MODULE 1




Labor Issues in Infrastructure Reform

A Toolkit

THE WORLD BANK

PUBLIC-PRIVATE
INFRASTRUCTURE
ADVISORY FACILITY

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1 2 3 4 07 06 05 04

ISBN 0-8213-5470-1

Library of Congress Cataloging-in-Publication Data

Labor issues in infrastructure reform : a toolkit / Public-Private Infrastructure Advisory Facility (PPIAF).
p. cm.
Includes bibliographical references.
ISBN 0-8213-5470-1
1. Public works—Management—Handbooks, manuals, etc. 2. Public contracts—Handbooks, manuals, etc. 3. Labor contract—Handbooks, manuals, etc. 4. Public works—Personnel management. 5. Public works—Employees. 6. Public works—Cost effectiveness. 7. Contracting out. 8. Infrastructure (Economics) I. Public-Private Infrastructure Advisory Facility. II. World Bank.

HD3850.L23 2003
352.7'7268—dc22 2003061161

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Acknowledgments

This toolkit was funded by the Public-Private Infrastructure Advisory Facility (PPIAF), a multidonor technical assistance facility aimed at helping eliminate poverty and achieve sustainable development through private involvement in infrastructure. Funding was also provided by the World Bank and the Netherlands Consultant Trust Fund.

The toolkit was managed and led by Sunita Kikeri of the World Bank's Investment Climate Department. Olaf Smulders, a consultant funded by the Netherlands Consultant Trust Fund, provided research and analytical support. The toolkit was prepared by the Adam Smith Institute (ASI) of the United Kingdom. The team comprised Terry Green (team leader), Brendan Martin, and Roberto Battista, and was supervised by Roger Usher, ASI Director.

The toolkit benefited from the inputs of representatives from international development institutions, the labor movement, and colleagues in the World Bank Group. They included Alberto Chong (Inter-American Development Bank); Antero Vahapassi (Asian Development Bank); Cleopatra Doumbia-Henry (International Labor Organization); Mike Waghorne (Public Services International); Peter Bakvis (International Confederation of Free Trade Unions); David Cockroft and Stuart Howard (International Transport Workers' Federation); and Amit Dar, Amy Luinstra, Anita Schwarz, Bill Kingdom, David Fretwell, Gordon Betcherman, John Speakman, Jordan Schwartz, Lou Thompson, Marc Juhel, Martin Rama, Omer Karasapan, Richard Hinz, Robert Mertz, Warrick Smith, and Yash Pal Kedia (the World Bank). Maria Honrado and Rosario Bartolome provided logistical support.

How to Use the CD-ROM

The toolkit's CD-ROM is designed to be intuitive and easy to use. It works like a Web site and can be viewed through a Web browser, but it doesn't require you to be connected to the Internet, except to access external web sites.

To access the toolkit, insert the CD-ROM in your computer. Choose the CD-ROM drive from **My Computer** and open the "toolkit.html" file located in the **toolkit** directory. You can then navigate through the CD-ROM as you do Web pages.

On the left-hand side of the screen you can see the main navigation panel.

- The **Home** link takes you back to the beginning.
- **How to Use the Toolkit** takes you to this page on the CD-ROM.
- The seven modules are the body of the toolkit. Click on each header to open the list of contents in each module, then click on each subheading to go to its pages. To collapse the subheadings, go back to the **Home** page.
- Below the modules you will find a site map that gives a graphic overview of the whole toolkit and how its elements relate to each other. The map requires the Flash Player plug-in. This may already be installed in your browser software, but if you don't have it, you can download it free from http://www.macromedia.com/downloads/
- At the bottom there is a search option. Type a keyword relating to the subject for which you are looking in the search box and click on **Go**. The search will look at the content of the toolkit and point you to the documents and pages that deal with that subject.

The main screen area in the center displays the pages of the module or submodule you have selected from the left-hand menu. Within the text you will find links to additional documents and tools as well as links to external Web sites. The links will only work if you are connected to the Internet.

On the right-hand side you will find a link to a page where you can download each module of the toolkit as a PDF document (which can be printed). To view the PDF documents you need to have the Adobe Acrobat Reader installed on your computer. If you don't have it, you can download it free from http://www.adobe.com/products/acrobat/readstep2.html

The right-hand menu also has links to the additional areas of the toolkit, including references, case studies, tools, additional materials, and documents. These come in a variety of formats, mainly PDF, but also documents in such Microsoft Office formats as Word, Excel, and PowerPoint.

1 MODULE

Labor Toolkit: Framework and Overview

A universal concern in infrastructure reforms is the effect such reforms have on labor. State-owned infrastructure firms often employ more people than required for efficiency, and often under favorable terms and conditions of service, leading to lower labor productivity and higher labor costs than private employers would bear. Some reform, in particular those involving private participation in infrastructure (PPI), may thus prompt surplus labor and changes in working conditions as governments adjust the work force to prepare for PPI, or as new owners or operators introduce efficiency improvements and expose enterprises to greater management discipline, new technologies, and increasing competition.

FRAMEWORK

Where labor adjustments are required it is important to ensure that labor programs are fully planned for in the PPI reform process. Designing and implementing labor strategies are difficult and sensitive tasks, and the challenges facing governments are many: labor opposition, lack of social safety nets, and lack of functioning labor markets among them. But experience shows that PPI can proceed smoothly if efforts are made early in the process to deal with labor issues. Labor programs are most effective when efforts are made to develop a strategy that balances the interests of consumers in receiving better and more efficient services with measures that provide fair and equitable treatment for workers, develop a mix of restructuring options, compensate surplus employees, help workers reintegrate into the labor market, and inform and involve workers and labor unions in the reform process.

The Toolkit provides practical tools and information to help policymakers handle sensitive labor issues in PPI.

Objectives

The primary objective of the Toolkit is to provide practical tools and information to help policymakers handle labor issues in PPI. (The Toolkit does not address the policy decision to undertake PPI or the other challenges involved, such as introduction of competitive markets, development of regulatory frameworks, and access to services for the poor. Those materials can be found in other toolkits and documents listed in the bibliography of this Toolkit.) Drawing from available information, practical experiences, and global best practices, the Toolkit provides a practical guide to assist practitioners in designing, implementing, and monitoring labor programs in PPI reforms, thus also helping build capacity in this challenging area.

Although broad lessons on labor adjustment in PPI are emerging, experience shows that no one strategy is universally applicable and the choice of measures depends on country and enterprise circumstances. Experience also shows that the interests of all parties need to be carefully balanced to ensure both good processes and good outcomes. Efforts to provide fair and equitable treatment for workers must be economically and financially feasible for the government and must give private operators the needed flexibility in making employment decisions. The Toolkit thus provides a wide range of frameworks, concepts, checklists, model documents, and case examples that together aim to help government officials make the appropriate choices for their circumstances.

The Toolkit focuses on labor issues in PPI, but it applies equally to restructuring of state-owned infrastructure enterprises without private participation arrangements. Such reforms often involve similar labor issues and many of the approaches and lessons are applicable. Similarly, whereas the Toolkit focuses on infrastructure enterprises, it is also applicable to state-owned enterprises in other sectors of the economy where labor issues are a major source of concern.

Users of the Toolkit will be better prepared to design and implement a labor program.

The primary audience for the Toolkit is government officials responsible for preparing and implementing PPI and enterprise reforms. The term "implementing agency" is used to represent this audience. The agency may be a unit within the ministry of finance, the ministry of economy, the privatization agency, the relevant sector ministry, or the enterprise itself. Wherever the Toolkit is used, it provides guidance on the policy and implementation challenges that governments face in dealing with labor issues. The Toolkit may also be a reference point for other stakeholders, including labor, the private sector, and consultants engaged in this area.

Users of the Toolkit should be better prepared to:

- Understand the benefits, risks, challenges, and key issues related to designing and implementing labor approaches in PPI reforms
- Choose among available approaches and analyze their political, social, financial, and economic implications
- Develop and implement appropriate labor strategies that balance the interests of the various stakeholders
- Formulate procedures for developing, implementing, and evaluating appropriate compensation packages and labor redeployment programs
- Manage labor issues during the transition process, including determining the respective roles of government, the private sector, and labor in the restructuring process
- Establish dialogue and communications with key stakeholders.

Structure of the Toolkit

The Toolkit consists of seven modules as described below.

Module 1—Framework and Overview: This module provides a summary of the entire Toolkit and sets out the framework for the more detailed technical modules that follow. It provides a decisionmaking framework and road map that policymakers can use to guide them through the process of labor restructuring. The overview module consists of this introduction to the Toolkit and eight other sections:

- Section 2 provides an overview of the main labor issues and concerns in PPI, briefly examines the impact of PPI on labor, highlights the broad lessons of experience in this area, outlines the broader policy reforms that can facilitate labor adjustment, and lays out the practical steps for designing and implementing labor programs that are covered in the rest of the module.
- Section 3 discusses the objectives in dealing with labor issues in PPI.
- Section 4 examines how to assess the size and scope of labor restructuring by conduct-

ing enterprise-level staffing analyses based on functional analyses and staffing norms.

- Section 5 examines strategies and options for dealing with labor restructuring where needed, in particular whether to carry out labor restructuring before or after PPI and the range of options for restructuring labor and the conditions under which they can be used.
- Section 6 discusses the key elements of a labor program, including severance payments, pension payments, retraining and redeployment support, and employee share ownership plans.
- Section 7 focuses on managing the process of labor restructuring, particularly issues related to stakeholder participation and implementation arrangements for the program.
- Section 8 covers the monitoring and evaluation aspects of labor programs.
- Section 9 concludes with a road map for a broader integration of labor issues in the PPI process.

Module 1 focuses on the key issues and lessons learned in each of those areas. It can be read as a stand-alone piece that provides an overview of the issues, or the various sections can be read independently as summaries of the subsequent modules that cover in depth the technical aspects and steps involved in designing and implementing various aspects of the labor program. These modules follow the same flow as module 1 and consist of the following:

Module 2—Labor Impacts of PPI: This module provides an analysis of the impact of PPI on employment, wages, labor contracts, and union participation.

Module 3—Assessing the Size and Scope of Labor Restructuring: This module describes the tools (such as staff audits, benchmarks, and work force analysis) available to determine the nature and level of labor restructuring requirements.

Module 4—Strategies and Options: This module reviews issues of timing and sequencing, and the various restructuring approaches that the implementing agency can take when designing labor programs.

Module 5—Key Elements of a Labor Program: This module considers the key issues in planning and implementing severance payments, pension payments, redeployment programs, and employee ownership share arrangements.

Module 6—Engaging with Stakeholders: This module discusses strategies and tools for involving workers, unions, and other stakeholders, as well as arrangements for implementing the labor program.

Module 7—Monitoring and Evaluation of Labor Programs: This module provides a framework for establishing monitoring and evaluation systems for labor programs.

Module 1 provides policymakers with a summary and a framework to help guide their decisionmaking through the labor restructuring process.

Modules 2 through 7 detail the technical aspects and steps in the design and implementation of a labor program.

The Toolkit also contains a Web-based CD-ROM with searchable documents, spreadsheets, sample terms of reference for obtaining the needed expertise to carry out various labor-related tasks, case studies, and other relevant data. The CD-ROM follows the module structure described above and provides a gateway into and an outline of each module's content, with such supporting materials as links to the full-print text modules of the Toolkit, and checklists, articles, case examples, tools, and links to other relevant Web sites.

The Toolkit is complemented by a CD-ROM that provides supplementary tools and documents.

Each module of the Toolkit is designed so that it can be read as a stand-alone piece in its own right, with cross-references highlighted where appropriate. Each module ends with suggestions for finding additional material on the CD-ROM and elsewhere. Icons in the Toolkit highlight:

- Tools available on the CD-ROM 
- Additional material and documents on the CD-ROM 
- Links to Web sites 
- Other materials and sources of information. 

Support for and Contributors to the Toolkit

The Toolkit draws on a wide range of materials and experiences from around the world. The aim is to provide policymakers with practical guidance on how to deal with labor issues in PPI reforms. The following organizations' financial contributions made the development of this Toolkit possible:

- Public-Private Infrastructure Advisory Facility (PPIAF), a multidonor technical assistance facility that helps developing-country governments improve the quality of their infrastructure through private sector involvement (see www.ppiaf.org/)
- Netherlands Consultant Trust Fund
- World Bank.

The Toolkit was prepared by the Adam Smith Institute of the United Kingdom, under the management and supervision of the World Bank's Investment Climate Department. Representatives from the following organizations reviewed the Toolkit and provided comments:

- Asian Development Bank
- Inter-American Development Bank
- International Confederation of Free Trade Unions
- International Labour Organisation
- International Transport Workers' Federation
- Public Services International
- World Bank.

We thank them for their contributions and recognize that those contributions do not necessarily imply endorsement of the final product.

LABOR ISSUES IN PPI: AN OVERVIEW

Often protected from competition and subsidized by their public sector owners, state-owned infrastructure enterprises frequently employ more people than required for efficiency, pay wages and benefits that are higher than their counterparts in the private sector, and have large, unfunded pension liabilities. These factors have led to lower labor productivity and higher labor costs than private investors could accept. As a result, those affected by PPI often fear that PPI and the associated efficiency improvements will require substantial labor restructuring, both before privatization as governments cut the work force to prepare for reforms and afterward when privatized firms continue to improve productivity. Indeed, PPI—and enterprise reform in general—has often required significant labor adjustments. But workers have also gained in some situations as new investments and dynamic expansion resulted in the creation of new jobs and as productivity improvements led to similar or better terms and conditions of service.

Labor Issues in Infrastructure Enterprises

Infrastructure firms vary greatly between countries and within a single country, but the introduction of private participation generally produces a number of changes:

- The objectives of the enterprise change, and broad social and political objectives of public sector ownership—such as full employment—become less important than efficiency and improved service delivery. At that point, governments look to other policies to secure employment, and the costs of such policies are made transparent or managed through the use of explicit budget subsidies.
- New competitive pressures are brought to bear, and private operators can no longer afford to maintain surplus employment or a work force with relatively low productivity. The threat of new entrants forces operators to adjust all operational aspects, including the work force.
- Contractual and regulatory obligations to provide cheaper, more accessible, and more reliable infrastructure services, often linked to penalty and incentive clauses, become a major feature and a source of pressure on the firm. If labor costs are high relative to comparable norms or if surplus labor exists on the payroll, private operators will seek to cut costs.

- New financial disciplines are imposed both by capital markets and by sector regulators, and managers must respond to these disciplines.

When firms remain under state ownership these changes and pressures also often arise as a result of some of the following factors:

- **New technologies:** New technologies are rapidly evolving in many of the traditional infrastructure sectors, such as fixed line telephony and ports (see box 1.1), and they require adjustments irrespective of ownership.
- **Sector reforms:** Many infrastructure sectors are facing profound shifts. Vertically integrated power companies are being restructured into separate companies for generation, supply, and distribution; national post and telephone companies that once offered the full range of services are being separated. Infrastructure enterprises must adapt to these changes.
- **Increasing competition:** Former monopolistic providers are being exposed to competition and challenged by new market entrants or regulatory regimes. These processes are likely to place pressures on firms in terms of job numbers, technologies, working practices, and skills.
- **Structural changes in the wider economy:** The adjustments that are being driven by changes within sectors (for example, technology) or at the micro level within companies (for example, changing work practices) also take place against a backdrop of macro-level changes within the market for labor, the composition of the labor force, and the economy as a whole. These overall structural changes in the economy—for example, moving from agriculture to services—can have profound effects on the demand for services, the structure of firms, and the work force.

In most enterprises these forces for change should result in a continuous process of work force restructuring, but for social and political reasons the adjustment process in state-owned firms may be delayed. The introduction of PPI, which often reflects the acute need for reform, tends to serve as

Box 1.1: Technology and Reform in Ports

Containerization, a technological improvement in ocean shipping, has revolutionized maritime transportation. By handling individual pieces of general cargo loads only twice—at loading and at unloading from a container—less port labor and ship capacity are required to transport the same amount of freight.

In a review of the impacts of technology on ocean shipping, Talley (1999) reported that the increased use of containers, coupled with new cargo-handling techniques and work practices, have led to a significant decrease in the demand for port labor. Huge job losses have resulted, ranging from 40 percent to 60 percent in many countries. In the United Kingdom dock jobs fell from 80,000 in 1967 to 11,400 in 1986 and by another 44 percent between 1989 and 1992. In France work rule reforms introduced in 1992 led to employment declines of 66 percent at six major ports. In Australia waterfront reforms introduced in 1989 led to a 40 percent reduction in stevedore labor over a two-year period.

Although dock jobs dramatically declined, longshoremen unions were reluctant to accept changes and negotiated arrangements to preserve work. In some cases, work rules, gang sizes, and compensation patterns remained the same for containerized cargo as for break-bulk cargo. On the Atlantic and Gulf coasts of the United States, labor–management negotiations led to a “50-mile rule” (that reserved for unionized longshoremen all “stuffing and stripping” of containers in or near ports), guaranteed annual incomes regardless of hours actually worked, and produced agreements that required shipping lines to use union labor for their vessel calls.

In the port of Buenos Aires the combination of deregulation, competition, and privatization has led to dramatic reductions in port charges: charges for shipping containers between Argentina and northern Europe declined by 30 percent to 70 percent in less than two years. Most of the savings have come from improved labor productivity. At the port of Buenos Aires total employment fell from about 8,000 just before the reforms to 2,500 in 1994 and has remained around that level. The liberalization of operating rules drastically reduced the requirements for stevedores, which also led to higher labor productivity; the weight of cargo per nonadministrative worker rose from 800 tons in 1991 to 3,000 tons in 1995 (see Estache and Carbajo 1996).

Longer-term structural changes in the economy will also drive work force restructuring.

a catalyst for reform. The case of Argentina's railways, where employment fell from 92,000 to 18,500 after privatization, is an example of dramatic employment changes arising from the introduction of PPI (box 1.2).

There is significant variation among countries and enterprises but generally speaking three labor issues need to be tackled in the course of PPI:

1. Employment levels
2. Labor contracts
3. Pension liabilities.

Those three factors are described below.

Employment Levels

Overstaffing has several causes, which often combine to ensure its persistence.

Historically, many infrastructure companies have employed more workers than they needed to deliver services efficiently and effectively. This was because the public sector often was seen as a vehicle for creating jobs in the absence of a private sector, partly for reasons of patronage and partly for meeting developmental or social objectives. Subject to weak performance incentives and to "soft" budget constraints, public sector managers often were also able to avoid dealing with the difficult restructuring and adjustment issues that private sector managers most likely would have been forced to tackle.

Kikeri 1998

As a result many infrastructure firms have excess manpower. For example, many African water utilities employ more than 10 employees per 1,000 connections, compared with a typical 2.5 to 5 employees per 1,000 elsewhere in the world

Box 1.2: Argentina Rail: Crisis and Reform

With 30,000 kilometers of track, the Argentine railroad enterprise, Ferrocarriles Argentines (FA), was the largest railroad in Latin America and the sixth largest in the world (after those in China, France, India, the former U.S.S.R., and the United States) at the time of its privatization in 1990. With 92,000 employees in 1990, FA was one of the largest employers in Argentina. FA's employees were not only unionized but also very powerful. Over time the unions intervened in all aspects of management, including staffing, internal organization, and strategy. For instance, because passenger services were more labor intensive than was freight transportation, the unions got FA to pay more attention to the former than to the latter, even though freight was relatively more profitable. They successfully resisted efforts to streamline FA's operations through consolidation and rationalization because it would make some employees redundant. From time to time the unions brought Buenos Aires to a halt by going on strike and paralyzing suburban rail service in the capital. FA's unions opposed privatization and there was no reason to think they could not veto its implementation by the Argentine government.

In most countries railroads would not have appeared on the first list of candidates for privatization, but the sector did so in Argentina because of the heavy demands it was placing on the government's out-of-control budget. Subsidies and grants received by FA made up fully 9 percent of the government's budget and 1 percent of Argentine gross domestic product. Among Argentine state enterprises, FA was the single biggest recipient of federal funds. In such a context only the privatization of giant enterprises could make a dent in the government's financial problems. Railway unions protested the government's plans and went on strike, paralyzing Buenos Aires, which coped with limited commuter rail service for 75 days. But the government held firm until the unions cut a deal with it. That deal included an agreement that redundant FA employees could be let go in exchange for one month's salary per year of service, with no maximum limit. Because the average worker had spent 20 years in FA's employ, the deal would cost the government an average of US$10,000 per worker. The World Bank helped finance this program through its structural adjustment loan. The Bank's backing assured workers that severance payments would be prompt and paid in full, unlike previous severance programs run by the Argentine government. Initial staff reductions took place through voluntary retirement programs because many of FA's employees were old. Subsequent reductions resulted from layoffs, concurrent with privatization. The company reduced its staff from 92,000 to less than 20,000 in 1997.

Source: Ramamurti 1996.

(World Bank 2001). Loss-making long-haul carrier Air India had a staff-to-aircraft ratio of 663 workers per aircraft in 1997, compared with ratios of between 170 and 340 workers in various Southeast Asian carriers: Singapore Airlines, Thai Airways, Malaysian Airlines, and Cathay Pacific (India, Disinvestment Commission 1998). In the 1960s Brazil's federal railways had a staff strength of 160,000, which came down to 42,000 before the privatization transaction began and was further reduced after privatization. In Argentina the corresponding figures for the railways fell from 92,000 to 18,600.

There are several cases where staff levels before PPI are twice those that existed after PPI.

Excess employment results in lower labor productivity and higher labor costs than private investors might be willing to bear and thus are often a central and controversial issue in PPI. Excess employment has led to fears of labor force reductions as governments cut the work force to prepare for PPI or as new owners and operators introduce efficiency improvements and expose enterprises to greater management discipline, new technologies, and increasing competition. The fear of job losses often becomes a focus for opposition by workers and trade unions—and sometimes for popular discontent with PPI as a whole.

Labor Contracts

The terms and conditions of employment are often stipulated in a contractual relationship between the enterprise and the employees. That relationship may be set out in legislation, in standard employment terms for public service workers, in separate labor contracts for each enterprise, or in individual employment contracts. Typically, many infrastructure firms are governed by well-defined collective labor contracts, partly because the size of the enterprise demands them and partly because workers in such sectors as railways, transportation, and power were among some of the earliest groups of workers to organize into the trade unions that helped put contractual agreements in place.

Labor contracts help create acceptable terms and conditions of employment, including the health, safety, or social well-being of the work force, and may have been negotiated many years previously. Some labor practices, however, may cause an enterprise to operate in less productive ways or at higher cost than is required. For instance, public sector employees are often paid better than their private sector counterparts, particularly at the lower skill levels, and often receive tangible and intangible benefits—such as job security, seniority rights, special pension arrangements, subsidized housing, health and educational services—that are not provided by private firms (Assaad 1997, Panizza 1999). All of these factors have led to a public sector wage premium in many countries (box 1.3).

A surplus of employees, accumulated over many years, often means that job losses become inevitable.

As industries and technology change and as firms are exposed to increased competition, change often becomes necessary and greater flexibility in working practices may be needed. These changes may involve market-based and merit-based remuneration systems, greater flexibility in the use and allocation of labor, and more flexible hiring and firing practices. Usually both employers and employees recognize that changes will be inevitable and so negotiation and revision is an important aspect of labor contracts. The process of gaining agreement on change may, however, be a challenge. In some cases there will be a tradition of centralized collective bargaining with one or two trade unions, but in others there will be fragmentation of work force representation across a much larger number of trade unions. In such cases the large number of unions itself often becomes a factor for consideration in revising contractual agreements.

Labor contracts can be highly effective in protecting workers, but may make it difficult for enterprises to adjust to new circumstances.

Where private infrastructure investors are entering competitive or contestable markets, they may wish to renegotiate or change some of these terms and conditions of service as part of a new employment agreement. New private owners or managers of infrastructure companies also may seek to renegotiate labor practices to meet commercial and operational performance objectives, as well as to respond to changing market demands and new technologies.

Pension Liabilities

Many infrastructure enterprises have large accumulated pension liabilities that have been promised to and earned by current workers under different pen-

Large pension liabilities can threaten the viability of a PPI transaction.

Box 1.3: Evidence of a Public Sector Wage Premium

There is no doubt that some groups of public employees are underpaid. The fact that governments have to offer very generous terms to persuade workers to leave voluntarily, however, suggests that the workers place high value on continued public employment. Even though salaries themselves may be low, the overall employment package of benefits as well as terms and conditions may be attractive to workers—and better than they might expect from the private sector. Several country studies have revealed evidence of a public sector wage premium. The following are some examples:

- Assaad (1997) found a public sector wage premium in Egypt, particularly for public enterprise workers who earned an average 20 percent to 28 percent more than other government workers. The wage premium, plus nonwage benefits equivalent to approximately 85 percent of wages, explained the attractiveness of public sector employment and the long lists of applicants for jobs in the civil service and state enterprises.
- Bales and Rama (2002) concluded that state enterprise workers in Vietnam were overpaid by about 20 percent relative to comparable private sector jobs. (Their findings were based on measurable earnings and benefits alone, and took no account of better job security, more generous pensions, more flexibility in work, or lowered effort levels.)
- Analysis by Bhorat and Liou (2002) in South Africa indicated that state enterprise workers received a wage premium of approximately 21 percent compared with those in the private sector.
- Terrell (1993) found large and statistically significant public–private wage differentials in Haiti, where public sector wage rates were about four times the average private sector wages. The high wages in the state enterprise sector (telecoms and electricity) appeared to arise from an explicit rent or premium—perhaps because of a process of distributing the enterprises' "monopoly rents" to employees. (Again, the rents did not include nonwage benefits and are therefore likely to be conservative.)

sion arrangements. Many of the pension programs are operated on a largely unfunded or "pay-as-you-go" 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. As a result many firms have a large liability for future benefits that are not accounted for and for which funds have not been set aside.

Unfunded pension liabilities and other pension issues can present a significant challenge for infrastructure privatization. Such liabilities, which are legally enforceable obligations, can be substantial and their settlement can become a major issue during PPI because investors may be reluctant to take over an entity until those liabilities are resolved. Voluntary departure or early retirement programs can also put a financial strain on pension plans. In Morocco, for example, the state-owned railway provided a generous pension plan with benefits paid by the railway itself. The system became financially unsustainable over the years and had to be reformed, not least because a proposed downsizing program would have made the pension plan even less sustainable (see box 5.14, module 5). There might also be legal issues involved. Attempts to tackle high pension costs and unfunded liabilities in the urban water supply in South Africa, for example, were subject to legal challenge (see box 1.8 in this module).

Those labor factors have led to fears about the potential negative effects of PPI on labor and have generated interest in developing labor programs aimed at mitigating the social impact of reform. The next section briefly describes the evidence concerning the impact of private infrastructure participation on employment.

Labor Impacts of PPI

A good understanding of the effects of PPI on the work force is essential because the implementing agency has to deal with a variety of interest groups with a range of beliefs and perceptions about what PPI will mean for them. Module 2 of this Toolkit describes in detail the evidence of the effect of private participation on employment, labor productivity, pay and benefits, work practices, and workers' representation and rights in infrastructure enterprises. Only a brief summary of the main findings is presented here.

The evidence shows that diverse labor impacts arise from PPI:

- Significant job losses have occurred in infrastructure enterprises, compared with losses resulting from privatization in general, and work force reductions of 50 percent or more are common.
- The greatest impact has been in those sectors where demand is declining because of competition from other modes (for example, railways), and in sectors with long traditions of overstaffing (for example, ports).
- Job losses have been significantly lower, and in some cases negligible, in sectors where demand is rising (for example, telecommunications) or where there is demand for expansion of the network (for example, water and sanitation).
- Labor restructuring is often necessary to improve the efficiency and competitiveness of state enterprises, regardless of whether PPI is involved. Indeed, much of the labor restructuring that has taken place to date and has been associated with PPI occurred well before privatization when state enterprises themselves adjusted their labor forces to improve performance.
- Where substantial job losses have occurred in state-owned infrastructure enterprises, they generally account for a small percentage of the total national labor force.
- In some countries, PPI combined with liberalization has led to net job creation in the sector as a whole (in telecommunications and ports, for example).
- Labor adjustments have led to improvements in labor productivity, particularly in such sectors as railways where surplus employment was high.
- These productivity gains have also resulted in wage improvements for employees who remained with the firms after PPI, particularly for skilled employees. Wages have generally been aligned more with market conditions.
- Labor contracts often have been revised in exchange for higher wages. In Latin American countries, for example, work rules and conditions of service were renegotiated to provide managers greater flexibility with respect to decisions on content and pace of work, labor allocation, and subcontracting of support and administrative services to nonunionized firms and subsidiaries. Although such changes tended to reduce union influence within the workplace, they conformed to labor laws and protected many of the other benefits enjoyed by workers.

New technologies, competition, and sector reform are drivers of work force restructuring.

In sum, the evidence shows a wide range of experiences with respect to PPI's impact on labor, depending on the initial conditions at the country and enterprise levels. PPI can bring benefits to workers through retained jobs, higher pay, and new job creation as a result of new investments and dynamic expansion. But large employment losses can and do occur as infrastructure sectors and enterprises are reformed, regardless of whether PPI is involved.

Private operators have strong incentives to reduce costs.

Labor adjustments are one of the most sensitive aspects of PPI and enterprise reform. The process is not easy and there are many challenges. Because they perceive the threat of unemployment and loss of benefits, labor unions and state enterprise workers often oppose reforms and that opposition leads to actions that delay or stop governments from tackling infrastructure problems. Particularly in developing countries, these difficulties are compounded by the lack of unemployment and social welfare systems, as well as the lack of alternative jobs in the economy. In such circumstances, the costs of reform for state enterprise workers can be high, involving loss of income, uncertainty, and difficulties in job relocation. Dealing with labor issues early in the reform process can help mitigate these social costs in a manner that both protects the interests of workers and ensures that consumers gain from better delivery of critical infrastructure services.

Dealing with Labor Issues In PPI

Whatever type of reforms are adopted, experience shows that PPI can proceed smoothly if efforts are made to deal with labor issues early in the reform process. Early attention is needed to:

- Assure workers that measures are being taken to compensate them for losses and to mitigate the social impact of adjustment
- Ensure fairness and transparency in the treatment of workers and thus help build wider support for the process
- Clarify labor liabilities and approaches in order to attract private investors
- Facilitate reforms and improve enterprise performance, including better and more reliable services, reduced fiscal drain, investment in new infrastructure, and faster economic growth.

Broader labor market policies are important but are covered only briefly here.

Dealing with labor issues often requires actions on two parallel fronts. At a broader level, the reform of labor market and other policies may be needed to promote private sector job creation. Such reforms and the development of the private sector help facilitate labor adjustments. Although important in their own right, these broader policy reforms are covered only briefly here; a detailed discussion is beyond the scope of the Toolkit. This Toolkit focuses on the parallel set of actions: the design and implementation of specific labor programs that address labor issues in PPI and infrastructure reforms. Such programs can do much to mitigate the social impacts of reform and in some circumstances can act as a catalyst for broader labor market and policy reforms.

Promoting Policies for Job Creation

The lack of alternative jobs for workers adversely affected by PPI or by enterprise reforms is a major concern in many developing countries. Many economies have been dominated by public sector enterprises and the vast resources they absorb from local banking systems have often crowded the private sector out of financial markets, slowing growth and the creation of productive jobs by the private sector. Labor market regulations—including restrictions on hiring and firing—and payroll taxes that raise the cost of labor have further exacerbated the problems and led to private sector reluctance to hire permanent labor. They have also created difficulties in adjusting the labor force according to changing economic circumstances.

Labor market rigidities make it harder for workers to move into new jobs as enterprises adjust, and generally lead to:

- Greater difficulty in implementing PPI reforms and labor adjustments.
- Greater opposition from labor to enterprise restructuring.
- A greater chance of limited results from retraining and redeployment initiatives. Such measures may provide a short-term palliative to labor adjustment, but there needs to be sufficient responsiveness in the economy to provide new private sector jobs into which workers can move.
- Higher economic cost of labor adjustment, because adjustment in the work force as a whole takes longer.
- Higher financial cost because more reliance must be placed on compensation payments to workers displaced as a result of restructuring.

Reforms aimed at increasing labor market flexibility and developing the private sector can, therefore, help make the restructuring process easier, enabling workers to shift more easily from one sector of the economy to another (see box 1.4). Typically, such reforms involve:

- Reducing hiring and firing restrictions by changing and simplifying labor laws and rules of severance.
- Removing barriers to labor mobility by dealing with housing and other social bene-

fits, removing location rules on collection of unemployment benefits, and improving job registration efforts. The availability of jobs and the ease of movement in and out of the labor market determine how quickly enterprises and workers can adapt following PPI and other broader economic reforms (see Betcherman 2002 and Freije 2001).

Betcherman 2002

- Improving information dissemination on job markets by making labor exchanges more efficient and removing restrictions on private sector recruitment and placement agencies.
- Reducing legal, fiscal, and regulatory barriers and disincentives to the development of small and medium-size enterprises, particularly disincentives to create new formal sector jobs.
- Accelerating the implementation of privatization policies. In countries where heavy state intervention continues to stifle the private sector and crowd out finance and opportunity for private investment, PPI and privatization, combined with liberalization and other policies aimed at private sector development, can help generate employment growth.

Relatively rigid labor markets will slow the process of post-reform adjustment.

Box 1.4: Labor Market Flexibility and Work Force Adjustment—A Snapshot in Estonia and Slovenia

The experience of two transition economies in Central Europe, Estonia and Slovenia, illustrates the consequences of different approaches to labor policies. In the early years after the fall of Communism in Central Europe, Slovenia took a highly interventionist approach with significant barriers to job termination, generous severance payments, generous support for unemployed workers, and efforts to support real wage rates. Estonia, by contrast, took a very liberal approach, with few barriers to job displacement or to new job creation and with modest severance payments, and gave little support to the unemployed and no effective wage floor. Unlike Slovenia, the government of Estonia also removed most barriers to foreign investment. These various measures led to markedly different adjustment paths and labor markets. The transition in Estonia led to a massive increase in worker flows out of some jobs and into others. Job destruction peaked at 10 percent per year in 1992 and 1993, but, with a lag of one year, job creation also surged to a 10 percent yearly rate. By 1994 the job creation rate exceeded the job destruction rate. By contrast job creation rates in Slovenia usually remained below 1 percent per year, although job destruction rates ranged from 3 percent to 8 percent.

Source: Orazem and Vodopivec 1996.

Whereas labor market reforms and other reforms associated with developing the private sector facilitate labor restructuring, they require attention at a broader level than does PPI and they are not the direct responsibility of the PPI implementing agency. Moreover, although labor market reforms ease the PPI process, they often take time. Because governments usually cannot delay PPI until labor market reforms are completed, labor restructuring strategies need to be designed in ways that take into account existing labor market constraints. In some cases these actions themselves can become a catalyst for undertaking the broader reforms.

Developing Labor Programs

In alignment with policies aimed at creating jobs in the private sector, the development of specific labor programs as part of the PPI effort can do much to secure support and mitigate the social costs of reform. Many countries around the world already have successfully managed major labor adjustment programs as part of the PPI process and there is a substantial body of international experience from which to draw.

Issues of labor flexibility may arise if the implementing agency needs to negotiate changes in labor contracts.

There is no one approach to addressing labor issues in PPI. Every country and every transaction is different. Much depends on the political, economic, and social conditions, as well as on the nature of the enterprise and the sector in which it operates. Nevertheless, several general lessons emerge from the experience:

Managers in implementing agencies can draw on the lessons of experience from many sectors and countries.

- **Labor issues can and should be addressed early in the reform process.** Labor issues are one of the more complex and politically challenging elements in PPI, and dealing with them early can help secure employee support and provide a social safety net.

- **Governments have an important role to play in the restructuring process in large troubled enterprises.** In cases with high levels of overstaffing or difficult labor relations, transferring infrastructure firms with the labor force intact is not an option because private investors are wary of taking on the burden of labor adjustments and employees are concerned that private investors may not provide an adequate social safety net.
- **A mix of options can be used to deal with labor restructuring.** Redundancy is one but not the only option. Other measures include: voluntary departures and early retirement, correcting payroll errors (such as identifying ghost workers), freezing recruitment, enforcing retirement rules, removing barriers to employees' departure, and reducing costs of staff substitutes such as overtime and fee-paid workers.
- **Voluntary departures are the most frequently used option.** Such schemes are generally considered to be politically and socially attractive, but issues of affordability and adverse selection need to be considered in their design and implementation.
- **Redeployment programs have yielded mixed results, but if properly targeted they can have social and economic benefits.** Better results can be achieved by ensuring that retraining is driven by demand, that it is targeted to workers for whom it is most cost-effective, and that nongovernmental and private institutions are involved in the delivery of services.
- **Funding for meeting the costs of labor adjustment must be secured early.** Severance schemes often involve very substantial amounts of money and it is important to give workers credible assurances that the funding for making timely payments is in place.
- **Early communication and consultation with labor is important.** Such efforts help build understanding and support and they assure workers that adequate arrangements are being made. Openness and transparency in decisionmaking on labor issues are important confidence-building measures. The implementing agency should ensure that labor adjustment is seen as a fair process, even if job losses are inevitable.

These lessons are discussed in detail in the subsequent sections of this module. The module shows that although labor issues are complex and challenging, they need not be an obstacle to PPI. With clear objectives, careful planning, and adequate resources, labor issues can be handled effectively while implementing government policy on the future of infrastructure.

The main steps involved in developing and implementing labor programs are dealt with in the subsequent sections of this module:

- Defining objectives
- Assessing the size and scope of labor restructuring
- Developing strategies and options for labor restructuring
- Developing key elements of a labor program, including severance, pensions, redeployment support, and employee share schemes
- Managing the restructuring process
- Putting in place monitoring and evaluation systems.

DEFINING OBJECTIVES

Work force reduction is rarely an objective in and of itself. Rather, the objectives of labor restructuring are better defined in terms that focus on the developmental, economic, and social goals sought from PPI or from enterprise reforms more broadly. In cases where stakeholder opposition is high, it is particularly important to communicate these objectives. If the objectives are not credible, or are vague or poorly articulated, the implementing agency will have more difficulty securing the support and resources needed for labor adjustment.

One tool to help clarify objectives is to describe carefully the ultimate desired *outcomes*, and to use those as a basis for setting objectives. Possible outcomes are:

- **More efficient operations and better service for customers**: Today's surplus labor often reflects the inability or failure of past managers to respond to changing circumstances. These surpluses need to be addressed if future PPI operations are to become efficient in adjusting to new markets, new technologies, and increasing competition (see module 2).
- **Lower operating costs:** The overall goal of many labor adjustment schemes is to help make the infrastructure enterprise or PPI scheme financially viable. Ideally this implies that it can reduce costs, including labor costs, and achieve sufficient levels of operational profitability to yield a return on investment and provide for reinvestment in maintenance or expansion of the infrastructure.
- **Better skills mix:** A better work force—perhaps one with fewer people who are better paid, better trained, and more capable—is a common objective. The enterprise may be overburdened with skills that have become redundant and may face a shortage of other, perhaps newer skills. For example, in telecommunications firms there may be a critical need to change the skills mix in response to new technology and changing customer requirements.
- **A more adaptable work force:** In addition to skill improvements there may be a desire for greater labor flexibility in work hours, work practices, or the structure of the work force.
- **Better labor relations:** There may be a need for new negotiation frameworks or a new labor contract to replace older ones and increase flexibility.

Outcomes may be short-term and urgent (for example, reducing operating costs), medium-term (improved services to consumers and business), or long-term (improved international competitiveness in the sector).

In addition to outcome objectives, governments will also have *process objectives*—that is, objectives dealing with how work force restructuring is to be done. Such objectives generally aim to ensure that:

- The adverse social costs of labor restructuring are mitigated by social safety net and redeployment programs.
- Implementation of the program is fair and transparent and balances the interests of the various parties involved.
- There is sufficient consultation and dialogue with key stakeholders, particularly unions and workers, during the restructuring process.

These objectives provide a framework for discussion and debate within government about the tradeoffs that must be made in designing a labor program, and help identify and make mid-course corrections during implementation as needed.

ASSESSING THE SIZE AND SCOPE OF LABOR RESTRUCTURING

One of the first steps in developing a labor program is to estimate the extent of labor restructuring that is needed. The implementing agency must get a clear handle on the work force to determine what if any changes are needed in terms of numbers, skills, and work practices. This usually involves carrying out a systematic staffing assessment that enables the implementing agency to:

- Determine the size and scope of any work force restructuring, including potential downsizing
- Improve targeting in any labor restructuring program, including identification of skilled workers critical to the operations of the enterprise

The bottom line: although labor issues are often challenging, experience shows that they can be addressed in a fair and professional way and need not be an obstacle to PPI success.

Thinking about the desired outcomes is one way to define objectives.

A reduced work force is not usually the main objective of a labor program. Rather it is a means to an end (such as improved efficiency or better service).

Three tools, all closely related:
- **Staff audits**
- **Benchmarking**
- **Work force analysis.**

- Enter into more informed negotiations and discussions with trade unions and labor representatives
- Ensure fairness and transparency of the process.

There are three tools that the implementing agency can use to carry out the staffing assessment and define the size and scope of labor restructuring:

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

In practice these are related and often are used together in a comprehensive analysis.

Staff Audits

A staff audit is an essential first step in assessing labor issues in the enterprise. Staff audits make an up-to-date analysis of the work force and provide the basis for subsequent benchmarking and work force analyses. They also create the necessary database for analyses of the costs of alternative severance and pension strategies.

Staff audits help to:

- Bring personnel records up to date.
- Identify and eliminate ghost workers who are on the payroll (that is, workers for whom salary payments are made but who do not in fact work in the enterprise). In Argentina's SOMISA steel company, for example, the introduction of a plant census with photo identification quickly revealed that 17 percent of the work force were ghost employees (Hess 1997).
- Provide a basis for developing severance and early retirement options and estimating costs if downsizing is needed.
- Improve the accuracy of subsequent work force analysis.
- Establish effective record-keeping procedures to allow management to control or regain control of the payroll, operate effective human resource management practices, maintain staffing information and databases, and comply with labor laws and regulations.
- Provide an accurate basis for review of job positions, pay grades, and scales. In some enterprises, harmonization of staff terms is an essential prior task to PPI. This is particularly the case where a new operating company is to be formed, perhaps drawing staff from civil service and public enterprise cadres.

Benchmarking

Benchmarks are fixed pieces of information that can be used to make comparisons with other similar fixed pieces of information. The process of benchmarking will help identify main problem areas in terms of the competitiveness of staffing levels and labor productivity. Labor benchmarks are used not only as a one-off activity for work force restructuring but also as a tool for continuously monitoring and improving performance and competitiveness (see box 1.5). In practice it is the *process* of benchmarking that generates most benefits through the challenging of current norms.

Box 1.5: 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)
- 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 in person-days per year.

Benchmarks provide managers with comparative data on performance and labor productivity. Although like-for-like comparisons are not always easy, there are several sources of information, and benchmark measures can give the implementing agency crude indicators of the scale of overstaffing.

There are three main types of benchmarks:

1. **Internal benchmarks:** By making comparisons within an organization, perhaps among different offices or time periods, it may be possible to quickly and easily identify some areas for improvement. An example is the approach adopted by Kenya's electricity distribution company. For each electricity distribution district, the company identified its characteristics (number of consumers, area, length of overhead line, number of substations, energy sales per customer) and found weighted averages for different classes of staff (engineers, foremen, linesmen, for example) that enabled it to easily compare areas of different labor productivity.
2. **Sector benchmarks:** Comparisons between enterprises in the same sector provide another measure. International or regional comparisons can be used where the PPI enterprise is a monopoly provider in the country.
3. **Functional benchmarks:** Organizations in other sectors that have similar functions can be compared. For example:
   - Gas, water, and power utilities might cooperate in benchmarking of metering or billing collection procedures.
   - Airlines and railways have similarities in managing the turnaround and dispatching of aircraft or trains.
   - Administrative processes are similar across many sectors and comparisons can be made.

Each of the three types of benchmarks has its place. In all cases, however, a combination of measurement and process analysis is important for effective benchmarking. Measurement identifies the gap, but the discussion, debate, and working through of changes provides the knowledge about how to close the gap.

Module 3 provides further details on benchmarks specific to each sector, as well as guidelines on where to obtain benchmarking data and the process of carrying out benchmark analysis.

Work Force Analysis

Staff audits and benchmarking are valuable for indicating the size and scope of overall downsizing that is likely to be needed. These tools, however, still only provide part of the information necessary for detailed assessments of downsizing requirements and methods of selection.

Detailed work force analysis is often needed, as illustrated by the case of Brazil Railways in box 1.6. The purpose of such analysis is to identify staffing requirements at the unit or operational level. Work force analysis will help the mangers in the implementing agency and enterprise managers to:

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

Module 3 provides a set of tools for work force analysis, including analysis and consolidation of staff audit and benchmark data, functional reviews, ratio analyses of staffing data, productivity reviews, age profiling, and supply forecasting.

More fundamental functional reviews are valuable, too, because they challenge the existing organizational structure and norms. They essentially ask some straightforward but difficult questions:

- Is this activity needed at all?
- Should the enterprise be undertaking this activity?
- If the activity is needed, is the enterprise really the best provider of this function?
- If this is a critical activity, is the scale and scope of operations appropriate?

Up-to-date records of personnel and the removal of "ghost" workers are immediate benefits of a staff audit.

A "benchmark" is a comparative measure. "Benchmarking" is the process of comparison.

These tools and the process involved in implementing them to carry out a staffing assessment are covered in detail in module 3. The assessment is generally carried out at the enterprise level. Where the quality of data is poor, the process of data collection and analysis can be time consuming. Moreover, the enterprise may lack the skills or resources to undertake staff assessments. In these circumstances the process may require a combination of resources involving enterprise staff and specialized consultants.

Investment in obtaining good staffing assessments is usually worthwhile. The assessments form part of the overall due diligence exercise in the PPI transaction and provide a tool to help the implementing agency negotiate with workers and unions. More important, they provide an estimate of the size and scope of labor restructuring, which helps identify the level and location of any excess staff and skill deficiencies. Staff assessments, however, should not become an end in themselves, because actual staffing needs will only be known during the PPI process as investors are brought on board. When the broad estimates of labor restructuring needs are known, the implementing agency can move on to strategic issues of timing and sequencing, and choices about which restructuring options to use.

DEVELOPING STRATEGIES AND OPTIONS FOR LABOR RESTRUCTURING

When the size and scope of labor restructuring are known, the next steps are to deal with strategic questions of timing and sequencing and to choose among various restructuring options. Among the key questions that practitioners usually face are: Should labor restructuring be done by governments

Work force analysis is a staffing planning activity that is focused on operational units in the context of work force restructuring.

Box 1.6: Brazil—Work Force Analysis in Rail Privatization

In 1992 the government of Brazil included the federal railway, Rede Ferroviária Federal Sociedade Anônima (RFFSA), in the National Privatization Program. This was the first major privatization of public infrastructure services in Brazil. Implementing the proposed privatization plan required some degree of reduction in RFFSA's labor force. 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. This reduction led to a substantial increase in labor productivity, from 250,000 to almost 1 million net ton-kilometers per employee. This level of labor productivity continued to be insufficient, however, not only when compared with similar North American companies but also with recently restructured and privatized railways in Argentina and Chile.

The strategy to deal with this excess labor had to be subtle because 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 detailed study based on international practice. The redundancy estimates were to be conservative because the idea was to avoid second-guessing what the concessionaire would actually need, while avoiding forcing the concessionaire to have to re-recruit "fired" workers, as had been the case in Argentina and the United Kingdom. In addition, the staff remaining at the company at the time of transfer to the private operator had to be adequate to avoid interruptions in service. To ensure this, 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, 1,953 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.

Source: Estache, Schmitt de Azevedo, and Sydenstricker 2000.

or be left to private investors? and What is the range of available restructuring options and under what circumstances are the options best used?

Timing and Sequencing Issues

The primary strategic decision is whether labor restructuring should be carried out by the government prior to PPI, or whether such restructuring should be left to the private sector after the PPI transaction is completed. There is no single approach and countries have followed different paths, depending on the timetable and urgency of PPI, the nature of the labor issues at the enterprise level, and the existing legal framework. There are three options in terms of timing:

1. Leaving restructuring entirely to the private sector
2. Leaving restructuring entirely to the government
3. Adopting a mixed approach.

Restructuring by the Private Sector

At one extreme is the option of leaving labor restructuring entirely to the private sector, on the grounds that private investors are generally in a better position to judge the level of employment and kind of skills needed. This option can work for companies in which earlier labor adjustments have largely tackled any problems of overstaffing, or where prior downsizing efforts have led to established processes and norms in place for severance and redeployment, thus making any future restructuring by the private investors relatively easy. In these circumstances it is possible to transfer responsibility for restructuring to the private sector.

But in infrastructure enterprises with high levels of overstaffing and difficult labor relations, leaving restructuring entirely to private investors may not be a viable option. Attempts to do so can put the PPI transaction at risk. Where political and labor opposition to PPI are high, private investors are wary of taking on the political burden of carrying out large-scale layoffs and thus are reluctant to bid. Moreover, when investors have to absorb large labor liabilities they discount the sale price accordingly, leading to lower sale revenues and potential public allegations that assets are being sold cheaply. Alternatively, they may demand government subsidies to cover the cost of the liabilities, thus subverting one of the original goals of PPI. Leaving large-scale restructuring to the new private investors may also create social problems, particularly where weak severance laws and social safety nets reduce welfare protection for workers.

Restructuring by the Government

For the above reasons, labor restructuring in large, troubled infrastructure enterprises is often seen as a government responsibility, on the grounds that government involvement is needed to:

- Resolve potential labor conflicts and minimize the burden of politically sensitive restructuring measures on private buyers
- Ensure that the social consequences of labor force reductions are properly addressed, particularly in ensuring payment of severance obligations and development of other social safety measures
- Increase the attractiveness of the enterprise and thus the feasibility of PPI. Government-led downsizing is also one of the few prior restructuring activities that is likely to improve the price that investors will pay for state-owned assets. The most comprehensive study of factors determining privatization prices, based on 236 privatizations in Mexico, found that a 20 percent reduction in the labor force prior to privatization would lead to a 24 percent increase in the price (López-de-Silanes 1997).

The strategy of leaving restructuring to the government has been adopted in a number of cases. In Argentina, for example, where surplus staff and strong unions were major sources of inefficiencies, the railway and energy enterprises undertook major employment cuts prior to PPI. The railway company reduced employment by close to 80,000 over several years. Similarly, in Brazil more than 18,000 of the nearly 40,000 railway workers were

Functional reviews can challenge the basic assumptions about the organizational structure of the enterprise.

MODULE 1

retired or became redundant before the systems were concessioned. Prior restructuring was undertaken not just to improve the prospects for sale but also to overcome labor opposition and ensure that the social consequences of layoffs were properly addressed.

Government-led labor restructuring has its own risks and disadvantages, however, particularly in terms of cost and adverse selection. Governments can be more generous than the private sector in setting compensation payments, leading to overpayment and issues of cost and sustainability of severance payments. Moreover, poor targeting techniques can lead to the loss of the better, most skilled, and most valuable workers during the course of labor restructuring. In the worst cases, workers who took the packages have been rehired, which has created incentives for the best and most skilled workers to accept severance (knowing that they can be employed or rehired easily) and led to the inefficient use of scarce public funds. The section on severance in module 5 treats these issues in greater detail.

A Mixed Approach to Labor Restructuring

To minimize the risks of overpayment and adverse selection, some governments have stayed away from a direct role in restructuring and have adopted more of a mixed approach. In some cases they have made the policy decision to grant private investors full flexibility to select the work force from the existing pool of workers according to need, while the government assumes responsibility for developing the labor program beforehand and for dealing with residual workers. Such an approach was used in Argentina's gas company, where employee restructuring was left to the new private investors who were allowed to select employees and the government provided incentives and a social safety net for displaced workers.

Work force downsizing and CEO replacement are measures that tend to raise privatization prices.

In other cases both government and investors have played a role in implementation: part of the restructuring has been done by the government prior to PPI, targeted at obvious areas of surplus, and part of the restructuring has been done by the PPI investor who is given full flexibility to further adjust staffing levels after assuming management control. Such an approach was adopted in the privatization of Argentina's telecommunications and energy companies, and in the case of Manila Water in the Philippines. In these cases prior to privatization the government established the severance and social safety net program, which was used for both phases of restructuring, and the cost of downsizing was shared by government and the private investor.

Whichever approach is used, the key is for government to clearly define the labor program before PPI so as to assure workers that their interests are taken into account and to clarify for investors the labor liabilities involved. Developing the labor program in advance and letting the new managers handle the actual restructuring process helps with the political viability of the process, while it avoids problems of adverse selection and sustainability of severance packages.

Table 4.1 in module 4 summarizes the pros and cons of the three approaches.

When issues of timing and sequencing are dealt with, the next step is for governments to examine the range of restructuring options and to decide which ones can be suitably applied under existing circumstances.

Restructuring Options

A range of options is available for dealing with large-scale labor restructuring. The options can be divided into three broad groups:

1. **"Soft" options,** which do not introduce elements of incentive or compulsion but rely on the application and enforcement of existing, and therefore less controversial, workplace regulations. Not simply natural attrition, these measures include hiring freezes, payroll management, and the transfer of staff to other government departments.
2. **Restructuring of the workplace:** Options in this group generally fall short of voluntary or involuntary departure and include measures such as administrative leave, job-sharing, part-time work, and, in some cases, the

shedding of noncore businesses. Some of these will be voluntary and 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**, which can involve:

   - Voluntary departure options that provide incentives for people to leave voluntarily, either through an early retirement program or the provision of generous severance packages. Acceptance of these options is not forced (although in cases where workers' future prospects are very poor, workers may feel that they have had little choice).

   - Compulsory redundancy options, where workers are required to leave employment without their consent.

Several factors influence the choice of options, including the extent and level of labor surplus, existing labor legislation, and the role of unions. Moreover, these restructuring options are not mutually exclusive; in practice they can be used in sequence or combined with one another:

- Soft options and workplace restructuring are generally most appropriate for a managed process of work force restructuring and downsizing, or in special circumstances such as transition economies where rapid, large-scale downsizing is not politically or socially feasible. In general, these approaches may work in the adjustment period prior to PPI, but in heavily overstaffed enterprises in urgent need of PPI such measures alone are not likely to be sufficient.

- Where there are high levels of surplus labor and PPI reforms are urgent, more drastic measures have been required. The most commonly used options in this regard are early retirement and voluntary departure programs. Particularly in countries with strong labor unions and weak social safety nets, as well as those where labor legislation prohibits outright layoffs, governments have resorted to voluntary departure programs by providing severance pay packages that have generally exceeded legally mandated requirements. The size of the payments has varied widely among countries and within countries among enterprises, depending on legal and contractual obligations and the strength of labor unions. Severance payments are covered in greater depth below.

- Compulsory retrenchment is used when voluntary departure programs are not sufficient. At Brazil Railways, for example, the restructuring program allowed for a two-phased approach. In the first phase, redundant staff were given the choice of voluntary separation with an enhanced severance package. Employees who did not accept the voluntary plan were laid off with legal entitlements plus an incentive package equivalent to 80 percent of the incentive offered under the voluntary program. Because of the reduced incentive, most of the employees took the voluntary program and only a few went through the compulsory retrenchment route. In other cases, compulsory retrenchment has been used because of difficulties in targeting severance offers or cost concerns associated with voluntary departure programs, or when certain units are closed or spun off.

The choice of strategies and options open to the implementing agency is often constrained by existing legislation. An early task is to review the legal framework for dealing with labor issues to see what is possible and what is not. Sometimes changes in the legal framework may be needed. Where such changes are difficult to carry out, the implementing agency may select options (such as soft measures or voluntary departures) that comply with existing legal requirements and so avoid the risk of legal challenges in court.

Thus, the choice of which approaches to use will depend on the existing circumstances at the enterprise and country levels, in particular:

- The size of accumulated surplus labor
- The legal framework

- The nature of labor relations
- The presence of established procedures and practices for handling restructuring.

DEVELOPING KEY ELEMENTS OF A LABOR PROGRAM

Once the broad strategy and options are determined, the next step is to develop the main elements of the labor program. Specific approaches to labor restructuring are bound to vary from one country and enterprise to the next, depending on local circumstances. But labor programs typically include four main components: severance payments, pension payments, retraining and redeployment support, and employee share ownership plans.

Severance Payments

In the absence of unemployment insurance and other social security arrangements in many developing countries, severance packages are typically the primary source of income support during the transition period to alternative employment. As such, they are a central element in any labor program.

Severance packages typically include some or all of the following components, each of which is discussed in detail in module 4 of the Toolkit:

- **Statutory end-of-service payments,** the levels of which are usually set out in legislation. Statutory payments can include notice period, or payments in lieu thereof; termination benefits; gratuity or pension benefits; earned leave; and payment of salary or wage arrears.
- **Compensation for enterprise-level benefits,** these being payments to retrenched workers for benefits as set out in the rules for each enterprise or as part of a formal collective bargaining agreement. These benefits can include housing; medical, education, and other welfare services; access to loans, perhaps at preferential rates; and subsidized or free food, equipment (for example, telephones), or services (such as supply of electricity).
- **Ex gratia severance payments** beyond statutory requirements, which are usually a key element of voluntary departure programs.

In addition to providing immediate income support, severance payments facilitate labor support and allow PPI to happen, and mitigate the social impact of layoffs in the absence of unemployment insurance systems. The financial and economic returns can also be high, with short payback periods and increases in the marginal productivity of redundant staff redeployed to productive activities elsewhere in the economy.

But the design and implementation of severance payments is one of the more challenging areas in labor restructuring. Four main issues typically arise:

1. Setting severance levels
2. Developing targeting and selection mechanisms
3. Choosing between a uniform approach and a case-by-case approach
4. Financing severance packages.

Severance Levels

For the reasons outlined above, many governments have resorted to voluntary departure programs by providing severance payments that exceed legally mandated requirements. The size of the payments has varied widely among countries and within countries by enterprise, depending on legal and contractual obligations, the negotiating strength of labor unions, and prior precedents.

In some cases an established severance arrangement may already be in place; in others, the existing scheme is not considered sufficient or there simply is none, and a new scheme may need to be developed. Usually, severance plans are based on a multiple of years of service and salary, taking into account legal or contractual obligations and, in some cases, prior experiences or precedents in the state enterprise sector more broadly. Such formulas are easy for managers to use (table 1.1) and are widespread in both the public and private sectors. As module 5 shows, severance formulas have generally ranged from 1 to 3 months of salary per year of service, with a typical average payment of 1.5 months per year of service.

In developing a severance scheme the main challenge lies in devising severance payments that are both attractive for workers and financially affordable and sustainable. Severance has to be attractive enough for workers to leave voluntarily. At the same time, governments cannot afford to overpay because overpayment leads to problems of cost and financing and to problems of adverse selection.

In practice, overpayment has often occurred because generous payments are seen to be politically and socially attractive. In Pakistan, for example, an agreement with the unions resulted in a package equivalent to five months' pay for each year of service, which neither the government nor the firms could afford to pay and which subsequently led to delays in implementation. If an overly generous package is offered to all workers, there is the added risk of adverse selection. In the rail sector in Argentina, for example, the across-the-board offer led to the loss of key staff, which hurt the performance of the newly privatized firm. There is considerable evidence from evaluation of downsizing programs that adverse selection can result in the rehiring of workers who have received compensation payments, and that leads to problems of moral hazard and inefficient use of scarce public funds (see, for example, Haltiwanger and Singh 1999).

Haltiwanger and Singh 1999

One way to contain the risk of excessive payouts and to minimize adverse selection is to set minimum and maximum levels of payment, where a minimum floor can be seen as fair to everybody while a maximum cap would ensure that workers and managers with longest seniority are not overpaid. Another way is to make workers who are within a few years from retirement, and thus have the least to lose in terms of future income, ineligible for voluntary schemes or for their severance payments to decline as they approach retirement.

A third approach is to better tailor severance packages to workers' characteristics through a loss-based method that takes into account factors such as seniority, gender, and education. Unlike standard severance formulas that compensate workers mainly for past service—where workers with higher seniority benefit disproportionately compared with workers having fewer years of past service and more years of denied service—a tailored approach that takes into account factors such as education and gender can predict the welfare loss of each worker and compensate the worker accordingly.

The loss-based severance method is more a complement to any existing method than a purely alternative severance method. Its advantages are that it serves as a benchmark to assess possible overpayment, helps induce the right self-selection, and helps contain costs. The approach aims to:

- Identify the factors that contribute to earnings loss after retrenchment. In several studies, women's earning losses have been greater than those of men.
- Use estimations of earnings functions, based on data from national household statistics,

A severance package has a number of elements. Each of these may be determined by different legislation, regulations, rules, or agreements.

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Table 1.1: Standard Severance Formulas—Advantages and Disadvantages

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

Rehiring is an indicator of program failure and poor design.

and make comparisons of workers' existing incomes with alternative private sector income sources.

- Create a specific formula to calculate the welfare losses that then can be used to determine the compensation each worker would receive.

The approach has been piloted in Guinea-Bissau, Madagascar, and Tanzania, and is described in Chong and Rama (2000). The data requirements and methodological issues are covered in further detail in module 5.

DOCS Chong and Rama 2000

Targeting and Selection

Another way to avoid adverse selection, reduce the risk of rehiring, and contain costs is to identify the work activities and subsequently the work force cadres to be separated, and then to target the severance offer only to workers whose jobs have been identified as redundant (through benchmarking studies or functional analysis, for example), rather than to offer severance to all employees.

There are other ways to improve targeting and selection as well. These are discussed in greater detail in module 5 and include:

- Giving managers the right to refuse an application for voluntary departure
- Using objective and independent methods of employee selection (standardized service records, assessment committees with independent members)
- Obtaining contractual commitments by workers to retire from public service as part of their exit arrangements
- Instituting penalties for the public enterprise in the event of rehiring
- Strengthening human resource management systems to enable better monitoring of staff recruitment and to avoid the rehiring of workers who were prior beneficiaries of voluntary departure or early retirement programs.

Uniform or Case-by-Case Approach?

Where governments are starting a program of work force restructuring across a number of infrastructure enterprises or organizations, a critical decision arises. Should government adopt a single, uniform approach to compensation that will apply to all enterprises, or should severance packages be negotiated on a case-by-case basis?

A uniform approach may be preferable where there are strong trade unions and where a series of case-by-case negotiations can result in very high costs to government. Such an approach would avoid a situation where each new award raises the minimum severance level for the next negotiations and creates a ratchet effect that leads to increasingly higher severance levels that eventually become unsustainable.

At the same time, some flexibility might be needed to take into account the particular circumstances of the enterprise (for example, based on levels of overstaffing or financial performance). One approach would be for the government to develop severance policies and guidelines within which enterprises are allowed flexibility. In such an approach, the government might finance the cost of severance according to the guidelines, and any severance beyond the guidelines would be financed by the enterprise. This might allow enterprise managers in more profitable firms to restructure their work force more quickly by offering higher payments that can be financed from the enterprise's own resources but within an overall framework that prohibits excessively high compensation payments that the rest of the public sector could not afford.

Financing Severance

The cost of severance payments can be high and funding arrangements need to be put in place early in the process to assure workers that timely payments will be made. In the absence of such arrangements government credibility can be at stake.

There are several sources of finance for severance and for labor programs more broadly:

1. **The government budget:** Government revenues can be used to finance restructuring programs, although these may be insufficient when countries are faced with large-scale severance programs.

2. **Disposal of assets:** An enterprise that has acquired nonrelated assets over the years can dispose of them through asset sales or privatization, and the revenues generated from the sales can be allocated to meeting the costs of downsizing. Problems can arise, however, if:

   - Government rules prevent disposal receipts from being retained by the enterprise, requiring instead that they be allocated to the general treasury account. This is normally the case where the enterprise is a departmental (civil service) organization, but there may be more autonomy where the enterprise is a public corporation or a company.
   - The assets are illiquid or difficult to sell, or the market for assets is (temporarily) depressed. This will lead to a timing delay in sales, or reduced proceeds if the implementing agency implements a "fire sale" of assets, at cheap prices.
   - There are legal issues such as a prior charge on the assets by creditors or uncertainty of title.
   - PPI enterprise managers and government officials are reluctant to dispose of key assets. For example, port managers or bus company managers may resist the disposal of potentially valuable land for commercial development.

3. **Privatization proceeds:** Some countries have sequenced the sale of valuable enterprises first in order to build up adequate funds from initial proceeds to finance the labor adjustment and other costs of more difficult transactions.

4. **Bonds, loans, and grants:** Governments can issue government bonds, and some profitable enterprises may take commercial loans to finance the costs of work force restructuring. Many governments, however, look to loans or grants from multilateral institutions and bilateral donors as potential sources of funds (see box 1.7). For example, World Bank loans, under carefully specified criteria, provided financing for severance packages for redundant workers in the restructuring of the Polish and Brazilian rail sectors and the privatization of Togo telecommunications.

5. **Enterprises and investors themselves, through profits from operations:** Where the level of employment reduction is low, current operations can finance the costs of retrenchment. For example, in restructuring the Lesotho Electricity Corporation (LEC), 40 to 50 percent of staff were considered surplus—around 250 people in total. The costs of severance were funded from LEC's ongoing operations. (Other items such as training, counseling, and communication were supported under a World Bank credit.) Where the new investors are responsible for financing retrenchment costs after assuming operations, these costs too are effectively financed from current or future profits.

A key decision is whether to adopt a uniform or a case-by-case approach to ex gratia severance packages.

Work on securing financial commitments must start early.

There are six sources of funds for labor programs.

Asset disposal is important but can take some time to implement. There is, however, nothing to stop the implementing agency from starting the process by, for example, commissioning initial valuations of assets.

Box 1.7: World Bank Support for Severance

"In the past the World Bank was not allowed to directly finance severance pay because it was not considered a productive investment. There were also concerns about the effectiveness of retrenchment schemes and the Bank's vulnerability to accusations of supporting and financing unemployment. But a number of factors led the Bank to decide in February 1996 to allow direct Bank financing for severance pay as part of investment operations. These included the importance of large-scale restructuring and privatization, the potential obstacles arising from lack of financing for labor shedding prior to sale, the growing evidence on the economic and financial returns to severance pay, and the limitations of adjustment lending. As a result, severance pay financing can now be provided for individual state enterprises or groups for enterprises throughout the reform process; that is, from corporatization to restructuring prior to privatization" (Kikeri 1998, p. 35).

6. **Creditors:** Where the enterprise is liquidated, creditors may ultimately fund the costs of (statutory) redundancy, as was the case in the liquidation of Aeromexico (see box 4.9, module 4).

Pension Arrangements

Some of the more complex issues in PPI arise from the way pension arrangements are addressed. A poorly conceived pension strategy can make an otherwise viable transaction effort untenable. The cost of past obligations or future commitments of an existing pension scheme are commonly among the more significant considerations in determining potential investors' willingness to participate in a PPI initiative.

Public sector employees often benefit from generous pension schemes that may far exceed those available to private sector workers, especially in developing and transition economies where pensions of any type are often unavailable to the majority of the work force. The value of pension benefits can be the largest single component of the compensation package for many workers and the only form of "savings" accessible to them. The current and future costs of sustaining these arrangements, however, are often so great that the way in which they are structured and financed becomes a key factor in whether an enterprise is financially viable over the long term.

Pensions also represent a potentially powerful tool for the restructuring of labor. They may be an effective means to lower labor costs through early retirements or voluntary separations and a powerful incentive to attract and retain highly skilled or essential workers.

The implementing agency must address three closely related but distinct matters in dealing with pension issues in PPI:

1. The measuring and resolution of existing pension commitments that have been accrued to date in a manner perceived to be reasonable, fair, and financially viable
2. The utilization of pensions in the process of labor restructuring through limited windows for early retirement or voluntary departure
3. The restructuring of pension arrangements in a way that makes them consistent with the future requirements and financial sustainability of the enterprise.

Each of those issues is complex and its resolution depends on the specific type of pension scheme in place. The issues must also be addressed in ways that satisfy the differing interests of employees, the prospective PPI investor, and government. Module 5 presents detailed guidance on each of these tasks for different types of pension schemes.

Engaging with Stakeholders

Given the importance of pension provision to workers' welfare, it will be essential to communicate, consult, and often negotiate with employees, trade unions, pension plan trustees, government (ministry of finance, labor, or social protection), and other stakeholders on changes in pension arrangements.

Where national or multiemployer pension plans may be required to commit additional resources to meeting the future obligations for pensions, it is essential that the relevant government ministry or the government actuary is consulted before communicating with unions and workers. Especially when these plans are actuarially bankrupt, or where government is about to reform the pension system generally, the implementing agency will need to be very careful about raising the expectation of workers' representatives about what is—and is not—possible.

Pension plan trustees or supervisory board members are important actors and stakeholders in pension issues in PPI. They will be able to inform the implementing agency about the structure of the plan, past precedents in interpretation of the plan, plan assets, and financial circumstances. As box 1.8 illustrates, pension plan arrangements may be both technically and politically difficult, and the implementing agency and trustees may find themselves on different sides of the negotiating table. It is therefore essential to consult with pension trustees. Their primary duty, however, is to the beneficiaries of the plan, and they may well have their own source of independent professional

Pension liabilities are increasingly recognized as a potential risk to enterprise restructuring.

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Box 1.8: South Africa—Pensions at Johannesburg Water Company

The reform of Johannesburg's water supply included efforts to implement more equitable and more financially sustainable pensions. The Johannesburg Water Company (JWater) was formed on November 21, 1999, and it inherited staff who were contributing to 12 different (defined-benefit) pension plans originally set up by the City of Johannesburg. Not only was this arrangement complex to administer, but the plans were not equitable, and generally favored white employees and senior managers. Moreover, the unfunded liabilities of the plans were large and growing, a situation exacerbated by high administration costs.

Restructuring of the company's pensions was essential. However, union representatives on the pension plans' boards of trustees had been generally opposed to the reforms of the city's water supply. Trustees had not formally recognized JWater as an employer because the rules of the plans did not generally provide for admission of nonlocal government employees. Moreover, trustees of the two largest (City of Johannesburg) pension plans were reluctant to make rule changes, and they used the need for such changes as a bargaining tool to obtain other concessions from the city.

These problems were not unique to the water sector; other city pension schemes had similar difficulties. In December 2001, in an attempt to resolve citywide pension problems, the city administration unilaterally closed all pension plans to further contributions. A new provident fund was created. This was a defined-contribution (accumulation) plan with a 15 percent contribution by employers and a 7.5 percent contribution by employees, plus life insurance and disability benefits. The city's unilateral action was legally challenged in the courts, and an interim order granted relief to the two largest plans in March 2002. Other schemes subsequently launched similar applications. If all are successful, then pension provision will essentially be unchanged and the implementation of pension restructuring will be dealt a severe blow or at least delayed.

With hindsight, there had been too little consultation with plan trustees, unions, and workers. The court challenge to the city was based on the grounds that (a) the interests of some pension plan members had been prejudiced, (b) the consultation process had been inadequate, and (c) earlier guarantees given by provincial legislation and the employer during the reorganization had been infringed. Those pensions issues are not yet resolved, but key lessons for labor adjustment in PPI are:

- Pension issues are complex.
- It is important to have early and effective consultation on pensions with workers, unions, *and* trustees.
- The allocation of pension liabilities must be clearly defined. (In this case the City of Johannesburg will meet unfunded pension liabilities up to the time of staff transfer, but thereafter responsibility rests with JWater.)

Source: Personal communication from staff in Johannesburg Water, 2002.

Pensions issues will be a critical component of any communications plan.

The implementing agency will usually need to enlist specialist advice on pensions.

If pension systems are in the midst of reform, this may well affect the way the implementing agency will package or restructure pensions within the PPI transaction.

advice. The implementing agency may also identify a need to recruit specialist professional advice on behalf of government.

Managing Links with Pension System Reform

For some PPI implementing agencies national pension reform will be of little relevance, either because the reform has already happened or because pension reform is not in the pipeline.

Where government is in the midst of system reform, however, strategic decisions may need to be made. Wider pension reforms can affect specific decisions on pension issues for a power, telecommunications, rail, or port PPI, or may set precedents for other state-owned enterprises. Until 1981 most public pension plans were defined-benefit, pay-as-you-go arrangements, potentially unsustainable financially. The most well-known early reforms were those of Chile in 1981, which introduced a system based on individual accounts with fully funded, fully vestable, and fully portable benefits, plus minimum pension guarantees for workers on low wages and interrupted contributions. Chile's reform was followed by reforms in several other Latin American countries. In Bolivia's capitalization program (box 1.9), pension reform and privatization of state enterprises (including utility

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Box 1.9: Bolivia's Capitalization Program

Bolivia's 1994 capitalization law is a unique example of a combined privatization and pension system reform program. Major state enterprises, including gas, telecommunications, railways, airlines, and electricity generation and transmission, were capitalized through a capital increase by private investors of up to 50 percent of the companies' capital. During 1995 and 1996 international and domestic investors acquired shares in these enterprises through competitive bidding processes. Government transferred the remaining 50 percent of the shares in the enterprises into two new privately managed pension plans that were also mandated by the capitalization law.

The Bolivian approach meant that there were no privatization proceeds to the state budget, but that the investment went directly into these infrastructure assets. At the same time, the utilization of pension plans helped provide for development of the local capital market and meet the social protection needs of the population.

Source: Guislain 1997.

Box 1.10: Brazil Rail—Pension Reform and Labor Adjustment

In planning for labor adjustment in Brazil rail, it was expected that about 5,000 workers would take early retirement and 13,000 would choose voluntary separation. In fact, almost the reverse occurred: 11,771 opted for early retirement and 5,886 for separation. The reason was a proposal in Brazil's Congress for radical reform of the pension system, which implied that eligibility to retire no longer would be based on the number of years worked but on age. Fear that changes in the social security law would mean that workers would have to work many more years to receive similar benefits or that the changes would jeopardize the retirement income of older workers led to an unexpected increase in the number of applicants for early retirement.

Source: Estache, de Azevedo, and Sydenstricker 2000.

and infrastructure companies) were intimately linked because the state's shareholdings were used to establish new pension schemes.

PPI work force restructuring may also be affected by the timing of systemwide pension reform. For example, labor adjustment in Mexico rail took place as pensions were being reformed, which meant that workers knew that the new private companies would provide pensions under new mandatory, fully funded arrangements (López-Calva 2001). In Brazil many workers opted for early retirement rather than severance because of pension reform (box 1.10). This response is not unusual; several countries have seen surges in applications for retirement when pension systems are under review and workers are uncertain of the outcomes. Depending on circumstances, therefore, PPI labor adjustment may be helped or hindered by pension system reform.

Pension system reform can encourage more workers to opt for early retirement.

Consultation with government is important to ensure consistency of approach and policy coherence between pension system reform and PPI implementation, particularly where:

- Government is proposing other changes that are directionally opposite to those that the PPI implementing agency might propose. For example, pension system reforms can include increasing the statutory age and sometimes removing any difference in retirement age between men and women (the implementing agency may in contrast propose early retirement); raising the minimum years of service for eligibility or changing the basis of eligibility from years of service to age (although the implementing agency may want to relax these eligibility criteria in order to encourage early retirement); or removing special and privileged pension rights (although the implementing agency may need to recognize these rights explicitly in negotiations with unions).
- Pension systems are moving from pay-as-you-go plans to ones that are at least partially funded to ensure that the systems as a whole are financially sustainable and will not collapse in 10, 20, or 30 years.

- Governments are moving away from defined-benefit plans to accumulation schemes.
- Negotiations on pension reforms are in progress between government and unions.

Redeployment Programs

Many governments have supplemented severance and pension packages with redeployment support to help workers regain productive incomes—whether through formal employment, self-employment, or informal livelihood activities. Such programs also offer an additional incentive to encourage voluntary departures and help win support for politically difficult restructuring. They are aimed at facilitating the shift of economically unproductive workers from infrastructure sectors to more productive sectors of the economy. One by-product of retraining and redeployment programs may be a general shift in attitude among the work force at large, away from a perceived reliance on public sector employment toward private sector jobs and self-employment.

In some cases redeployment programs have been developed explicitly for PPI employees; in others, redeployment support is provided as part of broader active labor market programs for the unemployed. Such programs differ from passive labor market programs that act more as a safety net for the most vulnerable people (box 1.11).

The main types of redeployment support are:

1. **Counseling,** which might include elements of trauma, financial, and life counseling, in addition to advice on services and support open to the displaced worker.
2. **Job search assistance,** which can include placement assistance (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 (through personal skill assessments, coaching, and job clubs).
3. **Training,** which may have different areas of focus, such as retraining and developing new skills in workers so that they can find new paid employment elsewhere; or training in small business, microenterprise, or livelihoods to help displaced workers find self-employment and incomes.
4. **Employee enterprise,** whereby opportunities and facilities are provided by the government or the PPI enterprise to enable employees to set up their own businesses. These facilities and supports include contracting out of services by the enterprise to newly separated workers; simple workspace facilities (sheds, garages, and small offices); and business incubators where workspace facilities are supported by business advice, shared facilities (fax and photocopier), and a degree of mentoring.
5. **Community-based approaches,** which look to local government, nongovernmental organizations, and community self-help groups, alone or in coalition, to develop employment opportunities at a local level. These can include public works programs that provide temporary employment opportunities through large-scale, labor-intensive projects.

Box 1.11: Active and Passive Labor Market Programs

Redeployment support services linked to enterprise restructuring programs are a particular subset of "active" labor market policy. "Active" labor market policies or programs are those that directly prepare or assist the reintegration of workers in the labor market through activities such as job search assistance, job placement plans, training programs, and employment subsidies. These can be contrasted with "passive" labor market policies, which support incomes, usually through financial transfers. Examples of passive policies are unemployment insurance, worker disability payments, and—relevant to the context of PPI labor adjustments—severance pay. Some have used the metaphor of a trampoline to characterize the concept behind active labor programs (to lift workers back into work) compared with the safety-net concept of passive programs.

The PPI implementing agency's plans for tackling pensions may run counter to government's overall policy.

Redeployment is a tool of active labor market policy.

There are five main types of redeployment support.

Counseling, training, and job search lie at the core of most redeployment programs (see figure 5.2 in module 5). Community-based approaches, public works, and employee enterprise are supplementary elements that can be appropriate in some circumstances. In designing programs, there is often opportunity to involve unions, local government and, where relevant, wider community and civil society groups in consultation processes.

On the whole, redeployment programs have had mixed results. Most evaluations have focused on the experience of industrialized countries. These experiences generally show that retraining programs resulted in modest gains in reemployment probabilities, but wage changes were negligible or negative. The same evaluations found that the costs of retraining are two to four times higher than job search assistance but are no more effective. By contrast, placement and counseling efforts tend to show positive results and are generally more cost-effective. Systematic evaluations of the impact of such programs in developing countries have been few, although anecdotal evidence suggests that retraining programs often fail because of timing delays, weak institutional capacity, low education levels, and the lack of employment opportunities for retrained workers. The programs frequently have been more driven by supply than by demand.

Nonetheless, emerging experience from a wider range of circumstances can inform the design and implementation of redeployment programs and help workers with several remaining years of productive life to acquire gainful new livelihoods. Better results are more likely if wider economic and labor market policies aimed at creating sustainable employment growth are already in place (as outlined in the second section of this module). At the program level, effectiveness can be improved by:

- Ensuring that redeployment services are driven by demand rather than by supply. This can be done by giving workers a choice between training and severance, and by building in a cost-sharing element through the use of vouchers and other instruments.
- Targeting services to workers for whom such services are most cost-effective—in particular, younger workers with basic educational levels and skills who are most likely to improve their labor market outcomes from retraining. Effective targeting requires that a survey of workers be undertaken as a preparatory step to obtain a clear profile of worker characteristics and needs.
- Developing a good understanding of the labor market that workers will be entering. This requires a labor market survey, done as early as possible. Proper labor market information is critical for setting up training and employment support programs that are relevant to workers' opportunities and needs.
- Getting a good understanding of the types of services, programs, and institutions that are in place to deliver services. This requires a survey of existing training and other labor market infrastructure to determine the capacities of service providers.
- Developing good counseling and advisory services to help match workers to appropriate and relevant retraining and other programs.
- Bringing in a wide range of institutions, including nongovernmental and private institutions, to foster competition and efficiency in the delivery of services, and using performance-based contracting arrangements where possible to improve incentives and efficiency.
- Giving workers access to information on the performance of training and other service providers so that they can better select courses and services (and at the same time make the program more demand-driven).
- Providing redeployment support to help workers set up their own small businesses instead of merely equipping them with skills for jobs in the formal sector—jobs that tend to be limited.
- Engaging effectively with stakeholders, particularly through consultation (see module 6).

Module 5 discusses in detail the different types of programs and the key steps involved in designing and implementing redeployment programs. These programs and steps include the use of surveys as building blocks for the program, designing incentives to ensure that programs are demand driven, costing out the services and securing funding arrangements, setting up labor funds or other implementation arrangements, identifying and commissioning service providers, and developing systems for monitoring and evaluating results.

Employee Share Ownership Plans

In work force restructuring, employee share ownership plans can be used in three ways:

1. As a form of *compensation* to displaced workers
2. As part of an *incentive* or reward package to workers who remain
3. As the basis for management employee buyouts or employee buyouts of units of the enterprise.

In such arrangements, governments have reserved shares, ranging anywhere from 3 to 10 percent depending on the size of the transaction, for employees in the PPI process, often at discounted prices and with special financing arrangements. Financing share ownership schemes is the major concern in developing countries. Some countries (for example, Bolivia and Chile) overcame this concern by allowing workers to use their end-of-service benefits to invest in the share program, with the guarantee that the value of the shares would not fall below their entitled benefits at the time of retirement. As a result, in many of the enterprises more than 80 percent of employees participated in the program. In addition to financial gains from such arrangements, ownership programs can help give employees a direct stake in the performance of the company and thus help improve labor relations and labor productivity.

Module 5 summarizes experiences in the use of employee share ownership mechanisms, and concludes that share transfers are probably best viewed as a supplement to rather than a substitute for severance payments.

The implementing agency can benefit from experience elsewhere when planning redeployment.

MANAGING THE RESTRUCTURING PROCESS

Experience shows that labor restructuring can proceed smoothly if stakeholders are involved and there are good communication mechanisms in place. The fears and concerns of workers can be significantly reduced when explicit efforts are made to inform them about the objectives, timing, and methods of PPI, as well as the packages and incentives that will be developed to minimize the social impact. To ensure a smooth process, governments also need to define implementation arrangements and create the capacity to carry out labor programs.

Engaging with Stakeholders

Privatization is almost everywhere a highly controversial process opposed by various stakeholders, including labor. For the following reasons labor opposition can be greater for infrastructure enterprises than for other state-owned enterprises:

- High levels of downsizing are often needed.
- High levels of investment are required, and the involvement of foreign investors is likely.
- PPI may coincide with tariff increases and rebalancing, particularly in sectors where the service is seen by some stakeholders as a "right" (for example, water).
- Infrastructure services are essential, and organized labor has some degree of power to disrupt those services through industrial action.

Share transfers are best seen as an addition to rather than a substitute for voluntary departure or early retirement.

The lack of labor involvement in the process has been a further contributing factor. Although there is a trend toward more openness, some governments are still reluctant to engage earlier and more openly with stakeholders. They recognize both the advantages and disadvantages of engagement (box 1.12) and will weigh the benefits and costs of engagement as summarized in table 1.2 below.

Box 1.12: Malawi—Experience of Consulting with Labor in Privatization

Malawi's experience is that labor opposition to privatization escalates if the labor movement is not involved early in the process:

> In many African countries labor unrest occurred because of lack of consultations. Our experience is that an explanation of the government's plans assures labor unions that sacrifices will be balanced with measures to allow the employees to share in the benefits of privatization….Two problems [however] emerge with regards to consultation with labor unions in general. The first is that most employees consider privatization as a means of forcing redundancy offers….There is yet another dimension to involvement of unions in the process. As we discovered in Malawi it could—and often does—lead to a significant complication and lengthening of the transaction. In addition, employees who have access to privileged and sensitive information tend to use it to their advantage in the bidding process, thereby undermining the integrity of the transaction (Sauti-Phiri 2002).

Three of the most common concerns for governments are that:

1. Stakeholder participation might delay PPI. Just as workers may be fearful of job loss, implementing agency officials, particularly at the start of the process where there are no ready answers, may fear that engaging with stockholders can lead to delays.
2. The very process of engaging stakeholders can raise workers' expectations, which officials may not be able to meet (for example, on the scope of consultation or on levels of severance). If, for example, the implementing agency consults with trade unions on the process of labor adjustment in PPI, then the implementing agency may fear that trade unions will reject that consultation and demand that the policy of PPI itself be challenged.
3. There is a lack of specialist skills, tools, and experience within government to engage with confidence on labor issues.

Stakeholders have more concerns over the involvement of the private sector in infrastructure than in other state-owned enterprises.

Those concerns have some validity in experience. But experience also shows that failure to involve stakeholders can have significant costs, can fuel conflict and suspicion, and may further delay PPI or lead to problems down the line. Instead, a well-managed process involving stakeholders can facilitate PPI. Equally important, it can encourage adoption of labor and working practices suited to local circumstances and thus improve outcomes. If properly planned and managed, the involvement of stakeholders can play an important role in strengthening the fairness, transparency, and accountability of the PPI process.

Key Stakeholders

There are many different stakeholders, defined as groups or institutions that may be affected by or may influence the design, implementation, and outcomes of labor restructuring and PPI more broadly. A good stakeholder analysis can identify these groups and provide information about and understanding of their interests and concerns. It is also a tool to inform the design of labor approaches and the process of engagement with workers.

Stakeholder analysis worksheets.

Further information on stakeholder analysis is set out in module 6, and stakeholder analysis worksheets are included on the accompanying CD-ROM. Some key points are outlined in box 1.13.

For any PPI scheme, there are five principal groups of stakeholders:

1. **Employees:** Employees can be broken down into several categories by, for example, status (temporary, permanent, and contract); age; skill; cadre (management, skilled, or manual); gender; and ethnicity. The concerns of different groups and the likely impact of work force restructuring on them may vary (see, for example, the case of Sri Lanka Telecom in box 5.7, module 5), and a better understanding of their concerns can therefore influence and improve not only the design and content of communication programs for workers but also the design of the labor programs themselves.

The implementing agency may first need to convince colleagues of the need to engage with labor and other stakeholders.

Table 1.2: Benefits and Costs of Participatory Engagement Processes

Potential Benefits	Potential Costs
• Helps build consensus about and "ownership" of PPI policies and projects • Saves time in the medium term by avoiding misunderstandings, disputes. and mistakes • Brings in the skills, experience, and knowledge of workers, trade unions. and other stakeholders, and thus helps identify and reduce technical risks to the PPI scheme • Enables more informed and inclusive decision-making • Fosters public debate and discussion • Encourages the adaptation of approaches to the particular local circumstances of each PPI • Develops awareness of other stakeholders' points of view, concerns, and aspirations • Reinforces the legitimacy and transparency of government's policies and tactics • Reduces political risks by bringing all interests into the process and demonstrating government commitment • Improves transparency and accountability to show that there is no hidden agenda, favoritism, or corruption associated with PPI	• Debate and discussion take the place of action; they delay implementation of the PPI plan • Wastes time by allowing the engagement to become an end in itself ("analysis paralysis") • Raises political awareness of (and opposition to) PPI proposals before government itself has had time to fully consider the options • Diverts scarce implementation capacity into management of the engagement process • Selection of those to be involved in consultation and dialogue reinforces the suspicions of those excluded (that is, participation is seen as a vehicle for exclusion of some groups) • Conflicts of interest rather than shared interests shape (that is, distort) project design and implementation • If not fully transparent, the process can be abused or captured by vested interests

2. **Unions:** Trade unions are important stakeholders and can influence the restructuring process, but implementing agencies may face challenges in engaging with them. Like governments, unions may lack the capacity to engage effectively. Some unions do not want to be seen as cooperating with employers, whereas others may oppose government policy on PPI as a whole. Consultation may be made difficult by the number of unions involved. For example, discussions on port reform in Sri Lanka involved 19 different unions, and in Orissa's power sector, for example, employees were represented by 43 trade unions and federations. In some circumstances, national and international federations are important parties, both in terms of capacity building for local unions in developing countries and of entering into general framework agreements at national or even international levels.

3. **Government:** As is true among employees and unions, there are different groups within government itself. The key ministries involved are likely to be the relevant sector ministry, the ministry of finance or economic planning, and the ministry or agency responsible for privatization. Other ministries, including those of social protection, labor, justice, and local government, also have a role. Understanding the different roles—and frequently competing interests—of these different factions within government is important in making sure that labor programs are effectively carried out.

4. **Investors:** Investors, whether foreign or domestic, often only enter into the discussions at the transaction stage. As a result their specific concerns may not be heard during much of the restructuring process. Earlier involvement of investors allows their

An inclusive process is more likely to lead to approaches that are tailored to local circumstances.

Key message: the challenges of engagement can be successfully managed.

Stakeholder analysis informs labor approaches.

Box 1.13: Key Points for Stakeholder Analysis

1. Stakeholder analysis can be based on new research (such as attitudinal surveys), available secondary data (such as publications, reports, or press clippings), simple structured interviews with individuals, focus groups, and small group meetings with stakeholders themselves and with informed people.
2. Based on the analysis, stakeholders can be mapped in terms of their influence and importance. Influence is the power that stakeholders have to affect the outcome of work force restructuring. Importance refers to the extent to which a successful outcome depends on involving those stakeholders.
3. The analysis may first be done as a draft exercise. The draft will reveal gaps in understanding of stakeholders' interests and uncertainties over appropriate engagement strategies, which then can be developed and refined through subsequent interviews, focus groups, or targeted opinion polls.
4. Interviews, small workshops, or a series of focus groups led by the senior manager in the implementing agency or a delegated officer ideally will involve representatives from stakeholder groups.
5. Making the process as objective as possible helps reinforce the credibility of government's commitment to a fair process, and can improve the quality of the analysis. Using an independent analysis, perhaps facilitated by a commissioned consultant, and drawing on prior interviews with stakeholders helps ensure objectivity.

interests to be taken into account and balanced with those of other stakeholders. Such involvement can take place through consultation meetings with investors, better communication of relevant policy papers, and early scheduling of prequalification. It may also be helpful to the ultimate PPI outcomes to delay the renegotiation of labor contracts until short-listed investors are consulted.

5. **Customers:** Consumers and other users of infrastructure services have a direct stake in the broader PPI process. Opinion polls and attitude surveys are valuable sources for developing an understanding of what people think. In general, however, customers want reliable services they can afford, which means they have an indirect interest in the capacity and productivity of the work force producing them. Conversely, workers are also consumers and so they have a broader stake in the process as well.

Table 1.3 summarizes the stereotypical concerns of these stakeholders. The stereotypes are only a starting point, however. Stakeholder analysis will most likely reveal other interests as well as differences within these groups, under the unique circumstances of each PPI transaction.

Forms of Engagement

Stakeholders can be engaged at different levels in the labor restructuring process through four main forms of engagement: communication, consultation, negotiation, and cooperation.

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, while those in negotiations expect that mutually binding results will be the outcome.

Negotiation is a distinct form of engagement that arises from the contractual employer–employee relationship between government and work force.

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. This distinguishes it from negotiation, which can be adversarial. Cooperative approaches often have longer-term and broader perspectives than negotiation.

A key question is which type of engagement should be used, and when. It is rarely the case that all stakeholders need to be communicated with at the same time. Engagement activities are therefore

Government is not a monolith—there may be pro- and anti-PPI factions.

Investors' views may not be heard until late in the PPI transaction.

Table 1.3: Understanding Stakeholder Interests

What customers want	What investors want	What government wants	What workers want	What unions want
• Dependable service • Affordable tariffs	• Tailored service for the poor • Steady, long-term returns • Market share, reputation, geographic presence • Mitigation of risks not under their control, or profits commensurate with risks • Clear regulatory frameworks and adequate freedom to manage the business	• Budget savings, reduced liabilities for the state • Tax, fee, or sale revenues • Happy customers and consumers • Fast environmental cleanup • Jobs for domestic firms	• Security of employment, livelihood, and remuneration • Satisfactory pay, working conditions, and work practices • Training, enhanced skills	• Retained bargaining position and status • Involvement in consultation • Maintained membership • No shift to "atypical" work • No loss of worker rights • Evidence of future jobs

Source: Adapted from Saghir and Taylor 1999.

often sequential and, depending on the circumstances, usually include steps to:

- Inform stakeholders about PPI.
- Communicate with employees and unions on the need for work force restructuring.
- Consult with employees, unions, and investors on restructuring approaches, including severance packages and procedures.
- Carry out negotiations among government, workers, and investors on issues such as labor contracts, pensions, and working practices. If there is an economic regulator for the sector, it may be involved as well.

One particular risk is premature activities. Hasty and ill-prepared communications can damage the credibility of government and delay PPI if they expose uncertainty in the government's approach. The implementing agency should be able to advise government officials and politicians about how and when to sequence engagement events and about the key messages to be conveyed. The basic rationale for why work force restructuring is essential for the PPI plan must be clearly articulated and understood within government before any efforts are made to communicate it.

Hints and tips on communicating with workers.

Module 6 outlines how to develop an engagement strategy and an engagement plan, with detailed guidance on communication, consultation, negotiation, and cooperation, and the CD-ROM includes guidelines on communicating with workers and guidance on the use of tools such as focus groups and videos.

The actual process of engagement is likely to have starts and stops, periods of progress and setback. It may not always be possible to follow a precise, neatly sequenced plan. As the discussion of Côte d'Ivoire Railways illustrates (box 1.14), a commitment to engage on work force restructuring issues

Consultation and negotiation are very different processes.

Box 1.14: Côte d'Ivoire Railways—Participatory Processes

The importance of the way in which labor issues are handled in the context of restructuring and privatization was demonstrated in the case of Côte d'Ivoire Railways. In the early 1990s the railway was restructured without union consultation. The union was unprepared for the challenge of restructuring and lacked the know-how and experience to effectively respond to it. The work force was reduced by about a third, but it soon became clear that there had been too many redundancies in some key areas—notably in signaling and security—and this caused operational difficulties. As a result of this and other deficiencies, the company found itself having to pay some of its remaining work force overtime, so that much of the potential of the process to put the railway on a more sound financial footing was undermined.

By contrast, a second phase of restructuring from 1993 onward, with which the union was more effectively engaged, produced better results. The company's 1993 activity report highlighted changes in commercial attitudes, reduction of fraud by 30 percent, and a 60 percent increase in availability of locomotives—a good sign of maintenance efficiency. The second phase also created a labor relations climate more conducive to the effective implementation of the privatization process, which began in earnest in 1995.

Subsequently, however, a breakdown in communications and consultation among government, management, and labor again produced avoidable problems. When the union asked for information about how further labor restructuring would be carried out, the request was ignored. This led to a strike and to direct actions, such as blocking the center of Abidjan with a locomotive. Details of the redundancies envisaged were provided eventually, but the union had managed to negotiate severance terms equal to 14 months of wages, double the initial offer. In addition, the number of years of contributions required to entitle an employee to an early retirement package was reduced from 20 to 15.

During the negotiations the union also proposed a plan to enable workers to establish their own businesses after retrenchment. Sitarail, the concession company that took over operational responsibility for the railways, agreed in principle to favor companies created by former workers when looking for subcontractors. Since then, track maintenance, company car fleet management, and printing of timetables and tickets have been contracted out to firms set up by former workers. Sitarail has also agreed to give preference to workers made redundant in 1995 when recruiting new staff, albeit on terms different from those that obtained before privatization.

These measures have helped mitigate the adverse effects of retrenchments. At the same time, workers who remained with Sitarail have gained from privatization. For example, although on paper the terms of the company's health insurance program is worse than before privatization, in practice employees have more confidence in it because the company now meets its reduced obligations, whereas before the larger commitments were not honored. In addition, the rail workers' union reports that working conditions have improved since privatization because of investment in workshops, equipment, and uniforms.

Source: Martin and Micoud 1997.

can lead to mutually acceptable solutions and improved outcomes for the implementing agency, the workers, and other stakeholders.

Implementation Arrangements

Two major requirements for a successful labor program are clear implementation arrangements and the capacity to undertake the various aspects of the program. For major PPI transactions this usually means the creation of a labor unit within the PPI implementing agency. Arrangements vary among countries but common institutional homes for the implementing agency are the national- or state-level privatization agency; the relevant sectoral or line ministry; the PPI enterprise itself; the central ministry of finance, economics, or planning; or special units set up to support sector or individual enterprise reforms (examples are British Coal Enterprise and Brazil's Port of Santos Labor Fund).

Once the agency is created, the government will need to assemble a team for implementation. A sample organizational structure for a PPI team is shown in figure 1.1. The implementing agency will need to include labor experts as part of the team for the labor restructuring program. The structure of the labor team will vary depending on the size and scope of the labor program.

In large PPI programs with a major labor component, and where there is little capacity elsewhere in the government to deal with labor, a small labor unit may have to be created within the PPI agency. In smaller programs, and where other groups in the government such as the ministry of labor have the required capability, it may be necessary to recruit an individual labor expert in the agency to coordinate implementation.

If there is an enterprise with a large labor restructuring program (as in many railways enterprises), labor experts may be recruited at the enterprise level (rather than at the implementing agency) to help carry out the restructuring process. In other cases, private sector management contractors have been engaged to implement enterprise or work force restructuring as part of the overall preparation process for PPI. Such arrangements enable the implementing agency to bring in additional capacity to deal with the short- and medium-term workload associated with the restructuring. And in yet other cases, special units or funds have been set up at the enterprise level to implement the labor program. Some are wholly financed by the central government budget, others by levies or with funding from local governments. One example is the Port of Santos Labor Fund (box 1.15).

The labor unit (or individual expert) is usually responsible for overall implementation, and the relevant tasks cover the full range of activities in the labor program:

- Completing the establishment of the labor unit, including the training and capacity building of any in-house staff.

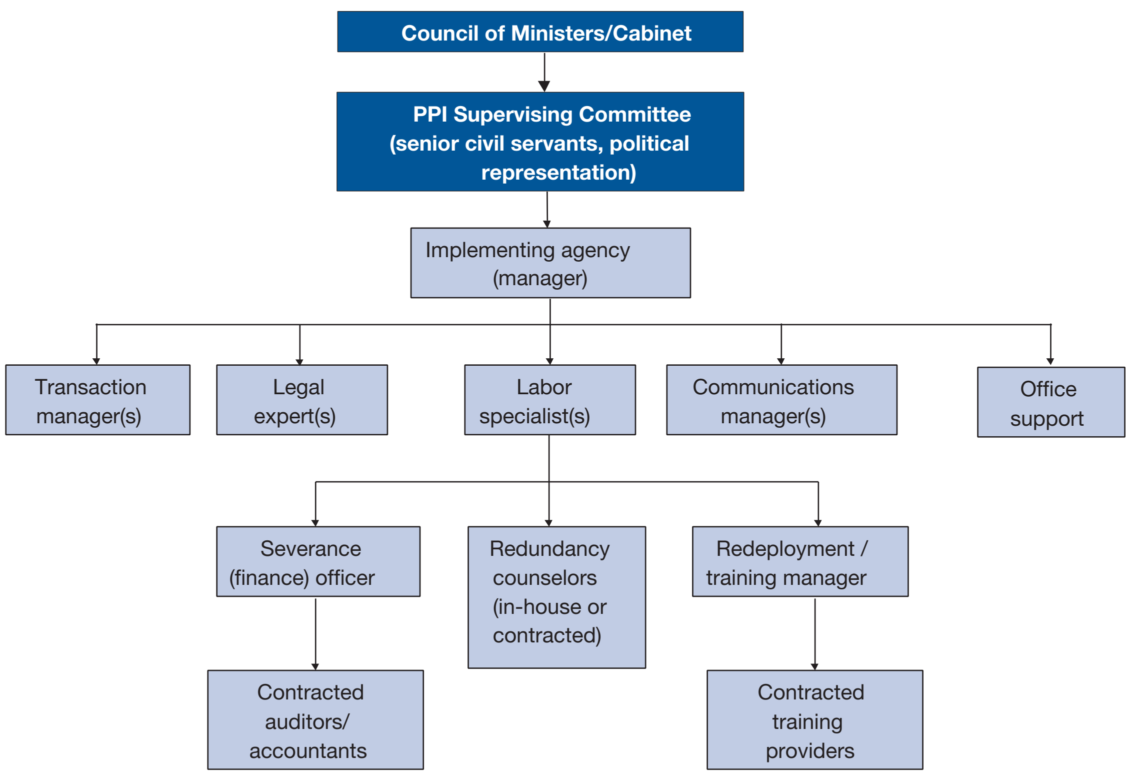

Figure 1.1: Organization Chart for a PPI Team (Sample)

Box 1.15: Port of Santos, Brazil—The Special Labor Fund

A special port workers' fund is being set up in Santos that should resolve years of bitter confrontations between stevedores and port operators at Brazil's leading port. The real 80 million (US$47.73 million) fund will be used to soften the impact of cutting the labor pool in Santos to about 4,500 dock workers from a current total of 11,500 employees. Money from the fund will be used to retrain port laborers employed by the administrator of the casual labor pool for alternative work within new high-tech and light industries that will be encouraged to locate to Santos. The project is also backed by the São Paulo State Federation of Industry, the Santos Port Council, local importers/exporters, state and municipal governments, and national governmental bodies dealing with dock labor. Rules for dismissals and claims are to be worked out. The local and central governments are expected to help bring high-tech and small businesses to Santos within three years or so. The technical plans are being presented to the unions for discussions, and following their agreement the plans will be presented to the national body coordinating the modernization and privatization of Brazil's ports and to the government in Brasilia.

Source: World Bank 2000 (Port Reform Tool Kit, Module 7, p. 16).

- Securing funding (if this has not already been done).
- Commissioning early initial reviews (for example, legal reviews and assessments of the need for labor restructuring).
- Designing and enacting procedures for the implementation of voluntary redundancy, early retirement, and other actions.
- Ensuring that stakeholder engagement (consultation, communication, negotiation, and cooperation) takes place sufficiently early for all key stakeholders so that the process can be seen as both fair and legitimate.
- Coordinating with other existing government organizations that may already be involved in redeployment support and that must be brought into the process. These include ministries of labor, trade, and industry and commerce; public employment offices; and finance authorities.
- Designing procedures for the approval, disbursement, monitoring, and auditing of severance funds.
- Designing and coordinating implementation of the redeployment (counseling and retraining) program for workers.
- Monitoring specialized contractors hired for the labor restructuring process.
- Commissioning monitoring and evaluation activities.

WWW PPIAF provides a quick-mobilizing grant facility for small inputs by PPI and sector specialists (see www.ppiaf.org).

In order to build capacity and support for developing labor programs, the implementing agency can seek technical and financial support for organizing study tours and workshops in the early stages of the reform program. As with other aspects of PPI, international donors are one source of such support. One international facility is the Public-Private Infrastructure Advisory Facility (www.ppiaf.org), a multidonor facility that offers rapid disbursing of grants for specific inputs by PPI, sector, and labor specialists.

Analytical and technical capacity is needed to carry out initial staffing and feasibility assessments, to design and implement the various aspects of the labor restructuring program, to analyze the financial and economic viability of the program, and to monitor and evaluate the net impact of the labor program.

When the labor restructuring program is completed, the labor teams or labor funds will be wound down, and this needs to be taken into account during project design. The case of British Coal Enterprise is relevant at this point because it shows how a significant redeployment support service can be closed down and privatized (see box 1.16).

Box 1.16: British Coal Enterprise—Privatizing Redeployment

One of the potential concerns about setting up large sector- or enterprise-specific redeployment units is that their services are only needed for a short time. How will the closure of those redeployment units be handled? One answer is to privatize them, too. This was the case with British Coal Enterprise (BCE). The fact that it could be privatized indicates the commercial worth of the assets and skills that BCE developed in support of former mining communities. Each of BCE's main areas of activity was privatized separately.

- **Outsourcing:** The expertise developed in four years of running what was initially known as British Coal's Job and Career Change Scheme led to the creation of the commercial outplacement division of BCE, known as Grosvenor Career Services. Grosvenor specialized in the delivery of redeployment training and career advice and was successful enough that Grosvenor was privatized through a management buyout in 1996. The Grosvenor team provided outplacement services to British Coal as well as other large private and public sector companies undergoing restructuring in the United Kingdom and Europe. Grosvenor also provided outplacement and labor restructuring technical assistance in coal field regions in countries of Eastern Europe under the European Union's Phare program. Grosvenor was subsequently acquired by Capita IRG plc.
- **Managed workspaces:** These units were the principal physical asset at the time of BCE privatization. BCE's experiences in providing serviced units in mining communities enabled the privatization of this division of BCE through a trade sale to Birkby plc in 1995. Birkby later merged with Mentmore Abbey in 1999 so that BCE's former workspace and business incubator division is now a part of a leading European office space management company.
- **Funding operations:** The business-funding division of BCE was sold to a management buyout in 1995, and the new company, Coalfield Investments Ltd., continues to invest in small and medium-size businesses in the coal-mining areas.

Source: British Coal Enterprise, Tawney and Levitsky 1997.

MONITORING AND EVALUATING LABOR PROGRAMS

During and after the labor restructuring program it is important to carry out a cost-benefit analysis of the various elements of the labor program so it is possible to decide which approach is the most suitable and beneficial to the situation at hand and to make midcourse corrections as needed in the design and implementation of the program. Although critical to success, monitoring and evaluation activities are often a neglected aspect of the labor restructuring process. Capacity in this area needs to be built and systems put in place to evaluate the individual elements and the program as a whole.

Governments commonly fail to monitor labor programs effectively.

MODULE 1

Objectives

Governments often invest too little in monitoring and evaluation even though there are several potential benefits:

- Better understanding of the financial and economic case for labor programs
- Reduced costs to government (mainly through better design)
- Greater benefits for workers, through better program design and through fine-tuning of the program
- The capture of data and experiences so that subsequent phases of the labor program can learn from past experiences.

For these reasons, monitoring and evaluation activities are important and explicit efforts are required to include the activities in the early stages of program design and after implementation to evaluate the net impact of the program.

Monitoring and evaluation tools can be incorporated in all four phases of the PPI process, as table 1.4 illustrates. Among the tools are:

- **Undertaking the initial feasibility assessments during phase 1:** Examples of such assessments are an analysis of labor redundancy in Vietnam in preparation for future downsiz-

Table 1.4: Analysis, Monitoring, and Evaluation in Labor Adjustment Programs

Activity	Initial assessment (Phase 1)	Design clarification (Phase 2)	Performance monitoring (Phase 3)	Impact monitoring and evaluation (Phase 4)
Orientation	Relevance and feasibility	Clarification and improvement	Justification and fine-tuning	Justification, accountability, and review
Focus of work	Program context and goals	All elements; specific objectives	Delivery and outputs	Outcomes
Timing	Before implementation	Before and during implementation	During implementation	After implementation
Typical issues	• What is the nature and extent of any overstaffing problem? • What do investors want? • Do we need a government-funded labor program at all? • Roughly how much will it cost to restructure the work force?	• Which severance or early retirement packages are the most cost-effective? • Which redeployment services should be offered?	• Are workers applying for voluntary departure in the numbers expected? • Are severance payments and redeployment services being delivered on time?	• What was the impact on the PPI transaction (delays, price)? • What were the fiscal costs and benefits for government? • What have been the welfare impacts on workers?
Typical tools	• Financial analysis • Staffing audits and benchmarking (see module 3) • Stakeholder analysis and consultation with investors and labor (see module 6)	• Financial analysis • Economic analysis • Stakeholder analysis	• Financial analysis • Monitoring of staffing numbers • Monitoring of participation and dropouts from counseling, training courses, and so forth	• Financial analysis • Economic analysis • Socioeconomic tracer studies

Source: Adapted from Owen and Rogers 1999.

ing (Belser and Rama 2001), an assessment of alternatives for a new restructuring program in Sri Lanka (Fiszbein 1992), and an assessment of the likely impact of a national civil service downsizing program in Ghana (Gregory 1994).

Belser and Rama 2001

- **Clarifying the design of the labor restructuring program during phase 2:** For example, an assessment of the financial and economic viability of the Algerian retrenchment program (Ruppert 1999).

Ruppert 1999

- **Monitoring the performance of the program during implementation in phase 3:** For example, monitoring the progress of work force restructuring in Brazil's federal railway (Estache, Schmitt de Azevedo, and Sydenstricker 2000).

Estache, Schmitt de Azevedo, and Sydenstricker 2000

- **Monitoring outcomes and evaluating the net impacts of labor restructuring during phase 4:** Examples include an evaluation of active labor market programs in Hungary (O'Leary 1997) and a tracer study of the consequences of retrenchment for civil servants in Ghana (Alderman, Canagarajah, and Younger 1994).

Concepts and Approach

Monitoring and evaluation early in the design of the program are critical in helping governments compare alternative options for severance and redeployment and in determining the cost and financing needs. Evaluation has to take into account the financial and economic returns of both the various components of the labor program and the program as a whole and the outcomes of the program itself in terms of effects on workers and on the enterprise. Periodic monitoring is important in keeping track of the program and learning from experience.

Financial vs. Economic Returns

A cost-benefit analysis has two main dimensions: *financial returns* and *economic returns*. From a public finance perspective, the financial returns of a labor program will be central to decisionmakers. This is particularly the case where the enterprise takes a loss and completing the labor restructuring will bring an improvement in public finances by reducing government transfers and subsidies and increasing tax payments from PPI firms. Provided that no rehiring takes place, labor programs can be cost effective with a payback period ranging from two to six years. Labor programs thus appear to offer good rates of financial return that few public investment projects would be able to match.

However, economic returns also need to be calculated and taken into account for several reasons:

- First, economic analysis assesses the impact on *aggregate output or welfare*. Financial returns do not indicate whether displaced workers are, in aggregate, more or less productive following the labor program. It is quite possible that a proposed labor program can be attractive from a financial perspective but can fail when subjected to economic analysis.
- Second, such analysis provides *an answer to opponents* of labor restructuring in PPI who may argue that government is making a bad decision by ignoring the wider economic costs and benefits (see, for example, the South African case in box 6.8, module 6).
- Third, the analysis may be *a requirement of international funding agencies*, whose lending or funding procedures need economic as well as financial analyses.

The economic rate of return from a labor program can be defined as the net increase in marginal productivity of surplus staff redeployed to another productive activity elsewhere in the economy, and the marginal gain from avoided labor-related costs; available evidence shows that it can be high. Returns are particularly high if there are other opportunities for employment and if redundant workers are likely to find jobs in the labor market.

Module 7 examines in greater detail the approach, methodology, and findings on both financial and economic returns in labor programs. It also provides the necessary tools to carry out cost-benefit analyses of labor programs.

Evaluating Effects on Workers and Firms

Evaluating the impact of the labor restructuring program on workers is another aspect of evaluation. Such evaluations typically cover (a) the impact on employment because job losses are important "headline" figures in the media and elsewhere and understanding what happens to jobs is important economically and politically; (b) the impact on wages and benefits; (c) the broader impact on workers' welfare in terms of their socioeconomic profile; and (d) the follow-up situation of workers, including duration of unemploy-

Most evaluations of work force restructuring programs reveal very fast payback periods.

ment and types of jobs found. Item (d) is particularly relevant in the evaluation of redeployment and training schemes, where common objectives are to reduce the period of unemployment and to prevent displaced employees from entering a pool of long-term unemployed workers. An equally important question for evaluation is the impact of labor restructuring on enterprise efficiency, including improvements in labor productivity, and on financial and operational performance.

These effects are often assessed through ex post worker and firm surveys. Such surveys are being carried out in a number of countries (for example, Brazil, India, and Vietnam). Module 7 highlights the main types of data that are usually collected in the surveys and the methodology for carrying out such assessments.

Economic analysis provides a perspective that financial analysis alone cannot provide.

A central requirement of any evaluation is that it separate the effects that would have happened anyway from those that resulted from the specific intervention. Before and after comparisons alone are not sufficient. If earnings rise after training, for example, that may not result from the training but from changes in the macroeconomy, local changes in labor demand, or such worker-specific attributes as lifecycle earnings changes.

Evaluation therefore requires a counterfactual alternative, which is normally provided by a control or comparison group of workers who did not participate in the severance or redeployment program. Counterfactual analysis can use either of the following groups:

- **Control groups**, which consist of participants selected at random from within a well-defined population from which the members of the treatment group are also selected
- **Comparison groups**, which consist of participants that are purposely matched to the participants of the treatment group.

Selecting appropriate evaluation techniques and counterfactuals is particularly important when examining the impact of redeployment programs. Policymakers need to know whether the resources they are spending are being efficiently used and whether programs are having the intended effect. Such analysis also helps make informed decisions on whether to expand, better target, or scale down programs. A range of evaluation techniques is available and module 7 discusses these in detail.

Periodic Monitoring

Monitoring differs from evaluation in that it is principally a management function aimed primarily at keeping track of implementation and making periodic assessments of the performance of the program (see box 1.17).

In potentially large-scale labor restructuring programs involving great numbers of workers and significant financial resources, it is important to monitor the implementation of the program to ensure that funds are being properly used to help workers and that all workers are being helped. At a minimum this requires the development of a system that tracks the numbers of workers leaving the enterprise and expenditures on severance and redeployment at the enterprise level and for the PPI program as a whole.

Periodic assessments or monitoring the performance of the various aspects of the labor program—for example, severance payments and redeployment support—also help policymakers and practitioners learn from experience and undertake midcourse corrections as needed. The potential benefits of such assessments are large: one study in Tanzania found that the information from monitoring studies could have saved government up to US$7 million during the course of retrenchment of around 5,000 state enterprise workers.

Monitoring of redeployment programs can be particularly valuable in that it can help identify weak-

Box 1.17: Monitoring vs. Evaluation

Monitoring is the continuous assessment of program implementation in relation 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 relation to stated goals.

nesses in the implementation of the program (for example, late disbursement of funds, lack of information on redeployment services) and readjust programs to deliver more appropriate training, counseling, and redeployment services to workers.

INTEGRATING LABOR PROGRAMS IN THE PPI PROCESS: A ROAD MAP

This section presents an illustrative road map for integrating the labor program in the broader PPI process. The road map will help the implementing agency put the various tasks and activities of a labor adjustment program within the context and phasing of the overall PPI transaction. The first steps for the implementing agency, however, are to establish a labor unit and to secure funding for the labor program.

There are four main phases involved in developing a labor program for PPI:

- Phase 1: Initial assessment or diagnostic phase
- Phase 2: Design of the labor program
- Phase 3: Implementation of the program
- Phase 4: Monitoring and evaluation activities.

Figure 1.2 presents a road map or overview of the labor adjustment process. It illustrates the integration of labor program planning with the wider PPI process. For example, the initial assessment of the labor issue should follow or take place parallel with a wider assessment of the health of the enterprise and in the context of the overall economic, social, and development objectives sought from enterprise restructuring or PPI.

The main boxes in the road map link to key modules in this Toolkit, and the oval shapes represent specific tasks or tools in the Toolkit.

Editable copy of the road map in Microsoft Power Point format

Phase 1: Initial Assessment

The first phase—initial assessment—is critical because it identifies the nature and scope of the labor program and provides the planning framework for the program as a whole. It includes:

- Clarifying the overall goals and objectives of labor adjustment (see the third section of this module)
- Assessing staff levels, skills, and the extent of overstaffing (module 3)
- Reviewing the external stakeholder environment (module 6), the legal circumstances, and likely costs including those related to severance and to pensions (module 5)
- Beginning the implementation of "soft" options.

In most cases, phase 1 will be an initial assessment of labor issues in PPI; the analysis, however, will continue through phase 2 (design) where detailed strategies and options are refined. In phase 1 there will not only be assessments regarding labor issues, but also assessments of the operational, regulatory, legal, and financial aspects of the PPI transaction more broadly.

The various phase 1 assessments can provide the basic information needed to prepare the initial submissions for decisionmaking by senior ministers or the cabinet. Box 1.18 sets out a generic checklist for such submissions.

Phase 2: Design of the Labor Program

Phase 2 builds on the assessments of phase 1 and allows the implementing agency to make specific proposals to decisionmakers. More specifically, phase 2 involves:

- Developing an overall strategy and restructuring options (module 4) for dealing with labor issues as part of the overall PPI strategy
- Developing concrete pension arrangements, severance packages, and retraining/redeployment programs, as well as financing arrangements (module 5)

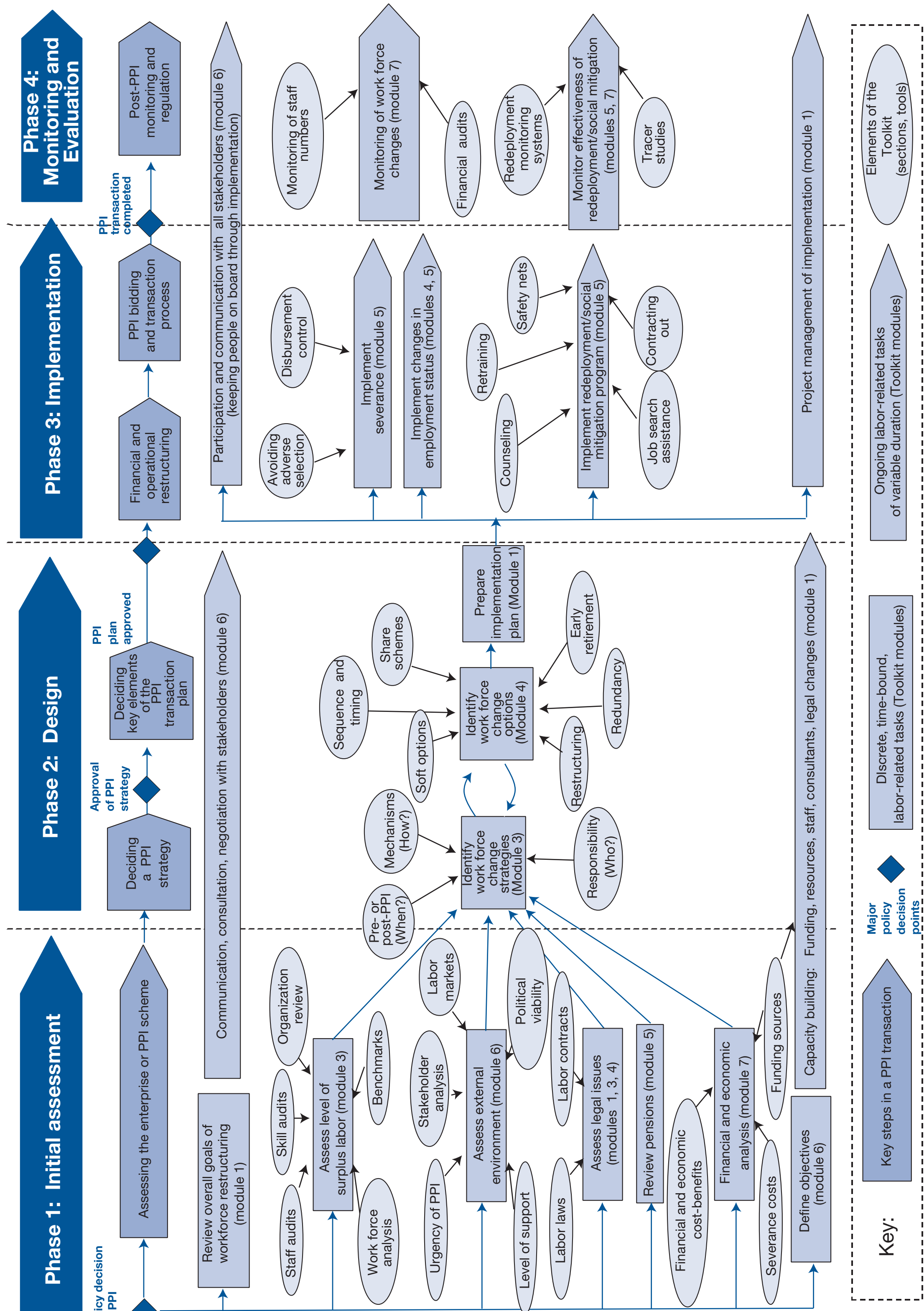

Figure 1.2: Road Map for Labor Adjustment

Box 1.18: Guidelines for Submissions to Decisionmakers

What are the minimum requirements for a paper submitted to the decisionmakers for decision? Although there may be detailed government procedures set out, in principle any proposal for a labor adjustment or work force restructuring program sent to the decisionmakers (be it a committee of senior ministers, the cabinet, or the council of ministers) should fulfill a few simple, straightforward tests:

1. There should be a one-page executive summary for busy ministers.
2. There should an adequate explanation of the objectives of the proposal (so that ministers do not have to try to guess the purpose of the proposal from the details).
3. There should be a range of options presented (typically three or four), including a base case "do-nothing" option where appropriate.
4. The authors should have identified the cost and revenue effects of the options on the government budget.
5. Subject to confidentiality and sensitivity concerns, the authors should have discussed the proposal with other ministries and agencies that will be most affected by, or most instrumental in, successful implementation of the program.
6. There should be some comment on the plans for implementation to demonstrate that these are practical and workable. Implementation risks should be identified.
7. There should be some attempt to identify and comment on the likely effects of each option. If these can be quantified, so much the better, but at least there will be quantitative assessment.

- Obtaining a legal mandate to deal with labor adjustment, including approval of policies to undertake work force restructuring supported by relevant government orders or regulations
- Defining implementation arrangements and developing implementation capacity (see the seventh module)
- Engaging with stakeholders through communication, consultation, negotiation, and cooperation (see module 6)
- Developing broader public information programs to ensure that the government's early messages are communicated (module 6).

The above tasks typically result in the development of an overall plan for dealing with labor restructuring that is similar to the road map in figure 1.2. A manager in the implementing agency might edit the road map in this Toolkit (which is a Microsoft Power Point diagram) and adapt it to his or her local circumstances, or use the Microsoft Project Plan template (see the CD-ROM).

Outline project plan for a labor program in Microsoft Project format.

Phase 3: Implementation

Phase 3 involves implementing the actual labor adjustment program, in particular:

- Implementing restructuring options (module 4) and completing any soft options started during phase 1
- Implementing severance and pension packages (module 5)
- Implementing redeployment programs (module 5)
- Engaging with stakeholders (module 6).

Phase 4: Monitoring and Evaluation

Although important, the final phase of any labor adjustment program—monitoring and evaluation—is often the most neglected aspect. When the difficult and painful task of adjustment is over, many government officials and implementing agency managers wish to move on and overlook this phase.

There are good reasons, however, to take monitoring and evaluation seriously:

Planning of a labor program needs to be integrated with the wider enterprise restructuring program.

- **It demonstrates that the implementing agency is accountable.** Given the very high costs of many labor programs, most implementing agencies will want to be able to show that they have managed the program effectively.
- **It reduces risk.** Effective monitoring allows problems to be recognized early and action taken to deal with those problems.
- **It allows lesson-learning.** Many implementing agencies recognize that they know very little about what really has happened to workers who were displaced. This puts the manager of the implementing agency at a disadvantage, facing questions from his or her boss, the press, or trade unions. It also allows subsequent programs to be implemented much more effectively.

The details of monitoring and evaluation systems are covered in detail in module 7.

Additional Material (on the CD-ROM)

Background and Overview Articles

Betcherman, Gordon. 2002. "An Overview of Labor Markets World-Wide: Key Trends and Major Policy Issues." Social Protection Discussion Paper 0205. World Bank, Washington, D.C.

Fretwell, David. 2002. "Mitigating the Social Impact of Privatization and Enterprise Restructuring." Working Paper. World Bank, Human Development Sector Unit, Europe and Central Asia, Washington, D.C.

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Rama, Martin. 1999. "Public Sector Downsizing: An Introduction." *The World Bank Economic Review* 13(1):1–22.

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PPIAF Case Studies of Labor Issues in PPI

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Cruz, Wilfred. 2001. "Addressing Labor Concerns during Privatization: Lessons from the Metropolitan Waterworks and Sewerage System (MWSS), Manila, Philippines."

López-Calva, Luis. 2001. "Private Participation in Infrastructure and Labor Issues: The Privatization of Mexican Railroads."

Ray, Pranabesh. 2001. "HR Issues in Private Participation in Infrastructure: A Case Study of Orissa Power Reforms."

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Web Sites

PPIAF: www.ppiaf.org. (Site provides access to other PPIAF tool kits, as well as information about PPIAF and about how governments and other agencies can access PPIAF resources to accelerate infrastructure development.)

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.)

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.)

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This toolkit was made possible through financial contributions from the Netherlands Ministry of Foreign Affairs.

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