Labor Issues in Infrastructure Reform

A Toolkit
Labor Issues in Infrastructure Reform

A Toolkit
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Workers and unions are anxious about the effects of PPI. Popular opinion shares many of those same concerns.

OVERALL TRENDS

PPI takes place in a changing global context that affects all businesses and national economies. There is, however, widespread concern regarding its impact on workers.

Public service workers and their unions often distrust PPI, fearing that it will have negative effects on employment numbers, pay, terms and conditions, and relationships with management. Set against a background in which many state-owned enterprises have provided their staff with employment security, and terms and conditions much better than those enjoyed by equivalent workers in the private sector, such anxieties are understandable. Moreover, there is no shortage of documented examples to show that these fears are well grounded.
ic expansion have resulted in new job creation at
the enterprise or sectoral level, and because pro-
ductivity improvements have led to better terms
and conditions of service. Moreover, workers are
also consumers and their households will benefit
from improvements in access and services.

The review of sector impacts in subsequent sections
of this module also indicates that PPI itself is not
necessarily the only cause of adverse impacts on
labor. Any counterfactual assessment of the impact
of PPI on labor must take account of levels of
labor adjustment that would have taken place any-
way, perhaps as a result of new technology or
structural change in the economy through a shift to
services. Overall, the experience of the impact of
PPI on labor is more varied and nuanced than is
suggested by the stereotypes.

There are significant differences between sectors,
and underfunded public service organizations have
often been unable to provide their employees with
the capital investment and new technology to
enhance their work and productivity. Many public
employers have held back improvements in salaries
and wages rather than reduce staffing and pay
more to those who remain, and that practice has
often had an adverse effect on their ability to
recruit and retain key staff. Some employers have
difficulties paying salaries at all, and a few have
even looted employees’ pension contributions.

By introducing new capital and by restructuring
human resources PPI can improve the earnings and
working environment of many workers, albeit
often by reducing the number of people directly
employed, at least in the short term. In addition,
efficiency improvements often lead to longer-term
security of employment, and—in some sectors—
employment expansion.

Although it is important to be aware of the poten-
tial and negative impact of PPI on labor, it is no
less important to be aware of the wider picture so
that costs and effects can be accurately assessed
and fairly attributed. Moreover, without funda-
mental enterprise reform, infrastructure services
will continue to deteriorate in many cases, at high
cost to consumers and users.

## EMPLOYMENT IMPACT

Job losses are the most obvious adverse impact on
labor. This section focuses on the impact of PPI on
the number of workers employed, beginning with a
brief introduction and then examining the evidence
sector by sector.

### Factors in Employment Reduction

Private participation in state-owned enterprises has
a variable impact on job numbers. There are sever-
al reports of positive net impacts of privatization programs in general. In the infrastructure sector, however, PPI is seldom associated with short-term increases in employment in the enterprises directly affected and is more usually associated with short-run job losses. These losses can be substantial because of the large size of the enterprises concerned and the unusually high level of labor redundancy in many infrastructure enterprises (box 2.2).

Many factors play an important role in determining the extent, pace, and timing of employment reductions. Although there are numerous country- and enterprise-specific circumstances, some patterns exist. For example, sectors such as rail and ports have generally experienced higher levels of downsizing than have the telecommunications and water sectors.

**Rail**

Overall, the most severe impact of PPI on employment numbers has been felt in railway enterprises. There are five potential explanations for this:

1. There is increasing competition from road operators. As road networks have developed and improved, trucking and bus operations have become stronger competitors for rail operations. There are now few passenger or general freight railways that are not subject to competition from road transportation.
2. Technological change has brought a shift away from labor-intensive operations; for example, more efficient diesel and electric trains, improved ticketing systems, increased use of freight containers, or the mechanization of operations such as track tamping.
3. Some rail companies maintained their protected monopoly status for many years and when that was removed, profound changes in operations, costs, and staff numbers followed.
4. Rail workers (along with mine workers) are some of the oldest and most significant groups of organized labor. In some countries (Argentina, for example) the unions were successful in preserving high levels of employment until economic crisis enabled reform.
5. Rail has been often a vehicle for job creation and patronage.

The result has been high levels of downsizing. In Argentina, where the railway was restructured into several separate freight and passenger networks and concessioned in 1994 and 1995, employment fell from around 95,000 in 1989 to approximately 17,000 in 1997. (In 1960 it had been as high as 200,000.) The scale of job loss associated with rail PPI in Argentina is typical for Latin America. In Chile, where there had already been a cut of 75 percent in the railway labor force between 1973 and 1990, the number was halved again in the course of privatization from 1990 to 1995. Brazil’s experience was similar (see box 2.3).

In Africa, rail PPPIs have also been associated with significant reductions in employment numbers, although not on the scale of Latin America where overstaffing appears to have been particularly high. Figure 2.1 shows how the work force adjustment in the joint railway of Côte d’Ivoire and Burkina Faso took place at the time of a major restructuring exercise in 1988, and then again at the time of PPI in 1995.
Job losses apparently associated with PPI do, however, need to be seen in the context of the sector as a whole. There have been substantial reductions even where rail has remained in the public sector. In Denmark’s national rail company, for instance, employment fell by nearly 29 percent in one year, from 1996 to 1997. Moreover, focusing on the enterprise rather than the sector can be misleading. New jobs can be created with contractors and subcontractors without showing up in the personnel numbers of the post-PPI companies themselves. For example, six years after the concessioning of Bolivia’s Eastern and Andean railroads, more than 50 percent of the employment in the sector is provided through outsourced contractors (see Valdez 2002).

That proved to be true. The work force was halved again, to a total of around 11,000, within a year of the start of concessions, meaning that since the beginning of the privatization process about 75 percent of the jobs had been cut. Source: Estache, Schmitt de Azevedo, and Sydenstricker 2000.

Port workers’ trade unions have opposed port reform because both job losses, casu- alization of labor (the shift to individual temporary contracts with less legal protection for workers), and changes in working conditions are of great concern (box 2.4). Whether or not the comments made in box 2.4 are a fair reflection of what has happened in all ports, they are typical of the perceptions of union leaders in ports—and indeed other infrastructure sectors.

An International Labour Organisation (ILO) survey of ports suggested that overstaffing was most serious where there are port labor pools—a measure that protects against casualization of labor—and that overstaffing was greater in operations than in administration. There has been a dramatic decline in employment in such ports. For example, in the port of Buenos Aires, Argentina, the suspension of the existing labor agreements led to a 50 percent reduction of the number of workers. Port reforms in Australia, France, and the United Kingdom cut employment levels by 40 to 60 percent (ILO 1996).

The Public-Private Infrastructure Advisory Facility (PPIAF) Port Reform Toolkit is a comprehensive source of information on all aspects of port reform, including labor issues.

![Figure 2.1: Employment in Côte d’Ivoire and Burkina Faso Rail, 1980–2000](Source: Martin and Micoud 1997; SITARAIL data.)

**Ports**

The port industry has been heavily influenced by global competition, technological change, and containerization.
Increasing competition compels port stakeholders to assess their cost structures and labor force. Competition is one of the principal motivating forces behind labor reform in ports. Impacts on individual ports depend on a number of factors, not simply PPI alone.

- The nature of port operations—the extent of containerization, the nature of the cargo—and the emergence of regional hub ports will be one factor. In particular where containerization and privatization occur about the same time, it is difficult to distinguish clearly which factor is responsible for job losses.

- The national economy has an impact. The effect of privatization in ports, rail, and other transport services depends on overall economic and trade performance because much traffic will be demand driven. If the economy stalls, so will demand for port and other transport services.

- The performance of other related logistical (rail, road terminals) and trade facilitation (customs) operations can have a profound impact. They can influence port competitiveness, cargo types, and volumes—and thus employment levels.

- The nature of industrial relations is also pertinent in assessing the impact. Effective unions enable employees to better defend changes to jobs and work practices.

Many government-owned ports face these issues—often in combination—and that can affect employment conditions and labor-management relationships in various ways (see table 2.1 and the PPIAF Port Reform Toolkit). Where the right factors come together, however, there can be net job creation in the ports sector (box 2.5).

### Water

Private participation in water infrastructure often involves investment plans that propose rapid expansion of the service area. This expansion helps protect employment numbers because any surplus can be absorbed. Nonetheless, many state-owned

#### Box 2.4: Union Perceptions of Privatization’s Impact in Ports

"Deregulation, privatization, flexibility and casualization have become the magic words and the solutions to all shortcomings. They are supposed to create wealth for all, but the real and practical consequences are mass dismissal of workers, worsening of working conditions and deterioration of health and safety...."

“In nearly all cases, investments in new port infra- and superstructures coincided with downward pressure on working conditions and employment in order to cut labor costs as much as possible. Deregulation, privatization and growing competition are leading to this downward pressure and subsequently to the increasing use of nonunion labor, casualization of labor and flexibilisation of labor relations and working conditions, all of which are not in the interests of workers” (International Transport Workers’ Federation 1997, p. 9–10).

#### Box 2.5: Employment Growth in Mexican Ports

In 1993 the Mexican government passed a law that enabled reform of Mexico’s ports. It dismantled the public agency Puertos Mexicanos, which was responsible for all ports, and provided for the decentralization of port management, the privatization of port operations, and the encouragement of competition among ports.

One element of the reform was the transformation of national collective bargaining into firm-level bargaining by the new private operators, so allowing these firms to negotiate with their workers according to local and business conditions. As a result the number of port workers employed by the public sector was reduced, but total port employment by private firms is rising because of an increase in the activity of ports.

For example, the port of Manzanillo had 2,100 workers before the reform, and at the end of 1997 the number had doubled. In Veracruz, with an initial number of 6,647 employees, the increase was not so spectacular in relative terms, but employment had risen to 8,260.

Source: Estache, González, and Trujillo 2001
water companies have low labor productivity, and the need to improve performance may necessitate work force reductions.

In the Czech Republic, for example, privatization of water supply and sewerage utilities began in 1992 and within five years the number of workers in the water supply companies had fallen by 26 percent. Similarly, in Hungary there was a 46 percent reduction in staff in one water company (ILO 1999b).

Employment reductions of a similar scale and range are associated with water PPIs in Africa, Asia, and Latin America (table 2.2). In Buenos Aires the numbers of permanent employees fell by about half to around 4,000. The consortium that won the concession for the service also reported, however, that it increased its indirect employment through contracts associated with its infrastructure expansion by as many as 5,000, producing a net increase of about 10 percent (Aguas Argentinas, personal communication).

### Electricity

In the electricity sector the need for rapid investment and expansion of infrastructure also reduces the extent of job losses. Nonetheless, the ILO reported employment cuts of more than 20 percent of the work force in a number of countries.

For example, in Côte d’Ivoire employment fell by 22 percent over a 5-year period following the start of a 15-year concession. The impact appears to have fallen particularly heavily on middle management. The new management decided to “flatten” the organization by reducing the number of hierarchical layers from 18 to 5.

As in other sectors, job losses also take place under public ownership, without PPI. In South Africa, for example, there was a 40 percent reduction in the number of workers employed by the publicly owned electricity utility Eskom over the six-year period from 1993 to 1999.

### Table 2.1: Possible Effects of Privatization on Employment in Ports

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<th>Labor–management relationship</th>
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<td>• Reclassification of posts</td>
<td>• Greater job mobility</td>
<td>• Greater emphasis on professionalism</td>
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<tr>
<td>• New job patterns</td>
<td>• Diminished guarantee of tenure and job security</td>
<td>• More discretionary power in making management decisions and formulating enterprise policies</td>
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<tr>
<td>• Labor retrenchment and direct job losses</td>
<td>• Need for retraining and skill upgrading</td>
<td>• More emphasis on strict implementation of those decisions and policies</td>
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<td>• Gender-biased employment policies</td>
<td>• Longer working hours and/or increased workload</td>
<td>• Marginalization of unions’ influence and bargaining power</td>
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<tr>
<td>• Discrimination against shop stewards and other labor representatives</td>
<td>• Payment by results schemes and pay freezes</td>
<td>• More tedious wage bargaining with preferences for individual rather than collective agreements</td>
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<tr>
<td>• Medium- and long-term employment gains resulting from increased investment, growth of privatized firms, and diversification of services</td>
<td>• Loss of seniority and service grades</td>
<td>• Tougher stance of management on workers’ performance and work discipline</td>
</tr>
<tr>
<td>• Wider wage differentials with greater incentive components</td>
<td>• Wider wage differentials with greater incentive components</td>
<td>• Efficiency arguments and profit making gain importance over social objectives</td>
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Source: Adapted from UNCTAD 1995.
In Latin America’s power sector the level of employment reductions appears to have been larger than elsewhere, which (as in other sectors) reflects the extent of previous overstaffing in those countries. In Argentina the ILO has reported that 22 percent of the work force was cut in the run-up to privatization and another 28 percent was cut over a similar period following privatization (table 2.3).

A similar pattern has been seen in Brazil (table 2.4 indicates the extent of reductions there). This also shows that work force adjustments can be substantial even where there is no PPI.

**Telecommunications**

In the telecommunications sector the natural monopoly characteristics that underpinned state ownership have largely disappeared. Technology has brought dynamic changes, including increased convergence with computing and media, while the market has become more segmented among long-distance, data, mobile, and local telephone services, for example.

New service providers have entered the market since the mid-1980s, including specialist cellular operators and Internet service providers. Therefore, although typically there has been a reduction in the number of workers employed by privatized telecommunications companies, growth in the sector among new entrants has generated more jobs than the numbers lost in the former public monopoly enterprise.

A recent study showed that from 1990 to 1994, employment increased by an average of 21 percent in newly competitive telecommunications markets in 26 Asian and Latin American countries, whereas countries that retained a monopoly showed only a 3 percent increase (Petrazzini 1996a).

The nature of the new jobs in telecommunications—in terms of the skills, experience, and cultural approaches they require—has changed greatly. This means that retrenched workers from privatized telecommunications companies are not necessarily well equipped for the new jobs that have been created (box 2.6). A great deal of retraining can be required, and in some cases that challenge has been tackled in the context of PPI. In the case of Sri Lanka Telecom, for example, none of the 800 workers was retrenched but many were

| Table 2.3: Argentina: Restructuring of Electricity Work Force after Privatization |
|----------------------------------|----------------|----------------|----------------|----------------|
| Company                         | Number of employees At time of privatization (1990) | employees After privatization (1993) | Percentage change |
| Central Costanera               | 795            | 661            | –16.8          |
| Central Dock Sud                | 75             | 60             | –20.0          |
| Central Pedro de Mendoza        | 59             | 31             | –47.5          |
| Central Puerto                  | 1,115          | 798            | –28.4          |
| Edelap                          | 741            | 542            | –26.8          |
| Edenor                          | 6,443          | 4,164          | –35.3          |
| Edesur                          | 6,529          | 5,051          | –22.6          |
| **Total**                       | **15,747**     | **11,307**     | **–28.4**      |

*Source: de Luca 1998b, p. 194.*
retrained in new skills suited to the new technologies. In India, too, a freeze on recruitment was linked to a program of retraining in the main telecommunications utility, Bharat Sanchar Nigam Limited.

Postal Services
A recent ILO review of employment trends in postal services suggests that experience in postal services varies—perhaps more than in other sectors. Among the main factors identified in job losses by the ILO are mergers and acquisitions, globalization, changing markets, new technologies, changing fashions, and structural and regulatory changes.

It is therefore difficult to separate the impact of the technologies from that of privatization and reorganization, but technological and related synergy effects and increased efficiency have influenced the quantity and quality of jobs in the postal service and the structure of the work force (ILO 2002).

In Malaysia in 1992 the Postal Services Department was transformed into Pos Malaysia, and nearly all employees chose to transfer to the new corporation rather than remain civil servants. Corporatization was accompanied by network expansion, new business, and services (advertising mail, courier services, printing, and express post, for example), so employment increased by 20 percent from 1992 to 2000.

On the other hand, Tanzania experienced a 45 percent decline in employment from 1994 to 1999 through attrition, voluntary separations, early retirements, and transfers, coinciding with an expansion in franchised operations. Improved productivity, performance, and business allowed a significant expansion (20 percent) of employment numbers in 2000.

In Latin America and the Caribbean employment remained stable or increased in several countries (Barbados, Brazil, Chile, Colombia, Jamaica, Mexico, Peru, and República Bolivariana de Venezuela) between 1995 and 1999, but declined in Argentina, Costa Rica, El Salvador, Panama, and Trinidad and Tobago. In Costa Rica, nearly a quarter of total staff took voluntary retirement in 1998 following the creation of an autonomous state postal firm, but in the following years recruitment to cover new demand and services largely restored employment numbers to their previous levels. In Argentina a program of voluntary departures led the permanent work force to fall by 25 percent from 1996 to 1999.

LABOR PRODUCTIVITY
PPI has enabled many governments to overcome long-standing problems of low labor productivity in public services. This has been done not only (and not even always) through reducing the work force but also through capital investment and service expansion.
All infrastructure operations can identify methods for measuring labor productivity and international benchmarks in the infrastructure sectors that are based on those methods. The practical use of those labor productivity measurements and benchmarks is less simple, however, because many circumstantial factors have to be taken into account.

Improving labor productivity is a matter of combining quantitative information with qualitative judgment in the most effective ways. Module 3 addresses those issues more fully. For the purposes of this module, the issue to be stressed is that PPI typically is associated with increasing labor productivity measured in terms of output per employee. This is, in part, because labor productivity tends to be too low under state management.

Almost invariably, labor productivity measured in terms of output per employee rises following PPI. In many cases, employment reductions are one means of driving up productivity, and in some cases they are indispensable. Increasing labor productivity does not, however, necessarily involve job cuts, and even when it does, there are other productivity-enhancing measures to be taken as well (see box 2.7). In fact, other ways of increasing labor productivity can be more important than employment reduction. Badly designed retrenchment programs that lead to the wrong workers leaving (the adverse selection problem) or to mass demoralization can even have the effect of reducing labor productivity.

**Box 2.6: ILO Analysis of the Labor Impact of PPI in the Telecommunications Sector**

The ILO has concluded that privatization and liberalization “have generally resulted in job losses among traditional telecommunications services operators in OECD [Organisation for Economic Co-operation and Development] countries, in which markets are considered mature, with generally satisfied demand for basic services, and competitive offers of new services. Job creation in industrialized countries is mainly due to the emergence of new enterprises or services.”

However, “in low-to-middle-income countries and those in transition, the supply of basic services has not yet reached saturation point and is sometimes far below it; employment creation is hindered by lack of solvent demand (demand in general is not lacking); and growth in the supply of telecommunications services is often impeded by local shortages of capital, although mobile communications are experiencing huge growth in many developing countries.

“While employment has fallen and continues to fall among the main traditional operators in mature markets, this situation is clearly not true for operators (whether privatized or not) in countries continuing to construct and/or modernize their network.

“Thus, in the Republic of Korea, the partial privatization of telecommunications and the termination of public employee status at the end of the 1980s did not result in staff reductions. For some years the opposite happened while the market underwent considerable expansion—in the years following privatization, the number of employees in Korea Telecom increased by 32 percent, but fell back by 12 percent following the period 1997–99, with the Asian financial crisis.

“In Mexico, the privatization of Telmex did not in itself result in job cuts—following an agreement with the trade unions there were no layoffs, and the work force increased (on paper at least) by 30 percent in the period 1997–99.”

As well as capital scarcity, many countries have also suffered from telecommunications skills shortages, which, says the ILO, “is often a consequence of lack of investment in training, or lack of basic information and communication technology (ICT) skills among potential recruits.”

As a result, foreign recruitment is a frequent option. “In Africa, where average teledensity is less than two telephone lines per 100 inhabitants, with most lines concentrated in urban areas, the lack of technical staff and expertise means that ICT-trained employees may well move to richer countries. Thus the principal employment preoccupation may be how to retain skilled staff and how to attract new ones, rather than a need to cut employment numbers, despite budgetary constraints.”

Source: ILO 2002, pp. 73, 84, 89.
cent productivity increase was attributable to service expansion, with only about a quarter the result of layoffs.

- **Capital investment**, especially in new technology, enables the same number of workers to produce more. This has been especially significant in the telecommunications sector, but has been instrumental in increasing productivity across other sectors as well.

- **Greater commercial orientation of enterprise managers**: This, however, is easier in a privatized environment. Public managers sometimes operate under conflicting sets of objectives—to provide an efficient service while employing surplus labor for political or social reasons—and often have been unable to tackle productivity problems in a sustained way.

- **Better management and faster decisionmaking**: Again, private sector managers are often able to make normal management decisions more quickly than are public sector managers. Delayed decisions on spending for critical repairs, small investments, or new recruitments hinder productivity. Public sector managers often have limited delegated financial authority, suffer from public sector liquidity shortages, and need to gain the approval of administrators in distant capital cities to make minor expenditures.

Of all the infrastructure sectors, railways have exhibited some of the highest levels of productivity improvements after PPI. This reflects the high level of surplus labor the railways have had to carry over the years and the subsequent high levels of work force downsizing. A review of six rail operations concluded that:

> The most dramatic results of the involvement of the private sector in the concessions (or privatizations) are undoubtedly the significant improvements in labor productivity. In all but one case (Côte d’Ivoire/Burkina Faso—a 33 percent improvement in five years), labor output per employee (expressed as the sum of ton-km plus passenger-km per employee) at

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**Box 2.7: Productivity Growth in Latin American Telecoms Following PPI**

Ravi Ramamurti has reported “explosive growth” in labor productivity in utilities and telecommunications following privatization in Latin America. It was achieved not necessarily through cutting jobs, but often through expansion of coverage, deployment of new technology, and other means. Even when employment numbers are sharply reduced, that is not the only factor in productivity increases.

Mexican telecoms increased the number of lines per employee by 13 percent a year in the first three years of privatization (which occurred in 1990), compared to a decline of two percent a year throughout the 1980s until the last two years before privatization when 10 percent increases were recorded each year.

Telecoms in República Bolivariana de Venezuela also recorded double-digit labor productivity increases in the first two years of privatization (beginning in 1991), and Argentina’s lines per employee rose by 19 percent in the first three years after privatization (1990) compared with 6.5 percent in the two years before.

Ramamurti explained how it was done: “The dramatic increases in labor productivity resulted from a deliberate effort to freeze the size of the workforce even as the network expanded by double digits. In Argentina, where workers were not promised job security after privatization, the new owners shed almost 50 percent of the original workforce, even as they hired younger persons with skills in areas such as information systems or marketing; companies recovered the US$15,000–$20,000 spent on severance compensation per employee in two years or less.”

least doubled and more often tripled or quadrupled. To some extent this was a result of traffic growth, but the greater share of the improvement must be attached to the programs which reduced the redundancy in the labor forces of the railways (Thompson, Budin, and Estache 2001, p. 10).

Thompson, Budin, and Estache 2001.

Figure 2.2 shows traffic units per employee—the standard measure of labor productivity in rail—in six Brazilian and two Bolivian freight concessions before and after PPI.

Service expansion and capital investment form a substantial part of the productivity increase in some cases, such as Trinidad and Tobago Post (box 2.8). Another example is Côte d’Ivoire electricity, which was privatized in 1990. By 1995 labor productivity (kilowatt hours per employee) rose by nearly 25 percent. The number of consumers per employee showed a slightly slower rate of increase, from 128 in 1990 to 156.7 in 1995, a rise of about 22 percent. Over the same period the number of workers employed fell by less than 5 percent (ILO 1999b, Plane 1998).

PAY

As with employment numbers, the impact of PPI on pay can be seen as an outcome of underlying and historical factors rather than of PPI as such. Privatization and other forms of PPI have tended to expose pay determination more to market forces, but this has been offset to varying degrees by legal provisions, collective agreements, and labor union strength. Therefore, the impact of PPI on earnings has varied in accordance with the net influence of these various factors.

In some sectors and grades publicly employed workers have received higher compensation than equivalent workers in the private sector. In these cases competitive pressures will encourage the agencies implementing labor programs to reduce costs and bring compensation more into line with market conditions. Equally, where public employees have been paid too little to enable recruitment and retention of some grades of skilled workers, market forces will push pay upwards.

Labor unions are able to take advantage of tight market conditions to negotiate pay and benefit increases for the workers whose skills are in short supply. They also may seek to extend the same improvements to unskilled workers or others in less demand.

In addition to the general tendency for PPI employees to relate pay more to market conditions, there are four other trends that can result from PPI across a range of sectors and countries:

1. The first trend is monetization of compensation (pay and benefits) packages as the non-wage benefits are converted to monetary amounts, bought out, reduced, or eliminated. Private investors are reluctant to take on the wide range of fringe benefits often found in state-owned enterprises (especially in tran-
changes in pay and compensation depend not only on private sector initiatives but also on labor laws and contracts.

Changes in pay and compensation depend not only on private sector initiatives but also on labor laws and contracts.

Box 2.8: Service and Productivity Improvements at Trinidad and Tobago Post

Under the 1999 Postal Act, following poor performance by the public operator, Trinidad and Tobago Postal Corporation (TTPost) was created, in consultation with the trade unions. A management contract was awarded to New Zealand Post, intended to enhance the reach of the universal service in TTPost as well as to improve revenues, profits, and customer satisfaction and reduce transit time.

According to World Bank reports TTPost has:

- Opened new, better-equipped outlets offering improved customer service
- Expanded home delivery to previously poorly served areas
- Established a wider range of products and services (including inland courier services) and expanded their availability
- Enhanced customer satisfaction
- Improved the reliability, speed, and security of mail delivery
- Increased revenue, productivity, and financial performance
- Improved working conditions and staff motivation.


In practice, the impact of these market trends can be constrained by rigidities in the pay revision process. These rigidities may be set out in labor laws, collective bargaining agreements, or labor contracts, some of which may predate the PPI transaction by many years.

In the utility and infrastructure companies of the former East African Community (EAC), for example, pay and benefits were very different between workers originally employed by the EAC and later recruits. These differentials have persisted in the years following the dissolution of the EAC, but more recent PPI reforms are now allowing the opportunity to revisit and harmonize pay systems so that they are more equitable. In some Mexican ports, longshoremen who had previously been paid by the ton of cargo handled were paid by the day after privatization. In the electricity privatization process in Pakistan, an agreement with the All Pakistan State Enterprises Workers’ Action Committee in 1991 provided for a 35 percent increase in basic pay and for allowances to be paid at the new rate.

In some cases PPI has produced “two-tier” work forces in which the pay (and other conditions) of retained workers is protected to some degree and new employees are recruited on different terms. An example is Cote d’Ivoire rail, where new recruits have lower basic wages than those retained from before PPI, but they also have bonuses mostly related to performance. Average pay in Cote d’Ivoire rail has increased following PPI, but so have differentials; therefore, the effect on different grades varies greatly.

In some cases, as employment has expanded in the longer term, the success of PPI has made pay increases above the rate of inflation affordable. For example:

2. The second trend is an increase in pay differentials, partly in response to labor market conditions and especially to attract and provide incentives in the recruitment and retention of experienced and skilled technicians and managers.

3. The third trend is the erosion of national-level collective bargaining, with a shift to enterprise-level bargaining or individual pay determination, a trend intensified by the increased use of subcontractors and casualization of labor.

4. The fourth trend is the change that pay systems undergo after PPI as new managers seek to relate earnings more directly to productivity performance.

In some cases PPI has produced “two-tier” work forces in which the pay (and other conditions) of retained workers is protected to some degree and new employees are recruited on different terms. An example is Cote d’Ivoire rail, where new recruits have lower basic wages than those retained from before PPI, but they also have bonuses mostly related to performance. Average pay in Cote d’Ivoire rail has increased following PPI, but so have differentials; therefore, the effect on different grades varies greatly.

In some cases, as employment has expanded in the longer term, the success of PPI has made pay increases above the rate of inflation affordable. For example:
• Following privatization, staff numbers in the Guyana telecommunications enterprise were cut in half, but the salaries of retained employees increased by 90 percent (Hinds 1995).
• In Argentina the real wages and salaries of employees of Entel and the Buenos Aires water concession increased by 45 percent in the three years following privatization (Kikeri 1998).
• In Chile the new owners of the electricity companies (Chilgener and Enersis) increased wages and introduced profit-sharing plans.
• In Orissa, India, retained employees in the privatized power sector received pay increases as well as improved promotion opportunities (Ray 2001).
• Workers at Malaysia’s Port Kelang who remained with the partly privatized company received compensation increases averaging 12 percent.
• In Mexico wages in a sample of privatized firms increased far in excess of rates elsewhere in the economy, with larger gains for blue-collar workers than for white-collar workers (Kikeri 1998).

BENEFITS

Public employees often enjoy a range of nonwage benefits that tend to be both greater in quantity and different from those that are more typical of the private sector. As mentioned in the pay section, PPI tends to lead to monetization of nonwage benefits as they are bought out. In addition, pension arrangements and other social provisions tend to change with PPI, and new benefits, such as employee shares, are sometimes introduced.

Pensions

Most public sector pension plans are of a defined-benefit type, usually guaranteeing the worker a fixed percentage of final salary at retirement, as well as a lump-sum payment. Such arrangements also exist in the private sector in some countries, but are on the decrease; the trend is toward pension plans in which more risk is borne by the beneficiary and less by the employer (see module 5).

Privatization and major downsizing can have profound effects on the pension plans. Those workers who are close to retirement and who are made redundant would be entitled to immediate benefits, while the amount of contributions that flow into the plan in the future are significantly reduced. This could seriously affect the financial viability of the fund. Where the private investor is required to set up a pension plan for the workforce taken over, as well as for new employees, the likelihood is that an accumulation-type plan will be established that is subject to investment risks and that has less guaranteed benefits than are provided under defined-benefit arrangements.

Pension arrangements are often a key issue in labor negotiations in the context of PPI. A report of an ILO bipartite meeting on privatization of municipal services (including electricity, water, public transportation, and other infrastructure sectors) noted that privatization often “entailed a lot of distress” for the workers affected:

The disappearance or reduction of pension schemes for which new employers had little regard represented one of the most dramatic consequences. Even where pension schemes were maintained, new upper limits had been set to qualify for benefits in countries such as Kenya, resulting in workers with fewer years of service leaving employment with no benefits (ILO 2001, p. 27).

However, the same meeting also heard that “social dialogue would provide agreed solutions to this dilemma in the form of provisions on early retirement, limited redundancy, aid to unemployed workers, and retraining.” An example was given:

Prior to privatization of the electricity sector in Hungary, the trade unions had negotiated an agreement with the Government. It would transfer five percent of privatization revenue to
a trade union managed fund in support of workers who left public companies in order to pay the differences between pensions and salaries in case of early retirement, and for a time to supplement unemployment funds beyond state provisions. Steps had also been taken to develop tailor-made training schemes, and the results had been so positive that Hungary had become a model for other countries of Central Europe (ILO 2001, p. 27).

Other examples of changes in pension arrangements both before and during PPI are described in module 5.

**Other Benefits**

Workers in infrastructure enterprises may derive not only wage income from employment but also a “social wage” composed of many elements. Housing; health care; childcare and preschool education; and sports, recreational, and cultural facilities have been provided. The introduction of PPI may lead to changes in these arrangements.

For example, as part of their remuneration, railway workers in Côte d’Ivoire were covered by a health insurance program. The concessionaire who won the contract under the railway privatization program did not wish to inherit the plan, but was agreeable to establishing a new one. Under the latter plan, the cost of contributions is shared between the workers and the company, and the workers pay a larger share than they did before. Although on paper it is a worse arrangement for the workers, in practice the state employees’ funds had been heavily in debt because the government failed to pay its contributions. Most employees no longer even applied to the fund for reimbursement of medical expenses. Now their entitlements are smaller on paper but they can rely on their being honored.

Also in Côte d’Ivoire the electricity concession company CIE set up three funds for its employees:

- Firstly, there is a social fund designed to provide allowances for family events. Hundreds of workers have benefited from it each year since 1991.
- There is [also] a savings and loan fund, which offers interest-free loans over periods of 12 to 15 months to workers who have saved for at least four months. Finally there is a collective investment fund by means of which compulsory wage deductions finance the acquisition of CIE shares. The shares are kept in an account which remains blocked until the employee leaves. The funds were widely shunned at the outset because the unions saw them as a kind of paternalistic balsam. However, the annual report for 1995 talks of growing use. The savings and loan fund alone has made 9,000 loans (Plane 1998).

The extent of the challenge has been much greater in the “transition” (formerly centrally planned) economies and especially in one-company towns and rural areas. In Russia, for example, enterprises were responsible not only for a range of mandatory benefits, such as sick pay, maternity allowances, and paid vacations, but also for a number of in-kind benefits (for example, kindergartens and recreational facilities). In the case of in-kind benefits, or “social assets” as they are known, the general policy has been to “municipalize” them. The results, and the impact on workers, however, have varied greatly (box 2.9).

**WORK PRACTICES**

The various forms of PPI tend to result in changes to working conditions and practices. The way this is done and the extent to which workers are involved in shaping new arrangements vary among employers, just as they do in the private sector more generally.

**Working Conditions**

As with other aspects of PPI’s effect on labor, there are some general trends, namely:

- PPI tends to produce flatter organizations by removing layers of middle management.
- Labor contracts tend to be simplified, often allowing the work force to be deployed in more flexible ways (as in the case of Telmex, presented in box 2.10).
Pre-PPI restructuring often means disposal of noncore assets or withdrawal from non-core operations and thus the elimination or outsourcing of some jobs.

In several sectors infrastructure companies have sought to establish greater flexibility (increased use of part-time work and fixed-term contracts, redeployment, and decentralization of labor relations) and other changes in working methods, employment, and industrial relations. For permanent staff, however, PPI often brings greater investment in training, as in Côte d’Ivoire’s electricity concession (box 2.11) and Mexico’s railways.

The impact of PPI on working hours varies. Influencing factors include labor market conditions, the legal framework, union strength, and attitudes. Attempts to increase labor productivity do not necessarily entail longer hours of work—indeed, they can involve reducing hours and intensifying work—but hours certainly have increased in some cases. For example, prior to the privatization of Entel, the Argentine telecommunications company, the government changed the work week from 35 to 40 hours. At times, however, government and the PPI partner work well together to maintain standards of worker competence and protect safety through regulation.
Subcontracting and Outsourcing

In recent years public and private sector organizations have increasingly outsourced noncore operations that can be provided more cheaply or at a higher quality by external specialists. Subcontracting can also be a redeployment mechanism. Subcontracts are one way for newly privatized infrastructure firms to reduce labor costs and change working practices and conditions while providing a transition for workers into new private sector employment and retaining some access to their specialist skills and knowledge (box 2.12).

In Côte d’Ivoire, the rail concessionaire, SITARAIL (Société Internationale de Transports Africains par Rail), agreed in principle to favor companies created by retrenched former state railway workers when looking for subcontractors. In practice, track maintenance, company car fleet management, and printing of timetables and tickets have been contracted out to firms set up by employees of the former state rail company.

Other PPI companies in Africa have also subcontracted to companies set up by their own former employees. In Guinea’s water PPI, for example, some 250 retrenched workers were given subcontracts through 20 small cooperatives. The subcontracted workers organized into 20 small enterprises that took over responsibility for installing new connections, maintaining canals, and landscaping. The concession company gave them training, logistical support, and initial working capital.

Sometimes, PPI leads to less rather than more subcontracting because nontransparent agreements are cancelled:

In Côte d’Ivoire…the new Compagnie ivoiriene d’électricité (CIE) contracts out much less than its predecessor, the EECl…. Electrical firms, which were often set up by members of the public enterprise’s staff (moonlighting), have collapsed after enjoying prosperous years when the process of privatization had not yet started (Plane 1998; see also Plane 1999).

**Gender Impacts**

In recent years among other political and social trends there has been increasing commitment by governments, employers, and unions to promote workplace equality between women and men. This has taken a variety of forms in practice, such as government commitments to ending discrimination of various types and combating sexual harassment, business commitment to retaining skilled and knowledgeable workers after maternity leave, and...
union campaigns for equal pay for work of equal value.

There is little hard evidence of the extent to which PPI has affected women workers differently from men, but what little there is, taken together with evidence from other sectors (see box 2.13), suggests that the impact often falls harder on women than on men, particularly in transition economies where female participation in the labor force is high. Sector impacts will vary, however. In Vietnam overstaffing of state enterprises was concentrated in male-dominated sectors, such as construction, mining, and transportation (Rama 2001a).

In the case of telecommunications the ILO notes that:

changes in work organization and job specification are more likely to be detrimental to women given that they are disproportionately represented in part-time work and are therefore less vis-

Box 2.11: New Working Practices in Côte d’Ivoire Electricity

After Côte d’Ivoire concessioned its electricity services to a company called CIE, the major shareholders of which were the French companies SAUR and EdF, the organization was flattened hierarchically by reducing the number of grades by half, from 18 to 9, and later to 5. A “management by objectives” approach was also instituted, with workers reorganized into “cost centers,” each with a defined list of tasks but with considerable autonomy about how to achieve them. Performance was closely monitored in terms of achieving targets, and bonuses of between 0.75 and 1.25 times one month’s salary could be earned. In the main, bonuses were awarded (or not) to the groups as a whole, with a small additional incentive payment also available to individuals.

The geographic decentralization of distribution is an illustration of this effort to make individuals responsible within their group. CIE is divided into a number of full autonomous regional boards. They in turn are subdivided into geographical sectors, each managing about 15,000 consumers. These sectors have great freedom of initiative, so they can be regarded as profit centers. By means of computerized comparative analyses, management can detect immediately where gains in economic efficiency can be made. Through privatization, the whole internal organization of the firm has been metamorphosed.

The arrival of the concessionaire was accompanied by a transfer of technical and organizational know-how. New work procedures codifying the duties of employees at their post were introduced and helped raise the efficiency of the firm’s operations. In support of this strategy, a great deal of effort was put into training further the already proficient workers.

CIE also brought back in-house the training operation that had previously been contracted out because it wanted to develop a new enterprise culture among its staff. So it set up a training division that offers two-year courses to all African electricity companies and that issues a vocational certificate in public utility management approved by the Ministry of Higher Education, plus short courses. Four years after the beginning of the concession, more than 2,000 CIE staff had been through courses there, and the company’s training budget had risen to a level equivalent to four percent of its wage bill.


Box 2.12: Outsourcing in Argentine Telecoms

“Telecom and Telefónica (the two companies which replaced Entel) also implemented voluntary retirement plans, which saw the departure of approximately 5,000 workers, or 10 percent of Entel’s workforce…. Interestingly, Telecom and Telefónica rehired a considerable number of those workers as contract employees. In this way, the companies obtained skilled labor while reducing their costs, such as pension contributions, vacation time, health insurance, and other fringe benefits. This maneuver also reduced the number of unionized employees.”

to showcase their skills and exercise their rights. Moreover, the main jobs that have declined in number in that sector—such as those of telephone operators—were mainly done by women. Commonly, overstaffing occurs in administrative and clerical positions, rather than in the more technically skilled jobs. The same obstacles that hinder the access of women to management positions can also disadvantage them in downsizing. At the individual level, women might lack the appropriate education, training or experience to be retained during restructuring, particularly when managers are competing for fewer positions, and criteria such as seniority and “last in, first out” considerations are used. Structural and cultural factors can also be an obstacle. Women managers might not have the same professional networks and personal contacts to enable them to compete for the remaining positions. Restructuring involving flatter management structures often affects women workers more than their male counterparts, with low-level and middle-management positions being most likely to disappear (ILO 2002, pp. 124–5).

The ILO cites restructuring at the Tanzania Telecommunications Company in support of its argument, but also notes evidence of increases in the percentage of women employed in some public and private post and telecommunications enterprises, and the redeployment of women into management and customer service functions (ILO 2002). Overall there have been few empirical studies of the variable impact of PPI on women and men in these sectors.

In energy and water utilities, most of the workforce tends to be male, but unions claim that job losses still affect women disproportionately because they tend to be concentrated in administrative and clerical functions. New owners are more likely to integrate such functions into their existing operations after privatization to achieve economies of scale (Belser and Rama 2001). Unions also point out that many social protections geared toward women only exist because unions fought for them, so if unions are weakened then it is likely that these protections also will be weakened.

**SUMMARY**

Evidence shows a diversity of labor effects resulting from PPI. Nonetheless some key trends and factors affecting outcomes in particular situations can be abstracted from the available information. The main comments that can be made are these:

- Analysis of impacts is confounded by the wide range of factors that affect the labor adjustment at the country, sector, and enterprise levels. Box 2.14 provides a generalized summary of some of those factors.
- The fact that job losses occur at the time of PPI does not necessarily mean that PPI is the direct, or only, factor causing those job losses. Significant job losses have also been
Box 2.14: Key Factors Affecting the Labor Impact of PPI

- The sector concerned, and especially the nature of the market in that sector, a category that in turn has two key variables: whether and to what extent the market is expanding or contracting, and whether and to what extent the market is competitive
- The extent to which PPI is associated with changes in technology that significantly affect the sector’s labor intensity
- The existing level of labor redundancy and productivity in terms of relevant international and national benchmarks
- National and local labor market conditions and social protection provisions
- The relative costs of labor and capital in the economy concerned
- The nature of the legal framework governing labor issues, and whether (and how) that is changing
- The content of existing formal agreements (for example, labor contracts and collective bargaining agreements)
- Government policy regarding employment protection and creation
- The balance of influence between interest groups in the labor relations environment
- The nature of the political relationship between the government and the relevant labor unions
- The attitudes and strategies of government, investors, and labor leaders
- The capacity and preparedness of government, investors, and labor in support of their strategies.

Some global agreements between trade unions and investors have been established.

Labor Impacts of Private Participation in Infrastructure

- Employment reductions drive productivity improvements in many sectors. Expansion of services, however, can also improve labor productivity when employee numbers remain stable.
- Changes in work practices and worker representation are often of as great a concern to trade unions as is job loss, particularly where this is associated with greater use of so-called atypical work practices (for example, casual employment and outsourcing).
- Although there is a general belief that women are more adversely affected by PPI-related changes than are men, there is little empirical evidence of a differential impact.

recorded in infrastructure enterprises even where there is restructuring without PPI (for example, Eskom South Africa’s 40 percent reduction over six years).

- Higher levels of job loss can occur in the infrastructure enterprises than in privatizations in general. Reductions in the work force of 50 percent or more have been reported.

- The greatest impact on jobs occurs in sectors where demand is declining because of competition from other modes (for example, rail worldwide and fixed line telephone services in industrialized nations); sectors where traditions of overstaffing have suffered following introduction of new technologies (such as port labor pools following containerization); and enterprises that have been shielded from the need to adjust for many years.

- Fewer job losses occur in sectors where demand is rising rapidly (such as fixed and mobile phone services in developing countries) or where there is demand for expansion of the network (for example, water and sanitation).

- Many of the analyses of job loss have been limited by their focus on the impact at the enterprise level rather than at the sector level. There is little information on the net effects on employment when taking account of growth in other modes (for example, trucking, bus, and rail operations; mobile and data telephony as well as fixed line services); the overall trend toward outsourcing of services in the sector because outsourced employment is not recorded by enterprises; and expansion of ancillary services (for example, distribution and supply chain logistics businesses at terminals of port and rail operations).
**Additional Material (on the CD-ROM)**


**Web Sites**

ILO: www.ilo.org. (Site offers a collection of papers on privatization and restructuring that can be downloaded at www.ilo.org/public/english/employment/privat/pub.htm.)

PPIAF: www.ppiaf.org. (Site provides information on other PPIAF resources and toolkits.)

PSIRU (Public Services International Research Unit): www.psiru.org. (The site publishes research on the impact of privatization on workers and trade unions.)

Rapid Response Unit: http://rru.worldbank.org. (This site is a gateway to a range of information on infrastructure, privatization, and private sector development policies.)

**Other Materials and Sources**


Assessing the Size and Scope of Labor Restructuring

A first step for the implementing agency is to assess the size and scope of labor restructuring. This module begins with an overview of the rationale for carrying out systematic staffing assessments and then summarizes three tools that the implementing agency can use in this regard: staff audits, benchmarking, and work force analysis.

OVERVIEW

This section outlines the rationale for a systematic assessment of the work force and introduces the key questions that the implementing agency must address.

A systematic assessment of the work force enables the implementing agency to:

- Determine the scope and nature of labor needs
- Enter into more informed negotiations and discussions with trade unions and labor representatives
- Reduce the risk of service disruption or operational difficulties through the loss of skilled workers
- Improve targeting in any labor restructuring program
- Ensure fairness and transparency of the process.

The principal objective of a staffing assessment is to determine existing levels and types of staff and compare those with what are needed. To that end the assessment will address the following questions:

- How many staff are there in the enterprise, and how does that compare with required amounts based on efficiency criteria?
- How can surplus staff be identified, and where is it located in the enterprise?
- Are there any particular skills or categories of worker that are scarce?
- Will future market or operational changes place some job skills in more demand than others?
- Are there particular key individuals or staff categories who must be retained—perhaps
because their experience is critical to the continued operation of the enterprise?

Staffing assessments are relevant in a range of restructuring circumstances. Work force restructuring has short-term (often urgent) as well as longer-term dimensions. This is illustrated in table 3.1, which characterizes three dimensions: work force reduction, work redesign, and organization redesign.

In many PPI programs all three dimensions are involved and the different tools described in this chapter can be applied to each of the dimensions. During the course of a railway PPI transaction, for example, there may be removal of ghost workers, early retirement and voluntary departure (work force reduction), more use of containers and streamlining of terminal turnaround times (work redesign), and the closure of redundant workshops (organization redesign).

There are three tools that the implementing agency can use to address the above questions:

- Staff audits or personnel inventories
- Benchmarking
- Work force analysis.

Although these are described as three different tools and are presented in separate sections, in practice they are closely related and often overlap. For this reason the model terms of reference for consultants (see the CD-ROM) include all of these tools because they may well be procured as a single con-

Table 3.1: Three Dimensions of Work Force Restructuring

<table>
<thead>
<tr>
<th>Focus</th>
<th>Work force reduction</th>
<th>Work redesign</th>
<th>Organization redesign</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>• Headcount</td>
<td>• Unnecessary work and jobs • Customer orientation</td>
<td>• Organizational structure</td>
</tr>
<tr>
<td>Timeframe</td>
<td>• Short (one to two years)</td>
<td>• Short to medium • Benchmarking • Work force analysis • Work</td>
<td>• Medium to long (five years and longer) • Work force analysis • Organizational reviews • Units, levels</td>
</tr>
<tr>
<td>Key tools</td>
<td>• Staff audits • Benchmarking • People</td>
<td>• Management contracts • Contracting out • Competitive processes • Moderate</td>
<td>• Privatization • Concessions • Leases • Extended</td>
</tr>
<tr>
<td>Factor(s) to eliminate PPI issues</td>
<td>• Downsizing • Short-term</td>
<td>• New working practices • Redesign and simplification of processes • Productivity improvement • Renegotiated labor agreements with unions</td>
<td>• Transfer of social work force (housing, kindergarten) • Exit from noncore activities • Incentive-based payment systems • Outsourcing and contracting out (employee enterprise)</td>
</tr>
<tr>
<td>Implementation and payback period Examples</td>
<td>• Severance • Early retirement • Layoffs • Job sharing</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: Adapted from Cameron 1994.
tract. In combination they can guide decisions about levels of redundancy, avoidance of adverse selection, and other aspects of restructuring strategy.

The tools described in this section can also be useful when the PPI transaction is not likely to happen for some time. Sometimes the preparation for PPI reform may take years, and during this time there will be proposals for organizational change. Such efforts can themselves benefit from systematic staffing assessments and the use of proper tools.

Staffing assessments and the tools employed in this process are a means to determine the potential size and scope of labor restructuring. The main objective is to estimate the broad extent of restructuring for planning purposes. The process should not become an end in itself or be viewed as a way to determine precise needs or identify individual surplus employees. Such an approach can be highly time consuming and may lead to delays not just in the restructuring process but in PPI itself.

**STAFF AUDITS**

Staff audits give an up-to-date analysis of the workforce and provide the basis for subsequent benchmarking and workforce analyses. They also provide the necessary database for accurate estimation of the costs of alternative severance and pensions strategies, and for the eventual disbursement of payments to workers.

**Objectives**

A staff audit is an essential first step in assessing labor issues in the enterprise. Staff audits help to:

- Bring personnel records up to date.
- Identify and eliminate ghost workers who are still on the payroll. In Argentina’s SOMISA steel company, for example, the introduction of a plant census with a photo ID quickly revealed that 17 percent of the workforce were shadow employees (Hess 1997).
- Provide a basis for developing severance and early retirement options and for estimating costs if downsizing is needed.
- Fill in critical data gaps (for example, employee age, grade, or start of service) that may be needed subsequently to calculate severance payments.
- Improve the accuracy of subsequent workforce analysis.
- Establish effective record-keeping procedures in order to allow management to control or regain control of the payroll, provide management with adequate human resource information, and comply with labor laws and regulations.
- Provide a basis for review of job positions, pay grades, and scales. In some enterprises, harmonization of staff terms is an essential task prior to the PPI transaction. This is particularly the case where a new operating company is to be formed, perhaps drawing staff from civil service and public enterprise cadres.

**Scope**

A staff audit is a fresh review of staffing. It provides up-to-date information on personnel, and typically includes data on:

- **Employee numbers, categorized by type of employment** (precise definitions will depend on national regulations). For example, permanent full-time and part-time employees; short-term casual, seasonal, or temporary workers; temporary workers engaged for many years (who may have acquired additional rights); professional staff recruited on ad hoc emergency terms; semipermanent workers; contract workers; workers on disciplinary suspension; workers on deputation from elsewhere in government; and workers on administrative leave.
- **Employee numbers, categorized by operational or social criteria**, such as location, job...
title, function, salary grade, level of education, age, gender, ethnic group, years of service, and other categories relevant to the country or the enterprise.

- **Employee skills**: Skills assessments are an integral part of the staff audit. They are particularly important in terms of maintaining service levels and quality, and they generally include assessment of individual employee functional or technical skills; identification of key individuals or groups of workers whose knowledge, experience, and institutional memory are critical to the effective operation of the enterprise; and the identification, through some form of gap analysis, of the difference between today’s skills and competencies and those required for the future success of the enterprise.

- **Employee compensation** for each employee, or category of employee, including basic monthly salary, cash and other allowances (for example, civil servants in Yemen receive a basic salary and up to 16 allowances), in-kind benefits (for example, housing, travel, and subsidized loans), and pension contributions by the employer.

- **Liabilities of the enterprise to the employee**, which may be important information to collect during the staff audit, particularly in enterprises in acute financial crisis where there may be arrears of salaries or benefits payable to employees, arrears of pension or social insurance payments attributable to employees (both employers’ contribution and employee contribution), and arrears of payroll taxes due to the tax authority and other payroll deductions.

In some cases data on these financial liabilities will be available for individual employees; in other cases, only at an aggregate level.

**Collecting Personnel Data**

The data set described above represents an ideal level of information needed to fully assess the work force, minimize adverse selection, and calculate an individual employee’s entitlements in the event of severance. In the first stages of planning, however, data may not be available and the implementing agency may need to obtain some basic minimum figures. Box 3.1 suggests a minimum data set.

Some well-managed enterprises will have up-to-date personnel records and the staff audit will be relatively easy to undertake. In many developing countries, however, adequate information is lacking and substantial effort is needed to build a credible and current personnel database. It will be more difficult when:

- The personnel administration and human resource management functions have been neglected.
- Salary and benefits are complex with many different components.
- Personnel records are entirely paper based, and there is no computerized information available to allow data manipulation, sorting, and analysis.
- Personnel record-keeping has been decentralized, which may mean greater amounts

### Box 3.1: What’s the Minimum Data Set for a Staff Audit?

In assessing the work force, the minimum information that the implementing agency will need for each employee:

- Age
- Gender
- Years of service and service start date
- Grade and/or category
- Salary
- Allowances
- Estimated arrears of salary
- Estimated arrears of pension, tax, and other benefits.

In the very first stages of staffing assessments, or where data are poor, averages or estimates for categories of employees will be needed (e.g. average salaries, estimated pension arrears, years of service for different cadres of staff).
of missing data and incorrectly maintained records.

- Records have been lost through damage (deterioration, fire, conflict).

Reviewing a sample of the existing records can help the implementing agency determine whether the data are:

- **Comprehensive**—Are all workers included? Are records for certain workers missing? Are performance records complete? Are all the records complete?

- **Accessible**—Is information easy to extract? Is it computerized? In some cases collecting specific information may require a time-consuming, manual review of paper records. Where there is reluctance on the part of enterprise managers, access to records may be deliberately delayed or made more difficult.

- **Accurate and up to date**—Are validation systems in place?

If records are poor, the updating of the personnel inventory is a critical and urgent first step. In such cases the staff audit will effectively provide baseline data against which all proposals for work force restructuring will be assessed.

The way that data are collected and staff audits are conducted is important, too. Effective staff audits will be transparent, and considered by workers to have been undertaken fairly. One way to do this is to use uniform and clear procedures. For example, when Middle East Airlines was conducting its staff audit in preparation for privatization, standard evaluation forms and curriculum vitae formats were prepared for each employee (see the CD-ROM for an actual example of an employee evaluation form). Another example of transparent procedures is the one adopted in Nigeria’s civil service census (box 3.2).

Staff are likely to be worried and made anxious by some aspects of the staff audit. Measures to help workers reduce anxiety include:

- Early, factual, and open communication with workers about the purpose of the staff audit, what will happen, where, when, and how.

- Early consultation with trade union representatives. Unions may be willing to participate in the staff audit and help ensure that it is open, fair, and transparent, and thereby assuage the concerns of their members.

Records of employee performance are an important data source for the staff audit process. Where appraisal or disciplinary records are incomplete, managers are often reluctant to dismiss staff on the basis of nonperformance because of the risk of noncompliance with labor laws or regulations.

Updating personnel records is, in principle, a relatively straightforward task, but it may be quite onerous, time consuming, and demanding of resources if the PPI enterprise has a work force of tens of thousands of people spread across an entire country, often in remote locations. In some countries, implementing agencies might learn from the experiences (both good and bad) of conducting civil service audits. An illustration of one approach to updating personnel records and identifying ghost workers is given in box 3.2.

**Collecting Information on Skills**

Even where there is overstaffing, employees are not just a cost but an asset too. Collecting information on their skills and capabilities will help to ensure that the right overall skills mix is available to the post-PPI enterprise and that critical skills are not lost.

**Skills Assessments**

Skills assessments extend the scope of the basic staff audit and are particularly valuable in sectors where there is rapid technological change, such as telecommunications. The purpose of a skills assessment is to provide information that will assist the implementing agency in identifying areas of skill shortages and avoiding problems of adverse selec-
Skills assessments have three elements:

- Assessments of current skill levels and shortages, based on current techniques and technology employed by the enterprise.
- Forecasts of future skill requirements (number and level), using modern technology and management practices. This has a degree of subjectivity and requires some insight into the types of technology that would be used under modernized public sector or private sector ownership and management.
- Analysis of the gap between current and likely required skills to identify areas of skill surplus and skill shortage. This is an important step because a skills shortage in the current enterprise could easily become a total surplus if the skills are not required in the post-PPI environment.

**Identification of Critical Skills**

Operations managers, responsible for maintenance or service delivery, usually know very well what skills are in short supply today—often much better than top management knows them. Senior management, however, will have a better picture of the overall direction of the enterprise—and hence future skill needs—so the skills audit will need the perspectives of both groups.

Sometimes critical skill surpluses and deficits are not hard to analyze (as in box 3.3). Although some
skill issues can be predicted easily, the implementing agency should be cautious in such decisions. In the airline example in box 3.3, for example, it is conceivable that a PPI investor might be interested in those skills to provide a new regional maintenance business for Boeing aircraft. Where new technology is to be encouraged, the existing managers may not have enough information about that technology to make the best decisions on future staff restructuring.

Union involvement can be useful in the case of skills audits. Often unions are aware of the need for reskilling of the work force and may take a lead on pushing for the reskilling of their members as part of work force restructuring. (See, for example, box 3.4.)

Skills considerations are highly relevant to work force restructuring in PPI because poorly planned labor adjustment that is not skill based can lead to loss of capability within the enterprise, which can affect service delivery and lead to perceptions that PPI has failed. Even when faced with an urgent and undisputed need for downsizing, the implementing agency will need to recognize that workers are also assets—and that their knowledge and experience may have value. Two examples from the railway sector illustrate the problems that occur when this knowledge is lost: Chile’s Fepasa railway (see box 5.10 in module 5) and the United Kingdom’s privatized track infrastructure (box 3.5).

Skills and knowledge can be thought of as the understanding gained from experience. If it is important in a particular PPI scheme, the implementing agency can encourage actions to reduce the loss of skills. The following are some of those actions:

- Ensuring that skills are covered in the staff audit.
- Effective targeting and selection of workers who are to be retained.
- Capturing of tacit knowledge, which is held in people’s heads and often revealed in unstructured forms (memos, notes, e-mails).
- Ensuring that skilled workers are compensated properly so that there is an incentive to stay.

**BENCHMARKING**

Benchmarking is an important mechanism for identifying the potential for labor productivity improvements (box 3.6). Making good comparisons can be difficult, but there are several sources of information. In addition the process of benchmarking will help identify problem areas in terms of overstaffing and opportunities for improving labor productivity.

**What Are Benchmarks?**

Benchmarks are fixed pieces of information that can be used to make comparisons with other similar fixed pieces of information. Labor benchmarks are not only used as a one-off activity for work force restructuring but also as a tool for continuously monitoring and improving performance and competitiveness. In practice it is the process of undertaking benchmarking that generates most benefits because it challenges current norms. Benchmarks provide managers with comparative data on performance and labor productivity. Although like-for-like comparisons are not always easy, benchmark measures can give the implementing agency crude indicators of the scale of any overstaffing.

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**Box 3.3: Middle East Airlines—Skills Mismatch**

A work force restructuring exercise formed part of the preparation for the privatization of Middle East Airlines in 2000–01. Of a total work force of 3,700, about 1,120 were estimated to be surplus to requirements. The largest group of redundant workers was 700 ground employees trained in servicing Boeing aircraft and not qualified to service Airbus aircraft, which made up all of MEA’s new fleet.

*Source: Middle East Airlines.*
There are three main types of benchmarks:

- **Internal benchmarks**: By making comparisons within an organization, perhaps between different offices or time periods, it may be possible to identify some areas for improvement quickly and easily. An example is the approach adopted by Kenya’s electricity distribution company (see box 3.7).

- **Sector benchmarks**: Comparisons in the same sector provide another comparison. International or regional comparisons can be used where the PPI enterprise is a monopoly provider in the country.

- **Functional (process) benchmarks**: There may be other organizations from different sectors but with similar operational functions that can be compared. For example, gas, water, and power utilities might cooperate in benchmarking their metering or billing collection procedures; airlines and railways are similar in the ways they manage the turnaround and dispatch of aircraft or trains; administrative processes, customer service response times, and staff appraisal performance will have similarities in all organizations.

All three types of benchmarks have their places, but a combination of measurement and process analysis is important for effective benchmarking. Measurement identifies the performance gap, but the discussion, debate, and working through of process and operating changes provide the mechanism for operational managers to identify change—including identification of the extent, location, and causes of overstaffing.

To understand the origins of labor productivity, implementing agencies will want to review a range of generic benchmarks (box 3.8), as well as those specific to the sector (box 3.9), such as:

- Number of employees per thousand connections (telephones or water)
Assessing the Size and Scope of Labor Restructuring

**Box 3.5: British Rail—Loss of Institutional Memory**

The experience following British Rail (BR) privatization illustrates how flaws in labor restructuring can bring the broader PPI agenda into disrepute. The BR privatization is much cited in Europe as evidence that private profit is incompatible with public safety and service reliability. But testimony given at a public inquiry following three fatal train crashes in the four years after privatization suggested that a principal lesson the experience provides for implementing agencies internationally is to pay adequate attention to issues of work force skills and institutional knowledge.

One former senior BR manager, Chris Green, who has since been recruited by one of the train operating companies to help them deal with their problems, told the *Financial Times* that the "collapse" of professionalism has been the "most fundamental" consequence of privatization. He cited contracting out and the departure of many junior and middle managers “with vital experience” as the cause of the problems. “The net result has been a collective loss of memory on the basics of running a railway,” he said. (*Financial Times*, “Inside Track: A Pragmatist’s Track Record,” February 14, 2001.)

The *Financial Times* has vividly drawn attention to the consequences of replacing an integrated work force and an established hierarchy with layer upon layer of contractors and subcontractors to carry out track maintenance more cheaply. “The first consequence was the breakdown of the old comradeship, which used to mean that problems were easily spotted, repairs made, and people could talk to each other,” the business newspaper’s analysis concluded, adding:

> Track workers operated in gangs and knew their stretch of rails like their own back gardens. Instead, workers became nomadic, moving to the next job with little or no local knowledge and instructions not to talk to rival workers except via a supervisor miles away. The second big problem was a growing lack of control over the staff and their work. There have been complaints of sub-contractors recruiting workers out of pubs to fill gaps on the night shift (*Financial Times*, “Railtrack Descent into Chaos,” February 22, 2001).

The overall effect was to break “traditional bonds and practices of passing on skills and experience,” the *Financial Times* commented, and this was exacerbated by the introduction of “hard-nosed commercial tensions into relationships that often needed to be co-operative.” “Safe working of the network is hardly possible in such a climate,” John Hurst, BR’s former organizational development manager, told the public inquiry into the crashes. “Merely taking steps of a technical and operational nature, in light of any particular disaster, will not address this underlying malaise which will inevitably chronically manifest itself in new disasters” (*Financial Times*, “Railtrack’s Rocky Train Journey to Its Fifth Birthday,” May 21, 2001).

**Box 3.6: Benchmarking Definitions**

*Benchmark:* A standard or point of reference used in measuring and judging quality or value.

*Benchmarking:* The process of continuously comparing and measuring an organization against business leaders anywhere in the world to gain information that will help the organization take action to improve its performance.

**Box 3.7: Kenya—Internal Benchmarking in Power Distribution**

For each geographic district in which it would be distributing electricity, the Kenya Power and Lighting Corporation (KPLC) identified its characteristics (number of consumers, area, length of overhead line, number of substations, energy sales per customer, and so forth) and found weighted averages for different classes of staff (engineers, foremen, linesmen, and the like) that enabled them to compare fairly easily areas of different labor productivity.
Box 3.8: Generic Labor Benchmarks

- Gross or net revenue per employee
- Total payroll costs (all employment-related expense) per employee
- Total/functional labor cost as a percentage of sales
- Ratios of headcount by function (management/operations; customer service/maintenance)
- Management salaries (relative to private sector norms)
- Salary levels by function (adjusted to allow comparisons)
- Hourly wage rate (standard and overtime)
- Average weekly hours per worker
- Units produced per work hour (unit productivity)
- Product/service line revenue per staff-hour/full-time equivalent employee
- Training days per person per year

Box 3.9: Sample Labor Benchmarks by Sector

Airlines
- Numbers of pilots or ground staff per aircraft
- Pilot hours per month

Bus
- Staff per bus (drivers and mechanics)
- Staff per 1,000 passenger kilometers

Electricity
- Number of workers per MW generated
- Number of workers per connected customer
- Number of workers per MW distributed

Ports
- Tons per port employee per year
- Tons per gang-hour or gang-day
- Tons per ship per gross and net ship-days
- TEU per hour (on container terminals) and TEU per gang per day

Because of the significant variation in type of cargo (bags, break-bulk cargo, project cargo, and so forth), port labor productivity is usually related to the cargo type and expressed on a per-day basis either as gross (overall time) or net (time minus agreed delays such as rain and the like).

Rail
- Employees per kilometer of line
- Total wages as percent of total revenues
- Tons-km (freight-service kilometers) moved per employee per year
- Passenger-km (passenger-service kilometers) moved per employee per year
- Traffic units (ton-km+passenger-km) per employee
- Staff-hours of maintenance employees per 1,000 locomotive-km

Telecommunications
- Number of main lines in service (working lines) per employee
- Number of employees per 1,000 main lines

Water
- Staff per 1,000 water connections
- Staff per 1,000 water and sewerage connections
- Staff per 1,000 people served
- Thousands of cubic meters of water sold per year per employee
- Kilometers of pipeline in the water supply system per employee
- Thousands of people served per employee
and usually with mechanisms for providing a measure of confidentiality.

Using Benchmark Measures

The collection and analysis of relevant data (metrics) are essential for the identification of areas of good or poor performance, and for the subsequent analyses of operational processes. This section gives some illustrations of labor productivity benchmarks reported in a number of infrastructure sectors, and makes suggestions on the collection and use of benchmarking data.

Comparisons within a sector can indicate potential low labor productivity, as the following examples illustrate.

Airlines sector:

- Before it was liquidated in the early 1990s the state-owned Zambia Airways employed 300 staff per plane, compared with an industry norm of 140 at that time (Kikeri 1998).
- Loss-making long-haul carrier Air India had a staff-to-aircraft ratio of 663 in 1997, compared with ratios between 170 and 340 in various Southeast Asian carriers: Singapore Airlines, Thai Airways, Malaysian Airlines, and Cathay Pacific (India, Disinvestment Commission 1998).
- At Middle East Airlines (MEA) pilots work 60 hours per month, compared with an average of 90 hours per month in Organisation for Economic Co-operation and Development (OECD) countries. The maximum number of flight hours at MEA is 9 in a 24-hour period, whereas the international average is 10.5 and at some airlines it reaches 12.

Bus operations sector:

- Comparisons of the performance of state bus companies in India showed big differences in labor productivity among states: staff to bus ratios varied from 6.03 in
Table 3.2 provides sources of international benchmarking data for a range of sectors.

### Table 3.2: Some Sources of InternationalBenchmarking Information

<table>
<thead>
<tr>
<th>Sector</th>
<th>Source</th>
</tr>
</thead>
</table>
  • The American Association of Port Authorities (whose members are 150 ports in North and South America and the Caribbean) distributes port statistics and information on labor-management relations. Information is available at www.aapa-ports.org. |
| Postal operations | Universal Postal Union: The union provides an online database with statistics on variables, including the number of full- and part-time staff. The database is available at www.upu.int. International Postal Corporation: This association of 22 postal operators handling 65 percent of the world’s mail undertakes some cooperative benchmarking projects, but to date none of the projects focus on labor issues. The Web site is www.ipc.be. |
| Road     | SAFIR: Comparative analysis of bus operations in South Asia (SAFIR 2002) is available at www.safir.teri.res.in. |
| Telecommunications | The International Telecommunications Union (ITU) (www.itu.int):  
  • The ITU’s statistics department collects aggregate data provided by national ministries or regulators at the country level on numbers of employees in the telecommunications sector. The ITU does not, however, hold data at operator level (although there is a database to facilitate contact with individual operators), and its statistics combine both mobile and fixed line employment.  
  • The human resources department of the ITU is establishing regional centers of excellence for training and staff development purposes, and has developed a computerized tool (MANPLAN) for forecasting strategic staffing and training needs.  
  • Regional comparative data are available in the ITU’s Africa, Asia-Pacific and Americas Telecommunications Indicators reports.  
  • The most recent telecommunications indicators from the ITU’s statistical database are available from the ITU web site: http://www.itu.int/ITU-D/ict/publications/. |
| Water    | Asian Development Bank:  
  • The ADB has financed two issues of the Water Utilities Data Book, which provides valuable information on water utilities in the Asian and Pacific region. The second edition was published in 1997 (McIntosh and Yinguez) and is available for purchase from the ADB, Manila.  
  • The ADB has provided support for benchmarking in particular regions (e.g., the Pacific Water Benchmarking Study [Delana 2002]). World Bank:  
  • The Benchmarking Water and Sanitation Utilities Project has a Web site that provides core cost and performance data: project information can be found on http://www.worldbank.org/watsan/topics/bench/wup.html.  
  • Although there is considerable benchmarking activity at the national level, much of the information is scattered. Information on an initiative to help utilities (and regulators) share and access data can be found at www.worldbank.org/watsan/pdf/benchmarking/pdf. Included there is a start-up kit for water utilities wishing to participate in benchmarking.  
  • The annual World Bank Water Forum provides a discussion and examples of the use of performance benchmarking, as does the World Bank publication A Water Scorecard (Tynan and Kingdom 2002). International Water Association (IWA): The IWA (www.iwahq.org.uk), a forum for sharing of experience among members, recently has published guidelines titled “Performance Indicators for the Water Industry” (Alegre 2000) and “Process Benchmarking in the Water Sector” (Parena, Smeets, and Troquet 2002). The IWA Foundation focuses on water issues in developing countries. |
Karnataka and 7.12 in Andhra Pradesh to 11.55 in Madhya Pradesh and 16.08 in Orissa.

• In Sri Lanka private sector bus companies operate with 2 to 3 staff per bus, compared with 5 to 13 staff for state-owned bus companies (SAFIR 2002).

Rail sector:

• A World Bank study of concessioned railways in seven countries showed wide variations in labor productivity, measured as outputs divided by number of employees in the rail sector. The most productive U.S. railways had 22 times fewer workers per traffic unit (passenger kilometers plus freight kilometers) than did some railways in Mexico (Thompson, Budin, and Estache 2001).

• Following railway privatization, PPI and restructuring the ratio of labor cost to revenues fell from an average of 64.3 percent to 48.4 percent in eight case studies (mainly from industrialized nations) (Kopicki and Thompson 1995).

Telecommunications sector:

• In Malawi the national telecommunications operator has a ratio of 16 working lines per employee compared with a Sub-Saharan average of 31 working lines (Sauti-Phiri 2002).

Water sector:

• An analysis of data from 246 water utilities (including 123 utilities from 44 developing countries) proposed a benchmarking target of 5 or fewer staff per 1,000 connections for developing-country water utilities. This target was based on the levels of productivity actually being achieved by the top quartile of developing-country utilities within the database. By contrast many developing-country utilities reported more than 20 staff per 1,000 connections (Tynan and Kingdom 2002).

• Comparisons among Vietnam’s provincial water companies show a number of operators with labor productivity well below the average (see figure 3.1), which would justify further assessment of the cause.

Making comparisons within a region can also prove valuable for implementing agencies that need to understand whether overstaffing is confined to just one enterprise or is a common problem in all infrastructure utilities. As shown in table 3.3, an assessment of the utility sector in Uruguay compared with other countries in the region signaled potential problems in labor productivity in a number of utility sectors. Regarding that table, two points are instructive:

1. Differences in productivity within a geographic region can be substantial. Implementing agencies do not need to compare between OECD industrial countries and developing countries to gain useful insights. The benchmarks and the comparators in this example were all classed in the 1997 World Bank World Development Report as upper-middle-income countries (except the Republic of Korea, which then was classed as lower-middle-income).

2. There is some degree of subjectivity. The basis for assessing the “best performance” benchmark was based on a range of sector and regional reports plus interviews with sector specialists for each country.

In practice, several factors make the comparison of benchmarks across countries and PPI operations challenging. These factors include:

• Increased outsourcing and contracting out: Because utility and infrastructure enterprises outsource many of their operations, comparisons based on units of activity per full-time, permanent employee may not provide a like-for-like comparison.

• Comparability of the scope of the PPI enterprise: Published data may report labor numbers and productivity in operations that are combined in some countries and separated in others—for example, telecommunications
and postal services; water and sewerage operations; and power generation, transmission, and distribution.

- **Differences in condition of the infrastructure**: Some older networks have high maintenance costs as a result of age or past inadequacies in investment in new technologies (be it optical fiber for telecommunications, port containers, or combined-cycle power plants).

- **Extent and nature of the network**: Service providers in dense urban areas will have staffing requirements that differ from those of rural providers. Some railways may have a markedly more benevolent topography than others, so that track maintenance costs are lower. Different regulatory regimes may place different legal obligations on the level of service provision, leading to very different cost and staffing structures.

- **Depth and quality of the data**: All benchmarking data sets will benefit from greater precision, clear definitions, and disaggregation. The more information that is available and the more that users can be sure of the relevance of the data sets, the more trust can be placed in them. Even so, averages can be deceptive and can be distorted by abnormally high or low performance.

- **Misuse and abuse of benchmarks**: Labor benchmarking statistics can be misused and used to exaggerate or underestimate the need for downsizing. For example, simply setting labor adjustment targets to match international best practice levels can be dangerous if it does not take account of the particular conditions bearing on the enterprise. Furthermore, data can be manipulated (for example, by excluding temporary or seconded workers) to suggest that staffing levels are not particularly high.

- **Age of the data and the fast-changing nature of the work force**: Almost by definition, a benchmark will be out of date the day it is published. One year’s best practice can soon translate into next year’s average performance so it is essential to ascertain the date relevancy of the data. Old data are still valuable, however, because they allow trends to be identified, thus enabling the implementing agency to assess whether productivity and efficiency gains are accelerating or stagnating. One example of changing productivity is that of Bharat Sanchar Nigam Limited (BSNL), the main state-owned telecommunications operator in India. As the number of subscribers has risen, staff numbers have remained constant and labor productivity has risen steadily (table 3.4).

### Table 3.3: Regional Comparative Performance Measures

<table>
<thead>
<tr>
<th>Sector</th>
<th>Uruguay</th>
<th>Argentina (private sector)</th>
<th>Brazil</th>
<th>Mexico</th>
<th>Chile</th>
<th>“Best performance” (and reasonable benchmark)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Telecommunications (main lines per employee)</td>
<td>88</td>
<td>155</td>
<td>121</td>
<td>174</td>
<td>153</td>
<td>294 (Korea, Rep. of)</td>
</tr>
<tr>
<td>Electricity (customers per employee)</td>
<td>102 (in 1995)</td>
<td>280</td>
<td>177</td>
<td>208</td>
<td>285</td>
<td>285 (Chile)</td>
</tr>
<tr>
<td>Water and sanitation (employees per 1,000 connections)</td>
<td>8</td>
<td>3</td>
<td>5.2</td>
<td>4</td>
<td>2.1</td>
<td>1.8 (Malaysia)</td>
</tr>
</tbody>
</table>

Policy and structural reforms in the sector:

Productivity benchmarks also change as a result of liberalization, new entrants into the sector, and new technologies. For example, a private sector operator and new entrant into telecommunications in India, Tata Teleservices, has about seven employees per 1,000 subscribers for the fixed services it provides in Andhra Pradesh (albeit using radio for the local loop)—approximately half the ratio achieved in 2000 by the former monopoly, BSNL. In general, as infrastructure companies are exposed to competition and new investment is increasing, the work force in benchmark comparators changes from year to year as a result of increased demand for very experienced managers and senior specialists with commercial, financial, and information technology skills; fewer unskilled workers but more workers with technical skills and experience in newer technologies (especially in sectors such as telecommunications); and fewer administrative and clerical jobs, but more customer service facilities.

In summary, the key to choosing and using benchmarks for labor adjustment is in selecting operations and measures that are as comparable as possible. The development of regional, national, and international benchmarking and information-sharing groups is likely to improve the availability, quality, and relevance of data. Comparative benchmarking provides valuable information on potential levels of overstaffing, even if it is best used in combination with other analyses. (See box 3.10 for a list of suggestions for making the best use of benchmarking data.)

Benchmarking Labor Costs

Given the difficulties in comparing labor productivity in terms of output per employee, one alternative approach is to focus more on benchmarks involving output per unit cost of labor or labor costs as a proportion of total operating costs.

In the rail sector, even comparisons of partial labor productivity measures are difficult because of differences in topography, traffic mix, technology, level of past investment, international trade disruptions, industrial geography, and so on. Basic measures such as ton-kilometers, passenger-kilometers, locomotive-kilometers, revenue ton-kilometers are, more often than not, estimates based on tons of freight or passengers multiplied by average length of haul or trip. The difficulty in calculating passenger-kilometer estimates is particularly great on railways with many urban commuters. Combined measures such as traffic units per employee (ton-kilometer+passenger-kilometer) suffer from similar problems.

There are significant differences in labor productivity between the “best” and the “worst” groups in developing countries.

The increasing use of contracting out makes it difficult to compare labor productivity based on full-time employee numbers.

### Table 3.4: India—Changing Labor Productivity at BSNL, Selected Years

<table>
<thead>
<tr>
<th>Year</th>
<th>Subscribers (millions)</th>
<th>Employees (thousands)</th>
<th>Employees per 1,000 subscribers</th>
<th>Subscribers per employee</th>
</tr>
</thead>
<tbody>
<tr>
<td>1981</td>
<td>2.15</td>
<td>289</td>
<td>134.45</td>
<td>7.44</td>
</tr>
<tr>
<td>1991</td>
<td>5.07</td>
<td>375</td>
<td>73.90</td>
<td>13.52</td>
</tr>
<tr>
<td>1995</td>
<td>9.80</td>
<td>419</td>
<td>42.78</td>
<td>23.39</td>
</tr>
<tr>
<td>1996</td>
<td>11.98</td>
<td>421</td>
<td>35.14</td>
<td>28.46</td>
</tr>
<tr>
<td>1997</td>
<td>14.54</td>
<td>429</td>
<td>29.50</td>
<td>33.89</td>
</tr>
<tr>
<td>1998</td>
<td>17.80</td>
<td>425</td>
<td>23.87</td>
<td>41.88</td>
</tr>
<tr>
<td>1999</td>
<td>21.59</td>
<td>424</td>
<td>19.64</td>
<td>50.92</td>
</tr>
<tr>
<td>2000</td>
<td>26.51</td>
<td>421</td>
<td>15.88</td>
<td>62.97</td>
</tr>
</tbody>
</table>

Source: Reports issued by BSNL.
Examining staff costs (wages plus benefits) as a percentage of total operating revenue reveals that, in a number of railways, staff costs alone exceed total revenues from users and are often the largest single cost category. This may be a better way to evaluate labor productivity than using a ratio of staff to traffic units (passenger kilometers plus freight kilometers) because it factors in differences between labor unit costs in different countries, which might be a reason for some railways legitimately being more labor intensive than others.

In some sectors labor costs are relatively low as a proportion of operating costs or capital costs. In an analysis of 77 electricity-generating plants in 28 industrial and developing countries, the average shares of cost were 10 percent for lubricating oil and materials and 13 percent for labor, but 48 percent for fuel and 29 percent for capital (Diewert and Nakamura 1999, based on a 1993 data set.)

Figure 3.1 provides a simplified performance structure for a generic utility and shows that labor costs are only one part of the overall cost structure.

In a few cases the PPI investor may not be very concerned about staff numbers, perhaps because there is little overstaffing or because low wages make labor a small proportion of overall costs.

More commonly, however, overstaffing means low labor productivity and high staffing costs. Low wages do not necessarily mean relatively low staff costs. In their analysis of 246 water utilities, Tynan and Kingdom (2002) found large differences within developing countries. Average staff costs as a proportion of total operating costs were 39 percent in developing-country utilities compared with 29 percent in industrialized-country utilities.

Even where labor productivity is poor, other factors play a part. For example, high water tariffs in Conakry, Guinea, were only partly the result of low labor productivity (by regional standards). High debt-servicing costs, considerable amounts of bad debt, low collection rates, and a high percentage of expatriate staff were other factors (Brook and Smith 2001). (That is why some governments and firms prefer to measure “total factor productivity” as a more accurate guide than raw output/input ratios on numbers or costs of workers; see, for example, Cowie and Riddington 1996 and Economic Commission for Europe 2002.)

Labor productivity “norms” may change quickly, especially following the introduction of competition or rapid growth in demand for services.

**Box 3.10: Hints and Tips for Using Benchmark Data**

- Be ruthless in data quality; cross-check anything that looks suspicious. Erroneous outliers can greatly distort comparisons.
- Ensure that definitions are clear—particularly in relation to full-time equivalent employees, categories of staff employed, and the scope of the comparisons—in order to help ensure genuine like-for-like comparisons.
- Don’t rely on just one measure because this can give a distorted picture. In the water sector, for example, staff per 1,000 connections may be inappropriate if some utilities have large numbers of shared (multiple-user) connections. In that case staff per 1,000 users and labor costs as a proportion of operating costs will be useful additional measures.
- Wherever possible visit benchmark organizations. Talk to the people who compiled the data.
- When starting up, historic data series are useful because they show trends and help spot erroneous data and trends.
- Use local or international consultants to support the work, but keep it as simple as possible. Avoid too many and too complex measures.
- Involve people, especially operational managers. Exchange ideas at provincial, national, and regional seminars.
- Although the short-term goal may be to collect information to help in immediate downsizing, valuable information can be obtained for the PPI bidding and transaction process (which may take two to four years). Where regulators are being established, the information also provides them with a baseline. Data improve over time, so “sell” benchmarking to PPI enterprise managers as an investment.

Benchmarks change constantly as technologies and work practices change.
**WORK FORCE ANALYSIS**

Work force analyses build on staff audits to analyze and forecast the structure of the work force and then match that structure to the requirements of the infrastructure enterprise.

**Objectives of Work Force Analysis**

Work force analysis comprises a set of tools that provides a bridge between the details of staff audits, benchmarking, and the wider organization design issues. Those tools, however, still provide only part of the information needed for detailed assessments of downsizing requirements and methods of selection.

Work force analysis is very similar to a human resource planning exercise, but in this context it is focused on the information needed for work force restructuring in preparation for PPI. Detailed work force analysis is particularly useful when a large enterprise is being broken up into new operating units, as illustrated by Brazil Railways in box 3.11. The purpose of work force analysis is to identify staffing requirements at the unit or operational level, and it will help managers in the implementing agency and the enterprise to:

- Identify the levels and types of staff needed for future requirements in operating units
- Make more informed decisions on transfers between units and the organization of severance schemes
- Avoid the loss of critical skills (adverse selection).

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**Figure 3.1: Structure of Performance Measures for Utilities**

Note: CCD = capital cost depreciation.

Work Force Analysis Tools

This section summarizes some tools that can be used by managers of the enterprise or the implementing agency to better understand the structure and composition of the work force.

Tool 1: Staff Audit and Benchmark Consolidation

The information gathered from staff audits and benchmarking is a critical baseline for conducting work force analysis. It is essential that this information is disseminated and shared by all enterprise managers who will be involved in work force analysis so that they have a common understanding of staff data. Rigorous debate and discussion on the staff audit and benchmarking data can then be a powerful catalyst for prompting managers to review current staffing assumptions and norms.

Tool 2: Functional Review of the Organization

Work force analysis must be informed by a wider organizational perspective. This may be provided by a corporate plan, a reform plan, or government policy, although in some cases such documents may not exist or may be too vague to be helpful. In those cases one of the most basic tools is a functional review of operating units. This review can be undertaken by managers themselves or be facilitated by consultants, and it can draw on the knowledge of the work force. Workers—and unions—may have perspectives and answers that are beyond the institutional knowledge of management or consultants.

Functional reviews challenge the existing organizational structure and norms by asking some straightforward but difficult questions:

Box 3.11: Brazil—Work Force Analysis in Rail Privatization

Following unsuccessful attempts to restructure Brazil’s federal railway, RFFSA, under the public umbrella, the government included RFFSA in the National Privatization Program in 1992. Implementing the proposed privatization plan required some degree of reduction in RFFSA’s employment. Although RFFSA had already made significant progress in reducing its employee headcount, the company’s labor productivity continued to be low. RFFSA had reduced its total staff from about 110,000 in 1975 to about 42,000 in May 1995. That reduction led to a substantial increase in labor productivity—from 250,000 to almost 1 million net ton-kilometers per employee. That level of labor productivity continued to be insufficient, however, when compared not only with similar North American companies but also with recently restructured and privatized railways in Argentina and Chile.

The strategy to deal with the excess labor had to be subtle. There were significant differences in labor productivity across RFFSA’s regions and uniform cuts across the board would not make sense.

The solution was to come up with new cost reduction plans for each of the six regional areas to be privatized, based on new operational procedures, with redundant activities identified by job categories. This was essentially a very meticulous job that required a very detailed study based on the best international practice. The redundancy estimates were to be conservative to avoid second-guessing what the concessionaire would actually need and avoid forcing the concessionaire to have to rehire “fired” workers as had been the case in Argentina and the United Kingdom. In addition, there had to be enough staff remaining at the company at the time of transfer to the private operator to avoid interruptions in service. To ensure that, a detailed analysis was conducted by the regional managers to assess both the staffing needs for each function and the number of excess workers. By the end of this analysis, RFFSA’s management had reasonable estimates of the staff reduction needs in each regional area. In May 1995 this process led to an employment reduction target number of 20,000 workers. Between May and September 1995, almost 2,000 workers voluntarily decided to leave the company, so that by the time the first concession was announced in September 1995 the new reduction target number was 18,047.

• *Is this activity needed at all?* In the case of a (loss-making) state bus company, which competed in a range of sectors (urban, rural, and intercity), the growth of a highly competitive, privately operated bus sector meant that there was little continuing rationale or need for a public service within urban routes.

• *Should the enterprise be undertaking this activity?* In the first phase of restructuring of Argentina’s national oil company, Yacimientos Petrolíferos Fiscales (YPF), many nonstrategic assets that YPF had amassed over the years were sold through unrestricted bids, including aircraft, schools, hospitals, and obsolete refineries (Grosse and Yañes 1998). In Russia and China many infrastructure enterprises maintained large social assets (housing, kindergartens, vacation rest houses) that subsequently were transferred to local government or were privatized.

• *If the activity is still needed, is the enterprise really the best provider of this function?* Maintenance of locomotives, aircraft, power pylons, and vehicles; employee transportation services; catering services—these are all activities that infrastructure companies have contracted out to specialist companies.

• *If this is a critical activity, are the scale and scope of operations appropriate?* For example, following the break-up of the former East African Community (EAC), Kenya Airways and Kenya Railways inherited workshops and other facilities (and staff) designed to service all three countries of the EAC. Although some of these units were no longer needed, they (and their staffs) were retained for many years.

Those questions are simple but getting the answers may be difficult. They also may be highly contentious and fiercely debated. Nonetheless, functional reviews are critical because they can expose whole activities, units, or operations that are redundant. These noncore activities are potential candidates for work force reduction.

In grossly overstaffed enterprises, functional analysis can be implemented as a zero-based approach. Argentina’s national oil company, YPF, was so overstaffed that the company and its consultants “decided to eliminate all positions and start from a clean slate while building the new organization frame” (Grosse and Yañes 1998, p. 57). (The organization shrank from about 52,000 employees to fewer than 6,000; 50,000 employees left with generous severance packages, and 3,500 new staff were hired).

There are many other approaches to organizational review, but functional analysis is one that closely relates to the wider reform agendas of many PPI plans.

**Tool 3: Ratio Analysis of Staff Data**

Data from the staff audit can enable detailed analysis, such as that undertaken by Brazil’s federal railway (box 3.11). Staffing ratios can be used as internal benchmarks to compare regions, units, or operations. Types of ratio analysis are:

- **Trend analysis**, which considers past ratios (for example, the ratio of managers to charge hands to unskilled workers), and projects those forward, perhaps with revised assumptions.

- **Staff turnover**, which is computed as the number of employees leaving in a year divided by the average number of employees in the same year multiplied by 100.

- **Length of service analysis**, which may be important in relation to the eligibility rules for severance and pensions (see module 5).

- **Cohort analysis**, which identifies the survival rate of particular groups or cohorts of workers. This can be particularly important where there has been an element of earlier restructuring, and where certain cohorts are particularly important (for example, engineers with bachelor’s degrees or airline maintenance staff trained on particular aircraft). The survival rate is the proportion of employees engaged during a defined period who remain after so many months or years. If 50 staff were trained in telecommunica-
tions engineering and only 20 remain in service after two years, the survival rate is 40 percent.

As with benchmarking, it is the process of examining, reviewing, and challenging staffing ratios that can yield the most benefits.

**Tool 4: Productivity Reviews**

Determining the number of staff needed to undertake a particular task is, in theory, just a simple formula:

\[
\frac{(\text{Number of tasks} \times \text{time required per task})}{\text{Number of employees required}} = \text{Time available per employee per year}
\]

This formula, however, does not take into account new technologies, alternative working methods, skills levels, work rate, and the impact of constraints on labor productivity. It is usually not sufficient to rely on such analysis alone because it does not challenge managers to find new ways of improving labor productivity.

In some enterprises the combination of government regulations, accumulated work force numbers, and “custom and practice” may have created well-established but now inappropriate labor productivity norms. These can be tackled through:

- The combination of good staff audit data and benchmarks
- Revisiting labor norms through a zero-based approach to labor budgets, linked where necessary to new work study assessments
- Experimental or pilot contracting out of tasks to the private sector
- Experimental or pilot investment in new equipment (in cases where labor productivity is low as a result of inadequate investment).

**Tool 5: Age Profiles**

Age profiles help predict the structure of the work force over time and the numbers of staff leaving or taking early retirement. There are three basic elements to such profiles:

1. **Present staff resources**
2. **Natural attrition** (for example, normal retirements, long-term sickness, death in service, maternity, and job change)
3. **Future restructuring or recruitment plans**

An illustration of age profiling is shown in figure 3.2. Age profile analyses will be particularly important if there have been recruitment surges or freezes that have distorted the “normal” age profile of the work force.

Mechanisms for preparing age profiles will vary from enterprise to enterprise but the underlying calculations are variants of factors such as present strength, expected new recruitment, average rate, and forecast strength over the next few years (see [Figure 3.2: Sample Age Profiles](image))

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**Figure 3.2: Sample Age Profiles**
the CD-ROM for an actual example of such calculations). The implementing agency can ask enterprise human resource managers to use such profiles to calculate the impact of hiring freezes or the rate of loss of key skill sets. Those calculations can be informed by ratio analyses, such as labor turnover rates, length of service, and cohort analyses.

Age profile approaches can also be disaggregated to assess particular groups of workers, perhaps by gender, particular skills sets, or particular locations.

Tool 6: Supply Forecasting

Work force analysis will not only inform the process of downsizing. In many cases enterprises need to both retrench and recruit at the same time. Many public enterprises have both a surplus of unskilled staff and a deficit in key technical, commercial, or managerial skills (often because they are unable to pay enough to recruit high-quality staff). Forecasting the supply of staff, by category, will be particularly valuable where there are known skill shortages (for example, financial skills, or skills in electronic engineering in a telecommunications enterprise) or where there is evidence of difficulty in recruitment or high levels of out-migration, HIV/AIDS, or other factors.

Supply forecasts will be informed by the skills assessments component of the skills audit. Forecasts will draw on information such as:

- Analyses of local or regional employment service (labor exchange) data, job advertisements, wage rates, and interviews with other enterprises.
- National- or state-level labor force surveys and statistics.
- Data on supply restrictions arising from legislation, collective bargaining agreements (job demarcation, work force numbers) and union membership.
- Analysis of the hiring practices of other relevant private sector employers.
- Relative pay scales of public sector and private sector employers.
- The availability of in-house staff capable of being retrained. If there is uncertainty, an internal advertisement for “expressions of interest” can determine the likely response and caliber of the applicants.

To facilitate any subsequent downsizing, these supply forecasts should be matched against categories of workers (grade, level, function, and cohort) to identify any group(s) that should or should not be selected for downsizing.

WHO SHOULD DO THE ASSESSMENTS?

Who should undertake the tasks of staff auditing, benchmarking, and work force analysis? This section considers the implementing agency’s options in undertaking those tasks.

Commonly, the work can be done by:

- In-house staff from the enterprise.
- Other government advisers. Some governments have well-established staffing and planning units that undertake staffing assessments of both government departments and state-owned enterprises.
- External consultants, either from the private sector or from management training and similar institutions that provide consulting services.

Table 3.5 summarizes the strengths and weaknesses of each group. Particularly where the quality of data is poor, both data collection and analysis can be demanding of time and expertise. In such circumstances a combination of resources, such as in-house staff and consultants, may be the best option.

It may be difficult for the implementing agency to find expertise within government to conduct fully objective staff assessments. This is particularly the case where staffing levels in the enterprise are based on old (public sector) standards and norms and do not take account of the impact of new technologies and work practices, or where there has
been little other experience with the improvements in labor productivity that usually follow private participation.

External consultants can be one source of expertise although their costs may be higher than in-house and government resources. Even so, investment in high-quality staffing assessments is likely to be worthwhile. The assessments will help the implementing agency when consulting and negotiating with workers and unions. They will also form part of the overall due-diligence assessment for the PPI transaction. The issue therefore is not so much one of cost but of providing sufficiently accurate and reliable information to enable all parties—government and PPI investor—to properly assess the labor issues related to the transaction.

Whether the work is done using government or private sector resources, the terms of reference will be the same and should aim to gather enough information to meet the objectives above. The Toolkit CD-ROM provides terms of reference for a scoping study.

<table>
<thead>
<tr>
<th>Source of expertise</th>
<th>Pros</th>
<th>Cons</th>
</tr>
</thead>
<tbody>
<tr>
<td>In-house team from PPI enterprise</td>
<td>• Has good access to data and individuals • Has good understanding of the business and the sector</td>
<td>• May be biased or lack independence • May be reluctant to make recommendations that risk careers of colleagues • May lack availability or sufficient time to conduct the work in-house • May lack skills if in-house human resources function has been administrative rather than strategic</td>
</tr>
<tr>
<td>Internal government advisers</td>
<td>• If linked to strong reforming central unit (e.g., office of the president or prime minister), may have strong authority • Bring understanding of detailed problems that arise in other government departments or state-owned enterprises</td>
<td>• Reluctant enterprise managers can block access to data • Will be more costly • National consultants may lack knowledge of sector reforms outside the country • International consultants may lack local understanding</td>
</tr>
<tr>
<td>External consultants</td>
<td>• Are independent • Can transfer experience of the effects in other enterprises and organizations that have introduced private participation nationally or internationally • May be specialists in the field of work force assessments • May have methodologies for conducting staff audits • Can provide specific training (e.g., in setting up a benchmarking program)</td>
<td>• May lack authority (look for evidence in the impact of previous reports) • May have limited international experience</td>
</tr>
</tbody>
</table>

Table 3.5: Pros and Cons of In-house and External Consultants
Additional Material (on the CD-ROM)


Web Sites

Bureau of Labor Statistics, United States:
http://www.bls.gov/. (This site provides public access to a wide range of labor statistics and international comparisons.)

International Telecommunications Union (ITU):
www.itu.int. (The ITU Telecommunications Indicators Database provides data sets on performance measures of telecommunications operators worldwide, including staffing.)

World Bank “Shrinking Smartly”:
www.worldbank.org/research/projects/downsize/. (This site is a clearinghouse for researchers, development practitioners, and government officials concerned about the difficulties encountered in downsizing a large public sector.)

Other Material and Sources


Kanawaty, George, ed. 1992. Introduction to Work Study. Geneva: International Labour Office. (Describes the basic techniques of work study, particularly for manufacturing and process tasks, and office work.)
This module considers the following strategic issues and analyzes available restructuring options. Among the key strategic questions are these:

- Who should undertake labor restructuring—government or investors?
- What range of options are available for dealing with restructuring?
- How should these options be sequenced?
- What legal and contractual issues might constrain the choice of strategies and options?

**Restructuring—Who Should Do It?**

The primary strategic decision is whether the government or the private sector should undertake labor restructuring. There is no one right approach and countries have followed different strategies, depending on the timetable and urgency of the private participation in infrastructure (PPI) as well as on the nature of labor issues at the enterprise level. There are three options:

- Leaving labor restructuring to the private sector—that is, following PPI
- Leaving labor restructuring to the government—that is, before PPI
- Taking a mixed approach.

**Labor Restructuring by the Private Sector**

In theory arguments can be made that labor restructuring is best left to the new private investors who:

- Are better equipped than the government to judge the level and kind of skills needed and to implement a process that minimizes adverse selection.
- Have greater incentives to minimize severance costs. Rama (1997) noted that severance packages can be more generous when designed by government.

Examples of PPI arrangements where labor restructuring was investor-led are Argentina’s gas transmission and distribution company and Guyana Telecommunications Corporation (box 4.1).
strategy is most likely to work in situations with modest initial levels of overstaffing, a high-growth sector (for example, telecommunications), no severe labor opposition to reform, and locations with effective job markets into which displaced workers can move.

Labor Restructuring by Government

Although restructuring led by the private sector is the preferred route, there are four scenarios in which government will likely need to be involved in labor adjustment:

1. In sectors where overstaffing is severe and opposition to PPI from the public and from unions and labor is strong, and private investors may be wary of taking on the political burden of carrying out large-scale work force adjustments.

2. Where there are legal and other restrictions on the investor’s ability to implement labor adjustment, either through labor laws or collective bargaining agreements. In India and Sri Lanka, for example, labor laws make it costly, time consuming, and cumbersome for the private sector to retrench staff (Basu, Fields, and Debgupta 1996; Fiszbein 1992; and Salih 2000).

3. Where labor restructuring costs are very high. In cases where investors take on sur-
plus labor they discount the sale price accordingly—and a low sale price may be politically difficult for government to accept.

4. Where there is future uncertainty about government’s policy and stance on public sector labor issues—for example, if there are significant arrears of wages to workers, unfunded pension liabilities, or investor concern that government might change the rules or laws on retrenchment or restructuring after the PPI transaction has been completed.

In any of those cases, only government action may be able to unblock potential labor problems quickly and avoid delays in PPI.

Where PPI plans are still in the making, government can take steps to reduce the work force through a variety of options, including natural attrition, a freeze on recruitment, the phasing out of pensioner workers, removal of ghost workers, voluntary departures, and compulsory redundancy. The privatization of telecommunications in Tanzania is one example (box 4.2) where work force reduction took

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**Box 4.2: Tanzania—Telecommunications Work Force Restructuring**

The government of Tanzania decided in 1996 to include utilities in the list of state-owned enterprises to be considered for privatization. The Tanzania Telecommunications Company Ltd. (TTCL) was then selected as the first of the utility state-owned enterprises to be divested.

In June 1997 TTCL had some 96,000 lines connected to its network, with annual growth of 3.4 percent and a waiting list of 84,000 lines. The company employed just over 4,688 workers in 1998. Between June 1998 and October 1999 TTCL reduced the number of employees to 3,720, mainly through attrition, restrictions on new employment, and early retirement.

In 1998 a firm of consultants, which was engaged to audit TTCL, recommended a further staff reduction of 1,659 employees. The company decided against forced reduction and instead took the route of a soft option that involved a continued program of attrition, restrictions on new employment except for prospective employees with critical skills, early retirement, and voluntary redundancies. The voluntary departure package was negotiated through the Communication and Transport Union and essentially provided for 6 months’ pay for up to 6 years of employment, 18 months’ pay for 6 to 10 years, 24 months’ pay for 10 to 25 years, and 30 months’ pay for up to and above 25 years.

The TTCL divestiture program was expected to take two years beginning in 1998. Privatization would involve the sale of new shares, giving the investor a 35 percent equity stake as well as management control. TTCL’s teledensity was less than 0.04 percent, and government policy called for an increase to 6 percent by 2020. The result was that the expansion program was initiated simultaneously with the privatization program. The market for mobile phones was also liberalized, and three mobile licenses were issued in 1998.

In implementing the program to reduce staffing in preparation for privatization, noncore activities were first unbundled from the core business. The program of expansion also allowed for some workers to be redeployed in the construction division. The net effect was that the company retrenched only 802 workers and most of these employees were severed through the plan negotiated with the unions. Slimming down the work force occurred over three years without large-scale, one-time severance resulting in vast numbers leaving the company at any one time. Because there was no termination of large groups at any time, the program did not attract negative criticism from the press or politicians.

The new strategic investor continued the expansion program that was established in the sales agreement based on the roll-out obligation of 800,000 lines within four years. The company was able to improve its labor productivity significantly while preparing for privatization without most of the negative consequences associated with utility labor retrenchment programs.

The expansion of the mobile operators (five mobile licenses issued by 2001, including one to TTCL) resulted in more than 300,000 mobile connections by December 2001. Many of the workers leaving TTCL were able to find alternative employment with the new mobile operators, which illustrates also that labor retrenchment is easier in industries going through technological changes and rapid expansion.

Source: Parastatal Sector Reform Commission, Tanzania.
place over a three-year period under government ownership prior to privatization. Another example of preprivatization work force restructuring is that of Eskom, South Africa’s electricity utility (which will be discussed in another context in box 4.6). Although government has an important role to play in these cases, there are also some risks associated with government management of labor adjustment. Those risks include the following:

- Because government managers (including those in the implementing agency) are not best placed to predict future staffing requirements, the wrong people may be selected. That in turn may lead to subsequent rehiring of retrenched workers.
- Overly generous severance payments negotiated with workers and unions may smooth over industrial relations in the short term, but may create precedents that are unsustainable for future restructuring of other enterprises or for the incoming PPI investor.
- If there is no political will or consensus, government managers may not be able to move decisively and so delay work force restructuring and PPI itself.
- Reluctant factions within governments may use labor restructuring as an excuse to delay PPI.

Government-led work force restructuring usually deals only with part of the work force, but there are occasional examples where governments have decided to make all workers redundant and settle all labor liabilities prior to PPI. That was the case in the concessioning of Malawi’s railway and of Zambia’s rail sector (see box 4.3). A shared approach provides benefits where government deals with a large part of the surplus work force before PPI, and the investor is able to fine-tune the process post-PPI.

1. Government first deals with an initial restructuring of the accumulated work force surplus before the PPI transaction is started, and sets up a social safety net or redeployment program.
2. The PPI investor then acquires management control and is given freedom to fine-tune staffing levels after the PPI transaction.

This shared approach offers the additional advantage of reduced cost to the government because the incoming investor may pay for further adjustments. In the shared approach both the government and the investor contribute to the costs and the decisionmaking involved in work force restructuring.

An example of a mixed approach is Argentina’s rail privatization, in which most of the 70,000-worker reduction was undertaken as part of the privatization process. Part of the reduction was privately financed, however, by the operators of the San Martin and Urquiza concessions. They began operations with a combined work force of 2,700 (compared with the previous public enterprise [Ferrocarriles Argentines] total of 8,800) but reduced that force even further to 1,700 at a private cost of US$10 million (Ramamurti 1997).

Another example is that of the Manila water concession, which provided early retirement to undertake a preconcessioning reduction followed by a probationary period of employment (see box 4.4). That mix allowed the new operator time to make its own assessments of the employees and protect the interests of employees.

Table 4.1 summarizes the advantages and disadvantages of the main choices on labor restructuring responsibility. Irrespective of who undertakes work force restructuring in preparation for PPI, labor adjustment will be a continuing process, not a one-time event.

**A Mixed Approach**

A mixed approach by which both government and the PPI investor are involved can help overcome the problems of leaving restructuring entirely to the government or to the private sector. In such an approach work force restructuring is implemented in phases:

**MENU OF OPTIONS**

This section presents a typology of labor adjustment (or work force structuring) options. There are
Box 4.3: Zambia—Redundancy for All Rail Workers

When the Zambia Privatization Agency (ZPA) and the Zambia Railways Corporation (ZRC) considered strategies for labor adjustment as part of a plan to privatize the operations of the railway, a combination of factors indicated that all 1,650 of its workers would receive redundancy payments—even those who kept their jobs. Those factors were:

- An exceptionally generous retrenchment package, negotiated previously with the Railway Workers Union of Zambia, which included a severance package of 3.2 months of salary per year of service plus resettlement and a freehold title on a farming plot (typically 5 hectares) for resettlement on land allocated for farming by a previous government.
- Labor laws that gave every worker in an enterprise transferred to a new employer the right to request that all terminal benefits be paid (including pensions and negotiated severance) and then to leave the enterprise. These laws also provided that any workers who transferred should receive terms and benefits no less generous than their current employment contract.
- Worker suspicion of the employment security offered by both private operators and government, given well-publicized bankruptcies of privatized firms. This meant that the trend in Zambia was for workers to readily accept voluntary or compulsory redundancy (especially when the packages were generous).
- ZRC’s financial circumstances. ZRC was in arrears in paying both employees’ and employers’ contributions to the workers’ pension fund.

Those circumstances meant that almost all workers were likely to leave the company rather than join the new operator, who would start with no experienced staff. Government decided to consider offering redundancy to all workers, but there was a financing problem with that idea: government could not afford the costs of retrenching 1,650 workers, although it could finance the retrenchment of the 650 or so workers estimated to be in immediate surplus (that is, the new operator was likely to require only about 1,000 workers). ZRC and ZPA commissioned a consultancy to meet with trade unions and help develop the options. This consultation process led to a revised plan that all workers be offered retrenchment as follows:

- 650 or so workers to receive a full and immediate package of retrenchment benefits, and lose the right to return to work in the enterprise.
- The remaining 1,000 workers to receive the full retrenchment package paid over three years from a portion of the concession fees that the PPI investor placed in a trust fund specifically for that purpose, with benefits protected from erosion as a result of inflation.


Box 4.4: Philippines—Use of a Mixed Approach through Probationary Employment

Overstaffing at the Metropolitan Waterworks and Sewerage System (MWSS) in Manila was addressed in two phases. Prior to privatization MWSS implemented an early retirement program that was used by about one-third of the work force. The remaining employees were absorbed by the concessionaire with a six-month probationary employment period. After that period the employees became permanent or were separated. The concessionaire ended up with a regularized work force of 4,300 employees, equal to slightly more than half of the preprivatized work force. Of the total number of retrenched employees, only 100 or so were involuntarily separated. The process was facilitated by an attractive voluntary retirement program, the main components of which added up to payments that were significantly more than they would have received if they were to have retired on the standard government retirement package. Training and work opportunities (including outsourcing) were provided for those who left the company. All rounds of separation were designed to be equivalent to each other. The estimated cost of the early retirement packages was P1.1 billion, or about US$44 million. Labor productivity improved significantly as a result of the privatization.

Source: Dumol 2000.
### Table 4.1: Labor Restructuring—By Whom and When?

<table>
<thead>
<tr>
<th>Responsibility</th>
<th>Advantages</th>
<th>Disadvantages</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Government:</strong></td>
<td>• May be essential if there is a large accumulated staffing surplus</td>
<td>• Can lead to adverse selection problems</td>
</tr>
<tr>
<td></td>
<td>• Demonstrates government’s commitment to sector reform</td>
<td>• Government managers may negotiate too-generous deals with labor in their anxiety for smooth industrial relations</td>
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<tr>
<td></td>
<td>• Increases the likelihood of attracting good investors and obtaining a good price for PPI</td>
<td>• It is the most costly option for government, which bears all of the costs.</td>
</tr>
<tr>
<td></td>
<td>• Enables government to implement change in labor laws and collective bargaining agreements</td>
<td>• Can deter investors if linked to “no subsequent retrenchment by the PPI investor” clauses or clauses that reduce labor flexibility</td>
</tr>
<tr>
<td></td>
<td>• Can be fast, if there is the political will and support</td>
<td>• Most politically risky—bad image of government</td>
</tr>
<tr>
<td></td>
<td>• Facilitates a uniform government policy toward labor adjustment in all public enterprises</td>
<td></td>
</tr>
<tr>
<td><strong>PPI investor:</strong></td>
<td>• In theory, gives the best labor efficiency gains because investors are best placed to know future staffing and skill needs and the match between labor and capital investment</td>
<td>• Unattractive for investors where there is a history of difficult labor relations and no proven track record of work force restructuring</td>
</tr>
<tr>
<td></td>
<td>• Minimizes adverse selection because the future employer does all the selection</td>
<td>• Can create a bad image for the private sector, which will be contrary to policy for governments with a desire to encourage private sector development</td>
</tr>
<tr>
<td></td>
<td>• Reduces political risk for government—crudely put, the PPI investor can be “blamed” for downsizing</td>
<td>• Appears least costly for government, although in practice the PPI investor will discount the price to meet these costs</td>
</tr>
<tr>
<td><strong>Shared approach:</strong></td>
<td>• Allows separation of pre- and post-PPI responsibilities. For example, government can retain responsibility for pension liabilities arising before the PPI contract.</td>
<td>• More likely to yield a case-by-case negotiated approach, which in practice can lead to bad precedent setting and government guarantees</td>
</tr>
<tr>
<td></td>
<td>• Allows government to deal with the bulk of the accumulated surplus and then allows the PPI investor to fine-tune the selection of workers</td>
<td>• More demanding of managers in the implementing agency who will need more commercial understanding of likely investor requirements, particularly if unions and government are negotiating on post-PPI terms</td>
</tr>
<tr>
<td></td>
<td>• Ownership of the challenge of work force restructuring is shared by government and the PPI investor</td>
<td>• More complex negotiations may delay PPI process</td>
</tr>
<tr>
<td></td>
<td>• Some reduction in the risk of adverse selection, compared with government-only restructuring.</td>
<td></td>
</tr>
</tbody>
</table>
many ways to restructure the work force. This section first reviews the different options and then outlines how they might be used in combination as part of a comprehensive labor program.

Early retirement, voluntary departure, and compulsory redundancy are the most commonly used options for labor adjustment. There is, however, a wide range of options that can be used by the implementing agency. The options are not mutually exclusive; in practice the options can be used in sequence or combined with one another.

Broadly, the options can be divided into three groups, as shown in figure 4.1:

1. So-called soft options, which do not introduce new elements of incentive or compulsion, but rely on existing and therefore non-controversial workplace regulations.

2. Options that involve restructuring of the workplace. Some will be voluntary whereas others, such as closure of noncore units, may be seen by workers as involuntary change, especially if there has been little consultation.

3. Retirement and redundancy through voluntary departure options or compulsory means. Voluntary options provide incentives for people to leave, either through early retirement or severance packages. Acceptance is not forced (although in cases where a worker’s future prospects are very poor, workers may feel that they have had little choice). Compulsory redundancy options force workers to leave without asking for their consent.

Although not strictly a labor-restructuring tool, employee share ownership (see module 5) is a mechanism that may be used in conjunction with labor restructuring. It can be used in three ways:

1. As an incentive or reward package for workers, particularly those who will remain in the work force.

2. As the basis for management employee buyouts or employee buyouts of units of the enterprise.

3. As a form of compensation to displaced workers whereby they receive shares instead of cash. As part of a compensation package, however, share transfers are probably best viewed as a supplement to, rather than a substitute for, severance or early retirement.

SEQUENCING OF OPTIONS

In planning a labor program, the implementing agency needs to take into account the sequencing of different options, and the right timing and sequencing can be critical to achieving a successful outcome.

As the examples of South Africa and Tanzania (boxes 4.2 and 4.6) illustrate, major PPI reforms often take time to implement. In such circumstances the implementing agency can start with soft options, progress through voluntary programs, and adopt compulsory redundancy if necessary. Figure 4.2 illustrates such a progression.

Although this Toolkit focuses on work force restructuring prior to PPI, the sequencing of options can extend into the post-PPI period. For example, in the mixed approach adopted in Brazil’s federal railway reform the sequencing of activities was planned in three phases:

- Phase 1: voluntary reduction by government through early retirement and voluntary departure, which were offered only to selected job categories.

- Phase 2: compulsory redundancy of employees with unnecessary activities, through an involuntary severance package equivalent to 80 percent of that paid to employees who voluntarily left RFFSA.

- Phase 3: post-PPI redundancy undertaken by the concessionaires. The terms of the contract provided that the concessionaire had to pay the same terms as for the phase 2 pre-PPI involuntary departure for any staff who were made redundant within one year (Estache, Schmitt de Azevedo, and Sydenstricker 2000).
Labor Issues in Infrastructure Reform: A Toolkit

In the event, the concessionaire was able to quickly identify the number of phase 2 involuntary redundancies that were needed, and labor restructuring was completed before privatization.

The sequencing outlined in figure 4.2 may only be appropriate where reforms are not seen as urgent. This in turn will depend on the level of over-

staffing, the political context for reform, the urgency of PPI investment, and government’s overall strategy for private participation in infrastructure. Where the need for infrastructure sector reform and investment is urgent, it will be necessary to bring forward early retirement and voluntary departure so that these are implemented at the same time as are soft options.
The speed at which the implementing agency can move in the early stages, however, is often constrained by:

- Lack of readily available resources to resolve issues (for example, to hire specialists to review pensions, to conduct staff audits, or to design an effective redeployment program)
- The need to comply with laws, labor contracts, and collective bargaining agreements
- Lack of good information to answer key questions on the scope of labor adjustment to be identified. (How many staff are there actually? How many are in surplus? Which skills are most critical? Are there pensions and salary arrears?)
- Lack of financing for meeting the costs of implementing retirement and redundancy options (covered in Module 5 in more detail).

**SOFT OPTIONS**

Soft options aim to restructure the labor force through the reinforcement of current work regulations. Options include payroll management, enforcement of retirement age, enforcement of disciplinary actions, staff transfers, and freezes on recruitment and promotions. These options can be a starting point to address overstaffing and can lead to substantial labor force reductions, without creating social or political controversy or unrest.

**Payroll Management**

Removing ghost workers, absentee employees, and ghost pensioners is usually an immediate and non-controversial step toward downsizing. At the enterprise level, however, obstruction can occur where payrolls have been inflated by corrupt and “well-connected” senior and middle managers. In those circumstances the manager in the implementing...
agency may need high-level support within government for his or her actions. Often, however, the mere lack of control has enabled the growth of ghost workers, and introducing a staff audit (see module 5) may be enough to yield significant effects. A plant census undertaken at the steel maker SOMISA in Argentina required photo badges for all workers. Reported employment levels of 14,500 employees quickly fell to 12,000 as shadow employees were eliminated (Hess 1997). In Tanzania’s civil service, a national census found that 16,000 (5 percent) of the entire payroll of 350,000 were ghost workers (International Records Management Trust 2001b).

Enforcement of Retirement Age

Enforcing the retirement age can lead to substantial reductions in some work forces by:

• Phasing out workers who are already over the retirement age
• Requiring workers to retire when they reach pensionable age.

Prior to transition in Hungary, about 20 percent of pensioners were active in the labor market. Privatized firms subsequently reduced these numbers, which fell to 9 percent by 1992, as the companies restricted the employment of workers who had reached pensionable age (Szeman 1994).

Enforcement of Disciplinary Proceedings

Many work forces have a small proportion of staff who are being investigated on disciplinary grounds. Some of these cases can linger for months and years while workers are suspended and on full salary or still working. If voluntary departure or compulsory redundancies are to be implemented, it is important that these cases are tackled first. This implies:

• Greater management attention to completing these cases
• Engagement of additional resources (for example, lawyers and arbitration specialists) to help the implementing agencies undertake disciplinary action in a fair and transparent manner.

To accelerate the departure of employees subject to disciplinary proceedings, some PPI enterprises have developed special voluntary departure package. For example, Eskom, South Africa’s power utility, developed a special package for employees who had received formal disciplinary warnings and who chose to resign following amicable discussions (box 4.5).

Staff Transfers to Other Public Organizations

One restructuring option is to transfer surplus staff from an infrastructure enterprise to another public sector organization (for example, a ministry, department, agency, or state-owned enterprise [SOE]). Transfers can let the PPI transaction proceed quickly with a much-reduced work force.

The principal argument against such tactical staff transfers is that they can merely shift an overstaffing problem from one part of the public service sector to another. In most cases governments will avoid such transfers unless there are genuine vacancies elsewhere in the public service. Occasionally, however, transfers have been used as a mechanism for quickly enabling urgently needed PPIs and investments. One example is Jordan’s Aqaba Rail concession (see box 4.6), which shows both the opportunity and the problems of tactical transfers.

Some infrastructure companies have workers who are government civil servants on deputation. A proportion of those workers might be transferred back in their original department, or elsewhere. This is an option, however, that will be unacceptable for many governments. If the civil service is overstuffed, simply transferring surplus workers from the SOE sector back into the civil service is not helpful for wider efforts to reform the civil service. Even if one particular PPI scheme only has a few workers who have retained their civil service status, a transfer program for those few may set an unwanted precedent.
Recruitment and Promotion Freezes

Recruitment and promotion freezes are always temporary in nature. Even if the freeze lasts a number of years, at some stage new staff must be hired and merit-based promotion reinstated. The implementing agency and the enterprise manager can at least halt increases in staff numbers through:

- Freezes on the hiring of permanent, temporary, or contract staff
- Selective abolition of vacant posts
- Elimination of guaranteed entry to the public service infrastructure company on completion of training programs
- Suspension of automatic advancement systems
- Suspension of the automatic replacement of staff who retire normally.

Advantages of Soft Options

Soft measures are particularly relevant if the manager in the implementing agency has some time before PPI and there is little urgency. Such measures offer:

- A relatively easy mechanism to implement, in political and managerial terms.
- A way to signal government’s intentions to tackle work force restructuring in a manner that can provide space for dialogue with unions, workers, and other stakeholders.
- A way to achieve progress even in very difficult circumstances. Where government or the PPI enterprise managers have effectively lost control over staffing and payroll, reintroducing basic staff audits and enforcing normal human resource management can help start the process of labor adjustment.

Box 4.5: South Africa—Phased Reform in Electricity

Eskom is South Africa’s state-owned electricity company. Government’s overall policy is to restructure the sector and encourage competition by (a) creating contestable markets for power generation and allowing the phased entry of private power generation, (b) separating generation from distribution and restructuring distribution and supply into a number of regional electricity distributors, and (c) introducing a regulatory framework.

Government’s policy is to avoid retrenchment of workers in state enterprises wherever possible, and the reforms and proposals for PPI have been a key target for opposition by the labor unions. Nonetheless the pre-PPI restructuring of Eskom has resulted in a 40 percent reduction of the workforce, from 65,000 to 39,000, over the last six years. This was achieved through a mixture of natural attrition and four different packages of voluntary departure:

- Most generous in terms of benefits is a voluntary separation package available to employees when the restructuring of an element of the company is imminent.

- A less generous severance package, known as the “surplus package,” is available in circumstances where the restructured unit is being implemented and surplus positions have been identified.

- A third package is available to individual employees whose performance has been the subject of review and who have been required to take a six-month performance enhancement program under which specific requirements are stipulated and appropriate training is provided. When an individual employee fails to satisfy the requirements of the program or chooses during the program to leave the company, this “volunteers’ package” is made available. About 6 of every 10 employees who take this training program do so successfully, that is, they remain with the company.

- The fourth package, known as the “disciplinary package,” is provided when an employee, following the initiation of a disciplinary process entailing formal warnings, counseling, and so forth, chooses to resign after amicable discussions.

A test of political commitment. If vested interests make it impossible for government to take these easy first steps, implementing harder options will not have much chance of success.

WORKPLACE RESTRUCTURING

Changes in the nature and structure of work are also useful tools for the implementing agency. They can enable control or reduction of staff costs while maintaining the work force largely intact until such time as the new PPI investor can select the staff needed.

Reducing Working Hours

Reduced working hours can cut salary costs through various approaches, including:

- Reduced work schedules for individual employees
- Reductions in shifts (for example, moving from three to two shifts)
- Rotation of employees on temporary administrative leave (this is one meaning of the term “layoff”)
- Operation of plant on reduced schedule (for example, three-day work weeks)
- Job sharing.

Those are typically short-lived measures, best suited to situations where managers can expect a turnaround in demand for staff. Those approaches were used, for example, by the airline and airports industries during the sharp downturn in demand for air travel in late 2001.

Placing Workers on Administrative Leave

Employees placed on administrative leave ("furlough") remain formally employed with the establishment but do not report to work. For professional staff, administrative leave may include periods of sabbatical or training. Administrative leave

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Box 4.6: Jordan—Tactical Staff Transfers at Aqaba Rail

The government of Jordan has embarked on an economic reform program that includes PPI. Loss of jobs is a concern, however, in an economy with relatively high levels of unemployment. This is particularly the case in the relatively poorer southern part of the kingdom where the Aqaba Railway Corporation (ARC) operates.

ARC was formed in 1972 to carry phosphate rock from the Jordan Phosphate Mines Company (JPMC) mines at El Abiad and El Hassa to the export facility at the main port of Aqaba. ARC had been operating with significant losses for several years, and its overemployment was substantial. As production was shifting from existing mines to the newer phosphate mine at El-Sheidiyeh over the medium to long term, ARC was consequently faced with the need for investment to handle the enhanced production at the El-Sheidiyeh facility.

After extended discussions concerning the fate of ARC’s 1,300 employees, the decision was made to extend a 25-year concession agreement leasing ARC assets to an international consortium.

The consortium has agreed to retain 500 workers from the existing ARC staff to be deployed in the upgrade and repair of the existing rolling stock and track. The government of Jordan has committed itself to employing the remaining 800 employees, with 150 employees going to other government agencies and 650 transferring to the new JPMC operation at El-Sheidiyeh.

If the government of Jordan had not solved the labor redundancy issue, privatization would not have been achievable. Essentially the approach has been to privatize first, to bring in investment, and to solve the employment issue later. The ARC project will result in an overall investment of US$120 million in railway infrastructure and will paving the way for a separate $600 million joint venture currently under progress between JPMC and an international fertilizer producer to transfer phosphoric acid from the El-Sheidiyeh facility through the port of Aqaba. Overstaffing, however, remains to be tackled as JPMC is prepared for privatization.

can be unpaid or partially or fully paid, depending on labor laws and labor agreements.

Administrative leave has been used in a number of countries. For example, in Argentina’s major infrastructure privatizations some workers were sent home with 50 percent of their salaries (Kikeri 1998, p. 6). By far the most extensive use of administrative leave, however, has been in the state enterprise and newly privatized sectors in China (box 4.7) and the countries of the former Soviet Union (FSU). An International Labour Organisation (ILO) survey of several countries of the FSU found that 30 to 80 percent of privatized enterprises made use of administrative leave, as did 60 percent of enterprises in China (see table 4.2). The survey observed that:

In the context of the FSU countries, administrative leaves are fairly costless to employers, reducing wage bills without the burden of severance payments, while providing an easy way to increase labor should conditions warrant. The disadvantage to workers is (at best) reduced income, but with the advantage, over displacement, of retaining rights to certain services or benefits provided by their employers. The most important of these rights may be adding work months to pension eligibility (Evans-Clock and Samorodov 1998, p. 68).

Administrative leave was also used to cope with the high levels of unemployment that arose in Russia, where the number of people employed had decreased from 73.8 million in 1991 to 65.4 million at the end of June 1997. At that time approximately 4 million workers were on administrative leave (Prokopenko 2000).

Administrative leave can provide workers with some form of social assistance until retirement, thus removing them from the enterprise work force but not placing them on a possibly overloaded pension system. This approach has been used in Poland (coal sector restructuring) and in Spain (steel and shipbuilding sectors). In Spain the programs were funded through an Employment Protection Fund, which provided (a) workers under 55 with three years of benefits equivalent to 80 percent of their gross pay, (b) workers of 55 and older with 80 percent of gross pay up to the age of 60, and (c) workers 60 and older with 75 percent of gross pay up to the age of 65 (Campa 1996).

Reorganizing the Work Force

A key change in human resources management over the last two decades has been the shift from asking “how many people do we need to do the job?” to asking “what is the best way to get the work done?” In other words there is a shift from focus on inputs (how many workers) to outputs (products or services). This shift has had a profound effect on the structure of the work force in many organizations, including infrastructure enterprises. Work force reorganization includes:

• Replacement of a single permanent cadre of workers with a mixture of core employees (permanent), close employees (temporary,
part-time, retained, and seasonal), and peripheral workers (casual workers, contractors)

- Greater use of outsourced contractors
- Removal or reduction of formal job demarcations, retraining within the enterprise, and greater multiskilling of the work force
- More innovation in forms of employment contract (twilight shifts, job sharing)
- Greater use of technology to facilitate changed work practices (remote metering and customer billing systems, customer-support call centers).

These measures may not have a large impact on work force numbers. Their importance lies, however, in the challenge of creating a more flexible but adequately represented and protected work force.

**Restructuring the Enterprise**

Enterprise restructuring may lead to posts becoming redundant as a result of the closure, disposal, or transfer of:

- **Noncore activities**: Some infrastructure operations have been not only vertically integrated but almost fully self-sustaining. Railways, for example, would have the capability for undertaking all repairs in-house. Such disposals are frequently associated with public sector reform and privatization, but they are also a normal activity in the private sector (see Dranikoff, Koller, and Schneider 2002).

- **“Social” units**: Public enterprises in the FSU and China commonly provided an extensive range of social services, particularly in health and education. Similarly, Indian Railways has a large medical service.

Historically these activities have been necessary to keep the PPI enterprise running effectively. Functional reviews may identify benefits to the enterprise if these activities are abolished, transferred to other government agencies, spun off, privatized, or contracted out (sometimes to redundant employees).

**RETIREMENT AND REDUNDANCY**

If soft options or workplace restructuring options are not enough, voluntary departures, compulsory redundancy, or both may be needed. Given high levels of overstaffing, most PPI schemes will need to turn to these options.

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**Table 4.2: Administrative Leave and Reduced Work Schedules in Countries of the Former Soviet Union**

<table>
<thead>
<tr>
<th>Country</th>
<th>Administrative leave</th>
<th>Reduced work schedules</th>
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<tbody>
<tr>
<td></td>
<td>Percentage of</td>
<td></td>
</tr>
<tr>
<td></td>
<td>establishments</td>
<td>Percentage of</td>
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<tr>
<td></td>
<td>placing workers on</td>
<td>establishments</td>
</tr>
<tr>
<td></td>
<td>on leave</td>
<td>placing workers on</td>
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<tr>
<td></td>
<td></td>
<td>reduced schedules</td>
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<tr>
<td></td>
<td>Percentage of</td>
<td>Percentage of</td>
</tr>
<tr>
<td></td>
<td>employees</td>
<td>employees</td>
</tr>
<tr>
<td></td>
<td>placed on leave</td>
<td>placed on reduced</td>
</tr>
<tr>
<td></td>
<td>a</td>
<td>schedules a</td>
</tr>
</tbody>
</table>

| Armenia     | 40.2  | 18.5 | 24.6 | 8.7 |
| China       | 63.1  | 4.8  | —    | —   |
| Georgia     | 43.0  | 37.5 | 10.1 | 5.3 |
| Kyrgyzstan  | 79.7  | 37.4 | 28.0 | 28.8|
| Russia      | 30.1  | 13.0 | 19.3 | 16.8|
| Ukraine     | 43.8  | 15.6 | 32.5 | 12.3|

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- Not available.
a. Percentage of all workers in surveys placed on leave or given reduced work hours during some period in the preceding year. Data on work time were not collected for China. Data relate to the period 1994–96.
Source: Evans-Clock and Samorodov 1998.
Voluntary departure arrangements are the most widely used mechanism for reducing the size of the work force and arguably are the most politically and socially acceptable largely because of their voluntary nature. A voluntary departure program invites workers to vacate their posts in exchange for a certain compensation package. The compensation may be a cash payment alone or it could be in the form of enhanced pension rights, shares in the new private enterprise, or other emoluments, plus a cash payment. The amount of compensation should act as an inducement to voluntary behavior and therefore is typically more generous than a statutory settlement payable under any national labor laws. Other benefits may also be included in the voluntary departure package (for example, retained rights to medical or housing benefits).

Voluntary programs often include an early retirement component. In such a program, workers cease work before the normal retirement age and receive a partial or full pension (see module 5 for more). Early retirement is usually a voluntary option, but it can be compulsory if the retirement age is reduced for all workers.

Most implementing agencies have used voluntary rather than compulsory departure as the core of their labor restructuring program (see, for example, the cases of Bolivia rail, Mexico railways, Orissa power distribution, and Brazil railways on the Toolkit CD-ROM). There are many reasons for this:

- **Political benefits**: It is usually better for government if redundancies can be limited to voluntary redundancies because it demonstrates that there has been limited coercion of the work force (see box 4.8).
- **Fairness**: A voluntary departure package is an indicator that government is treating workers fairly, which will in turn help smooth subsequent labor programs and SOE reforms.
- **Speed**: Voluntary departure programs, almost by definition, provide a better severance package than the minimum statutory benefit. Where compulsory redundancy is politically difficult, the enhanced benefit is an incentive for workers to leave relatively quickly and in larger numbers.
- **Control of rehiring**: Governments and donors alike are wary of creating a “revolving-door” situation where they finance the costs of severance for workers but then rehire those same workers. One problem with compulsory retrenchment through statutory procedures is that government may be legally unable to prohibit the rehiring of workers. In contrast, the voluntary departure offer is usually a bilateral contract between employer (government) and employee, and so enables government to include clauses prohibiting the employee from working again for government or the post-PPI enterprise.
- **Getting around restrictive legislation**: Compulsory redundancy procedures may be

**Box 4.8: Argentina—The Success of a Voluntary Approach**

In November of 1990, Argentina began restructuring its Public Administration and Public Enterprises. Voluntary exit programs were implemented to downsize companies. In 1991 and 1992 there were 28,300 and 56,000 retirements respectively. These programs cost $1 billion financed out of treasury funds, loans from the World Bank and the Inter-American Development Bank, and from the proceeds of the privatization.... Such a massive program of state employment reduction has not been without opposition. The weakness and infrequency of this opposition, however, is remarkable. And while clearly many factors have contributed to this...the absence of opposition to the state employment reduction was clearly also due to its purely voluntary nature” (Robbins 1996, pp. 6, 7).
determined by legislation, with statutory procedures, or within collective bargaining agreements or labor contracts. Governments may want to use voluntary departure to avoid compulsory redundancy procedures if those procedures set out mandatory and extended timetables for implementing compulsory redundancy or provide for court-based challenges—all of which could delay labor adjustment by several months, or if they require particular selection processes (for example, a last-in/first-out selection process might be mandated, even though the staff audit might show a need to retain younger workers with different skills).

For all these reasons, voluntary departure programs generally have been adopted to ensure a smoother, faster process of work force restructuring with less risk of confrontation with unions or workers.

Compulsory redundancy may be the selected route when:

- The enterprise is liquidated. This has been the case with a number of airlines, including Aeromexico (box 4.9).
- Governments make a policy decision to pay only the statutory minimum, either because of acute financial difficulties or an in-principle objection to “privileged” SOE employees receiving further benefits from government.
- Certain geographic or functional units are closed.
- Compulsory redundancy follows offers of voluntary departure, and insufficient workers have volunteered.

Compulsory redundancy is best achieved through clear objectives, open communication, and transparent and fair processes. The amount of statutory payment will be determined by labor laws or labor contracts.

Early retirement, voluntary departure, and compulsory redundancy each have their advantages and disadvantages for the implementing agency, as summarized in table 4.3.

**KEY CONSIDERATIONS IN DEVELOPING STRATEGIES AND OPTIONS**

The PPI implementing agency usually does not have a completely free hand when developing options and strategies for a labor program. Labor laws and the legal status of the enterprise and its employees prior to PPI often restrict the choices that are feasible, while political considerations can strongly influence decisions on employment protection for workers in the PPI bidding process.

**Labor-Related Legislation**

The strategies and options open to the implementing agency may be constrained by legislation, so an

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**Box 4.9: Aeromexico—Liquidation and Labor Adjustment**

One of two Mexican state-owned airlines, Aeromexico (Aeronaves de Mexico), had only 3 profitable years over the 30 years prior to its privatization, and the government had thought that it would be unable to sell the money-loser. But when 7,250 of the airlines ground workers went on strike in early 1988, the government seized the opportunity to exit. It declared the company bankrupt, terminated all labor contracts, and sold the company as an asset sale. Compensation to workers was paid by Aeronaves, and it was the creditors of Aeronaves who effectively bore the cost of severance because on average they received only about 70 percent of their claims against the company. Tandon (1995) has suggested that some of the better post-privatization performance of Aeromexico compared with that of the other state-owned airline (Mexicana) arose from labor adjustment issues—specifically:

- Mexicana had been unable to match Aeromexico’s aggressive campaign to improve service quality (which some observers felt reflected Mexicana’s inability to deal with the unreformed labor unions).
- The investors in Mexicana had needed to fund severance costs themselves—over 100 billion (old) pesos in 1992 alone.

Table 4.3: Advantages and Disadvantages of Early Retirement, Voluntary Departure, and Compulsory Redundancy

<table>
<thead>
<tr>
<th>Early retirement</th>
<th>Voluntary departure</th>
<th>Compulsory redundancy</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Advantages</strong></td>
<td><strong>Advantages</strong></td>
<td><strong>Advantages</strong></td>
</tr>
<tr>
<td>• Reduces immediate costs, particularly if pensions are deferred</td>
<td>• Makes a clean break with employees—no continuing government commitments</td>
<td>• Makes a clean break with employees—no continuing government commitments</td>
</tr>
<tr>
<td>• May be the most acceptable option for workers or unions, particularly if the pension scheme is a defined-benefit plan</td>
<td>• Can be structured as a one-time payment with predictable financial costs (and usually a quick payback)</td>
<td>• Can be structured as a one-time payment with predictable financial costs (and usually a quick payback)</td>
</tr>
<tr>
<td>• Shifts financing problems to pension fund or future governments (an “advantage” for today’s government, but one that creates a long-term fiscal liability)</td>
<td>• Is relatively simple to negotiate and implement</td>
<td>• Is likely to be the lowest-cost option if the statutory minimum payment is made to workers</td>
</tr>
<tr>
<td></td>
<td>• Gives the implementing agency and government flexibility in designing the package</td>
<td>• Permits the government to require that anyone selecting voluntary departure agrees not to work again for the public sector, or for the PPI enterprise, and so reduces the “revolving-door” problem.</td>
</tr>
<tr>
<td><strong>Disadvantages</strong></td>
<td><strong>Disadvantages</strong></td>
<td><strong>Disadvantages</strong></td>
</tr>
<tr>
<td>• Produces uncertain longer-term financial costs for government because returns from government pension funds are uncertain</td>
<td>• Has high immediate costs, especially because these plans tend to be generous</td>
<td>• Is the most politically difficult to implement</td>
</tr>
<tr>
<td>• May lead to loss of the most skilled or experienced workers if early retirement lowers the retirement age</td>
<td>• Demands that particular care be given to the selection process; generous plans can lead to a rapid exodus of the best workers</td>
<td>• Needs a formal and strictly implemented process if it is to be seen as a fair and unbiased process</td>
</tr>
<tr>
<td>• Pension funds may be unwilling or unable to provide early retirement benefits quickly because of problems of administrative capacity or lack of liquidity</td>
<td></td>
<td>• May have to comply with any collective bargaining agreements with trade unions on which processes to follow in the case of compulsory redundancy</td>
</tr>
<tr>
<td>• A substantial increase in pensioners might tip the pension plan into a financially unsustainable position</td>
<td></td>
<td>• Consultation and negotiation process can lead to long delays</td>
</tr>
<tr>
<td>• Government’s options may be limited by the terms of pension fund rules.</td>
<td></td>
<td>• Legislation may prevent the implementing agency from imposing a no-rehiring clause on compulsory retired workers, thereby opening a “revolving door”</td>
</tr>
<tr>
<td>• May need negotiation with pension fund trustees or the supervisory board, and so there is potential for delay in the PPI transaction</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
The early task for the implementing agency is to review the legal framework for dealing with labor issues (summarized in table 4.4), so that:

- Strategies and options can be designed within the legal framework.
- The need for any new legislation or amendments is recognized early.
- Labor issues can be appropriately sequenced with or incorporated into other legislation needed for the PPI arrangement.
- Legal issues do not delay PPI.

Any changes in labor laws need to be appropriately sequenced with wider legislative change in support of PPI. In Mexico’s rail privatization, for example, constitutional and legislative changes to permit private participation preceded guidelines on labor relations (box 4.10).

The legal review may suggest that labor laws and contracts need to be amended as in the following examples:

- The Algerian government enacted significant changes to its legislation on redundancy and severance in the mid-1990s. It implemented a package of severance pay plus a new unemployment insurance plan that spread the costs of redundancy over time. The legal requirement for union approval of layoffs was eliminated (Ruppert 1999).
- In Tanzania arrangements for the transfer of the labor force were included in new railway legislation that provided for overall sector restructuring, private participation, and establishment of an independent regulator for the sector.
- New laws to enable modernization and restructuring of the ports sectors, which included changes to the work force rights, were adopted in Brazil and Mexico.
- In Argentina, the PPI program was enacted entirely through presidential decrees, but a range of international standards, national laws, and collective bargaining agreements had to be amended for dealing with labor adjustment (box 4.11).

Laws and regulations relating to the continuity of workers’ rights and benefits will also require attention. The terms and conditions of employment in some PPI enterprises are relatively high compared with those in other private sector or public sector employment. Continuation of those terms and conditions can therefore be an important issue in the PPI process. Many privatization laws are silent on labor issues and workers’ rights, and effectively give freedom to the new owners to negotiate work force numbers as well as terms and conditions within the limits provided by the general labor code. Sometimes, however, workers’ rights are protected as part of the privatization legislation. For example:

- In Turkmenistan the privatization law ensures that transferred workers have the same rights as other workers to participate in employee ownership (box 4.12).
- In Malaysia new private owners are not allowed to modify the employees’ terms of service for a period of five years following privatization, including redundancy of the employee.
- Nepal’s Privatization Act (1994) provided for continuity of employment and of the terms of employment for workers transferred to the private sector. In practice this has been adopted in all privatizations in Nepal.
- In Tanzania new sector-specific legislation associated with the restructuring and concessioning of the railway provided for the transfer of staff and for their rights when the state corporation was restructured into a company. The article provides for:
  - Continuity of terms and conditions
  - Continuity of service period, which was deemed to be continuous from first employment in the corporation to end of service in the company.
  - Continuity of pension contributions in cases in which the pension plan was
### Table 4.4: Labor Issues Legal Framework

<table>
<thead>
<tr>
<th>Legal instrument</th>
<th>Features</th>
</tr>
</thead>
<tbody>
<tr>
<td>National constitution</td>
<td>• As well as providing the framework within which laws are made, changed, and interpreted, some national constitutions also contain specific provisions relevant to labor issues in PPI. For example, the South African Constitution guarantees the rights to form, join, and participate in labor unions and to collective bargaining.</td>
</tr>
<tr>
<td>Primary law</td>
<td>• In some cases PPI itself will require change to primary legislation; and other legislation might also cover the way in which PPI would be carried out, especially in relation to employment rights.</td>
</tr>
<tr>
<td></td>
<td>• Relevant laws can include not only those relating directly to employment, such as a labor code, but also those relating to public service provision and regulation, health and safety protection, and civil rights in such areas as nondiscrimination against women and minorities.</td>
</tr>
<tr>
<td></td>
<td>• In some jurisdictions, to a degree dependent on constitutional arrangements in the country concerned, laws and rules made at the subnational level by provincial authorities and even at the municipal level are as important as national laws.</td>
</tr>
<tr>
<td>Secondary laws, regulations</td>
<td>• In some cases governments have been able to develop PPI programs through decrees or other instruments of secondary legislation, normally (depending on the constitution) using powers provided under primary legislation, and these instruments can apply to labor issues.</td>
</tr>
<tr>
<td></td>
<td>• Regulatory arrangements—the powers handed by government to regulators whose independence might be safeguarded by law—can have direct and indirect effects on labor issues in PPI.</td>
</tr>
<tr>
<td>Commercial contracts</td>
<td>• Existing contracts with suppliers, intermediaries, or others might have implications for PPI plan employment and the structure of PPI bidding documents.</td>
</tr>
<tr>
<td></td>
<td>• Some contractual arrangements with workers, such as those enshrined in pension fund rules, can also have implications for labor and can either determine parameters within which change takes place or require revision.</td>
</tr>
<tr>
<td>Labor contracts and agreements</td>
<td>• The scope and legal status of labor agreements will vary in accordance with the statutory framework in which they exist. At the very least they are likely to cover the processes and consultative mechanisms by which agreements are renegotiated, should that be necessary.</td>
</tr>
<tr>
<td></td>
<td>• Some might be underpinned in a labor code, for example, whereas others might be based on general contract law.</td>
</tr>
<tr>
<td></td>
<td>• The precise form of legal instruments defining relations with labor and management vary—memoranda of understanding, collective bargaining agreements, and management agreements are among the forms—and each might require distinct procedures of review and revision.</td>
</tr>
<tr>
<td>International agreements</td>
<td>• Several ILO conventions and recommendations are relevant to PPI. Particularly noteworthy are those relating to the termination of employment (Convention 158), and the ILO’s “core labor standards” that now have the support of a wide consensus of international institutions and governments.</td>
</tr>
<tr>
<td></td>
<td>• In some sectors, such as airways, there are also international standards affecting terms of employment, so pilots, for example, do not work excessive numbers of hours that are incompatible with safety.</td>
</tr>
<tr>
<td></td>
<td>• International institutions and trade and investment agreements—such as those of the World Trade Organization, the European Union, and the North American Free Trade Agreement—also significantly affect the legal environment. There may be both direct impacts (where such agreements have social and labor clauses) and indirect impacts (where agreements on, say, procurement have implications for employment conditions and criteria in PPI bidding documents).</td>
</tr>
<tr>
<td>Informal instruments</td>
<td>• Government policy statements on labor, PPI, or privatization are relevant because government agencies will usually want to comply with those policies.</td>
</tr>
<tr>
<td></td>
<td>• Protocols and even “soft” legal instruments, such as codes of practice, can be significant. They require compliance or change and the procedures associated with them are typically underwritten in more formal legislation, meaning that due process is not just an ethical but potentially also a legal matter.</td>
</tr>
<tr>
<td></td>
<td>• “Custom and practice” or precedent can also have legal force because acquired rights can result and failure to observe precedent can be open to judicial challenge as being unfair or discriminatory.</td>
</tr>
<tr>
<td></td>
<td>• Informal instruments can operate at every level from the workplace to the international scene. An example of the latter is the Organisation for Economic Co-operation and Development’s guidelines for multinationals (OECD 2002).</td>
</tr>
</tbody>
</table>
transferred to the company from the corporation.

The legal assessment (see terms of reference for a legal review on the accompanying CD-ROM) should determine whether existing rights will be protected as an acquired right for a particular PPI arrangement. In some cases this may require legal interpretation. In civil-law countries the specific enterprise law, the labor code, the commercial code, and administrative law (government law) may have to be reviewed and a judgment may be required if there are inconsistencies among them. In common-law countries the circumstances in which such rules apply can evolve through case law. This has happened in the European Union, where litigation by unions established that...
acquired rights had to be transferred in the event of contracting out as well as mergers and acquisitions.

The CD-ROM that accompanies this Toolkit contains:

- Terms of reference
- Legal checklist
- Terms of reference for a review of labor laws as a basis for engaging a legal specialist or consultant to undertake the legal review
- A legal checklist and notes, which further elaborates on the range of laws, agreements, and conventions that may need to be checked.

### Employee Status Prior to PPI

During their preparation for PPI, infrastructure organizations are often subject to fundamental institutional changes that affect the status of employees, as described in table 4.5. A typical first change is when a departmental enterprise is transformed into a state-owned corporation, often through a specific act. Workers cease to be civil servants but remain public sector employees. Although there are usually greater freedoms than in the civil service, benefits and human resources policies often remain linked to those of the civil service and there is only limited delegation of employment policies to the corporation. Another change is the legal transformation (corporatization) of a statutory corporation to a joint stock company in which the government’s role changes to that of a shareholder and the company is governed by the laws regulating private companies. Although human resources policies still retain public sector characteristics, labor contracts and pay structures become more flexible, with greater autonomy at the enterprise level. The major change in PPI is the move from public to private ownership where workers cease to be public sector employees.

New Zealand rail is a good illustration of an infrastructure company in which the institutional organization has changed over time, paralleled by changes in employee status (box 4.13).

These changes are important for the PPI process. It will be clear to most parties that corporatization in particular is a possible preparation for private participation. Any changes in employee status, pay, benefits, and conditions that are agreed to as part of the broader institutional change while the enterprise is still publicly owned are likely to be preserved throughout the process to PPI. Trade unions are aware of this, and the implementing agency should be prepared to face tough negotiations and industrial action prior to PPI itself. Two examples from the telecommunications sector are summarized in box 4.14.

### Employment Protection in the Bidding Process

Two questions that frequently arise are whether to include employment conditions in PPI bids, and what types of conditions should be included.
Should the PPI bidding process include employment guarantees by the investor, and should the evaluation of the winning bidder take into account labor-related criteria, such as the bidder’s proposals for future work force restructuring?

The implementing agency can choose to set no employment criteria or conditions in the bidding documents, giving maximum flexibility to the private partner to manage labor issues. Alternatively, employment criteria or conditions can be included in the bidding process to protect employment and workers’ rights, as in the following examples:

- Including labor requirements as part of bid evaluation criteria, such as the number of employees to be retained. Investor selection will then be based, in part, on bidders’ response to those criteria.

- Imposing mandatory and specific labor conditions that must be complied with in the proposals submitted by all prospective bidders. Labor conditions may include obligations on:
  - Periods of guaranteed employment, where investors promise to maintain overall staffing at a certain minimum level for a defined period.
  - Implementation of redundancy programs. Normally these take the form of “no compulsory redundancies for x years.” For example, in Benin there was a standard “five-year no layoff” clause in privatization contracts (Campbell-White and Bhatia 1998). There are normally no restrictions on investors offering a program of voluntary departure.
  - The minimum severance benefits that workers can receive if there are compulsory redundancies or voluntary departures following PPI.
  - Continuity of terms and conditions of service, which require the investor to provide the same or better levels.
  - Workers’ right to participate in share ownership programs (module 5).

Bid conditions are usually more transparent than evaluation criteria. But although conditions and criteria are attractive from a political and social standpoint, the implementing agency often will recognize that they are not appropriate for the following reasons:

- Practicality and feasibility of enforcement: If government is unable to enforce bid conditions or investor compliance with promised approaches to labor management, conditions or criteria are ineffective tools. In Mozambique and Zambia, for example, labor guarantees at privatization were not kept (Campbell-White and Bhatia 1998).

### Table 4.5: Institutional Reorganization and Changes in Employee Status

<table>
<thead>
<tr>
<th>Type of PPI entity</th>
<th>Departmental enterprise</th>
<th>State-owned corporation</th>
<th>State-owned company (wholly owned)</th>
<th>Private company</th>
</tr>
</thead>
<tbody>
<tr>
<td>Relevant institutional legislation</td>
<td>Civil service regulations or civil service law</td>
<td>Act of parliament establishing statutory corporation</td>
<td>Joint stock company with 100 percent of shares owned by the state; subject to normal company laws and corporate code (including bankruptcy)</td>
<td>Joint stock company; subject to normal company laws and corporate code (including bankruptcy)</td>
</tr>
<tr>
<td>Employee status</td>
<td>Civil servant</td>
<td>Public sector employee</td>
<td>Public sector employee</td>
<td>Private employee</td>
</tr>
</tbody>
</table>

*Change of employee status and terms and conditions will require negotiation with trade unions and workers’ representatives.*
Suitability of employment guarantees: Employment guarantees work where surplus levels are modest and in high-growth sectors where excess labor can be absorbed through attrition and expansion. But they may not be a solution for public services or enterprises with severe overstaffing.

Impact on transparency of the bid selection process: The more complex the technical evaluation criteria, the greater the chance that the scoring is subjective and nontransparent. In Argentina, initial experiences with rail concessions led to dropping the labor criterion from the technical evaluation in later rounds (box 4.15).

Difficulty of comparing bids when bidders submit different labor treatment plans, as the United States wastewater example illustrates (box 4.15).

The following guidelines on the use of labor criteria and conditions in the bidding process help address the tradeoffs between political/social desirability and efficiency:

- Use labor conditions rather than labor criteria because conditions are more transparent, and allow like-for-like comparison of bids. Variant (alternative) proposals are still possible, which means that innovative proposals still may be captured.

- Set reasonable conditions so that they do not hinder flexibility. For example, provide transitional employment guarantees rather than longer-term ones, avoid prohibiting voluntary retirements, and specify condi-
tions that are likely to enhance value and performance, such as minimum annual investments in training.

- If setting labor criteria for bid evaluation, define the rules clearly—both to bidders and evaluators—to make the evaluation process as objective as possible and to avoid manipulation (for example, by counting part-time workers as full-time ones), and ensure transparency in publishing the results.

**STRATEGIES—A DECISION TREE**

Figure 4.3 provides a decision tree to help implementing agencies develop the overall strategy for labor restructuring and assess when and how labor restructuring should take place, taking into account circumstances at both the country and enterprise levels.

**Box 4.14: Telecommunications—Institutional Structures and Labor Adjustment**

**France Telecom—Preprivatization Institutional Changes**

Before 1991 France Telecom was a central government, autonomous, public law enterprise. In preparation for privatization, France Telecom had to be transformed to a joint stock company. The change of status from a civil servant of France Telecom to an employee under the general labor code regime and the fear of layoffs related to privatization became stumbling blocks to the privatization, resulting in strong opposition and a number of union strikes. The government had to enter into negotiation with the unions, and at each stage of the negotiation additional concessions were made, including guaranteeing the benefits of civil service status and a commitment that the company would remain 51 percent state owned.

**India Telecom—Labor Challenge to Corporatization**

In 1999 the departmental enterprise providing telecommunications services in India, the Department of Telecom Services (DTS), was prepared for corporatization. The corporatization of DTS was strongly and consistently opposed by the officers and workers of DTS (about 360,000 total). A nationwide strike took place in September 2000. The strike's impact was widespread: It received strong media coverage and drew support from other central government unions. It disrupted telecom services severely throughout India for nearly a week—all telephone lines, cellular, mobile, and Internet services countrywide, and all manually operated telephone and telegraph services were affected.

The strike was ended with the government having remained firm on the need for restructuring of the sector and the need to privatize. In October 2000 DTS was corporatized and converted to Bharat Sanchar Nigam Limited (BSNL), a new wholly state-owned company registered under the Companies Act.

However, several concessions had been made to unions and workers, the most important of which were:

- Maintenance of the staff's long-term pension benefits, which government guaranteed to meet from a consolidated central fund (although this funding mechanism was subsequently disputed)
- Maintenance of all terms and conditions and staff benefits
- Regularization of about 8,000 quasi-permanent and temporary staff, including providing them with pension benefits
- An immediate salary increase of 1,000 rupees per worker, plus recognition of improved pay scales and increments
- Free telephone connection for all employees, plus reduced call costs.

Sources: Guislain 1997; Adam Smith Institute, unpublished data.
Box 4.15: Experiences of Using Labor Factors in PPI Bidding

Argentina Rail

In the mid-1990s the government of Argentina restructured its railway into separate freight and passenger train networks, which were concessioned. The six freight concessions were issued first, and the bidding mechanism reflected both political compromises on employment and investment requirements. Bids for the freight networks were evaluated on the net present value (NPV) of the canon (annual concession fee) to be paid to the government, as well as on staffing levels, the quality of the business and investment plans, the proposed track access fee for intercity trains, and the share of Argentine interest in the consortium. The bidding process for freight concessions was perceived to be too complex and lacked transparency, however. The bid evaluation criteria were simplified in the subsequent issuing of passenger concessions. Those bidding documents defined the minimum services to be provided and a capital investment program, and bidding was based on the lowest level of government payment. Other criteria, including labor, were dropped.

United States—Municipal Wastewater Treatment

In 1996, intending to privatize its wastewater treatment service, the city of Buffalo, New York, invited proposals from three bidders and required them to set out what they would do with the existing labor force if they won the concession. Each company made a different offer. One stated that the company “is committed to employing existing staff and making significant investment in the greater advancement of each of its team members.” The company also undertook to extend the one-year no-layoffs pledge required by the city to five years, improving productivity instead through “our innovative approach to providing service level enhancements, and through ‘insourcing’ of minor capital improvements work, major corrective repairs and other services currently ‘outsourced’ by the board.” In addition the company proposed to implement an extensive training program on process control, maintenance, safety, warehousing, purchasing, and cost control measures. They made no promises, however, about union recognition, bargaining rights, or maintenance of pay levels.

A second bidder also proposed a comprehensive program of employee training and development and promised to maintain employment and terms of employment at then-current levels throughout the period of their five-year plan as a result of a planned extensive meter installation program. While promising to meet all the financial costs of these commitments, the company’s submission declared its assumption that all employees with more than 25 years of service, and therefore able to retire under the terms of the municipality’s pension arrangements, would be enabled to take early retirement.

The third submission anticipated retrenchments, stating that it would seek to eliminate “no layoff” language in existing labor contracts in the course of negotiating terms and conditions with the union, which it undertook to recognize as its workers’ bargaining agent. The company also said it would budget for a 3 percent pay increase, maintain medical payments for up to 18 months, provide training even for redundant employees, and offer other benefits.

In addition to the difficulties of comparing the bids, the city noted that the more commitments on employment made within the submission, the higher their proposed charge for the contract to the city, so that the city itself was faced with the cost of the tradeoff.

Sources: Thompson and Budin, 1997; documents provided by AFSCME, the U.S. public employees’ union.
Figure 4.3: Strategic Choices in Labor Adjustment—A Decision Tree

- Are policies and laws in place that enable labor restructuring?
  - Yes: Establish legislation or regulations on termination of employment as necessary, Renegotiate labor contracts
  - No: Establish and win support for new policies if necessary

- Are there consistent procedures in place for labor restructuring?
  - Yes: Develop and agree to harmonized procedures and institutional mechanisms for all PPI enterprises
  - No: Develop quick-win soft options

- Is there a need to restructure labor before PPI?
  - Yes: Government will finance and carry out initial labor restructuring, Determine timetable for labor adjustment within context of PPI, Determine extent of downsizing the government needs to do, Establish sources of funding
  - No: Use quick-win soft options
    - Eliminate ghosts
    - Make staff transfers
    - Freeze hiring
    - Develop plans for large-scale voluntary departure, early retirement, and compulsory redundancy
    - Develop redeployment and social safety net schemes

- Is rapid, large-scale downsizing needed?
  - Yes: Private sector is free to set terms of severance and staff numbers when the PPI transaction is concluded (within legal minimum)
  - No: Use a range of soft options
    - Take advantage of natural attrition
    - Enforce current rules
    - Eliminate ghosts
    - Make staff transfers
    - Freeze hiring
    - Encourage administrative leave
    - Develop early retirement and voluntary departure plans

- Is there a need to give special protection to workers?
  - Yes: State sets terms of severance post-PPI, or employment guarantees, which the private sector must adopt for a specified period after the PPI transaction is concluded
  - No: Private sector to finance and carry out labor restructuring

Political environment
- Extent of labor surplus
- Laws, regulations, collective agreements
- Are policies and laws in place that enable labor restructuring?
**Web Sites**


ILO ILOLEX: www.ilo.org/ilolex/english/index.htm. (Site provides access to ILO conventions.)

ILO NATLEX: www.ilo.org/dyn/natlex/natlex_browse.home. (Site provides access to 55,000 national laws on labor.)

World Bank “Shrinking Smartly”: www.worldbank.org/research/projects/downsize/. (Site is a clearinghouse for researchers, development practitioners, and government officials concerned about the difficulties encountered in downsizing a large public sector. Several papers on downsizing strategies are available for download.)

PPIAF: www.ppiaf.org. (Site features other PPIAF resources and tool kits.)


World Bank Social Protection: www1.worldbank.org/sp/. (This site provides access to the online version of the World Bank Core Labor Standards Toolkit, labor markets pages.)

**Other Material and Sources**


Washington, D.C. (This publication summarizes findings of a benchmarking study on best practices in downsizing in North American public and private sector institutions. See http://safetynet.doleta.gov/comon/downsize.pdf.)

**OECD Guidelines for Multinationals Enterprises: Global Instruments for Corporate Responsibility.** 2001 edition (see www.oecd.org). The OECD guidelines for multinational enterprises are recommendations on responsible business conduct addressed by governments to multinational enterprises operating in or from the countries that adhere to the Guidelines (the OECD members plus Argentina, Brazil, and Chile). The chapter on employment and industrial relations is one of the most detailed and comprehensive of the instrument, and deals with:

- Respect for core labor standards (freedom of association and collective bargaining, abolition of child and forced labor, nondiscrimination in employment and occupation)
- The preconditions for enabling effective negotiations and consultations between employers and employees and their representatives
- The provision of information to employees and their representatives
- The observation of adequate employment and industrial relations standards, particularly in the area of occupational safety and health
- Recruitment by enterprises of local personnel and provision of adequate levels of training to them
- Provision of reasonable notice to representatives of employees in cases of major changes in business operations
- Unfair influence on bona fide negotiations through transfers of operating units and/or employees to or from other countries
- The selection of management representatives endowed with the appropriate decisionmaking authority for collective negotiations.
Key Elements of a Labor Program

When the broad strategy and options for labor restructuring have been determined, the next step is to develop the main elements of the labor program. Specific approaches to restructuring are bound to vary among countries and enterprises, depending on local circumstances. But labor programs typically include four main components:

1. Severance payments
2. Pension payments
3. Retraining and redeployment support
4. Employee share ownership schemes.

Each of these components is discussed in depth in the following sections. At the end of each section is a list of the contents of the CD-ROM that accompanies this Toolkit, a list of pertinent Web sites, and a list of additional relevant materials and sources.

SEVERANCE

Severance payments are an important source of temporary income for surplus workers and they need to be designed and put in place early in the restructuring process. Because they are potentially costly for governments, it is important to design them well. This section of the module provides guidance on how to design severance plans, how to assess payment levels, and how to avoid some common implementation problems.

The design of severance packages must begin early in the labor program because it is a critical factor in the success of the program. An early start will provide time to assess all of the options. There is, however, no “cookbook” recipe or formula for determining severance payments.

Severance packages typically include some or all of the following components:

- **Statutory end-of-service payments**, the levels of which are set out in national or state legislation and over which there is no discretion (without legislative change)
- **Compensation for enterprise-level benefits**, which are payments to retrenched workers for benefits to which they are entitled according to the rules for each enterprise or as part of a formal collective bargaining agreement.

A severance package has a number of elements. Each element may be governed by different legislation, regulations, rules, or agreements.
• Ex gratia severance payments over and above statutory minimums, which form part of a voluntary departure agreement with workers.

**Statutory Payments**

Statutory termination payments are the minimum payments that any terminated worker must receive according to national or state legislation. These payments must be made whether employees leave through voluntary departure, early retirement terms, or compulsory redundancy.

The relevant laws and regulations vary among countries, but typically the main elements of statutory payments are:

• Notice period, or payments in lieu of notice
• Statutory termination benefits
• Gratuity benefits
• Pension benefits
• Earned leave
• Payment of salary or wages in arrears.

**Notice Payments**

National labor legislation often provides for a notice period prior to redundancy, typically ranging from one to three months and sometimes longer. In many cases there is the option to provide salary in lieu of the notice period. This enables managers to ask employees to leave the workplace immediately—an option with the following advantages:

• It avoids having retrenched employees working alongside their retained colleagues, which could lead to tension in the workplace.
• It enables managers to move quickly ahead with training and development for retained staff.
• It reduces the potential for theft, poor service, or sabotage by employees being let go.

**Statutory Termination Benefits**

Statutory termination benefits vary considerably among countries, as table 5.1 indicates. Benefits typically are based on a formula linked to years of service. Often workers must have completed a minimum period of 6 to 12 months of employment to be eligible for these benefits. The International Labour Organisation’s “Termination of Employment Digest” is an online resource that details national legislation and statutory severance payments and packages worldwide.

![The ILO Web site offers access to comparative data on statutory termination benefits: www.ilo.org.](www.ilo.org)

**Gratuities**

A gratuity is a benefit paid at termination of service to an employee reaching the date of superannuation or on retirement, resignation, death, or disablement. Some countries have primary legislation setting out the basis for statutory gratuity payments, in addition to other statutory termination benefits. In other cases enterprise-level rules may set the terms of gratuity or supplement the legislation.

**Pensions**

Pension entitlements are a substantial and important element of a worker’s severance package, and they are covered extensively later in this module.

**Earned Leave**

Some public sector or enterprise terms and conditions provide that termination benefits can include payment in lieu of earned (accrued) leave. For example, in Orissa, India, permanent employees are awarded “earned” leave at a rate of 15 days per year of service. If a worker takes no earned leave during the course 20 years of service, his or her earned leave could total 300 days ($15 \times 20$). At retirement any unused earned leave can be converted to cash, subject to a maximum amount of eight months of salary. In Orissa the payment of unused leave at the end of service is a nonstatutory pay-
## Table 5.1: Some Examples of Statutory Termination Benefits

<table>
<thead>
<tr>
<th>Economy</th>
<th>Notice period</th>
<th>Termination benefit</th>
<th>Other features</th>
<th>Information source</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cambodia</td>
<td>Sliding scale from 7 days (minimum) to 3 months for workers with more than 10 years of service</td>
<td>For workers with more than 1 year of service: 2 weeks' wages per year of service, up to a maximum of 6 months' wages</td>
<td>Workers on fixed-term contracts (rather than indefinite employment) are entitled to a severance payment as agreed in the labor contract, but not less than 5 percent of the total wages paid during the length of the contract</td>
<td>ILO 2000</td>
</tr>
<tr>
<td>China</td>
<td>30 days; notice is compulsory</td>
<td>Generally 1 month a year</td>
<td>Trade unions, workers, and labor administration must be consulted</td>
<td>ILO 2000</td>
</tr>
<tr>
<td>Estonia (1)</td>
<td>2 months</td>
<td>3 to 4 months of salary, depending on service period</td>
<td>No other liabilities on firms</td>
<td>Orazem and Vodopivec 1996</td>
</tr>
<tr>
<td>Estonia (2)</td>
<td></td>
<td>2 to 8 months of wages</td>
<td></td>
<td>Venesaar 1995</td>
</tr>
<tr>
<td>Hong Kong, China</td>
<td>As contract of employment, unless fewer than 7 days; a legal minimum of 1 month</td>
<td>After 2 years' service at capped rate per year of two-thirds of last salary or HK$22,500, whichever is lower</td>
<td>For collective dismissals there are no legislative requirements for notice, consultation, prior authorization from a judicial or administrative body, or any other restrictions in relation to proposed redundancies</td>
<td>ILO 2000</td>
</tr>
<tr>
<td>(Special Autonomous Region)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>India</td>
<td>1 month's notice</td>
<td>15 days’ wages per year of service, for workers with at least 1 year's service</td>
<td>Workers with more than 5 years of service also are entitled to gratuity payments</td>
<td>ILO 2000</td>
</tr>
<tr>
<td>Indonesia</td>
<td>Termination requires prior approval by the labor administration and consultation with trade unions</td>
<td>1 month per year up to a maximum of 5 years</td>
<td>General requirement to avoid redundancy wherever possible</td>
<td>ILO 2000</td>
</tr>
<tr>
<td>Kazakhstan</td>
<td>2 months</td>
<td>3 months of salary</td>
<td></td>
<td>Code of Laws on Labor of the Kazakh SSR (as amended to 1994)</td>
</tr>
<tr>
<td>Democratic Republic of Korea</td>
<td>30 days’ notice</td>
<td>Minimum of 30 days a year</td>
<td>Legal requirements to establish fair and rational standards for selection of redundant employees, and to consult with trade unions</td>
<td>ILO 2000</td>
</tr>
</tbody>
</table>

(Table continues on the following page.)
<table>
<thead>
<tr>
<th>Economy</th>
<th>Notice period</th>
<th>Termination benefit</th>
<th>Other features</th>
<th>Information source</th>
</tr>
</thead>
<tbody>
<tr>
<td>Malaysia</td>
<td>4 to 8 weeks, depending on length of service</td>
<td>4 weeks for 10 days for the first year, 15 days for 2 to 5 years, and 30 days per year for periods in excess of 5 years</td>
<td>Last-in/first-out selection has been imposed by courts</td>
<td>ILO 2000</td>
</tr>
<tr>
<td>Nepal</td>
<td>1 month</td>
<td>30 days per year of service, plus gratuity and other statutory benefits</td>
<td>Last-in/first-out, plus: • Non-Nepali nationals must be retrenched first, even if they have not been employed last • Workers and employees who are absent for a long period as a result of poor health must be retrenched first</td>
<td>Labor Act 1992</td>
</tr>
<tr>
<td>The Philippines</td>
<td>Approval to terminate is required</td>
<td>1 month a year if dismissed as a result of new technology; 1.5 months if dismissed as a result of enterprise closure or attempts to reduce losses</td>
<td></td>
<td>ILO 2000</td>
</tr>
<tr>
<td>Singapore</td>
<td>As employment contract, otherwise statutory minima of 1–4 weeks</td>
<td>None but that determined under collective agreements</td>
<td></td>
<td>ILO 2000</td>
</tr>
<tr>
<td>Slovenia</td>
<td>6 months (24 months prior to 1991)</td>
<td>1 month’s salary per year of service</td>
<td>Firms are responsible for taking steps to retrain or reassign workers</td>
<td>Orazem and Vodopivec 1996</td>
</tr>
<tr>
<td>Sri Lanka</td>
<td>1 month, but must report to commissioner</td>
<td>Labor commissioner determines entitlements but her guidance on criteria given to employers is to pay 2 to 3 months’ salary per year of service or full salary for the remaining period up to retirement, whichever is less, subject to a maximum of 50 months’ salary</td>
<td>Labor commissioner has absolute discretion to approve applications for redundancy</td>
<td>ILO 2000</td>
</tr>
</tbody>
</table>
### Table 5.1 (continued)

<table>
<thead>
<tr>
<th>Economy</th>
<th>Notice period</th>
<th>Termination benefit</th>
<th>Other features</th>
<th>Information source</th>
</tr>
</thead>
<tbody>
<tr>
<td>Taiwan, China</td>
<td>1 month</td>
<td>2 months’ salary for the first 15 years of service, 1 month of salary for the remaining years; maximum of 45 months’ salary</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>1 month’s current salary for each year or fraction worked, up to a maximum of 6 months’ salary</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Uruguay</td>
<td>Up to 3 months, depending on seniority</td>
<td>1 month of “normal salary” for each year of service; this is doubled, however, if the employee is terminated without just cause. In addition, the employee receives any undistributed, accumulated interest in his or her severance indemnity account.</td>
<td>“Normal” salary for severance is defined as basic salary plus all fixed regular payments and allowances and any profit-sharing payments, all brought to a monthly basis</td>
<td><a href="http://www.embassy.org/uruguay">www.embassy.org/uruguay</a></td>
</tr>
<tr>
<td>República Bolivariana de Venezuela</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Vietnam</td>
<td>45 days for workers with an indefinite employment contract</td>
<td></td>
<td>Generally, one-half of a month’s salary per year of service as severance allowance, plus 1 months’ salary per year of service as loss of employment allowance</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>ILO 2000</td>
</tr>
</tbody>
</table>

Arrears of Salary and Benefits

There is usually no legal or ethical disagreement that displaced workers should receive any salary or other benefits that are due them. Those arrears, however, can be substantial if financial problems have led enterprises to defer payments for some months or years. Arrears may comprise:

- Unpaid salaries
- Unpaid salary increases, cost-of-living adjustments, or scale revisions
- Unpaid allowances or allowance increases
- Unpaid pension fund contributions (both
employees’ and employers’ contributions).

Arrears can present practical challenges for the agency that is implementing the privatization of the infrastructure sector, among them:

- **Identification of the level of arrears:** Implementing agencies may be unaware of or may underestimate the extent of arrears. Enterprise managers also might have underestimated, hidden, or not reported the scale of the arrears problem. If large arrears come as a surprise late in the restructuring process, there may be a problem in finding funds to meet them at short notice.

- **Additional time delays:** Resolving the problem of how to finance unexpected arrears can take the time and attention of the implementing agency. Disputes with unions can easily arise over arrears. Calculating net arrears can also introduce further complexity and delay. For example, one bus company allowed its staff to keep a portion of passenger receipts in lieu of wages, and the register of these “informal” salaries needed to be reconciled before arrears could be finalized.

Arrears are a particular worry for ministries of finance and for donors. Rescuing enterprise managers from the problem of arrears may cause greater arrears problems in the future because (a) the rescue signals that government has taken a soft approach to the budgets of SOEs, and (b) if enterprise managers believe that the overstaffing problem ultimately will be dealt with through a generous government severance program (at the time of privatization or before), they have little incentive to tackle overstaffing and to make the hard labor adjustment decisions that are needed on a day-to-day basis.

Statutory payments, together with contractual benefits (described below), can represent a substantial proportion of the overall payments to workers in both middle- and low-income countries. For example, in the privatization program in Taiwan, China, the total severance package for a typical middle-ranked employee with 15 years of service is proportioned as follows: statutory payments (70 percent), compensation for cessation of pension (14 percent), and ex gratia severance (16 percent) (Chang 2002, pp.11–15). In Brazil, federal rail employees who took voluntary departure terms received an average of about US$8,000 in ex gratia severance and US$10,000 in legal entitlements. In India, too, workers in Orissa who accepted the government’s voluntary retirement scheme (VRS) received a significant proportion of benefits from statutory and contractual benefits—particularly workers with fewer years of service (figure 5.1).

Statutory termination benefits are usually paid from the current resources of the enterprise. Employers simply make the payment out of current operating expenses when workers reach a specified age or leave the enterprise. Generally there is no method of accounting for these liabilities, even though they can represent a substantial future commitment of an enterprise’s resources. Consequently, severance programs can represent one of the most difficult problems in a PPI transaction, because they are legally enforceable obligations that can have dramatic cash flow and solvency consequences during labor restructuring.

In Latin America, however, some countries require workers to contribute to an individual account into which some percentage of their salary is paid on a regular basis. In the event of separation—voluntary or compulsory—workers can withdraw monies from these accounts. Any surplus at retire-

![Figure 5.1: End-of-Service Benefits in Orissa, India](source: Adam Smith Institute, unpublished data, 2000.)
ment can be used toward the worker's pension provision. This approach is effectively a severance program funded through forced savings by workers themselves, and similar in some ways to the provident funds described in the pensions section of this module. Brazil has had a program of this type for more than three decades, where displaced workers can use their individual FGTS (Fundo Garantia por Tempo de Servicio) accounts. In the 1990s Colombia replaced its severance pay program with fully funded accounts of this type (de Ferranti and others 2000).

Contractual Benefits

Many enterprises provide a range of benefits, including medical, transportation, housing, food, and other allowances. These benefits are often set out in the administrative rules or regulations for each public enterprise or in collective agreements or labor contracts. The implementing agency will risk industrial unrest and legal challenges on breach of contract grounds if agreed benefits are not provided. Unlike statutory payments, however, the implementing agency does, in theory, have the option to negotiate these payments.

At separation, workers will usually have to be compensated for these contractual benefits as part of the overall severance package through one of two mechanisms:

1. Estimation of the value of each benefit for each worker
2. Conversion of allowances into a single nominal salary (as described in the case of Mexico railways [box 5.1]), which is then adopted as the worker's deemed salary in a severance formula.

In Nepal public enterprises set their own rules and regulations for treating such nonsalary benefits as medical coverage, housing, loans, and food allowances at termination. These allowances have varied greatly, and the government found that it had to engage accountants and consulting firms to undertake detailed assessments for each enterprise in order to estimate the costs of labor adjustment for its public enterprises. In Uganda the rules on termination payments vary among enterprises. Some include standard allowances received with pay as a basis for calculating terminal benefits; others do not include these allowances but do provide formulas that compensate for them (Campbell-White and Bhatia 1998).

Box 5.1: Mexican Railways—The Daily Integrated Salary

At the Mexican National Railroad Company (Ferrocarriles Nacionales de México, FNM), salary for the purposes of the severance scheme was identified as the “daily integrated salary.” It was calculated by adding the monthly amount of the base salary to the amounts of a wide range of enterprise benefits and dividing by 30 days of the month. Here is a list of the potential factors in that equation:

- Base salary
- Savings fund (monthly equivalent)
- Christmas bonus (monthly equivalent)
- Payment for vacations
- Special bonus for housing rental
- Special bonus for transportation
- Payment for basic bundle of goods
- Payment for educational support of children

- Incentive payment for attendance and punctuality
- Incentive payment for productivity
- Incentive payment for training
- Tenure bonus
- Performance bonus
- Support for automobile fuel

This formula was used to calculate the salary that applied both for workers eligible for an enhanced early retirement plan (with different retirement ages for men and women), and for those workers who were not eligible for retirement but offered instead a severance plan. Depending on their daily integrated salary, age, tenure, and gender, workers received, on average, between US$10,000 and US$25,000 as a severance payment (based on the average exchange rate in 2000).

Contractual benefits can be complex. The labor contract for workers in the Mexican national railway (Ferrocarriles Nacionales de México [FNM]) contained more than 3,000 clauses. In such cases renegotiation and simplification of the labor contract and payment rules are effectively essential prior actions to privatization and may include simplification of the rules on compensation for the loss of benefits for redundant workers. In Mexico a temporary contract was agreed to during the restructuring process for FNM—one that simplified the contract to 211 clauses. Following the private investment in infrastructure (PPI), the new railway operators negotiated separate labor contracts (López-Calva 2001).

Housing is often an important benefit that needs separate treatment. Two issues must be addressed in this regard:

- **The immediate treatment of displaced workers living in enterprise-provided housing:** The usual arrangement is to allow workers to continue to live in the housing for a specified period after termination, sometimes with reduced rents. For example, Tanzania Telecommunications Corporation Ltd. allowed workers a six-month rent-free period in which to find alternative accommodations. Brazil's railway, RFFSA, allowed separated workers to stay in their housing for one year.

- **The disposal of housing that is no longer needed:** Options include sale of the houses, with employees possibly offered the right of first refusal or a discount on the market sale price; transfer of houses to local or municipal governments (a practice that has been common in transition economies); and transfer of houses to a government property agency that continues to collect rent and manages the disposal of the government’s property portfolio in a structured way designed to maximize revenues.

Allowances for travel to home may be part of the normal statutory, enterprise, or contractual benefits or may be provided as a special ex gratia end-of-service benefit for workers. Either (capped) reimbursable costs or, more commonly, a defined allowance is paid toward the costs of transportation to a designated home location for the employee and his or her family and for the transfer of household furniture and possessions. The designated home location is often the location recorded in the employee’s service record at the date of joining the PPI enterprise. These allowances are most relevant where there are traditions of migration to work or where ethnic group or family links to the home area are important.

### Ex Gratia Severance Payments

Ex gratia severance payments are often provided as part of the overall severance package. Particularly in countries where the need to reward or placate labor is strong and social safety nets are lacking, as well as in countries where labor legislation prohibits outright layoffs, governments have resorted to promoting voluntary departures by offering severance payments that exceed legally mandated requirements.

### Developing Severance Formulas

Worldwide, in both private firms and in government, the most common approach for defining severance payments is a formula based on a multiple of years of service and salary. Such formulas are easy for managers to use and are widespread in both the public and private sectors. Table 5.2 describes some advantages and disadvantages of the standard formula.

The formula for severance payments has varied widely among countries and, within countries, among enterprises in different sectors, depending on legal and contractual obligations and the strength of labor unions. Examples of formulas used and the resulting payments in a range of infrastructure enterprises in developing countries are presented in Table 5.3.
### Table 5.2: Advantages and Disadvantages of Standard Severance Formulas

<table>
<thead>
<tr>
<th>Advantages</th>
<th>Disadvantages</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Relatively simple to understand, communicate, and implement</td>
<td>• Can be imported easily. Managers in a hurry may sometimes simply copy formulas from another country or enterprise.</td>
</tr>
<tr>
<td>• Attractive to unions because they can negotiate a formula for a class of workers</td>
<td>• Can substitute for analysis of actual needs</td>
</tr>
<tr>
<td>• Attractive to government because it can set a single formula as part of a uniform approach</td>
<td></td>
</tr>
</tbody>
</table>

### Table 5.3: Examples of Severance Formulas and Payments

<table>
<thead>
<tr>
<th>Economy/enterprise</th>
<th>Key features of voluntary departure</th>
<th>Other features</th>
<th>Source for further details</th>
</tr>
</thead>
<tbody>
<tr>
<td>Argentina:</td>
<td></td>
<td>Workers who left under voluntary retirement received approximately US$10,000 in severance</td>
<td>Shaikh 1996</td>
</tr>
<tr>
<td>Buenos Aires</td>
<td></td>
<td>In 1992 workers received approximately US$10,000 in severance.</td>
<td>Shaikh 1996</td>
</tr>
<tr>
<td>Water and Sewerage</td>
<td></td>
<td>Approximate cost in 1990 of US$10,000 per worker</td>
<td>Ramamurti 1997</td>
</tr>
<tr>
<td>Argentina</td>
<td></td>
<td>The amount offered was the same as statutory payments; Bolivian capitalization program had made a policy decision to implement a uniform scheme for all enterprises; no incentive for workers who voluntarily retired</td>
<td>Valdez 2002</td>
</tr>
<tr>
<td>Electricity</td>
<td>Post-PPI voluntary retirement undertaken by the concessionaire</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Argentina Rail</td>
<td>1 month per year of service, with no cap</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Bolivia Rail</td>
<td>3 monthly wages plus an equivalent of 1 wage per year of work for those with more than 5 years of service, plus statutory unemployment benefits</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Brazil:</td>
<td>Workers with 4 to 10 years of service, 1 month’s salary per year of service; workers with 10 to 20 years of service, 2 months’ salary; and workers with up to 25 years of service, 2.5 months’ salaries; workers also receive 180 percent of the accumulated funds in their FGTS accounts (a compulsory employee severance indemnity fund, to which all employees in Brazil contribute 8 percent of their basic salaries each month)</td>
<td>Those who left voluntarily gained a cash bonus of 33 percent of monthly salary per year of service; average total package received per worker was estimated at R$29,870</td>
<td>Carneiro and Gill 1997</td>
</tr>
<tr>
<td>São Paulo Railway</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Brazil:</td>
<td>60 percent of a month’s salary per year of service, but capped at 15 months’ salary; additional incentive for workers near retirement age is</td>
<td>Average package per worker was R$41,900</td>
<td>Carneiro and Gill 1997</td>
</tr>
<tr>
<td>Rio Grande do Sul</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Electricity Company</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

(Table continues on the following page.)
### Table 5.3 (continued)

<table>
<thead>
<tr>
<th>Economy/enterprise</th>
<th>Key features of voluntary departure</th>
<th>Other features</th>
<th>Source for further details</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Brazil:</strong> São Paulo Electricity Company</td>
<td>10 percent of all remaining wages up to the date of retirement; workers also receive 140 percent of the funds in their FGTS accounts 50 percent of a month’s salary per year of service for those with less than 10 years’ service; 40 percent if more than 10 years of service; no cap; workers also receive 140 percent of the funds in their FGTS accounts</td>
<td>Only workers with more than 6 years of service were eligible; workers were allowed to keep their use of housing for up to 12 months and pension payments were continued for 12 months; average payment to workers was about US$8,000, plus US$18,000 of statutory benefits</td>
<td>Carneiro and Gill 1997</td>
</tr>
<tr>
<td>Brazil Federal Railway</td>
<td>4 to 12 months of salary, depending on years of service, increasing for workers with 6 to 25 years of service and decreasing for older workers with more than 25 years of service; workers who delayed accepting voluntary departure and were made redundant during the period 1 year after privatization received 80 percent of these benefits</td>
<td></td>
<td>Estache, Schmitt de Azevedo, and Sydnes-stricker 2000</td>
</tr>
<tr>
<td>Guyana Telephone and Telegraph Company</td>
<td>Severance package equivalent to 22 months of salary</td>
<td></td>
<td>Hinds 1995</td>
</tr>
<tr>
<td>India: Federal VRS Scheme (1993–95)</td>
<td>1.5 months of salary per year of service, or 15 days’ salary for each year until retirement at age 58, whichever is less, plus statutory benefits</td>
<td>Three times better than statutory termination benefits of 15 days’ salary per year of service</td>
<td>Kouamé 1997</td>
</tr>
<tr>
<td>India: Orissa State Electricity Board</td>
<td>1.5 months’ salary for each year of service, or 30 days’ salary for each year until normal retirement date, whichever is less, plus statutory benefits</td>
<td></td>
<td>Ray 2001</td>
</tr>
<tr>
<td>Mexico Federal Railway (FNM)</td>
<td>4 months of salary plus 30 days for each year of service; part-time workers receive 3 months of salary plus 20 days of salary for each year of service</td>
<td>Salary was a daily integrated salary, which included base salary plus 12 other allowance elements; workers typically received between US$10,000 and US$25,000 in severance. An enhanced pension package was also provided, funded in part from privatization proceeds.</td>
<td>López-Calva 2001</td>
</tr>
<tr>
<td>Pakistan: Kot Addu Power Plant</td>
<td>Based on plan for industrial plant privatization in Pakistan; voluntary departure package of 4 months’ basic salary per year of service, plus gratuity of 1 month’s basic</td>
<td>Evidence of adverse selection (the most productive workers leaving). Average costs in 1990–93 were about US$3,000, but costs</td>
<td></td>
</tr>
</tbody>
</table>
Table 5.3 (continued)

<table>
<thead>
<tr>
<th>Economy/enterprise</th>
<th>Key features of voluntary departure</th>
<th>Other features</th>
<th>Source for further details</th>
</tr>
</thead>
<tbody>
<tr>
<td>The Philippines: Manilla Waterworks and Sewerage System</td>
<td>Salary per year of service (the “4+1” rule); officer cadre staff had a less-generous package of 2 months’ salary per year of service plus gratuity (the “2+1 rule”). Severance package based on years of service, using an “adjusted monthly pay” to take into account various allowances (this was around 30 percent higher than basic pay); workers with less than 20 years’ service receive 1.5 months per year of service; those with 20 to 30 years of service receive 2 months’ salary; and those with more than 30 years of service receive 2.5 months of salary.</td>
<td>At some industrial plants rose to US$10,000 after 1993</td>
<td>Kouamé 1997</td>
</tr>
<tr>
<td>Taiwan, China (Privatization Law)</td>
<td>Severance payment of 6 months of salary in addition to statutory payments.</td>
<td>Typical package for worker with 20 years of service totaled about US$15,400, roughly twice the standard government package of termination benefits</td>
<td>Cruz 2001</td>
</tr>
<tr>
<td>Vietnam (Decree 41/2002 on policy for redundant workers in SOEs)</td>
<td>Severance pay of 1 month per year of service (minimum 2 months); additional compensation of 1 month per year of service; lump sum of VND 5 million; continued salary for 6 months searching for job.</td>
<td>Applicable to all employees retrenched at privatization or laid off within 5 years after privatization</td>
<td>Government of Vietnam 2002</td>
</tr>
</tbody>
</table>

In some cases an established uniform formula may already be in place, in which case the key decisions already will have been made. Where the formula is not considered sufficient or where there is no formula in place, a new formula may have to be developed.

At the absolute lower limit, workers must receive the statutory minimum set out in the law. In practice, however, earlier precedents might set a de facto floor for negotiations. The absolute upper limit would be to place a worker on permanent administrative leave with full salary. Although that practice is uncommon, more often the practical upper limit is again that set by previously agreed precedents, even if those precedents are in different sectors and under different circumstances.

Spreadsheet tool for analysis of severance options.

In setting a level of severance for voluntary departure programs, the attractiveness of the package to workers has to be balanced with its affordability for the government. If the payment is too low, workers may not volunteer to leave, and that can threaten or delay the overall objective—a successfully completed PPI transaction. Low levels of severance are sometimes combined with a degree of coercion (for example, threats of compulsory redundancy, unit closure, or wage arrears). Such coercion will engender adversarial relationships.
with workers, unions, and government, and can damage the political credibility of PPI. If the payment is too high—that is, more than workers would actually need as sufficient compensation for the loss of employment—the government may not be able to pay it, and it may lead to excessive numbers of workers leaving the enterprise, including the best workers.

In practice, developing severance formulas is more likely to produce overpayment than underpayment for several reasons:

- **Political impact:** Except in the face of serious financial crisis, relatively generous severance payments are politically attractive.

- **High levels of compensation:** Salaries and benefits are often higher in the public sector than in the private sector (for example, see Bales and Rama 2002, Bhorat and Liou 2002, Panizza 1999, and box 1.1 in module 1 of this volume). Where program designers recognize a public sector wage premium they can reason that relatively generous severance awards are necessary if workers are to leave voluntarily.

- **Bias by plan designers in favor of generous packages:** This bias can occur for two reasons. First, designers may become too close to the concerns of workers or to the concerns of enterprise managers (for example, how to make downsizing go as smoothly as possible), and align themselves—perhaps unconsciously—with those interests rather than the interests of either public finance managers or society as a whole. Second, by erring on the side of generosity, plan designers can help ensure that the program is a “success”—an example of self-serving bias in their decisionmaking.

- **Availability of donor funds:** Although recurrent expenditures, including salaries, may be tightly controlled (subject to a hard budget constraint), donor funds for enterprise restructuring may be readily available. That combination of circumstances can encourage overpayment.

- **Ability to transfer costs to the taxpayer:** Governments can agree to generous terms (which makes difficult negotiations with unions easier) and then transfer the cost of that generosity to future taxpayers, as in Sri Lanka (Salih 2000).

- **Use of precedents:** Where other organizations have made generous payments (for any of the reasons outlined above), plan designers are likely to make the same mistake, either by meeting previous precedents or simply copying the earlier formula in the name of uniformity.

Where generous and unaffordable precedents have been set, choices must be made between using those precedents or negotiating new severance formulas. The choice will depend on the degree of political support for implementation, the costs imposed by the precedents, and the degree of concern for provision of a social safety net for displaced workers. A cost-benefit analysis of the financial and economic effects of the various options (see module 7) can inform this decision.

In designing severance levels there are various ways to achieve a balance between attractiveness and affordability, and those ways are discussed next.

### Setting Minimum and Maximum Levels
A minimum severance level, or a floor, can be set at some point above the statutory minimum termination benefit. A floor can be a useful tool for demonstrating that the severance package is fair and benefits everyone, including lower-paid staff.

A maximum severance payment, or a cap, also can be set. One of the main potential criticisms of severance plans, especially generous ones, is that highest-paid workers or managers can obtain exceptionally high payments. A cap is a simple measure to prevent such criticism, and can be expressed in absolute money terms or in months of pay. For example, the government of Madhya Pradesh VRS-98 placed a monetary cap of Rs. (rupees) 500,000 on payments to workers.

### Establishing Preretirement Rules
On its own, a simple straight-line formula (salary ×
years of service) would give maximum payments to the oldest workers in each cadre of employees. Just before retirement they would have the maximum payment. This is clearly a potential source of influence in employees’ behavior: it encourages employees to stay on so that they receive higher compensation amounts, and it discourages earlier voluntary departure. Some empirical formulas attempt to offset this by including an element that reduces payments as the retirement age approaches (see, for example, box 5.2).

Another approach to the preretirement period is to make workers who are past a specified age and within a few years of normal retirement ineligible for voluntary departure. This can improve efficiency because workers approaching retirement clearly have the least expectation of loss. If, however, there is a sharp cutoff, again distortionary effects can arise. For example, if a plan is introduced in which workers with fewer than five years until retirement are ineligible for voluntary departure, there will be a very high uptake of the option to leave by workers approaching cutoff point as well as a degree of dissatisfaction and inequity for workers who for timing reasons just miss the newly introduced benefits.

Adopting Loss-Based Formulas
An alternative approach to the standard way of setting severance amounts, based on labor economics and econometric methods, has been pilot-tested by the World Bank in Guinea-Bissau, Madagascar, and Tanzania, and has been described by Chong and Rama (2000). This approach (which is discussed in greater detail in module 7) recognizes that workers’ total incomes often will fall following separation or retrenchment (box 5.3), and it attempts to assess the level of severance that should be paid to offset those earnings losses. The following bullet points summarize the key features of this approach:

Chong and Rama (2000) described the application of a loss-based approach in Guinea-Bissau.

- Although the output from this approach to designing a severance package is a formula, it is one that takes account of the factors that influence individuals’ likelihood of gaining income after severance. For example, if better-educated workers are more likely to return to higher-paid employment after separation, the formula will reduce their severance payment. If women workers are more likely to have difficulty in finding a job, the formula will increase their severance payment.

- The formula uses objective data, such as national household survey data, surveys of living standards, or labor force surveys, to generate an econometric earnings function for private sector workers. By comparing incomes and benefits of similar workers in the formal (or informal) labor market, estimates of the likely earnings losses can be made.

- The losses recognized include earnings lost while a worker searches for another job; permanent loss of earnings that arises because a worker transfers to the private sector (remember, many public sector workers earn a premium wage); estimated losses of tangible benefits (for example, transportation to work, food and housing subsidies, and medical benefits); and estimated losses of intangible benefits (for example, job security, flexible working times, oppor-
tunity for bribes, access to equipment, and facilities for private use).

Table 5.4 summarizes the advantages and disadvantages of loss-based formulas. They can deliver the fairest levels of severance payment for individuals. Furthermore, by careful targeting they can reduce the costs of the severance program for government and avoid adverse selection. Estimates of the level of costs savings realized from tailored formula compared with savings realized from an empirical formula are 31 percent for SOEs in Egypt (Assaad 1999) and around 20 percent in the case of the Central Bank of Ecuador (Rama and MacIssac 1996, 1999).

But there also can be some difficulties in adopting a loss-based approach:

- Loss-based formulas are likely to be less relevant where there are existing and well-established precedents for severance formulas. Any change is likely to require substantial effort and to involve negotiations with unions, approval by ministers, and parliamentary debate.

- Delays incurred as a result of designing and negotiating complex severance formulas might threaten the pace of the overall PPI program. A delay in implementation while a new approach and formula are being developed and negotiated could also wipe out any potential cost savings from adopting this approach.

- Data requirements are substantial and the process can be time consuming if enterprise personnel records are poor or if there is little information on nonwage benefits or on the likely postseverance livelihoods and incomes of workers.

Like other severance formulas, loss-based formulas will need to be understood by unions and workers and be discussed during the consultation process:

If appropriate compensation is needed to make the workers accept the prospect of downsizing, it is very likely that the package will have to be negotiated with the public sector trade unions. In that case the final compensation package may not be the cheapest one, or the fairest one, but rather a compromise shaped by the bargaining power of all the players involved. From this perspective the [loss-based approach] should not be seen as an example of “mindless social engineering,” but rather as a tool to introduce some economic rationality into delicate political negotiations. While the approach

Box 5.3: Earnings Losses after Retrenchment

There are no tracer studies of the long-term impact of retrenchment on workers in developing countries. In industrial countries, however, the evidence is that earnings losses have been both large and persistent. Reviews by Fallick (1996) and Kletzer (1998) on displaced workers in North America indicate persistent earnings losses of between 10 and 25 percent of predisplacement earnings up to 10 years after displacement.

In Turkey earnings after reemployment among petrochemical and cement workers displaced during privatization were 57 percent and 61 percent, respectively, of their earnings prior to layoff. Most workers also lost a range of nonwage benefits (Tansel 1996).

In Ghana follow-up assessments of the earnings of civil servants showed a 48 percent fall after severance, although workers who found wage employment had a much smaller reduction in income. Note, however, that although:

under current economic conditions, many retrenched workers can expect their lifetime earning stream to be appreciably lower... we are persuaded that the difference in earnings before and after redeployment reflects the loss of a rent associated with civil service employment.... What the employees have lost, then, is a privileged post that, one can argue, they should not have held in the first place. Their gain in getting a civil service job was the Ghanaian taxpayer’s loss, and vice-versa for the post-redeployment loss in earnings (Alderman, Canagarajah, and Younger 1996, p. 285).
could certainly be refined, it represents an improvement compared to the ad hoc way in which these negotiations are usually carried out (Chong and Rama 2000, p. 26).

Whatever approach is selected, severance payments in early retirement, voluntary departure, and compulsory redundancy schemes can be structured to provide time-based incentives for workers to leave early.

More generous packages for voluntary departure than for compulsory redundancy are the norm. During Brazil’s railway reforms, workers were clearly informed that any compulsory retirees would receive only 80 percent of the package given to those who took voluntarily departure benefits (Estache, Schmitt de Azevedo, and Sydenstricker 2000). In Turkey the privatization law offered 30 percent more to employees who volunteered for early retirement (Tansel 1996). Early applicant bonuses can be offered. In the 1992 British Telecommunications downsizing plan, early applicants received an incentive payment.

Table 5.4: Advantages and Disadvantages of Loss-Based Formulas

<table>
<thead>
<tr>
<th>Advantages over empirical formulas</th>
<th>Disadvantages over empirical formulas</th>
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<tr>
<td>• Tailors the package to compensate individual employees so that the compensation that each employee receives is more fair—those who stand to lose most will receive the most</td>
<td>• Is subject to legislation or existing labor contracts that may preclude different (discriminative) treatment of workers according to factors such as age, gender, ethnicity, and location</td>
</tr>
<tr>
<td>• Reduces the risk of overpayment, which has plagued severance programs worldwide</td>
<td>• Potentially adds time to the work force restructuring process because of the need to locate specialist skills, conduct econometric analyses, and persuade policymakers and unions</td>
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<tr>
<td></td>
<td>• Has not yet been implemented beyond pilot (proposed) plans</td>
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<td></td>
<td>• Has a formula whose derivation is difficult to explain to policymakers and unions when seeking their support</td>
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Choosing a Uniform or a Case-by-Case Approach

For government the decision whether to negotiate severance on a case-by-case basis for each enterprise or to adopt a uniform severance plan for all public enterprises is a critical preliminary decision. Table 5.5 presents the advantages and disadvantages of each approach.

A case-by-case approach to severance, where payments are negotiated at the enterprise level, has arisen when there is a cautious, incremental approach to PPI and when, in the absence of any overall labor policy or guidelines, labor restructuring is dealt with at the transaction level. In some cases enterprises are also governed by their own labor rules or labor contracts, thus leading to a case-by-case approach. In others, a case-by-case approach has been adopted to ensure flexibility based on the individual circumstances of the company. Some governments, for example, have treated profitable and unprofitable enterprises differently, allowing profitable ones to pay higher levels of severance out of their own resources. That was the case in India and also in Tanzania when the government opted to concession port services and container terminal operation (box 5.4).

Although a case-by-case approach can provide flexibility, it can also create unwanted precedents. Each new award raises the minimum severance level for the next negotiations, and there is a ratchet effect that ensures increasing levels of severance. Such approaches can also fuel distrust in the process and bring the wider PPI program into disrepute, thereby threatening its sustainability.
Moreover, trade unions often oppose differentiation between enterprises on the grounds that (a) there should be equality of treatment for all workers in SOEs and (b) the financial distress of loss-making enterprises can be attributed to government mismanagement and therefore it is unfair to penalize employees.

Given the potential problems of a case-by-case approach, there are advantages to adopting uniform severance guidelines that, with some measure of flexibility to take into account enterprise circumstances, are applied to all enterprises (table 5.5).

### Table 5.5: Advantages and Disadvantages of Uniform and Case-by-Case Approaches to Severance

<table>
<thead>
<tr>
<th>Approach</th>
<th>Advantages</th>
<th>Disadvantages</th>
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<tr>
<td>Uniform</td>
<td>• Treats all workers more equally&lt;br&gt;• Has a more transparent process&lt;br&gt; • Reduces information asymmetry between government and unions—both know what the deal is&lt;br&gt;• Has predictable costs for severance in future years&lt;br&gt; • Facilitates central (ministry of finance) oversight and control over public spending on severance</td>
<td>• Needs good analysis of long-term downstream costs to avoid danger of government initially setting too-generous limits overall (especially if the first programs are small PPI transactions with low numbers of affected workers)&lt;br&gt;• Prohibits introduction of loss-based formulas tailored to each enterprise</td>
</tr>
<tr>
<td>Case-by-case</td>
<td>• Gives most discretion to government in setting severance payments in each enterprise&lt;br&gt; • Allows the tailoring of payments to each workforce and—in theory—the potential to deliver the lowest-cost programs for government (in practice, that occurs only if government is politically very strong)</td>
<td>• Signals to workers and unions that the level of severance is—in principle—always negotiable&lt;br&gt; • Encourages bidding up of severance payments (a ratchet effect) and sets a precedent for other PPI transactions&lt;br&gt; • Favors workers in enterprises with the most powerful unions, the most influential leaders, or the greatest potential to inflict economic damage through strikes or industrial action&lt;br&gt; • Is less transparent&lt;br&gt; • Leads to unpredictable costs for workforce restructuring&lt;br&gt; • Provides an opportunity for confrontational negotiation on both sides&lt;br&gt; • Is only effective if there is a strong government that is robust in the face of vested interests and case-by-case lobbying&lt;br&gt; • Makes monitoring and control of commitments more difficult if deal making is delegated to enterprise managers</td>
</tr>
</tbody>
</table>

Uniform guidelines can be perceived to provide fair and equal treatment for all workers and help ensure some measure of predictability in the process.

**Adverse Selection and Targeting**

A major issue in many severance programs is how to avoid adverse selection and rehiring of the best workers. Better targeting and selection of workers help avoid these problems.
Box 5.4: Tanzania—Severance Policies in Port Concessioning

In 1996 the government of Tanzania decided to invite private sector participation in the delivery of port services in Tanzania. They also invited private sector participation in the container terminal operation of the Tanzania Harbours Authority (THA) in the form of a 10-year operating lease. THA was one of the few SOEs in Tanzania with a history of sustained profits, and these profits resulted from its monopoly position and because fees to shipping companies were set in U.S. dollars. THA as a whole employed 3,500 workers; of that number 500 were directly associated with the container terminal business.

During the privatization of the container terminal the problem of how to handle severance came to the fore. Earlier proposals by the World Bank had suggested that government declare a consistent policy on severance. Government had decided, however, to retain its existing policy, which provided that:

1. Where an SOE was taking a loss, was unable to fund severance costs from profits, and had to rely on the central government budget to make severance payments, only the statutory minimum severance obligations were to be met by government.

2. Where the SOE was able to fund severance payments from profits, it could be permitted to pay an ex gratia sum beyond the statutory minimum.

In pursuing a program of severance of surplus staff, THA decided to offer an ex gratia payment in addition to statutory minimum obligations. Three problems immediately surfaced:

1. Although the number of workers involved and the financial cost were small in absolute terms, whatever was agreed would set a precedent for the other 3,000 THA workers (because the remaining THA operations were also listed for PPI).

2. The workers in the other utilities and infrastructure industries would use the case of the container terminal as a precedent. They would argue that the source of funding was unimportant and that the issue was one of equity.

3. There was a question of selection. The new operator (Tanzania Industrial Container Terminal Services Ltd. [TICTS]) was allowed to select from the 500 employees whose services it wished to retain. The question arose whether to pay only those who were not selected for reemployment or to retrench all 500 container terminal workers. Again, the workers and unions would take the decision as a precedent.

The government decided that all 500 container terminal workers would be retrenched and paid the statutory dues and that those workers who were not reemployed would benefit also from the ex gratia payment. Those employees who declined reemployment lost their rights to the ex gratia payment—a policy intended to avoid the problem of employees with critical skills declining employment, benefiting from the ex gratia, and later being rehired by TICTS because their skills were critical. The ex gratia payments amounted to about 12 months’ pay in addition to statutory payments.

The outcome is that the government has resolved labor issues in the PPI transaction of the container terminal. It also has avoided potential industrial unrest among other THA workers (who were watching and now expect similar treatment). However, the wider problem of inconsistency in the treatment of some 21,000 workers in other utilities and infrastructure remains.

Source: Parastatal Sector Reform Commission, Tanzania; Adam Smith Institute.

Adverse Selection

In many severance schemes there are concerns about adverse selection: that is, there is concern that the program will lead to the departure of the best workers and thereby result in the loss of critical skills and in the subsequent rehiring of workers who have received public money for severance. This section of the module provides some guidelines for addressing these concerns and making severance more efficient.

When an ex gratia severance payment is offered equally to all workers, it is usually selected by the most skilled and most capable employees. Those employees, who can easily find alternative employment elsewhere in the economy and who believe they have a bright future outside the enterprise, are precisely the people that the restructured enterprise would most want to retain. Overpayment of severance in public enterprises further contributes to adverse selection. In Argentina, for example, early railway retirees were among the most productive...
Adverse selection is a common challenge in workforce restructuring.

Box 5.5: Problems with Case-by-Case Setting of Severance—Sri Lanka and Zambia

Sri Lanka: Upward Revisions of Ad Hoc Severance Payments
Average ex gratia severance payments in Sri Lanka’s privatization program rose from 17.5 months of salary in 1987 to 53 months in 1997. By the time that Lanka Lohan (a steel company) was privatized in 1997, the package was considered so attractive that all workers applied to leave the firm, a clear sign that the package was overcompensating them. The increases took place because of strengthening trade union bargaining power, and the “ad hoc and lackadaisical manner in which labor issues were handled” (p. 190). In Sri Lanka, severance packages customized on a case-by-case basis for each enterprise proved to be downwardly rigid and confusing to the parties involved and they encouraged rent-seeking behavior and hostility to privatization. Another outcome was that government was no longer able to easily afford to restructure labor before privatization.


Zambia: Disparity in End-of-Service Benefits Fuels a Distrust of Privatization
The United Bus Company of Zambia was insolvent and was forced into liquidation. Under the applicable bankruptcy law, employees were entitled to 200 kwacha (equivalent to US$0.30) as preferred creditors for the legal minimum end-of-service benefit; for any additional amount they ranked as ordinary creditors in accordance with their contract terms of employment. In contrast, a cleaning worker who left Zambia Telecommunications after working there for only two years reportedly received a payment of 2 million kwacha (US$3,000). Such egregious disparities between the legal and contractual minimums for end-of-service benefits can create opposition to privatization and delay transactions.


Enterprise managers are concerned about the potential problem of losing their best people and their knowledge, particularly during periods of transition to new management and new working methods. For PPI investors, however, the transitional challenges of taking over management are more acute because it is vital to avoid disruptions in essential infrastructure services and to keep operations and equipment going until new equipment and systems have been set up.

Approaches to Selection and Targeting
Mechanisms to better target severance payments are the principal solution to the problem of adverse selection. If there is an across-the-board offer with no targeting or selection, anyone who volunteers for severance is automatically able to receive it, although perhaps on a first-come/first-served basis and perhaps with a cap on the number of workers who can take the offer. This approach is most likely to lead to adverse selection.

Better selection or targeting can be achieved in a number of ways, whether undertaken before PPI by government or after PPI by the new investor. Table 5.6 summarizes the advantages and disadvantages of alternative approaches to selection. (Note, however, that in some cases, the implementing agency or the investor may have little choice of selection tools if these are mandated in a collective bargaining agreement.)

Establishing selection procedures is therefore a critical management task in any labor program. Attention to detail and a commitment to enforce selection are essential. The following sections elaborate on the main tools for better selection and targeting: active management selection, management veto, and selection by cadre.

Active Management Selection
The data sets and tools used for staff audits (see module 3) can help managers in the active selection of staff and cadres for retrenchment. Those tools include:

employees, whereas many unproductive workers stayed, which led to production problems and shutdowns on various lines. In Pakistan, overly generous severance plans reportedly encouraged the most productive workers to leave.
Staff and skills audits, which help identify critical skill sets that must be retained or are in short supply

Individual appraisal or assessment records, based on the normal performance appraisal review on internal competency assessments, or on a special skill audit

Education and qualifications records, which can lead to poor selection when used alone because they neglect the questions of tacit knowledge and institutional memory.
• **Training records**, and evidence of employee response to training

• **Assessment based on the comments of supervisors and managers**, including assessments of employees’ willingness and flexibility to undertake a range of work, as well as their job histories (which offer evidence of increasing levels of responsibility) and their possession of transferable skills

• **Attendance records**, which detail unauthorized leave and medical absences (whether uncertified, self-certified, or certified by a doctor)

• **Special interviews and tests specifically for selection prior to severance** can supplement other data or fill in the gaps where an employee’s records are poor or missing if they are undertaken in an objective manner and if they probe and test for relevant skills and competencies.

The primary problem in management selection is that many worker traits are unobservable. Put simply, it is hard for the designer of a severance program to design selection criteria that distinguish between the productive and the unproductive worker on the basis of written records alone. Reliance on only one test may be unwise, as was found in Guinea and Sri Lanka (see box 5.6).

Using a range of the above tools is wise, and can help assure workers and unions that the process is being carried out in a fair and transparent manner. Selection tools will be most effective where an effective appraisal system is already in place, together with competent and professional human resources management.

**Veto by Management**

Giving managers the right to reject applications on an individual basis is another option. In practice this is a difficult route for many managers because they have to be prepared to reject applications for voluntary departure from their best workers. The task is made easier if:

• Relationships between managers and staff are sound, and program communications have not raised the expectation that the departure package is available automatically to all workers. Consider this approach, for example:

  *Deselection of certain potential [voluntary departure] applicants was done by personally calling those employees and persuading them not to apply since their future in the company was bright (Ray 2001).*

  Ray 2001 (a PPIAF case study).

• All parties have reasonable expectations that prospects in the company will improve after PPI (this will depend in part on the sector).

• Managers are prepared with plans for future salary structure and performance-based incentives to encourage workers to stay.

**Selection by Cadre**

Selection can be imposed through eligibility restrictions, which only allow certain groups of workers to participate in a voluntary departure plan. The criteria for selection may be related to age, years of service, cadre, grade, operating unit, or location:

• **Age or years of service eligibility criteria**: Some severance packages are only open to workers with a minimum period of years of service. This will discourage younger workers from taking voluntary departure, and is rational where a shift in the age or experience mix is an explicit objective. A problem can arise where mandated last-in/first-out rules combine with minimum eligibility rules to selectively disadvantage newer workers. The approach also may not be appropriate if large numbers of workers have recently been taken onto the permanent rolls (for example, as a result of negotiations with trade unions to regularize temporary workers).

• **Cadre**: If there is overstaffing in particular cadres, tiers, or grades, the plan may be offered only to those groups.

• **Operating unit or location**: Voluntary departure may be offered only to workers in particular units (for example, a construction or
Box 5.6: Challenges of Selection—Guinea and Sri Lanka

Guinea: Selection of Water Utility Workers in Conakry
The process of workers to transfer to new water companies was conducted through a series of objective tests (initially managed by the World Bank) that were “supplemented” with recommendations from former managers at the former utility—the DEG. The subjective evaluations raised serious concerns about objectivity (Ménard and Clarke 2000).

Sri Lanka: Worker Selection Processes during Privatization
“It was difficult to screen the high-quality workers from the low-quality workers. Even where exams were held for this purpose, those workers who wanted to leave the firm [through a voluntary departure scheme] performed in the exam very poorly” (Salih 2000, p. 193.).

Prohibition on Rehiring
The revolving-door syndrome (where workers are rehired after receiving severance) is indicative of a poorly managed labor program. Many severance schemes therefore set out explicit rules prohibiting rehiring. These are worth having, given the potential political and financial cost of such rehiring. Enforcement is difficult, however, and such restrictions usually can only reduce, not eliminate, the risk of rehiring previously separated workers.

Before they receive their severance benefits employees are usually required to sign a commitment not to return to work in the same enterprise. The design of any restrictions on rehiring will vary among countries and circumstances, but all should address the following aspects:

- The time period for restrictions: Are workers barred forever or just for a certain period (one year, five years)?
- The scope of the restriction: In the public sector, drawing reasonable reemployment boundaries can be difficult because of the intricacies of government. For example, if an employee is laid off from a state-owned maintenance unit) or in an operating division that is particularly overstaffed or that is being closed or outsourced.

As with other selection tools, selection through eligibility criteria requires commitment from government, as was found to be true in Sri Lanka (see box 5.7).

The alternative selection approaches discussed above and outlined in table 5.6 are not mutually exclusive and can be used in a mix. To illustrate, there could be no selection for unskilled cadres who are all surplus workers or for all workers in a regional unit to be closed, but active selection by management of all other cadres.

Eligibility is another mechanism for selection and targeting.

Box 5.7: Sri Lanka—Experiences of Selection through Eligibility Criteria

“Even when tiers of surplus labour were identified before putting VRS into operation, some workers maintained that this was discriminatory and that the option of voluntary retirement should be extended to all workers. However, the main opposition to targeting tiers for retrenchment came from workers who were not targeted. Opposition came from the more skilled grades of workers who felt they could obtain windfall gains through the compensation packages, since they could find alternative jobs without much difficulty. Hence, identifying tiers of redundancy labour for voluntary retirement was eventually dropped and across-the-board voluntary retirement was applied. This is why the problem of adverse selection (better workers leaving) was common in Sri Lanka’s voluntary retirement process.... Even where workers of an identified tier were subject to VRS, the problem of adverse selection could not be altogether avoided because the better workers within the tier opted to leave” (Salih 2000, p. 193.).
telecommunications company, can he or she work again for that same company or its legal successors (post-PPI)? For other public enterprises? For other local, state, or federal government bodies? For subcontractors engaged by the PPI enterprise following privatization?

- **Penalties to workers for breaking the terms and conditions:** These may be strengthened by including obligations to repay severance monies or lose the tax privileges associated with severance if workers are subsequently found to be rehired.

- **Mechanisms of enforcement and legislation:** These can present practical difficulties in monitoring and enforcement, and legal challenges in countries where the labor law does not permit restrictions on recruitment.

- **Restrictions on the use of funds:** Some donors have rules that restrict the use of their funds. For example, World Bank loans cannot be used to finance the severance of workers who leave and subsequently are rehired either in another part of government or in the same company after privatization. (See the discussion of financing arrangements in module 1.)

- **The views of PPI investors:** These views should be sought wherever possible. Some plans mandate that workers cannot work again for the same enterprises, but do not restrict workers from working for the new privatized company. This was the case in Brazil’s railway privatization (Estache, Schmitt de Azevedo, and Sydenstricker 2000). Elsewhere, however, investors have suffered from voluntary departure schemes that have prohibited workers from being employed by the subsequent PPI company. (See the example of Chile’s railway, Fepasa, in box 5.8.)

### Implementation Issues

Three main implementation issues arise in severance programs: (1) the definition of severance procedures, (2) payment options and procedures, and (3) monitoring and evaluation arrangements. This section covers the first two items; the third item is discussed in module 7.

### Severance Procedures

Well-documented redundancy and severance procedures can improve the quality and transparency of severance and can avoid the potential for dispute and opposition during implementation, which in turn may create delays. The advantages of having clearly established procedures are that (a) there is a common understanding on the terms, conditions, and definitions applicable to severance; (b) the prospect of redundancy has been raised and discussed (in some PPI utilities, the culture may still be one of “jobs for life”); and (c) there are clear guidelines for conducting severance activities (such as calculation of amounts owed to each worker or disbursement procedures).

Severance procedures should be set out in a policy statement or in regulations at the government or enterprise level, and usually are agreed to by government and worker representatives before restructuring starts. The CD-ROM accompanying this Toolkit provides an outline of a general redundancy policy and an example of a redundancy policy from a privatized freight railway.

![Outline of a redundancy policy.](image)

In addition to establishing procedures, governments can develop a manual for the entire severance process. The typical content of such a manual is set out in box 5.9.

Severance procedures generally cover the following areas:

- **Eligibility criteria:** Sometimes legislation or labor contracts will only provide for full-time or permanent employees as eligible for severance. The implementing agency will need to ensure that the treatment of other
categories of workers is properly defined, including:

- **Temporary, daily paid, seasonal, intermittent, or part-time workers:** Unions will often want to make casual workers permanent as part of the preprivatization restructuring and thus make them eligible for severance, as was the case in India’s telephone and power sectors (see box 4.8 and box 5.10). If, however, it is clear from staff audits that there are large amounts of surplus workers in these categories, it may be preferable to make special severance provisions to compensate workers for their losses, provide a social safety net, and secure support (see box 5.10, for example). In practice, given the often very low wages of this group, the incremental cost to government of including temporary workers within a severance program may be small relative to the benefits of doing so. Such calculations will have to be done on a case-by-case basis.

- **Probationary staff, apprentices, and contracted workers** are often excluded from severance plans. The rights of these groups depend much on national or state legislation, which can affect the design of the severance package.

- **Officers and managers:** Senior staff (defined by grade or by salary) may be
excluded from a severance package, given their higher salary and benefits levels. For example, in the concessioning of Chile rail, senior staff earning over US$1,800 a month were not eligible for early retirement benefits (see box 5.8).

- Definition of salary:
  - Many if not most plans define basic salary as the base for calculating severance payments.
  - A combined salary and benefits definition is another approach. In the case of Mexico rail (box 5.1), the “daily integrated salary” made up of 14 different elements was used both for severance pay and for early retirement packages.
  - In Chile retirement benefits are calculated on the basis of a “worker’s reference salary,” which is calculated as the annualized salary over the last five years of employment.

- Definition of years of service: In practice this needs to take account of issues such as:
  - Will prior service in another organization be taken into account?

### Box 5.9: Content of a Severance Manual

What should be included in a severance manual? Circumstances will differ but the procedures could include the following material:

- **Full definitions of all key terms.**
- **A description of the timetable for labor adjustment.** This will include descriptions of any enterprise restructuring activities (for example, closure of operating units, depots, or workshops), levels and scope of downsizing, phasing, and timetable.
- **A standard format or spreadsheet for calculating the amounts due for every worker.** This will be based on an agreed formula.
- **Detailed definitions of the calculation of severance benefits—statutory and contractual.** This will supplement the paper format or spreadsheet because calculating the value of the contractual (enterprise) benefits and allowances, in particular, can be challenging. There may be different schedules and eligibility rules for different groups of workers. And if those benefits are not well defined, if enterprise human resources management has been weak, or if data are missing, then in practice the interpretation of the rules may have been and continue to be subject to considerable discretion. One unit manager may apply rules differently than another, and similar workers can receive different severance amounts.
- **A standard submission format to the decision body for release of funds.** Normally, approval for the release and transfer of funds for severance will require review by the ministry of finance or by a committee involving representation from the ministry of finance. The standard format aims to ensure that all costs are captured, including statutory payments, enterprise dues, ex gratia severance payments, arrears of salary, arrears of pension contributions, other allowances, and other costs arising from the restructuring. If a noncore activity is being sold, closed, or liquidated, there will be other costs to the ministry of finance, such as those associated with salaries of core staff (security and accounting staff often need to be retained), as well as valuation, privatization, or liquidation costs.
- **A standard letter of agreement between the PPI enterprise manager and the government.** This will outline the role of the PPI enterprise manager, as well as public finance arrangements.
- **A standard letter that all workers sign when accepting voluntary departure.** This will include their acceptance of any restrictions on rehiring, and verify their recognition of any tax or social insurance consequences.
- **Terms of reference for the engagement of accountants and auditors to help implement a program.**
- **A standard format for the disbursement of payments to workers.** This format should provide for the signatures of the workers to acknowledge receipt, as well as countersignatures by witnesses (such as independent accountants or auditors).
- **Standard formats for tax purposes as appropriate for the national tax regime.**
How are part-years calculated?
Will service as a temporary worker count?
Will service as an unregularized temporary worker count?
What about apprenticeship or probationary periods and interruptions to service (such as times of military service)?

- Constraints on reemployment.
- Treatment of other benefits (loans, medical insurance, and so forth).
- Treatment of housing occupied by the workers.

Payment Options and Procedures

The implementing agency must decide how to pay severance to workers. Early retirement benefits are normally paid from the pension plan. For severance, the main options are to:

- Provide severance in a single payment. Many governments favor this approach because (a) employees tend to prefer lump-sum payments, (b) it is administratively simpler, (c) it provides a clean break, and (d) it avoids an impression of continuing government obligations toward the displaced worker. There are risks that a proportion of workers can very quickly dispose of lump-sum payments on consumption. Clearly, some cultural specifics in certain countries may predispose those workers more toward consumption than in other countries—for example, because of the social status of costly weddings or funerals.

- Provide severance as a salary continuation. In Chile’s rail sector most workers received 50 percent of their salary for a period equal to half the number of years of service plus one (see box 5.10). In a 1,000-response survey of severance practices in the United States, where severance is typically one or two weeks per year of service, 47 percent of organizations implemented severance payment through continuation of the salary (Lee Hecht Harrison 2001); a similar percentage (46 percent) used lump-sum approaches and some offered workers a choice between the two methods.

- Provide severance over a defined period. For example, when the Uganda Railways Corporation retrenched 1,300 staff in 1997, severance benefits were paid over a three-year period (Murungi 2002).

Box 5.10: Regularizing Casual and Stipendiary Workers in the Orissa Power Sector

Public sector enterprises can engage large numbers of workers on ad hoc or occasional terms. In the Orissa State Electricity Board, for example, 5,336 semiskilled workers, engaged for extended periods as daily paid “nominal muster roll” workers, were regularized as part of the preprivatization restructuring of OSEB. Their remuneration then rose from Rs. 30 per day to about Rs. 3,500 per month. Similarly some 250 so-called stipendiary engineers had been employed by OSEB through emergency recruitment procedures, but they lacked any service benefits other than a fixed stipend. Following corporatization of OSEB, most of these engineers were regularized and made permanent employees of the successor company—the Grid Corporation of Orissa . Although these groups were relatively weak stakeholders, their regularization helped create a strong positive impression regarding the reform process, and helped to back up the stance taken by the government of Orissa that power sector reforms would not lead to compulsory retrenchment. These workers could have been retrenched but, according to one former chairman/managing director, “possibly with such a beginning we would not have been able to carry on with the reforms” (p. 24).

There are choices for when and how severance payments are made.

- **Provide all severance as an annuity.** This is unlikely to be acceptable to workers if they have some pension arrangements or if they had the choice between early retirement and a lump-sum payment.

- **Allow workers to freely choose** among a lump-sum amount, staged payments, and an annuity.

Workers’ preferences for these different options will vary among countries. Preferences can be determined through well-designed and statistically valid surveys representing all of the work force (all ages, all cadres, and both genders), perhaps as part of the prelayoff worker surveys (described later in this module in the section on redeployment programs). Factors that influence workers’ preferences are likely to include:

- **Inflation:** Workers may want to quickly convert a lump sum into a tangible asset, such as housing, and may reject phased payments if there is a history of high inflation in the economy.

- **Degree of uncertainty about the future,** both personal and economywide.

- **Potential for small business:** If workers (or, perhaps, their spouses) can see income-earning opportunities, they may favor the opportunity to invest lump-sum amounts of their severance compensation in establishing a new microenterprise or small business.

Accurate and prompt payments of severance are critical. Workers who are paid incorrectly or late are treated unfairly and can create public dissatisfaction with the process. Moreover, in the absence of clear payment procedures there is a risk that severance monies will be captured by fraudulent people or that there is wide disparity in implementation among different units of the enterprise.

Therefore, the job of the manager in the implementing agency is to ensure that the right worker receives the right amount, at the right time, with no surprises. This generally involves the following steps:

- **Carrying out pre-audits of the proposed funds disbursement system, preferably with the help of the government accounting or auditing staff:** This can help ensure that processes are consistent with national public finance accountability regulations and with the requirements of any donors involved, defended from potential fraud, and able to provide an adequate subsequent audit trail.

- **Hiring accountants to provide implementation capacity:** Accurate calculation and verification of worker payments can be a time-consuming task in large-scale programs. If records are not computerized it might take 30 minutes to check each application. If 2,000 workers are to be retrenched, it would be equivalent to 125 person-days, without allowing for travel times and delays resulting from missing information, unclear rules, and other anomalies. Where internal resources are limited this task can be contracted out to national firms of accountants or to other professional firms of auditors or consultants. Some guidelines for this process include the following: have a panel of accountants to draw from, emphasize the need for independence of the accountants, do not let enterprises select their own accountants, and make the accountants also responsible for the accuracy of the payment process.

- **Developing computerized information technology systems that enable rapid analysis of worker dues:** In the privatization of Brazil’s RFFSA, each RFFSA office was equipped with software that gave information on all the incentives offered to each worker and a simulation of the benefits each would obtain (Estache, Schmitt de Azevedo, and Sydenstricker 2000).

- **Monitoring payments:** The scope of work of any subcontracted accountants and auditors can include supervision of the actual handover of payments to workers (see module 7).

Tools (on the CD-ROM)

Sample severance spreadsheet

Outline of a redundancy policy
Sample redundancy policy (EWS Freight Railway)

Terms of reference for a severance consultant

Additional Material (on the CD-ROM)


Other Material and Sources


PENSIONS AND PPI

This section identifies the key pension challenges facing the implementing agency and provides a brief introduction to pension plans for implementing agencies that may lack pension expertise.

The Pension Challenge

Implementing agencies face several challenges related to pensions. First, dealing with the accumulated liability of pension benefits that have already been promised and earned by current workers often is essential to determining whether privatization is feasible. Accumulated pension obligations may take a variety of forms, some of which may not be readily apparent in the financial records and statements of an infrastructure enterprise. Workers in potential PPI enterprises quite often are enrolled in the pension plans of civil servants or participate in the so-called provident funds established to provide about the difficulties encountered in downsizing a large public sector.)
some mechanism for mandatory retirement savings for salaried or formal sector workers.

In other cases special supplementary arrangements have been created to provide additional benefits to workers in industries of strategic significance (such as transportation, defense, and law enforcement), for workers in difficult or dangerous occupations, or for workers in highly skilled or high-pay industries. These benefits may be in the form of supplements to existing public social security programs or special-purpose pension arrangements to provide benefits to workers in a particular enterprise or industry. Both are often operated on a largely unfunded or “pay-as-you-go” (PAYGO) basis in which obligations are treated as a current operating expense rather than paid from reserves or asset pools to which payment is made at the time a future obligation is incurred.

This generally leads to circumstances in which, on an economic if not legal basis, there is a large liability for future benefits that are not accounted for and for which funds have not been set aside. When workers are covered by special-purpose pension arrangements, they can be legally enforceable obligations. When they participate in public or civil servants’ programs—although these may function on a PAYGO basis, they are likely to perceive accrued pensions as implicit obligations that must be settled when an entity is privatized.

Accrued pension liabilities typically are not fully (if at all) reflected in financial statements. These obligations, often referred to as arrears or unfunded pension liabilities, can be substantial. In industries with declining labor forces or aging worker populations, past pension obligations may be the single largest liability when properly measured and may represent a multiple of the market value of an entity. For these reasons PPI investors may be reluctant to take over an entity until they are assured that accrued pension obligations are fully resolved.

Second, pensions are a central concern as well as an effective tool in restructuring a labor force through downsizing. Providing early retirement programs or establishing arrangements in which workers can retain or access some of the value of their accumulated pension benefits is commonly used to provide incentives for voluntary departures or to achieve work force reductions in the least disruptive or controversial manner. These strategies have significant financial implications and may have substantial political and social policy consequences so they must be carefully developed with consideration for their objectives and costs. (Those considerations are discussed later in this module.)

Finally, designing the pension program to meet the future needs of a privatized entity is a key element of its viability as a going concern. In nearly all circumstances, including those in even the most fully developed economies, access to a reliable means of saving for retirement and providing old-age income security are crucial aspects of attracting and retaining high-value added labor. Workers in key management positions or with particularly valuable skills may be attracted to PPI candidates solely on the basis of the access they provide to reliable pension programs. This is especially true in developing or transition economies in which there are few competing alternatives available.

The way in which pension programs are structured in anticipation of or following privatization inevitably involves tradeoffs between controlling costs and providing sufficiently generous benefits to recruit and retain an appropriate work force. Available is a range of choices in the design of a pension program that will need to be carefully considered in the context of the type of workers required, the consequences of the choices made, the usefulness of the choices as a labor management tool, and the pattern and level of associated costs.

Some types of pensions are very effective in attracting younger, educated workers, often those with highly valued and marketable technical skills. Other types are more effective in retaining older workers or key management staff. Some pension arrangements have lower or more predictable costs, whereas others enable sponsors to constrain cash outlays in early years but may involve greater uncertainty about their long-run expense. These choices and tradeoffs are essential to the value and viability of a privatization candidate and are dis-
cussed further below. (See also the case of Morocco rail presented in box 5.11.)

Types of Pension Plans

Pensions are essentially collective arrangements designed to provide income for people no longer able to work because of age. In nontraditional societies or in industrial economies in which the multigenerational household is no longer the norm, pensions provide a means for the elderly population to survive. Pensions can be organized and run by government and public institutions, by private firms, or by a combination of both.

Pensions may be organized as contractual savings in which a worker builds up assets or credits that are returned in a variety of forms as income following retirement or through the redistribution of income from active to retired populations. Pensions are typically afforded tax privileges under which income taxes on the value of payments or contributions are deferred until the time they are received as retirement benefits. This “consumption tax” treatment often has significant fiscal consequences and may be the single largest tax privilege in many countries.

Although there is a wide variation in their specific design, there are two basic types of pensions. The older and more traditional pensions are those that promise workers a level of income for the rest of their lives after they reach a specified retirement age. These generally establish a benefit level based on a formula that takes into account wages earned and years of employment covered under the plan. These are broadly termed defined-benefit plans and include the majority of the public social security systems, civil servants’ pension plans, and many older occupational plans. Some defined-benefit plans try to set aside sufficient funds to pay the benefits by estimating their future value at the time they are earned and are therefore called funded plans. Others—commonly public social security and civil servants’ plans—pay benefits out of current receipts and are called unfunded arrangements.

Box 5.11: Morocco Rail—An Unsustainable Pension Scheme

In 1996 the government of the Kingdom of Morocco approached the World Bank for support for the restructuring of the state-owned railway, Office National des Chemins de Fer (ONCF). A key element of the restructuring was the conversion of the enterprise from a public corporation to a joint stock company. Although the ratio of staff costs to traffic revenue was better than that of most European railways at the time, it was still too high to ensure a sustainable financial position for ONCF, especially in the face of stiffer road competition. Labor costs were to be brought down to about 30 percent of operating revenues; this would involve a reduction in personnel from 13,800 in 1995 to 10,000 in 2000. Corporatization would not be possible, however, without changing the pension arrangements. The ONCF pension plan was an internal fund, more favorable than the common system applied to private enterprises, with pension benefits paid directly by ONCF. Retirees were paid their rights directly from the yearly staff and employer’s contributions plus a variable amount paid by ONCF to match the deficit. The system placed a major burden on ONCF finances. The high cost of the pensions was the result of very generous arrangements. The plan rules set the normal retirement age at 55 years (50 for drivers, compared with 60 years in the national retirement fund), and offered proportional early retirement after 21 years of service, an annual contribution rate of 2.5 percent, a high reference wage, wage-based indexing, and supplementary allowances and reversion of pension rights for family members. These benefits were unsustainable and would require an annual contribution rate of 50 percent if it were even to achieve a real financial yield of zero percent. Measures to change ONCF’s pension system were urgently needed because the downsizing program, plus a staff age profile leading to steadily increased retirements (the number of retirees increased by about 200 annually), would make the plan even less tenable.

Other pensions essentially provide a savings account for each individual in which contributions from the worker (and often the employer) accumulate. The value of these contributions and the earnings from their investment accumulate in these individual accounts. On reaching a specified age, or sometimes under other conditions such as separation from employment, the worker becomes entitled to the value of the account. In these arrangements there is no promise of a benefit level; all that is promised is the commitment to maintain the account. The benefit received is directly linked to the value of contributions made, so these are generally called defined-contribution plans.

The observation is often made that in defined-benefit arrangements the sponsor incurs all of the risks of unanticipated changes in investment returns or from miscalculations about the amount of time workers will live after retirement, whereas in defined-contribution arrangements these risks fall primarily on the individual worker. This principle is central when considering any restructuring of pensions in the privatization process.

Any type of pension can be organized on a national basis, by a single enterprise, or by a group of related employers. Pensions can be organized and administered by public or private institutions or by a combination of both. Workers in infrastructure enterprises may be covered by any of these types of pensions operated by either type of institution or through a combination of arrangements.

Some of the more prevalent types of pension arrangements are:

- **National pension plans**: Some countries have established government-run social security programs that generally cover all workers in the so-called formal sector—those who are receiving money wages. Coverage is typically limited to this group because it is only through wage records that taxes and contributions can be collected and benefit levels can reliably be set, although in many circumstances this relationship is tenuous at best. In developing economies only a small fraction of the total population may be covered—typically including infrastructure workers.

National pension schemes are typically operated primarily on a PAYGO basis and consequently have large unfunded and quite often untenable levels of future benefits. These arrangements can range from modest in scope to very generous (from those that seek to replace half of a worker’s income to those designed to replace nearly all of a worker’s income, even if that is not feasible over the long term). Infrastructure workers, especially in strategic or dangerous industries, may be afforded special privileges in these plans that provide higher income replacement rates or retirement at a younger age. Compensating workers for the loss of these special privileges can be very complicated and expensive and thus represents one of the more difficult pension problems in privatization. Public plans facing financing shortfalls may also seek payments to cover these future commitments if they are to be maintained—an expense that can be a major issue in privatization.

- **Civil servants’ pension plans**: Many countries without national schemes or those with modest benefit levels have established special pension programs for civil servants. These are often designed to provide nearly full income replacement, often at young retirement ages, to compensate for the presumed lower pay levels of civil servants or to retain members within the career civil service. Regardless of whether either of these motivations is necessary, the tradition of high pension levels for civil servants is maintained in many developing countries. They are nearly always defined-benefit plans, although this is slowly changing. They may be operated in conjunction with a national plan or they may move covered workers into a separate arrangement.

Infrastructure workers are often included in these arrangements and may perceive themselves as having forgone a significant por-
tion of their potential wages or other employment opportunities in the expectation of future high pension levels. This may or may not comport with reality, however, because with civil servants more broadly the expectations and perceptions will be key issues in any labor restructuring. Civil servants’ plans commonly are operated on an unfunded or partially funded basis.

As with national plans, these plans may not have aligned required contributions with the needs of long-term solvency and thus may represent an indirect source of subsidy for infrastructure entities. This not only distorts the measurement of actual compensation costs on an ongoing basis but may lead to demands for a very high payment to settle previously accrued but unfunded obligations when an employer tries to withdraw from the plan upon privatization.

- ** Provident funds:** Former colonial powers, particularly the British, established a particular type of savings institution known as provident funds, and these remain common in many developing nations in South Asia and Africa. These are defined-contribution arrangements in which an account is established for each participant and the contribution of a specified portion of wages is mandatory. Contributions often must be made by employers as well.

  Typically the funds are invested in safe but low-yielding assets, usually debt instruments of the government. Participants are often permitted to borrow the funds for specified purposes—the purchase of housing is a common example—and are entitled to receive the total amount that has built up in their accounts when they reach a specified age. In some instances provision is made to convert the account balance into a lifetime annuity.

  Although provident funds are primarily established as retirement savings vehicles, they are often used for a far broader range of purposes. Workers often deplete the full value of these savings to pay for relatives’ funerals, weddings, or education expenses or they are permitted to withdraw funds when leaving a job before retirement age.

  Because they are purely defined-contribution in nature and therefore, by definition, fully funded, these types of pension arrangements pose fewer problems of past liabilities or future commitment during PPI. They can, in fact, be a type of vehicle that essentially provides a source of severance pay to mitigate the short-term consequences of labor restructuring.

- **Occupational or employer-sponsored private pensions:** The least common but in some respects most problematic type of pensions likely to be encountered in a privatization initiative is occupational plans. These are special pension arrangements that have been established to cover workers in specific enterprises, sometimes called single-employer plans, or a group of related employers or members of a trade union, sometimes called multiemployer plans. Occupational pensions can be the only source of pension coverage in circumstances where there is no national pension program or where employees in certain industries are excluded from other arrangements. They also can be integrated into other plans, usually designed to provide supplementary benefits where income replacement rates are low or to provide for earlier retirement ages. Traditionally these types of pensions have been of the defined-benefit type; however, there is a recent trend toward defined-contribution plans.

  Occupational pensions are extremely diverse in form. They impose particular problems for implementing agencies because most developing countries have not established any sort of comprehensive rules or requirements for their establishment or operation. This can result in circumstances in which the benefits promised are not clearly specified, and that leads to considerable controversy about their settlement. Workers may be led to expectations about their pensions...
that are considerably at odds with the terms of the arrangement or the resources available.

Most significantly, occupational plans often result in substantial future financial commitments that have not been measured or accounted for in a reliable fashion and that have no funding set aside to ensure they can be met. These problems are especially pronounced for defined-benefit arrangements, but may also occur when defined-contribution plans must be funded or when the funding is not segregated from the sponsor’s other financial arrangements. They do, however, afford opportunities for using pensions to manage labor restructuring or to provide incentives to manage a work force, as discussed in subsequent sections.

Addressing Prior Pension Obligations

This section examines the issues and choices that must be addressed in assessing the feasibility of privatization and in resolving the existing pension obligations during implementation.

Measuring Existing Obligations

Pensions essentially involve the commitment by an employer to provide resources intended to be converted to income following the retirement of covered workers. This commitment can be as simple as an obligation to forward a specified portion of a worker’s pay to an individual savings account (for example, to a defined-contribution plan or provident fund) or the far more complex responsibility to fund and administer a program that will provide a monthly payment to replace a specified portion of a worker’s final salary for the remainder of the worker’s life (a defined-benefit plan based on final salary). In many circumstances the cost of these obligations represents the single largest long-term financial obligation of an enterprise. How this obligation is addressed will be a key determinant of the market value of an enterprise and will be critical to its long-term viability. There are several steps involved:

Step one: The first step in this process is to obtain a comprehensive understanding of all of the potential pension commitments that currently exist. Pensions are an integral aspect of labor negotiations and work force management. Although this is typically a formal process, perceptions and expectations are often as important as formal legal agreements. Care must be taken to be as thorough as possible in obtaining a full picture of the existing pension system.

Pension agreements may be contained in forms ranging from national laws covering all workers, collectively bargained agreements between workers and trade unions, formal plans outlined in legal documents executed by an employer, and informal agreements or acknowledged practices by an employer. Many countries do not have well-developed labor codes or pension regulatory regimes that establish standards for pensions. The extent to which any of these obligations is binding will depend on the laws and traditions applicable to individual circumstances. It is likely that some important practices and expectations will not be well documented.

At a minimum the relevant national laws and documents describing schemes for civil servants, provident funds, or any employer-specific arrangements will have to be obtained and carefully reviewed to assess the extent of an employer’s pension obligations. It is generally advisable to consult with officials of government-operated pension schemes, employee representatives, and any staff responsible for an enterprise’s human resources or personnel functions to identify any undocumented agreements or practices that are relevant. A thorough familiarization with any regulatory requirements having a specific focus on funding requirements, vesting rules (requirements for the irrevocable right to benefits when certain conditions are met), and procedures for the resolution of benefit disputes is advisable. This process should result in a complete inventory of potential pension obligations.

Step two: The second and likely far more difficult step will be to develop reliable measures of the
obtain an accurate assessment. Considerable future problems can result when the actual value or the “market value” of assets is at odds with the value shown in workers’ or a pension fund accounts, even if it is consistent with applicable financial accounting practices that may require assets to be carried at their purchase price until actually sold. It is very important to understand potential differences and obtain a current value in these circumstances where the actual value may be less, especially if there is a possible obligation of the pension sponsor to compensate for any shortfall.

Some countries may have established periodic audit requirements for pension funds. Unless there is an extremely strong system of auditor quality assurance and such an audit has been done very recently, it is generally advisable not to rely on an existing audit for these purposes. Even the most developed systems with strong compliance measures experience significant problems with the timely forwarding of pension contributions and the reliability of their financial statements. When enterprises face cash flow problems or when managers face significant uncertainty about their future employment contracts, pools of assets in pension funds often are among the most vulnerable to fraud, theft, or other manipulation. A recent and independent financial audit is therefore essential in nearly all circumstances.

Another common challenge in evaluating defined-contribution plans is the assessment of severance-type arrangements or other contingent future liabilities. Provisions providing one-time payments on the attainment of a specified age or on the termination of employment may be incorporated into pension plans, contained in national laws, included in individual employment contracts, or simply a matter of tradition and expectations. The latter especially may be an issue among senior managers. The cost of these provisions can be of equal or sometimes greater value than the regular contribution requirements and should be included in any assessment of future expected costs.

The process for defined-benefit plans is partly parallel because it also includes a similar need to obtain a reliable accounting and valuation of any
funds that have been set aside for pension purposes, thus imposing a similar need to undertake a reliable audit. In addition to this, however, is perhaps the most difficult and challenging aspect of dealing with pension issues—valuing the accumulated and future liabilities.

Almost without exception this requires the services of a professional actuary with experience specific to pension schemes. This is a process with two major elements: (1) obtaining very specific information about the employment history, wages, and demographics of the group of workers covered by the pension plan; and (2) arriving at reasonable assumptions regarding future patterns of employment, investment returns, and the life expectancies of the covered workers. The valuation of defined-benefit liabilities, because they often extend decades into the future, is highly sensitive to the accuracy of the underlying information and assumptions, thus perhaps making the development of these assumptions the most important aspect of the process.

Professional help is often needed for a pension review. The CD-ROM contains terms of reference for a pension consultant or actuary.

Countries with a long experience of defined-benefit pensions may have standards of practice or legal requirements for many of these factors. However, these are unlikely to exist in developing economies. Standards from other countries, because they are based on specific experience with investment returns and life expectancies among other key factors, generally are not transferable. Often a starting point for these assumptions can be derived from factors used by national pension systems, but in the end an assessment of reasonableness on a case-by-case basis will be needed. In most cases the judgment of a professional actuary will have to be relied on for these determinations. If there is not an established and reliable actuarial profession in a country—which is often the case—the magnitude of the costs and associated future financial risks may make incurring the expense of engaging the services of an established international firm a prudent course of action.

Step three: In order to fully and accurately assess the current status of pensions, estimates are also needed of the value of supplemental or contingent benefits. These benefits basically are additions to the regular benefits paid at normal retirement age and will typically include severance arrangements, provisions for which allow pensions to be paid at an age prior to the regular retirement age often triggered by labor force reductions, and additional benefits paid to workers in dangerous or difficult occupations. Because they often are not formal obligations until some future event occurs, these kinds of benefits frequently are not included in the accounting for pension obligations. They may, however, be legally enforceable and may represent a substantial portion of the current pension obligations (for example, privilege pensions in Central and Eastern Europe—see box 5.12). Special care must be taken to identify all of these obligations in the initial inventory of pensions and to estimate the future magnitude of their costs. Assigning some probability of these benefits being paid and deriving a measure of the current liability are often major parts of the work of an actuarial evaluation.

Determining the Funding Status

Assessing the status of current obligations will yield two key measures of the overall financial status of pensions. The first of these measures is often referred to as the accumulated- or accrued-benefit obligation. This is essentially a measure of the current value of funds set aside or previously paid as contributions in relation to the expected value of the pension benefits promised. This amount can either be expressed as a percentage or other ratio or as a net value. Pensions with a negative ratio of assets (or aggregate contributions) to future benefit obligations are commonly referred to as underfunded or are said to have pension arrears. Although there are international moves to improve the quality of pension disclosure in financial accounts (see box 5.13), many enterprises in developing and transition economies will lack good information on their pensions. The scale of pension obligations and problems of underfunding may therefore not be fully apparent until revealed in the PPI process.
Whether a pension is part of a national or civil servants’ system operated on a PAYGO basis or covers only the workers in a single enterprise, the funding status must be evaluated carefully. The collection of contributions from public enterprises is often lax and there may be substantial amounts of past contributions owed that are not accurately accounted for. Few countries have well-developed requirements for the prefunding of defined-benefit plans, and even when these are present the assumptions used for determining the required level of assets may be considerably at odds with reality.

Funding shortfalls also can be present in some defined-contribution arrangements where the fair value for the assets is less than the value of accounts. Severance payments or informal obligations are rarely funded in advance. When done properly, a full measure of the accrued funding status presents a full measure of the financial obligation the enterprise is likely to have to resolve at some point and often can be a major aspect of the evaluation of the future demand on cash flows as well as overall financial solvency. The measure of the accrued funding status is likely to be the single most important number.
Box 5.13: Accounting Standards for Defined-Benefit Plans

The international accounting standards (IAS 19) for pension benefits, introduced in 1999 by the International Accounting Standards Board, require that contributions in a defined-contribution plan be recognized as expenses. In contrast, the standards for defined-benefit plans have become more stringent, aiming to fully expose pension liabilities, and state that:

- Current service cost should be recognized as an expense.
- All companies must use the projected unit credit method (an accrued-benefit method) to measure their pension expense and pension obligation.
- Projected-benefit methods may not be used.
- The discount rate is the interest rate on high-quality corporate bonds of maturity comparable to plan obligations.
- Plan assets and reimbursement rights must be measured at fair value.
- Defined-benefit obligations should be presented net of plan assets.
- Reimbursement rights should be presented as a separate asset.

A net pension asset on the balance sheet may not exceed the present value of available refunds plus the available reduction in future contributions resulting from a plan surplus.

If the net cumulative unrecognized actuarial gains and losses exceed the greater of (a) 10 percent of the present value of the plan obligation and (b) 10 percent of the fair value of plan assets, that excess must be amortized over a period not longer than the estimated average working lives remaining for employees participating in the plan. Faster amortization, including immediate income recognition for all actuarial gains and losses, is permitted if an enterprise follows a consistent and systematic policy.

Past service cost should be recognized over the average period until the amended benefits become vested.

The effect of termination, curtailment, or settlement should be recognized when the event occurs.


derived from an evaluation of pensions and it provides the basis for the key strategic decisions discussed in the following sections.

The second element of the funding status is the development of a measure of future or projected pension-benefit obligations. This element provides a measure of the expected levels of future costs that would be incurred to maintain the existing pensions. There are two potential aspects of this. First, most of a projected obligation will comprise the costs associated with additional periods of employment by the covered workers. These costs will include the contributions required for defined-contribution plans and PAYGO systems or the additional years of work that will factor into the benefit formulas of defined arrangements. It is extremely helpful to distinguish between the various contributing factors for the projection (that is, employment patterns, mortality expectations, and the like) as it is developed because these factors will specify the costs and savings of alternative pension strategies.

A second element, usually much smaller, is the projected increase in wages or salaries that would raise the ultimate level of benefits even if no additional years of work were covered under the arrangements. Although it adds complexity, it is helpful to distinguish between the two elements because they will enable a more precise evaluation of the costs of options for addressing future pensions, as discussed in subsequent sections. Although it should be calculated separately, this second component is usually combined with the accumulated liability to derive the funding status.

Resolving Existing Pension Obligations

PPI investors will be extremely wary of becoming involved in circumstances where large financial obligations for previously promised pension benefits are present or may arise in the future. This makes the evaluation of the status of pensions as outlined above an essential early task in the PPI
planning process. Evidence that all prior pension obligations are fully addressed, either through paid-up contributions or assets set aside that are sufficient to cover their anticipated value, will substantially diminish investors’ actual or perceived risks, thereby removing a significant barrier to privatization. Conversely, the presence of unfunded or significant future obligations requires the development of a strategy to address them. There are three potential types of strategic approaches with many variations and combinations possible:

1. Renegotiate or modify the past pension obligation to bring the liability to a manageable level
2. Freeze or “ring-fence” the past obligation and establish a means either to set aside funds to meet the obligation or to transfer the obligation and associated risk to another entity
3. Establish a viable approach to resolve the past liability by setting aside assets or scheduling the payment of contributions in arrears on a schedule that is sustainable for the enterprise as a going concern.

Reduce Accrued Pension Obligations
The lowest-cost approach to resolving past pension liabilities obviously is to reduce the magnitude of the liability. The viability of this approach is likely to be determined by a combination of legal constraints and the assessment of potential consequences to labor or government relationships. The simplest method obviously is to renounce any obligation or commitment to previously earned pensions or to the portion of those that are in arrears or unfunded.

The capacity to do so will be determined by the legal constraints, which should be an integral part of the inventory of pensions discussed above. Prior pension obligations can be reduced through a retrospective modification of the benefit formulas, including steps such as:

- Reducing the proportion of wages replaced for each year of covered work
- Increasing the age at which retirement is permitted
- Increasing vesting periods (the period of participation in the pension system after which benefit rights are irrevocable)
- Terminating the pension and discontinuing any past benefits (in extreme circumstances).

The implementing agency should, however, recognize that some of these steps may be explicitly prohibited by law or may be vulnerable to a challenge under commercial or labor codes.

The advisability of such approaches is likely to be determined by the impact on labor relations and the extent to which government agencies administering national or civil servants’ plans are willing to permit entities to withdraw workers from participation and eliminate any future liability for contributions that are in arrears. Workers in public infrastructure entities, especially those included in civil servants’ schemes, are likely to represent powerful political constituencies and strongly resist such steps. Public pension schemes operating on a PAYGO basis and experiencing both short- and long-term financing problems also are likely to oppose such approaches.

Freeze Past Obligations
An intermediate approach to addressing past obligations is to freeze the existing obligation at its current level and take steps to address it in a manner that is viable for the future. In this approach the past pension obligations are honored, but additional benefits do not continue to accrue or they accrue at a different level or in a form more affordable or aligned with the anticipated needs of the future.

The separation of accrued and projected components during the evaluation of liabilities should provide a basis for judgments about the potential cost reductions of such an approach. This decision is closely associated with the determination of an appropriate prospective pension arrangement because closing down existing pensions in this manner has consequences for the future design.

Alternatives for resolving liabilities include development of a schedule for amortizing any shortfall over a period that matches a projected future funding stream, paying lump-sum settlements to affected workers in exchange for the settlement of the
obligation, “laying off” the liability through a contract with a life annuity provider or in some cases even permitting a public entity to take over the pension obligation in exchange for an agreed-on fee or future series of payments. In cases where there is considerable uncertainty regarding the capacity of an enterprise to fulfill future obligations and remain a viable concern, workers may be willing to accept one-time cash payments of lesser present value than the benefits they forgo in the settlement of future pension rights.

This process can be considerably complicated when a guarantee of pension benefits has been provided by a government agency or when there is an attempt to withdraw from a civil servants’ or other publicly managed defined-benefit plan that may be operated on a PAYGO basis. In these cases a negotiated settlement of future liabilities that is well in excess of the value of contributions to date may be required.

**Fully Fund Any Shortfall or Arrears**
The least controversial and disruptive, as well as the most direct, method of resolving existing pension obligations is simply to pay their full cost on a present-value basis. If this is financially viable and desirable it may be accomplished in a variety of ways:

1. The government budget: For example, the German government agreed to contribute US$1.25 billion into a new private pension plan in order to allow withdrawal from the public pension plan by Lufthansa Airlines. That amount would provide half of the capital needed in a new plan to meet the existing obligations; the airline would finance the other half (Guislain 1997, p. 78). More commonly, where governments take on responsibility for payments under existing plans, the obligation may be paid from the existing PAYGO system (for example, for early retirees in state-managed, defined-benefit plans).

2. Proceeds from the sale of assets belonging to the enterprise: These assets may be rolled into a separate fund that combines existing past liabilities and the obligations from future ones. Examples of the separation and isolation of pension assets and liabilities are provided by the cases of Tanzania Telecommunications Company (box 5.14), Japanese National Railways (box 5.15), and South American mines.

3. Privatization proceeds: Some countries have first sequenced the sale of valuable enterprises to build up adequate funds to finance the labor adjustment, including pension costs. Proceeds can either be monetary transfers, or—as in the Bolivian capitalization program (see box 1.9 in module 1)—transfers of government shareholdings in public enterprises into private pension plans. If the PPI investor is willing to take on pension liabilities, but at a reduced purchase price, that discount is effectively the same as the forgone privatization proceeds.

4. Donor loans and grants: Large sector reform and structural adjustment lending programs are a potential source. For example, World Bank loans financed severance packages for redundant workers, including pension liabilities payments, in the restructuring of the Polish and Brazilian rail sectors and the privatization of Togo’s telecommunications sector.

5. Rescheduled liabilities that are paid later from the profits of the PPI enterprise: In Romania the privatization of the Sidex steel factory involved negotiations among government, investor, and unions on the restructuring of arrears of social taxes—including pension contributions—that had accrued. Sometimes, this rescheduling may include the negotiated write-off of some debts, or the use of debt instruments by government (government bonds and securities) or by the PPI enterprises (corporate bonds). An example is the Moroccan Railways Corporation, which agreed with the government of the Kingdom of Morocco to finance unfunded pension provisions by issuing bonds over a five-year period.
Some PPI programs have created special funds to finance the costs of retirement. In the privatization of Mexico's national railway, a trust fund was set up to finance the retirement benefits of those workers who retired prior to privatization. This fund was negotiated between government and the labor union, and included part of the privatization proceeds and public funds from fiscal sources. The company transferred the pension liabilities to the federal government (López-Calva 2001).

**Box 5.14: Tanzania Telecom—Pension Plan Restructuring**

In 1998 Tanzania's privatization agency, the Parastatal Sector Reform Commission (PSRC) embarked on the privatization of Tanzania Telecommunications Company Ltd. (TTCL). An initial review revealed four pension plans in which employees were enrolled, and significant unfunded pension obligations that arose primarily from the East African Postal and Telecommunication Pension Fund (EAP&TPF) of the former East African Community (EAC). These liabilities presented a major problem, threatening to derail the privatization. They had been transferred to TTCL when EAP&T was separated into telecommunications and postal operations in 1994.

The government agreed that the privatized TTCL should transfer its employees to a new accumulation plan(s) and that unfunded liabilities would be removed from TTCL’s balance sheet. To facilitate this, a new company called Simu 2000 Ltd. was created. It took over TTCL’s unfunded pension liabilities and was required to ensure that the future pension obligations from these older pension plans are met. Simu 2000 Ltd. took over existing EAP&TPF assets plus noncore TTCL assets, in exchange for also taking over future pension liabilities.

Simu Ltd. was mandated to establish a small management team of no more than five employees, and to arrange for the sale of some of the assets and the transfer of proceeds to the National Social Security Fund (NSSF). The NSSF invested the proceeds and paid a fee of 7.5 percent of the total sum invested. Simu 2000 Ltd. was required to meet the monthly payment of pensions to the existing ex-EAP&T pensioners, and an initial advance was provided by the PSRC to cover this cost for three months and the initial administrative cost of setting up Simu 2000 Ltd.

Source: Parastatal Sector Reform Commission, Tanzania; Adam Smith Institute.

**Pensions and Labor Restructuring**

This section discusses how pensions can be used in labor restructuring because such adjustment is often a major part of any process of privatization.

The implementing agency may face difficult pension issues and negotiations with workers and unions during work force restructuring. Pensions can often represent a large portion of the compensation package for workers in these enterprises, especially if workers are enrolled in generous industry-specific or civil servant defined-benefit plans. Pension arrangements can also be adjusted to provide incentives for workers to leave employment voluntarily or used to cushion the impact on those who may be separated involuntarily. Various approaches with many feasible combinations are possible for integrating pensions into a labor restructuring strategy. These approaches can be considered in the context of two major categories: early retirement programs and voluntary departure incentives.

**Early Retirement Programs**

The least disruptive and contentious way to restructure a work force is to induce voluntary early retirement. Whether this is practical is a question of cost and of targeting the availability to redundant workers while retaining those who are essential to a going concern. Whether the benefits are enough to induce employees to volunteer for early retirement will depend on the type of plan offered (defined-benefit or accumulation), the levels of benefits promised, the vesting arrangements, participant eligibility, and other rules of the program—as well as employees’ assessment of alternative employment options.

Early retirement can be structured in three main ways—by providing:
1. An immediate but reduced pension
2. An immediate but enhanced pension to compensate in part for the lost opportunity to earn future benefits
3. A normal pension beginning at retirement age, perhaps with some lump sum at the time of early retirement.

Each of these three options is considered below.

With the first option, the worker who retires early receives an immediate pension payment but at a reduced level. A typical adjustment that is “actuarially fair” is to provide the same benefit formula for each year of service but then to reduce it by 5 percent for each year below the normal retirement age. Smaller percentage reductions may provide a similar equivalence if life expectancies are lower, as is often the case in developing countries. Care must be taken, however, to ensure that the longevity factor used is consistent with the characteristics of the affected workers, who may differ from the broader population. The estimation of an appropriate offset should be a relatively straightforward calculation for an actuary who has completed the evaluation of defined-benefit plans as discussed in previous sections. Pensions may remain at a reduced level until the worker reaches normal retirement age, or they may remain at a reduced level until death. An alternative approach that can be combined with adjustments in the benefit level to achieve lower initial reductions (and thereby strengthen incentives) is to eliminate or constrain the indexing of benefits until normal retirement age.

Statutory provisions may apply, too. For example, under Egyptian social security regulations workers who are aged 50 or above can receive a retirement

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**Box 5.15: Japan Railway’s Recurring Pensions Challenge**

Over the protests of the seven direct descendants of the former Japanese National Railways, the Diet [Japan’s parliament] approved legislation in October 1998 [for] a 60-year plan to pay off the ¥27.8 trillion ($205.9 billion at ¥135 = $1.00) worth of debt that remains from JNR’s 1987 privatization. Although Tokyo will shoulder most of the debt, the seven rail companies created from the now-defunct government railroad will be forced to take on ¥180 billion ($1.3 billion) worth of unfunded pension liabilities owed to former JNR workers now employed by them. The repayment plan has caught the attention of American shareholders of three of the Japan Railway firms as well as some U.S. legislators.

At the time JNR was privatized in 1987, it had ¥37.1 trillion ($274.8 billion) worth of red ink on its books. The seven companies that took over JNR’s passenger and freight rail operations agreed to assume ¥14.5 trillion ($107.4 billion) of the debt, while the rest—¥22.6 trillion ($167.4 billion)—was transferred to a new company, JNR Settlement Corp. JNR Settlement was supposed to whittle down the debt by selling off JNR assets, especially prime real estate holdings. The company also held all shares of the seven JR operating companies and so benefited when the three strongest—East Japan Railway Co., West Japan Railway Co., and Central Japan Railway Co.—publicly listed their shares during the past two years. Because of falling real estate prices and other factors, JNR Settlement not only has been unable to reduce its handed-down debt but has seen it grow to nearly ¥28 trillion ($207.4 billion).

The ¥4.3 trillion ($31.9 billion) in pension liabilities will be taken over by a new company, Japan Railway Construction Public Corp., which, in turn, will derive income from selling JNR Settlement’s real estate assets, offering more shares of JR companies to the public and forcing JR Group firms to pay ¥180 billion ($1.3 billion) of the cost.

The JR companies feel that Tokyo is being unfair in forcing them to pay an extra share of the pension liabilities. When their private pension plans were absorbed into the government’s pension system in April 1997, the administrators of the public plan said that the JR Group’s pension scheme was under funded by ¥940 billion ($7 billion). JNR Settlement agreed to absorb ¥770 billion ($5.7 billion) of the liability, and the seven operating firms took on the remaining ¥170 billion ($1.3 billion). The septet now says that the Tokyo government is reneging on the deal by making them pay another ¥180 billion ($1.3 billion).”

pension if they retire early. However, the pension is reduced significantly from what they would receive if they retired at age 60 (the normal retirement age). The amount of reduction is determined by a complicated formula that distinguishes between basic and variable components of wage. The loss of benefits amounts to 66 percent of full benefits for retirement at age 50, 57 percent at age 53, and 40 percent at age 57 (Assaad 1999, p. 141).

The second option is a pension that is available immediately and enhanced to cover the opportunity cost of forfeited future benefits. With this option, the enhancements may take the form of crediting the employee with more years of service than have been worked (added years) or of giving an additional lump sum to purchase an annuity for an extra pension benefit (the lump sum may be linked to years of service or to years remaining until normal retirement age).

Although such enhancements create a powerful incentive for early retirement, their costs must be carefully evaluated. What may appear to be small additions to credited years of service can have large consequences for the funding status that will need to be paid in the future.

With the third option for early retirement, payment of the regular benefits begins when the worker who has taken early retirement reaches normal retirement age, but there may be a lump-sum incentive payment at the time of early retirement. At Brazil's RFFSA, for example, the company continued to pay the employer’s and employees’ contributions to the national social insurance system for workers who took early retirement (for a maximum of five years, or until the worker reached age 55). In addition, the worker received six months’ salary during the first six months after early retirement.

There are several cases where governments have been so generous in their pension arrangements that the plans led either to excessive long-term liabilities on government or to the departure of too many staff through early retirement. Essentially these are cases where the implementing agencies have solved their immediate problem by transferring the financial obligations either to the new owner or to a future government. Examples include Sri Lanka Telecom (Salih 2000), Chile Rail, and a similar case in Australia’s rail sector where too many employees took early retirement and had to be rehired later under contract.

### Incentives for Voluntary Departure

Even where severance payments are the core element of voluntary departure plans, some compensation for past pension contributions may also be necessary. This can be a lump-sum payment or an obligation to pay a pension in the future, or a mix of the two. In general, the objective is to make plans as simple as possible, although complexities may arise if there are several classes of employees, different pension schemes, and different incentives required for different groups of workers.

An alternative to providing early retirement that may better target incentives to specific groups of workers or may entail lower costs is to make retroactive changes to eligibility and vesting rules. These rules, which are often very specific to the pension plan, can significantly affect the incentives and motivations for workers accepting early retirement or voluntary departure.

Eligibility rules can be based on age or based on years of contribution or service. For example, only workers over the age of 60 may be eligible to retire, or only workers who have a minimum of 20 years of contribution to the pension plan can qualify for early retirement.

Work force restructuring can result in amendments to the rules of the plan. In the case of PPI in Côte d’Ivoire rail, negotiations with unions resulted in the years of work required for pension eligibility being reduced from 20 to 15 years. This enabled a larger portion of the work force to depart or be separated while still preserving the right to future benefits without the expense of paying out immediate benefits.

Vesting rules in pension plans are often based on years of service; for example, until workers have accrued five years of service they cannot receive full benefits...
benefits. Like eligibility rules, vesting rules and conventions can influence workers’ decisions and their willingness to adopt early retirement. Although there is a trend to more immediate vesting, many plans still have long vesting periods. Vesting rules can act as a disincentive to workers leaving voluntarily.

The vesting arrangements may also need to be considered as part of the total compensation package. For example, if the principle to be used in downsizing is last-in/first-out, the redundancy package may have to take account of forgone pension contributions because the affected employees are unlikely to have fully vested benefits.

The details of these rules can significantly affect workers’ benefits. For example, in the electricity restructuring and privatization in Orissa, India, the former Orissa State Electricity Board (OSEB) included employees who had been deputed from government service. As for the Grid Corporation of Orissa (GRIDCO), when the board was unbundled and restructured into generation, transmission and distribution companies, the eligibility rules were less beneficial for these deputees than for OSEB employees. Specifically, OSEB employees had their years of service in OSEB carried over to count toward a GRIDCO pension, whereas former government employees had to have worked for 10 years within GRIDCO before becoming eligible for a GRIDCO pension (Ray 2001).

Whatever options are chosen for resolving existing pension liabilities, the pension scheme will be an important aspect of the operation of the restructured entity. Should the implementing agency set terms for future pension schemes, which would become a condition of the PPI contract? In general, that should be avoided as far as possible, and the PPI investor should have discretion to determine pensions arrangements within statutory requirements. The way in which pensions are restructured will affect how investors value an enterprise and assess its long-term viability. Providing investors with the widest array of choices and flexibility will therefore greatly enhance the attractiveness of an entity for privatization.

The extent to which this is possible will depend, however, on the nature and difficulty of negotiations among the work force, trade unions, and government. The Lufthansa Airlines pension review, for example, required agreement between the government and the company; and when British Coal was privatized, bidders were required to accept a new pension plan (see box 5.16).

If the implementing agency is negotiating a future pension plan, it is essential to consider carefully such issues as the following:

Future Pension Design

A successful privatization will usually require restructuring the pension scheme to take account of the different concerns of workers, investors, and government and to align the new pension arrangements with the long-term requirements of a privatized enterprise. This section sets out the key considerations and potential alternatives in designing and implementing pension arrangements, including consideration of incentives to attract and retain workers, the level and pattern (cash flow) of expenses, and strategies for funding and investment.

Box 5.16: British Coal—Negotiated Pension Agreements

When the United Kingdom privatized its coal industry, past benefits accrued (and the consequential liabilities for funding) remained the responsibility of the government. Investors bidding for the coal mines were, however, required to participate in a new pension arrangement that had been negotiated previously between the government and stakeholders, including the employees (trade unions). This was an accumulation plan but the investors had no say over the contribution rate. The new plan was only open to retained workers who had been members of the old (closed) defined-benefit schemes. New employees engaged by the investor after privatization were able to participate in a third, completely new, plan that the employer established.

Source: Adam Smith Institute, personal communication; DTI 1993.
• **Legal compliance:** The plan should be consistent with legislation. For example, some countries require that one contribution rate apply to all participants in order to qualify for specific tax benefits, and some do not permit the employee contribution to exceed that of the employer.

• **Plan viability:** Legislation may provide that staff transfers to a new employer after privatization should be on “no less generous” terms and conditions. That may present a challenge for PPI if it leads to demands, for example, that PPI investors provide or maintain financially unsustainable pension arrangements. Other matters such as deemed length of service are also important—in this case because of its effect on workers’ pension rights and benefits.

• **Plan type and contribution rate:** Most PPI investors (but few trade unions) would want to see new plans structured as defined-contribution rather than defined-benefit arrangements because defined-contribution plans make financial risk borne by the sponsor more readily determinable and predictable. The decision about plan type will depend on the joint assessment of financial risk and labor incentives as discussed below. Depending on the prevailing employment conditions in the country, an employer contribution rate of 5 to 10 percent of average wages should be sufficient to provide a generous plan by the standards of a developing or transition economy. A further 5 percent contributed by the employee should generally replace a significant portion of wages for long-term workers with a typical life expectancy of 10 to 15 years after retirement.

• **Consistency with other plans and national systems:** Care must be taken to ensure that any prospective pension arrangement does not set unwelcome precedents for other public sector schemes or enterprises. Will the plan lead to accelerating demands among workers in similar industries? Is it consistent with the purposes and scope of a pending or anticipated reform of a national pension system?

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**Work Force Management and Incentives**

Pensions are generally the largest element of compensation arrangements beyond the payment of wages and salaries. Although the average cost will be between 5 percent and 15 percent of a total compensation package, depending on the nature of the pension design and age of the worker, pension costs easily can exceed the wage bill for certain workers. That makes the design of the pension program on a going-forward basis a major issue in work force management.

There are essentially two main issues here: (1) the nature of the pension and (2) the level of benefits or generosity. Contemplating the replacement of an existing pension program will need to take into consideration both the potential effects of a change in expectations and an objective assessment of the future needs of the organization. Concerns about retaining key workers or limiting the adverse effects of difficult labor negotiations may significantly limit the movement toward what might otherwise be an appropriate design.

The basic decision of benefit design is the choice between a defined-contribution and a defined-benefit system. This is a question of matching the attributes of design to the requirements of the enterprise and the work force. Some of the key characteristics of each type are listed below.

**Defined-contribution plan:**

- Value is proportional to wages, with no differentiation by age.
- Is highly portable; workers take accounts with them.
- Offers greater flexibility in payout timing and options.
- Is easily transparent; workers can readily determine value.
- Financial risk is held by the worker.
Defined-benefit plan:
- Relative value of benefit usually increases with age.
- Has potentially large costs for early leavers.
- Offers little access to benefits before retirement.
- Value is hard to measure.
- Offers less financial risk for workers.

These characteristics make each type of pension appropriate for different work force management objectives.

Defined-contribution plan:
- Is attractive to younger workers with short tenure expectations
- Is effective in attracting scarce skills in mobile labor markets
- Is more effective in wage-competitive markets
- Has greater association with risk takers.

Defined-benefit plan:
- Is an effective retention tool for older workers and senior managers
- Is an effective means of protecting investments in training
- Is less attractive to young workers with highly marketable skills
- Is less conducive to competition in compensation
- Is associated with stability and risk aversion.

There are various potential combinations of the two basic designs that can merge aspects of any of those characteristics. One approach that is gaining acceptance in a variety of settings is a hybrid design in which workers are credited with a fixed amount in an individual account that accumulates with investment earnings during the working years. At an established retirement age, this account is converted into a monthly benefit. These types of arrangements may enable an enterprise to achieve many of the advantages of a defined-contribution pension in attracting workers and providing significant incentives to retain valued workers who are in their high-productivity later years of employment. The most important point is to recognize that neither model has any particular inherent advantage but rather a set of characteristics that should be aligned with anticipated needs.

Anticipated Expenses and Cash Flow

The two models also impose differing financial aspects that must be consistent with the objectives and constraints of the ongoing enterprise. In the aggregate, if the generosity of the pension is the same, both models should entail a similar present value of costs. The timing and pattern of costs, however, may be significantly different. The capacity of an enterprise to meet the cash flow demands of the short term may be an extremely important consideration in selecting a pension design.

Defined-contribution pensions involve constant and predictable cash flow demands. With workers’ accounts usually credited with actual investment earnings, sponsors are not exposed to volatility in financial markets. Defined-benefit pensions involve the sponsor committing to a future expense that may vary significantly, depending on employment patterns or the earnings on any assets set aside to fund the plan. Although this arrangement may defer cash flow demands to a later date, those demands are typically far more volatile in their cost and cash flow requirements. If there is a requirement or effort to prefund these demands, poor investment performance may impose future expense shocks and changes in assumed interest rates may make annual funding requirements extremely volatile. The differences are as follows.

Defined-contribution plan:
- Has level annual expenses
- Is predictable as a proportion of the wage bill
- Has early and constant cash flow demands
- Offers low risk to the sponsor.

Defined-benefit plan:
- Has variable expense and cash flow
Potential defers the cost to later years
- Has exposure to financial market and interest rate risk
- Has potential to produce future cash flow shocks.

**Funding and Investments**

Decisions will also have to be made regarding a strategy to fund future pension benefits. In a few cases strategy may be dictated by law, although in most circumstances involving privatization there is not likely to be a legal and regulatory framework for pensions that imposes significant requirements. Defined-contribution pensions generally involve payment of the full pension expense during the period in which the commitment is made. Individual accounts should be established for each participating worker, and sponsors will have to take a significant responsibility to ensure the integrity of the funds through oversight and periodic auditing.

The most challenging issues are likely to be decisions about the investment of the funds, whether these decisions are to be made by the sponsor or whether a limited menu of choices will be provided to workers individually. In nearly all circumstances the level of development of capital markets and the lack of financial literacy among workers will require that any assets be held in very safe, professionally managed portfolios that are professionally managed. In countries that have developed a system of licensed pension funds as part of a broader reform (as will be discussed in the following section) this should be a relatively simple choice. In other circumstances, sponsoring entities will likely need to choose an asset manager and establish portfolio limits.

Defined-benefit pensions, however, require far more complex decisions. The sponsor will have to decide the extent to which there is a capacity to set aside funds in advance. Funding defined-benefit pensions on a PAYGO basis may move expense and cash flow patterns into the future but can expose sponsors to untenable risks in circumstances where the benefit formulas create rapidly accelerating or volatile pension expenses. Factors such as unanticipated patterns in wage growth, inflation, or the future need to restructure the work force may create large and unexpected pension costs. It is therefore advisable for the sponsor of a defined-benefit arrangement to estimate pension expenses as they accrue (using the services of a professional actuary) and to fund them on an ongoing basis. These actions will prevent the build-up of unsustainable liabilities that can drive otherwise profitable enterprises into insolvency if not properly managed.

Funding for future pension expenses should be separated from the other activities of the sponsor and managed in accordance with a predetermined and disciplined investment strategy. This result is best accomplished through the services of professional asset managers but will necessitate the formulation of a general strategy. Developing this strategy is usually an area in which engaging the services of competent consultants is advisable. A well-formulated investment strategy can mean the difference between a successful pension restructuring and one that exposes the enterprise to enormous financial risks in the future. Success in this regard is nearly always a process of balancing expense against potential risks.

Some common strategic approaches involve the following:

- **Intermediated financial products:** In circumstances where there is a reasonably well-developed market, all of the financial risk of a defined-benefit pension can be managed through the purchase of investment products. This strategy will increase the cost but remove risk by purchasing intermediated products such as investments with fixed returns or, if available, a series of annuity contracts in which an insurance company agrees to pay out benefits in return for a preset fee.

- **Government-issued or -guaranteed bonds:** Government debt is generally safe but provides very low returns. Investment of pen-
sion funds in government debt is often risk free and politically desirable, but it will do little to diminish costs over the long run.

- **Asset-liability matching**: Pension funds commonly try to manage risks by purchasing investments whose value moves opposite any changes in liabilities. This strategy is sometimes called “immunization” or “duration matching.” It is a process that recognizes that the value of defined-benefit obligations is very sensitive to interest rates and seeks to purchase investments such as long-term bonds that will increase in value as a result of the same factors that might increase the level of future liabilities. These types of approaches are complex to administer but can significantly limit future exposure.

**Pensions: Implementation Steps**

This section outlines key implementation steps for pensions in PPI. There are three main steps:

1. Making information available to bidders
2. Ensuring adequate funds and administrative capacity
3. Obtaining technical support.

**Making Pension Information Available to Bidders**

The data room is a managed facility provided during the PPI transaction for bidders to examine supplementary, bulky, or detailed information. Bidding documents or the data room should provide information on:

- Relevant laws and collective bargaining agreements
- Details of existing pension plans, including plan rules; certificates of asset property titles; asset valuations; estimates of unfunded liabilities, including key assumptions; and estimates of arrears
- Any restatement of net pension assets and liabilities in the accounts of the infrastructure enterprise, adjusted if appropriate to bring them into line with international accounting standards
- Proposed pension system reforms
- The obligations of the PPI investor under the country’s labor code and related legislation, as well as any specific pension plan rules.

**Ensuring Adequate Funds and Administrative Capacity**

Large-scale early retirement programs can present a challenge for pension plan administrators. First, finance must be found to meet any gaps in the plan funds. Potential sources of finance are essentially similar to those outlined in module 1 of the Toolkit. Second, the administrative capacity to process the applications or to manage a new pension scheme must be considered. For example:

- In Brazil’s railway privatization, the early retirement process allowed a period of six months in which the workers’ net salary continued to be paid while the appropriate paperwork was being processed by the National Social Security Agency (INSS). If payment was not ready within the six-month period, the railway company would continue to pay the net salary, but in the form of an interest-free loan to be reimbursed by the retired employee after the date of his or her actual retirement (Estache, Schmitt de Azevedo, and Sydenstricker 2000).
- In Mozambique workers in the port and railway company were members of the pension system for public sector employees. Workers to be transferred to the new private sector concession managers were to have their pensions immediately transferred to the INSS plan, but this did not happen because the public sector pension system was insolvent. Without the transfer of funds the INSS...
could not enroll workers and the new private concessionaires could not contribute the employers’ share. The backlog of cases reached 4,000 workers.

- In India, the Pension Trust Fund for Orissa’s electricity sector was split among the four privatized distribution companies and the transmission company. There were, however, significant delays in establishing the distribution company trust funds, “due to the inability of the unions/associations to elect the employee’s representatives” (Ray 2001, p. 33).

Together with the specialist consultant, the implementing agency will need to take the following actions:

- Consult with the relevant pension authorities to identify what is realistically possible in terms of payment processes. To reach accurate conclusions, the agency will have to assess the need for specialist inputs from pension consultants, identify specific decisions required from government or trustees, assess the available administrative capacity to handle large numbers of early retirement programs, identify secure payment arrangements, and develop procedures to verify that correct payments are made to the correct employees.

- Consider whether some type of technical assistance or training investment may be necessary for new trustees or supervisory board members.

**Obtaining Technical Support**

Throughout the pension process the implementing agency will benefit from the recruitment of independent pension or actuarial advice for three reasons:

1. Assessment and valuation of the pension scheme: This enables the implementing agency to alert ministers and other decision-makers to the fiscal impact of any decisions on pensions and to the potential impact on proceeds from PPI.

2. Help in negotiations with trustees, workers, and other stakeholders.

3. Opportunity to give investors as much information as possible in bidding documents and data room: This will help PPI investors conduct their own due diligence of pension issues more quickly.

Box 5.17 gives one illustration of how actuarial advisers need to work with the infrastructure enterprise, pension plan trustees, and the implementing agency. The CD-ROM that accompanies this Toolkit provides outline terms of reference for the engagement of a specialist consultant for a specific PPI transaction. It also offers a job description and draft advertisement for the position of long-term pension adviser who might support a PPI office through a number of PPI transactions.

**Terms of reference**

Job description for a long-term pension adviser.

**Tools (on the CD-ROM)**

Terms of reference for a pension review

Glossary of pension terms

Frequently asked questions about pensions

Job description for a long-term pension adviser

**Additional Material (on the CD-ROM)**


Box 5.17: South America—Working with Trustees and Pension Advisers

**Description of the Pension Problems**

In one South American country, employees in two mining companies and the mines holding company contributed to one pension plan. The privatization strategy was to offer the mines separately and close the holding company, and an early question was whether there needed to be separate pension plans. The pension scheme actuaries advised that there were cost benefits to continuing with one shared pension plan, including lower actuarial, audit, and trustee fees, although they recognized that company control of pension plans was important and any cross-subsidization was undesirable. Cross-subsidization could arise not only through one firm having problems with pension contributions but also with differing age and gender profiles and with different earnings levels and retirement ages between the two companies.

Significant practical problems emerged in trying to assess the pension plan’s assets and liabilities. One of the fund’s major investment assets, a property investment, would be difficult to sell. Moreover, the pension trustees had not perfected title to this property. When actuarial advisers looked at liabilities, they found that they could not value the current pension liability because the company had failed to provide the data on employees necessary to carry out the valuation. Moreover, the previous valuation six years earlier recorded a significant liability, and the mine companies’ actuaries had then recommended an increase in pension contributions, which the companies had not implemented. According to the pension plan, this represented a liability of the company although it was not recorded as such in the company’s accounts. In addition to these two liabilities, the increasingly poor financial position of the mines had resulted in their inability to pay pension payroll contributions to the pension administrators, which represented a further liability.

The unions wanted employees to be paid full redundancy payments before privatization, but also wanted all pension rights transferred and not liquidated. The pension plan rules, however, indicated that only the trustees could make this decision—not unions or the government—and that employees also had the choice of opting out.

Inflation had eroded the value of many pensions, which had been reasonable when first awarded, and many pensioners were now below the national poverty line. Fear of criticism arising from such payments might deter an international investor from taking over the pension program.

**How the Problems Were Resolved**

Earlier privatizations in the country had tackled pensions through pension scheme liquidation or negotiated handover (such as the transfer of an existing plan to an insurance company) that occurred at the same time the new investors created a new pension plan. Under liquidation, existing pensioners received an annuity, whereas others received lump-sum payouts calculated by the actuaries or deferred pensions. For the mining companies, however, the problems of selling a major asset—the commercial property—made liquidation an unattractive option.

On the advice of the actuaries, the government chose not to create three separate pension plans but to establish a notional separation that removed any cross-subsidization while enabling the plan to continue owning assets in common. The title of the pension scheme to the commercial property was undisputed and government—working with trustees—took steps to perfect the title.

The actuaries advised that the existing pension provisions, particularly for those on very low pensions, could be ring-fenced and responsibility for payment transferred to an insurance company, although this would result in workers losing medical benefits that were then being paid by the company.

The government engaged additional financial and accounting help to identify missing personnel data required by the actuaries, who then updated the valuation. In its information memorandum for investors the government stated that both the backlog of payments to the pension scheme and the increases recommended by the actuaries were company liabilities that investors were to take on, but that any actuarial deficit (that is, the uncertain financial liabilities) would be settled by government through future contributions or settled with the investor at the time of payment.

The government made available the services of the pension scheme actuary to prospective bidders who required clarification on pension liabilities during the bidding period.

*Source: Adam Smith Institute, personal communication.*
Orissa Power Reforms.” PPIAF case study. World Bank, Washington, D.C. (Includes discussion of the treatment of pension issues in one PPI transaction—electricity reform in Orissa.)

Sin, Yvonne. 2003. “Pension Reform Options Simulation Tool Kit—PROST.” World Bank, Washington, D.C. (A presentation introducing the World Bank’s PROST methodology; helpful to illustrate the inputs that are needed to review very large or national pension systems.)

Web sites
Rapid Response: http://rru.worldbank.org. (The site is a gateway to a range of information on infrastructure, privatization, and private sector development policies.)

World Bank: www.worldbank.org. (Use the site’s search engine to locate information about pensions and specialist sources of information.)

World Bank Institute (WBI): www.worldbank.org/wbi/. (The WBI is the training arm of the World Bank and provides courses on—among other topics—pension reform. For example, see: www.worldbank.org/wbi/pensions/courses/february2003/presentations.html.)

Other Material and Sources


REDEPLOYMENT SUPPORT
Redeployment support aims to help displaced workers reenter the job market or become self-employed. Redeployment programs are politically and socially valuable, providing a tangible demonstration of government’s commitment to helping workers. But program design and implementation has to be considered carefully to ensure the cost-effectiveness and efficiency of such programs.

Redeployment support aims to facilitate restructuring of the enterprise, the sector, or the economy and to shorten and alleviate the period of unemployment and income loss experienced by displaced workers. It is an active rather than passive labor market policy response. This section summarizes the key types of redeployment support and the broad lessons emerging from international experience.

The main types of redeployment support are:

- **Prelayoff advice and counseling**, which—in addition to advice on separation and on services and support open to the displaced worker—may include elements of trauma, financial, and life counseling.

- **Job-search assistance**, which can include placement help (employment intermediation) to match workers with opportunities in the job market, time off for job search prior to termination of employment, and help in building skills and confidence to find a new job (interview skills, personal skill assessment, writing job applications, job clubs).

- **Training**, which may include retraining and skill upgrading so that displaced workers can find new paid employment elsewhere, and training in small business, microenterprise, or livelihoods to help them create self-employment and incomes.

- **Employee enterprise**, through which the resources and facilities of the PPI enterprise are used to create jobs for displaced workers by contracting out services needed by the enterprise to newly separated workers or by
setting up a range of facilities from simple workspaces to more sophisticated business incubators.

- **Efforts to create jobs** by looking to local government, nongovernmental organizations (NGOs), and community self-help groups, alone or in coalition, to develop employment opportunities at a local level. These can include large-scale, labor-intensive public works programs, local community activities, or small enterprise development projects.

How have redeployment programs worked in practice? The evidence shows mixed results. Reviews of retraining and other active labor market programs (mainly in the industrial countries of the OECD) found limited impacts (Dar and Gill 1995, 1998; Dar and Tzannatos 1999; Fay 1996). These findings are summarized in table 5.7. The evaluations revealed that retraining programs were generally no more effective than job-search help in increasing either reemployment probabilities or postintervention earnings, and they were between two and four times more expensive than job-search assistance.

Although many evaluations have focused on OECD experiences, the few evaluations of active labor market programs in developing countries also show mixed results, given the capacity, funding, and infrastructure constraints that many developing countries face. For example, Mexico’s PROBECAT program, which was enrolling half a million workers a year, may have had no effect on the employability of trainees (Wodon and Minowa 2001). Similarly, Tanzania’s redeployment program for more than 60,000 retrenched civil servants had no effect on employability, although the combination of counseling and training helped improve subsequent earnings (Blomquist 2002).

Redeployment programs, however, play an important political and social role in the labor restructuring process. When designed properly they can also be economically beneficial in moving unproductive workers to more productive sectors of the economy. The experience provides several general lessons in developing such programs:

- Implementing agencies should avoid overselling the programs, especially where jobs are scarce. In such cases, economic and labor market policies that generate sustainable economic growth and job creation are key in offering the best long-term prospects for displaced workers.

- Although national programs have had mixed results, there are opportunities for the implementing agency to design and implement more targeted redeployment programs that tackle the specific needs of workers from the PPI enterprise or scheme. Examples include rail privatization in Poland, where redeployment and retraining were integral components of the labor program.

Link to the Web site on Polish rail reform:

- Setting up a redeployment program takes time and is institutionally intensive. An evaluation of Brazil’s federal railway redeployment program noted that the main problems came from underestimating the time it was going to take to agree on the strategy to implement the training and the outplacement programs (Estache, Schmitt de Azevedo, and Sydenstricker 2000). One outcome was that the training program was not put in place until some months after workers were separated, and many workers had already moved on. Early interventions are beneficial to workers. Experience in industrial and transition countries indicates that displaced workers are better helped while they are still employed than after they have been unemployed for several months (Hansen 2001).

- Appropriate incentives for participants and service providers are important. Making training more demand-driven through the use of vouchers and other such mechanisms...
Table 5.7: Summary of Active Labor Market Program Evaluation Results

<table>
<thead>
<tr>
<th>Program</th>
<th>Appears to help</th>
<th>Comments</th>
</tr>
</thead>
<tbody>
<tr>
<td>Job-search assistance/employment services</td>
<td>Adult unemployed workers generally when economic conditions are improving; women may benefit more</td>
<td>Relatively more cost-effective than other labor market interventions (such as training), mainly because of the lower cost; youth usually do not benefit; difficulty lies in deciding who needs help in order to minimize dead-weight loss.</td>
</tr>
<tr>
<td>(19 evaluations)</td>
<td></td>
<td>No more effective than job-search assistance in increasing reemployment probabilities and post-intervention earnings, and is 2 to 4 times more costly.</td>
</tr>
<tr>
<td>Training of long-term unemployed workers</td>
<td>Women and other disadvantaged groups</td>
<td>No more effective than job-search assistance and significantly more expensive; rate of return on these programs is usually negative.</td>
</tr>
<tr>
<td>(28 evaluations)</td>
<td></td>
<td>Employment and earnings prospects are not improved as a result of the training; taking costs into account, the real rate of return of these programs is negative.</td>
</tr>
<tr>
<td>Retraining in the case of mass layoffs</td>
<td>Little positive impact—mainly when economy is doing better</td>
<td>High dead-weight and substitution effects; impact analysis shows treatment group does not do well compared with control; sometimes used by firms as a permanent subsidy program.</td>
</tr>
<tr>
<td>(12 evaluations)</td>
<td></td>
<td>Long-term employment prospects are not helped; program participants are less likely to be employed in a normal job and they earn less than do individuals in the control group; not cost-effective if the objective is to get people into gainful employment.</td>
</tr>
<tr>
<td>Training for youth</td>
<td>No positive impact</td>
<td>Very low take-up among the unemployed; significant failure rate of small businesses; high dead-weight and displacement effects; high costs; cost-benefit analysis is rarely conducted but sometimes shows costs to the unemployment insurance budget to be higher than for the control group; administratively intensive.</td>
</tr>
<tr>
<td>Employment/wage subsidies</td>
<td>Long-term unemployed workers by providing a means of entry into the labor force</td>
<td></td>
</tr>
<tr>
<td>(22 evaluations)</td>
<td>Severeley disadvantaged groups by providing temporary employment and a safety net</td>
<td></td>
</tr>
<tr>
<td>Public works programs</td>
<td>Relatively older groups and more educated workers</td>
<td></td>
</tr>
<tr>
<td>(17 evaluations)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Microenterprise development programs</td>
<td>Relatively older groups and more educated workers</td>
<td></td>
</tr>
<tr>
<td>(15 evaluations)</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Note: Based on evidence from around 100 evaluations of active labor market programs, mostly in OECD countries—mainly, Canada, Germany, Sweden, the United Kingdom, and the United States—but with some examples from transition and developing countries such as the Czech Republic, Hungary, Poland, and Turkey. Most of the evaluations were undertaken recently, during the 1990s.

Source: Dar and Tzannatos 1999.

is one way to improve the effectiveness of the programs. Another is encouraging the involvement of NGOs and private providers through the use of performance-based contracts for the delivery of services.

Many developing countries face challenges in putting in place effective redeployment programs. In many countries training is still supplied by state-run agencies that lack resources, market orientation, and institutional capacity. Private sector training providers are few or weak. Moreover, employees themselves often have little faith that training will improve skills and help them find alternative job opportunities, particularly when unemployment is high. All of those factors need to be taken into account in the design and implementation of redeployment programs.
Design and Implementation of Redeployment Programs

This section sets out the key steps in designing and implementing a redeployment program tailored to the circumstances of the PPI plan.

Step 1: Define Objectives

Before proposing redeployment support as part of a labor program, implementing agencies must be clear about the rationale for it. Potentially there are three objectives:

- From an economic standpoint, the objective is to facilitate the shift of unproductive workers to more productive activities elsewhere in the economy.
- From a social standpoint, the objective is to help workers acquire the necessary skills to become reemployed or self-employed.
- From a political standpoint, redeployment programs are intended to build public support for restructuring by signaling to citizens, communities, and labor representatives that those responsible for restructuring are ready and willing to help those who need and want help (Fretwell 2002). Such programs help make difficult reforms acceptable to workers and other stakeholders. In India, for example, trade unions supported the retraining elements of the National Renewal Fund (NRF) and welcomed this as a measure to offset the social costs of enterprise adjustment and reform (and they were subsequently very critical when the NRF funded mostly severance payments and little training).

In the right circumstances, redeployment programs can have important objectives. When those objectives have been clearly defined, the main challenge is to improve the effectiveness of redeployment programs.

1. A survey of employees, including the skills, capabilities, and expressed redeployment needs of workers
2. A survey of the labor market itself, including areas of supply and demand
3. A survey of potential redeployment service providers, including the types and capacity of existing public and private providers.

These three surveys could be carried out separately, but in practice the findings of each will inform the design of the redeployment program and close coordination is thus required. Outline terms of reference for the various surveys are provided in the accompanying CD-ROM.

Terms of reference for surveys of the labor market, workers, and potential redeployment providers.

Employee Surveys

Employee surveys provide a descriptive profile of the work force and help the implementing agency to:

- Understand the profile of workers in the enterprise
- Identify the most vulnerable groups
- Monitor and challenge proposals from redeployment service providers based on a factual information base
- Provide a baseline for subsequent monitoring and evaluation.

The survey can build on, but is different from, the staff and skills audits described in module 7. Those audits focus on the needs of the enterprise, whereas the worker survey focuses on the needs of workers who will lose their jobs (see, for example, box 5.18). The worker survey can also overlap with the stakeholder analysis needed for planning communications and consultation (see module 6). Stakeholder analysis might be usefully scheduled at the same time as the worker survey.

The worker survey can include:

- Assessing the likely plans of employees—what proportion will retire permanently, or return to their home towns or villages, or be
willing to migrate to find alternative incomes?

- Developing descriptive profiles of the workers being retrenched through individual interviews and focus-group discussions. These meetings can provide a description of different groups of workers that bring to life—for decisionmakers—the risk profiles, key concerns, and challenges faced by different groups. (Box 5.19 describes such risk profiles.)

- Assessing worker preferences in terms of severance packages (one-time lump-sum payments, phased payments, or salary continuation).

- Learning from the experiences of other workers, perhaps in other sectors, who have recently retired or been retrenched.

The outcomes of the survey can help in designing the scope of the labor program. Those at highest risk are unlikely to find jobs quickly and will benefit from job-creation activities (public works, support for small enterprise, and community programs) as well as access to income support. Those with the most skills and highest level of mobility may benefit more from job-search assistance skills upgrading or retraining.

Worker surveys are an important input into the design and implementation of redeployment programs and must be designed with considerable care. An example of such a survey is included on the CD-ROM that accompanies this Toolkit.

Design, implementation, and analysis of the survey can be subcontracted out to national consultants or to academic or policy institutions.

A redeployment program study is essential, and needs to cover three aspects:

- The labor market itself
- Redeployment service providers
- The characteristics of displaced workers.

Can the survey of workers be scheduled at about the same time as a stakeholder analysis?
Labor Market Survey
The supply and demand for labor and skills relevant to the workers leaving the infrastructure enterprise will form the core of the labor market survey. The survey typically would include assessments of:

- The capacity of the labor market to provide new formal jobs through estimates of job creation, job destruction, and labor turnover in the economy
- Trends in formal and informal employment and areas of job growth and decline
- Alternative employment opportunities, including levels of wages and benefits and any trends
- Probability of finding formal and informal sector employment
- Patterns of employment in the private sector, including changing hiring practices and skill requirements
- Any barriers to entry into and exit from formal employment.

The labor market survey needs to consider both the formal job market and the informal sector because the latter is often a major source of employment. In South American and Caribbean countries, for example, the informal sector represents typically one-third to one-half of the workforce (Freije 2001).

Box 5.19: Ukraine—Profiles of Displaced Coal Mine Workers
Level One—Highest Risk
A woman, alone with children, with 70 percent or more of the family income derived from mine wages, is in level one. People like this are clearly the most at risk of losing everything.

Example: L. N. is 35 years old and has lived in the community all her life. She has two school-age daughters. Her ex-husband moved away and provides no child support. She has worked in the mine five years as an unskilled aboveground worker and earns US$32 a month in total family income, all of which comes from the mine. Her job will be one of the first to go and is not considered to be transferable to another mine. She is very worried about how she will take care of her children.

Level Two—High Risk
Other aboveground workers make up this category. As a general observation, aboveground workers are considered a highly vulnerable group of workers, not possessing particularly transferable skills. All female staff work aboveground, and 83 percent of the total number of aboveground workers (1,389) are women; 17 percent (285) are men.

Example: V. C. is 60 years old and has lived 60 years in this community. She has worked 30 years in the same mine. She currently works above ground in the stockyard in an unskilled position. She and her husband have a monthly family income of $64, which includes their pensions. Their family income is closely tied to the mine, and it will be cut in half, to about $1 a day, when the mine closes. She is frightened when she thinks about it closing. No one will hire her.

Level Three—At Risk
Underground workers in the engineering and other professions form this group. They are the highest-risk group of the underground workers.

Example: V. G. is a 40-year-old man who has worked 25 years in the mine. He is an electrician under ground and earns $64 a month to support his wife and two school-age children. He is totally dependent on the mine. His wife is unemployed, and 100 percent of the family monthly income derives from the mine. He has no savings and worries that the mine closing is going to be a disaster for his family.

Level Four—At Risk but Mobile
Underground skilled workers (face miners, drifters, timbers/fitters, and coal transport workers) have the best chance of adjusting to mine closure. They are potentially the most in demand for their skills and hence the most mobile.

Example: O. Z., 38, has worked underground in the mine for 19 years, most recently handling explosives. Seventy-five percent of his family income derives from the mine. His wife earns $18 a month working in the hospital, and he is worried about the future for his two sons. Where will they work? He has lived in the same community his whole life and does not want to leave for another job. His skills considerably improve his chances of getting a new job.

Labor market surveys should not be seen as a one-time exercise. Follow-up studies on a periodic basis can detect trends and changes in the labor market, fill in any gaps in understanding, and improve the quality, relevance, and targeting of redeployment activities.

**Survey of Redeployment Service Providers**

A survey of service providers is the third important source of information in the development of a redeployment program. The main objectives of the survey are to:

- Identify the full range of available service providers, including public and private ones and NGOs, as well as smaller organizations that are often invisible (see box 5.20).
- Identify the types of programs they offer and any gaps in services.
- Assess their capacity to deliver such services. Where there are shortages of service providers, the implementing agency may need to design the program so that service providers from outside the region are invited to provide services in partnership with local providers, or so that incentives to develop the market are provided through instruments such as vouchers (see Steel 2003).
- Assess the performance of service providers in placing recipients or trainees in jobs. This can help determine appropriate performance measures to be included within performance contracts for service providers.

**Step 3: Identify the Main Components of the Program**

Counseling, training, and job search lie at the core of most redeployment programs (figure 5.2). Job creation, community approaches, public works, and employee enterprise are supplementary elements that can be appropriate in some circumstances.

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**Box 5.20: Tanzania—“Invisible” Service Providers**

Despite the hostile environment for private enterprise in the 1970s, the commercial district of Dar es Salaam still hosted many small, private business service providers—bookkeepers and accountants, forwarding and courier agencies, marketing agents, and business training establishments. These small businesses seemed to be invisible to the donor agencies and to the government, both of whom preferred to set up high-profile central promotion facilities. Yet these microfirms were operating as profitable commercial businesses; they understood the market and the business environment. To the outside observer it seemed that the small accounting offices, for example—stimulated by increased demand and with some technical help—could be the seeds of future accountancy, business advice, and consultant service firms. But they had to compete with donor-financed facilities working out of expensively staffed and equipped offices and providing free services. Fortunately for them, the local knowledge and the marketing efforts of these state-sponsored bureaus were weak, so the local service suppliers were not seriously damaged and largely retained their traditional “invisible” customers. It was an opportunity wasted, however, because these existing fledgling service firms themselves would have benefited from advice, training, and incentives to upgrade so as to contribute to enterprise growth and improved governance.

*Source: Phillips 2000.*

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**Figure 5.2: Core and Supplementary Elements**

- Public works
- Community approaches
- Employee enterprise
- Counseling
- Job-search assistance
- Training
- Supplementary elements
There is no one best model for redeployment programs. Country-specific and enterprise-level circumstances influence the types of redeployment components that are selected. Every situation will be unique, but some guidelines for when various redeployment measures are most likely to be appropriate are set out in table 5.8.

**Step 4: Design Appropriate Incentives**

Poorly designed redeployment programs may have little economic effect. To improve economic benefits, redeployment activities need to be structured in a way that creates appropriate incentives for workers and service providers alike.

An example comes from Chile, where training for displaced workers is provided through the National Training and Employment Service (SENCE), part of the Ministry of Labor and Social Security. More than 1,700 training providers to the program are registered, including private firms, municipalities, or universities. Funds for training are awarded through competitive bidding (publicly tendered) among providers, and must include commitment from private firms for a three-month apprenticeship for trainees. The program design helps ensure a degree of training relevance because both firms and training providers have incentives for monitoring quality (Freije 2001).

Table 5.9 summarizes incentive mechanisms that the implementing agency could adopt in a redeployment program. These are mechanisms for selecting the recipients of redeployment assistance and performance incentives for public or private service providers.

Specific incentives that can be adopted include avoiding or reducing stipend payments to employees who attend activities; cost-sharing by participants (especially for such services as training), including through vouchers; and performance-based contracts for service providers.

**Avoiding Stipends**

Many programs offer generous stipends to workers who attend the training programs. Although stipends encourage attendance—and hence high levels of activity rates are reported by training providers—they can significantly distort participation in redeployment plans. Several such plans have high dropout levels. Workers attend the courses while they have no other income, but as soon as they get a job they leave.

Increasingly, plans are moving to no or minimal stipends:

- In Trinidad and Tobago, training programs run by SERVOL (an NGO primarily working with poor youth) only provide training with a small stipend that is set low enough to prevent participants from dropping out of formal education and enrolling merely for the stipend.
- In India (Orissa and Andhra Pradesh), stipends for workers made redundant by the privatization program are kept at low levels.
- In Brazil’s rail privatization, a postprogram review proposed that at least part of the stipend should have been paid when training had been completed.

It is sometimes argued that the stipends given during training are social protection transfers. If this is a major issue for a large PPI scheme, then other mechanisms for targeting vulnerable workers and providing a social safety net need to be considered, such as a public works scheme or a broader social fund program.

**Cost Sharing and Vouchers**

One approach to making programs more effective is to introduce some element of cost sharing. Giving workers a choice between obtaining training or getting the equivalent amount in cash as part of severance pay is one way. Making a small deduction or charge for training is another, but this can chase away the poorest workers. A compromise approach is to offer free training for the poorest workers—for example, those with severance compensation below a defined amount—and then establish a sliding scale of (still modest) charges for other workers.

Another mechanism is the use of vouchers (either free or at some cost) to allow workers to select their own programs. Vouchers have been used as a
### Table 5.8: What Works Best When?

<table>
<thead>
<tr>
<th>Activity</th>
<th>When it is most appropriate or likely to work best</th>
<th>When it is unlikely to work well</th>
</tr>
</thead>
</table>
| Counseling and prelayoff support              | - Can be effective as a mechanism to provide information to workers if delivered efficiently, and on time (that is, before severance).
- Is useful as a screening mechanism to identify workers most likely to demand and benefit from training or other support.
- Works best where unemployment is frictional (that is, there are job vacancies but workers face information gaps) rather than structural (that is, workers lack the skills or live in the wrong places to fill existing vacancies) or where there is a lack of labor demand (that is, too few job vacancies). | - Is conducted too late (that is, after workers have left the enterprise).
- Is not supplemented by other redeployment services.                                                                                                                                                                                                                                                              |
| Job-search assistance/placement/employment information exchange services | - Works best where unemployment is frictional rather than the result of skill mismatch between workers and vacancies or a lack of labor demand.
- Country is large and job opportunities are available for workers with existing skills in other regions.
- Public employment service is trusted by workers and employers and offers effective employment intermediation services.
- Government has deregulated to allow the private sector also to provide placement services (with costs funded by the employer to prevent potential abuses of workers).
- There is a local tradition of worker migration, nationally or internationally.                                                                                                                                                                                | - Informal economy dominates.
- Economy is depressed and formal work opportunities are few.
- Country is small and private, and informal networks (that is, friends, family) are the most important sources of job information.
- Public employment services (PES) are weak, highly decentralized, and have little capacity to provide a national labor information exchange.
- Workers don’t trust PES (perhaps because they also monitor unemployment benefit fraud).
- Employers don’t trust PES (perhaps because they also regulate labor standards).
- Private sector placement and intermediation services are still illegal or excessively regulated.                                                                                                                                                       |
| Skills-based retraining/skills upgrading for employment | - Economy is growing reasonably fast and employers are hiring, but displaced workers lack appropriate skills.
- There is a local tradition of worker migration, nationally or internationally.                                                                                                                                                                                  | - Formal sector job opportunities are limited.
- Workers are illiterate or have a very limited skill base on which to upgrade.
- There are barriers to entry into employment (regulations on demarcation of jobs).                                                                                                                                                                    |
Table 5.8 (continued)

<table>
<thead>
<tr>
<th>Activity</th>
<th>When it is most appropriate or likely to work best</th>
<th>When it is unlikely to work well</th>
</tr>
</thead>
</table>
| Training for self-employment    | • Economy is diversifying or undergoing rapid structural shift to services (e.g., in transition economies, India, and China).  
  • New entry into small business is relatively easy, and economies are substantially deregulated.  
  • There are personal networks that can provide capital and support for entrepreneurs.  
| Employee enterprise             | • PPI schemes have potential to contract out services (such as meter reading, construction, facilities maintenance, infrastructure maintenance, and minor works).  
  • PPI schemes have managers committed to developing a flexible work force and helping contractors succeed.  
| Community-based programs        | • There is a history of civil society institutions (including trade unions) that can propose and manage local demand-driven projects.  
  • Decentralized local and municipal governments are effective, capable, and trusted.  
  • Formal sector employment opportunities are weak.  
| Public works programs           | • There have been massive layoffs, with significant numbers of workers needing a temporary safety net rather than a “trampoline.”  
  • Formal and informal economy and income opportunities are both weak.  
  • Vulnerable groups or regions can be identified and resources targeted there.  
  • Activities are demand-led by local communities and NGOs.  
  • Self-targeting is possible though rationing support to the poorest and most vulnerable people (e.g., through low wages, queuing).  
|                                 | • Economy is stagnant or in recession; the formal sector is moribund and not providing work for the informal sector.  
  • Economy is highly regulated, with excessive red tape that restricts small business and microenterprise start-ups.  
  • Strong culture of the public sector remains; workers expect “guarantees from government” for new businesses.  
|                                 | • Country has strong laws or tax disincentives against contracted labor.  
  • Strongly negative attitude exists toward subcontractors by management or trade unions.  
  • Continuing underemployment within the PPI enterprise conflicts with plans to contract out services to former employees.  
  • PPI operators have no effective disciplinary control over rent-seeking contractual practices.  
|                                 | • There is profound conflict among ethnic groups, factions, or interest groups.  
  • Initiatives can be captured by vested interest groups.  
|                                 | • Political interference and patronage systems lead to excessive spending and misdirected support (that is, not to the poorest people).  
  • National minimum wage is relatively high and can’t be reduced.  
  • Government regulations will not allow self-targeting of the poorest people through low payments (e.g., there is a mandatory minimum wage).  

### Table 5.9: Mechanisms and Incentives for Redeployment

<table>
<thead>
<tr>
<th>Activity</th>
<th>Selection mechanisms for displaced workers</th>
<th>Performance incentives for service providers</th>
</tr>
</thead>
<tbody>
<tr>
<td>Counseling</td>
<td>• No active selection required; should reach all workers and spouses</td>
<td>• Performance bonus to contractor if counseling reaches above a minimum percentage of workers</td>
</tr>
<tr>
<td>Job-search assistance/ placement/ employment</td>
<td>• No active selection required; should be open to all workers or • Self-selection by payment of a minimum fee (cash or voucher)</td>
<td>• Competitive bidding for job-search assistance</td>
</tr>
<tr>
<td>information exchange services</td>
<td></td>
<td>• Placement agency gets bonus for every worker still in job after, for example, 3 months</td>
</tr>
<tr>
<td>Skill-based retraining/skill upgrading for</td>
<td>• Counseling as a means of screening and matching workers with courses to improve the impact and relevance of the training</td>
<td>• Competitive bidding, plus quality control criteria for program accreditation of training institutions</td>
</tr>
<tr>
<td>employment</td>
<td>• Self-selection by payment of a minimum fee (cash or voucher)</td>
<td>• Penalties imposed on training agency for dropouts (monitored by independent auditor)</td>
</tr>
<tr>
<td>Training for self-employment</td>
<td>• Counseling as a means of screening and matching workers with courses to improve the impact and relevance of the training</td>
<td>• Competitive bidding, plus quality control criteria for program accreditation of training institutions</td>
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<td></td>
<td>• Self-selection by payment of a minimum fee (cash or voucher)</td>
<td>• Bonus for training agency for every worker still in job after, for example, 1 year (according to monitoring program)</td>
</tr>
<tr>
<td>Employee enterprise</td>
<td>• Active selection on the basis of objective appraisals of the business plans</td>
<td>• Commercially oriented enterprise, incubator, or managed workspace receives revenue benefits from successful cases</td>
</tr>
<tr>
<td>Community-based programs</td>
<td>• Active selection by managers of incubator or managed workspace</td>
<td>• Staged payments for activities</td>
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<td></td>
<td>• Self-selection of possible community projects, as proposed by community</td>
<td>• Transparency and audits</td>
</tr>
<tr>
<td></td>
<td>• Active selection of projects on the basis of (a) cost-benefit ratio and (b) social or poverty impact</td>
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<tr>
<td></td>
<td>• High levels of transparency in the community on the amounts and use of funds; independent auditing</td>
<td></td>
</tr>
<tr>
<td>Public works programs</td>
<td>• Active targeting of vulnerable groups and geographic regions/locations</td>
<td>• Performance-based contracts for services (e.g., transportation and supply of materials)</td>
</tr>
<tr>
<td></td>
<td>• Self-selection of the poorest displaced workers through mechanisms such as low pay (perhaps below minimum wage) and enforced queuing</td>
<td></td>
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</table>
A tool for obtaining training and business development services in Ecuador, Paraguay, and Peru. The experiences of these projects are relatively well documented (see, for example, Bothelo and Goldmark 2000; Goldmark and Fitzgerald 2001; and Goldmark, Bothelo, and de Andrade Orozco 2001). Other examples are:

- A pilot program for the use of training vouchers was launched in the Republic of Korea in 1998 (Betcherman and others 2000a, 2000b), and vouchers were proposed for training redundant workers in the Ukraine coal mines (World Bank 1996c).

- Tanzania’s Civil Service Redeployment Program has used vouchers for both counseling and training of some 63,000 retrenched employees (Blomquist 2002).

- In Kenya a project to stimulate demand and supply for training and business development services for the self-employed, microenterprises, and small businesses used a voucher mechanism. The demand-driven approach led to most training being provided by small-scale, but more experienced, private sector master craftsmen. It also helped expand, diversify, and customize the supply of training, and helped link the savings and credit associations of microentrepreneurs with microfinance institutions (see Steel 2003).

Vouchers help shift from such a supply-driven approach dominated by the training providers to one in which the clients (displaced workers) have the power to select services relevant to their needs (see figure 5.3). Experience with vouchers, however, is relatively recent. Although initial evaluations of programs are promising, there is insufficient evidence to recommend widespread use. Nonetheless, they do address some of the fundamental deficiencies in training provision. A voucher program tightly targeted at displaced workers has a number of potential advantages over other types of voucher schemes in that:

- The client group is well defined.
- Concerns about distortion of the market are less significant because funding for any type of redeployment training will distort the market for redeployment and training services.
- There is less concern over the sustainability of the program—it ends when the last group of workers has passed through it.
- Self-selection occurs when there is a charge for the voucher because workers who do not intend to use it do not buy it. In the Kenya project a charge of 10 percent was made. Even so, about 37,000 vouchers were issued and 32,000 persons trained.
- The voucher could be traded within families (using identification cards, ration cards, and the like to identify the trainee). This will answer a common request among older retrenched workers to have a younger family member trained in their place.

The problems that the implementing agency will face regarding vouchers are likely to be linked to administration and to the training institutions rather than to participants. For example:

- Programs may be complex and costly to administer.
- There may be a shortage of training providers willing to participate (although the introduction of vouchers can help to improve the supply of training providers).
- There can be attempts at fraud or collusion between trainers and workers to share revenues among themselves. That risk can be tackled through a combination of independent auditing (random checks of attendance at training courses, postcourse interviews with trainees), regular monitoring of performance, and annual or biennial competitive rebidding of the contracts for training.

**Performance Contracts**

More demand-driven programs can also be encouraged, without the complexity of vouchers, through
transparent, competitive procurement, regular retendering, and performance-related contracts for suppliers. In Turkey’s privatization program, for example, negotiated job placement rates were required in the contracts of service providers (at minimum levels of 10 percent for counseling and job placement services and 60 percent for retraining).

The reporting and publication of performance data can also support performance contracts. If potential program recipients gain access to good information on all training providers and performance measures (including numbers of other workers selecting the course, dropout percentages, quality ratings by former students, and success rates in redeployment), they are likely to move to programs that are both relevant and appropriate for them.

**Step 5: Set up a Redeployment Team**

When the redeployment program has been designed, a key step is to put in place a team to implement the program. The main tasks are to:

- Agree on the institutional home for the redeployment program. There are various options: one is to place the team in the implementing agency; another is to have a group such as the ministry of labor run the program. In either case, implementation of the actual program is generally subcontracted to private sector or nongovernmental institutions.

- Obtain the necessary expertise. The manager of the PPI implementing agency will have many other tasks and will need to delegate redeployment and severance matters to a labor specialist. (See the Toolkit CD-ROM for an outline job description for a labor specialist.)

- Advertise in well-known national newspapers to obtain a prequalified list of potential contractors who can subsequently be invited to bid for redeployment services. Private sec-
Experience with vouchers is relatively new.

Workers need honest, transparent information on the quality and performance of courses.

Labor funds can be a vehicle for a mix of government and donor initiatives directed at creating employment and supporting redeployment.

Social funds are more poverty focused, but can also support active labor market and social safety net initiatives.

Step 6: Develop Cost Estimates and Funding Arrangements

In addition to program activities, funding will need to cover the costs of:

- Administering the program, including the costs of labor experts, counselors, and the like
- Monitoring program progress and overall gross effects on workers
- Evaluation of the net impact at the end of the program

These funds should be linked to the overall timetables for PPI and severance because there is little point in releasing funds for a labor program before basic approvals for PPI have been received.

The accompanying CD-ROM provides a spreadsheet to help develop cost estimates for program activities.

Redeployment programs can be implemented and funded through national-level labor or unemployment funds, as has been common in Eastern Europe and Central Asia. These funds are typically financed on a discretionary basis from the state budget, often with the support of loans from donors and international financial institutions. The primary objective of these funds is to enable activities that help unemployed people get back into gainful employment. Where such funds do not exist, or where they serve a different purpose than what is required at the PPI level, separate arrangements can be made in which monies are channeled directly to the PPI implementing agency or to the group that is directly responsible for the redeployment program.

Social funds have also been used in some cases. Social funds are special-purpose, public sector arrangements designed to mobilize resources to alleviate poverty. Social funds differ from labor funds in that they are more directly concerned with poverty reduction and income support rather than employment generation. Their activities may, how-
ever, support displaced workers, particularly in regions of acute unemployment or in single-industry towns. Social fund activities are generally demand driven. Social funds do not directly implement social safety net programs, but rather solicit, evaluate, finance, and then monitor projects proposed and undertaken by private contractors, NGOs, or other groups. Social funds can attract substantial donor financing.

In the context of retrenched workers, social funds may serve a range of active labor market programs, such as retraining, microenterprise loans, and public works programs, in addition to social and welfare services. In 1985 Bolivia established the world’s first Emergency Social Fund to help miners who lost their jobs because of economic adjustment (see box 5.21). It proved so successful that it became the model for Bolivia’s Social Investment Fund set up in 1990 to finance long-term development of the country’s social services and to deal with the more intransigent problem of endemic poverty.

Further advice on the design and implementation of social funds is available from the World Bank at www.worldbank.org/socialfunds.

Box 5.21: Bolivia—The Emergency Social Fund

In Bolivia the state mining corporation reduced its staff from about 28,000 in August 1985 to fewer than 6,000 by the end of 1986. The World Bank supported an emergency fund to help redeploy the miners. The Emergency Social Fund (ESF) was set up as a temporary fund to finance a large number of small-scale, labor-intensive subprojects in infrastructure (housing, schools, road improvements, erosion, flood control, and irrigation works), as well as technical assistance and extension programs.

The ESF illustrates some of the benefits of public works programs. The greatest benefits from participating in the program were received by those who would have been least well-off without it. Although the subprojects originally were intended to employ mostly miners, only 15–20 percent of them were employed under the ESF. Studies showed that although a number of miners moved rapidly to new jobs, others were reluctant to participate in ESF projects because the pay was low. The subprojects’ ex post rates of return were generally positive and contributed substantially to reducing the social cost of adjustment after the economic crisis of the mid-1980s.


If rapid response facilities are in place or are being developed, the implementing agency might usefully build these into the overall design of the redeployment program.

Step 7: Identify and Commission Service Providers

The implementing agency’s office does not need to provide services directly, and many services can be contracted out. Terms of reference and contracts should include performance-based payment mechanisms to encourage performance, with clear performance measures and reporting requirements. This enables the program to be outcome driven (for example, by number of workers employed or number of workers with increased incomes) rather than numbers driven (for example, by number of workers counseled or number of workers who attended training courses).

Other measures to improve the quality of service provision are to:

- Introduce open competition into the provision of services, and ensure transparency in the process of selection and award.
- Provide for pilots or phased programs so that the initial performance of service providers can be checked, as well as the relevance of the activity. These help deal with the inevitable uncertainty as to what will work best. Pilot activities can then be tested, monitored, reviewed—ideally by independent specialists—and then rejected, amended, or expanded.
- Conduct regular progress reviews that are linked to incentive mechanisms, such as regular competitive bidding for services.
- Engage independent auditors and monitors to review and evaluate the service providers.
Step 8: Monitor and Evaluate the Program

Module 7 sets out monitoring and evaluation processes in some detail and describes a range of performance monitoring measures. The implementing agency’s key tasks here are to:

- Set up formal monitoring arrangements (again using independent contractors if possible) to provide regular reports on training and other services, and conduct follow-up surveys and focus groups to assess how redundancy is affecting individuals, families, and communities.

- Measure against performance indicators, such as numbers of other workers selecting the course, dropout percentages, quality ratings by former students, success rates in redeployment (see O’Leary 1995).

- Put performance and monitoring reports into the public domain so that workers can make more informed decisions on which services and providers are appropriate for their needs. This is important because, until training starts, neither the trainee nor the implementing agency has any real idea how good (or bad) the quality of training will be, especially if there are few redeployment service providers with prior experience in the country.

- Include short-term tracer studies on the impact of training on workers. This can help identify weaknesses in program activities. For example, if a training activity is only preparing workers for (perhaps nonexistent) formal jobs, ignoring the informal sector and self-employment, then it may have very limited success.

- Adapt the program in the light of performance findings.

- Provide for an independent net impact evaluation and then redesign as needed.

Counseling

Counseling is the first, and minimum, level of support that the implementing agency can put into place to help displaced workers. There are many types of counseling. Although cost-effective, counseling is often neglected.

Types of Counseling

The content of worker counseling can include:

- **Trauma counseling**: Job loss is a clear case of potential trauma in the lives of workers, and one component of the counseling process is to provide support and assistance to those who are particularly distressed by the event. Redeployment counselors may lack these skills and there is scope for involving NGOs with skills in these areas.

- **Financial counseling**: This is particularly important because severance may be the largest sum of money a worker receives in his or her life. Counseling can help people make prudent investment decisions by providing advice on:
  - How severance has been calculated.
  - Options for investing money (choices and risks).
  - Investing in self-employment. Experience shows that many recipients of severance pay assume (wrongly) that they need to invest large amounts to start a business, when in practice a more cautious “start small and test the market” approach may be needed.
  - The need to protect severance pay from fraudulent investment schemes set up to exploit the sudden increase in liquidity in a community where many people are receiving severance payments.
  - Helping prepare workers (particularly in rural communities) for the sudden arrival of large numbers of “extended family” seeking to benefit from the perceived windfall.

- **Counseling on job opportunities**, redeployment, and training services provides infor-
mation to workers on how to find new jobs and other income-earning opportunities, as well as how to access redeployment services (training, small business support, placement, and job-search services). There is some evaluation evidence (for example, Blomquist 2002) that counseling plus training are more effective than training alone.

Timing, Location, and Frequency of Counseling

Counseling can start when the first announcements have been made to workers about potential retrenchment. Two phases can be identified:

• **Prelayoff counseling**, which will focus on:
  - Providing accurate information to workers and their families on severance programs, possible training opportunities, the timing of activities, selection procedures, and treatment of staff housing, among other things. This helps improve workers’ decisionmaking and avoids damaging rumors.
  - Establishing facilities for counseling (and job-search assistance), which may be located within the workplace or in a separate facility that workers can easily access.

• **Postlayoff counseling**: Counseling during this phase can become more intensive but should not distract the worker from his or her own job-hunting efforts.

The workplace is often the best location for counseling, particularly for early interventions and prelayoff counseling. Improving employee accessibility to information about training opportunities is key. Information can be made available at various locations:

• In the premises of the utility or PPI plan (easiest for workers and the most cost-effective location for initial counseling)
• In temporary rented accommodations (useful where the redeployment program needs to distance itself from difficult separation process)
• Through mobile visits (for counseling or training of smaller groups)
• At job fairs or meetings; in the community, using facilities of training institutions, local government, or other partners; at traditional meeting places; or in workers’ homes.

Materials provided for workers should be in their own language. If many workers are illiterate, redeployment programs need to make more use of radio, video, group meetings, and means for providing information via other people in the community who meet workers face to face (for example, health workers or workplace “peer counselors”).

How much counseling is required? Intuitively, a single session is unlikely to be sufficient to help workers dealing with significant job-loss trauma or challenges in finding new income. In India practical experience with national and state-level schemes has found that repeated visits are necessary.

Designing an Effective Counseling Program

Counseling before and after severance is a relatively low-cost measure. Hess (1997) estimated counseling costs on the order of US$100 per worker. In practice the costs have been significantly lower. In state-level programs in India counseling costs have been estimated at about US$10 per retired worker, equivalent to about 10 percent of the cost of training delivered to each worker. The Toolkit’s CD-ROM contains a sample spreadsheet that facilitates the calculation of the costs of setting up a counseling program.

Counseling is relatively low cost, but that does not always mean it will be effective. The implementing agency can improve effectiveness if:

• There is rapid mobilization of counseling services. In some cases workers may disperse to their homes very soon after severance so it is essential to deliver counseling advice before that happens. For the implementing agency this means that operating budgets, recruiting and training of counseling staff,
and counseling materials all need to be in place well before workers start leaving the enterprise. A minimum of six months is ideally needed prior to the formal announcement of retrenchment so as to coordinate all the resources (staff, materials) necessary to set up a counseling program for a major workforce restructuring program.

• There is early attention to building capacity in counseling. The implementing agency can address this by:
  – Contracting a training provider. Counseling is an underdeveloped skill in many developing countries, and the implementing agency may need to look to NGOs with experience in disaster counseling, conflict resolution, and negotiation for “training the trainers.”
  – Using competitive bidding mechanisms to identify a range of potential service providers from government agencies, NGOs, and the private sector.
  – Recruiting and training local counselors. Some programs have successfully selected young college graduates as counselors for privatization redeployment programs. Local counselors have the advantage that they come from the same communities as the workers; and their local sensitivities and language skills mean that they can be quickly effective when they have had induction training.
  – Using peer counselors—that is, other employees from within the workplace.

• There is some degree of independence of the counseling service so that the advice is not compromised. This means:
  – Keeping counselors independent of tasks that are properly the work of the utility/PPI enterprise managers—for example, the announcement of layoffs or the selection of workers for redundancy. Counselors should be associated with helping the worker, not with the retrenchment process itself.
  – Ensuring that counselors are as independent as possible from the training program. Where counseling and training are combined, there is a risk that counselors become sales agents for the training programs and push workers to inappropriate courses simply to boost the numbers of “trained” workers.

**Job-Search Assistance**

Job-search assistance can be valuable because it helps identify and match workers’ skills to available job opportunities. Job-search efforts generally show positive results and, when targeted, can be cost-effective.

**Employment Services**

The purpose of job-search assistance (or outplacement) is to reduce the time and transaction costs that displaced workers would otherwise incur in trying to find new employment. There is evidence that job-search helps works, at least in situations where the formal labor market is active:

*The intervention that seems to work best—at the lowest cost—is job search assistance (sometimes combined with other labor market measures)* (Fay 1996, reviewing active labor market programs in OECD states).

Public employment services in particular have served as brokers matching jobs with job seekers, traditionally through physical centers (employment...
“exchanges”). Internet technology is also being used in some countries (box 5.22).

In a comprehensive review of active labor market programs, Dar and Tzannatos (1999) concluded that evidence suggested job-search assistance could have positive effects and is usually cost effective compared with other active labor market programs. Results, however, were linked to the labor market conditions—where overall unemployment is rising, job-search assistance has not had a positive impact.

Dar and Tzannatos 1999.

Assisting Job-Search Efforts

In industrial countries, a first phase of job-search assistance is often undertaken on the premises of the enterprise, and involves providing an outplacement center where workers can:

- Practice and be trained in job-search and interview techniques
- Share experience and gain employment ideas from other workers, perhaps through peer counselors, as members of a job club (see box 5.23), or from visits by other workers who have been made redundant earlier
- Receive other relevant counseling advice (financial, household planning, trauma, life, livelihood)
- Have access to information (books, brochures, video, presentations) on training courses, self-employment options, and other resources
- Have access to computers (where appropriate) for preparation of curriculum vitae and for searching Internet-based job prospects.

Another tool is the provision of an additional period of paid time during which workers continue to receive a salary but can use that time for job search. It can help both workers and managers:

- Managers in the enterprise reduce any potential problems arising from disaffected workers in the workplace.

Rebuilding displaced workers’ confidence is an important element of both counseling and job-search assistance.

Retraining

Retraining is often the biggest element of a redeployment program, and often the most costly. Retraining can be provided for both formal employment and self-employment. The record of such programs has been mixed. Retraining needs to be targeted and made demand driven if it is to be effective in cost and outcome.

Retraining for Employment

Retraining programs to facilitate formal sector employment are a common element in redeployment programs (box 5.24). Courses usually combine a mix of practical and theoretical training and include:

- Short-term (one to six months) vocation courses for unskilled and semiskilled work-
ers in areas such as taxi driving, basic carpentry, motor rewinding, dressmaking.

- Short-term technical courses for more skilled employees. For example, the growth in information technology services has prompted the popularity of computer training courses among more qualified workers redeployed from privatized SOEs in most Indian cities.

- In-service training and on-the-job training are particularly valuable. Often these provide mechanisms where workers can enhance or extend their skills through working as an “apprentice” to a skilled worker. In Kenya these were the most demanded training providers in a small-enterprise training program (Steel 2002). Training programs can work with employers to provide on-the-job training and a commitment to hire a proportion of trainees, perhaps in return for receipt of the worker’s stipend. (This approach was used in the PROBECAT program in Chile.)

Generally, training costs are about US$200–$500 per worker in middle-income countries (see Fretwell 2002). In Brazil’s rail restructuring, however, the average cost of training was about US$900 per worker, and similar costs were reported for group training in Hungary (O’Leary 1995). Uptake varies considerably but is generally relatively modest—typically 15 to 30 percent—and depends on labor market conditions, the relevance of the training, and the level of incentives (stipends) to workers.

Box 5.23: What Happens in a Job Club?

A job club is a group of workers who meet regularly together as part of their job-search efforts. The job club may be supported by the implementing agency or by the public employment service. Members of the club can determine their main activities, which could include:

- Receiving job leads from potential employers and job-search agencies
- Sharing information about job openings
- Developing job-search strategies
- Preparing curriculum vitae or résumés and helping each other complete job applications
- Creating job-hunting teams for moral support and shared transportation
- Taking field trips to workplaces that may be hiring
- Practicing interviews, telephone skills, and telephone follow-up calls
- Listening to speakers or watching videos about different kinds of jobs
- Getting and sharing information about housing, legal aid, medical assistance, and other resources
- Sharing experiences—good and bad—and talking about how they feel about trying to get a job and the effects of unemployment on them and their families; planning and taking part in shared social events.


Box 5.24: Retraining—Chile’s Program for Mine Workers

The Retraining Program for Displaced Workers is a pilot project organized recently by the government of Chile with the financial assistance of the Inter-American Development Bank Multilateral Investment Fund. The program is mainly designed for skilled adult workers displaced by industrial restructuring and technological progress. The program is currently focusing on the retraining of more than 1,000 redundant coal miners. The program managed by the Production Development Corporation includes subsidies for counseling, retraining, and employment intermediation services for displaced workers. The private agencies that provide these services are selected on the basis of competitive bidding and receive a maximum subsidy of approximately US$2,000 per reemployed worker. Enterprises that hire retrained workers receive a subsidy of approximately US$900 per worker. The retraining and reemployment program is part of a broader plan for industrial restructuring in the coal-mining region that offers a series of incentives for private investment in labor-intensive projects.

It should also be pointed out that governments may not want to offer redeployment and training, perhaps in circumstances where the broader reform goal is to reduce a culture of dependence on government for services, assistance, and subsidies. There may be a policy of offering a generous one-time severance package and encouraging a clean break between workers and government:

*We don't want to offer redeployment and retraining. We have offered a generous separation package, and workers are leaving quietly. If we offer them retraining, they will then expect a job at the end of it, almost a government guarantee (adviser to prime minister’s office, developing country).*

**Retraining for Self-Employment**

Most training for redundant workers has focused on training for jobs in the formal sector. In part this has reflected aspirations of government, implementing agencies, unions, and workers alike. But retraining for self-employment is also relevant, especially where formal jobs are scarce. Training for self-employment can address upgrading workers’ skills for the “informal sector” of casual employment and trading, and is best linked to broader small- and medium-size enterprise support. Reasons to focus on the informal sector are that:

- Many displaced workers have little formal commercial or business experience. A common counseling experience is that newly displaced workers, flush with their severance payments, can have overly ambitious plans for becoming entrepreneurs. Encouraging workers to try out their business ideas and their aptitudes for business with very small, low-risk, informal trading activities is often more appropriate than their investing—and risking—most of their severance money in an untested business.
- The state may well provide barriers to entry to formal business.
- The informal sector can provide income opportunities that workers value (Maloney 2003), as well as a transition into other full-time employment or formal business.
- Workers are often already engaged in part-time self-employment (and their spouses are as well).
- Only a small proportion of displaced workers will have the aptitude for formal business. For example, a study of OECD and transition economies found that only around 5 percent of unemployed workers will choose to become self-employed (Van Adams and Wilson 1994).

From a policy perspective, support for self-employment is an approach that can stimulate labor demand without distorting other aspects of the economic reform process (through subsidies, for example). As with retraining for employment, programs to encourage self-employment also suffer from dead-weight loss effects and will benefit from measures to select participants. For example, an evaluation in Hungary and Poland, based on more than 5,500 follow-up interviews, indicated that many of those receiving financial and training assistance for self-employment would probably have gained reemployment without government help.

**Employee Enterprise**

Some governments have helped employees set up their own enterprises to contract services that were previously provided by the state enterprise, or set up workspaces and small business incubators.

**Contracting out Services**

Contracted-out services are one way to encourage employee enterprise and thus reduce unemployment among displaced workers. The enterprise awards limited-term, outsourced subcontracts to firms set up by former employees. Those new small businesses may then create jobs themselves.

Contracts are usually awarded with exclusivity periods for a relatively short period—typically no
more than two years—long enough to provide a secure environment for the new business to learn the disciplines required of private enterprise. The limited life of the contract provides an incentive to them to improve their performance and innovate in order to successfully bid competitively at the end of the contract. It also encourages them to devote time to finding new work and opportunities from other clients.

Contracting out also may be part of a wider strategy for restructuring of the enterprise. Ancillary functions (for example, catering, building and equipment maintenance) and core functions (such as revenue collection) can be separated from the main business and the services purchased from private providers. In cases where the private sector is still developing, there may be limited skills and capacity in the market to provide certain specialist services. These contracted-out services may contribute to overall employment but need not necessarily employ the redundant workers.

Examples of contracting out include:

- **Privatization of service units:** For example, in Mexico rail privatization the period 1990–95 saw the sale of various small factories and workshops that provided services to the railway. Many of the workers who left the company in that period joined the small factories as workers (López-Calva 2001). In Bolivia’s railway, job losses in the privatized railway were partly offset by new jobs in maintenance contracting companies (Valdez 2002). Road reforms in a number of Sub-Saharan African countries have created new opportunities for road maintenance contractors (box 5.25).

- **Utility companies changing the skill mix, as they become more customer and service oriented:** For example, Telecommunications New Zealand (TNZ) concentrated its strengths on marketing and customer service, and outsourced many technical jobs. In a lot of cases, staff took early retirement or redundancy options before taking up positions with subcontractors who were called in to do the work (Ross and Bamber 1998).

- **Redundant utility employees being offered guaranteed contracts to undertake work such as meter reading:** In the privatization of the Manila water supply, the two concessionaires agreed to give preferred-contractor status to a service cooperative of former employees for one year (Cruz 2001). In the privatization of Argentina’s national oil company, about 5,000 retrenched employees received supplier contracts for up to two years for their approximately 200 newly formed businesses (Shaikh 1996).

- **Private sector contractors being required to give first right of refusal to displaced workers:** For example, following the introduction in 1992 of the Competitive Contracting Program, the city of Philadelphia, Pennsylvania (United States) implemented several programs designed to help public workers in the transition required by privatization and public–private competitions. The city created new job classifications and

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**Box 5.25: Malawi—Road Maintenance by Displaced Workers**

Road maintenance in Malawi has been transformed from an activity managed by the (former) Department of Roads using government road gangs to one that is managed by a new Roads Authority, where the actual work is undertaken by private sector contractors. This change did not occur overnight, however, and there was a two-year interregnum between the old and the new management. During those 24 months, basic road maintenance was carried out through contracts issued to small contractors by the Department of Roads. In practice these were groups of retrenched workers formed around former charge hands and foremen who provided skills and continuity. It may have been somewhat messy, and undoubtedly that was a period of muddling through, but this approach did allow workers and the government time to adjust to the new regime and the new arrangements, and provided something of a safety net for workers who were displaced from regular government employment.
established a redeployment office to match the skills of displaced employees with position openings in other departments. It also gave displaced employees preferential consideration for other city jobs and required private contractors to give first right of refusal to affected city workers.

Special assistance and training in setting up a business can be offered because workers may not be familiar with all the requirements and principles of small business. The implementing agency can therefore engage specialist small-business development agencies to undertake a selection and training program for applicants for contracted-out schemes.

If successfully designed, such programs can win the support of workers. Trade unions may be opposed to contracting out, however, because of concerns about workers moving into so-called atypical employment and less formal contracts that offer less protection to the workers.

Making Employee Enterprise Work

Not all employees are suited to employee enterprise, and not all the new companies formed are likely to succeed. This is normal—many small business start-ups fail, although ones that receive professional support have a higher success rate.

The prospects of creating sustainable new employee enterprises can be improved by:

- Engaging business development advisers to screen and select employees with the aptitude to become small contractors
- Ensuring that the plan documentation and contracts are clear, comprehensive, and coherent so that workers can understand their choices, options, and risks
- Providing professional support to the selected employees through access to business start-up training and microenterprise training (with a minimum level of basic business training being mandatory)
- Reducing the costs of initial business start-up by providing free or low-cost access to sheds, garages, and simple industrial units, and allowing workers to keep and take the tools of their trade with them into their new enterprise
- Providing an initial period (one to two years) of guaranteed employment or exclusivity to allow the new enterprises to start up
- Reducing the risks that management or trade unions will renege on promises to support the use of contractors in the future, through contractual clauses agreeing not to compete unfairly with the new companies over a longer period (say, five years) and allowing (not restricting) the new companies to diversify and find other clients, and public memoranda of understanding or enterprise policies in favor of the outsourcing and contracting out of specified services.

Job-Creation Initiatives

In many transition and developing countries, a primary problem is the lack of demand for labor. Initiatives that help create jobs are valuable in many redeployment circumstances, but particularly in regions or monoindustrial towns with high levels of local unemployment. These initiatives include public works programs, support for small and medium-size enterprises, and local and community development planning and job-creation incentives for employers.

Public Works

Labor-intensive public works programs are mainly thought of as safety net programs to deal temporarily with large numbers of poor people in crisis. Public works programs can, however, be appropriate in PPI labor programs in regions where there is a particular mix of high and chronic levels of unemployment, lack of formal social safety nets, and large numbers of vulnerable workers.
The pioneering Bolivian ESF had elements of public works programs within it and was initially intended to support redundant mine workers at a time when the economy was very weak (see box 5.21).

Well-integrated public works programs can combine safety net benefits with community action, productive investment, and a degree of encouragement for workers to engage in microenterprise (where elements of the public works are contracted out). Senegal’s public works program, managed by AGETIP (Agence d’Exécution des Travaux d’Intérêt Public), is an example of a public works program that combines these objectives and has developed transparent, streamlined procedures (see box 5.26).

Support for Small Business

Support for small business includes technical advice (business development services), microfinance, and managed workspaces and business incubators.

Detailed consideration of these types of support is beyond the scope of this Toolkit, but further sources of information on each of them is provided at the end of this section on redeployment.

Managed workspaces and incubators deserve special mention, however, because the assets of the PPI enterprise can be used to help workers start up a business in a relatively low-risk way by providing workspace and facilities. The principal difference between managed workspaces and incubators is that incubators try to bring together both physical space and technical assistance to start-up entrepreneurs in one location:

Workspaces and incubators can be set up independent of labor programs and may be wholly private or public-private partnerships. The best incubators are themselves profitable businesses, making their incomes from tenant rentals. The implementing agency, however, will principally be interested in looking at the existing assets held by the utility and infrastructure company and seeing how these may be used to benefit displaced workers.

British Coal Enterprise (BCE) is one of the early examples of this approach (see box 5.27). The BCE experience illustrates the value of very simple and basic managed workspaces. BCE workspace sites were often not attractive new buildings but converted former mine operation buildings. Some national and regional governments have invested in more substantial incubator facilities—some even moving toward high-tech science parks—but normally they have done so as part of a wider employment and economic development policy rather than as a strategy to deal with redeployment.

Worldwide there is much experience on the design and implementation of managed workspaces and business incubators. One source of information is the National Business Incubator Association.

The NBIA Web site is a source of information on incubators: www.nbia.org.

Box 5.26: Three-Point Checklist for Successful Public Works Programs

To make public works programs cost-effective, the implementing agency can check to see that:

1. They pay less than the prevailing market wage for unskilled manual labor in the program area. Restrictions on eligibility can be avoided by setting the wage rate at a very low level to ensure self-targeting (that is, only those in urgent need of a job take it, and as soon as they find better income opportunities they will leave the program).

2. The labor intensity of projects is higher than normal, although this may vary if the assets being created have real value for the poor in the area (for example, irrigation or road works that will benefit entire communities).

3. Where rationing of the public works scheme is required (for instance, where the demand for work exceeds the budget available at the [low] wage level), the program should be targeted at the areas with the most people disadvantaged by labor adjustment, as indicated by a credible poverty impact map.

Source: Adapted from Ravallion 1998.
Community-based approaches are those where communities—including local and municipal governments—participate in identifying, selecting, implementing, or monitoring programs designed to create employment or protect those who have lost jobs and incomes. The approach aims to build community partnerships to improve the business environment, strengthen the local economy, and create jobs for displaced workers. It also helps in rebuilding the economic foundation and increases citizen participation in local economic development efforts.

In some countries the employers remaining in the community have received incentives to create new jobs. For example, in Cape Verde vouchers were given to private employers to provide on-the-job training to employees retrenched as a result of privatization. The employers were reimbursed 40 percent of the salary of a retrenched worker for up to a period of six months (Kikeri 1998). In Poland loans at prevailing interest rates were made available to existing businesses to organize new employ-
ment places for at least 24 months. And in Hungary, the employment fund gave grant aid to enterprises making investments that would employ long-term employed workers. This was, however, the most costly form of active labor program—about six times more expensive than individualized training or self-employment assistance in terms of cost per person reemployed (O’Leary 1995).

Typically, the implementing agency or other government representatives or contractor will help organize a broad-based community task force to conduct an economic assessment and planning effort “owned” by the community. Community leaders are invited to participate in a structured economic renewal program designed specifically to strengthen the local economy and create more employment and livelihood opportunities. Workshops are conducted over, for example, a six-month period, and residents learn the principles of local economic development and are taught how to assess their community’s needs, write a local strategic plan, select and design projects, and begin implementing them. Community approaches may be complemented and financed by other programs, such as regional development initiatives, social funds, or labor funds.

Those approaches are particularly relevant where:

- The PPI plan produces significant employment effects on single-industry towns (for example, some ports).
- There is systemic and chronic unemployment in the region.
- There are opportunities that will benefit the community (for example, conversion of buildings into not-for-profit workspaces or public–private business incubators).
- The PPI plan leads to some resettlement of staff, perhaps because of the relocation or merger of operating units.

**Tools (on the CD-ROM)**

- Terms of reference for a redeployment survey
- Job description for a labor redeployment manager
- Sample worker survey
- Sample questionnaire for counseled workers
- U.S. Department of Labor adjustment model
- Monitoring and evaluation performance measures for job search assistance services

**Additional material (on the CD-ROM)**


**Web Sites**

- Committee of Donors for Small Enterprise Development: www.ilo.org/employment/sedonors. (The site provides access to guidelines on financial intermediaries and business development services for small enterprises.)
- The European Database of Business Incubators: europa.eu.int/comm/enterprise/bi. (Site provides access to information on incubators in 28 European countries, case studies, benchmarking information, and a database of nearly 950 business incubators.)
- International Labour Organisation’s International Training Centre: www.itcilo.it (For courses on enterprise development.)
- International Labour Organisation’s Small Enterprise Development: www.ilo.org/dyn/empent/empent.portal?p_prog=S.
- National Business Incubator Association: www.nbia.org. (This site provides information about the organization’s publications on business incubation and about annual conferences. NBIA provides materials and experiences from developing as well as industrial countries.)
- Polish Railway Retraining and Re-employment Agency: www.kaaz.pkp.pl/en/kaaz.html. (An exam-
EMLOYEE SHARE OWNERSHIP

Employee share ownership can be used as part of the PPI program, as an element of compensation, as an inducement to remain with the operation post-PPI, or as part of an employee buyout. This section outlines those potential roles.

Employee share ownership often has multiple goals, centered around:

- Concepts of redistribution through gain sharing of the wealth generated from the PPI enterprise.
- Reduction of the principal-agent problem (where managers behave in ways that hurt the interests of the firm and its owners). When workers and managers share in the profits of the firm there is likely to be closer alignment among the work force and managers and the owners of the enterprise (the shareholders).
- Reducing opposition to PPI by enlisting support from workers.

In work force restructuring, employee share ownership can be used in three ways:

1. As a form of compensation to displaced workers. Instead of cash, they can receive shares of the enterprise.

Available at www.unido.org/userfiles/PuffK/lalkaka.pdf.


2. As part of a new incentive or reward package for workers who remain with the enterprise.

3. As the basis for management employee buyouts or employee buyouts of units of the enterprise.

Compensation Packages for Redundant Workers

As part of a compensation package, share transfers are probably best viewed as a supplement to, rather than a substitute for, severance or early retirement. This is true for three reasons:

1. As a social safety measure, share transfers are problematic because the benefits that workers receive will depend on movements in share prices. Those movements in turn depend on uncertain micro- and macromacroeconomic factors. Implementing agencies should exercise considerable caution if they wish to promote share ownership as a compensation mechanism; dramatic falls in share prices during 2001 are reminders of share price volatility. Although in the past some workers have done very well from shares, these successes have been in sectors—such as telecommunications—that have recorded very high levels of growth for a period. A strategy that provides a large proportion of workers’ post-PPI compensation and safety net in the form of shares is too risky an investment strategy—particularly for older workers. Governments, however, have sometimes offered shares backed by a guarantee to workers.

2. Many developing countries have relatively weak institutional environments for their capital markets (that is, uncertain property rights, limited protection of minority shareholders, poor share registration and depository systems, and weak regulation and oversight). Combine that environment with a work force that has little experience of share ownership, and there are significant risks of governance failure and abuse.

3. If only a limited number of shares are available for allocation to employees, many managers would prefer to see those allocated to the remaining work force as a performance incentive rather than to departing workers.

Shares as an Incentive or Reward

The use of share transfers or discounts as an incentive to workers is a common feature of infrastructure PPI through privatization (see box 5.28). In an analysis of 630 privatizations of infrastructure, energy, and other enterprises, conducted by initial share offer in more than 59 countries, more than 90 percent of the transactions transferred shares to workers. On average 7.6 percent of the shares were sold to employees, often on favorable terms (Jones and others 1999). Data for the individual enterprises is available at http://facultystaff.ou.edu/M/William.L.Megginson-1/.

Some countries have established the concept or principle of employee share transfers in privatization laws. For example, Article 14(4) of Nepal’s Privatization Act 1994 states that “His Majesty's Government shall make available to the workers and employees of an establishment which is to be privatized some of its shares free of cost or at a subsidized price.” In Malawi the government encourages employees in privatized companies to buy shares in the form of an employee or management buyout. In such cases the privatization commission may offer a discount of 20 percent. In addition employees may be allowed to pay for their shares by deferred payment terms or through a privatization fund managed by the Investment and Development Bank of Malawi, as part of a financing agreement between that bank and the European Investment Bank. (The fund was so popular that the money originally allocated was exhausted within a few months.)

Employee Share Ownership Plans

An employee share ownership plan (ESOP) is a mechanism that enables and facilitates employee ownership in a company. As some of the examples
Box 5.28: Shares as Incentives in Infrastructure Privatization

**Thailand power:** Privatization of the Ratchaburi Electricity Generating Holding Public Company Ltd. provided for 45 percent of shares retained by Electricity Generating Authority of Thailand (EGAT), 40 percent of shares offered to the public through an initial public offering (IPO), and 15 percent offered to employees through an ESOP. The employees received shares at par value (10 baht/share) compared with the IPO price of 13 baht/share. The aggregate value of the shares offered to the EGAT employees was no greater than three times the monthly wage bill for all EGAT employees (Bhoocha-oom 2001).

**Bolivia rail:** In the concessioning of Bolivia’s rail networks, the ministry decided to use share options as a means to minimize risk and promote share ownership among workers. To access the option, workers had to purchase one share at a preestablished book value share price of US$20. The option contract gave workers the right to buy shares owned by the state or by public shareholders at book value, up to a total of their social benefits (one monthly wage per year of work). The option could be exercised anytime during a period of one or two years after the closing of the transaction with the private operator (it varied among companies as a result of negotiations). However, after the opening of the economic envelopes (financial tenders), the offer for the newly issued shares in the case of the eastern network was only 4.6 percent above book value and for the Andean network it was 54.3 percent below book value. Therefore, most of the workers decided not to exercise their options to buy additional shares (Valdez 2001).

**Italy's Enel:** The first stage of privatization of Enel Spa, the publicly owned Italian electricity sector operator, took place in November 1999. Approximately one-third of the capital stock of the company was floated on the Milan and New York stock exchanges. The offer was well subscribed and included share requests to 70,302 of the company’s employees (85 percent of the total group work force as of June 1999). In addition, the three main sectoral unions had promoted establishment of an association of employee shareholders (European Industrial Relations Observatory On-line [EIROnline]). Available at www.eiro.eurofound.ie/.

**Chile airline and power:** The second phase of Chile’s privatization program included a program that offered low-risk share ownership. As a general rule, workers were offered 5 to 10 percent of the company’s shares at a discounted price. To pay for the shares workers were allowed to borrow up to 50 percent of their severance pay, with the company promising to repurchase the shares at retirement at a value at least equal to the foregone severance payments. Therefore, employees could buy shares below market price with no cash outlay, with no risk of loss, and a potential for gain if the shares increased in value. The resulting enthusiasm among workers led, in some cases, to workers becoming the largest single shareholder group via personal borrowings used to expand their stake. This was the case in the privatization of LAN Chile (the airline), Metropolitan Chilicleta, and the Steel Company of the Pacific (Gates and Saghir 1995). In privatizing ENDESA, the electricity holding company, broader-based share ownership was encouraged, and the government not only placed 30 percent of the shares on the local stock market for the general public but also reserved shares for the work force.

**Mexico telecommunications:** To win over employees to the privatization of Telmex, the government offered them eight-year loans on favorable terms from a government bank to enable them to purchase 4.4 percent of its class A shares for a total of US$324 million. The bank held the shares in trust to ensure payment of the loan. The strategy was beneficial for workers: by 1995 employees had gained some US$1 billion in increased share value (Tandon 1995, Wellenius and Stern 1994).

**Ireland telecommunications and post:** In July 1998, 11,000 employees were given a 14.9 percent stake in Telecom Eirann—Ireland’s state-owned telecommunications company, through an ESOP, as part of an agreement that included 2,000 voluntary redundancies and changes to long-established working practices, and that was meant to help prepare the company for its subsequent privatization in 1999. Previous ESOPs in state enterprises (airline and electricity) had been limited to about 5 percent of the shareholding, but the 14.9 percent Telecom Eirann model set a precedent that was adopted for other infrastructure and utility firms, including the postal service, An Post EIROnline. Available at www.eiro.eurofound.ie/.

(Box continues on the following page.)
ESOPs now form part of the structure of privatization programs for infrastructure enterprises in developing countries. ESOPs are usually:

- Structured as a separate legal entity (often a trust) that purchases shares held on behalf of the employees, with a defined mechanism that describes how shares are distributed.
- Designed to take advantage of national tax laws so that the plans are tax efficient both for employees and for the companies. For example, the ESOP for Kenya Airways privatization was structured as a unit trust for tax reasons (Megginson, privatization database).
- Established by the enterprise, which contributes either new shares of its own equity into the ESOP or cash to buy existing shares.

Establishing a formal ESOP is relatively complex (see box 5.29) and requires independent professional advice. Except in the case of employee or management employee buyouts of infrastructure units, ESOPs normally provide a level of ownership of 5 to 15 percent. Higher levels of ownership often entitle representation on the board, but this may deter investors if they believe that further labor adjustment is essential after PPI is settled.

**Box 5.28 (continued)**

**Argentina water:** The Argentine government built workers’ support for the Buenos Aires water concession by pledging to transfer to them 10 percent of shares in the new water company when the dividends paid to the government for these shares covered their book value (US$12 million) (Alcázar, Abdala, and Shirley 2000). Similar programs were adopted in other Argentine enterprises. In the case of Argentina Gas (GdE), however, given the size of GdE relative to the number of total employees, the government decided to give less than 10 percent of the shares; employees were offered 3 to 5 percent because of the large size of the company relative to the number of the employees (Shaikh 1996, p. 4).

**Manila water:** In the concessioning of MWSS the concession contract required that the concessionaire grant every regular employee an annual stock (share equity) purchase bonus equal to not less than the last basic monthly salary due that year until all of a block of 6 percent of shares set aside for employee share ownership was fully subscribed (Lazaro n.d.; Cruz 2001)

**Senegal electricity:** In 1999 10 percent of the shares were offered for sale to workers.

**Kenya Airways:** In the 1996 privatization of Kenya Airways, the Dutch airline KLM became the largest single strategic investor with a shareholding of 26 percent, but 3 percent of the airline was also reserved for staff at the float on the Nairobi Stock Exchange.

**Additional Material (on the CD-ROM)**


**Web Sites**

Capital Ownership Group: www.capitalownership.org/. (This is the site of a think tank on ownership issues funded by the Ford Foundation.)

European Industrial Relations Observatory Online: www.eiro.eurofound.ie/. (This site monitors various
### Box 5.29: Checklist for Successful ESOPs

If some form of ESOP is to be established, here is a checklist of key issues that the implementing agency should ensure are being followed.

**Participation Issues**
- All employees should be able to participate, subject to a qualifying length of service such as 12 months.
- There should be no great discrepancy between management's stake and that of the rest of the work force.
- There should be similar voting rights.
- There should be similar dividend rights.
- Use of an employee trust aids flexibility and helps sustain the plan for the longer term.
- Transparency—particularly regarding the first allocation, where it is important that everyone knows broadly who is getting what.
- A “free share” allocation, even quite modest, is usually essential to get everyone in as a shareholder.
- Wages and other benefits (for example, pensions) should not be sacrificed for a share scheme.
- It is usual for employees leaving or retiring to have to sell their shares to the trust.
- The trust will be run by trustees and a balanced make-up of the trustees avoids its being dominated by any one faction—for example, two management representatives, two work force representatives, and one independent trustee agreed on by the other trustees would strike a good balance.

**Management Issues**
- The engagement of a specialist adviser, familiar with ESOPs, trust law, and taxation, will be essential.
- A participative style of management is adopted to make the best of the plan.
- Communicating with the work force before, during, and after the plan has been implemented is vital to gaining their initial and ongoing support, thereby creating the necessary long-term enthusiasm.
- Plans should be subject to full consultation with the work force.
- There is a need for culture change on both sides (that is, management and the work force), but it should be led by management.
- Employees need to understand the difference between their rights and duties as employees and their more limited rights as shareholders—an important part of the communications process, particularly around the time that the deal is completed.
- In all of the concerns about the work force, it is important to ensure that management has adequate incentives and that these arrangements are transparent. Often, an appropriate share option plan is one that allows employees to acquire additional shares when they achieve agreed targets, both corporate and individual, over, say, a three-year period.
- Management also still has the right to manage.

**Structural and Technical Issues**
- What is the source of the shares (existing government shares, newly issued shares)?
- What are the eligibility rules (how many shares to offer, when, and at what price)?
- What constitutes compliance with national legislation?
- Wages and conditions of employment should be kept separate from share ownership.
- Employee representatives (including trade unionists) should have access to independent professional advice about the plans.
- It is important to build in features that will promote the sustainability of the plan, such as leavers must sell their shares, use of trust.
- There is nothing wrong in principle with employees being asked to put their own money in—some employees will be more focused on their jobs if they have their own money at risk.
- For distribution of shares it is best to use tax-efficient share plans where available.
- Internal market: some of the work force will want to buy or sell some shares, and this is usually allowed in private companies, on a "matched" basis when the scheme has been running for a while.
- Depending on the size of the stake the employees have, they may be entitled to look at having a representative on the company’s main board—as a rule of thumb, a holding in excess of 25 percent?
- If the ESOP is put in place before PPI, should the ESOP offer existing employees the possibility to cash in at the time of privatization or should it be structured as a long-term, performance-related incentive plan for the employees who best respond to the transition to private management? (The answer is probably both, and this will have implications for how the ESOP is eventually put in place.)
An ESOP eases employee share ownership. A common model is a trust with well-defined rules on share distribution, transfer, and buyback.

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aspects of labor relations in Europe, including information on share ownership.)

National Center for Employee Ownership: www.nceo.org

Ohio Employee Ownership Center: http://dept.kent.edu/oeoc/AbouttheOEOC/AboutTheOEOC.htm. (This center, based at a university in the United States, has an international program.)

Rapid Response: http://rru.worldbank.org. (This site is a gateway to a range of information on infrastructure, privatization, and private sector development policies.)

William Megginson. http://faculty-staff.ou.edu/M/William.L.Megginson-1/ (This home page for Professor Megginson has a number of papers on privatization to download, as well as databases giving information on shares offered to employees in initial privatization public offerings, and longitudinal measures of share ownership in privatized enterprises worldwide.)

Other Material and Sources


Infrastructure services are vital to economic and social development. Many stakeholders therefore have an interest in the process and outcomes of private participation in infrastructure (PPI). This module guides the implementing agency in involving stakeholders, particularly workers and trade unions. Directions to more general resources on stakeholder consultation and communications are provided at the end of the module.

This section introduces the different forms of engagement and the sequencing of activities. It then discusses how to select different approaches and sequence the labor engagement process within the overall PPI transaction. It concludes with a brief discussion of the resource needs involved.

**Fundamentals of Engagement**

Many stakeholders will be involved during the course of a PPI transaction. Government is itself a vital stakeholder, as well as the principal decision-maker at key approval steps in the PPI process and the labor program. Investors, consumers, and regulatory authorities are stakeholders, too. The wider processes of public policymaking and strategic communication for privatization and PPI are described in material provided in the accompanying CD-ROM.

The CD-ROM contains:
- Worksheets for conducting stakeholder analysis
- Terms of reference for a stakeholder analysis.

As described in module 1, the starting point for engagement is a thorough stakeholder analysis. This module focuses on the processes of engagement with the key actors with whom government needs to interact in designing a labor program, in particular labor and trade unions.

**Forms of Engagement**

There are four forms of engagement that can apply in labor restructuring, namely:
- Communication
- Consultation
- Negotiation
Communication is mainly a one-way transfer of information from government, the implementing agency, or redeployment counselors to the stakeholder audience.

Consultation and negotiation are both two-way processes, but the expectations of outcomes are very different. Participants in consultation expect their views to be heard and taken into account, whereas those in negotiations expect that mutually binding results will be the outcome.

Cooperation can be seen as a more mature form of engagement where both sides expect to participate actively and are committed to win–win outcomes. That distinguishes it from negotiation, which can be adversarial and can yield win–lose outcomes. Cooperative approaches often have longer-term and broader perspectives than does negotiation.

Communication, consultation, and cooperation in the labor relations context align well with the three forms of engagement between citizens and government recognized by the Organisation for Economic Co-operation and Development (OECD) (see box 6.1). Negotiation is a distinct form of engagement that arises from the contractual employer–employee relationship between government and the work force. (Subsequent sections of this module deal in more detail with each of the four levels of engagement.)

Box 6.1: OECD—Defining Government–Citizen Relationships in Policymaking

An OECD study of the mechanisms of interaction between government and citizens in policy design, implementation, and evaluation recognized three forms of engagement: information, consultation, and active participation. The working definitions adopted in the study recognized a key role for government in setting the boundaries for engagement, and noted that the final decision-making responsibility remained with government:

- **Information**—a one-way relationship in which government produces and delivers information for use by citizens. It covers both “passive” access to information upon demand by citizens and “active” measures by government to disseminate information to citizens.
- **Consultation**—a two-way relationship in which citizens provide feedback to government. It is based on the prior definition by government of the issue on which citizen’s views are being sought and requires the provision of information.
- **Active participation**—a relationship based on partnership with government in which citizens actively engage in the policymaking process. It acknowledges a role for citizens in proposing policy options and shaping the policy dialogue, although the responsibility for the final decision or policy formulation rests with government.


Designing an Engagement Strategy

The engagement strategy sets out which of the various forms of engagement are to be used, and when. For the purposes of labor restructuring, which is the focus of this Toolkit, the main stakeholder groups are employees and unions, government, and investors—and the views of all need to be heard. It is, however, rarely the case that all stakeholders must be dealt with at the same time. An engagement strategy (see table 6.1) may therefore envisage a series of actions using all four forms of engagement. For example, the strategy might resemble the following:

- **Communication** with employees and unions on the proposed PPI transaction and the need for workforce restructuring.
- **Consultation** with employees, unions, and investors on restructuring approaches, including severance packages and procedures.
- **Carrying out negotiations** among government, workers, and investors prior to PPI on issues such as labor contracts, pensions, and working practices. If there is an economic
regulator for the sector, it too may be involved.

- Identifying opportunities for cooperation among business, unions, and local government in monoindustrial towns suffering from a major loss of employment.

One particular risk is that of premature activities. Hasty and ill-prepared announcements, press conferences, and newspaper or radio interviews can damage the credibility of everyone in government and so delay PPI if they expose uncertainty on key issues or weaknesses in the government’s “story.” The implementing agency should be able to advise government officials and politicians about when to sequence engagement events and the key messages to be conveyed. Certainly the basic rationale for work force restructuring must be clearly defined and understood before any government official or politician approaches TV, radio, or newspapers.

The actual process of engagement is likely to have stops and starts and periods of progress and setback. It may not always be possible to follow a precise, neatly sequenced plan. As the case of Côte d’Ivoire Railways presented in box 1.14 in module 1 illustrates, a commitment to engage on work force restructuring issues can lead to mutually acceptable solutions and improved outcomes for the implementing agency, workers, and other stakeholders.

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<th>Table 6.1: Outline of an Engagement Strategy (Illustration)</th>
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<td><strong>Type of engagement</strong></td>
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<td>Communication</td>
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Acquiring Engagement Skills

Effective engagement requires a particular mix of skills. Where government does not have these in house, some skills can be acquired through subcontracting to specialist providers or consultants. Skills and capacity in opinion polling, conducting focus groups, copywriting, media design and commissioning, and strategic advice can all be brought in.

Other skills, however, may have been developed in key people through training. As part of the communications process the senior manager in the implementing agency or senior government officials may need to communicate directly and credibly with workers or via radio or TV. Personal skills development for these circumstances may be very valuable. Negotiation training for key people can also have significant financial, strategic, and tactical benefits.

In some cases, it is more a question of acquiring the right person than the right skills. In Italy the “right” minister was able to be credible with trade unions (box 6.2).

The implementing agency can budget and secure financing for the government’s side of the engagement: consultants and advisers, opinion pollsters, stakeholder research and analysis, and media purchase. Donor funds are an important source of finance for these activities and resources, but building the capacity of other parties in the engagement should also be encouraged.

In many developing countries, for example, there are no effective trade unions or the existing ones have limited capability. Both the International Labour Organisation (ILO) and a number of international trade unions have programs designed to strengthen the capacity of trade union organizations in developing and transition countries. Although there are few concrete examples, the value of capacity building is increasingly recognized. In India the ILO helped trade unions in the telecommunications sector develop strategies for reskilling in the face of technological change. In Russia trade unions were seen as having an important role in coal sector restructuring. Over a five-year period, financing from a World Bank technical assistance loan allowed the trade unions to conduct regular seminars on topical issues in sector restructuring (for example, on relations with private employers), to maintain legal services in the coal regions, and to carry out monitoring and other activities relevant to sector restructuring (Artemiev and Haney 2002).

Where workers and trade unions are weakly organized, one approach is to ignore capacity building, exploit that weakness, and use coercion to accelerate work force restructuring. This approach, however, is embedded in a win–lose mindset. Cooperation, for example, assumes much more of a partnership or win–win approach. Attention to capacity building is therefore most likely to be adopted in the same circumstances as those in which cooperation is the appropriate engagement approach.

COMMUNICATION

The most basic issue for implementing agencies in managing the process of labor adjustment in PPI is to communicate effectively with all stakeholders.

Objectives

Good communication with workers and unions is important for successful PPI. Get it right and, all other things being equal, PPI can be relatively
smooth. Get it wrong and PPI can be delayed or postponed indefinitely.

The following are common objectives of a communication program:

- Build broad public understanding of and consensus for the need for reform
- Explain the rationale for work force restructuring and government’s efforts to mitigate adverse impacts on workers
- Influence and win support from a narrow group of key decisionmakers to approve policy, new legislation, or a restructuring strategy
- Educate all parts of government (ministers, officials, enterprise managers) to ensure a common understanding of the rationale, processes, and procedures of work force restructuring in PPI
- Inform workers and others of the procedures for restructuring, severance, and redeployment
- Promote the government’s approach to potential PPI investors
- Inform all stakeholders on progress
- Mitigate specific risks to the project that result from action or inaction by key stakeholders.

At a minimum, the implementing agency must ensure that employees and their representatives know what decisions have been made on work force restructuring, and why. They need to know the implications for them and any actions they must take. Poor (or late) communication of information about work force restructuring can lead to misunderstandings, rumors, low morale, and poor performance within the enterprise. Moreover, it can lead to breaches of law in countries where employees have a legal right to be informed about plans to downsize or change their terms of employment.

**Preparing a Communication Plan**

The communication plan must provide a timetable of activities and indicative estimates of the costs involved. Costs vary greatly from country to country and should be calculated at an early stage. (A checklist on the CD-ROM provides a list of items for which costs need to be determined.)

**Checklist for costing a communications program.**

In addition to timing and resource questions, a communications plan must consider five elements:

- **Audience**—to which audience(s) should communications be addressed?
- **Specific objectives**—what specific behaviors or changes should the communication lead to or avert?
- **Message**—what messages will encourage the desired behavior?
- **Communication channels**—what channels are available and effective?
- **Monitoring and evaluation plan**—how will the success of the communication be monitored and evaluated?

A methodology for bringing those five elements together into a practical communication plan is described by Cabanero-Verzosa and Mitchell (2002) on the Toolkit CD-ROM. That approach uses a standard template (illustrated in table 6.2) based on identifying stakeholders (the audience) and sharply defining the communication objectives.

**Cabanero-Verzosa and Mitchell 2002.**

**Audience**

Each of the key stakeholder groups identified by the stakeholder analysis should be included in the communications plan. Communications to other stakeholders may also be useful but should not distract from or compromise the program of communication to key stakeholders.

**Specific Objectives**

The specific objectives should be defined as tightly as possible so that it is clear what is wanted from the communications. For example:
“Ministers and officials in the sector ministry to know that downsizing by 15 percent will reduce government subsidies by the equivalent of $x million next year and will facilitate the PPI transaction, and that new work practices introduced over the last five years mean there will be no adverse impact on service level and quality.”

“Members of the council of ministers to approve the overall work force restructuring strategy by a specified date.”

“Leaders of the three main trade unions to agree to participate in consultations on work force restructuring.”

“All workers, including those in distant regional offices, to be aware of the severance options open to them by a specified date.”

The objectives also provide the basis for subsequent monitoring and evaluation, which can then check whether the communications have produced the desired effects.

Stakeholder analysis allows the implementing agency to disaggregate broad groups and better understand their concerns. This allows for messages to be fine-tuned and couched in terms relevant to different subgroups or audiences. For example:

• Unskilled workers may need to know that “government is offering a generous voluntary departure plan for unskilled workers because new technologies have meant that there are fewer unskilled jobs today and there is no guarantee of employment for unskilled workers tomorrow.”

• Skilled engineers and accountants may need to know that “the government is on track to bring in a PPI investor within two years, with new investment equivalent to $x million. Demand for the enterprise’s services are forecast to grow significantly. Skilled staff might benefit from staying on to see what new job opportunities and freedoms PPI can offer.”

In table 6.2 these differing messages are called “take-away” messages, to emphasize that they need to focus on the specific concerns of each stakeholder group and not on a vague and unfocused government desire to tell people about its work force restructuring plans.

To be credible, “take-away” messages need to be backed up by credible supporting evidence. Mere
assertions by government or the implementing agency will not be enough. Indeed, they could well be counterproductive; telling workers that retrenchment will open up new opportunities for them without providing evidence will only reinforce suspicions. Collecting, organizing, and presenting the supporting evidence may be very time consuming, so the timetable and work plan need to schedule the preparation of this evidence at an early stage. Among the main evidence to be gathered is the following:

- Benchmark data on labor productivity, which is one of many indicators of overstaffing
- Independently commissioned cost-benefit analyses of PPI, including impact on efficiency, investments, employment, and fiscal matters
- Data on the financial and economic costs of maintaining state-owned enterprises
- Data on enterprise debt and pension plan liabilities
- Data on enterprise subsidies expressed in terms of proportions of total government expenditure or converted into measures
- Data on employment trends within the sector.

Effective communications should not be confused with propaganda or “spin.” Although it is often necessary and legitimate to present the case for PPI and to detail any changes—such as work force restructuring—associated with it, it is just as important to give the bad news as well as the good. The whole process can be undermined by loss of trust if stakeholders lose confidence in the accuracy and honesty of what they are told.

**Delivering the Message**

Senior managers and ministers need to deliver messages themselves in face-to-face meetings. When written information is provided it should be presented in the appropriate language and in ways that reach all who are entitled to it—and that means taking into account the particular needs of different groups of workers. A note on the CD-ROM (“Do’s and Don’ts of Communicating with Workers”) gives some practical tips on how to use various communications tools.

**Checklist of “do’s and don’ts” for communicating with workers.**

The implementing agency can use a variety of channels for delivering messages. A media audit can be commissioned to provide factual information on alternative media and channels of communication. The audit can help the implementing agency select among various channels (table 6.3), some of which are also relevant to consultation, negotiation, and cooperation.

As table 6.3 shows, a variety of channels can be used. In rough order of effectiveness these channels are:

- Small-group meetings where officials can answer worker’s questions firsthand. A thousand workers can be addressed in 10 small groups of 100 people each, and the activity can be concluded in a few days.
- Meetings where the main presenters are “expert witnesses” credible to the audience. In the labor context, this often means workers who have lived through PPI elsewhere and so can speak with authority.
- Virtual meetings with these expert witnesses, through a nonpropagandistic video in which those workers describe their experiences before, during, and after PPI. In some countries useful videos are available, and making one can be a cost-effective option (see the CD-ROM note on preparing videos).
- Meeting with colleagues who have seen reform firsthand, ideally coworkers who have toured a PPI operation and spoken to the workers there.
- Personalized printed material, such as personal letters to individual workers or worker families, delivered with paychecks or sent to worker’s homes.

**Visits allow stakeholders to experience the real situation for themselves.**

**Effective communication is not propaganda.**

**Video presentations of workers’ views are powerful tools for communicating with other workers.**

**Small-group meetings with presentations by experienced workers are the key to effective communications and consultation.**
• Impersonal but detailed printed material describing, for example, redundancy, counseling, and retraining procedures in sharp detail.

• General radio or television advertisements.

• Impersonal general printed material, such as posters.

The best medium is the one with the most impact, so face-to-face meetings are usually strongest and an impersonal printed leaflet is probably the weakest medium.

Posters contain short messages that, even if true, are so abbreviated as to seem propagandistic and hence perhaps unbelievable. For workers whose livelihoods may be at stake, posters will be credible only if accompanied by more informative and more convincing materials.

Visits to see how others have dealt with PPI are valuable for government, workers, and unions alike, and are a means of communication in their own right. When planning visits, the following design points can be borne in mind:

• Hearing from fellow workers and colleagues is likely to be the most credible source of messages for workers. For this reason visits by workers to enterprises that have successfully experienced PPI are particularly valuable. Box 6.3 illustrates how the experience of seeing for themselves was important in winning the overall support of unions for the privatization of Manila water.

• If individual visits are only possible for a few people, short videos made up mainly of the comments of workers in other successful and completed PPI enterprises are an alternative way to provide supporting information for the take-away message (see the CD-ROM for practitioner guidelines on such films). For example, a video can be made of workers from the PPI enterprise visiting and talking to the workers in another enterprise that has already completed its PPI transaction. The documentary can then be screened back home, with some of the workers who made the trip and with some of the workers from the already-completed PPI site in attendance. The home audience of workers can then see the privatized plant secondhand, talk with the workers in the privatized plant, and talk with their own coworkers who traveled there and saw everything first-hand.

Communications can be combined: for example a visit, with a video, followed by a group meeting.

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Table 6.3: Example of a Media Audit—Picking the Right Tools for the Task

<table>
<thead>
<tr>
<th></th>
<th>Communication</th>
<th>Consultation</th>
<th>Negotiation</th>
<th>Cooperation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Opinion polls and focus groups</td>
<td>✔️</td>
<td>✔️</td>
<td>✔️</td>
<td>✔️</td>
</tr>
<tr>
<td>Small meetings</td>
<td>✔️</td>
<td>✔️</td>
<td>✔️</td>
<td>✔️</td>
</tr>
<tr>
<td>Mass meetings</td>
<td>✔️</td>
<td>✔️</td>
<td>✔️</td>
<td>✔️</td>
</tr>
<tr>
<td>Visits to other PPI schemes</td>
<td>✔️</td>
<td>✔️</td>
<td>✔️</td>
<td>✔️</td>
</tr>
<tr>
<td>Video documentary</td>
<td>✔️</td>
<td>✔️</td>
<td>✔️</td>
<td>✔️</td>
</tr>
<tr>
<td>Video memo</td>
<td>✤</td>
<td>✤</td>
<td>✤</td>
<td>✤</td>
</tr>
<tr>
<td>Consultation papers</td>
<td>✤</td>
<td>✤</td>
<td>✤</td>
<td>✤</td>
</tr>
<tr>
<td>Information brochures</td>
<td>✤</td>
<td>✤</td>
<td>✤</td>
<td>✤</td>
</tr>
<tr>
<td>Mass media (TV, radio)</td>
<td>✔️</td>
<td>✔️</td>
<td>✤</td>
<td>✤</td>
</tr>
<tr>
<td>Press releases</td>
<td>✔️</td>
<td>✔️</td>
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<tr>
<td>Press briefings</td>
<td>✔️</td>
<td>✔️</td>
<td>✤</td>
<td>✤</td>
</tr>
<tr>
<td>Posters</td>
<td>✤</td>
<td>✔️</td>
<td>✤</td>
<td>✤</td>
</tr>
</tbody>
</table>

✔️ = highly relevant tool; ✤ = somewhat relevant tool.

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Guidelines on videos for communicating with workers.
Visits by ministers and key officials can also be important:

One of the most important things we did was to take a group, including three ministers, on a tour of other countries’ privatization programs. It was not an easy trip, as the ministers were very demanding on protocol and status issues. Subsequently, however, decisionmaking was much faster, because the ministers had seen and heard the issues for themselves. They were also able to debate, question, and challenge proposals that came before the cabinet of ministers (adviser at a privatization agency in Asia).

Media can be combined for greater impact.

**Monitoring and Evaluation**

Communications campaigns are intended to alter stakeholders’ perceptions, so the implementing agency should check now and again to see what has been accomplished. This can allow the correction of misunderstandings before they emerge. The implementing agency therefore should plan to survey stakeholders periodically for changes in attitudes, actions, or intentions. Tools to assess them can include opinion polls, longitudinal surveys, and follow-up focus groups (with the same participants).

**CONSULTATION**

An effective way to communicate is to consult, but that is not the only reason for consultation. Consultation can also help improve the process and outcomes of work force restructuring.

**Role of Consultation**

As a two-way process, consultation:

- Offers a way to tap into the experience and knowledge of stakeholders in the design and implementation of labor restructuring proposals.
• Provides a source of information to tailor labor strategies more closely to prevailing circumstances
• Provides ideas about how to design the communications strategy, prepare for negotiations, and develop any cooperation projects that might be possible
• Adds legitimacy through involvement of stakeholders in decisions affecting their future.

Consultation should be undertaken with all key stakeholders. Consulting with trade unions has a particular facet, however: union opposition to PPI often has its basis in a belief that the unions are insufficiently consulted about PPI, or consulted too late when there are problems in the process (box 6.4).

Methods of Consultation

As well as one-to-one or small-group meetings, the principal tools that the implementing agency can use to consult are:

• Focus groups, which help the implementing agency to understand what people really think; identify, explore, and design poll questions that matter to the audience; and estimate the intensity of feeling on a subject (which polls cannot gauge). Focus groups are relatively fast, cheap, easy, and reliable. The CD-ROM provides notes on how to undertake focus groups.

Notes on managing focus groups.

• Opinion polls, which offer evidence of stakeholder attitudes. To be statistically relevant, opinion polls require at least 1,000 respondents. Some PPI workplaces are not that large. Even when they are, a problem with polling is that the wrong question might be asked. You might find out that 86 percent favor one solution rather than another, but you might not find out that the best solution is a third one about which they have not been asked.

• Policy papers, which can take various forms and have narrow or wide audiences. A strategy paper for a cabinet or the council of ministers might seek approval from ministers. A draft policy statement or “white

Box 6.4: Trade Unions and Consultation

The key issues and agenda for each union will vary, and can only be determined through a stakeholder analysis and through the process of engagement itself. Here, however, is what one global union federation with more than 20 million affiliated members in public services has commented, in general, on what unions want:

Politicians and public managers must be made to state clearly the goals of any particular privatization measure and show how it would achieve them. Trade unions have a right and a responsibility to ensure that those goals are in the public interest, to satisfy themselves that they will be achieved in ways that involve fair treatment of public employees, and to insist that alternatives to privatization and commercialization are fully explored. That is why they must insist on being consulted at every stage of the process and ensure that any changes in service and employment levels and conditions are negotiated (Public Services International 1997).

This statement encapsulates the key issues typically raised by trade unions and workers:

• Fair treatment for employees
• Negotiation rather than imposition of changes in employment numbers and conditions of service
• Consideration of alternatives to PPI—with no or limited private sector involvement
• Consultation with unions at every stage of the process
• Accountability and transparency of decision-making on PPI.

The relative importance of each of these issues will vary from country to country and among PPI plans. Some issues (such as fair treatment) are unexceptional, whereas others (consultation at all stages) may not be easy for government to agree with. Whatever the case, it is important that implementing agencies be prepared to discuss these issues with union leaders.
paper might put policy proposals into the public domain for wide debate, perhaps using Web sites.

- **Consultation frameworks and joint task teams**, which are institutional arrangements to facilitate consultation, debate, and discussion on labor adjustment issues. They can be sector based or national. For example, in the ports sector, task force or task team approaches have been established to provide a forum for government, port managers, port users, and workers’ organizations to share views. (See an example from the Ghana port sector in box 6.5, and the Public-Private Infrastructure Advisory Facility [PPIAF] Port Reform Toolkit). Several countries also have long-standing institutional arrangements for consultation through tripartite forums of government, business, and labor.

**NEGOTIATION**

Negotiating changes in work force numbers or conditions of service lies at the heart of the challenge facing the implementing agency. This section provides a framework for negotiations, and some examples—good and bad—from different environments.

If consultation is meant to seek views about the **nature of the changes** to be made from a range of stakeholders, negotiation is intended to agree on the **terms of those changes** with the people directly affected by them. In practice, negotiation—as a specific form of engagement—will usually involve investors, workers and trade unions, and government.

For example, in the Buenos Aires water concession, the labor union was represented on the committee that was set up to oversee the process and was closely involved in negotiations on restructuring methods, severance options, and retraining arrangements (World Bank 2002).

Negotiation is a common feature of work force restructuring in infrastructure enterprises simply because the enterprises are usually large and the work force is generally organized. The employer–employee relationship between government and the work force provides the primary context for negotiation as a form of engagement. Key actors in the negotiations are therefore government and workers’ representatives, although each party may enlist support (lawyers, advisers, nongovernmental organizations [NGOs]).

**Box 6.5: Ghana Port Reform—Working Effectively with Unions**

The Ghana Ports and Harbours Authority (GPHA) is to be converted into a “landlord” port authority whereas the private sector will participate in port operations, particularly container handling operations, dock yards management, sites maintenance, and services. A critical issue was overcoming the resistance to change from many of the stakeholders in the port industry. This was achieved through:

- Timely, proactive, and professional actions of the government of Ghana (particularly the initiatives of the minister of roads and transport) and the GPHA management
- Avoidance of any autocratic approach
- Adoption of a consultative, persuasive, and participative style, which has resulted in a very positive atmosphere among the port community with regard to implementation of the port component of the GHATIG Project.

- Inclusion of representatives of the Maritime and Port Workers Union on the organizational restructuring and labor rationalization working team of the Project Implementation Committee and their attendance at its meetings on a regular basis.

There was public consultation through a national workshop on the acceptability of the government’s policies about port reforms. The minister of roads and transport also made personal visits to the ports to speak and, more important, to listen to the port work force and the port labor unions.

Negotiation is important because of the financial consequences for all parties. As box 6.6 illustrates, an otherwise exemplary engagement strategy can lead to adverse consequences for government if the negotiation element goes awry (in that case, on pension matters).

The ability to negotiate through collective bargaining is central to unions. Most OECD countries permit and guarantee rights to collective bargaining and the freedom of workers to associate, but restrictions on these rights exist in a number of developing countries. Although the economic benefits of collective bargaining for workers and for enterprises are context specific and not very clear cut (Aidt and Tzannatos 2002), unions can play a key role in achieving negotiated changes in work practices that are of mutual advantage and more sustainable.

The centrality of negotiations for unions has four practical implications for the implementing agency:

1. Unions might expect to be engaged in negotiation at times when the implementing agency might be using other forms of engagement (communication, consultation, or cooperation).

2. Attempts by government to diminish the opportunity for negotiated change are likely to be vigorously opposed.

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**Box 6.6: Engagement Strategies in the Privatization of Sri Lanka Telecom**

Sri Lanka Telecom (SLT) was partially privatized in 1997 through the divestiture of 35 percent of shares plus management to a strategic investor—NTT of Japan. Issues of redundancy were considered explicitly from the time that privatization was envisaged in the sector. The sector was large, employing over 8,000 workers in the early 1990s. It was clear from the outset that worker support was essential if privatization was to be done smoothly, even though overstaffing was not a critical issue. Over a period of five years, from 1992 to 1997, various strategies were adopted to involve and increase worker awareness on preparations for privatization and the process itself.

A national steering committee was appointed to make high-level decisions and recommendations regarding the transaction while a Telecom Cell was created at the PERC (the privatization agency) to handle implementation of the transaction. The cell was meant also to interact with the 31 trade unions operating in SLT. However, for the purpose of closely interacting with the cell, the unions were represented as a “joint front” involving nine trade unions. Six union leaders already had been sent to visit privatized telecommunications companies in Chile and Mexico to familiarize themselves with the facilities available in those countries.

An independent consultancy group (the National Institute of Business Management, NIBM) was appointed to study labor issues relating to the reconstruction of SLT. A key finding by NIBM was that trade union leaders did not always voice the opinion of the majority of workers. This suggested that the trade unions had to be contacted individually and the workers had to be addressed directly. Such dialogue was found to be much more productive than dialogues with the union leaders alone. In fact, certain trade unions with skilled workers (accountants, engineers) were strongly in favor of privatization, recognizing that it would lead to enhancing of company worth and career development opportunity.

An in-house magazine, Amathuma, was launched by a media subcommittee. SLT also conducted regional open house “awareness” forums at offices throughout the island, along with representatives from the Ministry of Posts and Telecom, PERC, and NIBM. Several media campaigns were also launched, addressing the need for restructuring SLT and the telecommunications sector.

All of this careful preparation led to the comparatively smooth transition of SLT from a government department to a privatized enterprise. No workers were retrenched during the process. The government, however, had to pay a high price for this relatively peaceful transition. The price was not just in the form of expenses incurred during the awareness campaigns, or in terms of airfares for the unionists. The principal expense came in handling the negotiations that arose with regard to pensions, with the outcome leaving the government with substantial pension commitments to several hundred telecom workers for several decades hence.

3. Negotiation processes (that is, those that reach a mutually agreed outcome) may widen the scope of discussion to matters beyond the original ones. This means that workforce negotiations may start with a limited discussion of the number of surplus workers but quickly expand to cover all aspects of workforce restructuring—selection processes, redeployment options, treatment of pensions, terms and conditions of transfer, and employment guarantees.

4. The process of negotiation may be widened even further. Trade unions (and others opposed to PPI) may challenge the government and the implementing agency on policy, financial, or social grounds. If the rationale for PPI is not well communicated, or if there are flaws in the process, these issues too may be brought to the workforce restructuring negotiations. An example is the restructuring of South Africa’s transport rail (Spoornet) networks, during which consultations and negotiations took place through a joint task team. The trade union team emphasized the importance for the union (SATAWU) of widening the debate (see box 6.7), and both parties found the process demanding of time and resources (see box 6.8).

In an ideal world, everybody would gain all the time from effective negotiations among PPI stakeholders, but in the real world, although win–win situations often arise, just as often tradeoffs have to be made and competing interests have to be balanced.

**Steps in Negotiations**

There is no easy recipe for negotiations, but clarity of the objective (a successful PPI) and good preparation will always be needed. At its simplest, negotiation requires four steps:

1. Making preparations
2. Identifying and discussing potential areas of negotiation
3. Proposing and bargaining
4. Closing.

**Step 1: Making Preparations**

Preparation is essential. Working with other government stakeholders, the implementing agency must:

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**Box 6.7: South Africa Rail Restructuring—Widening the Negotiation**

"Last year government announced its plan to break Spoornet [the state-owned rail enterprise] into separate businesses and concession them to the private sector. This year, after more than six months engagement with labour, government has accepted that this plan makes no developmental, business or financial sense. What persuaded government to change its view? Why did it adopt such a flawed plan in the first place? The first important point is that SATAWU [South Africa’s transport workers’ union] successfully used Parliament and the press, as well as mass action and a march to the Minister of Transport’s office, to put pressure on government to engage in serious and meaningful consultation. The trade union movement can draw several lessons from this experience. Firstly, engaging with government requires a large commitment of time and resources—in this case the SATAWU policy officer [and two researchers] working between half and full-time for more than six months. Secondly, the labour team focused on issues of socio-economic development and sustainability, rather than simply negotiating over job loss. Thirdly, management was a crucial party to the process, since only management can generate the detailed financial and business information that is necessary for a proper assessment of restructuring proposals. Fourthly, labour has to take responsibility for managing the process of engagement, as the DPE [Department of Public Enterprises, responsible for the management and restructuring of state enterprises] lacks the skills of stakeholder consultation. Finally, government was not monolithic. Fortunately, management was totally opposed to government’s plan, and there were officials both within DPE and in other departments, and ministers, sufficiently committed to socio-economic development to change their minds on the basis of the evidence" (Von Holdt 2001, pp. 2–4).
• Reconfirm overall objectives—expressed in terms of the overall PPI project, as well as work force restructuring.

• Define government interests and attempt to predict those of the other parties (drawing on the findings of earlier stakeholder analysis).

• Identify the best solution that could be achieved for government without negotiating, and identify possible outcomes that could meet the needs of government and the other parties.

• Decide which overall outcomes are fixed (absolutely nonnegotiable), and which have some scope for variation.

• Consider likely scenarios and outcomes from the negotiations (“what if...?”) and estimate cost impacts where possible. The implementing agency may also need to balance between the need to maintain levels of infrastructure service (adversarial negotiations that lead to strikes and disruption of essential services are undesirable for both political leaders and the economy) and the need to avoid “giving away” improved conditions of service while the company is in the public sector because overly generous conditions can frighten off investors at the time of the PPI transaction.

• Have a full understanding of the detail of legislation and labor contracts likely to affect negotiations. In many countries, collective bargaining rights and procedures are prescribed in legislation, while labor agreements also cover them. (See module 4.) So a first step is to establish the legal and contractual situation. Where negotiation procedures are not set out in labor contracts, a preliminary step is to discuss and share the details of the negotiating process, including its logistics, participants, and overall timetable. Third-party mediation and arbitration bodies may also have a role (see the CD-ROM for comments from one such body).

Notes on arbitration and labor conflict prevention.

**Step 2: Discussing Potential Areas of Negotiation**

During this stage both sides set out what outcomes they are looking for. The discussion stage of negotiations contains significant exchange of messages and information about the wants and needs of each party. It is important not to close this out too soon, or to “box in” the other party, because the other party has little or no room for making concessions and effectively is forced out of the negotiations before moving to the next step—proposing and bargaining.

Table 6.4 provides a checklist for implementing agencies that suggests possible negotiating issues between labor and government, setting out labor’s possible concerns and potential bargaining incentives and the outcomes that may be mutually beneficial. Although it is not an exhaustive checklist because every circumstance will bring out different issues, it can be used as a starting point and a framework for identify-
ing areas of potential negotiation, building on step 1.

This stage is also important in creating the right climate for discussion. The aim of the implementing agency should be to engender a tension-free atmosphere where mutual trust and confidence can be developed.

**Step 3: Proposing and Bargaining**

It is during this stage that personal negotiation skills are most important. Key elements are clear communication, active listening, a willingness to separate the people and personalities from the subject of the negotiation, and a desire to look for outcomes that can satisfy the interests of all parties (even though they cannot always be found).

There may be a number of negotiations going on in parallel for different subsectors or issues (perhaps pensions or legislative change) or for different

**Table 6.4: A Checklist for Negotiations with Labor**

<table>
<thead>
<tr>
<th>Issue</th>
<th>Labor concern</th>
<th>Potential bargaining areas</th>
<th>Possible outcomes or agreements</th>
</tr>
</thead>
<tbody>
<tr>
<td>Staff reduction to meet competitiveness benchmarks</td>
<td>• Job protection • Loss of competitiveness through loss of vital skills</td>
<td>• Enhanced employment security for remaining work force</td>
<td>• Costs savings used for capital and equipment</td>
</tr>
<tr>
<td></td>
<td>• Loss of institutional knowledge and memory</td>
<td>• Improved dialogue</td>
<td>• Investment to increase labor productivity</td>
</tr>
<tr>
<td></td>
<td>• Fair process and avoidance of union victimization</td>
<td>• Alternatives to retrenchments</td>
<td>• Sequenced employment reduction timetable</td>
</tr>
<tr>
<td></td>
<td>• Compensation</td>
<td>• Consistent and transparent selection criteria</td>
<td>• New job evaluation, career development, and pay system</td>
</tr>
<tr>
<td>Introduction of flexible work practices instead of rigid work rules</td>
<td>• Intensification of work • Health and safety</td>
<td>• Severance terms, including retraining, job-search assistance, and a retrenchment package</td>
<td>• Hierarchy of reduction mechanisms: attrition, soft options volunteers before compulsion</td>
</tr>
<tr>
<td></td>
<td>• Too much discretion rests with management</td>
<td></td>
<td>• Mutually agreed severance processes, terms, and selection procedures</td>
</tr>
<tr>
<td>Improvement in labor productivity</td>
<td>• Sharing benefits of productivity • Unfair measurement methods</td>
<td>• Training in new ways of working and skills</td>
<td>• Training courses for flexible work and multi-skilling of the work force</td>
</tr>
<tr>
<td></td>
<td>• Further job loss</td>
<td>• Enhanced employability and job satisfaction</td>
<td>• New rules for labor deployment and organization</td>
</tr>
<tr>
<td>Merit-based recruitment</td>
<td>• Fair and transparent process</td>
<td>• Team-based flexibility and worker empowerment</td>
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</table>
### Table 6.4 (continued)

<table>
<thead>
<tr>
<th>Issue</th>
<th>Labor concern</th>
<th>Potential bargaining areas</th>
<th>Possible outcomes or agreements</th>
</tr>
</thead>
</table>
| Flatter hierarchy | • Equal opportunities (gender, ethnic group)  
• Loss of middle-management jobs  
• More work and responsibility  
• Inadequate supervision and support | • Negotiated, objective selection criteria  
• Targeted severance support for middle managers  
• More responsive management—frontline communications  
• Increased pay for increased responsibilities | • Equal opportunities procedures  
• Middle-management severance package covering pension, retraining, and redeployment  
• New hierarchical structure and communications procedure  
• Job evaluation, career development, and new grading structure |
| Change in skills mix | • Impact on redundant workers  
• Evidence base for skills-mix decisions | • Training in new skills  
• Rewards for gaining qualifications  
• Support for redundant workers  
• Enhanced employability | • Skills and qualifications audit  
• Job evaluation and new career development program  
• Training courses, access rights, and budgets  
• Dialogue arrangements |
| Market-oriented pay structure | • Loss of collective bargaining  
• Equal pay for work of equal value  
• Protection for low-skilled workers  
• Widening differentials | • Access to training, rewards for gaining skills and qualifications  
• Transparent pay determination criteria  
• System for reviewing effects of restructuring | • New pay, grading, job evaluation, and career development system  
• Improved skills mix  
• Equal opportunities |
| Reduction of nonwage labor costs | • Loss of pension rights  
• Loss of social benefits  
• Loss of custom and practice benefits | • Putting retirement benefits on sustainable footing  
• Improved quality of remaining benefits  
• Compensation for lost benefits | • New pension arrangements  
• Assurance of future benefits  
• Buyout of lost benefits  
• Stronger governance of pension funds  
• Disciplinary and grievance procedure  
• Revision procedures |
| Managers’ right to manage (and discipline) the work force | • Fairness and transparency  
• Protection against injustice | • Shared benefits of improved discipline  
• Disciplinary rules linked to grievance rules | • Working hours and shift patterns/premiums  
• Review procedures  
• Recognition and representation criteria  
• Bargaining procedures and facilities |
| More efficient use of company resources | • Nonsocial working hours  
• Health and safety | • Independent health and safety reviews  
• Rewards for shift work  
• Clarity of procedures  
• More effective bargaining system | |
operating divisions. The implementing agency will then need to ensure coordination among all these aspects. The example from South Africa (box 6.8) again illustrates this point.

Step 4: Closing

When agreement has been achieved, it is important to be sure that it can actually be implemented by all parties. The agreement needs to be put in writing, but rushing to signature may be inappropriate. Usually each party will have to ratify the agreement: workers’ representatives need to gain agreement from the work force, and the implementing agency may need approval of the privatization agency, ministers, or the head of state.

COOPERATION

Where circumstances are favorable, effective communication strategies, consultation exercises, and negotiation processes can lead to deeper forms of engagement in which stakeholders actively participate in the design and implementation of PPI and labor adjustment programs.

Cooperation in Practice

Consultation and negotiation with labor can lead into more active forms of participation in the design and implementation of programs to deal with labor issues. These more cooperative forms of engagement are based on a win–win philosophy whereby most stakeholders obtain mutual benefits, as illustrated in box 6.9.

Cooperative approaches to engagement during work force restructuring have parallels with the concept of “social dialogue.” That concept implies going beyond the traditional forms of collective bargaining to a continuous process of engagement among the social partners—government, business, labor, and (in some circumstances) other civil society interests. Social dialogue aims to build an environment in which engagement with labor can bring sustainable gains to both sides within a long-term perspective, and has been defined by the ILO as “all types of negotiation, consultation or simply the exchange of information, between and among representatives of governments, employers and workers, on issues of common interest relating to economic and social policy.”

Box 6.9: From Confrontation to Cooperation in Indianapolis

When the U.S. city of Indianapolis, Indiana, decided to invite the private sector to bid to run most of its services, the city’s workers, organized in the American Federation of State, Country and Municipal Employees, planned to resist the plans, with militant action if necessary. The union also proposed an alternative based on the idea that if the workers were given a fair shot at putting into practice their own ideas about how to improve services while spending public money less wastefully, they could compete with the private contractors and win.

The city’s mayor, Stephen Goldsmith, was skeptical at first but decided that the workers had valuable knowledge they could contribute to the PPI process. As a result, the workers were involved through their union in designing the competitive bidding program, improving their own efficiency, and competing with private companies. A great deal of restructuring was required, and the city established a labor pool to which surplus workers were transferred and from which other departments of the city and private employers could recruit. Training was provided for these workers.

Indianapolis succeeded by this route in reducing its annual budget by $12 million and services have improved so much that the city and the workers’ union were jointly awarded an Innovations in American Government Award by the Ford Foundation and the John F. Kennedy School of Government at Harvard University. Workers’ earnings have greatly increased because of a gain-sharing agreement under which workers are awarded 25 percent of the savings their efforts achieve below already reduced budgets.

Source: Martin 2004 (forthcoming).
Circumstances that Suit Cooperation

The nature of cooperation will vary greatly according to circumstances. Cooperation is, however, likely to be most appropriate in any of four circumstances:

1. Where large-scale, fundamental restructuring of a sector critical to economic development is foreseen: Here the agenda is not simply downsizing, but more a question of sector reform. Where it is clear from past history that this restructuring—including PPI and work force restructuring—will be complex and protracted, then cooperation may be more likely to lead to success than relying only on other less participatory forms of engagement. It may take much longer, however (see box 6.8).

2. Where private participation and labor adjustment are deeply opposed, perhaps by a strong and powerfully organized work force with public support: In this case, cooperation is the only way forward and government has fewer choices. Attempts at overt coercion by government may lead to vigorous industrial action, disruption of infrastructure services, and discredit to PPI as a whole.

3. Where there are acute social challenges: For example, if PPI involves drastic job losses in monoindustrial towns (some port or railway towns, mining towns), with few alternative employment options, then community-based redeployment measures are likely to be needed (as discussed earlier). In such circumstances, participative and cooperative approaches among government, local government, municipalities, enterprises, trade unions, and other NGOs are likely to be needed.

4. Where there is a strong political consensus in favor of inclusive processes and social dialogue: South Africa is one example of a country where government has established formal frameworks for the participation of trade unions and workers’ organizations in policy formulation and implementation on PPI and enterprise restructuring.

If cooperation is about mutual advantage and win–win relationships, why is cooperation not always the norm, and why do tough negotiations or strikes occur? Circumstances vary greatly, but three points can be made:

1. In practice, consultation and negotiation usually work. Engagements that lead to mutually successful negotiations are in fact more common than one expects at first sight. High-profile industrial disputes catch the attention of the media, but overlook the many more disputes that are resolved through negotiation, arbitration, and other mechanisms. This should give the implementing agency some confidence—engagement usually has positive, not negative, outcomes.

2. Parties may misjudge one another's position (information asymmetry). Government, workers, unions, and other parties may each lack complete information. One party may misjudge another's position, and it is only later that each becomes aware that the other party did indeed mean what it had said. For the implementing agency, this reinforces the need to prepare well for negotiations and, at the outset, to ensure that the messages and rationale for PPI and work force restructuring are well made and well communicated.

3. Negotiating credibility must be demonstrated occasionally. If government is to be
creditable in undertaking reform, or if a trade union is to be credible to its membership, from time to time each may have to demonstrate that credibility. Resolving an acrimonious strike can be portrayed as a success for both parties if each audience believes that the credibility of its “side” has been enhanced. The strike can earn one or both parties the right to a fair hearing for several years because the threat of action has become more credible. The implementing agency has limited options here. If government (or labor) has decided that such a strong demonstration of credibility is needed, then all that can be done is to manage the situation by (a) continuing to communicate accurate, honest information to all stakeholders to reduce any information asymmetry; (b) taking steps to reduce adverse impacts of strikes or other industrial action on the public, consumers, and business users of infrastructure services (for example, by stockpiling fuel reserves for power stations, contracting for substitute transport services, using new modes and routes of transshipment, and emergency liberalization of services to private operators); and, perhaps more important, (c) keeping the channels for discussion and debate open so that engagement is facilitated when it is (sooner or later) resumed.

**Tools (on the CD-ROM)**

Terms of reference for stakeholder analysis

Stakeholder analysis worksheets

Checklist of communication costs items

Do's and don'ts of communicating with workers

Working with opinion polls and focus groups

Making short films for worker communication—a practitioner’s view

Notes on arbitration and prevention of labor conflict

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**Additional material (on the CD-ROM)**


**Web sites**

ACAS (Arbitration and Conciliation Advisory Service): www.acas.org.uk. (Site offers downloads on handling redundancy and labor relations.)

ILO International Training Centre: www.itcilo.it. (Site offers courses on social dialogue.)

PPIAF Port Reform Tool Kit: www.ppiaf.org. (Module 7 addresses engagement and labor issues.)

Some international trade union organizations:

- Public Services International: www.world-psi.org.
- Trade Union Advisory Committee to the OECD: www.tuac.org.

**Other Material and Sources**


World Bank. 1996. World Bank Participation Sourcebook. Washington, D.C. (This publication reviews participatory approaches to development activities, and includes case studies and methodological appendixes.)
This module provides guidance on why and how to evaluate the costs and benefits of labor restructuring programs and how to set up effective monitoring systems to track progress and learn from experience.

**OVERVIEW**

The specific objectives for monitoring and evaluation of labor programs are to:

- **Assess financial and economic returns.** Labor programs involve spending considerable resources in the short run to reap some gain in the longer term. Consequently the decision to undertake a labor restructuring program should consider the financial and economic returns involved, much the same as would an investment decision.

- **Learn from past experiences.** Monitoring and evaluating a program’s effectiveness can help assess what works and what doesn’t, and the lessons from past experiences can inform future labor programs.

- **Reduce costs to government.** Most labor programs can be very costly. Cost-benefit analyses help avoid the experience in one country where a policy of generous levels of severance pay (the highest in the region) had been set, but where the key decisionmaker later admitted, “We didn’t actually work out how much it was going to cost us. We just made our decision after looking at other [voluntary departure] schemes elsewhere, but felt we should increase it somewhat.”

- **Help make the case for work force restructuring.** There will always be opponents of work force restructuring. Cost-benefit analyses can help provide key information for communication and negotiation (see module 6).

- **Assess financial sustainability and identify required financial resources.** Cost-benefit analyses can help provide insight into the financial sustainability of the overall program by taking into account the overall costs of the redundancy program and estimating the impact of possible future additional redundancies. These costs should take into account all associated costs: compensation, redeployment, and the costs for the
pension system where there are early retirement programs.

Early analysis can be critical in helping governments assess severance options and the size and scope of the resource envelope for which funding is required. Consider the following example: An economic reform—implementing agency had embarked with some success on a pilot program of privatization. In most cases work force restructuring took place prior to privatization (and in some cases, closure). The agency developed a five-year plan for accelerated privatization that would include major infrastructure enterprises. Empirical estimates of likely levels of downsizing were made, based on experience in the pilot state-owned enterprises (SOEs) and from similar enterprises elsewhere in the region. Those estimates revealed that unexpectedly high levels of expenditure on voluntary departure might be required in 2005 and 2006 (about US$200 million annually) when restructuring of large mining and infrastructure enterprises was planned. This analysis helped to inform planning by government (the ministry of finance, in particular) on (a) the sequencing of privatization and (b) discussions with donors on a new lending facility in support of privatization and state enterprise reform.

The audience for analyses will extend beyond the implementing agency. Although analysis is an essential input for decisionmaking on labor programs, work force restructuring is both a technical issue and a political issue. The logic and rigor of technical analysis may not always be the decisive factor, and the quality of presentation is important too. In practical terms this means that:

• The findings are presented in a way that will be accessible to policymakers and to a wider audience (for example, an overly academic presentation may not communicate conclusions effectively).

• The presentation of financial and economic analysis will reveal political costs and benefits. Simple examples are:
  – Comparing the number of workers who may lose their jobs with the number of beneficiaries of private participation in infrastructure (PPI) and infrastructure sector reforms (for example, projected number of households expected to receive new water or power connections).
  – Presenting estimates of likely employment outcomes for the sector as a whole, not just the state enterprise. For example, in telecommunications immediate short-term job reductions in the state enterprise may be quickly made up by new jobs in new entrants in mobile and data communications.
  – Expressing the financial cost savings to government from work force restructuring in terms of the alternative social benefits that could be provided from those savings (that is, number of new rural schools or health clinics built a year, annual maintenance of rural roads, annual salaries of school teachers).

• Financial and economic analysis of the labor program needs to be complemented by stakeholder analysis (which includes political concerns), as discussed in module 6, and cost-benefit analysis of the wider case for PPI, in situations where opponents of labor adjustment are likely to challenge PPI itself (see the negotiations section in module 6).

The usefulness of analysis is constrained by two further factors: time and the availability of the data. Governments often must make their decisions based on limited and incomplete information—they rarely have the luxury of the time needed to conduct a full analysis and to receive robust conclusions. Even when analysis is done, the quality of available data may restrict the usefulness of analysis.

ASSESSING FINANCIAL RETURNS

Governments, like the private sector, need to assess the financial costs and benefits of a work force restructuring program. Unlike the private sector, however, governments also need to assess a pro-
gram’s economic costs and benefits to society, or the economy, as a whole. The key questions and potential tools of analysis are summarized in table 7.1.

As outlined in module 1, the immediate triggers for work force restructuring are often financial crisis, not economic crisis. In such cases the financial analysis can be a more critical question for government than is economic analysis.

Financial Costs—A Checklist

Table 7.2 provides a checklist of potential financial costs that may be incurred and that must be included when assessing financial returns. Essentially, the following equation captures the situation:

\[
\text{Financial costs} = \text{SC} + \text{RC} + \text{FC} + \text{CC} + \text{JC} + \text{TC} + \text{UC}
\]

where SC is the present value of severance costs, RC is the current net value of retirement costs, FC is the existing value of transportation for worker and family, CC is the cost of counseling, JC is the cost of job-search assistance, TC is the cost of training, and UC is the present estimated value of unemployment benefit and other social payments.

When collating those costs the implementing agency will need to ensure that:

- All costs are viewed from the perspective of government as a whole. For example, costs should include any incremental cost to government of additional unemployment benefits or pensions for displaced workers.

- Costs are all brought to present values. In a major restructuring, downsizing is likely to be a phased activity, so planned downsizing two or three years hence should be appropriately discounted. In addition, the estimated costs to the pension plan of any early retirement benefits paid in future may need to be measured in terms of present value.

### Table 7.1: Financial Analysis—Key Questions and Tools

<table>
<thead>
<tr>
<th>Question</th>
<th>Tool</th>
</tr>
</thead>
<tbody>
<tr>
<td>How much will the program cost?</td>
<td>• Initial estimates of total program cost, based on rough assumptions of severance costs (see the quick calculator on the accompanying CD-ROM)</td>
</tr>
</tbody>
</table>
| What are the financial benefits? (How much money will government save?) | • Net present value of net cash flows to and from government, taking account of savings in:  
  − Salary and related costs and allowances  
  − Retirement benefits  
  − Other nonsalary benefits |
| How can the program be funded?                                          | • Financial gap between cost estimates and potential funding sources (consider budget sources, privatization revenues, commercial loans, donor funds, and so forth) |
| How long will the program take to pay for itself?                       | • Payback analysis—how long before the costs of a labor program are recovered through savings in reduced wages and other labor-related costs? |
| What is the financial impact of different approaches to selection and work force restructuring? | • Payback and net present value analyses for different groups of employees (grade, age group, operating units) |
| Looking at the economy as a whole, do the economic benefits of work force restructuring exceed its costs? | • Analysis of alternative severance formulas  
  • Substitution of financial costs and benefits with economic costs and benefits in analyses |
Financial benefits should also be considered in the context of government as a whole, not just of the infrastructure enterprise.

**Table 7.2: Checklist—Financial Costs of a Labor Program**

<table>
<thead>
<tr>
<th>Item</th>
<th>Comments and examples</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Direct costs of separation</strong>&lt;br&gt;Present value of severance costs (SC)</td>
<td>• Includes all the costs described in module 5: ex gratia, statutory payments, gratuity, bonuses, allowances per enterprise rules, payments negotiated in individual or collective labor contracts.</td>
</tr>
<tr>
<td>Net present value of retirement costs (RC)</td>
<td>• Estimated present value of future obligations to provide retirement benefits (using realistic estimates of life expectancy, investment returns, and so forth)</td>
</tr>
<tr>
<td>Present value of transportation for worker and family (FC)</td>
<td>• Costs should include possible arrears in pension contribution and any additional investments needed to ensure the financial sustainability of the pension scheme.</td>
</tr>
<tr>
<td><strong>Redeployment costs</strong>&lt;br&gt;Counseling (CC)</td>
<td>• Costs vary according to the enterprise (central or dispersed), country (size, transportation costs), nature of the work force (locally hired or nationally hired).</td>
</tr>
<tr>
<td>Job-search assistance (JC)</td>
<td>• Counseling costs based on expected take-up rates.</td>
</tr>
<tr>
<td>Training (TC)</td>
<td>• Assume that almost all workers will receive counseling.</td>
</tr>
<tr>
<td><strong>Other costs</strong>&lt;br&gt;Present value of estimated additional unemployment benefit and other social payments (UC)</td>
<td>• Little data on actual uptake in severance programs—perhaps 60–75 percent</td>
</tr>
<tr>
<td></td>
<td>• Only a percentage of the work force is likely to undertake training—perhaps 10–30 percent, according to experience.</td>
</tr>
<tr>
<td></td>
<td>• Costs of social insurance to workers: Estimate additional social insurance payments according to rules. Estimated periods of unemployment can be derived from social security records, public employment service records and interviews, private sector placement agencies, and surveys of workers displaced previously.</td>
</tr>
</tbody>
</table>

**Financial Benefits—A Checklist**

Table 7.3 summarizes sources of benefits from a labor program, as portrayed by the following equation:

Financial benefits = W + R + B + O + P

where W is the present value of wage savings, R is the current net value of retirement benefits saved, B is the present value of savings in kind (nonwage allowances and other benefits), O is the current value of reduced operating costs, and P is the estimated increase in PPI transaction proceeds resulting from the labor force adjustment.

As with costs, benefits should be assessed *in the context of overall government spending*. If an enterprise gains cost savings as a result of the transfer of staff to another enterprise or elsewhere in government, then overall there is no cost saving to government (as in the example of the transfer of Aqaba rail employees to the Jordan Phosphate Mines Company, described in module 4, box 4.6). The pension analysis similarly needs to consider
the whole government context. If pension costs are merely transferred from the enterprise to another publicly guaranteed scheme, then there may be no cost saving for government.

Most benefits are self-evident, but pensions can be complex. In a defined-benefit plan with a high ratio of pensioners (receiving pensions from the plan) to employees (contributing to the plan), a large number of departures could tip the plan into financial insolvency. Complexity can also arise if different workers within enterprises have different pension programs. To illustrate, if some workers are public servants and others are enterprise workers subject to a general labor code, net savings to government might be higher for retrenchment of the public servants because they have more generous pension benefits.

<table>
<thead>
<tr>
<th>Item</th>
<th>Comments and examples</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Direct benefits of separation</strong>&lt;br&gt;Present value of wage savings (W)</td>
<td>• This is usually the largest single source of savings: Includes wages of separated staff plus additional costs, allowances per enterprise rules, payments negotiated in individual or collective labor contracts.</td>
</tr>
<tr>
<td>Net present value of savings in retirement benefits (R)</td>
<td>• Some pension costs must be paid even without restructuring, so the difference between what would be paid with and without the labor program should be estimated. &lt;br&gt;• Benefits also arise from the elimination of ghost pensioners.</td>
</tr>
<tr>
<td>Present value of savings on benefits in kind—both variable and semivariable (B)</td>
<td>These benefits can include but are not limited to: &lt;br&gt;• Transportation to work, subsidized food (canteens), and heating fuel costs &lt;br&gt;• Reduced medical costs &lt;br&gt;• Child support and childcare (kindergartens) &lt;br&gt;• Free or subsidized housing or reduced housing maintenance costs.</td>
</tr>
<tr>
<td><strong>Other benefits</strong>&lt;br&gt;Present value of reduced operating costs (O)</td>
<td>• Reduced costs, such as transportation and vehicle costs, reduced administration costs (fewer support staff), reduced pilferage. &lt;br&gt;• In some cases disposing of employee housing (perhaps cheap sales to workers), surplus offices, depots, and vehicles will reduce running costs. &lt;br&gt;• Increase resulting from downsizing per se. &lt;br&gt;• Increase (or decrease) resulting from more (less) flexible labor contracts. &lt;br&gt;• Increase resulting from faster PPI transaction. &lt;br&gt;• These may be difficult to estimate but are potentially significant. López-de-Silanes (2002) found that a 20 percent reduction in the work force before privatization led to a 24 percent increase in net privatization price (see box 7.5).</td>
</tr>
<tr>
<td>Estimated increase in PPI transaction proceeds as a result of work force restructuring (P)</td>
<td></td>
</tr>
</tbody>
</table>

Table 7.3: Checklist—Financial Benefits of a Labor Program
**Financial Payback Analysis**

Where the costs of work force restructuring are wholly front-loaded, the simplest method of analysis that could be considered is undiscounted payback (or breakeven) analysis. In the example presented below, an initial expenditure of $100,000 in severance payments is “paid back” by the end of year 4 as a result of annual savings (wages and other staff costs) of $25,000. The simple payback (or breakeven) period is calculated as the number of years it takes for the wage bill savings to equal the financial costs—in this case 4 years.

<table>
<thead>
<tr>
<th>Year</th>
<th>Work force restructuring costs ($)</th>
<th>Cash savings ($)</th>
<th>Net cash flow ($)</th>
</tr>
</thead>
<tbody>
<tr>
<td>0</td>
<td>100,000</td>
<td>-100,000</td>
<td></td>
</tr>
<tr>
<td>1</td>
<td>25,000</td>
<td>-75,000</td>
<td></td>
</tr>
<tr>
<td>2</td>
<td>25,000</td>
<td>-50,000</td>
<td></td>
</tr>
<tr>
<td>3</td>
<td>25,000</td>
<td>-25,000</td>
<td></td>
</tr>
<tr>
<td>4</td>
<td>25,000</td>
<td>0</td>
<td></td>
</tr>
<tr>
<td>5</td>
<td>25,000</td>
<td>25,000</td>
<td></td>
</tr>
<tr>
<td>6</td>
<td>25,000</td>
<td>50,000</td>
<td></td>
</tr>
</tbody>
</table>

The introduction of discounting in the above example gives a more accurate picture of the payback period. By taking into account the lesser value of money tomorrow instead of today and assuming an annual discount rate of, say, 10 percent, the initial expenditure of $100,000 is paid back not at the end of year 4 but during the course of year 5.

The payback period is calculated on the basis of the fraction of year 5 needed to bring net cash flow to zero. In this case:

\[
\text{Payback} = 5 - \left(\frac{-5,250}{25,000}\right) = 5.21
\]

**Some Results of Payback Analyses**

In a survey of work force restructuring programs in six countries, Svejnar and Terrell (1991) found that payback periods varied from just four months to 4.7 years. Haltiwanger and Singh (1999) evaluated the financial returns of 41 downsizing operations based on World Bank internal documents for a range of civil service and state enterprise retrenchment programs. Their evaluation included a discounted financial payback method, which assumed a 10 percent annual discount rate. For the 24 operations with sufficient information to calculate payback analyses, their results can be summarized as follows:

- In 9 cases there were no net financial benefits from downsizing. These cases imply that there is never any payback (that is, the payback period is infinite). These circumstances arose as a result of rehires, new hires, or an increase in wages for the retained workers.
- In 15 cases there were positive financial benefits and the average payback period was 2.3 years. Fourteen of the programs had short payback periods of between 0 and 3.6 years—the one exception being the Bolivian mining corporation where the payback period was 10 years. The other 3 enterprises in the sample had payback periods of 3.40 (Bangladesh jute), 1.44 (Pakistan public enterprises), and 1.56 years (Argentina public enterprises). Programs with immediate payback periods (0 years) were those that involved involuntary reductions without direct compensation of other assistance.

These findings are striking. On the one hand, many labor programs appear to offer exceptionally good rates of return. Few investment projects display such

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**Most evaluations of work force restructuring programs reveal very fast payback periods.**
high financial returns as the 15 cases mentioned. Other programs, however, have not recovered their cost, often because of the problems of adverse selection and rehiring described in module 5.

Discounted Cash Flow Analysis

Work force restructuring can be viewed as a project. Classic investment projects are based on an (often high) initial capital investment, followed by a stream of positive cash flows arising over a number of years. Those positive cash flows are derived from productivity improvements that lead to higher revenues or greater savings. Work force restructuring shares a similar pattern, so the tools of investment analysis can be applied equally well to a work force restructuring project as to a capital investment project. (A sample spreadsheet is presented on the CD-ROM.)

Where work force restructuring involves significant downsizing, it is difficult to persuade some to see this as a “productive” investment. Downsizing is productive, however, in the sense that it removes and reallocates unproductive labor to more productive activities elsewhere. It increases labor (and often total factor) productivity within the enterprise. Where there is a genuine surplus within the work force, the jobs are not “real” jobs, and surplus workers’ marginal productivity within the enterprise is likely to be close to zero. Their expected productivity will be greater in other employment or other activities outside the enterprise.

When using discounted cash flow analysis techniques for labor adjustment, the implementing agency should check that:

- A mix of indicators is used, rather than relying on a single measure such as internal rate of return or net present value (see box 7.1).
- An appropriate discount rate is selected.

Choosing the right discount rate is a com-

Box 7.1: Indicators for Cost-Benefit Analysis

Three main indicators for cost-benefit analysis are:

1. **Internal rate of return (IRR)** is the discount rate at which the future streams of costs and benefits are equal. The higher the IRR, the better the project, so the IRR method is a convenient way to compare different alternative options in labor programs.

2. **Net present value (NPV)** is the difference between the discounted streams of future costs and future benefits. If costs exceed benefits, the NPV is negative; if benefits exceed costs, the NPV is positive. The NPV is the value, discounted to the present, of undertaking a work force restructuring project rather than not doing so. NPV assessments require that a predetermined discount rate is selected. One criticism of NPV assessments is that, when comparing alternative restructuring proposals, the decision rule would select the largest project (giving the highest NPV) over a smaller project with a higher IRR but a lower NPV.

3. **Benefit-cost ratio (BCR)** is the ratio between discounted total benefits and costs. Thus, if the discounted benefits are $150 million and the discounted costs are $100 million, the BCR is 1.5 (and the NPV is $50 million). The BCR is a useful check to the NPV process, as a way of spotting program options that offer attractive NPVs only because they are large. Reporting of BCRs again demands mention of the discount rate used.

In complex activities, such as work force restructuring, a single number—be it IRR, NPV, or BCR—is unlikely to be enough for informed decisionmakers. **Sensitivity analysis** shows how variations in the key assumptions underlying the analysis influence the expected outcomes of the restructuring program. At its simplest, this means running a spreadsheet model under different assumptions and presenting these variations in a table.

Many people would object to the idea that downsizing can be seen as a “productive” investment, but work force restructuring can be analyzed using the normal tools of investment appraisal.
plex issue but, in practice, sources of information for the rate are the general interest rate defined by the ministry of finance for the application of public funds—the best source—or offices of international lending agencies such as the World Bank and regional development banks.

- Costs and benefit flows have been calculated for a sufficient period. If discount rates are about 8–12 percent, then a 20-year period is likely to be sufficient.

ASSESSING ECONOMIC RETURNS

This section outlines the rationale for, and elements of, economic analysis of labor programs. The resources listed at the end of this module include several examples of economic analyses of work force restructuring in public enterprises.

Rationale

As discussed above, the near-term financial benefit for government is sometimes the critical factor for cash-strapped ministries of finance faced with an urgent need for infrastructure enterprise reform. However, economic analysis is also needed for the following purposes:

- First, it assesses impact on aggregate output or welfare. Financial analysis tells nothing about whether displaced workers are, in the aggregate, more or less productive following the labor program. It is quite possible that a proposed labor program can be attractive from the financial analysis perspective, but can fail when subjected to economic analysis.

- Second, it provides an answer to opponents of work force restructuring in PPI, who may argue that by ignoring the wider economic costs and benefits, government is making a bad decision (see, for example, the South African case presented in box 6.9 of module 6).

- Third, it may be a requirement of international funding agencies whose lending or funding procedures need economic as well as financial analysis.

Labor productivity issues are central to an economic view of work force restructuring, which sees the process as a reallocation of resources within the economy. From an economic cost-benefit perspective, the cost of restructuring must be met by an increase in worker productivity following displacement. The effect of moving workers out of the PPI enterprise into other parts of the economy can lead to negative outcomes if overall labor productivity falls, neutral outcomes if overall labor productivity is unchanged, or positive outcomes if overall labor productivity rises. Much therefore depends on the assumptions regarding marginal productivity of the worker in the enterprise compared with the marginal productivity of his or her activities following retrenchment.

Economic vs. Financial Costs

Economic cost-benefit analysis is similar in approach to the discounted cash flow approach to financial analysis. As the spreadsheet sample on the accompanying CD-ROM shows, both financial and economic analysis can be combined in the same cost-benefit model. Financial costs and benefits are substituted by economic costs and benefits in the economic cost-benefit analysis.

Differences between economic and financial costs (summarized in table 7.4) are as follows:

- Financial costs of severance (item 1): In economies with no tax distortions or subsidies, and no fiscal budget constraint, the financial costs of severance would not normally be treated as an economic cost. Rather they would be seen as a neutral transfer payment. Most developing countries, however, do have distortions and budget constraints, so severance payments to workers divert public funds from other uses. Except in a few upper-middle-income countries, a conservative approach would be to treat the economic costs of severance as 100 percent of the financial costs.
• **Financial costs of early retirement** (item 2): Similar considerations apply for the costs of early retirement as for severance. In practice, the principal difficulty is likely to be the estimation of the present value of the net financial costs of early retirement.

• **Financial costs of redeployment** (item 3): If private sector firms are providing redeployment services (training, counseling, outplacement) then the full market price of the training can be taken as the economic resource cost of redeployment. Where governments delegate redeployment to state agencies that are heavily subsidized and operating below capacity, the economic costs are likely to be below financial costs, and an adjustment factor should be applied.

• **Marginal productivity of employees in the SOE** (item 4): If there is a genuine surplus of workers, their retrenchment will not result in a loss of productivity in the enterprise, and the marginal productivity of employees in the enterprise can be set at zero. This is a reasonable assumption, if the work force restructuring strategy adequately tackles the risk of adverse selection (for example, through close targeting of workers offered severance, through restricting downsizing to cadres with obvious levels of surplus labor, or through a mixed government–investor approach (see table 4.1, module 4).

• **Financial savings on wages** (item 5): This is likely to be one of the largest sources of savings. Two points are important:

  1. Given the evidence of rehiring in many downsizing programs, an explicit adjustment factor to take rehiring into account may be appropriate in the financial analysis. If workers are hired elsewhere in government, or by the same enterprise, financial saving will be reduced. For example, employees of the Sri Lanka Transport Board were induced to leave with severance funding, but were being rehired almost simultaneously (Svejnar and Terrell 1991). High numbers of workers rehired following a labor program are an indicator of the failure of the program, both in a financial sense (a waste of public money in financing the costs of the workers’ departure) and in an economic sense (a failed attempt to reallocate the workers’ labor to more productive use). Some new hiring is occa-

---

**Table 7.4: Economic vs. Financial Costs and Benefits**

<table>
<thead>
<tr>
<th>Item</th>
<th>Cost and benefit items</th>
<th>Include in financial analysis?</th>
<th>Include in economic analysis?</th>
</tr>
</thead>
<tbody>
<tr>
<td>Costs</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1</td>
<td>Financial costs of severance</td>
<td>Yes</td>
<td>Yes—adjusted</td>
</tr>
<tr>
<td>2</td>
<td>Financial costs of early retirement</td>
<td>Yes</td>
<td>Yes—adjusted</td>
</tr>
<tr>
<td>3</td>
<td>Financial costs of redeployment</td>
<td>Yes</td>
<td>Yes—adjusted</td>
</tr>
<tr>
<td>4</td>
<td>Marginal productivity of employees in the SOE</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td>Benefits</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>5</td>
<td>Financial savings on wages</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>6</td>
<td>Financial savings on nonwage benefits</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>7</td>
<td>Marginal productivity of worker outside the SOE</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td>8</td>
<td>Marginal productivity value of labor savings</td>
<td>No</td>
<td>Yes</td>
</tr>
<tr>
<td>9</td>
<td>Increase in privatization proceeds from downsizing</td>
<td>Yes/No</td>
<td>No</td>
</tr>
<tr>
<td>10</td>
<td>Increase in privatization proceeds from faster PPI</td>
<td>Yes/No</td>
<td>No</td>
</tr>
</tbody>
</table>
sionally needed, however, to bring missing skills to the work force.

2. A decision needs to be made on whether to adjust wage savings to take account of enterprise profits. All other things being equal, a wage saving should ultimately return to the budget whether the enterprise is fully or partially subsidized.

- Financial savings on nonwage benefits (item 6): This should take into account savings from reduced expenditure on all allowances, plus projected cost savings arising from the closure or reduction of services provided to employees such as food, medicine, housing, education, and cheap loans.

- Marginal productivity of a worker outside the SOE (item 7): This is the product of (a) the probability of an employee's engagement in a productive activity and (b) the net income produced by this activity. The marginal productivity of the retrenched worker after he or she has left the enterprise therefore depends greatly on his or her circumstances following retrenchment (see “Assessing the Effects on Workers’ Welfare” in this module for a list of potential postretrenchment circumstances). Incomes will depend on worker attributes (age, education, and, in some situations, gender); market conditions (overall economic growth rate, labor market supply, and demand); and worker location (capital city, urban, rural).

Estimates of workers’ marginal productivity should be based on local market information. This should be assumed to be less than current salaries. But what factor should be applied? Evidence suggests that even in industrial economies a permanent earnings reduction of 15–20 percent can be expected among displaced workers, but reductions may be even greater in developing countries with public sector wage premiums (see box 1.1 in module 1). Moreover, many workers go not into formal employment but into informal employment or self-employment, about which there are fewer data. Estimates of marginal productivity—disaggregated by the major classes of workers—can be best sourced from data of actual wage or income levels outside the public sector, gained from labor surveys, national statistics, agricultural economics studies and research, household income surveys, interviews with placement and business support agencies, and (if possible) focused follow-up studies from earlier retrenchment exercises.

- Marginal productivity value of labor savings (item 8): The economic value of the wage savings following downsizing should reflect the opportunity costs of these savings if invested by the enterprise in expanded service areas, improved productivity, or improved quality of service by the enterprise. Assuming the enterprise is budget constrained, then this opportunity cost can be set as 100 percent of the financial cost.

- Increase in privatization proceeds from downsizing (item 9): Global evidence of the increase in privatization proceeds as a result of downsizing is limited. The best study (that of López-de-Silanes 1997) suggests an increase of net privatization prices of 12 percent for every 10 percent reduction in the labor force. However, because investor behavior is difficult to predict, a conservative approach would be to ignore the prospect of improved privatization prices in both economic and financial analysis, or treat it as a factor in a sensitivity analysis.

- Increase in privatization proceeds from faster PPI (item 10): A key rationale for work force restructuring (particularly through voluntary departure and early retirement) is that it helps remove barriers to PPI investment by reducing political and worker opposition to PPI.

In the absence of country-specific estimates, a conservative approach to cost-benefit analysis will probably ignore this time effect on privatization proceeds, not least because there are many potential sources of delay to
a transaction in addition to labor issues. Nonetheless, in some circumstances the time effect may be a significant source of benefits.

**EVALUATING LABOR MARKET PROGRAMS**

**Constructing the Counterfactual Analysis**

Evaluation is the periodic assessment of the relevance, performance, efficiency, and impact of the project in relation to stated goals. It differs from monitoring in that it is not an essential task for the implementing agency. Evaluation is mainly concerned with impact, which may only be measurable toward the end of implementation or in later years and so is often better done by a separate agency independent from implementation.

A central requirement of any evaluation is separation of the effects that would have happened anyway from those that resulted from the intervention. Before-and-after comparisons alone are not sufficient. If earnings rise after training, for example, that may be the result not of the training but of changes in the macroeconomy or local changes in labor demand or of such worker-specific attributes as life-cycle changes in earnings.

Evaluation therefore requires a counterfactual test, which is normally provided by a control or comparison group of workers who did not participate in the severance or redeployment program. Box 7.2 illustrates the importance of creating such groups for a hypothetical redeployment training program.

Counterfactual analysis demands careful choice of the scenarios against which the outcomes of labor programs are compared. For example, if the introduction of a PPI project in a declining public sector port leads to the loss of 1,000 cargo-handling jobs out of a total of 3,000 jobs through voluntary departure over three years, which of the following is the appropriate counterfactual comparison?

- The before-and-after calculation of 1,000 job losses
- A comparison with trends in other similar public sector ports (which might suggest an annual decline of 10 percent in cargo handlers as mechanization is introduced)

**Box 7.2: The Importance of Control Groups—A Hypothetical Example**

In the town of Abca, 1,000 workers were laid off as a result of the closure of the ABC Gas Company. Based on random selection, 500 workers were given a severance package and the other 500 were put through an intensive retraining program in computer skills. All 1,000 people were monitored over time. Three months after the completion of the training, 400 trainees were employed. This employment rate of 80 percent for the treatment group was touted by many as the impact of the training program.

However, Abcan evaluators cautioned against using only this figure to judge the success of the program. They wanted to compare this employment percentage to that of the control group—those who did not go through training. It was found that 375 of the control group of 500 were also employed three months after the treatment group completed its training—an employment rate of 75 percent. Hence, Abcan evaluators judged that the true impact of the training program was 5 percent, not 80 percent.

Although this example makes many generalizations—there was no selection bias or randomization bias, those who got a severance package did not enroll in any training or other related labor programs, and so forth—it serves to illustrate the importance of using control groups when evaluating the impact of labor programs.

Source: Adapted from World Bank, no date.
• A comparison with normal annual rates of job loss and job creation in private sector ports (a private sector counterfactual test)
• A comparison with cargo-handling labor benchmarks in the most efficient ports internationally against which the port can reasonably be compared.

In each case the counterfactual alternative provides the “what-would-have-happened-if” comparison (in this case, what would have happened if PPI had not happened). Each comparison is, however, likely to give rather different answers, and small differences in the assumptions and comparisons being made can lead to very different conclusions. This is why the use of a counterfactual test with a very clear definition of the assumptions being used is so important.

Assessing the Impact of Redeployment

In developing countries the evaluation of redeployment programs, social safety net programs, and active labor market programs has generally been inadequate.

One reason for the neglect of evaluation might be that properly assessing the impact of redeployment presents a significant technical challenge to evaluators everywhere. Undertaking a robust counterfactual analysis is particularly difficult because participants in, for example, a training program may be selected or may self-select. Such selection biases can distort policy conclusions, and redeployment programs are especially prone to these biases.

Evaluators use two methodological approaches to tackle these selection problems:

1. An experimental approach randomly assigns individuals to enter a program. This approach avoids many (though not all) of the selection problems of statistical methodologies. It is difficult to implement, however, for practical reasons (that is, cost and the fact that only current or future programs can be evaluated by this approach) and for ethical and political reasons (for example, some workers are refused entry to the program). Few developing countries are likely to implement such an approach. A recent illustration of such an evaluation is that of a job-search assistance program for unemployed workers in the United Kingdom, where the evaluation identified a 6 percent lower unemployment rate among participants five years after the initial program (Dolton and O’Neill 2002).

2. A statistical approach allows selection of the participant and nonparticipant groups after the redeployment program has started. To deal with selection biases, complex econometric techniques are needed to reduce the biases (elimination is not possible). Regression techniques and matched-pair comparisons are the principal statistical tools. The main advantage of statistical approaches is that the evaluation can be done at any time, provided that adequate longitudinal data are available.

Dar and Gill (1998) summarized these alternative methodological approaches in the context of retraining programs. Theoretically, experimental techniques are more robust. However, the statistical approach is more practical, although it can be subject to large biases that risk offering false conclusions to policymakers. Matched-pair statistical techniques are preferable to regression-based techniques because (a) they offer the greatest potential for reducing differences between the participant and nonparticipant groups (other than the redeployment program), and (b) the results are easier for nonstatisticians and policymakers to interpret.

The example of the evaluation of Mexico’s retraining program for unemployed and displaced workers (box 7.3) illustrates some of the challenges of conducting evaluations. Problems for evaluators include:

• Creaming: If program managers are evaluated on the percentages of trainees who find employment, then creaming may occur. In this situation managers actively select the best or most-qualified trainees to inflate the program’s apparent success rate:
The analogy is to whole milk where the richest part, the cream, floats to the top and can be skimmed off. Creaming is an issue in labor market programs because if only the most able people get reemployment assistance, then the benefit to society of the programs is not as great as it might be otherwise. Highly qualified program entrants have a good chance of becoming reemployed even without the services offered in the program, while for less qualified applicants the program services might be the only realistic path to employment (O’Leary 1999, p. 3).

To tackle this problem in evaluations, the right counterfactual test is needed. If the employment rate of participants is compared with that of all displaced workers, then the apparent success of the program will be inflated. Control or comparison groups should therefore compare trainees with other displaced workers who had similar levels of qualifications and other observable attributes.

- **Creating matched control or comparison groups:** If evaluations are undertaken some time after the program is completed, it becomes increasingly difficult to ensure matching between the treatment and the control or comparison groups. In Mexico’s PROBECAT evaluation, for example, the comparison group was taken from a separate data set of an urban household survey of workers who were also unemployed at the time that unemployed trainees entered the PROBECAT program. Such different data sets may not be fully comparable. Ideally, control or comparison groups should be individually matched, but adequate data for such matching are available only sometimes.

- **Self-selection:** In training programs where individuals choose (self-select) whether to enter the program, the problem of constructing the counterfactual comparison becomes more difficult because those who attend the program will be different from those who do not. If trainees volunteer for the program because it offers a stipend, for example, this can lead to selection biases when evaluating the program.

- **Dropouts:** This is a related problem. If trainees drop out of the program when they find jobs, is that counted as a program success? Or does it simply show that trainees merely participated for the stipend?

- **Dead-weight loss:** In later phases of PROBECAT, in-service training was provided by local employers. Government provided the workers’ stipend, and the employers were required to hire at least 70 percent of the trainees. “Dead-weight loss” refers to the fact that firms participating in the in-service training would have hired some of the same workers anyway.

- **Influence of the very existence of the program:** The evaluation approach outlined in box 7.3 used a conventional “differences-in-differences” approach, where the before-and-after earnings or employment changes for participants in the redeployment program are compared with the before-and-after change for a similar group of nonparticipants at a similar time. The approach assumes that the existence of the program itself is an external variable. Training programs may function as a form of job search for many of their participants (Heckman and Smith 1998). The decision to participate therefore also needs to be controlled for in the design of the evaluation.

- **Displacement effects:** If a program participant improves his or her reemployment chances at the expense of nonparticipants, then one person’s job may merely be taken by another. If this happens the program’s overall benefit to the economy as a whole may be less than intended.

- **Changes in program design:** Programs often change their design and approach during implementation. This is a problem for evaluators because (a) it compounds selection problems and (b) what they are evaluating may be seen as the “old” approach and therefore not relevant.
Given the importance often attached by governments to redeployment, there is a good case for better evaluation. In a review of active labor market programs, Fay (1996) concluded that evaluation will be improved if:

- Evaluation is made compulsory in the program design phase. Most donor-funded programs are subject—or potentially subject—to postevaluation. Although the benefits of evaluations may not accrue to the government, they will improve the quality of the database for other countries.

- Evaluations are more rigorous. Evaluation of the overall effects of labor programs is complex. The design of the evaluation methodology requires specialist economic and evaluation skills.

- Evaluations are undertaken by nongovernment agencies. This has two benefits: governments do not need to use scarce professional resources; and if the results come from an independent organization, they will probably carry more weight.

- The period of evaluation is extended. Impacts on workers of, for example, retraining may not be observable shortly after the end of training. It may be valuable to wait longer after the program before beginning the evaluation.

Evaluation studies of active labor programs have been conducted in middle-income countries at costs of about US$150,000 (Fretwell 2002), which is a relatively modest amount compared with the levels of expenditure incurred.

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**Box 7.3: Example of a Redeployment Evaluation—PROBECAT, Mexico**

In 1984, as a response to a growing economic crisis, the government of Mexico established a labor retraining program for unemployed and displaced workers—Programa de Becas de Capacitación para Trabajadores, or PROBECAT. Revenga, Riboud, and Tan (1994) reported an impact evaluation analysis. The evaluation set itself four clear questions. First, what is the impact of training on the subsequent employment experiences of trainees? Second, does training increase the speed with which trainees move from unemployment to employment? Third, conditional upon finding employment, what effect does training have on the monthly earnings, work hours per week, and hourly wages of trainees? Fourth, do the monetary benefits from program participation outweigh the costs of providing retraining for the unemployed?

PROBECAT was a large program. At the time of the evaluation it had trained 251,181 unemployed people and provided 9,268 courses since 1987. During the training period (usually three months), program participants received a stipend equal to the minimum wage. Vocational courses were organized to respond to the needs of the local labor market and were designed to redress local shortages of workers with particular skills. These needs were determined through periodic studies of local labor market conditions.

Not everyone was eligible to participate in PROBECAT. The selection procedure gave variable weights to different criteria, including the number of economic dependents, attainment of certain levels of basic education, prior work experience, and unemployment of less than three months. The weighting scheme was quite complex and nonlinear, and only individuals with a total composite score exceeding a threshold level were eligible to join the program. In addition, participants had (in theory) to be between the ages of 20 and 55 and be registered as job seekers at the local state employment office. This nonrandom selection of individuals into PROBECAT posed potentially serious measurement problems for the evaluation of the training program.

The evaluation approach taken was to adopt a statistical methodology to account for the selection bias in the program, and to compare the post-training labor market experiences of PROBECAT trainees with those of a comparison group—a matched sample of unemployed people who were eligible for but did not participate in the training program. The evaluation found that participation in the training program decreased the period of unemployment for men and women trainees and increased the monthly earning of men but not of women.

In addition, the costs and benefits of redeployment need particular attention because they are often neglected in evaluations. Although evidence is patchy (Dar and Gill 1998), cost-benefit assessments indicate that:

- Large-scale retraining programs may not be as effective as other measures, such as job-search assistance.
- Targeting programs may improve their relevance and effectiveness. In some cases (for example, in Hungary) redeployment training is better focused on relatively disadvantaged job seekers, whereas other evaluations (such as PROBECAT in Mexico) suggest that the program is more cost-effective if focused on better-educated and more experienced job seekers.

Box 7.4 offers some key indicators that could be used both for interim (gross impact) monitoring of redeployment programs (where usually there will be batches of trainees) and for subsequent net impact evaluations.

**Assessing the Effects on Workers’ Welfare**

One of the simplest approaches to estimating worker welfare loss was that of Galal and others (1994) in their evaluation of the impact on workers of one form of private participation (privatization). As Birdsall and Nellis (2002, p. 31) pointed out, that approach was “simple, completely open in noting the short cuts taken and derives a usable, quantified answer to a most complex question”—in their case, whether workers had been worse or better off following severance. To illustrate their approach they simply assumed an average wage in the economy (for example, $250 per month), and if it took workers 10 months to find a job, then workers receiving a severance package of $2,500 would be no worse or better off.

This simple approach does not provide a robust counterfactual test. In practice, however, it can be difficult to eliminate other factors influencing the impact on workers. As Rama and Maclsaac (1999, pp. 101–2) noted:

> The most straightforward indicator of the loss experienced by displaced employees is the change in their annual earnings, excluding returns from invested compensation. This indicator could be criticized on the grounds that earnings before separation do not provide an appropriate counterfactual. A case could be made that the appropriate comparison is with the earnings these employees would have received had there been no downsizing. If the situation prior to downsizing was unsustainable, it could be argued, earnings would have declined in any event. Alternatively, if the situation was sustainable, some of these employees would have gotten pay raises and promotions in the 15 months elapsed since separation. More generally, the appropriate comparison would be between the lifetime earnings profile after separation from [the enterprise] and the corresponding earnings profile in the case of no separation. But this comparison would require heroic assumptions, so that it is safer to stick to observed earnings before and after separation.

**Box 7.4: Possible Cost and Benefit Indicators for Redeployment Programs**

- Average cost per entrant into counseling or training—disaggregated among different types of counseling or training
- Average cost per trainee employed
- Percentage of trainees employed or self-employed
- Percentage of trainees engaged in the vocation of training
- Average monthly wages/net incomes of trainees (absolute and relative to preprogram incomes)
- Average household incomes (to assess effects on other family members and the household as a whole)
More robust evaluations of effects on worker welfare, however, can use the same experimental and statistical methodologies described above for evaluating redeployment impacts. Unfortunately, there have been few longitudinal tracer studies on what actually happens to displaced employees over time.

A further difficulty in assessing impacts on workers’ welfare is the wide range of workers’ outcomes following displacement:

- They retire and cease looking for paid employment or income-earning opportunities.
- They cannot find work or incomes and remain in long-term unemployment.
- They find alternative permanent employment.
- They find alternative short-term, contractual, or informal employment.
- They chose to become self-employed as individuals or start a microenterprise.
- They launch a formal small business with potential for growth.
- They expand existing income-earning activities that they were already running while employed in the enterprise (either “moonlighting” or “daylighting”).
- They migrate out of the region to find jobs or to return to rural communities where the family home is based.

If workers migrate to find new employment, follow-up evaluation is more difficult and more costly, and it is likely that such workers will not be captured in subsequent evaluations. In a survey of 5,334 workers from Brazil’s railway, 1,217 workers could not be found because they moved without a trace (Estache, Schmitt de Azevedo, and Sydenstricker 2000).

In a follow-up survey of 675 former workers in Brazil that was conducted two to three years after retrenchment, it was found that although 53 percent were earning less than when they were at the state enterprise, 23 percent were making a better living. In general the dispersion of wages was greater in this survey than one conducted nine months earlier. (There is no information on the sampling methods in these surveys, however.)

Most cost-benefit assessments make fairly simple assumptions regarding the consequences of displacement—a number of months of unemployment at a wage of zero, followed by a wage of, for example, 60 percent of the previous wage. Without more detailed tracer studies the impacts of more complex outcomes may not be well known. Nonetheless, it is clear that many displaced workers move into self-employment. Table 7.5 shows one example from Turkey, where nearly one-fifth of workers displaced during privatization used their severance money to enter into self-employment. A January 1998 survey of displaced workers in Brazil’s federal railway found that “over half work on their own and 20 percent have opened their own business. Only 18 percent are employees and four percent are civil servants” (Estache, Schmitt de Azevedo, and Sydenstricker 2000, p. 18). A tracer study in Ghana found that nearly 70 percent of displaced civil servants went into self-employment (table 7.6). In addition, there may be impacts on others. Although SOE workers are relatively well paid, those benefits may be shared with households and extended families.

### Assessing Overall PPI Benefits

Evaluating the success of a labor program requires that initial objectives be revisited. It asks, what were the initial objectives? and did the program meet those objectives?

An evaluation can be made at two levels:

1. **Evaluation against the specific objectives of the labor program itself:** This is the focus here, especially the impact of redeployment programs on workers’ incomes and the period of unemployment, and the impact of labor adjustment on workers’ welfare.

2. **Evaluation of the contribution of the labor program to achieving the wider policy objectives of PPI:** The effects of a labor program may go well beyond the consequences for indi-
individual displaced workers. Table 7.7 indicates the scope of a comprehensive assessment—which would include impacts on government, consumers, investors, and labor unions, as well as workers themselves. Box 7.5 summarizes information on the extent to which labor variables influence privatization prices.

**MONITORING LABOR PROGRAMS**

Monitoring of the labor program is a management task, but one that is often overlooked and neglected.

Monitoring differs from evaluation in that it is principally a management function, which typically

<table>
<thead>
<tr>
<th>Use of severance money</th>
<th>Petrochemical workers (n = 682)</th>
<th>Cement workers (n = 563)</th>
<th>Total (n = 1,245)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Established own business</td>
<td>12.8</td>
<td>22.0</td>
<td>17.0</td>
</tr>
<tr>
<td>Used for daily expenses</td>
<td>31.4</td>
<td>28.2</td>
<td>30.0</td>
</tr>
<tr>
<td>Lent money</td>
<td>6.0</td>
<td>1.7</td>
<td>4.0</td>
</tr>
<tr>
<td>Placed time deposit in a bank</td>
<td>22.1</td>
<td>5.4</td>
<td>11.2</td>
</tr>
<tr>
<td>Bought a house</td>
<td>40.0</td>
<td>36.1</td>
<td>38.2</td>
</tr>
<tr>
<td>Bought gold or foreign exchange</td>
<td>9.4</td>
<td>18.3</td>
<td>13.3</td>
</tr>
<tr>
<td>Bought treasury bills</td>
<td>1.6</td>
<td>0.4</td>
<td>1.1</td>
</tr>
<tr>
<td>Bought securities</td>
<td>0.9</td>
<td>0.7</td>
<td>0.9</td>
</tr>
<tr>
<td>Used interest income for daily expenses</td>
<td>7.1</td>
<td>5.0</td>
<td>6.2</td>
</tr>
<tr>
<td>Used rental income for daily expenses</td>
<td>4.2</td>
<td>3.4</td>
<td>3.8</td>
</tr>
<tr>
<td>Bought a car</td>
<td>18.1</td>
<td>10.0</td>
<td>16.7</td>
</tr>
<tr>
<td>Bought land</td>
<td>3.5</td>
<td>1.4</td>
<td>2.6</td>
</tr>
</tbody>
</table>

Note: Based on an interview where respondents were faced with a number of possible choices and asked to choose as many as applicable. So, for example, around 40 percent of petrochemical workers stated that they bought a house with their severance compensation.

Source: Tansel 1996.

<table>
<thead>
<tr>
<th>Preferred employment status</th>
<th>Agriculture</th>
<th>Nonagriculture</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Number</td>
<td>Percent</td>
<td>Number</td>
</tr>
<tr>
<td>Self-employment</td>
<td>1,124</td>
<td>72</td>
<td>1,906</td>
</tr>
<tr>
<td>Cooperative</td>
<td>420</td>
<td>27</td>
<td>680</td>
</tr>
<tr>
<td>Private wage employment</td>
<td>20</td>
<td>1</td>
<td>184</td>
</tr>
<tr>
<td>Government</td>
<td>2</td>
<td>0</td>
<td>8</td>
</tr>
<tr>
<td>Subtotal</td>
<td>1,566</td>
<td>100</td>
<td>2,778</td>
</tr>
<tr>
<td>No preference (number)</td>
<td>95</td>
<td>n.a.</td>
<td>932</td>
</tr>
<tr>
<td>Total sample size (number)</td>
<td>1,661</td>
<td>n.a.</td>
<td>3,710</td>
</tr>
</tbody>
</table>

n.a. Not applicable.

Note: Based on sample of workers opting for retraining.

Source: Alderman, Canagarajah, and Younger 1994.
### Table 7.7: Assessing Labor Programs—A Checklist of Potential Effects on Different Stakeholders

<table>
<thead>
<tr>
<th>Type of impact</th>
<th>For government</th>
<th>For unions</th>
<th>For employees</th>
<th>For consumers and customers</th>
<th>For investors</th>
</tr>
</thead>
<tbody>
<tr>
<td>Positive effects</td>
<td>• Reduced subsidies or net costs of providing PPI services</td>
<td>• Greater job security and safety (but for fewer employees)</td>
<td>• Salary improvements for retained workers</td>
<td>• Faster access to improved PPI services</td>
<td>• Improved financial performance</td>
</tr>
<tr>
<td></td>
<td>• Time advantage from faster completion of PPI transaction, and faster implementation of investment or service improvements</td>
<td>• Stronger role, if consulted and participating in the labor program</td>
<td>• Changes in labor contracts that affect (improve or reduce) non-wage benefits</td>
<td>• Evidence of growth in supply of services (e.g., access to water) or demand for services (number of passengers on trains)</td>
<td>• Reduced costs</td>
</tr>
<tr>
<td></td>
<td>• Revenues from PPI transaction (concession or privatization receipts)</td>
<td>• Time advantage from faster completion of PPI transaction, and faster implementation of investment or service improvements</td>
<td>• Improved labor productivity</td>
<td>• Reduced costs to business (e.g., telecommunications, transportation)</td>
<td>• More flexible labor contracts</td>
</tr>
<tr>
<td></td>
<td>• Increased in tax revenue from private operators</td>
<td>• No disruption of service (power supplies, port operations)</td>
<td>• Reduced tariffs to consumers (services)</td>
<td>• Reduced tariffs to consumers (services)</td>
<td>• Improved labor productivity</td>
</tr>
<tr>
<td></td>
<td>• No disruption of service (power supplies, port operations)</td>
<td></td>
<td>• Service quality improvements</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Negative (adverse) effects</td>
<td>• Political costs (if disputes)</td>
<td>• Loss of membership numbers</td>
<td>• Loss of salary and other tangible and intangible benefits for displaced workers</td>
<td>• Increased tariffs (if there are labor cost increases)</td>
<td>• Higher wage or benefits costs if negotiated upward by labor prior to PPI</td>
</tr>
<tr>
<td></td>
<td>• New incremental costs</td>
<td>• Reduced bargaining power</td>
<td></td>
<td></td>
<td>• Less flexible labor contracts</td>
</tr>
<tr>
<td></td>
<td>• Financial loss if rehiring takes place</td>
<td></td>
<td></td>
<td></td>
<td>• Loss of valuable skills if adverse selection</td>
</tr>
</tbody>
</table>
Box 7.5: Impact of Downsizing on PPI Prices

The very high levels of downsizing in infrastructure enterprises described in module 2 suggest that infrastructure enterprises are qualitatively different from other privatizations or PPI schemes. Unfortunately, there is little evidence of the impact of downsizing on PPI prices received from investors. In part this is because investor behavior is inherently complex, and in part because downsizing is often part of a wider package and investor responses to downsizing may be confounded by other changes (such as revised labor contracts or relations). In some cases, without work force restructuring it is unlikely that any investor will be found. The dramatic work force restructuring in Mexico’s airlines, described in module 4 (Box 4.9) is one example. Another is Argentina’s railway, which Ramamurti (1997) characterized prior to privatization as a “lemon”—an enterprise not attractive to a private investor because it was in a stagnant or declining market with poor profit prospects—but noted that:

The government did several things to turn FA [Ferrocarriles Argentines] from a lemon—not into a plum—but into a much sweeter proposition than before (a grapefruit?) Four government steps in that direction were: breaking the FA’s unions, picking up the tab for downsizing its work force, splitting up the company into smaller parts and then leasing rather than selling its assets. In addition, the unions agreed to greater flexibility in the deployment of workers, and to negotiate contracts with private owners that would increase rail’s competitiveness (p. 1982).

One attempt to review alternative factors influencing privatization prices is that of López-de-Silanes (1997). Using a database of all 236 Mexican privatizations between 1983 and 1992, he assessed the factors that influenced privatization price (as measured by a privatization quotient [PQ]). He found that “labor issues play a central role in explaining privatization prices” (p. 997), and that after accounting for endogeneity, reduction in the labor force increased privatization prices: “the net effect of a 20 percent reduction in the labor force before privatization is a 24 percent increase in PQ, evaluated at the predicted mean” (p. 1015). Moreover, union relationships were important: union contract renegotiation improved privatization prices (although this was not statistically different), and industrial disputes strongly depressed privatization prices: “one of the strongest results...is that an additional strike in an SOE leads to a 19 percent reduction in the net price evaluated at the mean predicted PQ” (p. 997).

A more recent assessment by Chong and López-de-Silanes (2002) undertook follow-up surveys of 308 privatized enterprises taken from a global database of privatizations. Using dummy variables for various labor downsizing policies, they found that labor downsizing did little for net privatization prices. The analysis, however, was unable to differentiate between large levels of downsizing—as occur in most infrastructure privatizations—and more modest levels of downsizing (only a quarter of the survey respondents provided any numerical information). Evidence of the complexity of investor behavior comes from private sector work force restructuring. The common assumption is that stock market prices will rise following downsizing. Abraham and Kim (1999) reviewed a number of studies on the effects of downsizing on investor behavior and found that the evidence is inconclusive. Their own study of 381 firms found that both layoff announcements and employment guarantee announcements lead to reductions in stock market share prices. They suggested that investor response depended on the net result of four possible effects on investor behavior following downsizing:

1. A positive cost-saving effect (downsizing reduces cost of production)
2. A positive efficiency effect (downsizing improves overall firm efficiency)
3. A negative industrial relations effect (downsizing leads to poorer labor relations)
4. An ambiguous signaling effect (for a firm in good shape, layoffs indicate a positive response to changing circumstances; for firms in poor shape, layoffs confirm that firm performance is poor or even worse than expected).

Note: PQ is government’s net privatization price after restructuring, adjusted by the percentage of company shares sold plus total liabilities at the time of privatization, divided by the total assets of the company at the time of privatization.
Box 7.6: Monitoring and Evaluation Defined

**Monitoring** is the continuous assessment of program implementation in relationship to agreed schedules and the use of program outputs by beneficiaries.

**Evaluation** is the periodic assessment of the relevance, performance, efficiency, and impact of the program in relationship to stated goals of the program.

involves both review of performance against target performance indicators and forward-looking forecasts (see box 7.6). Effective monitoring of the labor program is integral to good management by the implementing agency. It provides the agency continuous feedback on implementation and identifies both successes and problems as early as possible to facilitate timely adjustments to project operation.

The potential benefits of monitoring assessments are large: one study in Tanzania found that the information from monitoring studies could have saved the government up to US$7 million during the course of retrenchment of about 5,000 state enterprise workers.

Given the potential scale of infrastructure work force adjustment programs (thousands of workers, perhaps tens of millions of dollars), making the case for monitoring should seem unnecessary. It is clear, however, that when the work force restructuring plan is in place, some governments fail to monitor it adequately.

Why is this so? Five possible reasons:

1. **Ownership**: a general problem of all monitoring (and evaluation). If there is no customer for monitoring information, then monitoring systems are unlikely to work.

2. **An (incorrect) belief that implementation is the easy part**: When the big decisions have been made on the severance package, the mechanism of restructuring, and the scope of restructuring, the implementing agency and government officials may feel that the main challenges have been resolved. Unfortunately, all the evidence suggests that effective work force restructuring needs strong, active ownership and strong monitoring during implementation.

3. **Compartmentalization within government**: Institutional gaps between policy and implementation responsibilities for work force restructuring can result in a lack of policy coherence and coordination.

4. **The desire for a clean break**: There may be a concern that follow-up surveys can lead to raised expectations by workers of what government may be able—or willing—to do for them. Particularly if politicians have agreed generous severance terms, there may be a desire to minimize all contact with workers following severance.

5. **Exaggerated expectations**: There is a tendency among politicians and government spokesmen to convey exaggerated expectations of what redeployment programs can achieve. Hence, there is little subsequent interest in monitoring or evaluation if doing so might reveal a different story.

Where day-to-day implementation of some elements of work force restructuring is delegated to the enterprise or to other agencies, monitoring systems are particularly valuable. Here are some key steps that the implementing agency can take to help:

- Define and promulgate a set of monitoring indicators, against which the implementation managers report, and indeed on which the implementing agency reports. Possible indicators are set out in box 7.7. These indicators on their own will not guarantee effective monitoring. But the selection of an indicator can help to ensure that progress is made in that area.

- Require regular staffing reports from the enterprise. These will be especially relevant where there are high risks of adverse selection or rehires or a history of labor hoarding, or where the PPI process is likely to be slow. A sample monitoring report provided on the accompanying CD-ROM illustrates a format for monthly or quarterly reporting of work force change due to natural retirement and attrition, soft options (such as transfers,
administrative leave, and removal of ghost workers, early retirement and voluntary departure, rehiring, and new hiring.

- Clearly define the objectives and institutional responsibility for monitoring. This can include the creation of special units within the implementing agency to monitor compliance with labor (and other) conditions in PPI contracts. In Germany the privatization agency—the Treuhandstadt—set up a special department responsible for enforcing privatization contracts using penalties and legal action; when the agency was dissolved, those monitoring tasks were transferred to another government body.

**Tools (on the CD-ROM)**

- Spreadsheet for analysis of labor projects
- Labor program monitoring report
- Example terms of reference for impact evaluation

**Monitoring and Evaluation of Labor Programs**

Governments commonly fail to monitor labor programs effectively. Insufficient investment in monitoring can suggest that the size of the implementation challenge has been underestimated.

**Box 7.7: Severance and Redeployment: Some Monitoring Indicators**

The key objectives of monitoring are to assess overall progress and performance of the work force restructuring program, to identify the extent of adverse selection, and to reinforce accountability in the use of public funds. Examples of monitoring indicators are:

**Severance Indicators**

- Numbers of workers displaced by different mechanisms (early retirement, voluntary departure, mandatory departure, administrative leave)
- Disaggregation of displaced workers by age, grade, years of service, gender, ethnic group, region
- Disaggregation of displaced workers by skill/job description/operating unit
- Staffing ratios (based on relevant benchmarks, such as those described in module 3)
- Total wages and staff-related costs (from financial management reports)
- Total employment changes in the enterprise—infloWS and outflows (monthly or quarterly reports).

**Redeployment Indicators**

- Time between workers’ termination and receipt of monies
- Time between termination and receipt of audited accounts for disbursement
- Total and average severance payments
- Percentage of disbursements with queries/outstanding (sorted by reason)
- Numbers of appeals filed by workers against severance period.

**Additional Material (on the CD-ROM)**


**Web sites**

International Institute for Labour Studies, www.ilo.org/public/english/bureau/inst/ (Conducts and publishes research on labor markets and labor policies.)


**Other Material and Sources**


References


Labor Issues in Infrastructure Reform: A Toolkit


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