 17 apply

5. Supply chain[2] issues are addressed in paragraph 18.

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[1] These conventions are:
ILO Convention 87 on Freedom of Association and Protection of the Right to Organize
ILO Convention 98 on the Right to Organize and Collective Bargaining
ILO Convention 29 on Forced Labor
ILO Convention 105 on the Abolition of Forced Labor
ILO Convention 138 on Minimum Age (of Employment)
ILO Convention 182 on the Worst Forms of Child Labor
ILO Convention 100 on Equal Remuneration
ILO Convention 111 on Discrimination (Employment and Occupation)
United Nations Convention on the Rights of the Child, Article 32.1

Requirements

Working Conditions and Management of Worker Relationship

Human Resources Policy

6. The client will adopt a human resources policy appropriate to its size and workforce that sets out its approach to managing employees consistent with the requirements of this Performance Standard. Under the policy, the client will provide employees with information regarding their rights under national labor and employment law, including their rights related to wages and benefits. This policy will be clear and understandable to employees and will be explained or made accessible to each employee upon taking employment.

Working Relationship

7. The client will document and communicate to all employees and workers directly contracted by the client their working conditions and terms of employment, including their entitlement to wages and any benefits.

Working Conditions and Terms of Employment

8. Where the client is a party to a collective bargaining agreement with a workers' organization, such agreement will be respected. Where such agreements do not exist, or do not address working conditions and terms of employment (such as wages and benefits, hours of work, overtime arrangements and overtime compensation, and leave for illness, maternity, vacation or holiday) the client will provide reasonable working conditions and terms of employment that, at a minimum, comply with national law.

Workers' Organizations

9. In countries where national law recognizes workers' rights to form and to join workers' organizations of their choosing without interference and to bargain collectively, the client will comply with national law. Where national law substantially restricts workers' organizations, the client will enable alternative means for workers to express their grievances and protect their rights regarding working conditions and terms of employment.

10. In either case described in paragraph 9, and where national law is silent, the client will not discourage workers from forming or joining workers' organizations of their choosing or from bargaining collectively, and will not discriminate or retaliate against workers who participate, or seek to participate, in such organizations and bargain collectively. Clients will engage with such worker representatives. Worker organizations are expected to fairly represent the workers in the workforce.

Non-Discrimination and Equal Opportunity

11. The client will not make employment decisions on the basis of personal characteristics unrelated to inherent job requirements. The client will base the employment relationship on the principle of equal opportunity and fair treatment, and will not discriminate with respect to aspects of the employment relationship, including recruitment and hiring, compensation (including wages and benefits), working conditions and terms of employment, access to training, promotion, termination of employment or retirement, and discipline. In countries where national law provides for non-discrimination in employment, the client will comply with national law. When national laws are silent on non-discrimination in employment, the client will meet this Performance Standard. Special measures of protection or assistance to remedy past discrimination or selection for a particular job based on the inherent requirements of the job will not be deemed discrimination.

[2] Supply chain refers to both labor and material inputs for the life-cycle of a good or service.

Retrenchment

12. The client will develop a plan to mitigate the adverse impacts of retrenchment on employees, if it anticipates the elimination of a significant number of jobs or a layoff of a significant number of employees. The plan will be based on the principle of non-discrimination and will reflect the client's consultation with employees, their organizations and, where appropriate, the government.

Grievance Mechanism

13. The client will provide a grievance mechanism for workers (and their organizations, where they exist) to raise reasonable workplace concerns. The client will inform the workers of the grievance mechanism at the time of hire, and make it easily accessible to them. The mechanism should involve an appropriate level of management and address concerns promptly, using an understandable and transparent process that provides feedback to those concerned, without any retribution. The mechanism should not impede access to other judicial or administrative remedies that might be available under law or through existing arbitration procedures, or substitute for grievance mechanisms provided through collective agreements.

Protecting the Work Force

Child Labor

14. The client will not employ children in a manner that is economically exploitative, or is likely to be hazardous or to interfere with the child's education, or to be harmful to the child's health or physical, mental, spiritual, moral, or social development. Where national laws have provisions for the employment of minors, the client will follow those laws applicable to the client. Children below the age of 18 years will not be employed in dangerous work.

Forced Labor

15. The client will not employ forced labor, which consists of any work or service not voluntarily performed that is exacted from an individual under threat of force or penalty. This covers any kind of involuntary or compulsory labor, such as indentured labor, bonded labor or similar labor-contracting arrangements.

Occupational Health and Safety

16. The client will provide the workers with a safe and healthy work environment, taking into account inherent risks in its particular sector and specific classes of hazards in the client's work areas, including physical, chemical, biological, and radiological hazards. The client will take steps to prevent accidents, injury, and disease arising from, associated with, or occurring in the course of work by minimizing, so far as reasonably practicable, the causes of hazards. In a manner consistent with good international industry practice,[3] the client will address areas, including: the identification of potential hazards to workers, particularly those that may be life-threatening; provision of preventive and protective measures, including modification, substitution, or elimination of hazardous conditions or substances; training of workers; documentation and reporting of occupational accidents, diseases, and incidents; and emergency prevention, preparedness and response arrangements.

[3] Defined as the exercise of professional skill, diligence, prudence and foresight that would reasonably be expected from skilled and experienced professionals engaged in the same type of undertaking under the same or similar circumstances globally.

International Finance Corporation
World Bank Group

Performance Standard 2
Labor and Working Conditions

April 30, 2006

Non-Employee Workers

17. For purpose of this Performance Standard, "non-employee workers" refers to workers who are: (i) directly contracted by the client, or contracted through contractors or other intermediaries; and (ii) performing work directly related to core functions essential to the client's products or services for a substantial duration. When the client contracts non-employee workers directly, the client will use commercially reasonable efforts to apply the requirements of this Performance Standard, except for paragraphs 6, 12, and 18. With respect to contractors or other intermediaries procuring non-employee workers, the client will use commercially reasonable efforts to: (i) ascertain that these contractors or intermediaries are reputable and legitimate enterprises; and (ii) require that these contractors or intermediaries apply the requirements of this Performance Standard, except for paragraphs 6, 12, and 13.

Supply Chain

18. The adverse impacts associated with supply chains will be considered where low labor cost is a factor in the competitiveness of the item supplied. The client will inquire about and address child labor and forced labor in its supply chain, consistent with paragraphs 14 and 15 above.

Attachment 2

Harnessing Global Forces to Create Decent Work: A Successful Experiment in the Cambodian Apparel Sector*

Sandra Polaski
Carnegie Endowment for International Peace

Introduction

For the past seven years, a path-breaking and successful policy experiment in the small southeast Asian nation of Cambodia has harnessed global forces to create employment and improve working conditions. The fundamental strategy is to improve labor conditions, verify the improvement through monitoring by a respected international organization and use the results to create a "safe haven" for production and sourcing by international firms who wish to avoid reputation risk. The policy has been pioneered in the apparel sector, which is the main exporting industry in Cambodia and the largest source of formal private sector employment.

The International Labour Organization (ILO), a specialized agency of the United Nations, conducts ongoing monitoring of conditions in the apparel factories.[1] The results are published in highly transparent reports that detail compliance or non-compliance by each factory with national labor laws and internationally agreed basic labor rights.[2] Until the end of 2004, these reports were used by the US government as a key input for decisions under an innovative scheme that allowed increased access to the US market in response to improved working conditions and labor practices. An important element of the experiment that was largely unanticipated but has proven critical to its ongoing success is the use of the ILO reports by private retail apparel firms that buy from Cambodian producers. These buyers, conscious of their brand reputations, use the reports to determine whether their supplier firms comply with labor standards, to encourage remediation of problems, and to shift orders if factories repeatedly fail to improve.

The project combines roles for national governments, international organizations, firms at the global and local level and trade unions in previously untried ways. The experiment warrants attention by policy makers elsewhere for two reasons. First, it introduces novel policy tools that can help developing countries insert themselves into the global production system and create needed employment without sacrificing decent wages and treatment for workers. These new policy tools now have a record of effectiveness that

* Originally presented at the conference "Decent Work, Social Policy and Development", sponsored by the International Institute for Labor Studies, Geneva, November 2006.

can be examined and replicated by others. Second, the project relies primarily on private sector forces, while utilizing limited but essential public interventions to correct for market failures. The resulting system changes the incentives facing private actors, effectively aligning their interests more closely with public objectives.

As policy makers search for effective ways to harness global production systems for local development and employment objectives, the Cambodian experiment offers new and successful methods that can be replicated elsewhere. It also provides important analytical insights about the underlying mechanisms that determined the project's success.

Genesis of the Project

Cambodia is one of the least developed countries in the world. It entered the modern global economy late, partly because of civil strife from the 1960's through the 1980's. As the country stabilized in the 1990's, it sought to make up for lost time in its economic development. One important strategy aimed to transform a handful of state-owned textile and apparel factories into an export industry, to attract new foreign direct investment into the apparel sector, to earn foreign exchange and to create jobs for the underemployed Cambodian workforce. The apparel industry requires relatively low levels of investment and limited skills on the part of workers. It is typically the first step in the process of industrialization and Cambodia was eager to take it.

The global apparel trading system was governed for 40 years by a system that allowed countries to set quota limits on the textile and apparel exports from any one country that could enter their markets.[3] The quota system was codified in the Agreement on Textiles and Clothing of the World Trade Organization (WTO), in force until January 2005.[4] Because Cambodia was a latecomer to the apparel industry, it was not party to that system and therefore had no quotas. It was free to sell into the large, affluent markets of the US and EU, for example, but at the same time those countries were free to limit or cut off access at will in the absence of negotiated agreements. Notwithstanding that risk, willing investors from Hong Kong, Taiwan, China, South Korea and other countries bought, leased or built apparel factories in Cambodia. Buyers from the US and Europe also arrived, in part to circumvent the export limits they faced when purchasing from other countries under the global quota system.

The infant apparel industry grew rapidly. From virtually no apparel exports in 1994, exports had grown to almost half a billion dollars in value by 1998.[5] The share going to the US increased rapidly, to the point that in 1998 the domestic US textile and apparel industries called for import restraints. The US government concurred and initiated negotiations with Cambodia to bring it under the quota system.

Meanwhile in Cambodia, the growing workforce in the apparel factories became increasingly discontent with conditions. The workers turned for help to labor unions, many affiliated with political parties. Demonstrations and strikes became increasingly common. In June of 1998, supportive labor groups in the US petitioned the US government to review claimed abuses of workers' rights in Cambodia's apparel factories.

These converging issues formed the backdrop for the quota negotiations. They came at a time when the US government was increasingly interested in linking trade privileges with support for labor rights.[6] US and Cambodian negotiators worked out a three-year apparel trade agreement for the period 1999-2001 that established quota limits on the twelve largest categories of apparel exports. However, in a unique step, they agreed that if the Cambodian government were able to ensure substantial compliance by the apparel factories with national labor laws and internationally agreed labor rights, the new quotas would be increased on an annual basis.[7] The parties agreed to consult twice each year during the three-year agreement to identify the key challenges involved in meeting that overall goal. These consultations established practical goals for each semiannual period, which were used as benchmarks to determine whether to grant the quota increase for the subsequent year.

Both parties recognized that a reliable source of information on the actual practices and conditions in the factories would be needed for the quota determination. The capacity of the Cambodian government to inspect private firms and enforce national labor laws was extremely weak. It was tacitly acknowledged that reporting by government inspectors was not credible as a basis for the quota decisions. Alternatively, private for-profit and not-for-profit monitoring groups existed, but none were deemed to have the credibility to provide the basis for significant government decisions that would have broad economic impacts. To fill the gap, the two countries turned to the ILO, an arm of the United Nations system with responsibility for setting international labor standards and supervising compliance. The ILO operated a supervisory system that was oriented toward reviewing the conduct of governments, both through periodic examinations of their compliance with ratified labor conventions and in response to complaints raised by trade unions and others.[8] The organization had never monitored the private sector and had never engaged in on-the-ground inspection of workplaces. The request from the US and Cambodia to take up a new role evoked a cautious response from the Director General of the organization, Juan Somavia, and provoked debate within the ILO bureaucracy and governing body.[9] After a deliberative process, Somavia decided that the ILO should support a project that was seen to have value by the member states involved and that had the backing of both employers and trade unions in the target country.[10]

Key Mechanisms in the Strategy

Two of the main mechanisms on which the original project was based have been identified: the creation of a trade agreement that provided positive market access incentives as a reward for improved labor conditions; and the inauguration of a new role in private sector by an international agency.

Linking Trade and Labor Rights

The idea of linking trade privileges to labor standards had been discussed since at least the early twentieth century, but the first practical applications date from the mid-1980s.[11] The first such instruments to be created arose under the multilateral trading system, which from the early 1970s allowed countries to extend special trade preferences to developing countries for the purpose of aiding their development. Wealthy nations may extend lower tariffs or other market access privileges unilaterally to such countries without violating international trade rules under the WTO that forbid discrimination among trading partners. In 1983, the US made such additional trade privileges conditional on respect for labor rights by the developing country recipients.[12] In 1993, the US also linked labor provisions to a negotiated free trade agreement, in the form of a side agreement to the North American Free Trade Agreement (NAFTA).[13] This pact included commitments by the trading partners to enforce their own labor laws, with the possibility of being fined or losing some of the trade benefits created by the pact if they failed to carry out that commitment.

Both types of instruments linked trade and labor rights through what can be viewed as a negative incentive. Countries were granted trade privileges, but the benefits could later be withdrawn for failure to comply with labor obligations.[14] The US-Cambodia Textile Agreement, by contrast, created a positive incentive. Against a baseline level of access to the US market, additional quota would be granted annually for progress on labor rights in the previous period. The incentive was positive in that nothing would be lost but something could be gained through improvement of labor conditions. The arrangement had the potential to elicit ongoing improvements in performance in order to qualify for a greater quota bonus in the subsequent year. The effectiveness of the reward was enhanced by the close temporal connection between the behavior of firms and government in one year and the rewards that would flow from good behavior during the following year. Significantly, both government and private firms faced the same incentive to improve labor conditions.

Based on the sector's performance, the US government decided to award a 9% increase in quotas during 2000 and again in 2001.[15] The parties were pleased with their experiment and agreed to extend the trade pact for three additional years, from 2002 through 2004. Quota bonuses of 9%, 12% and 18% were awarded for those years.

Monitoring of the Private Sector by the ILO

The second innovation mechanism in the Cambodian experiment is the novel role for the ILO. To make the quota decisions, the US needed credible and timely information on actual labor conditions in Cambodian apparel factories. The Cambodian government was not an effective source of such information. As noted above, Cambodia had been engaged in civil strife or outright war for much of the last 30 years, and is still struggling to establish full rule of law. The state is generally weak and faces severe resource constraints. Civil servants, including labor inspectors, are woefully underpaid. As a result, it is difficult to attract and hold competent inspectors. The average wage of a civil servant is the equivalent of US$28 per month.[16] By contrast, the minimum wage in the apparel industry in Cambodia is $50 per month, and the average monthly wage in the sector is about $72.[17] By any account, the pay of government inspectors does not provide an acceptable minimum standard of living, and therefore second and third jobs that compete for inspectors' time are the norm, not the exception. Taking bribes from employers is also common. Under these circumstances, the role of the national public authorities in inspecting workplaces and ensuring compliance with labor laws was a goal to be pursued over the medium term. It was not a reliable source of information for the immediate purposes of the textile agreement. At the same time, a growing apparel sector that created jobs and profits was part of the solution to the problem of government capacity, as it would increase the tax base and resources for essential government functions. So while building public capacity to enforce laws was desirable, a short-term solution was needed to fill the information gap.

It was theoretically possible to engage private actors to monitor the worksites. Over the course of the 1990's, the creation of corporate codes of conduct and the need to monitor their implementation created a body of experience among an array of private actors. They ranged from for-profit accounting organizations such as KPMG and PricewaterhouseCoopers (PWC) and specialized for-profit auditing groups like Intertek Testing Service, to non-profit social auditing groups such as Verité and non-profit multi-stakeholder groups like the Ethical Trading Initiative, Fair Labor Association and Social Accountability International. However none of these groups had established credibility at an international level and among the diverse groups affected by the textile agreement, including employers, investors, buyers, labor unions, consumers and governments. The entire field of social auditing is still at an experimental stage with no clear leader or widely accepted methodology.

In the absence of either national public capacity or satisfactory international private capacity, the two governments faced the necessity of finding an agent to supply a missing function: provision of internationally credible workplace inspection and information to market participants. Although the ILO lacked specific experience in factory monitoring, it possessed an established record of neutrality and expertise and was acceptable to all concerned parties. The ILO was established by the Treaty of Versailles in 1919 and was the oldest agency in what would become the UN system. Over the years, it had gained extensive experience in evaluating labor rights in countries at all levels of development. As global economic integration accelerated in the 1990's, labor markets became increasingly integrated as well, causing greater competition among workers of different nations and greater scrutiny of labor conditions in distant workplaces. Rich country governments felt increasing pressure from constituents to maintain labor conditions at home while improving standards abroad. It was natural that government policy makers grappling for means to address the new challenges would turn to the ILO to play new roles. For most of the 1990's, however, the new roles envisioned were in the public sphere, and entailed functions such as technical assistance and capacity building for ministries of labor in the developing world. The unprecedented US-Cambodia agreement, with its requirement for reliable, timely and credible information about actual factory conditions, pushed the ILO to move beyond its traditional public sphere. Arguably, this foray into the private domain may prove to be a critical element of continued relevance for the ILO, as global production chains increasingly elude the effective control of national labor ministries and labor inspectorates.

How the Mechanisms Work

The experiment was put in place through two formal agreements: the textile agreement that began January 1, 1999 and an agreement between the ILO, the Cambodian government and Cambodian garment manufacturers to launch the monitoring initiative, signed on May 4, 2000.[18] The two agreements operated independently, but in complementary ways. The potential quota bonus created an incentive for the Cambodian government and the factory owners to improve labor conditions in order to obtain economically valuable increases in access to the US market; and the ILO monitoring program provided critical information for the bonus decisions. However there were shortcomings in the basic arrangement launched by the two agreements that might have greatly limited its effectiveness. A key shortcoming was that the ILO monitoring program, as created, provided for voluntary participation by factories. By contrast, the quota bonus was awarded to the country as a whole, based on overall performance. The voluntary nature of participation meant that information would be incomplete, and perhaps unrepresentative, to the extent that factories chose not to participate. Further, it created a perverse incentive for firms to stay out of the monitoring program, because those factories that did participate would bear the burden of improvement while non-participating firms could share the increased bonus without the increased costs of better labor practices (a "free-rider" problem, in economic terms). The government of Cambodia recognized these distortions quickly, as they began to emerge. It stepped in to remedy the shortcoming in the original plan design by issuing a regulation (the Cambodian term is *prakas*) that limited the availability of export quota to the US to those firms participating in the monitoring program.[19] This resulted in full participation and allowed the ILO monitors to generate information on the entire sector. The Cambodian government's innovative action demonstrates that even a relatively weak and resource-constrained government can find ways to leverage its power by creative use of those instruments that it does control, such as export licensing and issuance of quotas.

A second potential shortcoming was that the ILO monitoring program required reports on conditions in factories, but left unclear whether the information would be provided in aggregate form or would identify conditions in individual factories, by name. As the monitoring program began, this issue remained unsettled. After discussions with the multiple stakeholders, the ILO decided to issue reports that aggregated results in the first instance. These "synthesis reports" would give a profile of problems in the sector without naming individual firms. However, after a period of time was allowed for remediation of any problems found, the ILO monitors would re-inspect each factory for compliance. Factories that had not remedied violations of national labor laws or international labor rights found on the first visit would be identified by name in a subsequent report, with details of each area of non-compliance. This decision established a level of transparency regarding factory conditions that was significantly higher than that provided by any private monitoring programs that currently exist.

These two seemingly small public interventions, one by the Cambodian government to make participation in monitoring a requirement for receiving export privileges, and the other by the ILO to provide full transparency of monitoring results, together created a situation that was unprecedented in the realm of private sector compliance with labor norms. Once the monitoring and reporting system became fully functional, the two interventions resulted in the provision of extensive, specific information to all actors regarding labor conditions and legal compliance in the entire Cambodian apparel sector. This transparency changed the incentives facing private actors, including both the factories producing garments and the international firms that bought their products. The latter now knew the full range of labor conditions in their existing supplier firms and all other garment firms in the country.[20] Under conditions of transparency, the factory owners now had multiple incentives to come into compliance with labor laws and improve working conditions. They stood to gain increased market access to the US through the quota bonus system. They faced peer pressure from other firms, whose own quota bonus would be at risk if other factories failed to comply. Perhaps most importantly, international buyers who were concerned about working conditions and/or their brand reputations now were able to choose between supplier factories on the basis of good information about their labor practices.

Good information is a prerequisite for any well functioning market.[21] The Cambodia experiment marks the first time that credible information about labor conditions in a developing country's workplaces has been widely accessible to both public and private actors at the local, national and international levels. The experiment provides an unprecedented opportunity to witness the effect on market participants' behavior. As noted above, the first effect was to align the incentives facing private firms with Cambodia's twin public objectives of winning more market access to the US while improving labor conditions. A second effect, operating purely between private actors, was the shifting of orders to compliant firms. While the public incentive of quota increases was the more readily apparent, the private incentive for firms to improve their labor standards to attract reputation conscious buyers was very significant as well, perhaps dominant in some cases.[22] This can be seen by examining the evolution of apparel exports over the period of the experiment. From 1999 through 2002, apparel exports from Cambodia to the US of items that were covered by quota limits increased by 44.8%, from a value of US$433 million in 1999 to US$627 million in 2002. Over the same period, exports of garments that were not covered by the quotas increased by 302%, albeit from a smaller base of US$83 million in 1999 to US$334 million in 2002.[23] This pattern indicates that buyers were attracted to place orders with factories that were compliant with labor norms even when they were making decisions on items that were not restricted by quota and thus would not benefit from the labor-based quota increases. Collectively, these buyer decisions shifted the composition of Cambodia's apparel exports. In 1999, only 19% of exports were of non-quota items, while by 2002, 53% of exports were not under quotas.

This experience led the Cambodian government and the country's apparel manufacturers to conclude that the value of good labor standards and transparency would survive the end of the quota system.[24] In 2003, they asked the ILO to continue the monitoring program for another three years, beyond the end of the Agreement on Textiles and Clothing. As the end of the quota system neared in 2004, the World Bank Group's Foreign Investment Advisory Service (FIAS) conducted surveys among apparel buyers. These surveys revealed that buyers rated Cambodia's labor standards higher than those of regional competitors, and that the buyers would continue to purchase garments from Cambodia if credible monitoring by the ILO were to continue.[25] After quotas ended on January 1, 2005, the Cambodian government and the ILO developed a long-term plan to continue the monitoring program and eventually turn its operation over to an autonomous Cambodian monitoring organization. The current plan is to have a robust local organization that can maintain credibility with international actors in place by January 2009. The ILO will continue to supervise the monitoring project during a transition period through 2008, while building the capacity of a new Cambodian monitoring agency to assume responsibility thereafter. The project has been renamed "Better Factories Cambodia" and expanded to include training for factory managers on how to achieve and maintain good labor standards. The results of ILO monitoring are now reported through a sophisticated internet-based system that allows closer tracking of violations and improvements.[26] The Cambodian government ensured that the project will continue to operate on an industry-wide basis after the quotas expired by making continued participation in monitoring a condition for receiving export licenses.[27]

The economic basis for this strategy can be understood as a risk mitigation or insurance function. The ILO monitoring and reporting system provides a form of reputation risk insurance to global apparel retailers who source their goods in Cambodia. While labor conditions are still far from perfect in the country's apparel factories, as discussed below, ILO inspections reveal any serious abuses, allowing buyers to insist on rapid remediation or shift orders to other factories with better practices. The detailed ILO factory monitoring reports that form the basis of the public reports discussed above are provided to the individual factories soon after the monitoring visit, to allow them to begin remediation. Many buyers now routinely require their suppliers to share those reports when they are received, rather than waiting for the periodic public reports issued by the ILO.[28]

Although most apparel buyers have their own internal codes of conduct and undertake factory compliance inspections themselves or contract with for-profit or non-profit monitoring agencies to do so, none of these efforts have the high credibility of the ILO system. Purely self-regulatory schemes may assure buyers that their suppliers are not violating laws or codes of conduct, but they have little credibility with the public and other interested actors. The skepticism of these outside actors is founded on the potential conflict of interest between the firm's incentive to cut costs and its desire to avoid reputation risk. This perceived conflict of interest is compounded by the lack of transparency of private sector self-monitoring efforts, creating a potentially large credibility gap. A respected third party such as the ILO, whose governance structure includes governments, trade unions and employer organizations, has interests in the monitoring process that broadly correspond to the combined interests of the workers, firms and governments involved in the monitoring scheme. The high level of transparency that the ILO adopted in its reporting further enhances the credibility of results, because the specificity of the reports allows for challenges by any actors that hold information to the contrary. This operates as a reality check and reinforcement of the credibility of the ILO. It is hard to imagine a purely self-regulatory scheme that could achieve this level of credibility.

Impact on Employment

The impact of the quota bonus and monitoring experiment has been positive for employment and working conditions in Cambodia's apparel sector by many measures.[29] At the most basic level, the increases in quota and the decisions by reputation-conscious buyers to source their products from Cambodian factories have been key drivers of a very large increase in output and employment in the sector. In 1998, before the textile agreement took effect, apparel factories employed about 80,000 workers. By late 2006, apparel employment stood at 325,000.[30] These jobs make up a major share of scarce formal sector employment and are among the highest paid jobs in the country for low skilled workers. The overwhelming majority of employees in the sector are young women, aged 18 to 25, from rural households. To put the desirability of these jobs in context, the minimum monthly wage in the sector (US$50) is greater than the entire average monthly household income in rural areas (US$40).[31] Average monthly apparel wages are about US$72, and many workers earn more through production incentives and overtime. Remittances by workers to their families in the countryside have been credited with living many rural households out of poverty. According to an Asian Development Bank survey, 90 percent of those surveyed regularly send a major portion of their monthly income home to ensure that their families have enough food to eat and are able to send younger siblings to school rather than putting them to work.[32]

Another measure of the impact of the experiment can be found in the ILO monitoring reports. Sixteen reports had been issued by mid-2006.[33] Each report covers a group of factories that were visited by the ILO monitors. After the first visit, the details of compliance or non-compliance with national labor laws and international labor standards are reported, in an aggregated form, for that group of factories. The ILO then allows those factories a period of several months for remediation of any problems found, while it visits a different group of factories. Later, it revisits each group, noting which recommendations (called "suggestions" in the ILO reports) have been acted upon and which have not been remedied. In a subsequent report, the ILO publishes these findings, identifying each factory by name and noting whether it has complied with the suggestions or not.

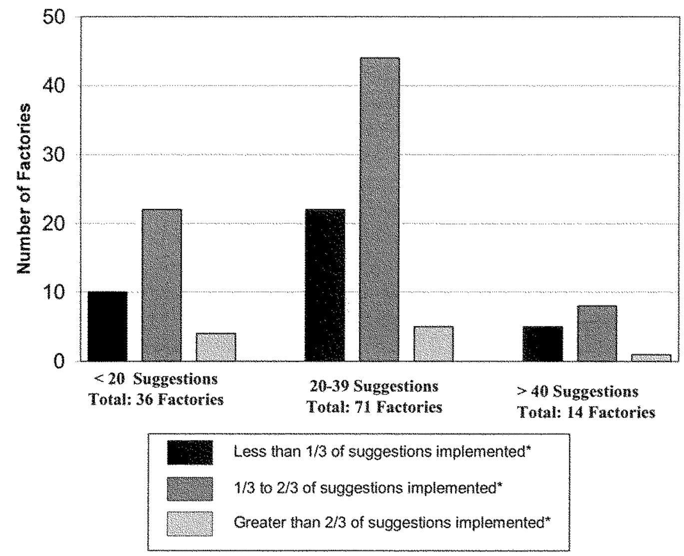
The reports show that on their first visit, ILO monitors typically found a mixed pattern of compliance and non-compliance by factories.[34] Compliance was good in two key areas of basic labor rights: there was little or no child labor and no forced labor. Gender discrimination was not a widespread problem in hiring or wages, however discrimination on the basis of pregnancy was fairly common and isolated instances of sexual harassment were found. Widespread problems were found in incorrect payment of wages and excessive hours or forced overtime. Violations of health and safety laws were common, including both minor and more serious infractions. Problems with freedom of association—the right to form unions and bargain collectively—were found in a relatively small number of factories, although the violations found were sometimes very serious.

The pattern of initial findings was in itself somewhat encouraging. Before the advent of the ILO monitoring project, a British Broadcasting Corporation (BBC) program had interviewed two ostensibly underage workers in a factory that supplied apparel products to Nike. While many knowledgeable observers questioned the accuracy of the program, Nike ended its contracts with the factory and left Cambodia. After the ILO began its monitoring program and issued its first report, Nike returned to place orders in Cambodia and continues to do so. This demonstrates the value of the ILO's credibility to global firms. Although Nike had internal monitoring mechanisms in place before the BBC report, the company knew that its own internal findings would not be sufficiently credible to counter the damaging report. The ILO's findings, by contrast, command global respect.

The ILO monitors made detailed suggestions to each factory to correct the deficiencies that were identified. Factories were subsequently re-inspected. At the first re-inspection, monitors found that some progress had been made by the majority of factories in correcting the problems identified. Sixty-one per cent had implemented between one-third and two-thirds of the ILO's suggested corrections, while an additional 8% of factories had implemented more than two-thirds of the recommendations. A small group of factories came into full compliance with the ILO recommendations. Due to the sheer volume of practices reviewed by the monitors (there are 156 items are on the checklist they use) and the number of suggestions for improvement, it can be difficult to see the patterns in the ILO reports. Figure 1 is an attempt to quantify the results, through a schematic that groups the responsiveness of factories to ILO recommendations. The factories are sorted into four categories: those with relatively few deficiencies on the first inspection (fewer than 20 of the 156 items required improvement), those with 20-39 deficiencies, and those with 40 or more deficiencies. For each group, the figure presents the percentage of problems that were corrected between the first and second visits (less than one-third, one-third to two-thirds, or greater than two-thirds of suggestions implemented).

Figure 1

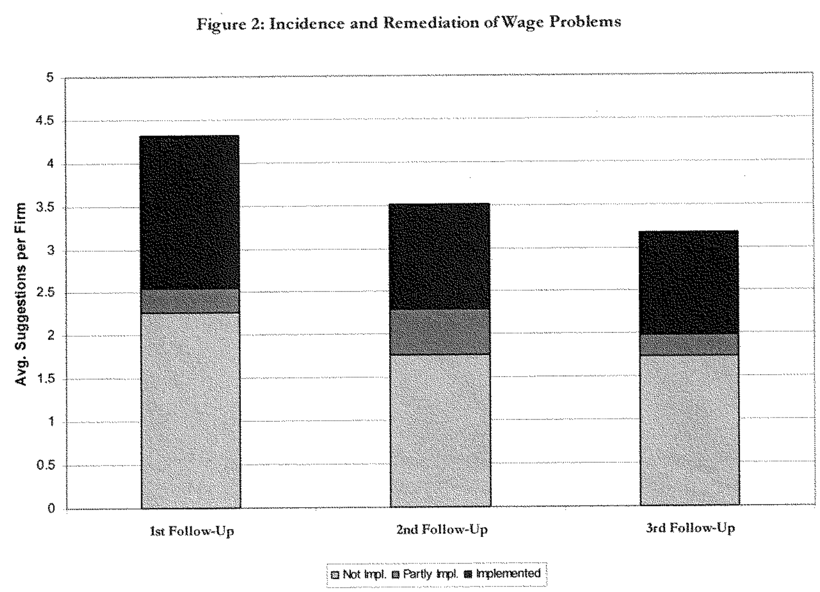
Figure 1: Reinspected Factories: Response to ILO Suggestions



* Includes suggestions partly implemented and in the process of being implemented.
Source: Tabulations of ILO Third, Fifth, and Eighth Synthesis Reports on the Working Conditions Situation in Cambodia's Garment Sector

As factories have been revisited in ensuing years, there has been a general declining trend in the number of problems found. In some important areas, such as wages, compliance with laws on minimum wage and other payments has improved considerably. Figure 2 summarizes re-inspection results for wages. In the factories that had been inspected through October 2005, the number of violations found on each follow up visit declined.

Figure 2



Source: Tabulation of ILO First through Fifteenth Synthesis Reports on the Working Conditions Situation in Cambodia's Garment Sector by Kristopher Nordstrom, Terry Sanford Institute of Public Policy, Duke University, April 2006.

In addition to improved compliance with wage laws, the ILO reports show progress over time on freedom of association and collective bargaining. Other measures tend to confirm this. For example, while there were few examples of unions successfully establishing themselves in apparel factories before the US-Cambodia textile agreement and the ILO monitoring program began, by 2004 there were about 500 registered factory level unions.[35] The ILO estimates that 40 to 50 percent of the 325,000 garment sector workforce belongs to unions.[36] The monitoring reports also document some progress in health and safety, although few firms were in full compliance with the law and ILO suggestions.

The ILO reports continue to provide a source of useful and reliable information about conditions in the factories and progress on remediation of problems. Although many problems remain, it is remarkable that so many factories have made rapid changes and corrections to practices that routinely confront apparel workers in many developing countries.

The Cambodia experiment also gave rise to progress in the factories through channels other than the ILO monitoring program. Significant benefits arose from collaboration between the Cambodian and US governments to fill gaps in Cambodia's regulatory regime that had hindered the implementation of labor laws. The Cambodian labor law, which was drafted with the assistance of the ILO and adopted in 1997, is a modern law incorporating all of the basic international norms. However the law left many institutional and procedural lacunae that were meant to be filled in through regulations, known in Khmer as *prakas*. Few of these regulations had been enacted and the resulting procedural gaps included such basic matters as the method for a union to establish its status as the legitimate representative of workers in a factory and thus gain the legal right to engage in collective bargaining with the employer. Another missing regulation involved the creation of an arbitration council, which was foreseen in the law as a venue to resolve workplace disputes without the need for strikes or lockouts by private sector actors or for intervention by government inspectors and courts.

These gaps came to be a major focus of the semiannual meetings between the Cambodian and US governments. Progress on drafting and issuing the most critical *prakas* sometimes was used as a benchmark by the US in judging whether to award a quota bonus.[37] In drafting the procedural regulations, the US assisted the Cambodian government when invited to do so, and further help was sought from the ILO. Draft *prakas* were reviewed with employers' organizations and trade unions for further modification before being enacted. Gradually, procedures were put in place that allowed for orderly determination of worker, union and employer rights and obligations.[38] The arbitration council *prakas* was issued and the body was established with further assistance from the ILO. The arbitration council is now functioning and commands wide respect from employers, trade unions and workers in the private sector. Two hundred and seventy-five cases had been filed with the council between its establishment in 2003 and mid-2006.[39] A digest published by the council after its first year of existence showed that 85% of the disputes had been resolved, either through awards or agreement.[40] Large numbers of workers and managers have now had the experience of peaceful settlement of disputes based on neutral interpretation of laws and contracts, as well as the more intangible but significant experience of participation in a rules based system that serves their interests. Thus, the labor consultations mandated by the textile agreement provided an impetus and contributed to the articulation of institutions that extended the rule of law and dispute settlement in Cambodia. These mechanisms are likely to have positive spillover effects on the broader political system. Lessons from other developing countries suggest that nations that create institutions to successfully resolve distributional conflicts enjoy stronger and steadier growth than those that do not.[41]

Benefits and Costs

Many of the benefits of the quota bonus and monitoring experiment are direct, quantifiable and substantial. The quota bonus itself constituted a clear benefit to the Cambodian government, apparel firms and workers. For example, in 2002, the value of the quota bonus was US$56.4 million (calculated by multiplying the 9% quota bonus for that year times the share of exports under quota, valued at US$627 million).[42] By the same calculation, about 13,000 jobs were created by the increased exports that year, and workers earned total wages of US$9.5 million at those jobs. As the quota bonus grew to 12% in 2003 and 18% in 2004, the value to all parties increased dramatically. The earnings of apparel firms and workers also translated into increased tax revenue for the government. Beyond the quantifiable contribution of the quota bonuses, the risk mitigation that the good labor practices and monitoring offered to buyers led to their increased sourcing from Cambodia. Although it is impossible to calculate a precise level of orders attributable to the risk mitigation effect, the earlier discussion of growth in non-quota exports suggests that this effect was even larger than the quota increases, with attendant contributions to exports, employment, wages and taxes.

The ILO monitoring program has led to benefits for Cambodian apparel workers beyond the creation of jobs. They are now more likely to be paid the wages to which they are entitled under law, to receive appropriate overtime pay and bonuses, to work in safer and healthier workplaces that pose less risk to their well-being and to enjoy freedom of association, which in turn gives them the wherewithal to further improve wages, benefits and treatment through their collective bargaining strength.[43]

The costs of the program have been surprisingly modest. The initial three-year monitoring project was funded at US$1.4 million. The US and Cambodia governments contributed US$1 million and US$200,000, respectively, and the Garment Manufacturers Association of Cambodia contributed US$200,000. Spread over three years, with an average of 200,000 workers in the sector, the annual cost per worker was US$2.33 and the annual cost per factory was US$2,333. These costs compare very favorably to private monitoring schemes in the region, where the cost of factory inspections and certification that the factory conforms to a buyer's code of conduct can range as high as $10,000.[44] The current cost of the monitoring project, after additional features were added to assist factory managers and workers, is less than US$3 per year for each worker, or US$2800 for each factory.[45]

The program has been cost effective primarily because of personnel costs. The project director and assistant director are hired by the ILO at competitive international salaries, reflecting the substantial experience and expertise required by the positions. However the monitors are hired locally in Cambodia, at salaries that are attractive by Cambodian standards, but very economical by international standards. The director trains the local monitors and exercises oversight to ensure that the monitoring meets international norms. The local monitors (there are currently about twenty) are carefully selected and generally have been praised by all parties.[46] Because the monitors are paid at levels that are attractive in Cambodia, they are less vulnerable to the temptation to corruption faced by low-paid government labor inspectors. (In addition, all inspections are carried out by teams of two and the teams visiting particular factories are rotated to minimize the risk of bribes.) The structure of salaries in the project makes it possible to carry out activities at a level of competence that commands international credibility while paying most salaries at the local level. One reason for the high costs of many private monitoring programs is that auditors are typically paid at international salary or consultant levels and are often flown in for inspections from distant locations with attendant travel, housing and per diem costs.

The cost-effectiveness of the local hires is further enhanced by their equally important non-monetary contributions. The local hires speak Khmer and thus are able to communicate with both workers and employers. As local residents, they are well positioned to meet with workers and unions away from the work place if necessary. By contrast, private auditors who are not locally based may have difficulty communicating with workers and may not inspire their confidence, particularly if the only contact is in the workplace where workers may feel intimidated by their employers. A final benefit of this approach is that the locally hired monitors acquire important technical, process and conflict management skills that add to the store of the society's human capital.

The distribution of costs of the Cambodia program was less than optimal until recently in one respect. International buyers, who gained substantial economic benefit from the project, did not contribute directly to its costs. In effect, the project provided reputation insurance for the buyers without requiring that they pay a premium. That deficiency has now been addressed, to some extent, as major international buyers have begun to contribute modest sums to sustain the project.

Prospects for the future

As already noted, the Cambodian government and apparel factory owners decided that there is an international market for good labor standards that are verified through credible, transparent monitoring. They have decided to continue the strategy indefinitely, despite the end of the quota system.[47] Financial support for the project has broadened considerably in recent years, as international development agencies witnessed the complementary gains in economic development, employment creation and poverty alleviation that Cambodia was able to achieve through this innovative approach. Funding continues to be provided by the Cambodian government and Cambodian garment industry, with small amounts contributed by the Cambodian trade unions. Now major additional funding is also provided by the World Bank, the Agence Française de Developpement (AFD), the Asian Development Bank (ADB), and New Zealand's International Aid and Development Agency (NZAID). As mentioned above, the major international buyers of Cambodian garments also began to contribute to the costs of the program from 2005.[48]

The transition in 2009 to a structure and program that does not involve the ILO will test the possibility of transferring the ILO's credibility to another organization. There is reason for optimism. From the beginning, the actual monitors have been Cambodian nationals, trained and supervised by ILO managers. They have now gained several years of experience. Local trade unions and NGOs can be expected to demand continued transparency and accuracy in the factory reports going forward. The government, the firms in the apparel sector and their international buyers will want the program to maintain its global credibility, since this provides the key advantage enjoyed by the Cambodian industry in an increasingly competitive international environment.

Lessons and Conclusions

The Cambodian policy experiment can be judged as a success measured against its own objectives: to increase apparel exports, thereby improving economic growth, and to improve working conditions and worker rights in the country. The indicators of success in meeting these goals have been cited. A largely unanticipated benefit was the importance of the reputational advantage that international apparel buyers found under this regime. In fact, the policy continues beyond the temporal framework in which it was originally conceived, namely the apparel quota system that ended in 2005, primarily because of this benefit. The project also generated unanticipated spillover benefits to the wider society, as it fostered dialogue between employers, workers and government and created a neutral, credible dispute settlement mechanism that provided a rapid alternative to a court system plagued by weaknesses typical of low-income countries. The experience of participation and inclusion by groups such as workers, who had been largely excluded from decision making processes of the government and private firms, creates a precedent and expectation of wider democratic participation.

New policy ideas and their successful deployment are relatively rare in the international system. When such successes occur, it is useful to search for lessons that can be learned at the analytical level and to inform policy making elsewhere. Five distinct characteristics of the innovative Cambodian policy were essential to its success.

<u>1. Positive incentives</u>

An important innovation in Cambodia was the manner in which trade privileges were linked with improved labor rights. Labor provisions had been included in other trade agreements and trade preference programs by the US and some other governments, but those provisions operated as negative incentives.[49] In those arrangements, trade privileges were granted to the trading partner with the condition that they could later be revoked if governments failed to improve existing problems, if labor conditions deteriorated or if new violations were discovered. In negotiating terms, the privileges were "front-loaded".

By contrast, the textile agreement with Cambodia created a positive incentive that operated prospectively. The additional market access (quota) was not granted until the Cambodian employers and government met pre-established benchmarks of progress on labor conditions, resolved specific problems and upgraded legal instruments. The improvements had to be demonstrated first, and then the commercial reward followed. The difference in impact of positive and negative incentives can be substantial. Looked at from the perspective of the recipient country, a positive incentive system requires real changes in behavior in order to access the desired market reward. Under a negative incentive system, continuing improvement in labor standards may be less likely once the desired market access has been granted. The deterrent effect of a general and vague conditionality may be discounted by the recipient. From the perspective of the granting country, it may be politically unappealing to employ a negative incentive, because revoking privileges already granted can disrupt ongoing economic activities. Partly as a consequence of these considerations, negative incentives are typically employed only in cases of egregious abuse of labor rights. This can limit the efficacy of such systems to achieve incremental, sustained progress on labor rights and conditions.

In this case innovation went beyond the substitution of positive for negative incentives. The positive incentives were structured in a way that required progress in each annual period to gain a quota increase for the following year. The repetitive nature of the exercise elicited more progress than a one-time qualifying period could achieve. It allowed modest, feasible steps to be taken and rewarded rapidly, as part of the repeated annual exercise. This aspect of the policy design is particularly important, because many of the labor problems encountered in developing countries are difficult to solve in one stroke.

The precise incentive granted at the outset of the Cambodia experiment is not available because the quota system has ended. However many restrictions on developing countries' exports still exist in markets abroad and policy makers could find many other opportunities to link prospective trade benefits to progress on labor rights and other desirable developmental objectives. For example, bilateral free trade agreements, which typically phase out tariffs over a period of many years, could accelerate those tariff reductions, or offer tariff benefits beyond the basic reductions if agreed benchmarks were met on labor standards.

2. Goal setting

The semiannual consultations between the two governments proved to be an important mechanism for harnessing the positive incentives to practical goals. Benchmarks were set that could be achieved in a six to twelve month period. The goals ranged from major structural changes, such as the issuance of necessary regulations and creation of institutions to the remediation of specific, egregious problems in particular factories. Once the ILO monitoring reports became available, an overall goal in each period was the demonstration of effort and steady progress by factories in remedying any identified problems.

The short-term goals were agreed in consultations between the two governments, and included apparel factory managers and workers' organizations. The involvement of all relevant Cambodian actors in the discussions meant that the resulting goals were widely known. The specificity of goals meant that all actors understood what was expected. The challenge faced by the parties was to identify goals that were sufficiently ambitious to contribute to significant and sustained progress in labor rights, while recognizing the constraints on the Cambodian actors.

Policy makers seeking to replicate this approach should include a frequent consultative process that sets objectives and takes stock of progress. It would be desirable to include all affected actors in the consultations.

3. Role of an international intergovernmental organization

As noted above, the Cambodia monitoring program marked the first time the ILO had inspected factories or directly monitored private sector behavior. The organization proceeded in a careful, deliberative manner, which slowed the development of the program somewhat but allowed it to build consensus among relevant actors at each step. It gained experience through an iterative process of inspections and a problem solving approach to issues that arose. This careful process was an important factor in the success the monitoring program has enjoyed.

The experience has built a strong new capacity within the ILO that is highly relevant to the needs of its constituencies elsewhere. As countries struggle to balance economic growth with social equity, and to advance trade while promoting acceptable levels of labor standards, the ILO could be called upon to use its newly developed skills to monitor and provide credible information in a wide range of situations. Such an invitation could come from governments, and it is likely that the ILO would act only if the governments involved explicitly requested its participation. However the private sector could also initiate ideas and projects involving the ILO, and then solicit their governments to endorse or join the project.

The role of the ILO is illustrative of a function that could be assigned to other intergovernmental agencies that deal with different substantive matters. It is not difficult to imagine a role in monitoring and oversight of private sector actors, including those engaged in self-regulation. As an example, an effort known as the Kimberly Process, a scheme to stop trade in diamonds that fuel and finance civil wars in Africa, recently agreed that self-regulatory efforts by the diamond industry required more aggressive oversight by governments and greater transparency of information about traded diamonds.[50] This role could be played efficiently by intergovernmental organizations.

4. Transparency

One aspect of the Cambodia monitoring program that has been indispensable to its success is the high level of transparency that the ILO provided through its reports. As discussed above, this transparency allowed governments, firms, trade unions and other interested parties equal access to the information generated. The reports served a multiplicity of purposes in the hands of different actors and reinforced the common interests they shared. Any future monitoring role for the ILO or other intergovernmental agency should replicate at least this level of transparency.

The question arises whether private auditing groups could substitute for an intergovernmental organization to provide monitoring with a similar degree of transparency and credibility. Currently, no private sector group has attempted this level of transparency. Those groups that monitor labor conditions in factories abroad have been unwilling to identify the specific factories inspected and the findings, both positive and negative, in those factories. (Some multi-stakeholder monitoring groups, such as the Fair Labor Association, have improved their transparency in recent years, but reporting covers only a small percentage of factories or buyers.) Without specific information about a particular factory and its performance, outside actors are not in a position to act on the information. In addition, the credibility of reporting is undermined and a useful check on the accuracy is lost if workers or others who might possess conflicting information about a particular firm's behavior are not able to identify firms in the reports. The reputation risk to factories and buyers is not effectively mitigated by reports that lack adequate transparency and credibility. Unless private monitoring groups report with full transparency to all interested actors, it is unlikely that they could fill the role of providing sufficient information to improve the functioning of markets and generate the progress on overall performance that was achieved by the ILO in Cambodia.

5. Role of governments

The apparel industry in Cambodia was a major beneficiary of the policy experiment, but did not initiate it. The multiple firms in the sector faced a classic coordination problem in which all firms would be better off with increased market access in the form of quota and increased purchasing by international buyers. However individual firms did not want to lead the effort, without assured participation by all, to avoid bearing disproportionate costs of improving labor conditions. The role of the Cambodian and US governments in initiating the policy, and the role of the Cambodian government in requiring sector wide participation, were essential.

The Cambodian government had a strong self-interest in creating the policy and making it work. The self-interest encompassed economic, social and political objectives. In the economic realm, the gains to be achieved were increased exports, as a stimulus to overall economic growth, increased employment and increased fiscal revenues. The societal interest of the government was to improve the employment, incomes and working conditions of Cambodian workers. The apparel sector offers the best employment available to unskilled workers in Cambodia, and thus expanding the number of positions was a major goal of the government. The largely young, female workforce is mainly drawn from rural households. The women's remittances have a beneficial economic effect on those households and the countryside more broadly. At the political level, worker unrest was rising in the years after Cambodia achieved peace in 1991. In a polity where disputes had long been resolved through violence, the creation of a peaceful alternative to distributional disputes was a significant breakthrough.

Due to resource and capacity constraints, the government had very limited ability to achieve its goals through direct governmental interventions such as inspection, fines or judicial settlement of disputes. In this case, the government effectively leveraged the policy instruments it did possess, such as the ability to negotiate market access abroad and the granting of export licenses, to elicit greater compliance by firms. Even least developed countries such as Cambodia have instruments with which to achieve a more favorable insertion into the global economy by leveraging international norms and intergovernmental capacity to their own purposes.

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[1] The ILO is a specialized agency of the United Nations system.

[2] The member states of the ILO, currently 178 nations, have agreed that all workers have certain fundamental rights, regardless of the level of development of their country. These include the right to freedom of association and collective bargaining, freedom from forced labor, restrictions on employment of children and elimination of the worst forms of child labor, and freedom from discrimination in employment. *ILO Declaration on Fundamental Principles and Rights at Work,* Geneva, June 1998. Available at www.ilo.org.

[3] The quota system dates back to the 1960's and reflected the fact that these industries were important sources of exports, income and jobs in many countries, both rich and poor. To address concerns of domestic industries and workers in rich countries, while allowing poor countries to grow out of poverty, successive international agreements were negotiated over several decades that allocated shares of guaranteed access to rich country markets. As developing countries' capacity grew, they began to push for a phase-out of the system, and this was finally agreed in the negotiations that created the World Trade Organization in 1995. The quota system was phased out over ten years and completely eliminated on January 1, 2005.

[4] The Agreement on Textiles and Clothing succeeded the Multi-Fibre Arrangement or MFA in 1995.

[5] "Cambodia: Selected Issues and Statistical Appendix", IMF Country Report No. 03/59, International Monetary Fund, Washington, DC, March 2003, p. 9.

[6] Polaski, Sandra, "Protecting Labor Rights through Trade Agreements: An Analytical Guide", *Journal of International Law and Policy*, Vol. 10, No. 1 (Fall 2003), p. 14.

[7] US-Cambodia Bilateral Textile Agreement, available at: http://199.88.185.106/tcc/data/commerce_html/TCC_2/Cambodiatextilebilat.html.

[8] See ILO website, www.ilo.org.

[9] The ILO is governed by a unique structure that includes the governments of the 178 member countries (controlling half of the votes in decisions), employers' organizations (one quarter of votes) and labor unions (one quarter of votes).

[10] Conversation with the author, Geneva, Switzerland, January 19, 2000. See also Elliott, Kimberly Ann and Richard B. Freeman, Can Labor Standards Improve under Globalization? Washington, DC: Institute for International Economics, June 2003, p. 117.

[11] Polaski, op. cit., pp.13-15.

[12] Such programs are permitted under the Generalized System of Preferences (GSP) of the World Trade Organization. The European Union also created a similar link between respect for labor rights and market access under its GSP+ programs.

[13] The North American Agreement on Labor Cooperation (NAALC), agreed between Canada, Mexico and the US in August 1993. Available at www.naalc.org.

[14] Verma, Anil, "Global Labour Standards: Can we get from here to there?", Centre for Industrial Relations and Rotman School of Management University of Toronto, December 2002. Available at: http://www.fu-berlin.de/iira2003/papers/track_3/Workshop_3_4_Verma.pdf

[15] Elliott and Freeman, op. cit., pp. 117-118.

[16] IMF Country Report No. 03/59, op. cit., p. 27.

[17] ILO, Better Factories Cambodia, "Cambodian garment industry: one year later", May 31, 2006. Available at http://www.betterfactories.org .

[18] Because of delays in launching the monitoring project, decisions on the quota increases for 2000 and 2001 were made without the benefit of information from the ILO monitoring project.

[19] *Prakas* No. 108 MOC/M2001, Cambodian Ministry of Commerce, March 28, 2001.

[20] Interviews with factory managers and buyers, reported in Kolben, Kevin," Trade, Monitoring, and the ILO: Working to Improve Conditions in Cambodia's Garment Factories", *Yale Human Rights & Development Law Journal,* Vol.7 (2004), p. 105-106.

[21] The problem of imperfect information is a widely recognized impediment to well-functioning markets. See for example Joseph Stiglitz, "Information and the Change in the Paradigm in Economics", in *The Nobel Prizes 2001*, ed. Tore Frangsmyr (Stockholm: The Nobel Foundation, 2002), pp. 472-540.

[22] Kolben, op. cit., p. 106.

[23] IMF Country Report No. 03/59, op. cit., p. 9.

[24] Siphana, Sok, Secretary of State for Commerce, Royal Kingdom of Cambodia, speaking at the World Bank Group's International Conference on Public Policy for Corporate Social Responsibility, Country Session 1, October 8, 2003.

[25] World Bank, "Overseas buyers plan to continue purchasing Cambodian garments after 31 December", Press Release No. CMB2004/01, December 3, 2004.

[26] Agence France Presse, "Cambodia: UN labour body expands monitoring of Cambodia's garment factories", 11 February 2005.

[27] ILO, Better Factories Cambodia, "About Better Factories". Available at http://www.betterfactories.org.

[28] Kolben, op. cit. pp.105-106.

[29] For example, an extensive list of positive results is included in a speech by Lorne W. Craner, US Assistant Secretary of State, "Corporate Social Responsibility at the State Department", March 11, 2004. Available at: http://www.state.gov/g/drl/rls/rm/30962.htm

[30] ILO, Better Factories Cambodia, Quarterly Newsletter No. 6, October 2006, p.3. Available at http://www.betterfactories.org.

[31] IMF Country Report No. 03/59, op. cit., p. 13.

[32] Asian Development Bank, "Preventing Poverty and Empowering Female Garment Workers Affected by the International Trade Environment". Available at: http://www.adb.org/gender/country/cam005.asp.

[33] ILO Synthesis Reports on the Working Conditions Situation in Cambodia's Garment Sector. Available at: www.ilo.org/public/english/dialogue/ifpdial/publ/cambodia.htm.

[34] Ibid.

[35] Raghwan, Raghwan, "Uncomfortable but Taking Part—Cambodia's Unions and the PRSP", in ILO, ed. "Trade Unions and Poverty Reduction Strategies , special issue of *Labour Education,* Vol. 2004/1-2, No. 134-135, pp. 55-58. Available at http://www.ilo.org/public/english/dialogue/actrav/publ/134/index.htm.

[36] ILO, Better Factories Cambodia, Quarterly Newsletter No. 6, October 2006, p.3 . Available at http://www.betterfactories.org.

[37] Public meetings between the US and Cambodian governments, June 4, 2001 and November 30, 2001, in which the author chaired the US government delegation.

[38] For example, *Prakas* No. 305 established procedures to determine the representation status of unions. Issued by MOSALVY (Cambodian Ministry of Social Affairs, Labor, Vocational Training and Youth Rehabilitation), November 22, 2001.

[39] See Arbitration Council web site at http://www.arbitrationcouncil.org/eng_index.htm

[40] Ibid, see "Digest #2" of 2004.

[41] See for example Dani Rodrik, "Institutions for High-Quality Growth: What They Are and How to Acquire Them", *Studies in Comparative International Development,* Vol. 35, No. 3 (Fall 2000).

[42] IMF, IMF Country Report No. 03/59, p. 9.

[43] Elliott and Freeman, op. cit., p. 118.

[44] Nguyen Manh Cuong, Deputy Director, International Cooperation Department, Ministry of Labor, Invalids and Social Affairs, Government of Viet Nam, speaking at the World Bank Group's International Conference on Public Policy for Corporate Social Responsibility, Country Session 1, October 8, 2003.

[45] ILO, Better Factories Cambodia, "Funding". Available at http://www.betterfactories.org

[46] International Labor Organization and US Department of Labor, *Mid-term Evaluation Report* of the project, "Ensuring that Working Conditions in the Textile and Apparel Sector in Cambodia Comply with Internationally-recognized Core Labour Standards and the Cambodian Labour Law", Phnom Penh, February 2003.

[47] Financial Times, "Cambodia favoured in Asian labour survey", 3 December 2004.

[48] ILO, Better Factories Cambodia, "Funding". Available at http://www.betterfactories.org

[49] Polaski, op. cit., pp. 21-22.

[50] Financial Times, "Conflict diamond curbs agreed", November 10, 2006

"The Fight against Global Poverty and Inequality: The World Bank's Approach to Core Labor Standards and Employment Creation"

Wednesday, October 3, 2007

CHAIRMAN'S NOTE:

The Committee learned that that prior to the testimony of Dr. Ngozi Okonjo-Iweala -- who had been invited to testify as a witness by the Republican minority of the committee -- she had already agreed to join the World Bank as a managing director with responsibility for Africa, South Asia, Europe and Central Asia. I believe her pending appointment to the senior management team of the World Bank should have been made known to the Committee.

Additional Question from Chairman Frank to Peter Bakvis, Director of the Washington Office of the International Trade Union Confederation/Global Unions:

Chairman Frank to Mr. Peter Bakvis:

In her testimony and in response to questions during the hearing, Dr. Ngozi Okonjo-Iweala claimed that the "Doing Business" report is not used by the World Bank or IMF to pressure countries to dismantle or diminish labor standards. Specifically pointing to her experience with the Bank when she was the minister of finance in Nigeria, Dr. Okonjo-Iweala said that the "Doing Business" Report was not used by the Bank as the basis for loan conditionality or as a reference point for other kinds of mandates. She further claimed on general terms that the idea that the World Bank or the IMF can load up conditionality on the back of a loan is a dated one, which no longer applies in the current operations of these institutions.

Mr. Bakvis, do you have any evidence to the contrary? That is, can you point to any specific instances in recent World Bank or IMF documents that show that or how the "Doing Business" Report is, in fact, used as a basis for conditionality to pressure countries to dismantle basic worker protections?

Reply from Peter Bakvis:

I don't doubt Dr. Okonjo-Iweala's claim that the Nigerian government of which she was finance minister had the autonomy to ignore the recommendations of the World Bank's "Doing Business" report. However it would be incorrect to generalize from this experience that all other African countries are in the same enviable position. Because of its abundant oil wealth, Nigeria has enjoyed several years of rapid economic growth and the government no longer has to borrow from the International Monetary Fund. Most other African countries are still highly dependent on IMF and World Bank loans, as are many other low-income countries, and they cannot as easily dismiss the international financial institutions when they are told that their Doing Business labor market indicators are out of line.

For example, in the West African nation of Burkina Faso, which is a very poor country, the World Bank made it a condition of its 2007 Poverty Reduction and Support Credit (PRSC) loan that the country had to improve its business climate as measured by "Doing Business". The loan document stipulates that Doing Business's "rigidity of employment index" will be one of the four monitoring indicators used to determine whether Burkina Faso is fulfilling the loan condition. This is clearly a case where the World Bank imposed a condition to which the government did not easily consent. An IMF report posted shortly before the PRSC loan was finalized noted that the authorities of Burkina Faso disputed the Doing Business ratings for their country.

Another example of the Bank imposing a Doing Business-inspired labor law reform against a nation's will was in the Asian country of Nepal. The World Bank invoked Nepal's Doing Business labor indicators to design a deregulatory labor reform that was opposed by the elected government, trade unions and employers. In 2005, the king of Nepal seized absolute power and in January 2006 the World Bank's Nepal country director wrote a letter stating that the Bank could cut off budget support to the king unless he decreed the Bank-approved labor reform. The king did as the Bank demanded but he lost his dictatorial power only six weeks later after a popular uprising and the new democratic government repealed the decree.

In another low-income country, the ex-Soviet republic of Kyrgyzstan, the IMF used the Doing Business labor indicators to justify requiring that the government undertake a labor law reform approved by the Fund. The IMF made this into a structural benchmark as part of its conditionality for Kyrgyzstan's Poverty Reduction and Growth Facility (PRGF) loan, and the government was obliged to carry it out before the end of 2006.

In several other countries, the World Bank has funded specific projects for implementing labor market reforms based on the Doing Business indicators. Sometimes the Bank funds these through special "Doing Business loans". Even in countries where labor market deregulation is not made into a loan condition, the fact that the World Bank's highest profile publication tells developing countries that they have to deregulate their labor markets in order to improve their Doing Business rating and become more investment-friendly can have a huge influence, even though the Bank has never demonstrated any credible link between its Doing Business labor indicators and economic growth. Low-income countries are well aware that these ratings enter into the Bank's Country Policy and Institutional Assessment (CPIA), which the Bank uses to determine countries' overall level of access to funds from its concessionary lending arm, the IDA.

In contrast to Dr. Okonjo-Iweala's assertion, the World Bank does not deny the strong impact of its Doing Business ratings. When the Bank released "Doing Business 2008" on September 26, the Bank's press release stated: "Doing Business has inspired or informed more than 113 reforms around the world". It does not say how many of these were labor law reforms but my organization, the ITUC, has documented 23 cases, including the three I just mentioned, of specific recommendations for labor market deregulation included in World Bank or IMF country policy reports. Sixteen of these were documented in a report the ITUC released in response to "Doing Business 2008". I am pleased to submit it to the Committee as additional material (see attached, or click here http://www.ituc-csi.org/IMG/pdf/doing_business.pdf:).

On the broader question of Dr. Okonjo-Iweala's claim that the World Bank no longer loads up loan conditionality like it used to, there is lots of independent research showing that changes have been little more than semantic, in spite of the Bank having a adopted "Good Practice Principles" in 2005 where it promised to apply loan conditionality more sparingly. Last year, the European Network on Debt and Development issued a report on World Bank loans for 20 low-income countries and found that the number of binding conditions, requiring policy measures such as privatization and trade liberalization, had increased to 15 per loan in the newest loans as compared to 13 per loan in the previous ones. The increase was even sharper if you include criteria such as "prior actions", "benchmarks" or "triggers". The Bank does not technically consider these to be conditions, but they are certainly treated as such by borrowing countries because they determine access to present or future financial support from the Bank. It is far too soon to claim that World Bank loan conditions are a thing of the past.

# # # #

The IFIs' Use of *Doing Business* to Eliminate Workers' Protection: Analysis of *Doing Business 2008* and new country evidence

ITUC/Global Unions[1] – Washington Office

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[1] The Global Unions group is made up of the International Trade Union Confederation (ITUC), which has 168 million members in 153 countries; the Global Union Federations (GUFs), which represent their respective sectors at the international trade union level (BWI, EI, ICEM, IFJ, IMF, ITF, ITGLWF, IUF, PSI and UNI); and the Trade Union Advisory Committee (TUAC) to the OECD. The ITUC was created 1 November 2006 through the unification of the International Confederation of Free Trade Unions (ICFTU), the World Confederation of Labour (WCL) and several previously unaffiliated national trade union organizations.

Executive Summary

Doing Business, the World Bank's highest-circulation annual publication, hails the former Soviet republic of Georgia in its 2008 edition for having "some of the most flexible labor regulations in the world", naming it one of two countries in the world where "workers ... have the best protection". Georgia's flexible labour code, which was introduced in 2006, has been criticized by the International Labour Organization for granting employers the unlimited right to dismiss workers without cause and for imposing severe restrictions on trade union action and workers' right to bargain collectively. Despite its adoption, which should have stimulated the creation of more and better jobs according to *Doing Business*, the most recent data show that poverty in Georgia has increased from 27.2 to 31.0 per cent while unemployment has increased from 12.6 to 13.9 per cent as compared to levels of two years earlier.

The case of Georgia calls into question not only *Doing Business*'s peculiar judgement that governments which contravene internationally-recognized workers' rights should be lauded for providing "the best protection" in the world, but also the assertion that labour market deregulation automatically spurs economic growth and employment. In the four years since the first edition of *Doing Business*, the World Bank has modified the criteria in its "Employing Workers" index slightly, but continues to use indicators which reward countries for removing limits on work time, reducing minimum wages, abolishing workers' recourse against unjust dismissal, and eliminating requirement of advance notice for mass dismissals.

Under *Doing Business*'s ranking, Afghanistan, Georgia, Haiti, Mongolia and Papua New Guinea earn better marks system for "Employing Workers", because of their deregulated labour markets, than do prosperous economies with low unemployment and high productivity such as Finland, Korea, Netherlands, Sweden and Taiwan. These examples contradict *Doing Business*'s claim that the policies enumerated in the "Employing Workers" section are a recipe for high-quality job creation. The World Bank has never produced evidence to show that higher levels of "rigidity" as measured by the *Doing Business* "Employing Workers" indicators are a major obstacle to job creation. *Doing Business* cites one published study to support its methodology but misstates one of its key conclusions, and otherwise resorts to dubious anecdotal evidence, sometimes contradicted by other World Bank reports, to back up its claims about the need to eliminate workers' protection regulations.

This paper condemns *Doing Business*'s underlying assumption that labour regulations have costs but not benefits, and for ignoring the economic and social rationale that leads countries to limit working hours or set minimum wages. By discouraging countries from maintaining anything above the bare minimum level of labour market regulation, *Doing Business* actually undermines development goals promoted by the World Bank and other international organizations. For example, if most sub-Saharan African countries were to adhere to the *Doing Business* criterion that minimum wage levels not exceed more than 25 percent of the value added per worker, they would be forced to set minimum wages at less than a dollar per day—the threshold for extreme poverty. South Africa, which has attempted to remedy long-standing discriminatory practices in the labour market with affirmative action rules on lay-offs, earns a poor score in the "Employing Workers" index because *Doing Business* gives bad marks to countries that have any kind of priority rules for dismissals. *Doing Business* furthermore penalizes countries that adopt employer-funded publicly administered social protection programmes.

While *Doing Business 2008* implies that it supports the ILO's core labour standards, a number of countries known for repeated violations of workers' rights once again scored well in this year's edition. Colombia, where dozens of murders of trade unionists occur every year and are rarely punished; China, where workers are banned from joining any union but the official state-controlled organization; and Saudi Arabia, where women are banned from numerous professions and trade unions are entirely prohibited, all rank better than do most countries in Western Europe.

Although World Bank officials have steadfastly refused to admit that *Doing Business* is intended to drive labour market deregulation in developing countries, *Doing Business* has repeatedly insinuated otherwise. The first edition of the report, *Doing Business in 2004*, spoke of the positive results of countries that had undergone the "deregulation experience", by which it meant "a general reform toward reduction of the scope of employment regulation". A more recent World Bank press release said: "The annual *Doing Business* updates have already had an impact. The analysis has inspired and informed at least 48 reforms around the world. The lesson – what gets measured gets done."

The labour market deregulation ideology of *Doing Business* has spread into the World Bank and International Monetary Fund's policy advice and lending conditions for countries. *Doing Business* is frequently cited in IMF Article IV Consultation reports, as well as in World Bank Country Assistance or Country Partnership Strategies. This paper documents 16 recent cases of World Bank and IMF country strategies that use *Doing Business* indicators and rankings to pressure countries to deregulate their labour markets. The World Bank also uses *Doing Business* labour market rigidity scores as a component of its Country Policy and Institutional Assessment (CPIA), which determines how much aid to allot to poor countries, and has incorporated *Doing Business* into its overall labour markets strategy. Far from being a mere index of perceptions about countries' labour market regulations, as its authors have claimed, *Doing Business* has become a dangerous tool used to encourage countries to remove essential workers' protection.

Introduction

1. *Doing Business 2008*, published by the World Bank in September 2007, praises the former Soviet republic of Georgia as one of two countries in the world where "workers ... have the best protection".[2] The previous year's edition of *Doing Business* had already declared Georgia to be the world's "top performer" in the area of labour law reform because "Georgia's new labor regulations help workers move to better jobs".[3]

2. In contrast, the latest economic report prepared by the International Monetary Fund on Georgia, a low-income country that depends on concessionary loans from the Fund, does not bear out the image of a workers' paradise painted by *Doing Business*. The August 2007 IMF report states that an "area of disappointment has been in reducing poverty, with poverty rates virtually unchanged". The IMF report actually contains statistics showing that Georgia's poverty rate is significantly higher in 2006, at 31.0 per cent, than where it was two years earlier, 27.2 per cent. Unemployment has also increased, according to the IMF, having grown from 12.6 per cent in 2004 to 13.9 per cent in 2006.[4]

3. Why then, does the World Bank's *Doing Business 2008* designate Georgia to be a labour utopia? Because, according to the report, "Georgia has some of the most flexible labor regulations in the world". These regulations, which were included in a labour law adopted in May 2006, include the following features:

- The new labour law allows any worker to be dismissed without valid reason.
- The new law defines a collective agreement as any contract between an employer and two or more employees, effectively marginalizing trade unions' position as workplace bargaining agents since at least 100 people are needed to form a trade union.
- The new law gives employers the right to unilaterally establish the rules concerning a number of working conditions which previously were subject to collective bargaining.
- Any strike, regardless of the nature of the work or sector of activity, cannot exceed 90 days.
- Additionally, Georgia's Organic Law on the Suspension and Prohibition of Activities of Voluntary Associations allows for the prohibition of trade unions on the grounds of stirring up social conflict.
- There have been reports of threats and intimidation for trade union activity from workers in local government, education, mining, pipelines, port facilities and other sectors, but no action has been taken by the ministry of labour.

[2] World Bank, *Doing Business 2008* (Washington, 2007), p. 19
[3] World Bank, *Doing Business 2007* (Washington, 2006), p. 1 & 19
[4] IMF, *Georgia: Sixth Review Under the Three-Year Arrangement Under the PRGF* (Washington, August 2007), p. 13 & 15

- The Georgian government has refused to reply to numerous requests by the International Labour Organization that it amend the 2006 labour law, which the ILO considers not to be in conformity with the core labour standards.[5]

Doing Business 2008 does commend Georgia for having ratified all of the ILO's core labour standards conventions. However, ratification does not mean observance and application, a distinction that the World Bank could have learned if it had bothered to consult the ILO, or Georgian trade unions and employers, about the labour law situation in the country.

4. Since the first edition of *Doing Business* was issued by the World Bank in October 2003, Georgia is only one of dozens of developing country where *Doing Business* has been used to recommend that governments carry out far-reaching labour market deregulation and applauded those that did so – in flagrant disregard of the impact on poverty levels, employment, wages, working conditions and respect for workers' fundamental rights. The World Bank has assiduously promoted *Doing Business*. It has become the Bank's highest-circulation publication, has been incorporated into the World Bank's overall labour markets strategy, and has been used by staff of both international financial institutions (IFIs), the IMF and World Bank, to recommend specific measures for eliminating workers' protection.

5. In several countries, recommendations for dismantling workers' protection based on *Doing Business* indicators have been made into IMF and World Bank loan conditions. In one such country, Nepal, the World Bank's country director wrote a letter in January 2006 stating that the Bank could cut off budget support to the king of Nepal, who at the time had seized absolute power, unless he rapidly decreed labour market deregulation, despite the fact that the "tripartite constituents" (elected government, employers, trade unions) were opposed. The king did as the World Bank director instructed but, unfortunately for the Bank, a popular uprising led to the king losing his dictatorial powers six weeks later and the new democratic government quickly annulled the king's decree.[6]

6. This report presents sixteen country cases of the use *Doing Business* by the IFIs to eliminate workers' protection. They add to seven other country cases documented in an earlier report, which was sent to IFI officials. The IFIs never responded to the earlier report, but the World Bank has continued to assert that reforms based on the *Doing Business* indicators, which purport to identify labour regulations that are obstacles to investment, will result in higher economic growth and employment. As is shown in this report, *Doing Business* makes assertions about a causal relationship between its "Employing Workers" indicators and employment growth that has never been borne out by empirical evidence. *Doing Business* has ignored important research disproving the claimed causal link and has misstated the conclusions of other research which it has invoked in support of its methodology. Even anecdotal cases such as Colombia, Georgia and Macedonia, presented as success stories of labour reform in past and present editions

[5] ITUC, *2007 Annual Survey of Violation of Trade Union Rights* (Brussels, September 2007)
[6] ICFTU, *How the World Bank and IMF Use the Doing Business Report to Promote Labour Market Deregulation in Developing Countries* (Washington, 2006)

of *Doing Business*, fail to substantiate the claim that elimination of labour regulations inevitably leads to the creation of more and better jobs.

Four years of *Doing Business*

7. *Doing Business*, an annual World Bank publication produced since 2003 by the Bank's Private Sector Development department, claims to help countries achieve higher growth by identifying obstacles to private-sector investment, such as delays for issuing business permits or laxity in enforcing contracts. Countries are told that they can improve their growth rate by reducing or eliminating these obstacles. Labour market regulations have always been an important target of the publication, starting with the first edition when "Hiring and Firing Workers" was included as one of the five original themes of *Doing Business in 2004*. The first edition advised countries that they had much to learn from countries that had undergone the "deregulation experience" in the area of labour legislation. Countries with dubious records in respecting fundamental workers' rights, such as Colombia, have been singled out for praise for having undertaken labour market deregulation.

8. While some other aspects of *Doing Business* have also been controversial[7], the international trade union movement has focused its analyses and criticisms on those aspects of the publication that concern labour, most particularly the section entitled "Hiring and Firing Workers", which was renamed "Employing Workers" in the fourth edition. In October 2003, a few weeks after the launch of *Doing Business in 2004*, the general secretary of the ITUC's predecessor, the ICFTU, wrote to the president of the World Bank and called attention to the fact that the Bank's publication was promoting measures to eliminate labour regulations "without specifying that they can contribute to reducing the living standards of workers and act against poverty-reduction goals".[8] The ICFTU pointed out that the message of *Doing Business* that labour market regulations are nothing but an impediment to investment appeared to contradict other recent Bank reports supporting improved social protection, core labour standards and negotiating with unions on changes that affect workers. The World Bank's vice-president for Private Sector Development responded to the letter and defended *Doing Business*, denying that any change was needed in its approach to labour regulations and stating that the objective of *Doing Business* was to reduce poverty by "documenting successful reforms to improve growth opportunities for small and medium-size firms and to enhance entrepreneurship".[9]

9. No evidence has ever been produced by the World Bank to show that poverty reduction or enhancement of entrepreneurship requires establishing a 66 hour workweek, bringing minimum wages to below 25 per cent of value added per worker, abolishing all forms of recourse against unjust dismissal, and eliminating any advance notice

[7] In particular, *Doing Business* has been accused of being biased against non-Anglo-Saxon legal systems, and notably those based on European civil law. See for example: Association Henri Capitant des amis de la culture juridique française, *Les droits de tradition civiliste en question: À propos des rapports Doing Business de la Banque mondiale*, Société de législation comparée (Paris, 2006).
[8] Letter, Guy Ryder (ICFTU) to James Wolfensohn (World Bank), 21 October 2003
[9] Letter, Michael Klein (World Bank) to Guy Ryder (ICFTU), 7 November 2003

requirements for mass employment terminations. However these were all requirements established by *Doing Business* for countries that wished to attain the best ease-of-doing-business designation. *Doing Business* grades countries according to whether regulations such as these exist in the country. It calculates index scores and establishes rankings of countries on the basis of the indicators. Some of the precise criteria for calculating the indicators, such as the 66-hour workweek[10], were later modified, but the fundamental approach remains the same: best performer designations are given to countries with the lowest level of labour regulations.

10. The authors of *Doing Business* have claimed that they agree with the International Labour Organization's core labour standards (CLS), which are based on eight of the ILO's 188 conventions adopted since 1919.[11] These CLS conventions cover freedom of association and the right to collective bargaining (ILO Conventions 87 and 98); the elimination of discrimination in respect of employment and occupation (Conventions 100 and 111); the elimination of all forms of forced or compulsory labour (Conventions 29 and 105); and the effective abolition of child labour, including its worst forms (Conventions 138 and 182). Despite lip service acknowledging the relevant conventions, the *Doing Business* indicators do not take account of whether countries actually observe CLS. In fact, *Doing Business* has given some of its best scores and rankings in the labour category to countries that routinely violate CLS.

11. For two years in a row, in its 2006 and 2007 editions, *Doing Business* granted the global best performer designation for their labour regulations to two small Pacific island states having hardly any labour regulations of any kind and that were among the handful of countries not members of the ILO, which has 181 member countries. As non-ILO members, these two countries were not required to abide by the CLS. In the 2008 edition, recurrent violators of fundamental workers' rights, including Belarus, China, Colombia, El Salvador, Eritrea, Saudi Arabia, Swaziland and Uzbekistan, all received a better ranking for "Employing Workers" than most countries of Western Europe. The *Doing Business* list of relatively good performers for employing workers thus includes a country that keeps wages artificially low by imprisoning workers who try to organize outside of the state-controlled union – China; a country that holds the world record for the number of trade unionists murdered each year, almost all in total impunity – Colombia[12]; and a country which outlaws trade unions entirely and bans women from several categories of work – Saudi Arabia.

[10] *Doing Business 2007* dropped the 66-hour workweek in favour of the following rule: the minimum workweek must be at least 5.5 days and, for at least 2 months per year, no less than 50 hours; weekend work must be unrestricted at all times.

[11] Recent editions of *Doing Business* mention that the CLS exist, but do not express explicit support for them. However, *Doing Business* implies that any labour standards other than the CLS generally play a negative role in developing countries: "Beyond these regulations and principles [contained in the CLS], … most developing countries err on the side of excessive rigidity" (World Bank, *Doing Business 2007*, (Washington, 2006), p. 18).

[12] Praised by the first and second editions of *Doing Business* because the government had reduced the minimum wage and made it easier for workers to get fired, Colombia has also won the dubious distinction of being the country where workers' representatives most often get fired on. More trade unionists have been murdered in Colombia than in any other country since the early 1990s. The ITUC has documented 1165 cases of Colombian trade unionists assassinated since between 1994 and 2006; only 14 perpetrators

Bogus economic justifications

12. The basic methodology of the "Employing Workers" section of *Doing Business* is as follows:

a) Labour-related regulations or requirements are assumed to have costs but no benefits.
b) Indicators for different types of regulation are calculated for each country on the basis of the existence of certain legal labour requirements or on their estimated cost to a typical business.[13]
c) Average "rigidity of employment" indices are calculated on the basis of the existence or the cost of the requirements for the typical firm in each country surveyed.
d) Countries are ranked according to their "rigidity of employment" indices, with better rankings given to countries having the lowest indices, such that countries having no labour regulation of any sort get the best ranking.
e) Countries having lower labour market indicators are assumed to be more business-friendly and therefore more successful in attracting private investment, such that they will have higher rates of growth and job creation.

13. It is to be noted that the whole edifice of *Doing Business* is based on a series of assumptions: that labour regulations have costs and no benefits; that certain rules should be taken into consideration but other regulations or common practices not; and that a lower level of regulation always results in more investment and higher growth. Evidence to back up these assumptions in *Doing Business* ranges from inexistent to anecdotal and from highly selective to erroneous. Firstly no explanation is given as to why it is legitimate to assume that all labour regulations have costs but no benefits. Such an assumption ignores the rationale, economic as well as social, that led to the introduction of limits on hours of work (long work hours led to decreased productivity and higher accident rates); for obliging employers to provide advance notice and to contribute to the cost of income maintenance of dismissed workers; for establishing minimum wages; and for obliging employers to contribute to the cost of the care of injured workers, their overall health and their retirement income.

14. As explained in more detail in paragraph 25 below, *Doing Business* introduces a bias against labour regulations in developing countries, which is where the World Bank and IMF have their greatest influence, by excluding from the calculations several types of workers' protection in industrialized countries that produce actual benefits for many workers, but do not constitute statutory obligations. These may derive from the influence of trade unions, which are generally stronger in industrialized countries, but often apply to many non-unionized workers not covered by collective agreements as well. They

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were ever tried and sentenced for any of these murders. See ITUC, *Annual Survey of Violation of Trade Union Rights* (Brussels, 2007).

[13] This paper does not deal with the formulas used to calculate the indicators. The aggregation and weighting system and the coding method, for which no justifications are provided in *Doing Business*, present major methodological problems, as shown in: Berg and Cazes, *The Doing Business Indicators: Measurement issues and political implications* (ILO, Geneva, 2007), p. 9-13

include, for example, advance notice and severance benefits for dismissal, recourse against dismissals considered unjust, and employer-provided pensions and health care benefits.

15. The other basic assumption of *Doing Business*'s section on "Employing Workers" is that labour regulations prevent employment creation in the formal sector. The rationale was expressed by *Doing Business in 2006*, which carried the subtitle *"Creating Jobs":* "Inflexible labour markets stifle new job creation and push workers into the informal sector. ...Most developing countries err on the side of excessive rigidity, to the detriment of businesses and workers alike. ...Reforms of employment regulation reduce business costs... The result is a higher employment rate".[14] Specific measures that countries should undertake were also presented in the report.

16. However *Doing Business in 2006: Creating Jobs* cites only two studies (one of which, by a World Bank author, was "forthcoming" and unavailable when cited) to support the contention in its chapter on "Hiring and Firing Workers" that reduced labour regulation automatically increases employment.[15] Strangely, for a publication that emphasizes developing countries' need to reform, both studies only arrived at conclusions for OECD countries concerning the supposedly positive impact of looser labour laws on employment levels. Equally strangely, the World Bank must have been aware when it published *Doing Business in 2006: Creating Jobs* that the OECD was at that point completing a major reassessment of its decade-old *Jobs Study*, a reassessment which cast substantial doubt on the idea that labour market deregulation automatically enhances employment creation.

17. The OECD's *Policy Lessons from Reassessing the OECD Jobs Strategy* concluded: "there is no single combination of policies and institutions to achieve and maintain good labour market performance".[16] The OECD found that the "successful performers" in terms of employment growth included both countries with light employment protection legislation (EPL) and low welfare benefits, and others with more restrictive EPL, generous welfare benefits and coordinated collective bargaining. But whereas the former group of countries (which includes the US) is characterized by "relatively wide income disparities", the latter (which includes the Nordic countries) "have achieved high employment and low income disparity".[17] Another OECD publication examined the determinants of structural unemployment in OECD countries and found that "the impact of EPL and union density are statistically insignificant".[18] Subsequent editions of *Doing Business* quietly dropped the reference to the two studies used in *Doing Business in 2006: Creating Jobs* to assert that labour market regulations were a statistically significant cause of unemployment in OECD countries. However, they never corrected the original assertion nor mentioned that the OECD itself had determined the claim to be unjustified.

[14] World Bank, *Doing Business in 2006* (Washington, 2005), p. 21 & 26
[15] ibid, footnote 9, p. 26
[16] OECD, *Boosting Jobs and Income – Policy Lessons from Reassessing the OECD Jobs Strategy* (Paris, 2006) p. 18
[17] ibid, p. 19
[18] OECD, *Employment Outlook 2006* (Paris, 2006), p. 212

18. *Doing Business 2007* restated the assertion that labour market regulations drive workers into the informal economy – "the less flexible the regulations, the more businesses hire workers informally"[19] – but this time cited only one article, by Botero and others, to back up this claim.[20] Moreover, all editions of *Doing Business* have stated that the methodology of the labour indicators was developed in the Botero study and adopted in *Doing Business* "with minor changes".[21] In reality, the Botero article provides no support for the key assumption of *Doing Business* that labour market regulations and requirements lead businesses to hire workers in the informal economy and that the regulations are therefore an impediment to employment creation in the formal economy. Contrary to the assertion repeatedly made in various editions of *Doing Business*, the Botero study found that labour market regulations are not significantly correlated either with the size of the informal economy or with employment levels in the informal economy. The "minor changes" *Doing Business* made in adopting the methodology of the Botero study apparently included altering one of its important conclusions by assuming a causal relation that the study was unable to substantiate.

19. While *Doing Business 2008* repeats the claim that the methodology of the "Employing Workers" indicators is based on the Botero paper "with minor changes", it no longer cites any studies in support of the claimed broad link between employment growth and deregulation. It does cite two papers in support of a narrower claim linking growth of exporting businesses and flexible labour regulations, one prepared by the World Bank and the other by the IMF.[22] However, neither of these papers had been posted on the two institutions' respective web sites when *Doing Business 2008* was published in September 2007; the papers could therefore not be verified. In light of the 2006 external assessment of the World Bank's research activities, which cited several examples of an unfortunate common practice at the Bank where "research was used to proselytize on behalf of Bank policy, often without taking a balanced view of the evidence" and research that did not support Bank policy was ignored, one should take such in-house references with scepticism, especially when the sources cannot be consulted.[23]

20. *Doing Business* has also resorted to anecdotal evidence by citing specific countries as proof that the labour market deregulation measures the Bank puts forward will lead to increased employment creation. Even other World Bank publications sometimes find these cases to be unconvincing. For example, *Doing Business in 2005* lauded Colombia as one of the two "world's most successful investment climate reformers over the past year ... [for] increasing the flexibility of labor laws".[24] It predicted that Colombia's "bold" labour reforms would produce "the largest payoffs ... in reducing

[19] World Bank, *Doing Business 2007* (Washington, 2006), p. 18
[20] Botero, Juan et al., "The Regulation of Labor", *Quarterly Journal of Economics* (June, 2004)
[21] World Bank, *Doing Business 2008* (Washington, 2007), p. 73
[22] ibid., p. 20 & 24, footnotes 4 and 6
[23] Banerjee, Abhijit, et al, *An Evaluation of World Bank Research, 1998-2005* (2006), cited in "World Bank 'uses doubtful evidence to push policies'", *Financial Times*, 22 December 2006
[24] World Bank, "Doing Business 2005: Poor Nations Struggle to Reduce Red Tape for Business, Miss Large Growth Opportunities", World Bank News Release No:2005/69/S, 8 September 2004

unemployment"[25]. However a year later, the Bank released a special study on Colombia's labour market reform which determined that the impact "seems to have been modest" in terms of employment creation.[26] The report's conclusion was that "the impact of the reform *may* have been positive. However, making this link is not an easy task".[27] That hardly sounds like the "large payoff" from Colombia's "successful" labour market reform confidently predicted by the *Doing Business* experts.

21. For most people who have an elementary knowledge of labour market issues, a simple perusal of the *Doing Business* rankings should convince them of the implausibility of the claimed identification of a link between deregulated labour markets as measured by *Doing Business* and improved economic performance and employment creation. Because of their deregulated labour markets, Afghanistan, Armenia, Georgia, Haiti, Mongolia, Papua New Guinea, Solomon Islands and Yemen all outrank such prosperous, high productivity and low unemployment countries and regions as Finland, Korea, Luxembourg, Netherlands, Norway, Slovenia, Sweden and Taiwan in their 2008 *Doing Business* "Employing Workers" scores. Few analysts other than the *Doing Business* authors and, presumably, those in the World Bank and IMF who use *Doing Business* to design labour market reform proposals, would assert that the first group of countries has found the successful recipe for high-quality job creation that the latter group should emulate.

Doing Business: World Bank's main template for labour market reform

22. What has been particularly disturbing for national trade union organizations affiliated to the ITUC (and its predecessor organizations) is the fact that *Doing Business* has become the most important template used by the World Bank and the IMF to promote labour market reform in developing and transition countries. Other World Bank publications and reports have occasionally put forward more balanced views on labour standards, showing that they have economic and social benefits and not only costs, but these have the status of discussion documents or analyses that rarely serve to design specific reforms.[28] Since 2006, the International Finance Corporation (IFC), which is a member of the World Bank Group, has made it an obligation through its Social and Environmental Performance Standards that all IFC borrowers must abide by specific requirements based on the CLS, and the IFC has prepared "Good Practice Notes" to support its performance standards. However the IFC's clients are private companies, not governments, and neither the performance standards nor the good practice notes are addressed to governments. Claims by some World Bank officials that the approach of *Doing Business*, which examines labour regulations exclusively as to whether they help

[25] World Bank, *Doing Business in 2005* (World Bank, 2004) p. 30

[26] World Bank, *Colombia: Country Economic Memorandum* (Washington, 2005), p. 90

[27] World Bank, *Colombia: Labor Market Adjustment, Reform and Productivity* (Washington, 2005), p. 33

[28] An example of a more balanced analysis recognizing that labour market regulations can play a positive role is to be found in the World Bank's *World Development Report 2006: Equity and Development* (Washington, 2005), which states that "Labor markets are generally not competitive ... [and] can lead to unfair and inefficient outcomes when the bargaining position of workers is weak.... Public intervention can improve market outcomes and lead to significant equity gains: more equal opportunities for workers, better working conditions, and less discrimination." (p. 186).

investors or not, are "offset" by other Bank reports, ignore the different manner in which these reports are used in Bank operations relating to client-country governments.

23. Starting in 2003, World Bank country offices began using *Doing Business* to encourage governments to do away with labour market "rigidities" by calling attention to the country's "Hiring and Firing Workers" indicators (called ""Employing Workers" indicators starting with *Doing Business 2007*) in comparison with other countries. They frequently did so during press conferences or public meetings and began including recommendations to reduce labour market rigidities in country reports, such as County Economic Memorandums (CEMs), Country Assistance Strategies (CAS) and Country Partnership Strategies (CPS). Countries were told that, if their labour market rigidity indices were higher than regional averages, they should work to get them lower than the regional average. In countries already below the regional average, it was more typical for the Bank's country reports to introduce comparisons with select countries in other regions of the world with particularly low indicators. Recommendations to deregulate labour markets on the basis of *Doing Business* scores have appeared in a growing number of World Bank CEMs, CAS and CPS, and also in IMF Article IV Consultation reports. In some countries, the recommendations have been made into World Bank and IMF loan conditions. Several country cases showing this use of the *Doing Business* have been documented in reports produced by the ICFTU and ITUC, including in this report further below.

24. After writing to the World Bank president in October 2003 and receiving an unsatisfactory response, the ITUC's predecessors and other Global Unions partner organizations raised the problems posed by the *Doing Business* labour market rigidity scores and their use to pressure countries to eliminate workers' protection in numerous written and verbal communications made to Bank staff and Executive Directors. These have included eight twice-yearly statements addressed to the Bank and IMF at the occasion of their annual and spring meetings and two longer analyses. All of these documents pointed out the methodological flaws of *Doing Business*'s labour market indicators and gave examples of the damages its recommendations had caused. In addition, a number of national affiliates of the ITUC have complained to their governments about these problems. Several governments have informed the unions that they share concerns about the *Doing Business* labour indicators and the way they are used.

25. Among the problems raised by the trade union movement about the *Doing Business* labour market rigidity scores and rankings are the following:

- The indicators take no account of the general situation of workers' rights, industrial relations or social protection that exists in the county. *Doing Business* advises countries that national legislation should not require any advance notice for dismissals, individual or collective; any severance pay of more than eight weeks' wages; or any recourse against unjust dismissal. The limitation of severance pay to a short period obviously poses much less of a problem in countries that provide unemployment benefits to maintain part of the income of dismissed workers for a certain period (all industrialized countries) than those that do not (all but a few developing countries). Similarly, the elimination of any statutory recourse to contest dismissals has a greater impact when no other recourse exists (as in most developing countries) than when workers have other forms of protection, such as a strong union movement with collective bargaining agreements that provide a recourse to many workers (several industrialized countries) or strong anti-discrimination laws that permit workers to sue employers for various types of unjust dismissal (for example, in the United States).

- The comparisons *Doing Business* carries out on labour regulations between countries are made for a full-time male employee who has worked in the same company for 20 years and is not unionized, unless membership is obligatory. Employees having twenty years seniority are highly atypical in developing countries, but less so in industrialized countries. *Doing Business* is therefore basing its indices and rankings on conditions that apply to a tiny proportion of the labour force in developing countries. Conditions that may appear generous on paper, for example high severance pay granted to employees who have extended seniority, in reality may be largely theoretical if hardly anyone can benefit from them. In industrialized countries, even those where less than half of workers are covered by collective agreements, the impact of unions tends to be quite broad, and benefits and protections gained by unionized workers also apply to many who are not unionized or covered by collective agreements. This happens less frequently in developing countries. By ignoring those kinds of protections, the *Doing Business* indices understate the level of real protection enjoyed by many industrialized country workers compared to those from developing countries.

- *Doing Business* penalizes countries that have a statutory minimum wage, unless it is less than 25 per cent of value added per worker. This level represents less than $30 per month, i.e. less than $1 a day, in most Sub-Saharan African countries. The World Bank has defined $1 a day as the extreme poverty threshold and has endorsed Millennium Development Goal Number One, which is to eliminate extreme poverty. By giving worse rankings to countries which require that wages exceed extreme-poverty levels, *Doing Business* is working at counter-purposes with the World Bank's stated objectives, and in this case, with an objective that the World Bank declared to be its overarching goal in 1999.

- *Doing Business* opposes any advance notice for dismissal requirements or obligatory severance pay exceeding eight weeks, even though many World Bank loans for restructuring of services or state-owned enterprises have required that compensation be provided to workers who lose their jobs. *Doing Business* is therefore advising countries that they should not require the application of the kinds of measures for which the World Bank provides financial assistance.

- Since 2002, the World Bank has supported the promotion of the ILO's core labour standards, one of which requires that countries eliminate discrimination in respect of employment and occupation. Some countries with long-standing discriminatory practices in the labour market have put in place affirmative action rules, for example concerning lay-offs. South Africa is an example of such a country. *Doing Business* gives bad marks and worse rankings to countries that have any kind of priority rules for dismissals. Thus, countries that attempt to abide by ILO principles supported by the World Bank to combat discrimination in the labour market are penalized by *Doing Business*.

- *Doing Business* counts any obligatory employers' contributions to social security (old-age pensions, health care, maternity leave, workplace injury, etc.) as a negative and includes them under two categories: "Employing Workers" and "Paying Taxes". It gives worse rankings to countries that have higher levels of social security contributions as a proportion of profit. Social security contributions paid by workers, through income taxes or through consumption taxes are not counted, nor does *Doing Business* count employers' contributions made for health care coverage or old-age pensions that are common in the United States and some other industrialized countries but not obligatory by law. *Doing Business* shows an obvious bias against employer-funded publicly administered social protection and, once again, against developing countries. Shifting the burden of funding social protection away from employers and onto the general income tax or value added tax systems is not a viable option for many low-income countries where the tax regime either does not exist or may be difficult to expand so as to generate sufficient revenue.

- Starting with the first edition of *Doing Business* and up to the present, the section on labour has used the terms "employment regulations", "labor laws", "labor regulations" and "worker protections" synonymously, and the strong message of *Doing Business* is that these laws or regulations must be made more flexible or eliminated. *Doing Business* bases its indices and rankings on specified types of regulations, including minimum wages, hours of work, hiring rules and dismissal rules. However, when countries are told by *Doing Business* that the World Bank favours "making labor regulations more flexible", they may well infer that this should apply to all types of labour regulations institutions, including collective bargaining systems. As will be shown in some of the country cases, the IFIs sometimes use bad *Doing Business* scores as justification for pressuring countries to eliminate sector-level or national collective bargaining.[29]

[29] The fact that many World Bank reports recommend dismantling sector-level collective bargaining arrangements in favour of firm-level bargaining or individual contracts is likely to reinforce the impression that the World Bank sees collective bargaining as a mixed blessing. See for example: World Bank, *Enhancing Job Opportunities in Eastern Europe and the Former Soviet Union* (Washington, 2005), p. 47 & 49.

- The same *Doing Business* message about the need to do away with labour regulations can also be understood to apply to occupational health and safety rules. The Bank's last World Development Report that dealt extensively with labour issues actually called attention to the problem of weak enforcement of occupational health and safety regulations in low- and middle-income countries and supported stronger enforcement.[30] Support for stronger enforcement would be strictly off-message as far as *Doing Business* is concerned, so it is not surprising that it does not mention regulations for health and safety at work. However, the carelessness with which *Doing Business* throws around its call to do away with labour regulations can lead governments, or staff of the IFIs, to presume that the Bank believes occupational health and safety rules to be as much of a nuisance as any other labour regulation. The weaker presence of trade unions and collective bargaining that is likely to result from labour market deregulation will, in any case, contribute to weaker enforcement: "the role of labor unions in ensuring compliance with health and safety standards is often an important one".[31]

World Bank's refusal to recognize problems caused by *Doing Business*

26. In addition to informing the president of the World Bank in writing of the problems posed by the *Doing Business* labour market indicators, the ICFTU/Global Unions sent the Bank two detailed analyses laying out their objections.[32] Representatives of the World Bank responsible for *Doing Business*, including the vice-president for Private Sector Development and the lead author of the report, accepted to meet with representatives of international trade union organizations on three occasions (2004, 2005 and 2006) to discuss the publication. While acknowledging that *Doing Business* examined labour regulations exclusively as to their perceived negative role as impediments to investment and did not examine any positive role they might play, they denied that there were any problems with the overall approach.[33] They also claimed that *Doing Business* did not intend to indicate any kind of judgement as to what an appropriate level of regulation might be. They stated than an appropriate level might well be superior to zero, which is the score conferred on countries whose regulations are equal to or below the minimum criterion established in *Doing Business*, such as a minimum wage below 25 per cent of value added per worker or the absence of any advance notice rules for dismissal.

27. In 2005 the ICFTU informed Bank officials responsible for *Doing Business* that several World Bank country offices had established rankings of countries using the *Doing*

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[30] World Bank, *World Development Report 1995: Workers in an Integrating World* (Washington, 1995), p. 77-78

[31] ibid., p. 78

[32] ICFTU, *Comments by ICFTU/Global Unions on the World Bank's Doing Business in 2005: "Hiring and Firing Workers"* (Washington, 2005) and ICFTU, *How the World Bank and IMF Use the Doing Business Report to Promote Labour Market Deregulation in Developing Countries* (Washington, 2006)

[33] A leading argument used by the World Bank officials was the debatable assertion that, since it is the Bank's highest-circulation publication, *Doing Business*'s popularity somehow constitutes a validation of the methodology used.

Business labour market rigidity indices in which the best rankings were given to countries having the scores closest to zero, and that the Bank offices used these rankings to tell countries with higher indices that they should get rid of labour regulations so as to improve their ranking. The Bank's top officials responsible for *Doing Business* told the ICFTU that they did not support ranking countries on the basis of their *Doing Business* indices and, furthermore, that anyone who used the indicators to promote labour market deregulation was "misinterpreting" them.

28. The Bank evidently changed its mind about the appropriateness of ranking countries on the basis of their *Doing Business* indicators, since starting in 2006 the Bank published rankings of countries for each category. Countries with the lowest indicators, i.e. the least amount of labour regulations, were awarded the "Best Performer" status for that category. *Doing Business in 2006* granted the "Best Performer" trophy for its labour regulations to Palau, a Pacific island state of 20,000 inhabitants that is not an ILO member and has almost no labour regulation of any kind. In its 2007 edition, published in September 2006, *Doing Business* bestowed the top prize for its (lack of) labour rules to the Marshall Islands, another small Pacific island country that was not a member of the ILO at the time. By designating non-ILO member countries having virtually no workers' protection rules as global champions in the area of employment of workers, the message of *Doing Business* could not have been clearer: as far a labour laws are concerned, the best level of regulation is no regulation at all.

29. As for Bank officials' claim that those who used the *Doing Business* labour market indicators to pressure countries to deregulate their labour markets were "misinterpreting" the data, one can only presume that the *Doing Business* team has one message for those outside the institution who complain about flaws in *Doing Business* and another for Bank staff. Over the four years that *Doing Business* has been published, there has been a steady growth in the number of country reports prepared by the World Bank – notably County Assistance Strategies, Country Partnership Strategies and Country Economic Memorandums – that include policy recommendations based on *Doing Business* labour market indicators. The Bank's sister institution, the IMF, also uses the *Doing Business* labour indicators to make policy recommendations with growing frequency, often as part of the policy advice contained in Article IV Consultation reports. In several countries, the labour law reform proposals have been made into lending conditions of the IMF or World Bank.

30. In June 2006, the ICFTU documented seven country cases where the IFIs had made very specific labour market deregulation proposals on the basis of *Doing Business* scores, sometimes backed up by loan conditions. The present report documents sixteen additional cases of the World Bank and IMF using *Doing Business* labour indicators to push for labour market deregulation. Unless one is to surmise that hundreds of IFI staff members are systematically and deliberately "misinterpreting" the Bank's highest-circulation publication, it is not credible that the Bank never intended that *Doing Business* be used for that purpose, as those responsible for the publication have told trade union representatives. Their own written words say otherwise. The first edition of the report, *Doing Business in 2004*, spoke of the positive results of countries that had undergone the

"deregulation experience", by which it meant "a general reform toward reduction of the scope of employment regulation".[34] By the fourth edition, a World Bank press release quoted one of the authors of *Doing Business 2007* as boasting about how much the publication had contributed to reducing the burden on businesses: "The annual *Doing Business* updates have already had an impact. The analysis has inspired and informed at least 48 reforms around the world. The lesson – what gets measured gets done."[35]

31. The flawed labour market indicators of *Doing Business* are furthermore used as a determinant of low-income countries' overall access to World Bank funds from the International Development Association (IDA), the Bank's concessionary lending arm, through the Country Policy and Institutional Assessment (CPIA). Although the Bank has not been transparent in its process for determining country scores and no public justification of scores is given, it is clear from the Bank's *CPIA Assessment Questionnaire* that Bank staff have been instructed to use the rigidity of employment indices of *Doing Business* as "Guideposts" in two categories: "Business Regulatory Environment" and "Social Protection and Labor". Under the category of "Social Protection and Labor", good marks are supposed to be granted to countries that, according to the *CPIA Assessment Questionnaire*, meet the following criteria:

- "Social protection programs provide income support to poor and vulnerable groups"
- "Government has ... passed legislation that conforms with core labor standards and is implementing these through its policies and programs"
- "Labor market regulations and active labor market policies promote broad access to employment ..."
- "... Pension and savings programs provide affordable, adequate, sustainable and robust income security"[36]

32. The *Doing Business* labour market indicators actually do not measure any of these qualities; if anything they measure their absence. *Doing Business* does not take account of observance of core labour standards in calculating its indicators and some of the world's most notorious violators of CLS feature among *Doing Business*'s best performers under the category "Employing Workers". Nor does *Doing Business* give better scores or rankings to countries that offer adequate old-age pensions and other types of social protection. On the contrary, *Doing Business* gives worse scores to countries that require higher employers' contributions towards social security. These contributions are counted in two categories: (i) under the section "Employing Workers" as "nonwage labor costs" which include "all social security payments (including retirement fund; sickness, maternity and health insurance; workplace injury; ...)"; and (ii) under the category "Paying taxes" as part of the "total tax rate", which includes "social security contributions and other labor taxes paid by the employer". The latter are counted in the country's overall *Doing Business* ranking, with a higher level of social security

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[34] World Bank, *Doing Business in 2004* (Washington, 2003), p. xix

[35] World Bank news release, *Doing Business 2007: Business Becomes Easier Worldwide; African Nations Push Through Regulatory Reforms* (Washington, September 2006)

[36] World Bank, *Country Policy and Institutional Assessments: 2005 Assessment Questionnaire* (Washington, December 2005), p. 29-30.

contributions resulting in worse rankings. By counting the *Doing Business* labour market indicators as part of the CPIA, which determines access to concessionary funds, the World Bank is perversely rewarding countries that violate good labour and social standards while claiming to do exactly the opposite.

33. By 2007, the Bank's Human Development Network had incorporated the application of the *Doing Business* indicators into the Bank's overall labour markets strategy through a programme called MILES: "the MILES framework will make use of ... Doing Business ... to develop the policy instruments to create a more employment-friendly climate for business".[37] Given the growing reference in World Bank programmes to the *Doing Business* labour indicators, it is not surprising that their use has increased to become the basic template used to justify and design labour market deregulation, not only by the World Bank but also by the IMF. Several recent cases illustrating this use are presented in the following paragraphs. A previous report produced by the ICFTU in 2006 described cases concerning seven countries: Bolivia, Colombia, Ecuador, Lithuania, Nepal, Romania and South Africa.[38] Sixteen additional country cases are presented below, all taken from IMF or World Bank country policy reports dated from October 2006 to July 2007.

IMF and World Bank's use of *Doing Business* to pressure for elimination of workers' protection: 16 new country cases

Algeria

34. In its February 2007 Article IV Consultation for Algeria, the IMF refers to two-year-old *Doing Business 2006* indicators (which apply to January 2005), to support the need "to improve the business climate for private enterprise". Furthermore a *Selected Issues* paper produced by the IMF argues on the basis of the country's "relatively high" *Doing Business* labour market rigidity indicator that Algeria should increase labour market flexibility by "shortening the notification period and the length of the procedure for dismissal, lowering employer contributions intending to allow laid-of workers to receive unemployment benefits, ... and allowing the employer to choose which workers to lay off without constraints".[39] "Decentralized wage negotiations" are also proposed as a means to achieve the more business-friendly climate, even though *Doing Business* does not measure anything having to do with collective negotiating arrangements in countries.[40] As noted in our analysis in paragraph 25, the general message of *Doing Business* that labour market deregulation is a good thing tends to be interpreted as concerning labour market regulations and institutions that go well beyond the specific regulations that *Doing Business* purports to analyze.

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[37] World Bank, *The World Bank and the Social Dimension of Globalization: An Update to the Board on the Bank's Activities on Employment and Collaboration with the ILO* (Washington, April 2007), p. 24. "MILES" is an acronym in which the "I" stands for "investment climate, institutions and infrastructure".

[38] ICFTU, *How the World Bank and IMF Use the Doing Business Report to Promote Labour Market Deregulation in Developing Countries* (Washington, 2006)

[39] IMF, *Algeria: Selected Issues* (Washington, February 2007), p. 28

[40] IMF, *Algeria: Article IV Consultation Staff Report* (Washington, February 2007), p. 13

Antigua and Barbuda

35. The IMF's Article IV Consultation report for Antigua and Barbuda presents graphs, based on *Doing Business* data, showing that the country has a relatively low (i.e. "good") ranking as to overall cost of doing business, "but the cost of dismissals is high'", which it strives to prove by presenting comparable cost-of-dismissal indicators for four other countries that have lower indicators than Antigua and Barbuda. The four countries presented are Belize, Estonia, Iceland and Mauritius, only one of which is remotely in the same region as Antigua and Barbuda. The IMF invokes these figures when it notes that "a stagnant working-age population and labor shortages pose challenges for labor market policy", and suggests that "reform of regulations, including for dismissals" will help meet this challenge.[41] One can only speculate as to how IMF staff – who frequently concede to trade union delegations they have no expertise in labour market issues – developed their puzzling theory that making it easier to fire workers will resolve problems of labour shortages in Antigua and Barbuda. The Article IV report offers no explanation.

Burkina Faso

36. A recent IMF loan review document on for Burkina Faso underlines the need to "improve the business environment" as determined in the *Doing Business* survey, even though it is noted that "the authorities dispute some of the numbers being used" in the Doing Business report. In order to improve the country's *Doing Business* score, the IMF asserts the need for "enhancing labor market flexibility" and "reconsidering the labor code".[42] A subsequent World Bank loan document states that part of the 2007 Poverty Reduction Support Credit loan will be used to "improve business environment", and the *Doing Business* "rigidity of employment index" will be one of the four monitoring indicators used to determine whether the objective has been achieved.[43]

Czech Republic

37. The IMF's latest Article IV report presents a table derived from *Doing Business* and states that "a recent World Bank assessment suggests that doing business in the Czech Republic is considerably more onerous than in many EU economies". The IMF notes that "the business sector views the new labor code as a missed opportunity for a substantive improvement in labor market flexibility" and then overtly takes the side of employers in asserting that "a more flexible labor market is needed to enhance growth potential". The IMF specifically calls for "reforms of social benefit entitlement programs [which] would improve incentives to work" and "reforms in the area of employment protection".[44] The IMF implies that *Doing Business* supports the need for labour market

[41] IMF, *Antigua and Barbuda: 2006 Article IV Consultation Staff Report* (July 2007), p. 16-17
[42] IMF, *Burkina Faso: Sixth Review Under the Arrangement Under the PRGF* (Washington, October 2006), p. 15 & 24
[43] World Bank, *Program Information Document: Concept Stage, Report No. AB2797* (Washington, January 2007), p. 4
[44] IMF, *Czech Republic: 2006 Article IV Consultation Staff Report* (Washington, February 2007), p. 16, 17 & 19

reform by invoking the issue just before a paragraph describing the Czech Republic's "onerous" climate for business. In fact, an examination of the *Doing Business 2007* labour market indicators shows that the Czech Republic had a lower ranking in this category than its eight closest neighbouring countries.

Georgia

38. *Doing Business 2007* designated Georgia as the "top reformer" of the year for its "far-reaching reform of labor regulation" and *Doing Business 2008* repeats praise for Georgia as a model labour law reformer. Among the features of the 2006 reform that *Doing Business* found laudable are a new law that "discards the premium required for overtime work [and] eliminates the requirement to notify and get permission from the labor union to fire a redundant worker".[45] *Doing Business* confidently affirms that by making easier for companies to dismiss workers, "Georgia's new labor regulations help workers move to better jobs". It provides no data to back up this assertion, which is not surprising since both poverty and unemployment rates were higher in 2006 than two years earlier.[46] Nor does it mention that the government of Georgia refused to consult the social partners – trade unions and employers – on the far-reaching reform, in spite of ILO advice that it do so, or that the ILO advised the government of inconsistencies with Conventions 87 and 98, which are two of the ILO's core labour standards conventions. Instead, *Doing Business 2008*, launched in September 2007, singles out Georgia as a country where "workers ... have the best protection".[47]

Greece

39. Citing the *Doing Business* labour market indicators for Greece, the IMF's Article IV report for the country called for "further reform" of labor markets so as to improve the business climate. Among the reforms the IMF urges are "relaxation of strong employment protection legislation and decentralization of the bargaining system".[48] As noted in another case, *Doing Business* does not claim to measure particular collective bargaining arrangements, but the general message of *Doing Business* that any kind of labour institution or regulation is bad has been used to preach against all forms of centralized or coordinated collective bargaining. Such a blind prejudice against coordinated bargaining may counteract the very goal of employment creation that *Doing Business* claims to espouse. The most extensive research that the World Bank carried out on the impact of collective bargaining found that "countries with highly coordinated collective bargaining tend to be associated with lower and less persistent unemployment".[49]

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[45] World Bank, *Doing Business 2007* (Washington, 2006), p. 1 & 19.
[46] IMF, *Georgia: Sixth Review Under the Three-Year Arrangement Under the PRGF* (Washington, August 2007), p. 13 & 15
[47] World Bank, *Doing Business 2008* (Washington, 2007), p. 19
[48] IMF, *Greece: 2006 Article IV Consultation Staff Report* (Washington, January 2007), p. 13 & 18
[49] Aidt & Tzannatos, *Unions and Collective Bargaining: Economic Effects in a Global Environment* (World Bank, Washington, 2002), p. 12

Jordan

40. The IMF's latest Article IV report for Jordan observes that "the World Bank's latest Doing Business Survey has shown slippages in most areas", and advises Jordan to engage in "increasing labor market flexibility by … easing hiring and firing legislation".[50] The IMF makes no mention of recent reports documenting widespread abuse of workers in Jordan, particularly among migrant workers in export processing zones.[51] The IMF's insistence that Jordan make it easier for firms to fire workers could counteract efforts that the ILO has undertaken, working jointly with the Jordanian government, to end this abuse. As in the numerous other countries where the IMF and World Bank urge labour market flexibility on the basis of *Doing Business* scores they judge to be faulty, no account is taken of the social and economic costs of eliminating labour market regulations.

Kyrgyzstan

41. Kyrgyzstan's "Employing Workers" indicator as calculated by *Doing Business* is referred to in the latest World Bank Country Support Strategy. In its most recent loan review reports for the country, the IMF also invokes *Doing Business* and goes a step further than the Bank by requiring Kyrgyzstan to undertake a labour law reform approved by the Fund as a loan condition. The following obligation is included as a "structural benchmark" in the structural conditionality that Kyrgyzstan must meet for its IMF loan: "Submit to IMF staff a report prepared by the ministry of labor and social protection recommending measures to improve labor market flexibility".[52]

Lesotho

42. In its most recent Article IV Consultation report for Lesotho, the IMF encourages the government to reduce the cost of doing business in the country. Among several other measures, the IMF takes aim at wage levels and says that it favours "downward flexibility of real wages" in Lesotho so as to "improve competitiveness".[53] The IMF does not discuss what impact the impoverishment of Lesotho's workers will have on overall poverty levels in a country where many extended family members often depend on income from a sole wage-earner. The Article IV report for Lesotho also fails to mention that wage levels in Lesotho are already lower than other countries in the Southern African region. For example, wages in Lesotho's important garment manufacturing sector are less than a third of those in neighbouring South Africa. The IMF does point out Lesotho's low wage levels in its Article IV report for Swaziland, where, in an attempt to pressure the government there to "reduce the cost of doing business", it provides data showing that wages in Lesotho are only half of those in Swaziland.[54]

[50] IMF, *Jordan: Article IV Consultation Staff Report* (Washington, March 2007), p. 17
[51] See Solidarity Center, *The Struggle for Worker Rights in Jordan* (Washington, December 2005), and ITUC, *Annual Survey of Violation of Trade Union Rights 2007* (Brussels, 2007)
[52] IMF, *Kyrgyz Republic: Article IV Consultation Staff Report* (Washington, March 2007), p. 29-30
[53] IMF, *Kingdom of Lesotho: Article IV Consultation Staff Report* (Washington, November 2006), p. 16-17
[54] IMF, *Kingdom of Swaziland: Article IV Consultation Staff Report* (Washington, March 2007), p. 14-15

Macedonia

43. *Doing Business 2007*, which was published in September 2006, praises Macedonia for having "followed a similar path" to Georgia by engaging in far-reaching labour regulation reforms. *Doing Business* notes that the new labour code "extends the maximum duration of term contracts"; "reduces both the notice period and the severance pay for dismissal"; "allows businesses to use 150 hours of overtime in a year, at normal wages"; and "scraps earlier regulations offering numerous perks to trade union leaders".[55] All of these reforms were not sufficient for the World Bank however, since six months after the publication of *Doing Business*, it issued a demand that Macedonia continue "increasing labor market flexibility", this time in the Bank's Country Partnership Strategy (CPS) for Macedonia. According to the CPS, Macedonia should further deregulate the labour market in order to "improve the business climate" and be "consistent with the MILES framework".[56] Strangely, the same document cites the results of a business environment survey showing that labour regulations were only the fifteenth obstacle mentioned by owners of firms, well below concerns such as cost of financing, contract violations, corruption, functioning of the judiciary, uncertainty about regulations and crime. The CPS for Macedonia does not address most of these concerns but does emphasise the need for more flexible labour markets, even though the new labour code was enacted in 2005.

Madagascar

44. Madagascar's most recent Country Assistance Strategy (CAS), prepared in March 2007 by the World Bank, asserts on the basis of the *Doing Business 2006* scores (which are based on January 2005 data – no reason is given why two-year-old data are used even though newer ones were available since September 2006) that "government regulations still remain burdensome". It further states that "Madagascar needs to … increase labor flexibility" and that current labour market institutions constitute a "bottleneck to investment and growth".[57] No explanation is given in the CAS for attributing this negative economic impact to Madagascar's labour market institutions. One learns from the CAS that the World Bank will carry out a labour market review, but only in fiscal 2008. It appears that the Bank already has its mind made up that labour market institutions need a major overhaul even before studying the matter. Madagascar's ranking for the *Doing Business 2006* "Employing Workers" index is also cited in the IMF's July 2007 Article IV Consultation report for the country.

[55] World Bank, *Doing Business 2007* (Washington, 2006), p. 19
[56] World Bank, *Country Partnership Strategy for FYR Macedonia* (Washington, March 2007), p. 7 & 10
[57] World Bank, *Country Assistance Strategy for the Republic of Madagascar* (Washington, March 2007), p. 12, 17 & 38

Mauritius

45. We noted in other cases above that *Doing Business* scores are sometimes used to justify a dismantling of coordinated or centralized collective bargaining arrangements, following the logic that any kind of labour market deregulation is good, even though *Doing Business* does not purport to deal with collective bargaining issues. The World Bank did this in its CPS for Mauritius, which announces that the Bank will provide a Development Policy Loan for "reforming the labor market", one facet of which will be "overhauling the current tripartite wage-setting machinery".[58] The overall aim of the reform, according to the CPS, "is to secure a position for Mauritius in the top ten most investment- and business-friendly locations in the world (according to the *Doing Business* survey)". The IMF joined in the chorus in its subsequent Article IV report for Mauritius, making it clear that the ultimate aim was to put downward pressure on wages: "labor market reforms must unfold as planned, with a view to increase wage flexibility".[59]

Mozambique

46. In common with some other countries described above, Mozambique recently introduced labour law reform, in 2006, but also in common with those countries, the World Bank continued pressuring the country to further deregulate its labour market so as to improve its *Doing Business* ranking. The Bank's 2007 CPS for Mozambique includes a Labor Market Reform project for this purpose. An earlier *Mozambique Country Economic Memorandum* published by the Bank had looked into Mozambique's labour market institutions and found that "the causation between labor market flexibility and employment growth is not always clear"; "evidence is lacking as to whether restrictive labor regulation is a binding constraint in Mozambique"; and there is "lack of evidence about potential losers from the [reform] process".[60] Despite the World Bank study expressing doubt as to whether labour market deregulation will have positive economic results, the CPS states that Mozambique's 2006 reform "falls short of the changes necessary" because it does not sufficiently reduce Mozambique's labour market rigidity ranking as calculated by *Doing Business*.[61]

Peru

47. The World Bank's CPS for Peru states that "making the labor code flexible" is among its four main priorities, the reason being that "Doing Business 2007 data ranks Peru poorly" and that, notably, "labor regulations are among the most cumbersome in the world". The CPS gives examples of how Peru's *Doing Business* labour market indicators are higher than the regional average and, especially, "the English-speaking industrialized countries average". The report specifically mentions the need to reduce firings costs and

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[58] World Bank, *Country Partnership Strategy for Republic of Mauritius* (Washington, October 2006)
[59] IMF, *Mauritius: Article IV Consultation Staff Report* (Washington, June 2007) p. 20
[60] World Bank, *Mozambique Country Economic Memorandum* (Washington, September 2005), p. 41
[61] World Bank, *Country Partnership Strategy for Republic of Mozambique* (Washington, April 2007), p. 53

non-wage costs and announces a special "Doing Business loan" to be implemented in fiscal year 2010 to address the alleged "constraints to growth". Strangely, the CPS also reports: "Peru has been the highest performer among developing countries in the region in GDP growth".[62] It provides no analysis explaining how, in this context of high growth, supposedly cumbersome labour regulations constitute a constraint to growth. Nor does it explain by how much Peru's rate of growth with increase as a result of their elimination, or what the negative impact of the elimination of labour regulation will be on workers' wages and living conditions, on poverty levels or on income inequality.

Slovenia

48. Slovenia is generally considered one of the most successful transition economies of Central and Eastern Europe (CEE) in terms of overall prosperity and labour market performance. Slovenia's GNP per capita is 55 per cent higher than that of the second most prosperous CEE country, Czech Republic, and its 2006 unemployment rate of 6 per cent is well below that of any other CEE country (the next lowest, Czech Republic, is slightly over 7 per cent). Slovenia's 6 per cent unemployment is also significantly lower than the average in the European Union's original fifteen Western European members (the EU 15), whose average unemployment was 7.4 per cent in 2006.[63] But one doesn't learn any of this from reading the IMF's latest Article IV Consultation report for the country, which instead harps on Slovenia's unsatisfactory *Doing Business* indicators as compared to some other European countries. The IMF claims that the "high cost of doing business and rigid labor markets have distracted foreign direct investment" and that therefore "structural reforms are needed in labor markets ... to reduce the high cost of employment protection legislation".[64] Some of Slovenia's economically less successful CEE neighbours have adopted the kind of labour market deregulation policies promoted by *Doing Business* and the IMF. Evidently, the IMF is not troubled by lack of success elsewhere when it calls on Slovenia to dismantle its workers' protection regulations.

Timor-Leste

49. Repeating similar language found in many other IMF Article IV reports, the report prepared for Timor-Leste reprimands the country for its poor *Doing Business* scores: "The World Bank ranks Timor-Leste as one of the most difficult countries for doing business." The assertion is supported by including a table with data from *Doing Business* comparing Timor-Leste's rankings in different categories, including for "Employing Workers", with those of some other countries and regions. The table shows that, for most categories, Timor-Leste has a worse *Doing Business* score than neighbouring Indonesia. However such is not the case for "Employing Workers", where Timor-Leste's rank is twenty-five countries better than that of the neighbouring country. Nevertheless, the IMF, which often admits that is has no expertise in labour matters, singles out the need

[62] World Bank, *Country Partnership Strategy for Republic of Peru* (Washington, December 2006), p. 8, 17, 54 & 94

[63] OECD, *OECD Statistics* data base (Paris, 2007) and World Bank, *2007 World Development Indicators* (Washington, 2007)

[64] IMF, *Republic of Slovenia: Article IV Consultation Staff Report* (Washington, May 2007), p. 18, 20 & 22

for new legislation to "encourage greater labor market flexibility" as one of the two priority areas in Timor-Leste where "greater efforts are needed to create an environment that encourages private investment and growth".[65]

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[65] IMF, *Democratic Republic of Timor-Leste: Article IV Consultation Staff Report* (Washington, February 2007, p. 10 & 21

USCIB UNITED STATES COUNCIL FOR INTERNATIONAL BUSINESS

House Committee on Financial Services Hearing on

The Fight Against Global Poverty and Inequality: the World Bank's Approach to Core Labor Standards and Employment Creation

Wednesday, October 3, 2007, 10:00 a.m.
2128 Rayburn House Office Building

Views of the United States Council for International Business

Summary

Since private sector growth is the main engine for economic development, the World Bank's *Doing Business* report has rightly focused on helping countries develop sound regulatory environments that promote private sector development. And since the vast majority of new jobs are created by small and medium sized companies – those with the least ability to deal with excessive red tape – *Doing Business* is helping the very people who are at the heart of job growth

Women and younger workers are most affected by efforts to increase labor market flexibility – and are thus potentially the groups that stand to be helped most by reforms encouraged by *Doing Business*. Countries that have very rigid labor markets and excessive job security favor those already in the workforce. The majority of those who are excluded tend to be women and younger workers, so efforts to increase labor market flexibility will disproportionately help these two disadvantaged groups.

The *Doing Business* report is not, nor does it claim to be, a panacea for development and employment creation. It is, however, a unique and useful tool for identifying regulations and practices counterproductive to those objectives. And it has generated keen interest among reformers in developing countries eager to attract investment and improve the business climate for local enterprises. For these reasons – as well as for the lively and constructive debate that has accompanied its publication – the World Bank and the *Doing Business* team are to be commended.

Introduction

The United States Council for International Business (USCIB) is a membership organization with over 300 leading U.S. companies, professional services firms and associations that promotes an open system of global commerce. As the exclusive American affiliate of the three leading global business and employers' organizations, USCIB provides American business views to policy makers and regulatory authorities worldwide, and works to facilitate international trade and economic development.

Through one of these affiliates, the International Organization of Employers (IOE), which represents employers from 138 countries in the International Labor Organization (ILO), USCIB and our members participate directly in the work of the ILO. USCIB's Executive Vice President represents the views of American employers in her capacity as one of 14 employer representatives on the ILO Governing Body, and USCIB coordinates the U.S. employer delegation to the annual ILO International Labor Conference, which develops ILO conventions, recommendations and declarations. USCIB also represents business on the President's Committee on the ILO and its legal subcommittee, the Tripartite Advisory Panel on International Labor Standards. The views expressed in this paper also reflect those of the IOE.

USCIB is therefore well placed to discuss ILO standards and how they do – or do not – relate to the World Bank's approach to employment creation, particularly as articulated through its series of *Doing Business* reports and the indicators on which these reports are based. USCIB recently hosted the launch of the *Doing Business* 2008 report. To help inform the panel discussion, USCIB suggests five key points for Committee consideration:

1) The World Bank's *Doing Business* project speaks to the relationship between economic development, regulation, and employment creation;
2) The World Bank's *Doing Business* indicators on employing workers are fully consistent with ILO labor standards;
3) *Doing Business* promotes a U.S.-style approach to labor market flexibility;
4) *Doing Business* suggests ways to reduce the informal economy, where workers have no protections;
5) *Doing Business* has not led to changes in labor legislation to the detriment of workers.

1) The Relationship Between Development, Regulation, and Job Creation

"An environment that supports investment, growth and entrepreneurship is essential to the creation of new job opportunities." This quotation is from a 2006 Ministerial Declaration of the U.N. Economic and Social Council. It reflects a consensus expressed in any number of internationally agreed declarations on the relationship between appropriate policy and regulatory frameworks, business formation, and employment. There is also widespread consensus on the role of small and medium -sized enterprises as the chief engines of job creation.

A good regulatory environment for business does not mean no regulation. Places with excellent business climates are not characterized by lack of rules, any more than heavier business regulation is simply associated with better social outcomes. All successful economies regulate, but they seek to do so in ways that are appropriate to their circumstances and least costly and burdensome to their businesses. Sometimes this may require simplifying laws and regulations; sometimes dismantling them. In this context, the World Bank's *Doing Business* reports provide a valuable service in shedding light on those aspects of business regulatory environments that are conducive to doing business and those that are not.

2) The indicators on employing workers are fully consistent with ILO standards

It has been claimed that the World Bank ignores, or even undermines, fundamental labor rights because the *Doing Business* report does not address or measure such rights. However, the methodology behind the indicators on employing workers in the 2008 report has been refined to ensure that the indicators are consistent with all 187 ILO conventions.

These 187 ILO conventions cover 22 main subject areas and address virtually every aspect of working life. Eight of the conventions – concerning the elimination of forced labor, the abolition of child labor, the elimination of discrimination in hiring and work practices, and freedom of association and the right to collective bargaining – are considered "core" or "fundamental" conventions. It is the obligation of every government, by virtue of its membership in the ILO, to uphold the principles that animate them. There is no conflict between the World Bank's *Doing Business* indicators and these fundamental conventions: a country can both comply fully with all of the fundamental conventions and earn the top score on the *Doing Business* "ease of employing workers" index. This is the case with Georgia, which has some of the most flexible labor regulations in the world and has ratified all eight of the ILO core labor conventions. Georgia scores high on the index because the index is based on a set of variables that measure the flexibility of regulations, not whether a country violates any of the core labor standards.

Thus, the methodology in the *Doing Business* section on employing workers examines a completely different set of issues: (1) types of labor contracts, (2) whether there is a trainee wage, (3) work schedule and overtime restrictions, (4) rules governing redundancy termination, (5) non-wage labor costs (such as social security payments and payroll taxes) and (6) the cost of firing. These issues are covered in four ILO conventions. The attached paper, prepared by the International Finance Corporation (IFC), discusses in some detail the relationship between these conventions and the practices covered in the *Doing Business* report.

3) *Doing Business* promotes a U.S.-style approach to labor market flexibility

What the *Doing Business* indicators on employing workers do measure is red tape and labor market flexibility. Many governments try to balance labor market flexibility and job security. Some reach a good balance, as in the U.S., which is ranked first in the *Doing Business* report on ease of employing workers. Others do not. *Doing Business* is useful in highlighting where governments have tipped the scales in favor of job security at the expense of job growth.

Extensive and rigid labor law protections in Africa, for example, do not seem to have helped raise many workers out of poverty. In Sierra Leone, it costs an employer 189 weeks of severance pay to dismiss a worker. Workers in Eritrea are entitled to 34 days paid vacation, the highest in the world. Other Sub-Saharan African countries provide generous maternity benefits. But the sad fact is that these protections apply only to a tiny percentage of the workforce (mainly public sector workers). In these countries, providing job security and gold standard social protection have been given a higher priority than all other objectives, including helping businesses to create new jobs and helping the jobless find work. Such regulations work to the detriment of both workers and employers, because they apply to so few people. In many countries, the vast majority of workers are forced by excessive regulation into the informal economy, where they have no rights or protections at all.

4) Doing Business addresses the causes of informality where workers have no protections

In general, countries with effective business regulations – those ranked highest on *Doing Business* – have small informal economies. Those with restrictive regulations – those ranked lowest – have informal economies larger than the formal economy. In Bolivia, the World Bank estimates that 400,000 workers have formal jobs in the private sector – out of a population of 8.8 million. In India, a country of 1.1 billion people, 30 million workers have such jobs. In Malawi, 50,000 out of a population of 12 million. In Mozambique, 350,000 in a country of 20 million. In these places, rigid or inappropriate labor regulations does, or at least contributes to doing, the exact opposite of what it was designed to achieve – it protects a few workers to the detriment of the workforce as a whole. In such countries, entrepreneurs will start businesses anyway, but they will be unlicensed – informal. This means no taxes are paid, but it also means no access to credit, no ability to enforce contracts, and no guarantee of labor protections.

By helping countries to improve their business climates, *Doing Business* is helping workers move from the informal economy to the formal economy and thus to better labor protections. Following reforms in Mexico, the number of registered businesses jumped nearly 6% and employment increased by 2.6%. A study of Peru has estimated that the size of the informal economy would drop from 60% of the economy to 37% if their regulations to start a business were as simple as those in the U.S. In additional to moving those workers into the formal economy and better protections, formal businesses hire four times as many workers as informal ones, leading to more new jobs.

5) Doing Business has not led to a major overhaul of labor legislation to the detriment of workers.

With all the sharp attacks on *Doing Business* and the claims that it undermines labor rights around the world, one might expect that that most of the reforms from *Doing Business* concern labor regulations. In reality, the exact opposite is true. Of the 178 countries included in the *Doing Business* ranking, only 12 made significant changes to their labor codes in 2006-7 that can be attributed to the *Doing Business* indicators. And of these, eight increased labor flexibility, while four made labor regulations more rigid. Nor is there any evidence that workers' rights have been diminished by the changes.

Here are some examples of labor reforms that have been enacted as a result of the *Doing Business* project:

- The Czech Republic revised its labor code to provide more flexible working hours. It also reduced the notice period for a dismissal from 3 months to 2 months, but increased the severance pay by an additional month.
- Latvia extended the maximum duration of fixed-term contracts from 2 years to 3 years.
- Spain made it easier for employers to convert workers' contracts from fixed term to open ended, resulting in over 125,000 conversions.
- Uganda removed restrictions on weekend work; employers and employees are now free to mutually agree on the legally required day of rest.
- Pakistan extended overtime limits for retail workers from roughly 3 hours a week to 12 hours a week and made working hours more flexible.
- Bhutan eased restrictions on night work and allowed pregnant women to work past 9:00 p.m., if they so choose.
- On the other hand, some countries made labor regulations more rigid: Venezuela extended its ban on layoffs to anyone earning three times the minimum wage. Moldova increased its severance pay requirement from 20 weeks to 28.7 weeks.