

**Social Impact and Social Mitigation of Enterprise Restructuring:  
Implications for Croatia  
Policy Note-**

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**Background on Enterprise Restructuring and Privatization**

There has been growing recognition within the World Bank of the need to design interventions directed at enterprise restructuring and privatization<sup>1</sup> with greater attention to the social impacts of those interventions and to the design of possible social mitigation measures. A principal instrument for enterprise restructuring<sup>2</sup>, structural adjustment lending, has been revised under the new Operational Policy 8.60 for development policy lending to include a determination of the likely poverty and social impact of the operation.<sup>3</sup> Country Assistance Evaluations have indicated the need for attention to the distributional impact of private sector development activities and to linkages among the various reforms;<sup>4</sup> weak institutions and the lack of comprehensive, country-specific private sector development strategies have hampered development effectiveness in this area.<sup>5</sup>

Despite relative agreement on recommending privatization of state-owned enterprises (SOEs), policy advice to transition countries has differed on the method, speed and sequencing.<sup>6</sup> Competition and the relative strengths of the various stakeholders (government, ministry officials, managers, workers, and unions) have tended to influence the design and implementation of privatization programs.<sup>7</sup> Within ECA, the experience with the political economy of privatization has been characterized as “reveal[ing] a

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<sup>1</sup> This policy note is focused on how social impact and social mitigation measures have been integrated into enterprise restructuring. The complete debate on enterprise restructuring and privatization is well beyond the scope of this paper. See, John Nellis, “The World Bank, Privatization and Enterprise Reform in Transition: A Retrospective Analysis” OED, 2002 and also OED, *Economies in Transition*.

<sup>2</sup> Some enterprise restructuring has occurred in the context of investment lending, but the adjustment lending constitutes the primary use. OED’s Project Performance Assessment Report on the Poland Privatization and Restructuring Loan, for example, notes that programmatic adjustment loans are a better instrument to address these types of projects with the need to maintain momentum of the privatization process.

<sup>3</sup> See OP 8.60, paragraph 10. During the corporate review process, a decision should be made on whether the policies supported by the DPL are likely to have significant poverty and social impacts. The Program Document should summarize the analytic knowledge about those impacts and the borrowers’ systems for mitigation of negative impacts and enhancement of positive impacts. See also OPCS, *Good Practice Notes for Development Policy Lending #2: Using Poverty and Social Impact Analysis to Support Development Policy Operations*, October 2004.

<sup>4</sup> CAEs have also noted the necessity for institutional development through technical assistance loans supporting adjustment. See for example, the recent Romania CAE (May 2005) observes that as the World Bank became concerned with the mode and quality of privatization, institutional development became an explicit objective and adjustment loans were accompanied by parallel TA focusing on institutional development.

<sup>5</sup> OED, *Private Sector Development: Findings and Lessons from Selected Studies: #17*.

<sup>6</sup> OED, *Assistance to Transition Economies: Were there Alternatives?*

<sup>7</sup> *From Plan to Market: World Development Report 1996*, p. 53

severe and politically charged tension with promoting efficiency and rewarding existing stakeholders.”<sup>8</sup>

ECA project documents and CASs often cast the rationale for privatization in terms of potential efficiency gains to the economy and the extent of direct subsidies from governmental budgets for state-owned enterprises. The first stage of transition focused on the establishment of market-driven, private sector-oriented economies. In recent years, the requirements of European integration and accession have led to an emphasis on fiscal discipline. Closer attention has been paid to implicit subsidies such as budgetary credits, nonpayment of taxes and accumulation of tax arrears, transfers from off-budget funds, and government payment of guaranteed loans. EU candidate countries have faced similar policy challenges in mitigating the impact of unemployment due to structural shifts in the economy.<sup>9</sup>

### **Background and Implications for Croatia**

This policy note provides an overview of social impact and social mitigation measures have been addressed in World Bank- supported enterprise restructuring<sup>10</sup> programs in ECA.<sup>11</sup> The focus is on lessons learned from the experience elsewhere in the region that could provide guidance to and policy options for Croatia in the on-going process of enterprise restructuring.

In the past few years, WB evaluation and policy guidance to the GoC has stressed the need to tackle subsidies to state-owned enterprises. The 2001 Country Assistance Evaluation noted that the targets for reduction of the role of the state were relatively modest,<sup>12</sup> and the 2003 Country Economic Memorandum emphasized that the privatization strategy pursued in 1990s has not facilitated restructuring. Policies of implicit subsidies (see above) have delayed SOE restructuring, discouraging new enterprises (particularly small and medium), expansion of existing firms, and sustainable job creation.<sup>13</sup> More recently, the 2004 Country Assistance Evaluation characterized privatization of SOEs as problematic. Under the new Programmatic Adjustment Loan

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<sup>8</sup> *From Plan to Market: World Development Report 1996*, p. 143.

<sup>9</sup> Bernard Funck and Lodovico Pizzati, eds. *Labor, Employment and Social Policies in the EU Enlargement Process*, World Bank, 2002. See Johannes Linn’s introduction on page 19 in which he notes that “But as one permits or encourages the downsizing of old industries, the social costs of transformation must be appropriately addressed (as, for example, in the current programs of coal sector restructuring in Central and Eastern Europe, supported by the World Bank) and an effort must be made to explain the approach to the affected population groups.”

<sup>10</sup> Restructuring refers to the cost cutting, efficiency- and competitiveness-enhancing steps required to position a firm to survive and thrive in a market environment. Privatization is a principal means of achieving restructuring. Privatization, however, does not guarantee that restructuring will occur, but is more strongly associated with enterprise restructuring than other methods. Djankov and. (World Bank, 2000.)

<sup>11</sup> While the primary focus will be on the ECA experience, selected experiences from other regions are also included. Existing reviews of the labor impacts of enterprise restructuring were also consulted.

<sup>12</sup> OED, Croatia: Country Assistance Evaluation, February 2001, p.5-6. The CAE notes that modest targets “suggest either excessive timidity on the part of the Bank, continued lack of ownership by the government or the difficult circumstances in the region.”

<sup>13</sup> Croatia, Country Economic Memorandum, p. 5. and vol. 2, p.129.

(PAL) program, the GoC has committed to privatization or liquidation of 1,000 SOEs by the end of 2007. This is consistent with the diagnosis of the needs for enterprise restructuring and privatization in the Pre-Accession Assistance Needs (PAAN) approved in July 2004.<sup>14</sup> As of April 2005, there are still over 100 SOEs with majority state-ownership. With respect to the former agricultural and food SOEs, a small number (13) of the most difficult cases remain. Half of these are agrokombinats with a large number of employees constituting a significant proportion of employment in the area.<sup>15</sup>

Overall, regulation of the Croatian labor market has tended to maintain existing jobs rather than create new ones.<sup>16</sup> High unemployment is due to strict employment protection legislation.<sup>17</sup> As with large SOEs elsewhere, SOEs in Croatia can be characterized as having too many employees with rigid labor contracts and often wages and benefits higher than those in the private sector. The restrictiveness in the labor market caused by employment protection legislation is reinforced by rigidities due to collective bargaining agreements in SOEs. Labor regulations require multiple steps for dismissals, such as cancellation of the contract and a lengthy, legally defined period of notice. Both wages and the unemployment rate have risen in Croatia, additional manifestations of rigidities in the labor market.<sup>18</sup> For example, Hrvatske Željeznice (Croatian Railways) has been characterized by low productivity due to a staffing surplus that had been increasing relative to the volume of freight and passenger rail traffic (which was decreasing). Furthermore, collective wage agreements with unions had raised labor costs by 6% as of March 2005.

Protecting the existing employees in Croatia has its costs. Only 43% of the working age population is employed; high unemployment (14.3%), nearly double that of the EU and there is low labor force participation (50.2%) Although poverty is relatively low, the main economic causes of income poverty are limited employment opportunities and inadequate targeting of the social safety net.<sup>19</sup>

Social welfare legislation has been subject to frequent amendment, adding various categories of beneficiaries.<sup>20</sup> This has resulted in considerable expenditures on non-insurance social transfers such as social assistance, maternity, children, war veterans and invalids. Although the overall level of social protection spending is high, poor targeting

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<sup>14</sup> As of July 2004, there were 142 companies with majority state ownership, 163 companies in which the state's share is between 25% and 50%, and 740 companies in which the state holds a stake of 25% or less.

<sup>15</sup> Jos Hayes, "A Strategic Framework for Improving Competitiveness in the Agricultural and Food Sectors in Croatia," paper commissioned under World Bank technical assistance loan.

<sup>16</sup> Predrag Bejaković and Viktor Gotovac, "Employment and Unemployment in the Republic of Croatia," in *Croatian Accession to the European Union: Economic and Legal Challenges*, Institute for Public Finance, 2004. See also Jan Rutkowski, "Does Strict Employment Protection Discourage Job Creation; Evidence from Croatia, Policy Research Working Paper 3104, August 2003.

<sup>17</sup> Croatia Country Economic Memorandum, July 2003, p. 13.

<sup>18</sup> Predrag Bejaković and Viktor Gotovac, "Employment and Unemployment in the Republic of Croatia." Employment protection legislation is stricter in Croatia than in any other EU accession country. Croatia CEM, p.13.

<sup>19</sup> Croatia, Country Assistance Strategy, November 2004.

<sup>20</sup> Predrag Bejaković and Viktor Gotovac, "Employment and Unemployment in the Republic of Croatia," p.217

and administration of benefits means that the most vulnerable members of society are not necessarily protected, including those affected by enterprise restructuring. Cash benefit expenditures are much higher in Croatia than in other countries at the similar income level, and benefits are also managed by different ministries with categorical benefits handled by the Ministry of Intergenerational Solidarity, Families and Veterans, (MHSW) and social benefits and services managed by the Ministry of Health and Social Welfare. Under the PAL program, the GoC has agreed to convene an inter-ministerial working group<sup>21</sup> to prepare and oversee the implementation of a strategy for reform of social benefits spending. The goal of the strategy, agreed in the PAL negotiations, will be to reduce the overall level of social benefits spending while increasing the share of the means-tested social benefits.

Taken together, these various policy challenges in Croatia indicate the need for careful design and targeting of social mitigation measures as the enterprise restructuring proceeds. The remaining enterprise restructuring will require retrenchment, and this process may face more obstacles due to the delays in implementation. Although targeting of social benefits is being addressed, more vulnerable unemployed workers may not have not adequate support. As outlined below, experience with World Bank-supported enterprise restructuring indicates that measurements of social impact and social impact analysis can provide inputs to this process.

### **Measuring Social Impact**

In ECA, recognition of the implication of social impact on reform progress occurred when the first wave of reforms encountered obstacles in implementation of well-designed programs. OED characterized the First and Second Industrial Restructuring Projects in Hungary as adopting an innovative approach to systemic reform, but continued along the following lines:

However, some of these measures (e.g., adequate bankruptcy procedures), although in place, were never enforced, due to the absence of an appropriate framework to absorb the social cost of adjustment. At the time of the design of the ISAL, although the social costs of the program were anticipated, no provision was made in the loan to mitigate the adverse impacts of bankruptcy and closures on the population. This may have contributed to the reluctance by the authorities, at the time, to accelerate the bankruptcy proceedings. Issues concerning the social cost of adjustment and other inter-related fiscal matters were subsequently addressed under the SALs which followed.

Expected social impact has at times been cast in terms of opposition to privatization, rather than measured concretely, and social impact analysis has been missing or incomplete.<sup>22</sup> Organized labor and employees of state-owned enterprises (SOEs) have posed the main opposition to privatization due to fears of job loss and of changes in

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<sup>21</sup>The inter-ministerial working groups is comprised of representatives from the Ministry of Health and Social Welfare; Ministry of Families, Veterans and Intergenerational Solidarity; Ministry of Economy, Labor and Entrepreneurship and Ministry of Finance.

<sup>22</sup> The ILO recommends early identification of stakeholders and establishment of institutional arrangements for their involvement. See B. Martin, "The Social and Employment Consequences of Privatization in Transition Economies: Evidence and Guidelines, IPPRED Working Paper #4, ILO, 2000.

working conditions and terms of employment.<sup>23</sup> Employment in privatized firms generally decreases, at least in the short-term.<sup>24</sup> Fears are often fueled by inaccurate or incomplete information about social impact,<sup>25</sup> and proponents of labor often are highly critical of privatization, focusing on the negative effects on employment, income distribution, and worker welfare.<sup>26</sup> Labor opposition can create high political costs, leading to governmental reluctance or slowing the speed of privatization.<sup>27</sup> Labor unions tend to prefer that SOE workforce issues be addressed by governmental programs, as unions can have greater impact on the government, including on severance terms.<sup>28</sup> Another factor that may influence the timing of restructuring is that private buyers prefer or require the government to address retrenchment before privatization, so as minimize labor disputes. Government-led labor restructuring, however, tends to lead to great attention to development of social mitigation measures.<sup>29</sup>

In certain cases, despite an initial period of confrontation, unions and workers have served as sources of industry-specific knowledge that can provide input to the restructuring process, identifying possible areas for internal reorganization and skill shortages with the industry. In Russia coal restructuring, technical assistance facilitated the role of trade unions in managing social impact, including conducting seminars, maintaining legal services in the coal regions, and monitoring.

The form of privatization most widely used in Croatia, management/employee buyouts,<sup>30</sup> is also the method likely to have the least impact on employment.<sup>31</sup> In Croatia, even with the slow pace of privatization, accelerated inflows into unemployment have occurred due to enterprise restructuring.<sup>32</sup> Although privatization and restructuring is generally expected to increase employment opportunities in the longer-term, short-term job losses are typical.

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<sup>23</sup> OECD, *Privatizing State-Owned Enterprises*, p. 16. Kikeri, "Privatization and Labor."

<sup>24</sup> Megginson and Netter, "From State to Market"

<sup>25</sup> Sunita Kikeri, "Privatization and Labor: What Happens to Workers When Governments Divest" World Bank Technical Paper No. 396. 1998.

<sup>26</sup> Birdsall and Nellis, *Winners and Losers*, p. 51.

<sup>27</sup> Sunita Kikeri, "Privatization and Labor: What Happens to Workers When Governments Divest" World Bank Technical Paper No. 396. 1998, and Yi Chen, "The World Bank and the Provision of Assistance to Redundant Workers," Social Protection Discussion Paper Series #112.

<sup>28</sup> Birdsall and Nellis, *Winners and Losers*, p. 52.

<sup>29</sup> Sunita Kikeri, "Privatization and Labor: What Happens to Workers When Governments Divest," p. 13.

<sup>30</sup> This form of privatization has been common in the Yugoslav successor states, due in part to the pre-transition structure. The discussion in *Slovenia: From Yugoslavia to EU Accession* weighs the positive and negative legacy of self-management. On the one hand, managers had some responsibility for running firms in a quasi-market environment; on the other hand, the strong role of internal ownership (by managers, workers and pensioners) hindered efficient restructuring. The gradualist approach adopted by Slovenia aimed at "making the costs of transition socially bearable." Other countries that used management-employee buyouts are: Poland and Romania, and the voucher program in Lithuania tended to function in that manner. This form of insider ownership tends not to be stable and evolves into another form. Insider buy-outs pose other problems (asset stripping, illicit use of assets) as detailed in the 2004 Croatia Country Assistance Evaluation, p.19-20.

<sup>31</sup> Sanjeev Gupta, Christian Schiller, Henry Ma, and Erwin Tiongson, "Privatization, Labor and Social Safety Nets," *Journal of Economic Surveys*, vol. 15, No. 5, p. 655. N.B. Authors are from the IMF.

<sup>32</sup> Croatia, Country Economic Memorandum, vol. 1, p. 12

Privatization in heavily subsidized SOEs that have been protected from competition (such as steel, railways and energy enterprises) has been more likely to require significant reductions in staffing levels. Of the various sectors<sup>33</sup> in which such significant enterprise restructuring has occurred, the mining sector has focused consistently on measuring social impact and developing social mitigation measures. In ECA, mining was heavily subsidized and has undertaken significant restructuring. Poland, Romania, Russia and Ukraine have all borrowed from the World Bank to finance this process; all have analyzed social impact in some form, using this analysis in design, implementation and/or monitoring of mitigation measures.<sup>34</sup> Furthermore, labor activism is a common response to coal sector restructuring, and the isolated, mono-industrial dimensions of mining results in significant community impact and second-order effects due to job loss.<sup>35</sup> Although Croatia does not face mine restructuring issues, the SOEs remaining to be restructured share some of the characteristics: a high level of subsidies, activist labor (shipyards), and protection from competition.

Until recently, systematic research has been lacking, however, on the dimensions of job loss, the consequences for remaining employees, and implications for dismissed workers.<sup>36</sup> Pay levels, terms of employment, and job security for workers who remain at privatized enterprises have not been addressed or have been assumed to stay constant.<sup>37</sup> In addition, many workers who are formally employed at a SOE are on reduced work schedules, forced leave, or have accumulated pay arrears.<sup>38</sup> Often the extent to which such workers have found alternative employment is not fully known. Distributional impacts of reforms have been analyzed through Poverty and Social Impact Analyses (PSIA)<sup>39</sup> carried out in the context of programmatic poverty assessments and through projects.

As part of the Privatization Social Support Project in Turkey, three studies were undertaken to monitor the social impact of privatization: 1) a privatization economic

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<sup>33</sup> Social impact analysis of power sector reforms has focused on consumers and the impact of increased tariffs on households and the poor. See Julian Lampietti, ed. *Power's Promise: Electricity Reforms in Eastern Europe and Central Asia*. World Bank, 2004.

<sup>34</sup> Haney and Shkaratan, p.17.

<sup>35</sup> Michael Haney and Maria Shkaratan, *Mine Closure and Its Impact on the Community: Five Years after Mine Closure in Romania, Russia and Ukraine*. Social Development Paper #42, June 2003.

<sup>36</sup> Kikeri, p. 7. Birdsall and Nellis observe that the effects of privatization on employment levels have received surprising little rigorous analysis. *Winners and Losers: Assessing the Distributional Impact of Privatization*, Center for Global Development, Working Paper #6 (May 2002), p. 21.

<sup>37</sup> See the literature review in the Annex to Birdsall and Nellis, *Winners and Losers*.

<sup>38</sup> C. Evans-Clock and A. Samorodov, "The Employment Impact of Privatization and Enterprise Restructuring in Selected Transition Economies" ILO- Working Paper IPPRED-16., 1998. The ILO study found that these workplace practices can contribute to growing poverty among the employed.

<sup>39</sup> "Poverty and social impact analysis (PSIA) refers to analysis of the distributional impact of policy reforms on the well-being or welfare of different stakeholder groups, with a particular focus on the poor and vulnerable. PSIA also addresses sustainability and the risks to policy reform and help to monitor poverty and social outcomes and impacts of policy changes." User's Guide for Poverty and Social Impact Analysis. See for example, the BiH "Poverty and the Labor Market" 2005 as part of the Programmatic Poverty Assessment for BiH. A number of PSIA's in ECA have focused on the impact of utility reforms.

impact study, 2) a privatization coping strategies study, and 3) a labor redeployment services study. The first consisted of three rounds of surveys, comparing the economic status of workers in firms that have been privatized and in firms to be privatized. Workers were asked about their uses of severance payments and the impact of privatization on their family.<sup>40</sup> In the Macedonia Social Support project (more below), social monitoring surveys were financed under the project. Similarly, impact evaluations of targeted social mitigation programs were conducted to assess the effects of measures adopted in the Romania Mine Closure and Social Mitigation project and to contribute to the design of the follow-on project. Ex-post social impact monitoring was utilized in Ukraine to assess the impact of mine closures and downsizing and to evaluate the effectiveness of mitigation policies.<sup>41</sup>

As described above, tracer studies tracking retrenched workers can provide key inputs to the design of social mitigation measures. Retrenchments usually have an uneven impact on men and women due to differences in types of jobs, contracts and seniority.<sup>42</sup> In some cases, there have been gender differences in the percentage of retrenched workers in self-employment<sup>43</sup> which would affect the type of retraining or job search assistance to be provided. Similarly, lower-skilled and lower-educated workers have been found to have greater difficulty in finding jobs.

### **Social Mitigation Measures**

Globally, the amount of World Bank lending providing labor assistance to workers redundant due to enterprise restructuring doubled between 1994 and 1998. The most frequently used have been 1) training, 2) labor market mobility and 3) severance pay programs.<sup>44</sup> In ECA, the mining sector, in particular, has been a focus for operations that have used the monitoring of social impact to assist with the design of social mitigation measures. OED's evaluation of the experience with extractive industries<sup>45</sup> has been reflected in the design of subsequent operations in that labor redeployment was recommended to be the focus of a separate operation.

Macedonia has addressed the various elements of SOE restructuring with the support of a number of operations over time (see footnote 49); the Social Support project<sup>46</sup> was linked to the Financial Sector Adjustment Loan 2 with a component designed mitigate social risks from SOE restructuring. The project also provided assistance to long-term

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<sup>40</sup> A majority (67%) of workers who remained employed at privatized firms considered privatization as having had a positive impact on their company.

<sup>41</sup> Haney and Shkratan, *Mine Closure*.

<sup>42</sup> Susan Razzaz, "Minimizing Negative Distributional Impacts of Public Sector Downsizing" PREMnote #84, April 2004. This note focuses on public sector downsizing, but some of the findings and recommendations are applicable to enterprise restructuring.

<sup>43</sup> Studies of retrenched workers from SOEs in Zambia indicate that women are more likely to be self-employed than men. The PSIA of mining sector reform in Romania found greater impact on women of downsizing and less willingness to work in the informal economy.

<sup>44</sup> Yi Chen, "The World Bank and the Provision of Assistance to Redundant Workers: Experience with Enterprise Restructuring and Future Directions"

<sup>45</sup> OED, *Extractive Industries and Sustainable Development*, Volume II- World Bank Experience, p.36.

<sup>46</sup> ICR rating- Highly Satisfactory.

unemployed in addition to those affected by retrenchments, an element that could be applied in Croatia, given the presence of long-term unemployed. OED's findings on earlier operations in Turkey's SOE restructuring program stressed the necessity for realistic timelines in privatization and stressed the importance of assessing the political risks early in the project cycle, including possible sources of resistance.

As in Macedonia, related operations addressed the various aspects of restructuring in Serbia, but these were facilitated through adjustment lending, supplemented by technical assistance grants and loans. Serbia's Private and Financial Sector Adjustment Credits 1 (May 2002)<sup>47</sup> and 2 (June 2003) to privatize and restructure socially-owned enterprises were complemented by the Social Sector Adjustment Credit (April 2003) focusing on reforms in pensions and labor, while enhancing the focus on social assistance and poverty monitoring.

Summarizing common factors in the range of ECA experience with managing the social impact of enterprise restructuring indicates the following issues to be addressed in designing mitigation measures:

1. Determining the extent of back wages/ wage arrears.
2. What has been promised in terms of severance payments (including statutory obligations)
3. Loss of non-wage benefits provided by enterprises (social assets and services) and identification of who has taken over these services

As to the specifics of program, social mitigation responses vary along the continuum between adapting existing institutions and policies to address restructuring to development of ad-hoc or situation specific programs. The use of measures in combination, as in Macedonia, has been found to increase effectiveness.<sup>48</sup> Options utilized are:

- Employment services (job search assistance, placement, counseling)
- Training, retraining and on-the-job training

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<sup>47</sup> The first loan was rated highly satisfactory by OED, and the second loan was rated highly satisfactory during the QAG quality at entry review. The second loan was a continuation of the reform program begun under the first. The project was considered outstanding for building directly on the progress of first PFSAC, pursuing the same objectives to further closure and taking advantage of the institutional foundation laid by PFSAC I. The measures in PFSAC2 streamlined entry of new companies, contributing to the increase of employment at SMEs at the same time as SOEs were being restructured.

<sup>48</sup> See David Fretwell, "Mitigating the Social Impact of Privatization and Enterprise Restructuring" Social Protection Discussion Paper #405, March 2004. A study by the ILO found that use of measures in combination tended to increase their effectiveness. N. Meager and C. Evans, *Evaluation of Active Labor Market Measures for Long-Term Unemployed*. Within ECA, the provision of social services through enterprises also raised additional issues for restructuring. The policy implications of social service provision has diminished for Croatia as the enterprises have in general ceased to supply such services, whether or not they have been restructured. Simon Commander and Mark Schankerman in "Enterprise Restructuring and Social Benefits" (EBRD) examine Russian and Ukrainian experience in this regard. They conclude that effective reform must delink provision of benefits from incumbency in a firm, therefore reconfiguring access to benefits. Access to certain benefits (health and child care) could be addressed through provision of transitional income support which would decline over time as wages adjust.



- Job creation (temporary employment, public service/public works, short-term employment guarantees, wage/employment subsidies)
- Small business advisory services/business incubator /micro-enterprise development
- Income support (severance payments, preferential allocation of shares)
- Social welfare/ social benefits/ unemployment benefits (altering to address anticipated retrenchment, improving targeting)

Country factors such as a rapidly growing economy, well-established private sector, and the presence (or absence) of social safety nets have influenced the choice and effectiveness of social mitigation measures.<sup>49</sup> In ECA, an evaluation of active labor market programs in four countries found variation in impact within and between countries. Different categories of workers have tended to benefit from different programs with training programs having slightly higher positive impact on women and younger and middle-aged workers. Less-educated workers tend to benefit from short-term transition employment. Participants in wage-subsidy programs have tended to be younger, less-educated, and often long-term unemployed, but the impact of such programs is not uniformly positive.<sup>50</sup> An evaluation of a larger group of public works programs shows that they can serve as short-term safety nets, but there is little evidence that such programs improve long-term employment prospects.<sup>51</sup>

For example, in the Macedonia Social Support project,<sup>52</sup> various options were used in combination with components addressing severance payments, labor redeployment (employment counseling and retraining), and improved targeting of social benefits. In addition, the project specified evaluation of the impact of the labor redeployment services and supported capacity-building for the Ministry to undertake monitoring. For Croatia, this is a key lesson learned from this project, as small business advisory programs, micro enterprise development, and business incubator programs have been undertaken, some of them donor-supported, but impact monitoring has not occurred systematically.

Of the various social mitigation measures available, caution should be particularly applied in the use of severance packages to induce workers to leave SOEs voluntarily. Traditional severance packages tend not to be related to losses that workers experience,

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<sup>49</sup> Sunita Kikeri, "Privatization and Labor: What Happens to Workers When Governments Divest?" World Bank Technical Paper No. 396, 1998.

<sup>50</sup> D. Fretwell, J. Benus, and C. O'Leary, "Evaluating the Impact of Active Labor Programs: Results of Cross Country Studies in Europe and Central Asia," Social Protection Discussion Paper #9915, 1999. The impact analysis used a quasi-experimental design to examine programs in Czech Republic, Poland, Hungary and Turkey designed to expedite redeployment of labor.

<sup>51</sup> Gordon Betcherman, Karina Olivas, and Amit Dar, "Impacts of Active Labor Market Programs: New Evidence from Evaluations with Particular Attention to Developing and Transition Countries" Social Protection Discussion Paper Series #402, January 2004

<sup>52</sup>The objective of the Macedonia Social Support project was to mitigate the negative social and economic impact from SOE restructuring occurring under the Financial and Enterprise Sector Adjustment Loan. Earlier projects, specifically the Social Reform Technical Assistance project supported the government in SOE restructuring through actions to reduce the individual and community impacts of worker dislocation. (OED rated the project as likely to be sustainable and have substantial ID impact.) Currently under implementation, the Macedonia Social Protection Project addresses pensions and targeting of cash benefits.

but are usually calculated on wage and seniority, which tend to disadvantage women. Workers at a particular industry or enterprise may seek to be treated as a special case and request higher compensation.<sup>53</sup> Social impact analysis has found that severance payments have tended to go into consumption, and without parallel policies to encourage labor market re-entry, workers tend to seek social protection after funds from the severance packages have been used. Another set of issues with severance packages in SOE restructuring are similar to the risks faced by their use in public sector reforms:<sup>54</sup> 1) adverse selection, 2) overpayment, and 3) moral hazard.<sup>55</sup> Within ECA, severance payments have ranged from three months pay to 24 months. A related concern with respect on valuation occurs if SOEs have “ghost” or “fictitious” workers- workers who remain formally as employees to gain certain benefits (including pension), but have found employment elsewhere, usually in the informal economy. Options to address some of the concerns with the use of severance packages would be to spread these over time or to re-cast them as entitlements that are conditional on entering into some new productive activity.

Although take-up on self-employment, business incubators and micro-enterprise development services is usually quite low, they can be effective when well-targeted. In particular, older better-educated workers tend to benefit more from these programs. It is likely that labor retrenchment will affect this social group (as these are the workers currently protected under existing labor legislation), and stock-taking on the existing programs<sup>56</sup> could be combined with impact evaluation.

In ECA more generally, the choice and design of operations has depended on the stage of restructuring and the specific nature of the challenges. Sequencing has emerged as key in developing social mitigation measures. Labor redeployment programs should be in place prior to any large-scale lay-offs.<sup>57</sup> The selection of implementing agencies is crucial in

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<sup>53</sup> See for example, the discussion in Jolanta Hess “Recommendation and Proposed Strategy for Trepca Restructuring” Kosovo Sectoral Employment Strategy, June 2004.

<sup>54</sup> This includes severance pay during retrenchment in public enterprises either wholly or majority owned by the state. See the Operational Memorandum on Financing Severance Pay in Public Sector Reform.

<sup>55</sup> Adverse selection occurs when severance packages encourage well-performing staff to leave, and moral hazard refers to workers who have received severance packages being rehired by the same enterprise or entity. The Operational Memorandum notes that in the case of public enterprises being restructured for privatization, the rehiring of previously retrenched workers is unlikely. The Operational Memorandum on financing severance pay in public sector reform specifically states the necessity of addressing social impact and the use of analytic work in designing mitigation measures. Paragraph 9 states as follows “*Social Impact*. Public sector reform operations financing severance pay address the social costs of retrenchment. The design of such operations should take into account the effect of layoffs on groups that may suffer disproportionately and be rendered vulnerable as a result of layoffs, and, where appropriate, ensure that mitigation measures are adopted as part of, or in parallel with, the operation. Appropriate analytic work to identify and assess the potential social costs of retrenchment should inform the design of operations financing severance pay and any relevant mitigation measures. Operations will generally contain change management strategies to ensure that affected public sector staff are made aware of what is happening and are informed about the options available to them.”

<sup>56</sup> The Territorial Socio-Economic and Institutional Assessment prepared for the Croatia Social and Economic Recovery Project provides some overview of programs in the Areas of Special State Concern.

<sup>57</sup> Chen, “World Bank and the Provision of Assistance to Redundant Workers: Experience with Enterprise Restructuring and Future Direction.”

ensuring that fast acting and targeted support reach vulnerable unemployed workers. In Hungary, the rapid response model (based on North American experience) provided services to workers prior to retrenchment, including both information and planning services.<sup>58</sup>

## **Recommendations and Next Steps**

### *Measuring Social Impact and Facilitating Strategy*

Croatia's experience indicates that social impact analysis would be appropriate in determining mitigation measures. Evaluation of active labor market programs underline the necessity of disaggregating affected workers prior to designing new measures. Issues to be examined would be: worker age, gender, education, skill profile, wage arrears, hours worked, secondary job holding, and other coping mechanisms. Data sources for this analysis could include the Labor Force Survey, Business Environment Enterprise Survey (BEEPS), and official employment and wage data. Surveys of enterprises, including perhaps the BEEPS could aid in determining the skills in demand and the extent of mismatch between retrenched workers' skills and those needed in the labor market. In addition, a tracer study may prove useful in determining mitigation measures through identifying the outcomes for those who have already left SOE employment in earlier retrenchments. The Regional Development and Living Standards study will also provide inputs for this process.

Findings from social impact analyses in other contexts indicate that "restructuring" is often viewed by workers and affected community members as a synonymous with enterprise closure,<sup>59</sup> indicating one of the areas to be addressed is that of improved dialogue. Such dialogue may be time-consuming, but ultimately efficacious. Implementation of the Slovenia Enterprise and Financial Sector Adjustment loan was affected by the slow pace of legislative reform, but OED concluded that consensus-building (and the time necessary to achieve it) was a key to such fundamental reforms. Significantly, the Slovene experience generated a broad public debate and awareness on the necessity to address issues such as wage growth, pension reform, and privatization of SOEs.<sup>60</sup> Experience in Croatia indicates that union concern in railway restructuring, for

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<sup>58</sup> Gary Hansen and Maria Heidkamp, "Innovative Approaches to Worker and Community Adjustment in Hungary" in *Regional Development and Employment Policy*. Findings indicate that it takes nearly half the time for workers to find new jobs when they have access to early intervention services prior to severance.

<sup>59</sup> Haney and Shkaratan, p. 29.

<sup>60</sup> The OED Evaluation Memorandum stated it in the following terms, "The lessons derived from this operation [Enterprise and Financial Sector Adjustment] reinforce those derived from other operations in other transition economies: (i) coherent macroeconomic, enterprise, and banking sector reforms are essential; (ii) fundamental reforms generate wide-ranging debate on policy, institutional, and legislative issues, and time is required to develop a consensus and to adopt the required legislation; and, (iii) it is important to establish professionally staffed institutions with clear mandates to develop and implement transition policies and programs." The ILO stresses Johannes Linn in his introduction to *Labor, Employment and Social Policies in the EU Enlargement Process* notes that one of the key lessons of downsizing industries is that the social costs must be addressed and "an effort must be made to explain the approach to the affected population groups." p.19. This echoes the experience in OECD countries which has derived the following steps: 1) consult and negotiate with labor groups at the earliest possible stage, 2)

example, were lack of communication by the management, lack of a concrete action plan, and disproportionate percentage of layoffs among non-managerial staff versus managerial. The findings from upcoming PSIAs for the Brodotrogir and Uljanik shipyard restructuring can be used as a basis for identifying such issues and opening a dialogue on response. The apparent “prosperity” of these subsidy-dependent enterprises may obscure the need for restructuring to worker and other stakeholders. Workers are often unaware of the programs of support already available; older workers who will lose both income and status are particularly

In Russia, the World Bank assisted the Russian government in developing a strategy to address the impact of coal sector restructuring. The strategy process was initiated by mapping the resources, policy and information flows and ensuring the input of regional and local governments, and a stakeholder analysis that unpacked the various diagnoses of the key problems. Differences in proposed policy preferences had followed from these perspectives. To facilitate the process of reform, an interagency commission was established with representatives from different levels of government, including municipalities and ministries and agencies. Mapping served to identify institutional capacity, mechanisms and procedures for reducing adverse impacts. For example, in Russia, the role of the Treasury Department was expanded to encompass a new system for accountability and benefit delivery. The expertise of an agency within the Ministry of Energy was tapped in terms of calculations of benefits, based on anticipated retrenchment. In Croatia, some of elements of this process have begun under the PAL program, but the ongoing challenge is to build in-country constituency and capacity.

Given the political economy of coalition government, the World Bank can play a critical role as a facilitator and a catalyst in enabling the GoC to use existing institutions more effectively to address the remaining “hard cases” of SOE restructuring and privatization. Consolidating the various initiatives and coordinating interventions is a key challenge for the GoC, but lessons learned from other experiences indicate that some form of working group on enterprise restructuring with representatives from the various ministries, agencies, and local authorities can be effective. Given the need to address the protective labor legislation systematically and the difficulties in the political economy of such reform, broad coalition participation in any working group would be critical.

### *Reform and Social Mitigation Measures*

Based on the lessons of evaluations and previous operations, the preferred option in development of social mitigation measures is a package of services with a focus on labor redeployment. Services should be linked to labor demand and actual workplaces and be designed with careful targeting. The GoC should be realistic about goals and allocate resources based on a cost-effectiveness basis (rather than on stakeholder strength and advocacy), bearing in mind that a growing economy creates jobs not labor programs, but

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identify issues at the onset, 3) establish a framework for mitigation against adverse effects, 4) communicate the benefits of privatization and 5) explain government plans for mitigation. OECD, *Privatizing State-Owned Enterprises*, p. 16

that labor programs can facilitate the process of responding to a new economy. Addressing the stringent employment protection legislation needs to occur in parallel.

A general multi-sector, multi-region approach<sup>61</sup> would be advisable in Croatia. This will help prevent higher costs due to the stronger SOEs in a more privileged sector (such as shipyards or railways) negotiating a more favorable severance package. State concerns about regional disparities and inequities could be addressed in through tailoring the specific emphasis in labor redeployment services provided, based on enterprise analysis.

Integrating local authorities into the planning process can identify opportunities in the regional economies that could be developed and absorb some of the laid-off workers. The planning process at the županija level with the development of regional operational programs (ROPs) could be integrated into planning for SOE restructuring. ROPs identify regional resources and opportunities. Not all SOE assets are necessarily attractive for investors during privatization. In many cases (such as agrokombinats), land and unused buildings could be used for other productive uses.

Once strategic directions have been defined, and institutional actors have been identified, both in terms of existing and potential roles, the next steps are defining the specific mix of options to be utilized. In planning labor redeployment services,<sup>62</sup> the characteristics of the retrenched workers should be taken into account in determining the extent of job placement services (generally younger workers with needed skills), institutional and on-the-job training (older workers with skills not in demand) and redeployment services that would respond to lack of labor demand (business incubators, small business technical assistance). Some of these programs already exist in Croatia and could be more effectively utilized. Data on skill profiles and enterprise surveys can be used to determine the extent of retraining needed. As discussed above, tracking system and evaluations are necessary to determine the efficacy of given interventions; flexibility to adapt programs, particularly with respect to regional variations in the economy in Croatia. Tailoring to regional variations should also take into account incentives that local governments have to create environments for investment.

The remaining hard cases of SOE restructuring are likely to involve significant social impact, in some respects amplified by the time delay in transition. Mitigating this social impact will require consensus-building and careful design in response.

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<sup>61</sup> Fretwell, "Mitigating the Social Impact," p. 6.

<sup>62</sup> The Global Labor Toolkit for Labor Issues in Infrastructure Reform received a highly satisfactory from QAG in the first evaluation of non-lending technical assistance. The QAG panel noted that it was a comprehensive source of information that is useful to Bank's client countries and in restructuring exercises.