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**Liberia.**  
**Expanding formal employment through labour market reforms.**

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# Liberia.

## Expanding formal employment through labor market reforms.

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«Jobs are instrumental to achieving economic and social development. Beyond their critical importance for individual well-being, they lie at the heart of many broader societal objectives, such as poverty reduction, economy-wide productivity growth, and social cohesion. The development payoffs from jobs include acquiring skills, empowering women, and stabilizing post-conflict societies. Jobs that contribute to these broader goals are valuable not only for those who hold them but for society as a whole: they are good jobs for development.»

(World Development Report 2013 on Jobs, World Bank)

The objective of this report is to provide an **assessment of labor market regulations** in Liberia, in particular **employment protection legislation (EPL)**, **minimum wages**, and **social insurance** schemes. This is particularly relevant as a new labor code, the Decent Work Bill, has just been legislated with a twofold increase in the minimum wage, rising concerns that it will further reduce an already limited demand for formal employment (less than 20% of total employment). Without changing the Decent Work Bill, which is taken as a political constraint, the report makes proposals for reforms “at the margin” aimed at extending demand for formal employment, with specific social insurance schemes targeted at the newly formalized employees.

## Table of contents

Executive summary.....	3
1. Conceptual framework.....	4
2. The Liberian labor market. ....	8
3. Employment protection legislation and minimum wages in Liberia.....	11
4. Effects of EPL.....	15
5. Is EPL too high in Liberia?.....	17
6. Effects of minimum wages. ....	20
7. Is the minimum wage too high in Liberia? .....	22
8. Social insurance schemes .....	25
9. Reforming civil service insurance schemes .....	28
10. A new labor contract for the informal sector.....	29
11. Conclusions.....	32
References.....	34
Appendix A. The extent of the informal employment – cross-country comparison.....	38
Appendix B. EPL index. ....	40

## Executive summary

- Providing social protection in poor and especially very poor countries faces a major challenge coming from the lack of formality of many employment relationships, which reduces the scope for labor market regulations, in particular employment protection legislation (EPL), minimum wages, and social insurance (pensions and disability) schemes, all applying to formal employment only.
- The relationship between informality and regulations however runs in both directions: not only informal employment has an impact on the effectiveness of labor laws; obligations which are too difficult to understand and too costly or too difficult to comply with deter formal employment, increasing unemployment, self-employment and irregular employment.
- Employment protection as granted by the new Decent Work bill is high in Liberia. However, the available international empirical evidence suggests that the impact of EPL is smaller than the intensity of the debate would suggest, in part because of the limited enforcement that EPL regulations have, due to insufficient administrative capacity. There is however a cost of regulation that goes beyond increased hiring and firing costs: red tape. EPL is just one of the many formalities that registered businesses have to comply with, and that create an incentive to remain in the informal economy.
- The major expected effect of the Decent Work bill does not come from EPL but rather from the twofold increase in the minimum wage. The available empirical evidence suggests the new level of the minimum wage is too high and, if strictly enforced, might cause a contraction in formal employment of at least 30%.
- Social insurance (pensions, work injuries and disability) schemes confirm the picture of a pyramidal labor market, with increasing levels of protection and benefits: at the bottom are informal employees (more than 80% of total employment), who get nothing. They are not protected against unfair or discriminatory dismissals, work injuries and disability, they are not subject to a minimum wage, and will receive no pension at old age. The middle layer is made of formal employees in the private sector (13.3% of total employment). These workers benefit from EPL and minimum wage, have the right to an old age pension and are insured against work-related injuries and illnesses. At the top are civil servants (4.6% of total employment), with the highest job protection and additional pension and disability schemes.
- To reduce disparities and improve fiscal sustainability, a first proposal is to align the benefits of civil servants to those in the private sector, by canceling the Public Service Pension scheme.
- To improve coverage and protection, extending formal employment, a second proposal is to introduce a new labor contract, labeled 'junior contract', with little formalities and almost zero red tape as a first step into formal employment. The incentives to use this contract come in the form of a government subsidized pension voucher, which workers can either save until retirement, or give to an elder relative for immediate cash in. Such vouchers serve therefore three goals: i) formalizing employment relationships, ii) help workers who can afford it build their retirement savings, iii) provide cash transfers to households in needs, through a self-targeted mechanism.

## 1. Conceptual framework

When it comes to the goal of promoting more and better jobs, there is ample consensus that **growth is essential**, and policies aimed at fostering and nurturing economic development and employment should be right at the center of any discussion.<sup>1</sup> Sustained growth can change people's lives and perspectives in just a few decades.<sup>2</sup> With reference to Liberia, key determinants that impede economic growth include insufficient **access to financial capital, physical capital (infrastructures) and human capital (education and health)**<sup>3</sup>, while a crucial issue is **governance**, in particular the development of inclusive rather than extractive political and economic institutions, and a regulatory framework that limits the scope for rent seeking behavior on the part of both private businesses and public officers<sup>4</sup>.

Economic growth alone however is not sufficient to bring social cohesion and prosperity to a country. Two other fundamental ingredients are **limitation of inequality**<sup>5</sup> among the members of the society and **risk management** in individual life-time trajectories<sup>6</sup>. Social protection serves these two goals from **a top-down approach**, that is, with the government providing **social insurance, social assistance, basic welfare provisions and social legislation** to its citizens (box 1).<sup>7</sup> Moreover, there is ample evidence that social protection can **contribute to and reinforce growth** itself, by permitting more investment in human and physical capital, increasing returns on those investments thanks to better health, nutrition and cognitive development, encouraging riskier but more productive activities.<sup>8</sup> The beneficial effects of social protection on the economy and the labor market also include smoothing the economic cycle and protecting against employment-related accidents and occupational diseases. Finally, social services provide an important number of jobs themselves, usually with a high share of female employment.<sup>9</sup>

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<sup>1</sup> See WB (2012d), OECD (2009a).

<sup>2</sup> At the current 2.7% annual population growth rate (in line with Sub-Saharan countries average), to meet the Liberia RISING 2030 (GoL, 2013a) target of making Liberia a middle income country by 2030, with a level of GDP per capita of at least 1,000 US\$ in constant terms (starting from a level of 421 US\$ in 2012), an average annual growth rate in GDP of 7.8% is required.

<sup>3</sup> See Dessus et al. (2012), Foster and Pushak (2011), Kaplan et al. (2012), the Liberia Inclusive Growth Diagnostic report (WB, 2012b) and Liberia's New National Development Plan (WB, 2013a) prepared by the World Bank. For a broader perspective on growth and development in Africa, see ACET (2014).

<sup>4</sup> See Kaplan (2008), Acemoglu and Robinson (2013).

<sup>5</sup> See UNDP (2013) and UN (2012).

<sup>6</sup> *Risk management* comprises *risk mitigation* (protecting income and consumption in the face of shocks such as disease, unemployment, or disability in old-age), *risk coping* (combating poverty and deprivation by ensuring access to a basic set of goods and services) and *risk reduction* (improving individuals' earnings opportunities by promoting investments in human capital, giving access to credit, and improving the functioning of labor markets). In the terminology of the World Bank Social Protection and Labor Strategy (WB, 2012c) these three functions correspond to the three characteristics of *resilience* (insuring against the impacts of different shocks), *equity* (protecting against destitution) and *opportunity* (promoting human capital and access to productive work) –see Robalino et al. (2012).

<sup>7</sup> Howell (2001).

<sup>8</sup> See OECD (2009b), ERD (2010), Lal et al. (2010).

<sup>9</sup> See EU/ILO (2013).

### **BOX 1: Social protection.**<sup>10</sup>

Social protection can be regarded as a kind of insurance policy against poverty and a tool for delivering social justice, as well as a means of promoting inclusive development. It is an expression of solidarity and cohesion between the haves and have-nots, between different social classes, between employers and workers, between governments and citizens, and even between nations. Social protection is usefully distinguished in social insurance, social assistance, (basic) social security and social legislation.

**Social insurance** schemes are contributory: they involve the provision of semi-standardized benefits in an automatic and impartial form, on the basis of specific individual rights and duties (such as the payment of contributions). Coverage is typically occupational. Social insurance differs from private insurance as it is compulsory (which allows the elimination of adverse selection problems) and financed through contributions (proportional to income, and linked to average risk profiles) rather than premia (computed on the basis of individual risk profiles). As such, it shares with other social protection measures a redistributive nature. Examples of social schemes are retirement pensions, unemployment compensation schemes and injury and illness-related benefits.

**Social assistance** programs are non-contributory and financed through general taxation: they are discretionary and conditional interventions designed to respond to specific needs in a targeted manner. Coverage is universal but selective (with respect to the specific needs and characteristics of individuals or families) and residual (with respect to the ability of individuals or families to face these needs). Examples are cash and in kind transfers, fee waivers, school feeding, labor market programs such as skill-building, job search and matching assistance, etc.

**(Basic) social security** measures, or social security *strictu sensu*, are also universal and financed through general taxation: differently from social assistance however, they involve unconditional measures with egalitarian payments and services (eg. health and education in many countries).

**Social legislation** is aimed at reducing risks in the first place and identifying liabilities for those risks. In particular employment protection legislation (EPL) refers to hiring and firing rules and provides protection in case of workers' dismissals. Other regulations involve matters such as child labor, working conditions, discrimination in the workplace, health and safety regulations, rights to strike, form and join unions, maternity rights, and minimum wages. Labor market regulations are often complemented by a system of employment relations (also termed 'industrial relations') covering other institutional arrangements that characterize and shape the employment relationship, from employee voice mechanisms in the workplace, to collective bargaining arrangements at company, regional, or national level.

**Social protection has gained momentum** in Africa, with a number of recommendations, declarations and initiatives taken in the past ten years by national and regional organizations.<sup>11</sup> It is now widely acknowledged that institutional risk-reduction policies are **affordable even in poor African countries**<sup>12</sup>: while a comprehensive package may still be beyond reach, individual programs and projects are deemed feasible in most countries including Liberia, laying a foundation for a comprehensive and more articulated system in the longer term. Success seems to be related to the presence of a **strong political commitment** and **well-designed implementation mechanisms**, combining high-level policy guidance with heavily decentralized delivery mechanisms, possibly building on existing informal schemes.

However, providing social protection in poor and especially very poor countries faces a **major challenge coming from the lack of formality** of many employment relationships: **self-employment and "cashwork"** (work for cash

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<sup>10</sup> *Social security and welfare* are also used as a synonym of social protection.

<sup>11</sup> See ERD (2010) for a brief history.

<sup>12</sup> See ISSA (2008, 2011), O'Clairigh (2009), UNICEF (2009), Durán-Valverde and Pacheco (2012).

without any formal agreement or expectation of continuity) in urban areas, and **rural employment** in the countryside.<sup>13</sup> In the case of Liberia, these form of employment cover more than 80% of total employment, but Liberia is not different from other low and middle income countries in this respect. Another challenge comes from **insufficient administrative capacity**, which limits the possibility of administering means tests and more in general compromises targeting. This is why **social security, with universal and unconditional schemes providing a basic social protection floor** to all citizens, is of primary importance in these countries: in particular free or heavily subsidized access to **health and education, school and child-feeding** programs and possibly non-contributory **social pensions** schemes.<sup>14</sup> This is also the rationale of the Social Protection Floor initiative undertaken by the ILO, with the collaboration of the WHO under the framework of the United Nations.<sup>15</sup>

Still, because these schemes are not targeted to disadvantaged groups, they risk to benefit disproportionately the less poor. This is particularly true in rural areas, where it is more difficult both for the government to provide public services<sup>16</sup> and for the citizens to access them<sup>17</sup>. In rural areas, where the top-down approach of social protection is more difficult to implement, an alternative strategy is for the government to favor **bottom-up risk management and inequality reduction through resource-sharing** among members of a local community. Community-based social protection (CBSP) mechanisms encompass not only micro-insurance or community-based schemes that directly manage an insurance mechanism but also institutions established by civil society (eg. cooperatives, associations or micro-finance institutions) that among other objectives facilitate the access of their members to insurance mechanisms.<sup>18</sup> These cooperative efforts might also involve production: pooling resources between farmers through farmers' organizations and cooperatives also allows the exploitation of **economies of scales to improve access to markets, technology and land**, hence boosting productivity and ultimately economic growth.

Figure 1 depicts how all the elements described above interact with each other, allowing the activation of either **virtuous or vicious cycles**.

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<sup>13</sup> See Lund (2009).

<sup>14</sup> See ILO (2010, 2012a).

<sup>15</sup> ILO (2011a, 2012a).

<sup>16</sup> For instance because of lack of doctors and teachers willing to live in remote areas.

<sup>17</sup> For instance because of transport costs and opportunity costs of lost home production.

<sup>18</sup> Coheur et al. (2008). See also Habtom and Ruys (2006) and Barrientos and Barrientos (2002).

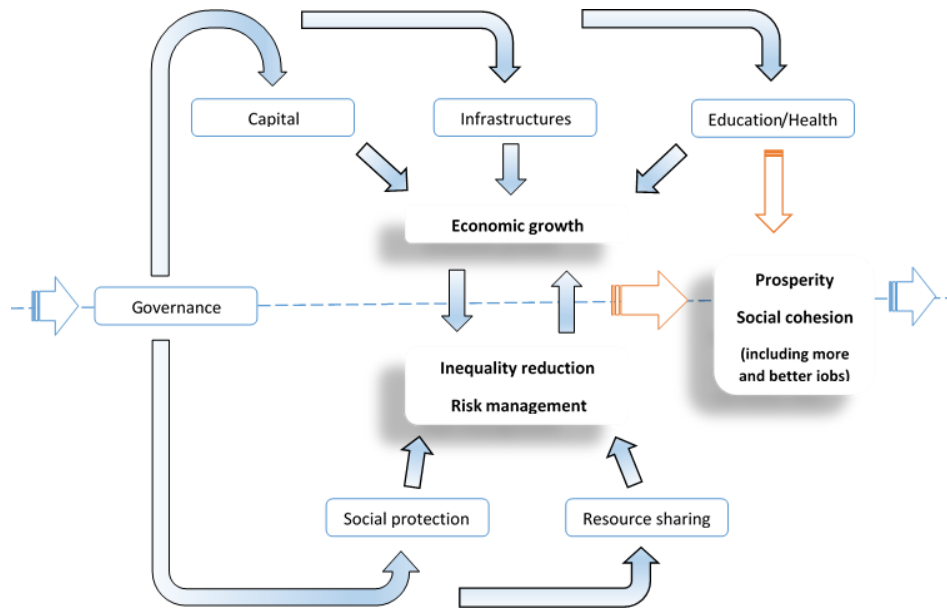


Figure 1. The road to prosperity and social cohesion.

The objective of this report is to provide an **assessment of labor market regulations** in Liberia –in particular **employment protection legislation (EPL), minimum wages, and social insurance** (pensions, work injuries and disability) schemes– in this broader perspective. **Labor market regulations only apply to formal employment, but they contribute to determine its extent:** obligations which are too difficult to understand and too costly or too difficult to comply with deter formal employment, increasing unemployment, self-employment and irregular employment. The World Bank, in a background note for the World Bank 2012–2022 Social Protection and Labor Strategy<sup>19</sup>, identifies five main labor market challenges for Low- and Middle-Income Countries: the first is the **size of informal employment** (the «share of the labor force that is self-employed or working in household enterprises in low productivity activities, often without pay», which amounts to 81% of workers in Sub-Saharan Africa), while the second is **limited access to risk management systems**, which leaves too many people exposed to income shocks. In the report we investigate whether changes in the current labor market regulations can enlarge the size of formal employment, allowing more people to access basic insurance mechanisms and in the process enlarging the tax base and building improved administrative capacity. We show how the system is now comprised of three levels of employment relations, enjoying increasing protection and benefits: informal employment, formal employment in the private sector, and formal employment in government. While we touch upon the issue of aligning the benefits of civil servants to those in the private sector, the bulk of our analysis focuses on how to enlarge the scope for social protection by increasing the extent of the formal economy, that is, by **creating incentives for attracting more workers and employers into formal employment relationships**. We propose the introduction of a second-tier labor contract, labeled '**junior contract**', with little formalities and almost zero red tape as a first step into formal employment. The junior contract involves a different social contribution mechanism with respect to standard contracts, and lower protection against dismissal. The incentives for using this contract mainly come from a government-subsidized pension voucher, which workers

<sup>19</sup> WB (2012e).



can either save until they reach retirement age, or give to a relative already above retirement age for immediate cash-in, at a discount value.

The report is structured as follows. Section 2 offers a brief description of the Liberian labor market, with a large share of informal employment. Section 3 reviews Liberian labor market regulations (employment protection legislation and minimum wages), with a detailed analysis of the provisions contained in the recent Decent Work bill. Section 4 looks at the effects of EPL, both in theory and according to the empirical evidence. Section 5 asks whether EPL is too high in Liberia, and the answer is likely yes, in particular as it contributes to the red tape (ie. bureaucracy) that deter formal employment relationships. Section 6 looks at the effects of minimum wages, again both in theory and in practice, while section 7 asks whether the recently legislated 4 US\$ per day level for the minimum wage of unskilled laborers is too high: the answer is definitely yes. The previous level of 2 US\$ per day, or neighborhoods thereof, seem more appropriate to the Liberian labor market. Section 8 looks at social contribution rates and benefits, both for the private and the public sector. A proposal for a drastic reform of the social protection schemes for civil servants is advanced in section 9. The discussion of EPL, minimum wages and social insurance schemes paves the way for a proposal to introduce a new labor contract as an intermediate step between informal and formal employment (section 10). Finally, section 11 offers some concluding remarks.

## 2. The Liberian labor market.

As it is well known, official statistics on **unemployment** in very poor countries as Liberia suffer from two problems: first, they depict only a partial and not very useful description of the labor market, as most people cannot afford to stay idle so they become self-employed and get engaged in some petty activity, possibly in exchange of food, other goods, or some limited amount of cash; second, the statistics are not regularly updated. For example, the latest data available for Liberia date back to 2010 and put the *unemployment rate at a mere 3.7%* at a national level (table 1).<sup>20</sup>

	Labour force participation rate (%)	Inactivity rate (%)	Employment-to-population ratio (%)	Unemployment rate (%)	Vulnerable employment rate (%)	Informal employment rate (%)
<b>Liberia</b>	<b>62.8</b>	<b>37.2</b>	<b>60.5</b>	<b>3.7</b>	<b>77.9</b>	<b>68.0</b>
Urban areas	54.9	45.1	52.0	5.5	67.5	59.3
Rural areas	71.2	28.8	69.6	2.3	86.1	75.0
Male	66.1	33.9	63.8	3.4	68.3	61.3
Female	59.9	40.1	57.5	4.1	87.3	74.7
Greater Monrovia	52.8	47.2	49.3	6.5	63.2	56.6

Table 1: Labor market indicators. Source: LISGIS (2011, Executive summary).

**Underemployment** might be a more appropriate concept for describing such labor markets. People are underemployed, according to the ILO standards, if they work less than some nationally defined threshold, they are willing to work additional hours, and they are available to work additional hours. In Liberia LFS 2010 data the

<sup>20</sup> A second wave of the LFS by the Liberian statistical office (LISGIS) is planned for 2015 but lack of funding might result in a delay.

underemployment rate is however also very small, at 3.3% of the labor force (table 2): Liberians might be involved in “petty jobs”, but they are around for many hours a day (the average number of weekly hours worked in the 2010 data is 47).

	Urban			Rural			Total		
	Male	Female	Total	Male	Female	Total	Male	Female	Total
Number working < 40 hours & want more	6,000	8,000	14,000	11,000	12,000	23,000	17,000	20,000	37,000
Total hours currently worked by them	132,000	164,000	296,000	301,000	254,000	556,000	433,000	419,000	852,000
Average hours currently worked last week	21.5	20.4	20.9	27.6	21.5	24.4	25.4	21.1	23.1
Total additional hours wanted	54,000	76,000	130,000	82,000	108,000	190,000	135,000	184,000	320,000
Average additional hours wanted per week	8.7	9.5	9.1	7.5	9.2	8.4	7.9	9.3	8.7
Underemployed, as % of LF	2.4	3.1	2.8	3.5	3.8	3.7	3.0	3.5	3.3
Underemployed, as % of eligible pop	1.4	1.6	1.5	2.6	2.6	2.6	2.0	2.1	2.0

Table 2: Persons in time-related underemployment. Source: LISGIS (2011, table 6.7).

If unemployment and underemployment are concepts of little use in countries as Liberia, a more relevant measure could be that of **vulnerable employment**, defined as being an own-account worker (self-employed without employees) or contributing family member (without a pay), and the vulnerable employment rate is obtained by dividing this figure by the total employment. The 2010 figures put the *vulnerable employment rate* at 78.8% nationwide (table 3).

Status in employment	Urban			Rural			Total		
	Male	Female	Total	Male	Female	Total	Male	Female	Total
Paid employee	96,000	34,000	130,000	52,000	13,000	65,000	148,000	47,000	195,000
Employer	9,000	6,000	15,000	3,000	4,000	7,000	12,000	9,000	22,000
Own account worker	110,000	172,000	282,000	192,000	201,000	393,000	302,000	373,000	675,000
Member of producers' cooperative	4,000	2,000	6,000	4,000	2,000	5,000	7,000	4,000	11,000
Contributing family worker	19,000	25,000	44,000	49,000	81,000	130,000	68,000	107,000	174,000
<b>Total</b>	<b>239,000</b>	<b>240,000</b>	<b>479,000</b>	<b>300,000</b>	<b>301,000</b>	<b>601,000</b>	<b>539,000</b>	<b>541,000</b>	<b>1,080,000</b>
Paid employee	40.5	14.2	27.3	17.2	4.4	10.8	27.5	8.7	18.1
Employer	3.8	2.5	3.1	1.1	1.2	1.1	2.3	1.8	2.0
Own account worker	46.2	72.0	59.1	64.2	66.7	65.5	56.2	69.1	62.7
Member of producers' cooperative	1.6	0.8	1.2	1.2	0.6	0.9	1.4	0.7	1.0
Contributing family worker	7.9	10.6	9.3	16.3	27.0	21.7	12.6	19.8	16.2
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Vulnerable employment indicator (%)	54.1	82.6	68.4	80.5	93.8	87.2	68.8	88.8	78.8

Table 3: Status in employment and vulnerable employment. Source: LISGIS (2011, table 4.6).

Vulnerability is linked to the high share of **informal employment** (see again table 1), which is a common problem of very poor countries (see Appendix A). Summing vulnerable employment to unemployment gives something we might label **labor market distress**, which in 2010 amounted for Liberia to 78.6% of the labor force.<sup>21</sup>

BOX 2: Measuring labor market distress.

Measuring labor market distress by looking at vulnerable employment and (formal) unemployment is intuitive and informative. However, this measure suffers from two problems: **i) it cannot be easily compared** to measures of unemployment in other countries, in particular in developed countries, and **ii) it cannot be easily updated**. With respect to the first problem, we do not know whether the 78.6% figure is equivalent to an unemployment rate in developed countries of about 80%, nor we have any theoretical or applied tool for making a conversion. With respect to the second problem, updating the figures requires working with a representative sample of individuals, which basically means replicating the LFS. A more easily obtained measure of excess labor supply is the length job queues for formal vacancies at big firms.<sup>22</sup> Tracking job queues over time allows an easy monitoring of the labor market. Moreover, under some assumptions, data on vacancies and job queues can be manipulated to obtain an **implicit unemployment rate** for the formal sector which can be used for **cross-country comparison** (Richiardi, 2014).

As an example, we report the size of job queues at selected (big) firms in Monrovia:

Firm ID	Sector	Occupation	Total employment <sup>1</sup>	Vacancies opened (last year)	Average applications per vacancy <sup>1</sup>
1	Banking	Bank tellers / customer service	60	30	16.7
		IT workers	7	5	12.5
2	Telecommunications	All employees	109	22 <sup>1</sup>	37.5
3	Hotel and restaurants	All employees	125	20	42.5
4	Cement	Unskilled	85	10	72.5
		Skilled	35	7	20
		Technical	10	3	7

Table 4: Job queues, March 2014, selected companies in Monrovia.

<sup>21</sup> This figure is lower than the vulnerable employment rate because the latter is measured as a share of employment, not of labor force. The Liberian LFS sometimes incorrectly refer to the working age population as “labor force”; here, labor force is defined according to the ILO standards as employed + unemployed.

<sup>22</sup> The main advantage of looking at job queues in the formal sector is that it requires interviewing only a restricted number of human resource managers at large companies rather than a representative sample of individuals and is therefore quicker and cheaper to implement than standard labor force surveys –in Liberia in April 2013 there were only 71 registered companies with more than 50 employees out of 9,385 businesses (source: Liberian Business Registry, see box 3). Moreover, It also provides a measure of excess labor supply differentiated by types of jobs (as defined by occupation/industry), in accordance with the observation that labor markets are often segmented.

### BOX 3: Firm size distribution in Liberia

According to Business registry data (April 2013 updates), 60.9% of the 9,385 registered businesses are micro (0-3 employees), while 37.4% are small (4-20 employees) and 1% are medium (21 to 50 employees). There are only 71 registered firms with more than 50 employees (table X). Building Markets, an NGO, has a database of Liberian suppliers comprising 2,738 enterprises. Firm size in this sample is moderately bigger.

Firm type	Size	Business Registry		Building Markets data	
Micro	0-3 employees	5712	60.9%	1082	39.5%
Small	4 - 20 employees	3507	37.4%	1279	46.7%
Medium	21 to 50 employees	95	1.0%	239	8.7%
Large	51 + employees	71	0.8%	138	5.0%
Total		9385	100.0%	2738	100.0%

Table 5: Firm size distribution. Source: Liberian Business Registry (April 2013) and Building Market database (March 2014).

A high share of informal employment is obviously a problem when it comes to providing security through labor regulations. Such labor regulations are meant to address labor market failures that result in inefficient or inequitable outcomes: excessive churning and underinvestment in training, moral hazard and adverse selection in employment-related private insurance schemes, departures from competitive equilibria due to uneven bargaining power between workers and firms, incomplete information, discriminatory practices, etc.<sup>23</sup> Employment protection legislation and minimum wages have been widely adopted to address some of these failures. EPL consists of rules governing hiring and termination and defining the degree to which job security is guaranteed. Minimum wages are the lowest hourly, daily or monthly remuneration that employers may legally pay to workers.

In the next section we review the labor market regulations in Liberia, including the new reform contained in the Decent Work Bill which is expected to be enacted later this year.

### 3. Employment protection legislation and minimum wages in Liberia.

Labor prescriptions in Liberia are detailed and diversified. A much debated Decent Work bill has finally been legislated in April 2014, after five years in Parliament. The acrimony that characterized the debate over the bill is symptomatic of the fact that labor market regulations are perceived as part of the social contract, whose changes are always a hot political issue. After the President will sign it, the Decent Work bill will replace the existing labor code, which in turn has been modified over the years, with the last amendments made in 2007.

In this section we start from describing the “old” code, as it provides a comparison for evaluating the new Decent Work bill. All labor-related topics are covered, including recruiting procedures, equal treatment, wages, probation, working hours, overtime, holidays, sick leave and medical treatment, benefits, social security and tax

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<sup>23</sup> WB (2012d).

issues, training contents of apprenticeship contracts, dismissal procedures, minimum wages, etc. Box 4 describes the main features of the “old” law.

#### **BOX 4: The “old” Liberian labor law**

**Forced labor** is forbidden. Any agreement between an employer and an employee containing the conditions and terms of employment is deemed a contract.

**Fixed term** contracts can last up to two years, and be renovated for a maximum of 18 months. Contracts can be oral or written. Contracts for less than six months or for an indefinite period are deemed **oral**, and need not to be written. Contracts for a definite period of six months or more, or contracts stipulating conditions of employment which differ materially from those customary in the district of employment for similar work, or contracts for employment outside of the Republic of Liberia must be **written**.

**Recruiting** is severely regulated.<sup>24</sup> There is a prohibition of recruiting Liberian workers abroad, an obligation to apply for a permit to the Ministry of Labour to recruit workers, a prohibition of recruiting workers aged less than 18 (which is decreased to 16 for specific occupations approved by the Ministry of Labour, “as not being injurious to the moral and physical development of non-adults”), and an obligation for the worker to certify before the Ministry of Labour to have been properly and duly recruited in accordance with the law.

A **preference for Liberian workers** over foreigners is explicitly stated. All employers are required to hire employees, except agricultural and unskilled laborers, from the lists of qualified Liberian workmen and employees maintained by the Ministry of Labor and Labor Agents. Except for administrative, supervisory, or technical positions, it is forbidden to hire a foreign employee unless the list of qualified Liberians has been exhausted or there is no qualified person on the list capable of performing the job to be filled. In the latter case, a special authorization has to be accorded by the Ministry of Labour.

The **minimum age** for work is set at 16 years. Children under age 16 are prohibited from working during the school day and may only work for wages if the employer can demonstrate that they are attending school regularly and have a basic education. However, the law does not prohibit the use of children in work that exposes them to sexual, physical, and psychological abuse; takes place underground or in confined spaces; and involves the transport of heavy loads, all of which occur in sectors where Liberian children work.

The **probation period** cannot be less than one month and more than three months.

**Termination with just cause (disciplinary dismissals)** are allowed for major offenses that amount to a “gross breach of duty” for fixed term contracts or “serious breach of duty” for open-ended contracts. No redundancy benefits must be paid: the employer is only required unpaid salaries, if any.

**Redundancy (economic) dismissals**, when the employer is compelled by economic conditions or other reason to discontinue a given business or part of it which results in loss of employment (redundancy) or when employment is severed or terminated on account of bankruptcy, dissolution, closure, or cessation of operations (severance) are subject to the payment of four weeks’ remuneration for each year of employment, with one month’s notice (two weeks in the case of a non-salaried employee) and notification to the Ministry of Labour.

**Termination without cause** requires the employer to pay the employee the salary owed for the remaining time under contract, for fixed term contracts, and one and a half month salary for each completed year of service for open ended

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<sup>24</sup> According to the law, recruiting is defined as “all operations, undertaken with the object of obtaining or supplying the labour of persons who do not spontaneously offer their services at the place of employment or at a private employment agency by the Ministry of Labour”.

contracts, including any accrued wages and all unpaid benefits, with a one month's notice (or one month's pay in lieu of notice). Moreover, no termination without cause is possible for open ended contracts after ten years of employment.

**Temporary redundancy** may last up to 3 months and are subject to a pay at 50% of salary.

Where a **wrongful dismissal** is alleged, the Labour Court has the power to order reinstatement, but may order payment of reasonable compensation to the employee in lieu of reinstatement. In assessing the amount of such compensation, the Labour Court takes into consideration (i) reasonable expectations, in the case of dismissal in a contract of indefinite duration, and (ii) the length of service. In no case the amount awarded can be higher than two years of salary or wage, computed on the basis of the average rate of salary received in the six months immediately preceding the dismissal (this limit is increased to five years if the employee was dismissed to avoid the payment of a pension).

The maximum **hours of work** is 8 hours per day and 48 hours per week. Employee who works less than 8 hours on any day of the week may be required to work overtime on other days of the week, with a maximum of 9 hours per day and 48 hours per week with no overtime pay. Regular overtime must be paid at a rate not less than fifty percent above the normal rate, and employers must keep an accurate record of overtime work. All employees are entitled to one day (24 hours) of rest per week. Exemptions are allowed for "Preparatory or compulsory work", with a maximum of 56 hours per week, "work performed at irregular intervals" and "work in which attendance at place of employment is chief requisite", with a maximum of 12 hours per day / 72 hours per week, and "industry of seasonal nature", with a maximum of 56 hours per week (but a maximum average of 48 hours per week calendar year). Special exemptions are also allowed to the 8 hour work day (for actual or imminent disaster or accident, urgent repairs to plant, equipment, machinery or other property, prevention of damages to perishable goods, "work of vital public importance" and "exceptional pressure of work"), which must be notified to the Ministry of Labour.

Public **holidays** must be paid and work is authorized only under some circumstances. A right to paid annual leave is granted, but only after the third year of employment (third year: 2 weeks; fourth year: 3 weeks; fifth year and onwards: 4 weeks).

Female employee has right to paid **maternity leave** of 3 months at full pay, and termination of employee for reason of pregnancy is unlawful. Twelve days of **sick leave** are allowed per year.

**Equal treatment:** all citizens are entitled to equal pay for equal work (art. 18 of the Constitution). This extends to foreign workers.

The **minimum wage** is set by a Minimum Wage Board, which can recommend different levels for different economic sectors and occupations. The national law prescribes a minimum wage for unskilled laborers of 0.25 US\$ per hour excluding benefits (2 US\$ per day) in the non-agricultural sector, and 1.50 US\$ per day in the agricultural sector. Skilled labor has no minimum fixed wage, and the minimum salary for civil servants was 5,600 Liberian dollars (US\$ 65) per month.<sup>25</sup>

There is no obligation to pay **benefits**: the employer remains free to decide whether to pay medical insurance, education, transport, telecommunications, etc. to the employees (as long as equal treatment is granted).

The employer acts as a withholding agent, deducting **income taxes** at source from the employees' salaries and paying them to Ministry of Finance, on a monthly basis.

Workers, except civil servants, have the right to **strike**.

With the exception of employees in state-owned enterprises and public servants, all workers have the right to form and join **unions** and engage in **collective bargaining**.

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<sup>25</sup> US Department of State (2013).

The new Decent Work Bill can be assessed with respect to the provisions discussed above.<sup>26</sup> The bill will replace the existing labor law, and will cover all workers in the formal and (in theory) in the informal sector, be them nationals or foreigners, with the **exclusion of civil servants**.

The bill brings forward a more precise definition of an employment relationship, requiring one or more of the following: i) subordination to the control or direction of the other person; ii) lack of control over the hours of work; iii) in the case of a person who works for an organisation, the person is a part of that organisation; iv) work continuity (an average of at least 40 hours per month over the last three months); v) economic dependence; vi) technical dependence (the person is provided with tools of trade or work equipment); or vii) unicity of the work relationship (the person only works for or renders services to one employer).

The bill explicitly states that all rights and protections envisaged apply to every woman and man, without distinction, exclusion or preference. A fundamental part is the enumeration of the **fundamental rights** of the workers –the equal pay principle, union and collective bargaining rights, freedom of association, prohibition of discrimination and sexual harassment.

The most controversial issue is a rise in the **minimum wage**, which is now set at 4 US\$ per day for unskilled and domestic workers, and to 6 US\$ for skilled workers. The main differences with respect to the previous labor law are listed in box 5: apart from commendable but generic statements of principle, the bill contains **little innovations with respect to the previous law, but for the twofold increase in the minimum wage**.

#### **BOX 5: The Decent Work Bill**

In addition to fixed term (definite) and open ended (indefinite) **contracts**, the bill allows for **project works**, that is, contracts for the completion of a specific task. Also, **casual employment** is added to full time and part-time employment.

A casual employee who is engaged by the same employer on a regular and systematic basis during a period of six months has the **right to convert casual employment to part-time or full time employment**, according to the number of hours the employee is usually engaged to work.

The minimum duration of the **probation period** has been removed. The maximum duration is still three months.

A distinction is introduced between disciplinary dismissals and termination for just cause.

**Disciplinary dismissals** are allowed in case of grave misconduct on the part of the employee, irrespective of the type of contract and without advance notice.

**Termination with just cause** is possible, for open ended employment, based on i) the ability of the employee to perform the work required, ii) the conduct of the employee, iii) the operational requirements of the undertaking, establishment or service. It is required that the employer implements a fair internal procedure before making a final decision whether to terminate an employee's employment with just cause.

**Redundancy dismissals** remain basically unchanged, with a severance payment of four weeks' remuneration for each year of employment, with advance notice and notification to the Ministry of Labour and the unions. The advance notice is four weeks after one year of employment, reduced to three weeks between six months and one year of employment, two weeks between three months and six months of employment, and one week below three months of employment. The requirement of advance notice is convertible in equivalent pay. A provision is made for use of the "first in, last out" principle in determining which employees to make redundant.

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<sup>26</sup> The comments made here are based on the last draft available.

**Termination without cause** is no longer possible. Provisions for **wrongful dismissals** remain basically unchanged, with an additional option for the Ministry or the court to order both reinstatement and compensation.

**Hours of work** and **leave periods** are only marginally changed.<sup>27</sup>

The **minimum wage** is set to 4 US\$ per day for unskilled and domestic laborers and to 6 US\$ per day for skilled workers, with the Minimum Wage Board in charge of periodical re-evaluations.

## 4. Effects of EPL

The economic literature breaks down turnover costs into recruitment costs (looking for and selecting suitable workers), training costs (providing firm-specific training) and dismissal costs. While the first two types of costs are specific to the nature of labor relationships (eg. more or less specialized), dismissal costs are more closely linked to regulations, in particular EPL. From a theoretical point of view, an increase in dismissal costs has a very clear effect, that is, a **decrease in turnover but not necessarily in the average level of employment**.<sup>28</sup> In fact, higher dismissal costs push down the number of both dismissals and hires. Knowing that it is more costly to dispose of surplus workers if they need to, companies are consequently more reluctant to recruit them when the demand calls for it. Conversely, the effect on average employment in the medium term remains uncertain. From the employers' point of view, the disadvantage deriving from a lower turnover is a decrease in flexibility and in the ability to swiftly adapt to demand conditions, with a consequential loss of competitiveness with respect to firms not affected by the regulation (including foreign businesses).<sup>29</sup> From the workers' perspective, lower turnover is **good for insiders** (those who already have a job) but **bad for outsiders** (unemployed and new labor market entrants). In particular, with lower turnover the average duration of unemployment and the share of long-term unemployed increases. At a macroeconomic level, even if the level of employment is unaffected, hiring and termination restrictions can slow down labor reallocation and hence constrain productivity growth.<sup>30</sup>

However, less turnover also presents positive aspects.<sup>31</sup> More stable employment arrangements encourage **investments in human capital** and thereby increase productivity, the willingness of workers to accept technological change and internal job mobility. From the perspective of workers, EPL increases job security and therefore also income security, reducing labor market risks. At a macroeconomic level, EPL acts as a **stabilizer of**

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<sup>27</sup> In the current draft, the maximum hours of work is still 8 hours per day and 48 hours per week. Employee who works less than 8 hours on any day of the week may be required to work overtime on other days of the week, with a maximum of 12 hours per day (it was 9 hours in the old law) and 48 hours per week with no overtime pay. A collective agreement may provide for averaging of ordinary hours of work and overtime over a period of up to four months, with a maximum of 53 ordinary hours and 5 overtime hours per week. The weekly rest period is extended to 36 consecutive hours which, unless otherwise agreed in writing, shall include Sunday. Provisions concerning overtime pay, seasonal industries, cases of urgency, public holidays, sick leave and annual leave remain basically unchanged. Entitlements to annual leave can be cumulated for up to three years. Annual leaves must be taken in no more than two periods of no less than one week. Lunch break is extended to one hour. A 14-week maternity leave is granted (it was three months in the old law), with a minimum of 6 weeks of leave after the date of birth. The maternity leave can be extended for one unpaid month, following medical advice and certification. Fathers are entitled to a 5-day leave without pay at the time of the child's birth.

<sup>28</sup> Bertola (1990).

<sup>29</sup> Possible negative effects on the level of employment are mainly linked to this supposed loss of competitiveness.

<sup>30</sup> These negative effects of EPL have been the basis for a call for increased liberalization of labor markets, powerfully advanced by the influential OECD *Jobs Study* (Oecd, 1994).

<sup>31</sup> See Berton et al. (2012).



**employment over the business cycle**, whereas a higher sensitivity of employment to the economic cycle would leave workers more exposed to the risk of unemployment at exactly the time when the situation of the labor market is at its most difficult. As a result, the net effect of EPL on the level of employment is theoretically ambiguous: in economic models, it depends on such subtle features as the functional form of labor demand functions, the persistence of labor demand fluctuations, and the size of discount and attrition rates.

In **dual labor markets**, where one category (formal employment) is covered by EPL and another category (informal employment) is not, EPL might reduce labor demand in the covered sector, and push more vulnerable workers (low-skilled individuals, young people, and women) into unemployment or into informal sector jobs. As such, it might even increase poverty.

The available empirical evidence broadly supports the implications coming from theory: EPL implies a reduction in employment volatility, with more ambiguous results on employment levels.<sup>32</sup> Overall, the available empirical evidence suggests that the impact of EPL is smaller than the intensity of the debate would suggest. Especially in developing countries, this result can also be explained with the **limited enforcement** that EPL regulations have, due to insufficient administrative capacity. Table 6 reports the main findings of the literature, as summarized by the 2013 World Development Report on Jobs (WB, 2012d).

Dimension	Indicator	Findings	Comments
Living standards	Aggregate employment and unemployment	Either no impact or modest negative (positive) impact on employment (unemployment)	Evidence for both industrial and developing countries (largely Latin America) Results tend not to be robust.
	Employment for particular groups	Prime-age males favorably affected Youth, women, and low-skilled unfavorably affected	Partial reforms for two-track labor markets lead to more precarious employment for affected groups.
	Employment dynamics	Longer durations in employment, unemployment, and out of the labor force Smaller flows between different types of work status	
	Adjustments to shocks	Increases in negative impact of shocks	Consensus not strong
	Wage distribution	Reduces wage dispersion	
Productivity	Labor and multifactor productivity growth	No consistent conclusion	Very little evidence for developing countries
	Training	Positive effect	Longer-duration employment spells and greater human capital investments
	Technological change	Negative effect	Few studies
	Reallocation of labor	Negative effect because smaller labor flows	
Social cohesion	Fairness	Signals social responsibility of employers	Depends on enforcement and coverage "Two-track" regulations can be seen as unfair.
	Security	Positive because of longer tenure	Depends on enforcement and coverage
	Equality	Greater wage equality has modest equalizing effect on income distribution.	Evidence mostly for industrial countries

Table 6: Empirical evidence on the impact of EPL. Source: WB (2012d).

<sup>32</sup> See Cazes and Verick (2013).

## 5. Is EPL too high in Liberia?

**Employment protection as granted by the labor law is high** in Liberia, though it is not straightforward to compare it to other countries as a comprehensive summary measure of protection –the EPL index, see Appendix 1) is available only for OECD members and an additional small set of developing countries.<sup>33</sup> In the World Bank Country Policy and Institutional Assessment data, EPL is embedded with social protection. Liberia ranks 2.50 on a scale from 1 (low) to 6 (high), equal to the average IDA (International Development Association, a World Bank fund for poor countries) eligible countries in Sub-Saharan Africa classified as fragile situations. Among the Doing Business (DB) indicators, which consists in objective measures of business regulations homogenously constructed by the World Bank for 189 economies (WB, 2013b), there are also indicators of employment protection and regulation, specifically as they affect the hiring and redundancy of workers, the cost of labor and the rigidity of working hours. Since 2011, after a change in methodology, the World Bank does not provide anymore an overall ranking of countries with respect to the Employing Workers indicators.<sup>34</sup> However, it is easy to rank the countries in terms of specific indicators. **Among the 15 ECOWAS countries, Liberia ranks 11<sup>th</sup> in terms of redundancy costs, 10<sup>th</sup> in terms of number of days of paid annual leave, and is the country with the highest ratio of minimum wage to value added per worker (table 7).**<sup>35</sup>

	(1)	(2)	r(2)	(3)	r(3)	(4)	r(4)	(5)	r(5)
	Fixed-term contracts for permanent tasks	MW for case-study worker (US\$/month)	rank	Ratio of MW to VA per worker	rank	Paid annual leave* (days)	rank	Severance pay for redundancy dismissal* (weeks)	rank
Benin	Yes	62.0	10	0.54	11	24.0	10	14.1	6
Burkina Faso	Yes	68.0	11	0.63	12	22.0	7	11.9	4
Cape Verde	No	0.0	3	0.00	3	22.0	7	43.3	13
Côte d'Ivoire	Yes	73.4	14	0.00	3	28.4	13	14.1	6
Gambia, The	Yes	0.0	3	0.00	3	21.0	4	0.0	1
Ghana	Yes	55.2	7	0.12	6	15.0	2	86.7	14
Guinea	Yes	0.0	3	0.00	3	30.0	15	10.8	3
Guinea-Bissau	No	0.0	3	0.00	3	21.0	4	43.3	13
<b>Liberia</b>	<b>Yes</b>	<b>52.0</b>	<b>6</b>	<b>0.91</b>	<b>15</b>	<b>24.0</b>	<b>10</b>	<b>40.0</b>	<b>11</b>
Mali	No	55.4	9	0.13	7	22.0	7	14.1	6
Niger	No	55.4	8	0.85	13	22.0	7	3.5	2

<sup>33</sup> Moreover, as the 2013 World Development Report on Jobs (WB, 2012d p. 260) puts it, «the specific nature of labor regulations reflects the society for which they are written. Important determinants include a country's legal tradition, as well as civic attitudes toward solidarity, inequality, and trust. The content, as well as the impact of regulations, is also influenced by interactions with other potentially complementary institutions such as collective representation and social insurance».

<sup>34</sup> This decision was prompted by critiques to the "old" Employing Workers indicators – see Berg and Cazes (2008).

<sup>35</sup> A special Doing Business report (WB, 2013c) focuses on the so-called g7+ group, which is a country-owned and country-led global mechanism established in April 2010 to monitor, report and draw attention to the unique challenges faced by fragile states. The member countries are Afghanistan, Burundi, the Central African Republic, Chad, the Comoros, the Democratic Republic of Congo, Côte d'Ivoire, Guinea, Guinea-Bissau, Haiti, Liberia, Papua New Guinea, Sierra Leone, the Solomon Islands, Somalia (for which however Doing Business does not collect data), South Sudan, Timor-Leste and Togo.

Nigeria	Yes	115.7	15	0.52	10	6.0	1	22.9	10
Senegal	No	72.4	13	0.45	9	25.0	12	16.3	8
Sierra Leone	No	34.8	5	0.40	8	24.0	10	144.0	15
Togo	No	68.0	12	0.90	14	30.0	15	17.3	9

\* for a worker with 10 years of tenure

Table 7. Selected Employing Workers indicators from the WB Doing Business database, 2014. Ranks go from 1 (most flexible) to 15 (most rigid). Source: own computation on WB Doing Business database.

The Employing Workers indicators however look only at the “law in the books”; as such, they can be considered at most a proxy for labor market flexibility (and lack thereof) in the formal employment (neglecting compliance issues). In Liberia however, as reported in section 2, the formal sector accounts for less than 20% of total employment (40% of the non-agricultural employment). Indeed, if we look at the overall DB indicators, which combine *de jure* rules (binding legal requirements) with the *de facto* experiences of firms, Liberia is placed 4<sup>th</sup> out of the 15 ECOWAS countries (though it still ranks only 144 out of 189 countries surveyed, table 8).

	Sub-Saharan countries ranking (47 countries)											
	ECOWAS ranking (15 countries)	Overall ranking (189 countries)	Starting a Business	Dealing with Construction Permits	Getting Electricity	Registering Property	Getting Credit	Protecting Investors	Paying Taxes	Trading Across Borders	Enforcing Contracts	Resolving Insolvency
Ghana	1	67	20	37	6	4	5	5	9	8	4	16
Cabo Verde	2	121	8	28	28	6	14	24	11	4	1	38
Sierra Leone	3	142	9	45	41	40	12	3	20	19	29	33
<b>Liberia</b>	<b>4</b>	<b>144</b>	<b>5</b>	<b>27</b>	<b>23</b>	<b>44</b>	<b>12</b>	<b>28</b>	<b>5</b>	<b>21</b>	<b>37</b>	<b>34</b>
Nigeria	5	147	18	33	45	47	1	9	34	28	22	13
Gambia, The	6	150	21	18	17	20	39	45	44	5	8	14
Burkina Faso	7	154	19	8	22	21	22	28	31	40	17	17
Mali	8	155	26	19	16	15	22	28	30	30	23	20
Togo	9	157	38	20	10	34	22	28	35	9	31	15
Côte d'Ivoire	10	167	15	38	30	23	22	35	36	34	16	11
Benin	11	174	27	16	32	27	22	35	39	11	45	23
Guinea	12	175	29	34	7	28	35	45	45	16	21	25
Niger	13	176	34	39	18	11	22	35	32	43	24	30
Senegal	14	178	14	40	42	42	22	44	42	3	38	18
Guinea-Bissau	15	180	34	21	47	40	22	24	27	12	28	38

Table 8. Doing Business indicators – ECOWAS countries. Lower ranking countries are better performers. Source: WB Doing Business database.

The discrepancy between the Employing Workers and core Doing Business indicators stresses two related points: i) increasing **protection for formal employment** risks to be only slightly more than an exercise in political correctness, for countries with a high share of informality; ii) any measure has to be evaluated with respect to its **effects on formal employment, informal employment, and overall employment growth**.

Coherently with the picture emerging from the Doing Business indicators, data from the World Bank 2009 Enterprise Survey confirm that **EPL is not a major concern for Liberian firms**: only 3% of the sampled firms report labor market regulations as a major or very severe obstacle (table 9).<sup>36</sup>

How much of an obstacle is:	no or minor	major or very severe
Electricity	31%	59%
Transportation	43%	39%
Competition from informal sector	63%	22%
Access to land	63%	24%
Courts	65%	18%
Crime, theft and disorder	58%	26%
Access to finance	45%	32%
Tax rates	45%	18%
Tax administration	53%	10%
Business licenses and permits	58%	16%
Political instability	70%	21%
Corruption	41%	37%
<b>Labor regulations</b>	<b>81%</b>	<b>3%</b>
Labor skills	67%	6%

N= 150

Table 9: Obstacles to business activity. Source: own elaboration on World Bank Enterprise Survey (2009).

Moreover, competition from the informal sector also does not appear to be a major concern, suggesting that **the risk of EPL inducing more firms and employment relations into informality is also small**. However, there is a cost of regulation that is normally neglected in standard analyses, which becomes very important when it comes to a country like Liberia with poor administrative capacity: red tape. **EPL is just one of the many formalities that registered businesses have to comply with, and that create an incentive to remain in the informal economy**. The evidence on the issue is only scant, but the data cited in the World Bank 2010 report on employment and pro-poor growth coming from a IFC/World Bank 2006 study show that about one quarter of the sampled firms did not formalize because the steps were too expensive, another quarter because the steps were too complicated, and an additional fifth because they could not comply with all the requirements; these motivations together accounting for over two thirds of the respondents.<sup>37</sup>

<sup>36</sup> See also WB (2009).

<sup>37</sup> WB (2010).

## 6. Effects of minimum wages.

Theory provides clear predictions of the effects of a minimum wage in the case of a competitive labor market: if set above the market clearing level, the **minimum wage increases unemployment and the equilibrium wage level** (if set below such level, the minimum wage is ineffective). As for EPL, it benefits insiders (those who get a job at the higher wage level) and hurts outsiders. This **backfiring effect** of minimum wages on employment implies that although minimum wages can be a tool for poverty and inequality reduction, setting them too high might lead to greater income inequality.<sup>38</sup>

However, real labor market depart in a number of ways from the stylized competitive framework: «in the case of a monopsony (when employers face a labour supply curve that is not perfectly elastic and therefore set wages), for example, or in the case of a dual labour market where the minimum wage actually does not apply to the secondary market or informal labour market, results may dramatically change. So, generally, those effects will depend crucially on a series of **institutional variables**, including the degree of compliance, enforcement, sanction for non-compliance, structure of minimum wages and the existence of uncovered sectors».<sup>39</sup> A major concern however remains that wage-earners in developing countries mostly belong to an elite group, which enjoys higher standards of living and privileges not accessible to others such as the self-employed or those involved in family work.

The empirical evidence, which has mainly focused on South American countries, suggests some, albeit **small, negative effects of the minimum wage on employment**, partly to the benefits of the informal sector and self-employment.<sup>40</sup> Table 10 summarizes the main results.

Dimension	Indicator	Findings	Comments
Living standards	Aggregate employment	Either no impact or modest negative impact	Both industrial and developing countries Some studies show positive employment effect.
	Employment for particular groups	Negative employment impacts concentrated on youth and low-skilled	Some studies show positive employment effect.
	Wages	Positive effect	Effect strongest around minimum wage Some evidence of positive effect in informal sector
	Wage distribution	Reduces wage inequality	
	Poverty	Reduces poverty	Some studies find no effect.
Productivity	Labor and total factor productivity	No consistent conclusion	Rarely analyzed
Social cohesion	Fairness	Provides "decent" wage	Depends on enforcement and coverage

Table 10: Empirical evidence on the impact of minimum wages. Source: WB (2012d).

Vulnerable workers are most hurt by high minimum wages: in particular young, low-skilled, and female workers. **Both formal and informal sector workers' salaries appear to be affected by the minimum wage.** In fact, the minimum wage is often more binding in the informal than the formal sector, due to a perception of fairness (the

<sup>38</sup> Terrell and Almeida (2008).

<sup>39</sup> Cazes and Verick (2013, p. 68).

<sup>40</sup> See Cazes and Verick (2013).

so-called “**lighthouse effect**”) that affects more people in the informal sector since wages are generally lower.<sup>41</sup> On the supply side, workers’ bargaining power is reinforced by the notion of a fair wage. On the demand side, employers might voluntarily offer the fair wage to attract labor and minimize turnover costs. Also, wage gains are largest for those earning near the minimum wage, but the **wage benefits (and job losses) are experienced throughout the entire wage distribution**. These results are notably because of the extent of informal employment and a weak enforcement capacity in developing countries, which would suggest little effect of the minimum wage.<sup>42</sup>

Focusing on African countries, a 10 percent point increase in the minimum to median wage ratio in Kenya is associated with a decline in the share of formal employment of between 1.2-5.6 percentage points –and an increase of between 2.7-5.9 points in the share of self-employment.<sup>43</sup> Ghana’s minimum wage policies during the 1970s, 1980s and early 1990s led to a reduction of formal sector jobs with an employment elasticity of between 12 and 18%, with a similar increase in informal sector jobs.<sup>44</sup>

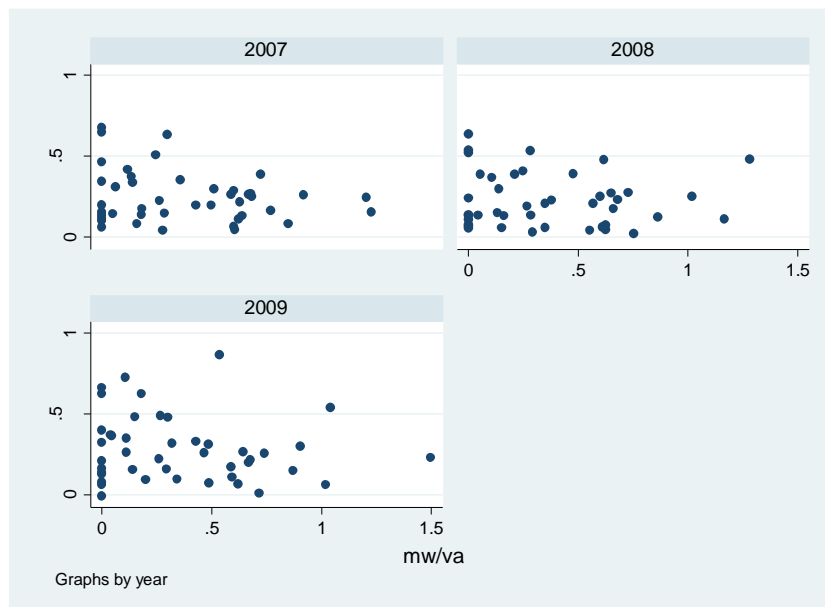


Figure 2: Higher minimum wages in African countries do not foster inflation. Minimum wages are expressed as the fraction of value added per capita (source: WB Doing Business indicators); inflation rates are computed from GDP deflators (source: WB).

An additional concern might be that increasing the minimum wage would translate into higher inflation. This does not appear to be the case: figure 2 plots the ratio of minimum wage to value added in a given year against the cumulative inflation rate in the next three years, for 48 African countries. (A minimum wage ratio of zero means that there are no minimum wage provisions in the country.) Data on minimum wage ratios come from

<sup>41</sup> Khamis (2013).  
<sup>42</sup> Cunningham (2007).  
<sup>43</sup> Andalon and Pagés (2008).  
<sup>44</sup> Jones (1997).

the WB Doing Business database, while inflation rates are computed using data on GDP deflators, also made available by the World Bank.

Inflation seems to be independent from the minimum wage. The result also holds for different time windows (one to five years) for the inflation rate. Also, minimum wage *changes* over the previous year do not appear to have an effect on future inflation (figure 3).

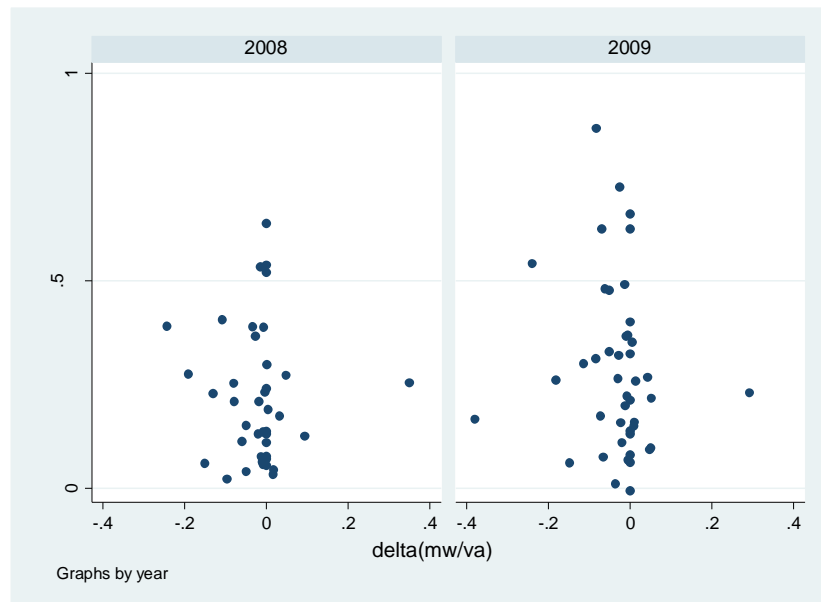


Figure 3: Increases in the minimum wages in African countries do not foster inflation. Minimum wages are expressed as the fraction of value added per capita (source: WB Doing Business indicators); inflation rates are computed from GDP deflators (source: WB).

## 7. Is the minimum wage too high in Liberia?

Debates continue regarding the **level at which minimum wages should be set**.<sup>45</sup> In Liberia, the discussion on the Decent Work bill in Liberia has mainly focused on this issue, starting from the observation that **the purchasing power of the minimum wage has been declining** since the end of the civil war (figure 4).

<sup>45</sup> See ILO (2013a,b), Boeri (2012), ILO (2009), Saget (2008).

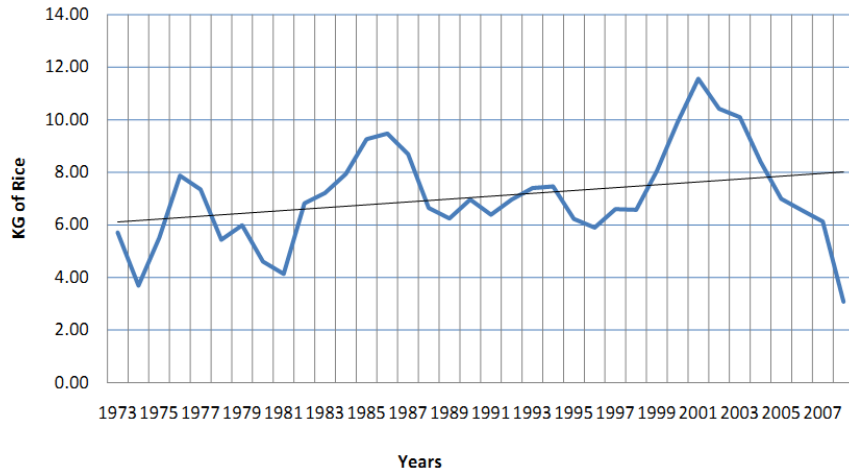


Figure 4: Purchasing power of the minimum wage (1972-2008). Source: WB (2010a).

However, this does not automatically means that the minimum wage should be increased, nor that it would be optimal to double or triple it. Figure 5 reports the ratio of the minimum wage to the average wage, according to the ILO Wage database, in 2008.<sup>46</sup> **The average value is about 0.35-0.40**, in a range that goes from practically zero to almost three quarters.

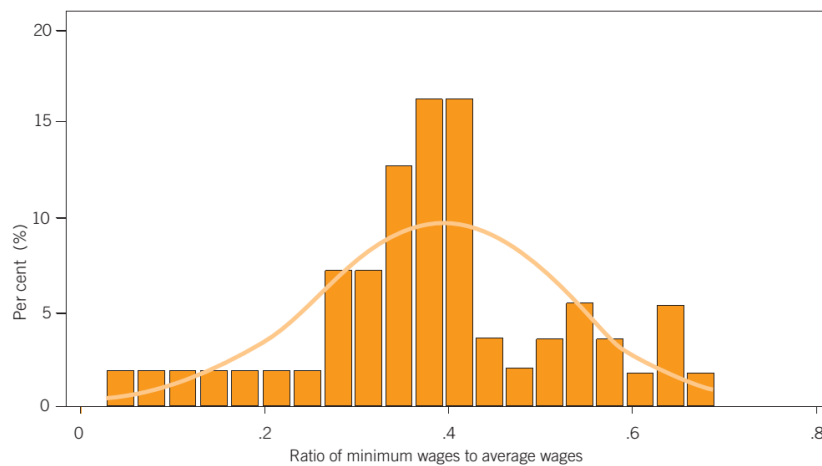


Figure 5: Ratio of minimum wages to average wages. Source: ILO (2009).

For Liberia, data on wages come from the 2010 LFS.<sup>47</sup> For paid employees, the average cash wage received per week is US\$ 73, and there is an additional payment in-kind of \$1, making an average total of US\$ 74. But averages can be deceptive. Half of all people receiving cash payments as paid employees are actually receiving

<sup>46</sup> Liberia is not included in the database.

<sup>47</sup> LISGIS (2011).



less than 20 dollars a week. The reported cash earnings of the self-employed indicate that their average wage is only US\$ 21 per week, with a small additional amount as payment in-kind. As a result, the overall weekly average amount of cash received by the working population that receives wages or earnings is US\$ 32 per week, with a small amount (less than one dollar) as additional payment in kind. Applying the 40% reference level for the minimum wage to the average weekly wage of 74 US\$ points to a “correct” value of 29.6 US\$ per week, while including also the self-employed leads to a “correct” value of 12.8 US\$ per week. This is **in line with the old minimum wage of 2 US\$ per day** (12 US\$ per week).

Alternatively, we could use the most recent data on the ratio of minimum wage to value added per worker (which does not require to know the distribution of wages), coming from the 2014 WB Doing Business database. Figure 6 (left panel) reports the distribution of this indicator, for the 153 out of 189 countries with a positive minimum wage. There are five outliers with a minimum wage higher than GDP per capita: Democratic Republic of Congo, Honduras, West Bank and Gaza, and Zimbabwe. **The overall average is 0.40**, going down to 0.36 if we exclude the outliers. Restricting our attention to African countries (right panel) we get an average ratio of 0.55 that goes down to 0.44 if we exclude the Democratic Republic of Congo and Zimbabwe.

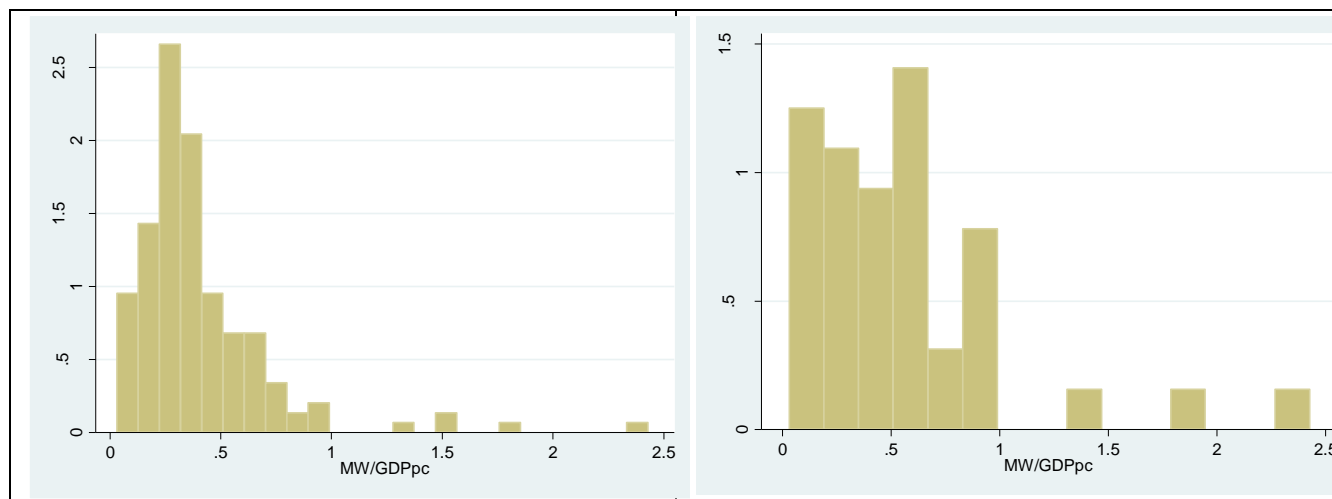


Figure 6: Distribution of minimum wage-to-GDP per capita ratio. Left: all countries with positive minimum wage (153 countries). Right: African countries (40 countries). Source: WB Doing Business 2014 (2013 data).

In the 2010 LFS data, total employment was 1,091,000. We assume that total employment grew in the period 2010-2012 at the same rate as total population (2.7%). Given that GDP was 2 billion US\$ in 2012, the value added per worker is estimated at 1,730 US\$. Considering 300 working days per year, this leads to an average value added per worked day of 5.8 US\$ per day. Applying the 40% value we get a “correct” minimum wage of 2.3 US\$ per day. This is again **in line with the old minimum wage of 2 US\$ per day**.

Overall, it seems fair to conclude that the old level of the minimum wage at 2 US\$ per day was a fair value. The new Decent Work bill has doubled it. To get a sense of what this means, consider that in the US the minimum wage is about 6 US\$ per hour, that is 48 US\$ per day. **The new minimum wage in Liberia is 10 times smaller**

**than in the US; however, Liberia is more than 100 times poorer than the US** (at a GDP per capita of 473 US\$ in 2013, against 53,101 US\$ in the United States<sup>48</sup>).

Assuming an employment elasticity of -15% in Liberia –similar to the one found in Ghana but smaller than in Kenya, see the previous section– under the hypothesis of linear effects **we should expect the formal sector to shrink by 30% as a consequence of the increase in the minimum wage**. Moreover, there is evidence that the effects are far from linear for extreme values of the minimum wage: for instance, large increases in the minimum wage in Colombia in the late 1990s led to significant employment losses.<sup>49</sup> Therefore, the 30% employment loss in the formal sector should be considered as a low estimate. There is however one safety valve, that could help in the Liberian case: a further **decrease in the compliance rate**. There are no data on compliance rate in Liberia, but with such a large increase in the minimum wage, and given the low administrative and judicial capacity in Liberia, it can be expected that the new level of the minimum wage will be enforced only partially. The fact that the new minimum wage is also quite controversial in the political discourse, as documented by the debate over the Decent Work bill, might also induce low compliance.

In conclusions, common sense and basic economic analysis suggest that **the new levels of the minimum wage, just legislated, are too high and will not be strictly enforced; if enforced, they would pose serious harm to formal employment**, increasing disparities between a few workers who will enjoy a wage increase, and many others who will become cashworkers or self-employed, losing access to social insurance schemes and other benefits.

## 8. Social insurance schemes

Social insurance is provided in Liberia through NASSCORP, the social security agency, under two contributed schemes: the **National Pension Scheme (NPS)**, and the **Employment Injury Scheme (EIS)**. They basically cover all (formal) workers in the private and public sector, with only limited exemptions. Public employees have an additional, non-contributory pension and injury scheme, the **Public Service Pension (PSP)**. Boxes 6 and 7 summarize the main features of social insurance schemes in Liberia.

### **BOX 6: Old Age and Survivors pensions**

**Coverage:** all employees who are working in Liberia (or abroad for a Liberian employer) for a firm of any size, with the exclusion of i) casual workers, ii) family labor, and iii) domestic employees iv) special categories (armed forces, government security forces, judges, etc.) contribute to the National Pension Scheme (NPS), administered by NASSCORP, the social security agency. Voluntary coverage is possible for self-employed persons and others not compulsorily covered.

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<sup>48</sup> IMF World Economic Outlook database, April 2014. Liberia ranks 176 out of the 182 countries surveyed (only The Gambia, Niger, Democratic Republic of Congo, Central African Republic, Burundi and Malawi have a smaller GDP per capita than Liberia, in US\$); the US ranks 9 (Luxembourg, Norway, Qatar, Switzerland, Australia, Denmark, Sweden and Singapore are richer in per capita terms).

<sup>49</sup> Kucera and Roncolato (2008).

**Contributions** amount to 3% of salary (deducted at source) on the part of the employee, plus 3% on the part of the employer, in the private sector. An ongoing reform should increase the contribution rate to the national pension plan to 4% on the part of the employee and 4.25% on the part of the employer.

**Old Age pension** amounts to 25% of the average pay in the best 5 years of career. For every additional 10 monthly contributions the pension is increased by 1% of the average pay, up to 40%. Old Age pensions can be claimed at age 60 after at least 100 months of contributions. Retirement from employment is necessary to get the pension before the age 65. A worker totaling 12 monthly contributions or more but less than 100 monthly contributions can claim an old age settlement, equal to the employee's contributions plus accrued interests.

**Invalidity pension:** In case of permanent invalidity, a worker receives 25% of average monthly earnings, plus 1% for every 10-month period of contributions in excess of 50.<sup>50</sup>

**Survivor benefits** of 50% of the insured's pension are payable to a widow or a dependent disabled widower. 10% of the insured's pension (20% for a full orphan) is payable for each child under the age of 21. The maximum survivor pension is 100% of the old-age pension or disability pension, whichever is higher.

**Civil servants** have an additional, non-contributory, pension scheme (Public Service Pension, PSP, run by the Civil Service Agency). Retirement on this scheme is mandatory at 65. Below age 65, retirement is allowed with at least 25 years of service (y.o.s.). Monthly payments are as follows: 25 to 29 y.o.s. (or less than 25 y.o.s. if above age 65) entitle to 33.3% of the last salary earned (excluding allowances); 30 to 39 y.o.s. entitle to 50% of the last salary; 40+ y.o.s. entitle to 60% of the last salary. A Fixed monthly contribution of 1,300 LD is added, independently from tenure. Civil Servants also get an extra lump sum transfer at retirement (a "handshake package") of about US\$ 350 under 25 years of service (y.o.s.), US\$ 500 between 25 and 29 y.o.s., US\$ 700 between 30 and 39 y.o.s., and US\$ 1,000 for 40+ y.o.s. Survivors' benefits amount to 50% of the civil servant's pension and can be paid to the surviving husband/wife until remarriage, or to the minor child until he/she reaches the age of 18.

#### **BOX 7: Work Injury and Disability**

**Coverage:** all employees who are working in Liberia (or abroad for a Liberian employer) for a firm of any size, with the exclusion of i) casual workers, ii) family labor, and iii) domestic employees iv) special categories (armed forces, government security forces, judges, etc.) contribute to the Employment Injury Scheme (EIS), administered by NASSCORP, the social security agency. Voluntary coverage is possible for self-employed persons and others not compulsorily covered.

**Contributions** amount to 1.75% of salary on the part of the employer only, paid to NASSCORP.

**Qualifying conditions:** there is no minimum qualifying period, but injury must occur in course of work (including commuting to, and from work).

**Temporary Disability benefits** amount to 65% of average monthly earnings in the past 12 months, payable after a 14-day waiting period (the first 14 days are compensated retroactively if the disability lasts longer than 14 days) until full recovery or certification of permanent disability.

**Permanent Disability pension** amounts to 65% of average monthly earnings in the past 12 months, if totally disabled. A constant-attendance supplement of 25% of the pension is also envisaged.

**Partial Disability pension** gives a percentage of the full pension proportionate to the assessed degree of disability, according to the schedule in law.

**Workers' Medical benefits** cover reasonable expenses for medical and surgical care, hospitalization, drugs, and appliances.

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<sup>50</sup> A noncontributory scheme is available for needy disabled workers who are ineligible for regular benefits.

**Death benefits** involve a Survivor pension of 20% of the insured's average monthly earnings in the past 12 months, payable to a widow or a dependent disabled widower, and an Orphan's pension of 10% of the insured's average monthly earnings in the past 12 months (20% for a full orphan) for each child under the age of 21.

**Funeral grants** cover the cost of the burial, up to a maximum of \$500.

**Civil servants** with a medical certificate of ill health who have not reached age 65 or 25 year of service (y.o.s.) are entitled to a monthly payment of 33.3% of the last pay plus 1,300 LD. This scheme is part of the Public Service Pension (PSP), run by the Civil Service Agency.

Old age and disability schemes in Liberia configure a **pyramidal system** (table 11). At the bottom are **informal employees** (more than 80% of total employment), who get nothing. They are not covered in case of a work injury, and will receive no pension at old age. The middle layer is made of **formal employees in the private sector** (13.3% of total employment, according to 2010 LFS data). These worker have the right to an old age pension of up to 40% of their monthly salary, computed as the average of their five best years, and are insured against work-related injuries and illnesses. At the top are **civil servants**<sup>51</sup> (4.6% of total employment), with the highest level of protection. Because they can cumulate their NASSCORP entitlements with their own special scheme, civil servants can retire with up to 90% of monthly salary, plus the fixed amount of 1,300 LD. In theory, if they are declared ill they can take home more than 98% of their pay (65%+33.3%).

Enterprise type	Number of employees
Government	50,000
Public/state-owned	6,000
Non-profit organizations	22,000
Private households	13,000
Non-farm private enterprises	63,000
Farm private enterprises	35,000
Others	6,000
Total paid employees	195,000
Total employment	1,091,000
Share of private paid employment to total employment	13.3%
Share of civil servants to total employment	4.6%

Table 11: Paid employees by enterprise type. Source: LFS 2010 (LISGIS, 2011).

The same pyramidal structure also holds with respect to job protection: informal employees are not protected at all, formal employees in the private sector are covered by EPL as described in section 3; government

<sup>51</sup> The 1973 Act establishing the Civil Service Agency (CSA) explicitly defines the Civil Service as comprising the entire body of employees in the civil administration of the country, excluding elected and appointed officials, and military and security personnel.

employees are also protected by the nature of their employer, which is bigger, more unionized, and less subject to market (demand side) fluctuations.

## 9. Reforming civil service insurance schemes

In assessing the benefits to civil servants, it should be kept in mind that until recent government employees earned a very low pay in Liberia. As in the old Soviet joke (“they pretend to pay us, we pretend to work”), it was considered that such a low pay was a major cause of poor productivity in the public sector.<sup>52</sup> **Increasing pay and incentives for civil servants** was therefore an important part in the strategy of reform of the public administration, with the aim to attract talented workers and re-build morale and capacity. Accordingly, salaries in government were gradually increased, with the lowest paid civil servants obtaining a monthly pay rise from about 15 US\$ in 2007 to about 100 US\$ today.<sup>53</sup> Attractive benefits are a legacy of the past but are considered to fit this strategy.<sup>54</sup>

True, low pay at work in the past meant little privileges after retirement, even with favorable rules. Pensions were often so low that public employees were kept in office well beyond retirement age to protect their income. However, because entitlements are defined benefits and referred to the last pay, the recent wage increases had a **big impact on public pensions debt**: public employees are now kept on government payroll beyond retirement age because the government has no money to pay for their pensions.<sup>55</sup>

**A process of reform of the PSP scheme is currently ongoing.** The two main goals are i) create a single integrated pension scheme that covers all branches of government including civil service, foreign service, political appointees, judges, and legislators (military and paramilitary not included), to reduce distortions and inequity

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<sup>52</sup> It is worth citing at length a passage of the Civil Reform Strategy 2008-2011 (GoL, 2008, p. 24): «The salaries of Liberian civil servants in the recent past have been so low that their “take home pay” could literally neither defray the costs of transportation to and from work every month, nor purchase a bag of rice which is the country’s staple food. Until 2006, many government workers earned, on the average, the equivalent of US\$15 per month, while the price of rice was above US\$18 per 100 kilogram bag. The salaries of the middle and senior managers were lower than most West African countries; they averaged around US\$20 per month. Salaries of civil servants have eroded dramatically since the 1970s. [...] Not surprisingly within the context of this dismal situation, civil servants have been generally disenchanting and demotivated. The Service has become unattractive and has lost its most capable professionals to the private sector, NGOs, and United Nations’ agencies. Effectiveness has suffered due to reduced work efforts and declining levels of productivity both in quantity and quality. The low salaries of civil servants has weakened transparency and accountability mechanisms. Civil Service managers often lack the moral authority to enforce performance standards. As a result, civil servants are mostly either absent or late for work with the explanation that they are “hustling in search of livelihood” for their households. A substantive number of civil servants are alleged to either be attending university or holding second jobs during Government work time. Low salaries have become the excuse for civil servants to explain away their procurement-related corruption and rent-seeking behavior in the provision of normal services to the public. Overall, real commitment to public service is low». The privileged status of government employees was however one important cause of tension and resentment which led to the civil war.

<sup>53</sup> This is two times the “old” national minimum wage.

<sup>54</sup> See also Palacios and Whitehouse (2006).

<sup>55</sup> A simple back of the envelop computation can reveal the order of magnitude of such public pension debt. Assuming prudentially an average wage of 100 US\$ per month (which is equal to the minimum wage in the public sector) for the 50,000 public employees, retirement at 60 with an average of 30 years of service and a 50% replacement rate, and an expected residual lifetime of 15 years, we get a future liability of 450,000,000 US\$ (neglecting the ‘handshake’ package), that is approximately 25% of GDP and 100% of government budget. A mere 5 years increase in the expected residual lifetime, quite likely if the country remains peaceful in the next decades, would push the debt up to 600 million US\$.

between government service employees, and ii) restrict the growth of outstanding pension liabilities. Savings will come from a reduction in the benefits (proposals suggest that retirees with 40 years of service will receive a maximum of 75% of their earnings –40% from NASSCORP and 35% from PSP) and an increase in employees' contributions (3%) from the actual level of zero.

**Our suggestion is far more radical: cancel PSP.** Distortions are minimized if all employees are treated equally, irrespective of whether they work in the private or in the public sector. Social insurance should be fully homogeneous, and run by a single agency (NASSCORP). According to this view, all government employees (including civil service, foreign service, political appointees, judges, legislators, military and paramilitary) should pay the standard contributions to NASSCORP, matched by the standard contributions by the employer (the Government). To attract and motivate public employees, better wages and incentives should be provided, together with better job quality and work environment. Using also the benefit lever only makes the system more opaque, and costly.

## 10. A new labor contract for the informal sector.

The guiding principles behind our proposed labor market reform are twofold: **extending protection to vulnerable workers**, and **reducing disparities among workers**. This means extending benefits at the bottom and cutting privileges at the top. In the last section we have suggested to cut benefits for civil servants. Providing more protection to informal workers is the focus of this section, and can be done in two ways: through general **social assistance and social security** measures, (see box 1) –which bring security to these workers because they are citizens, and not because they are workers– and through **social insurance** measures, which requires finding a way to formalize them. **Increasing formal employment** has several additional advantages, on top of enlarging the pool of beneficiaries of social insurance schemes. First, it allows a **better control over health and safety issues in working conditions**. Second, it **increases the knowledge available to the government, strengthening administrative capacity** and paving the way for more and better services to be delivered to the citizens. Third, it **enlarges the potential tax base** (even if the newly formalized workers are granted tax exemptions, as we suggest). Fourth, it induces a **change in attitude** of workers and employers, who gradually learn the value of formalized rights and duties. Last but not least, the reduction of informal employment must be seen as an inevitable step in a country's development, and a visible sign of its modernization efforts.

A first challenge to expand formal employment is counteracting the negative expected effects of the Decent Work bill. We definitely would support bringing back the minimum wage to its old level of 2 US\$ per day for unskilled workers, together with a general simplification of EPL in order to make formal employment more attractive. However, in the wake of the long legislative process that led to the bill, we take the current legislation as a constraint, considering that the political space for discussion on the topic has already been exhausted. Therefore, we opt for a strategy of **reforms "at the margin"**, leaving current regulations in place and introducing a new labor contract with different and less stringent provisions. This strategy has been followed by many advanced countries during the 1990s and 2000s to comply with OECD recommendations of making labor markets more flexible.<sup>56</sup> **The main risk of introducing more flexible labor contracts** at the margin is to create a dual labor market, where bad jobs substitute good jobs leading to a precarization of the labor force.<sup>57</sup> However, this is a risk that **should not be of concern in Liberia**. First, in Liberia the labor market is already dual: as we have seen, there is a big gap in entitlements between the haves, a minority of formal employees, and the have nots, a majority of informal workers. Second, substitution of good jobs with bad jobs is the likely outcome of the sharp

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<sup>56</sup> See OECD (1994).

<sup>57</sup> Berton et al. (2012).

increase in minimum wage, which the reform will partly counteract. Third, the new contract contains specific clauses that makes it an option for upgrading informal employment, rather than downgrading formal employment.

The main characteristics of the new contract, which we label “**junior contract**”, are listed in box 8 (they should be considered as only indicative, at this stage). The contract is available only to firms with three employees or less.<sup>58</sup> The contract puts a very light administrative burden on the employer: all that is required is that the employer buys a monthly **pension voucher** and gives it to the employee. This is the proof that the employee was hired during that month under a junior contract, and could be used by the employee for instance in a loan application, or in a lawsuit for discriminatory firing. The voucher has a fixed value and is not related to the pay. The employer pays 50% of this value as the cost of the voucher, while the government puts the remaining 50%. Vouchers can be cashed in by the employees once they reach the retirement age. Vouchers can also be cashed in by a relative up to the second degree (aunt, uncle, grandparent) who is already beyond retirement age, at a discount of one third. Finally, vouchers also give access to the Employment Injury Scheme, for which the employer pays no additional contributions. As a first scenario, the face value of the voucher is set at 30 US\$ (1 US\$ per day), of which **15 US\$ are paid by the employer, and 15 US\$ are credited by the government. If saved until retirement age, the voucher is worth 30 US\$ plus accrued interests; if cashed in immediately by a relative already above retirement age, the voucher pays back 20 US\$.** To remain competitive with informal work, the remuneration paid by the employer directly to the employee is **exempt from income taxes**.<sup>59</sup> Remuneration is left to individual bargaining between the employer and the employee, and it is not subject to any reporting requirement. We are in principle in favor of setting a **minimum wage** also for junior contracts. However, for the reasons discussed in section 7 the minimum wage will have to be lower than 4 US\$ per day. We see three alternatives:

- a) Junior contracts are subject to the same national minimum wage as set in the Decent Work bill (4 US\$ per day for unskilled workers): because wages need not to be communicated, enforcement will probably be low, and use of junior contracts will not be discouraged.
- b) A specific minimum wage is legislated for junior contracts, for instance at 2 US\$ per day: this is our first best but probably very difficult to be agreed upon, given the debate over the minimum wage in the legislative process of the Decent Work bill.
- c) It is specified that junior contracts are exempt from minimum wage regulations, possibly with the additional requirement that a worker can be employed with a junior contract only for a limited number of years (3 or 5 years, for instance), so that the exemption is justified by the transitional nature of the contract. This option however is not very coherent with the idea of a pension voucher, which should envisage the gradual building up of retirement savings.

Among these alternatives, given that the first best is likely to be not attainable, we favor remaining silent about the issue, which basically means alternative a): an implicit ***don't ask, don't tell policy***.

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<sup>58</sup> An alternative is that junior contracts are limited to a maximum of three employees per firm (of any size), during any given month. This would remove the discontinuity in regulation at the threshold of three employees, at the cost of permitting some substitution between standard and junior contracts in bigger firms.

<sup>59</sup> In some countries (eg. Italy), vouchers are used as a payment method for occasional work (they are called “work vouchers”). The employer buys as many vouchers as needed to pay the employee at a price equal the net value (7.50 EUR) plus social contributions (2.50 EUR). The worker can redeem the net value by handing in the vouchers at local post offices, selected banks branches and tobacconists (the contributions are credited on the worker’s social security account). Income gained with work vouchers is tax free (though income taxes could be easily deducted from the amount paid to the worker). The reason why we envisage to separate the direct payment of wages from pension vouchers is to avoid the impression that the remuneration is “taxed”: the voucher costs more (10.00 EUR) than what the worker gets (7.50 EUR), which will create an incentive to remain informal.

**BOX 8: The junior contract.**

- a. A junior contract is an oral contract between an employer (who is not also an employee) and an employee.
- b. Junior contracts are possible only in firms with 3 employees or less.
- c. No employee can hold more than one junior contract in a given month.
- d. Income earned under junior contracts is exempt from income taxes.
- e. Junior contract holders are protected from discriminatory firing.
- f. Junior contract holders are automatic enrolled in the Employment Injury Scheme (EIS), with contributions paid by the government. However, injured workers figure in the count of junior workers for all the time they receive a benefit from NASSCORP. To determine benefits under the EIS scheme, a salary equal to the old minimum wage of 2 US\$ per day is imputed.
- g. For a worker to be employed with a junior contract, the employer has to give him, in addition to a pay, a monthly pension voucher.
- h. Every voucher has a nominal value of 30 US\$, of which 15 US\$ are paid by the employer, and 15 US\$ are put by the government.
- i. An employer can buy a maximum of 3 pension vouchers every month from NASSCORP. On every numbered voucher NASSCORP writes the name of the employee, the name of the employer, and the period (month/year) of work.
- j. NASSCORP holds a registry of employers and employees, recording the number of pension vouchers bought and received every month.
- k. Vouchers can be cashed in by the employee after retirement age, or by a relative up to the second degree (uncle, aunt, grandparent) who is already beyond retirement age. Accrued interests are paid between the issue and collect date.
- l. If the voucher is cashed in by a person different from the one to whom the voucher is titled, a 33.3% discount is applied (from 30 US\$ to 20 US\$, plus accrued interests).
- m. No person can cash in more than one voucher every month. NASSCORP holds a registry of pensioners.
- n. Banks are required to accept vouchers in deposit, at no cost. Upon withdrawal, banks can return summary statements reporting, for each voucher, the voucher number, the employee's name, the employer's name, and the period of work, in lieu of the original voucher.

Two crucial issues concerning the new labor contract are i) **substitution between standard and junior contracts**, and ii) **substitution between the voucher and the wage**, the risk being that the government merely subsidizes bad jobs. The threshold on firm size for using junior contracts should help limiting substitution of standard contracts with junior contracts: informal employment is more widespread in micro enterprises, so that there will be more opportunities of upgrading from no contract to a junior contract than downgrading from a standard contract to a junior contract. With respect to the second substitution effect, the fact that the greatest surplus is realized if workers save the voucher, and the need for obtaining the cooperation of an elder relative for cashing in the voucher immediately, should help in avoiding or limiting the wage decrease. Moreover, even if the voucher prompted a dollar-for-dollar reaction on part of the employers, that is, a 15 US\$ per month reduction in wages, still there would be some value added in the formalization of the employment relationship and in the creation of a registry of (former informal) employers and workers. Specific counteracting measures could also be taken, as transforming the pension voucher in a work voucher (see footnote 59).

The **incentives for workers and employers** to use the new labor contract come mainly from the surplus that the government is putting in. Workers have access to heavily subsidized savings. If their family is desperate for money, they can cash in the voucher immediately, at a discount. Employers have the possibility, at a very little cost, to make the overall remuneration more attractive. Moreover, because there is a limited number of junior contracts available at each firm, employers can use them to incentivize and select workers. Finally, the voucher also involves enrolment in the EIS, which is valuable both for employees (it gives some protection in case of injury or disability) and for employers (who will face less moral and social pressure to take care of the injured or the disabled workers). The provision that injured workers still count for the 3-employee limit should eliminate the incentive to report fake casualties.



The **cost for the government** depends on the cash in decisions of workers. If the vouchers are saved, the cost is postponed to when the workers will retire, which is, given the age structure of the Liberian workforce, many years into the future, when the country will hopefully be richer (and past liabilities less onerous). In the meantime, the vouchers generate a positive cash flow for the government (equal to the employers' contributions). Moreover, in the long run the government would have to take care of many of these individuals anyway, if they remained in the informal economy: wages in informal employment are simply too low to allow for retirement savings. If on the other hand workers decide for an immediate cash in, the cost for the government is limited (5 US\$ per month per worker) and the voucher becomes a cash transfer family support program with an efficient self-targeting mechanism.<sup>60</sup> Such a scheme, might also be considered as laying the foundation for a **pay-as-you-go, partly contributed pension scheme to complement the current funded system**, while keeping a high degree of flexibility to meet the diversified needs of workers and households. Additional advantages of empowering the elderly by ultimately handing them the cash are strengthening family cohesion, and enforcing more discipline on the youngsters, who pose the biggest threat to social stability and peace.

## 11. Conclusions

This report has provided an assessment of labor market regulations in Liberia, in particular employment protection legislation (EPL), minimum wages, and social insurance schemes. While optimal labor market regulations might not exist, or be far beyond reach, bad regulations can severely hamper job creation, foster inequality, create the wrong incentives and pose a burden to public finances.

Our analysis suggests that the relatively high level of protection granted, at least in theory, by EPL provisions in Liberia constitutes only a limited barrier for formal employment. The negative effects come mainly from a perceived complexity of the regulations, rather than from rigidities and firing costs.

On the other hand, our assessment is more severe with respect to the effects of the sharp increase in the minimum wage mandated by the recent Decent Work bill. Doubling the minimum wage (from 2 US\$ to 4 US\$ per day for unskilled workers) is very likely to bring negative labor market consequences, reducing formal employment in favor of self-employment and cashwork. The available international evidence suggests that employment losses in the formal sector might exceed 30%.

Given that the *de facto* job security and minimum wages are higher in the public sector, the labor market in Liberia looks like a pyramidal system: informal employment at the bottom, formal employment in the private sector at the middle, and civil service at the top. Social insurance makes this pyramid steeper: informal workers have no pension entitlements and receive nothing if they are injured or disabled; formal employees in the private sector have access to the National Pension and Employment Injury schemes administered by NASSCORP, whereas civil servants, in addition to the NASSCORP schemes, are enrolled on very convenient terms in special schemes administered by the Civil Service Agency.

To achieve more equality and better protection, two policies are recommended: align the treatment of public employees to that of private employees (which basically means dismantling the special insurance schemes of the Civil Service Agency), and introduce incentives to formalize informal employment arrangements. We suggest that such incentives take the form of a government subsidized pension voucher, which workers can either save until retirement, or give to an elder relative for immediate cash in. The vouchers serve therefore three goals: i)

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<sup>60</sup> Funding for the program might also come from the savings generated by the dismantling of the PSP scheme.

formalizing employment relationships, ii) help workers who can afford it build their retirement savings, iii) provide cash transfers to households in needs.

In conclusion, two things should be remarked. First, the labor market reform proposed here considers the new level of the minimum wage as a political constraint, at least in the short term. Ideally, according to our analysis the minimum wage in Liberia should be reduced to its previous level of 2 US\$ per day for unskilled workers, to be revised upward only as the country grows richer. Second, labor market reforms are not the only way to provide more and better jobs.<sup>61</sup> Liberia needs policies aimed at improving the productive capacity and the growth rate of the economy (top half of figure 1), as it needs public work programs, which not only provide income to the most disadvantaged, but increase their employability once the programs end, leaving participants more endowed with work experience, training, and motivation.<sup>62</sup> However, while the design and management of active labor market programs has improved over the recent years –see the positive experiences of the YES (Youth, Employment, Skills) program and LYEP (Liberia Youth Employment Program)– labor market regulations appear still little attentive to economic principles and very influenced by ideological principles. We hope that this study brings incentives more at the center of the discussion about labor market reforms, in Liberia.

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<sup>61</sup> See Lee and McCann (2011), DFID (2004).

<sup>62</sup> See Lal et al. (2010).

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## Appendix A. The extent of the informal employment – cross-country comparison.

The following figures, taken from ILO (2011b), compare the extent of the informal employment across developing economies. Liberia is in the middle of the ranking (figure A1). Updates are available (see ILO, 2012c), but since the last Liberian data (LFS) refer to 2010, we older report is more meaningful for comparing Liberia with other countries.

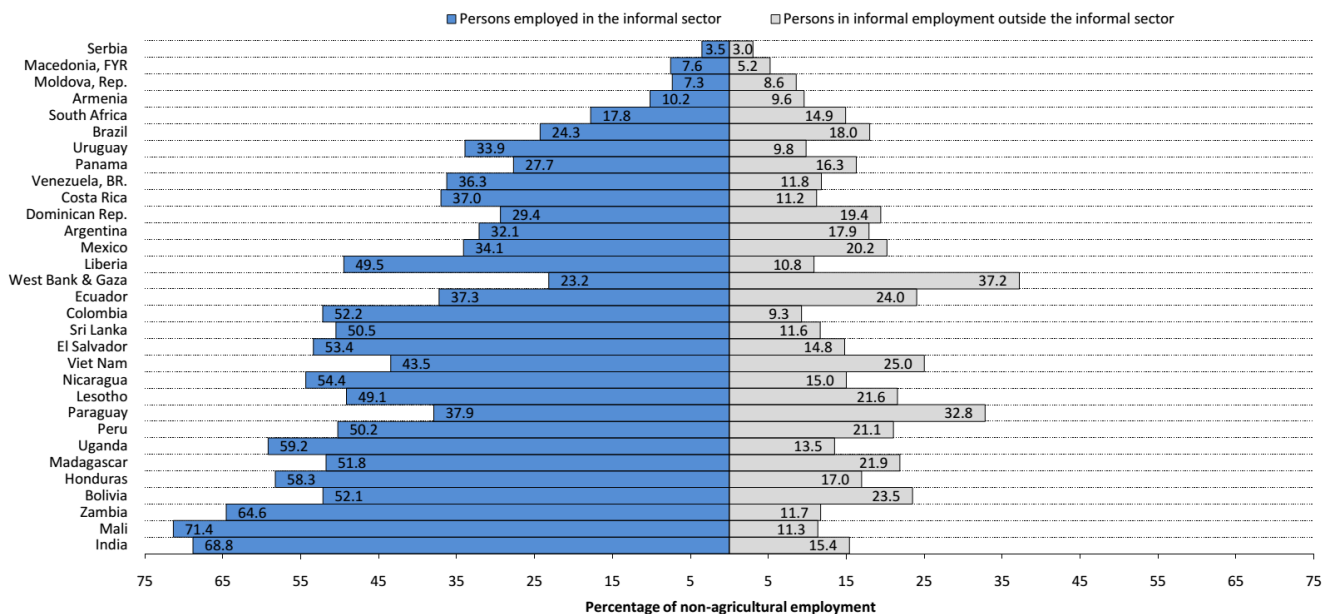


Figure A1: Persons employed in the informal economy by component. Source: ILO (2011b).

The extent of informal employment is negatively related to GDP per capita (figure A2) and positively related to the incidence of poverty (figure A3): indeed, Liberia has fewer informal employment than expected, given its low level of income per capita.

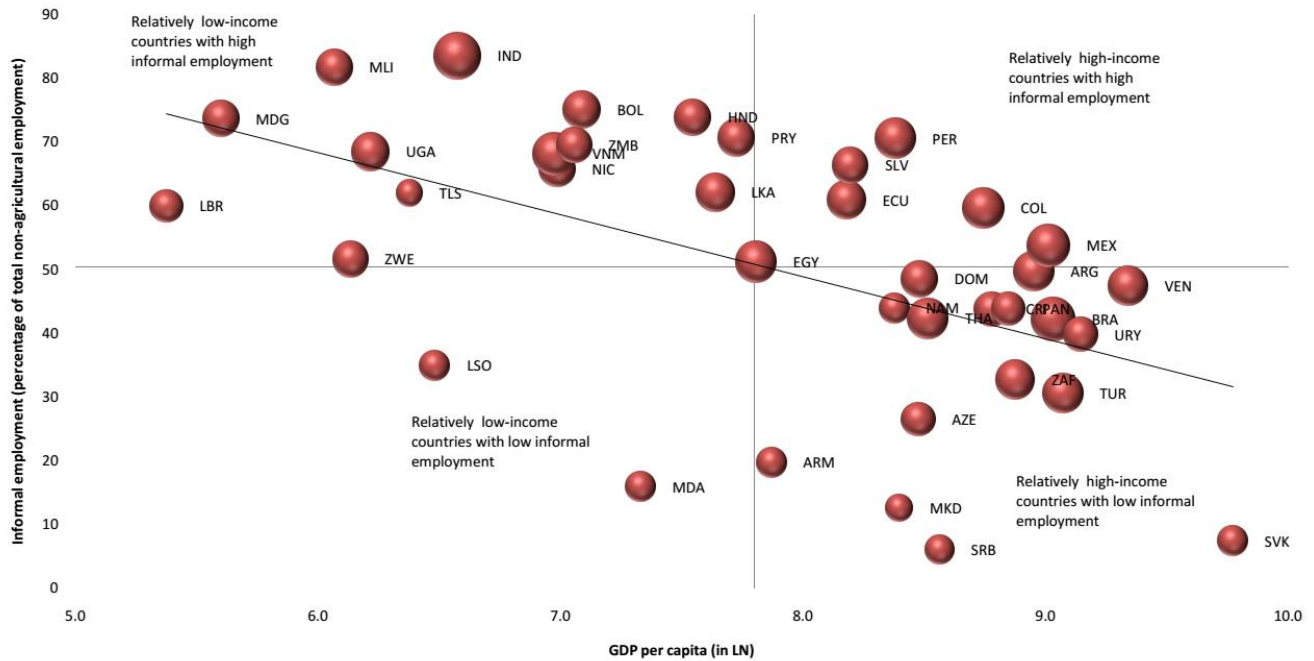


Figure A2: Informal Employment and GDP per capita. Source: ILO (2011b).

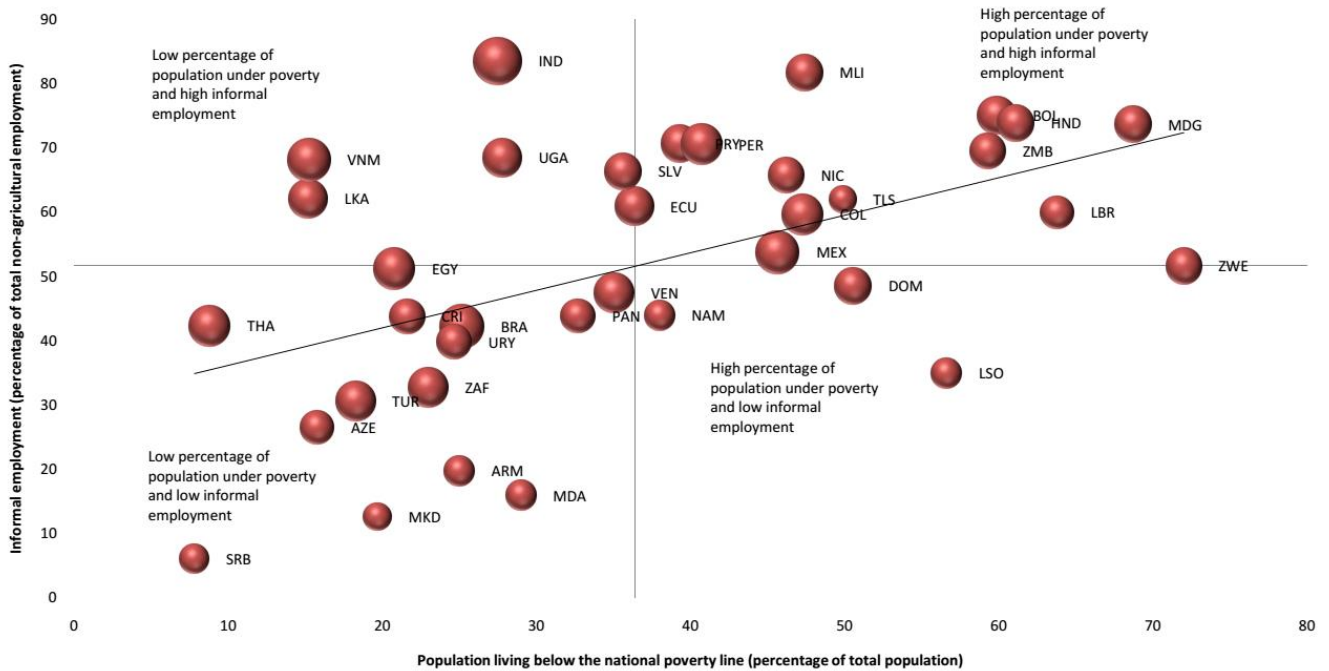


Figure A3: Informal Employment and Poverty. Source: ILO (2011b).



## Appendix B. EPL index.

Original unit and short description		Assignment of numerical strictness scores						
		Assigned scores						
		0	1	2	3	4	5	6
<b>Item 1</b> Notification procedures	<b>Scale 0-3</b> 0 when an oral statement is enough; 1 when a written statement of the reasons for dismissal must be supplied to the employee; 2 when a third party (such as works council or the competent labour authority) must be notified; 3 when the employer cannot proceed to dismissal without authorisation from a third party.	Scale (0 – 3) × 2						
<b>Item 2</b> Delay involved before notice can start	<b>Days</b> Estimated time includes, where relevant, the following assumptions: 6 days are counted in case of required warning procedure, 1 day when dismissal can be notified orally or the notice can be directly handed to the employee, 2 days when a letter needs to be sent by mail and 3 days when this must be a registered letter.	≤2	< 10	< 18	< 26	< 35	< 45	≥ 45
<b>Item 3</b> Length of the notice period at	9 months tenure <b>Months</b> 4 years tenure <b>Months</b> 20 years tenure <b>Months</b>	0 0 < 1	≤0.4 ≤0.75 ≤2.75	≤0.8 ≤1.25 < 5	≤1.2 < 2 < 7	< 1.6 < 2.5 < 9	< 2 < 3.5 < 11	≥ 2 ≥ 3.5 ≥ 11
<b>Item 4</b> Severance pay at	9 months tenure <b>Months pay</b> 4 years tenure <b>Months pay</b> 20 years tenure <b>Months pay</b>	0 0 0	≤0.5 ≤0.5 ≤3	≤1 ≤1 ≤6	≤1.75 ≤2 ≤10	≤2.5 ≤3 ≤12	< 3 < 4 ≤18	≥ 3 ≥ 4 > 18
<b>Item 5</b> Definition of justified or unfair dismissal	<b>Scale 0-3</b> 0 when worker capability or redundancy of the job are adequate and sufficient ground for dismissal; 1 when social considerations, age or job tenure must when possible influence the choice of which worker(s) to dismiss; 2 when a transfer and/or a retraining to adapt the worker to different work must be attempted prior to dismissal; 3 when worker capability cannot be a ground for dismissal.	Scale (0 – 3) × 2						
<b>Item 6</b> Length of trial period	<b>Months</b> Period within which, regular contracts are not fully covered by employment protection provisions and unfair dismissal claims can usually not be made.	≥ 24	> 12	> 9	> 5	> 2.5	≥ 1.5	< 1.5
<b>Item 7</b> Compensation following unfair dismissal	<b>Months pay</b>	≤3	≤8	≤12	≤18	≤24	≤30	> 30
<b>Item 8</b> Possibility of reinstatement following unfair dismissal	<b>Scale 0-3</b> The extend of reinstatement is based upon whether, after finding of unfair dismissal, the employee has the option of reinstatement into his/her previous job, even if this is against the wishes of the employer.	Scale (0 – 3) × 2						

Table B1. EPL index: Individual dismissals of workers with regular contracts. Source: OECD (2004).

Original unit and short description		Assignment of numerical strictness scores						
		Assigned scores						
		0	1	2	3	4	5	6
<b>Item 9</b> Valid cases for use of fixed-term contracts (FTC)	<b>Scale 0-4</b> 0 fixed-term contracts are permitted only for “objective” or “material situation”, <i>i.e.</i> to perform a task which itself is of fixed duration; 1 if specific exemptions apply to situations of employer need ( <i>e.g.</i> launching a new activity) or employee need ( <i>e.g.</i> workers in search of their first job); 2 when exemption exist on both the employer and employee sides; 3 when there are no restrictions on the use of fixed-term contracts.	6 – scale (0 – 3) × 2						
<b>Item 10</b> Maximum number of successive FTC	<b>Number</b>	No limit	≥ 5	≥ 4	≥ 3	≥ 2	≥ 1.5	< 1.5
<b>Item 11</b> Maximum cumulated duration of successive FTC	<b>Months</b>	No limit	≥ 36	≥ 30	≥ 24	≥ 18	≥ 12	< 12
<b>Item 12</b> Types of work for which temporary work agency (TWA) employment is legal	<b>Scale 0-4</b> 0 when TWA employment is illegal; 1-3 1 to 3 depending upon the degree of restrictions; 4 when no restrictions apply.	6 – Scale (0 – 4) × 6/4						
<b>Item 13</b> Restrictions on number of renewals	<b>Yes/no</b>	–	–	No	–	Yes	–	–
<b>Item 14</b> Maximum cumulated duration of TWA contracts	<b>Months</b>	No limit	≥ 36	≥ 24	≥ 18	≥ 12	> 6	≤ 6

Table B2. EPL index: Temporary employment. Source: OECD (2004).

Original unit and short description		Assignment of numerical strictness scores						
		Assigned scores						
		0	1	2	3	4	5	6
<b>Item 15</b> Definition of collective dismissal	<b>Scale 0-4</b> 0 if there is no additional regulations for collective dismissals; 1 if specific regulations apply from 50 dismissals upward; 2 if specific regulations apply from 20 dismissals onward; 3 if specific regulations apply at 10 dismissals; 4 if specific regulations start to apply at below 10 dismissals;	Scale (0 0150 4) × 6/4						
<b>Item 16</b> Additional notification requirements	<b>Scale 0-2</b> There can be notification requirements to <i>works councils</i> (or employee representatives), and to <i>government authorities</i> such as public employment offices. Countries are scored according to whether there are additional notification requirements on top of those requirements applying to individual redundancy dismissal. 0 no additional requirements; 1 when one more actor needs to be notified; 2 when two more actors need to be notified.	Scale (0 – 2) × 3						
<b>Item 17</b> Additional delays involved before notice can start	<b>Days</b>	0	< 25	< 30	< 50	< 70	< 90	≥ 90
<b>Item 18</b> Other special costs to employers	<b>Scale 0-2</b> This refers to whether there are additional <i>severance pay</i> requirements and whether <i>social compensation plans</i> (detailing measures of reemployment, retraining, outplacement, etc.) are obligatory or common practice 0 no additional requirements; 1 one additional requirement; 2 if both requirements apply.	Scale (0 – 2) × 3						

– Not applicable.

Table B3. Collective dismissals. Source: OECD (2004).

<b>Level 4</b> Scale 0-6	<b>Level 3</b> Scale 0-6	<b>Level 2</b> Scale 0-6	<b>Level 1</b> Scale 0-6
Overall summary indicator	Regular contracts (version 2: <b>5/12</b> ) (version 1: 1/2)	Procedural inconveniences <b>(1/3)</b>	1. Notification procedures (1/2) 2. Delay to start a notice (1/2)
		Notice and severance pay for no-fault individual dismissals <b>(1/3)</b>	3. Notice period after 9 months (1/7) 4 years (1/7) 20 years (1/7)
			4. Severance pay after 9 months (4/21) 4 years (4/21) 20 years (4/21)
	Temporary contracts (version 2: 5/12) (version 1: 1/2)	Difficulty of dismissal <b>(1/3)</b>	5. Definition of unfair dismissal (1/4) 6. Trial period (1/4) 7. Compensation (1/4) 8. Reinstatement (1/4)
		Fixed term contracts <b>(1/2)</b>	9. Valid cases for use of fixed-term contracts (1/2) 10. Maximum number of successive contracts (1/4) 11. Maximum cumulated duration (1/4)
	Collective dismissals (version 2: <b>2/12</b> ) (version 1: 0)	Temporary work agency employment <b>(1/2)</b>	12. Types of work for which is legal (1/2) 13. Restrictions on number of renewals (1/4) 14. Maximum cumulated duration (1/4)
			15. Definition of collective dismissal (1/4) 16. Additional notification requirements (1/4) 17. Additional delays involved (1/4)
			18. Other special costs to employers (1/4)

Table B4. EPL summary indicators at four successive levels of aggregation, with weighting scheme. Source: OECD (2004).