

**LABOUR LAW AND DEVELOPMENT:**

**CREATING AN ENABLING REGULATORY  
ENVIRONMENT AND ENCOURAGING  
FORMALISATION**

**Paper Submitted for Conference of the  
Regulating for Decent Work Network**

International Labour Organisation  
Geneva, Switzerland  
July 8-10, 2009

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# I INTRODUCTION

What should developing countries do in order to increase their economic growth and speed up the rates at which their citizens converge to the level of material well-being obtained in today's advanced nations? This question has vexed thinkers from diverse fields since the post-war period and consensus has only been reached in a few instances. The late 1980s and 1990s was one period in which there was a high level of consensus regarding what was to be done, coalescing around strategies of market liberalisation and privatisation, involving the winding back of state legal and institutional regulation.<sup>1</sup> However, when the reforms that had been recommended were not successful in producing economic growth and material well-being, some thinkers and prominent development institutions concluded that the original prescriptions needed to be augmented with additional regulatory or institutional reforms. The main focus has been on strengthening property rights and banking and securities regulation. However, labour laws have also come under increasing scrutiny: if trade liberalisation did not produce the expected results, it must be because labour markets were not sufficiently flexible or other institutions required adjustment. This is what Dani Rodrik calls the 'Washington Consensus-Plus' agenda.<sup>2</sup> Influenced by the work of New Institutional economists such as North,<sup>3</sup> the focus has more recently been on 'getting institutions right', to supplement economic structural reform, in order to overcome perverse incentives created by inefficient or corrupt systems of governance.

The 'Washington Consensus-Plus' agenda in some ways marked a major shift for policy makers who adhere to neo-classical economics. Instead of prescribing the rolling back of the state, it effectively re-instates a role for the state and other institutions in regulating the market. The policies are based on a recognition that markets are 'embedded' in institutions and regulatory systems and these systems impact upon the nature of the market: the efficiency with which it functions and the benefits of its outcomes. As Rodrik puts it: "Governance reforms" have become the buzzword for bilateral donors, and multilateral institutions, in much the same way that liberalisation, privatisation and stabilization were the matras of the 1980s".<sup>4</sup> However, the agenda remains largely a 'one-size-fits-all' approach. Despite some notional recognition that institutions are complex, path dependent, and that they interact with local cultures in unforeseen ways, the same prescriptions are made for varying domestic contexts.

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<sup>1</sup> For a list of the policies that were included in the Washington Consensus agenda, see John Williamson's article in which he coined the term: 'What Washington Means by Policy Reform', in J. Williamson, ed., *Latin American Adjustment: How Much Has Happened?* Washington, Institute for International Economics (1990) see also Dani Rodrik, *Growth Strategies*, John F. Kennedy School of Government, Harvard University (2004) at <http://ksghome.harvard.edu/~drodrik/growthstrat10.pdf>

<sup>2</sup> Dani Rodrik, 'Rethinking the Growth Policies in the Developing World, John F. Kennedy School of Government, Harvard University, 2004, at [http://ksghome.harvard.edu/~drodrik/Luca\\_d\\_Agliano\\_Lecture\\_Oct\\_2004.pdf](http://ksghome.harvard.edu/~drodrik/Luca_d_Agliano_Lecture_Oct_2004.pdf)

<sup>3</sup> D North, *Structure and Change in Economic History* (1981).

<sup>4</sup> Dani Rodrik, 'Second-Best Institutions', (2008) author's copy.

The World Bank's annual 'Doing Business' report is an example of this 'Washington Consensus-Plus' agenda.<sup>5</sup> The report rates countries against a range of indices that measure the theoretical 'ease' of doing business under particular legal and institutional models, where 'ease' appears to be assessed according to estimated cost and other 'burdens' associated with compliance with legal and administrative rules and procedures across a range of policy areas. The 'Doing Business' report is not an empirical study, that is, it does not measure the *actual* ease of doing business: entrepreneurs are not interviewed; the outcomes are not compared with growth figures or other possible empirical measures of the capacity to undertake business activity. Instead, the legal institutions are assessed against a number of assumptions concerning the factors that ought to make doing business easy and therefore facilitate the growth of businesses.<sup>6</sup> One of the indices is the ease of 'hiring and firing workers', which appears to be included on the assumption that higher formal labour standards in the organised sector lead to an increase in informal employment, and therefore lower growth. It is this aspect of the agenda that is both of greatest interest and concern to us as labour lawyers.

The universal prescription made in the 'Doing Business' report, is that labour regulation be reduced as to make hiring and firing easier. It has for some time been argued that this constitutes the imposition of American law and legal institutions on developing countries.<sup>7</sup> A convincing argument could be made against this 'one size fits all' approach by pointing to the empirical flaws in the World Bank's assessment of modes of public governance or regulation and their influence on development.<sup>8</sup> This is not our purpose here. The primary aim of this paper is to provide a range of contemporary theoretical frameworks for thinking about labour regulation in developing countries which suffer from significant informal economies. By drawing upon ideas from the fields of development studies, comparative law and regulatory theory, we offer some approaches which we hope will act as constructive alternative to the 'Washington Consensus-Plus' formula of institutional and regulatory reform in contexts in which there is wide-spread non-compliance with labour and other laws.

In the first part of this paper we address some basic concepts and issues, review literature from the area of 'New Institutional Economics' and 'comparative law' and examine some of the problems with the key assumptions underlying the 'Washington Consensus-Plus' agenda. This body of theoretical work suggests that laws and legal institutions, or particular approaches to the operation of laws and institutions, cannot simply be 'transplanted' from other judicial and cultural settings. On the contrary: States must adopt regulatory approaches that are suited to their particular developmental, cultural, political and institutional environment. In part two of the paper we ask whether labour regulation is inconsistent with development aims.

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<sup>5</sup> World Bank, *Doing Business in 2006: Creating Jobs*, Washington (2006).

<sup>6</sup> Davis and Kruse describes the process in: K. E. Davis and Michael B. Kruse, 'Taking the Measure of the Law: The Case for the Doing Business Project' (2007) 32(4) *Law and Social Enquiry*.

<sup>7</sup> Thomas M. Franck, 'The New Development: Can American Law and Legal Institutions help Developing Countries?', (1972) 12 *Wisconsin Law Review* 767. For methodological criticisms see: Benito Arrunada, 'Pitfalls to Avoid When Measuring Institutions: Is 'Doing Business' Damaging Business?' (2007) 35(4) *Journal of Comparative Economics* 729-747

<sup>8</sup> Janine Berg and Sandrine Cazes, 'Policymaking Gone Awry: The Labor Market Regulations of the Doing Business Indicators' (2008) 29(4) *Comparative Labor Law and Policy Journal*.

We draw on development theory to argue that labour regulation is in fact a key element of successful development strategies. The challenge for developing nations is to be able to design and implement labour regulation that is both effective in improving labour standards *and* which helps foster formalisation of the informal economy, assisting economic growth. In the final part, we suggest that regulatory theory, and in particular, a version of the concept of ‘responsive regulation’ developed by Ayres and Braithwaite,<sup>9</sup> provides a rich source of ideas for achieving policy goals in innovative ways [which take account of the insights of comparative law and development theory]. This is especially relevant to states that lack the resources to effectively implement more conventional ‘command and control’-style regulation.

## A. Key Concepts for Understanding the World Bank’s Approach

Before proceeding to our argument, we outline the key concepts that we make use of throughout the paper, including ‘labour regulation’, ‘labour law’ and the ‘informal economy’. We also provide a brief synopsis of the approach to labour regulation which is found in various World Bank policy documents, keeping in mind that the approaches espoused by the World Bank are by no means uniform.

The logic of World Bank’s ‘Doing Business’ report is underpinned by the assumption that labour regulation is hierarchical command and control regulation. Notwithstanding acceptance that institutions matter, the World Bank report very much suggests that ‘deregulation’, or the removal of legal restrictions on hiring and firing, will make it easier to do business. This paper avoids the simplistic debate about regulation versus deregulation by accepting that all markets require regulation.<sup>10</sup> Moreover, our definition of labour regulation is much broader than a model of legal rules enforced by state agencies. For the purposes of this study, ‘regulation’ includes, *but is not limited to*, the use of legal rules and sanctions as a mechanism for setting and enforcing behavioural norms. In other words, ‘regulation’ is not just about setting rules – although this remains essential – it is more broadly about how best to bring about changes in behaviour. And this might, of course, include inducing changes to comply with legal rules such as labour laws, or other means of achieving the policy goals of those laws.

As labour lawyers, we highlighted the World Bank’s focus on legal regulation of hiring and firing. However, labour law is a much broader field of study and of regulation than this suggests. This paper conceives of ‘labour law’ or ‘labour-related laws’ as any State recognised labour rights and standards that reflect the general goal of improving the quality of working life, and the relative bargaining power of people who are dependent upon their labour for a living.<sup>11</sup>

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<sup>9</sup> Ayres and Braithwaite, others?

<sup>10</sup> J Howe, “‘Deregulation’ of Labour Relations in Australia: Toward Command and Control” (Working Paper No 34, Centre for Employment and Labour Relations Law, University of Melbourne, 2005).

<sup>11</sup> C Arup et al, ‘Employment Protection and Employment Promotion: The Contested Terrain of Australian Labour Law’ in M Biagi (ed) *Job Creation and Labour Law: From Protection Towards Pro-Action* (2000) 99.

The informal economy is one where workers and enterprises are ‘not recognised or protected by legal and regulatory frameworks.’<sup>12</sup> The concept of the informal economy (often also referred to as the ‘informal sector’<sup>13</sup>) has been used to describe a startlingly heterogeneous array of forms of work and of work organisation:

they include own-account workers in survival-type activities, such as street vendors, shoeshiners, garbage collectors and scrap- and rag-pickers; paid domestic workers employed by households; homeworkers and workers in sweatshops who are “disguised wage workers” in production chains; and the self-employed in micro-enterprises operation on their own or with contributing family workers or sometimes apprentices/employees.<sup>14</sup>

The term ‘informal economy’ has the advantage of including also informal employment relations in formal enterprises.<sup>15</sup> Thus it helps to develop a focus on the nature and quality of the work relationship, rather than on the status of any enterprise for which a person works. In general, though, informal economies are comprised of small and micro-enterprises (MSEs), or to put it another way, small and micro-enterprises are more likely not to comply with laws, and not to have laws enforced upon them, compared with larger enterprises.

While for a time it may have been thought that the informal economy would diminish in significance, this has not proved to be so: the informal economy has been the main source of employment growth in recent years, particularly in developing and transition economies.<sup>16</sup> Of 42 developing countries for which information is available, 17 had more than half of their total employment in the informal economy.<sup>17</sup> As estimates, the ILO has put forth these shares of non-agricultural employment that are in the informal economy: 48% in North Africa, 51% in Latin America, 65% in Asia and 72% in Sub-Saharan Africa.<sup>18</sup> In countries that include informal employment in agriculture, these percentages become even higher: a composite figure for India is 93% of total employment working in informality. Today MSEs often represent a majority of all enterprises (both in developed and developing economies) and between them employ, or have the potential to employ a significant proportion of the world’s workers: one International Labour Organisation study across seven countries found that MSEs accounted for 97.5 to 99.7 percent of all enterprises.<sup>19</sup> Indeed, the informal economy and the small and micro enterprises within it often provide the most dynamic opportunities for workers to engage in productive activity: among other things the informal economy is often the place in which workers are absorbed when

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<sup>12</sup> ILO, *Decent Work and the Informal Economy*, above n 1, 3.

<sup>13</sup> The term ‘informal economy’ has the advantage of including also informal employment relations in formal enterprises: Gerhard Reinecke and Simon White, *Policies for Small Enterprises: Creating the Right Environment for Good Jobs* (IFP/SEED, ILO, Geneva, 2004) 52. Thus it helps to develop a focus on the nature and quality of the work relationship, rather than on the status of any enterprise for which a person works.

<sup>14</sup> Ibid.

<sup>15</sup> Gerhard Reinecke and Simon White, *Policies for Small Enterprises: Creating the Right Environment for Good Jobs* (IFP/SEED, ILO, Geneva, 2004) 52.

<sup>16</sup> ILO, *Decent Work and the Informal Economy* (2002) 1.

<sup>17</sup> John Langmore, *International Strategy for Decent Work*, International Labour Office (2003)

<sup>18</sup> ILO: *Women and Men in the Informal Economy: A Statistical Picture*, Geneva, ILO, 2002.

<sup>19</sup> Ibid 19.

they are forced out of formal economy work, as for example through privatisation of state-owned enterprises.<sup>20</sup>

Previous research suggests that job quality within the informal economy and the micro and small enterprises that constitute it are often far lower than the formal sector.<sup>21</sup> In sum, incomes are generally much lower in the informal economy than the formal economy, and informal economy workers generally receive no health benefits, no work-related child care, no sick leave and no pensions. If treated unfairly by employers, they have no recourse to the courts, because the employment relationship is rarely documented.<sup>22</sup> It is a tautology to say that non-compliance with laws – including labour laws – in the informal economy is endemic.<sup>23</sup> However, the concepts of the ‘formal economy’ and the ‘informal economy’ are not simple opposites. Enterprises are usually found somewhere on a continuum of compliance: they are formal in some respects, but not in others. This reflects the limited and contingent state of business development of many micro and small enterprises in developing economies, which is in large measure a result of frequent and rapid fluctuations in demand in the markets in which they operate.<sup>24</sup> Evidence suggests that entrepreneurs make strategic choices about which laws they will and will not comply with, and thus the level of formality of the enterprise.<sup>25</sup>

Informing the World Bank approach is the view that the key to economic development is converting the ‘informal’ into the ‘formal’. Thus far, our views do not depart. Where we depart is with regards to the causes of informality and thus recipes for converting the informal to the formal, at the same time as increasing job quality and labour standards. For the authors of the ‘Doing Business’ report, labour laws are seen as a major cause of informality. Two key reasons are espoused for the increase in informal employment. The first is that arduous labour laws increase labour market rigidity, thus reducing the creation of new jobs or the absorption of non-standard workers (women and youth) into formal employment. The ‘Doing Business’ report explains that ‘[w]ith rigid regulation, common in developing countries, employers choose conservatively’.<sup>26</sup> This argument has been made repeatedly by the World Bank. For example, an influential 1995 report entitled *Labor and Economic Reforms in Latin America and the Caribbean* argued that the large proportion of workers in the informal economy in Latin America was attributable to ‘labor policies that overlooked the role of wages and working conditions as incentives and market signals, reducing the number of formal jobs and encouraging the development of the informal sector’.<sup>27</sup> The other is that onerous labour laws simply create incentives for law evasion (or informality). This analysis of the causes of informality has at times resulted in the universal prescription of lowering the labour standards found in labour laws,<sup>28</sup> and at

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<sup>20</sup> Reinecke and White report that ‘policies of economic liberalization caused an increase of the MSE share in non-agricultural employment’: Ibid 22.

<sup>21</sup> ILO, *Decent Employment through Small Enterprises: A Progress Report on SEED activities* (IFP/SEED, ILO, 2004) 17.

<sup>22</sup> These conditions are further outlined in the next section of the paper.

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<sup>24</sup> Reinecke and White, above n 4, 18.

<sup>25</sup> C Maldonado, ‘The Informal Sector: Legalization or Laissez-Faire?’ (1995) 134 *International Labour Review* 705, 727.

<sup>26</sup> At 21.

<sup>27</sup> World Bank, *Labor and Economic Reforms in Latin America and the Caribbean* (1995) 6.

<sup>28</sup> This prescription is found in the ‘Doing Business’ report.

other times resulted in the prescription that small enterprises be exempted from the application of labour laws.<sup>29</sup>

It is our view that the reasons for informality, and thus the preferred regulatory prescriptions, are more complex than this. We have elsewhere found that there is already, in many countries, selective formal application of labour laws to small and micro-enterprises.<sup>30</sup> Yet, even where labour laws formally apply to small and micro-enterprises, they are very rarely enforced. Thus, it is difficult to find empirical evidence to support the proposition that burdensome labour laws are a *cause* of informality. (Conversely, it is difficult to find evidence that selective formal application, or the exclusion of small enterprises from labour laws, has resulted in increased formality on behalf of enterprises.)

The reasons for the surprising growth in the informal economy must thus be found elsewhere. There is evidence to show that informal economies grew following financial crises (and are therefore likely to grow again in response to the present crisis).<sup>31</sup> Financial crises in the 1980s and 1990s caused average GDP falls of 5% to 12% in the first year, and negative or only slightly positive growth for several years thereafter.<sup>32</sup> For countries that had triple crises, such as Argentina, the costs were extremely high. This drop in GDP both reflected and resulted in a reduction of formal employment. The human, social and economic cost of these crises has been enormous, with the loss of employment and the increase in poverty and inequality lasting long after the financial effects have eased.<sup>33</sup> Informal employment also grew after the implementation of structural reform packages, which both preceded and followed financial crises.<sup>34</sup> These packages involved (amongst other policies) the dismantling of publicly owned corporations, which were major employers in many countries, forming part of employment generation strategies. People who found themselves unemployed due to structural reform turned en masse to informal employment for survival. Informal economies have grown most in countries that

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<sup>29</sup> Find reference for the second prescription.

<sup>30</sup> Fenwick, C, Howe, J, Marshall, S, and Landau, I, *Labour and Labour Related Laws in Small and Micro Enterprises: Innovative Regulatory Responses*, SEED Working Paper 81, International Labour Organisation, Geneva, 2008, 159 pp.

<sup>31</sup> These included the Japanese crash in 1990, from which Japan has been unable to recover for well over a decade; the Scandinavian crash of 1991-2; the Mexican crisis of 1994-5; the Asian crisis of 1997-99; the Russian Crisis of 1998; the Brazilian crisis of 1999: Wade, R., (1999) "Out of the box: rethinking the governance of international financial markets", *Journal of Human Development*, vol.1., no.1, UNDP, [author's copy], p.3.

<sup>32</sup> For example, following the Thai financial crisis the exchange rate fell 33% between June 1997 and the end of 1998; GDP fell about 10% in 1998; imports (in US dollars) fell 34%, exports (in US dollars) fell 7%: R Wade, (2001) "The US role in the long Asian crisis of 1990 – 2000", in *The East Asian Crisis and its Aftermath*, (eds.) Revera, F., and Lukauskas, A Edward Elgar, 2001, p.195-200.

<sup>33</sup> Eddie Lee and Marco Vivarelli, *Understanding Globalization, Employment and Poverty Reduction* (International Labour Organisation, Geneva, 2003). See also: John Langmore, *International Strategy for Decent Work*, International Labour Office (2003)

<sup>34</sup> Labour economists disagree about the impact of reforms such as reduction of tariff and non-tariff protections. A study by Goldberg and Pavcnik indicates that the impact of trade protection on informal employment depends on other factors, such as labour market flexibility, however, the introduction of greater flexibility through labour law deregulation only impacts positively on employment where there were previously very high levels of rigidity: Pinelopi Goldberg and Nina Pavcnik, *The Response of the Informal Sector to Trade Liberalization*, National Bureau of Economic Research (2003) < [www.nber.org/papers/w9443](http://www.nber.org/papers/w9443) >

experienced financial crisis in which social security was underdeveloped, as people sought any means for survival.<sup>35</sup> Importantly also, for our purposes, the structural reform packages that preceded financial crises generally involved labour market deregulation. This drastically reduced the protections available to those who were extruded from the highly organised sectors of the labour market due to privatisation and following financial shocks.<sup>36</sup> We can see, therefore, that labour market deregulation has frequently been associated with growth in informal economies.

We can conclude that the reasons for informality are complex. Entrepreneurs are driven by a range of other factors in their decision to comply with or disregard laws. For instance, studies of entrepreneurs in Vietnam and China conducted by Gillespie indicate that they are also influenced by the norms of the trading networks they are embedded within.<sup>37</sup> This insight, and others drawn from the comparative law field which are surveyed later in the next section of this paper, imply that regulatory approaches need to be designed so as to both suit the local environment and create incentives for formalisation. Work by Reinecke and White suggests that entrepreneurs make strategic choices about regulatory benefit or cost.<sup>38</sup> This shows that they react to the policy choices implemented by governments in the design of the regulatory environment for MSEs and the informal economy. This is significant because it suggests that MSEs and the entrepreneurs that own and manage them are likely to be responsive to carefully constructed policy approaches. As we have foreshadowed, a key part of our argument will be that States should design their regulatory approaches with this sort of responsiveness in mind. This necessitates moving beyond the debate between regulation and deregulation, and instead points towards thinking carefully about ways in which regulation can be designed so as to generate incentives for compliance and to foster job quality, productivity and income generation.

## B. How do informal economies impede labour market development?

There are a variety of reasons why informal economies impede development, broadly defined. Here, we focus on the ways they hinder *labour market* development. There is a broad consensus that enterprises in informal economies generally offer workers employment conditions which are lower than those found in the formal economy, and thus inhibit the quality of life of the individuals working in informality. Informal economies are generally constituted by small and micro enterprises. Empirical evidence suggests that average incomes in the MSE sector are lower than in larger enterprises.<sup>39</sup> In industrialised countries, average income levels in MSEs tend to be

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<sup>35</sup> Julius Court and Giovanni A. Cornia, *Inequality, growth, and poverty in an era of liberalization and globalization* (Oxford University Press, Oxford, 2004).

<sup>36</sup> *Ibid.*

<sup>37</sup> John Gillespie, Departmental Seminar, Monash University, October 7, 2008. See also J. Gillespie, "Localizing Global Rules: Public Participation in Lawmaking in Vietnam" (2008) 33 *Law & Social Inquiry* 673–707, J. Gillespie, "Developing a Typology for Commercial Regulation in Socialist Transforming Asia" (2009) Forthcoming *Law and Society Review*. In the field of behavioural economics, Levinson and Peng have found that cultural differences impact upon economic decision-making: Justin D. Levinson and Kaiping Peng, 'Valuing Cultural Differences in Behavioral Economics' (2007) 4 *ICFAI Journal of Behavioral Finance* 32-47.

<sup>38</sup> Reinecke and White (2004) 53.

<sup>39</sup> Reinecke and White (2004) 34.



lower than in larger enterprises.<sup>40</sup> While evidence for industrialising countries is more limited, existing surveys suggest that incomes also tend to increase with firm size.<sup>41</sup> For example, in Chile, a 1998 national industry survey found that small enterprise workers earn approximately 50 percent of the income of those in large enterprises.<sup>42</sup> Working hours in MSEs tend to be longer than in larger enterprises. Studies in China, Vietnam, Nepal, Thailand, and the Philippines suggests that workers in MSEs work well beyond the statutory maximum and are often required to work overtime with little notice and often without compensation.<sup>43</sup>

Most forced labour likely occurs in informal economies. Often however children are engaged in forms of work that are linked to the formal economy, including agriculture, mining, fishing and manufacturing.<sup>44</sup> There is a significant likelihood that child labour will be found in MSEs as much child labour is performed in household enterprises that use unpaid family labour. Instability and insecurity are pervasive in the informal economy, by its very nature.<sup>45</sup> High labour turnover in enterprises may operate as a disincentive for training and investment and thus further inhibit the economic and social development of both the enterprise and the individual worker.<sup>46</sup> Most informal economy workers lack any form of social protection, which includes mechanisms for health, life, disability and unemployment insurance, as well as pension schemes, childcare and maternity leave.<sup>47</sup> In Latin America, it has been estimated that only 28.1 percent of workers in micro enterprises (1 to 5 workers) make social security contributions,<sup>48</sup> and in Vietnam, that 83.7 percent of MSEs do not pay social security contributions.<sup>49</sup> Workers in the informal economy are more frequently exposed to workplace hazards and suffer more work-related injuries and illnesses than employees in larger workplaces.<sup>50</sup> Compliance with occupational health and safety regulations in MSEs is very limited.<sup>51</sup> In Ghana, an ILO study has

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<sup>40</sup> 'Job Quality and Small Enterprise Development' (1999) 4.

<sup>41</sup> Ibid.

<sup>42</sup> Figure cited in Flores (2003) 2.

<sup>43</sup> See, eg, Cooke, 'Employment Relations in Small Commercial Businesses in China' (2005) 27–29; X Zheng, L Lu and S U Idris, 'Working Time in Transition: The Dual Task of Standardization and Flexibilization in China' (Conditions of Work and Employment Series No. 11, School of Labor and Human Resources, Renmin University of China, ILO, 2005) 4; Pham Thi Thu Hang, 'Creating a Conducive Policy Environment for Employment Creation in Small Enterprises in Vietnam' (IFP/SEED Working Paper No. 31, Series on Conducive Policy Environment for Small Enterprise Employment, ILO, 2002) 33–4; I Noerlund, 'The Labour Market in Vietnam: Between State Incorporation and Autonomy' in J Dragsbaek Schmidt, J Hersch and N Fold, *Social Change in Southeast Asia* (1998) 155, 166–8; Chapagain (2001) 22–3; Brown, Thonachaisetavut and Hewison (2002) 17; and finally, for the Philippines, see F Bacungan and R Ofreneo, 'The Development of Labour Law and Labour Market Policy in the Philippines' in S Cooney et al (eds) *Law and Labour Market Regulation in East Asia* (2002) 110–1.

<sup>44</sup> Ibid 22–23.

<sup>45</sup> 'Job Quality and Small Enterprise Development' (1999) 4.

<sup>46</sup> See, eg, 'Job Quality and Small Enterprise Development' (1999) 2.

<sup>47</sup> 'Job Quality and Small Enterprise Development' (1999) 1–2.

<sup>48</sup> This should be contrasted to 79.3 percent of workers in private enterprises with 6 or more workers and the public sector. Cited in Reinecke (2005) 8.

<sup>49</sup> Vietnam Chamber of Commerce and Industry, 'Survey on Micro and Small Enterprises in Viet Nam' (Survey Report, IFP/SEED unpublished background paper, 2001) as cited in Pham (2002) 32.

<sup>50</sup> Lamm and Walters (2004) 94; Reinecke and White (2004) 34.

<sup>51</sup> See, eg, A Scott, 'Occupational Health and Safety in SMEs' (1998) *Small Enterprise Development* 14.

found that workers in MSEs often work in unsafe and unhealthy work environments.<sup>52</sup>

Collective bargaining is very limited in informal economies.<sup>53</sup> Generally, the smaller an enterprise, the less likely it is to be covered by a collective agreement.<sup>54</sup> The absence of collective agreements in the MSE sector is particularly acute in countries in which enterprise unionism is dominant, including most Latin American nations.<sup>55</sup> Union density in informal economies is also generally very low. In Argentina, trade union density in enterprises with up to five workers in 2001 was only 13 percent (compared to 49 percent for salaried workers in enterprises with six or more employees).<sup>56</sup> An exception to low union density in the MSE sector is Denmark, where 87 percent of workers in firms with 1 to 10 employees were unionised in 1994.<sup>57</sup>

Around three-quarters of informal workers are women.<sup>58</sup> Studies carried out in Zimbabwe in the early 1990s, for example, found that 97 per cent of all enterprises were micro-enterprises (being those with 5 or fewer employees) and that of these, 67 per cent were run by women.<sup>59</sup> Similarly, in Taiwan a 1998 study found that SMEs employed more than 50 per cent of the labour force, and a 1992 study found that more than two thirds of the workers in these firms were women. (That study also found that over 75 per cent of these women did not receive a wage.)<sup>60</sup>

As a consequence of recognition of the generally poor working conditions experienced in the informal economy there is widespread agreement that it is desirable to reduce the size of informal economies, and increase the incentives for entrepreneurs to adhere to regulations rather than avoiding them. Whilst retreating to informality has often been the only means of survival for many people following the transition from state socialism to capitalism and also the financial crises which occurred throughout the 1980s and 1990s in developing countries, in the long term, opportunities for economic growth and improvements in material well-being for all citizens are limited by the presence of an informal economy. However, there are vastly different understandings of the way in which the informal economy impacts upon the labour market, and relatedly, the best way to reduce the size of informal economies. Is informality a consequence of the rigidity of the labour market due to unduly high formal labour standards, or does the presence of an informal economy contribute to greater rigidity of the labour market? In this section of the paper we outline our views regarding these questions from the perspective of development economics.

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<sup>52</sup> P Morton, 'Job Quality in Micro and Small Enterprises in Ghana: Field Research Results' (IFP/SEED Working Paper No. 68, ILO, Geneva, 2004) vii.

<sup>53</sup> Biagi (1995) 456.

<sup>54</sup> Ibid.

<sup>55</sup> Ibid.

<sup>56</sup> Reinecke (2005) 10.

<sup>57</sup> QUIT (Grup d'Estudis Sociològics Sobre la Vida Quotidiana i el Treball) and IRES (Institut de Recherches Economique et Sociales), *Industrial Relations in SMEs* (1999).

<sup>58</sup> Reinecke and White (2004) 5. More recent figures were difficult to find.

<sup>59</sup> L Mayoux, 'Jobs, Gender and Small Enterprises: Getting the Policy Environment Right' (SEED Working Paper No. 15, ILO, 2001) 44.

<sup>60</sup> Wang and Cooney (2002) 197.

Economists largely agree that industrial upgrading is one of the keys to development.<sup>61</sup> Industrial upgrading is the process of improving the processes and technologies used in production. It involves organisational learning and capital investment to improve the position of firms or nations in international trade networks.<sup>62</sup> Economic development through industrial upgrading entails shifting 'resources away from diminishing return activities and towards increasing return activities'.<sup>63</sup> Increasing return activities are closely associated with higher levels of real incomes in a 'virtuous cycle'. The opposite is also true: diminishing return activities are associated with a 'vicious cycle' of lower incomes.<sup>64</sup>

What role does the labour market play in promoting either 'virtuous' or 'vicious' cycles when an informal economy exists in a national economy? Post-war development economists, such as W. Arthur Lewis, stressed the role of underutilisation of human labour, or 'underemployment' in underdevelopment.<sup>65</sup> Put simply, a state of low-level equilibrium can prevail when two economies exist side by side. Lewis was concerned with the effects of the non-wage-based agricultural sector, but informal economies may have a similar effect to that which he described. According to Lewis, in a dual economy, when the more productive capitalist sector offers additional employment, the number willing to work at the existing wages is greater than demand. The less productive sector provides a pool of labour which is virtually 'unlimited'. Lewis argued that this distorted wages, leading to low paying wages in the capitalist economy.<sup>66</sup>

The porous relationship between informal economies and formal economies has a number of consequences for development. One of the results of low family incomes, produced by underemployment and the evasion (or irrelevance) of wage standards in the informal economy, is that children are forced to work. Child labour, which continues to be a major concern in informal economies around the world, is a major barrier to participation in education. Hidden employment in the informal economy also reduces access to vocational training and further specialisation or advancement of skills. Even when vocational training is made available via vocational training institutions, access to it is virtually impossible because of the precarious nature of work in the informal economy, and by the typically long working hours. Workers simply don't have the resources or the time to attend training. The failure of workers or enterprises to pay taxes also reduces the capacity of the state to provide education. Limited access to education in turn contributes to rigidity in a labour market. Without a broad-based education, individuals are ill equipped to deal with changes demanded of the labour market by the natural process of technological attrition or 'schumpertian shocks'.

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61 Sanjaya Lall, 'The Employment Impact of Globalization in Developing Countries' in E Lee and M Vivarelli (eds), *Understanding Globalization, Employment and Poverty Reduction* (Palgrave Macmillan, Basingstoke and New York, 2004). Lall argues that upgrading is hindered by market failures such as financial instability.

62 G. Gereffi, 'International Trade and Industrial Upgrading in the Apparel Commodity Chain' (1999) 48 *Journal of International Economics* 37, 39.

63 R H Wade, 'On the causes of increasing world poverty and inequality, or why the matthew effect prevails' (2004) 9 *New Political Economy* 172.

64 Ibid.

65 For a good recent interpretation of Lewis's work, see K. Basu, *Analytical Development Economics: The Less Developed Economy Revisited*, MIT Press, Cambridge, Mass., 1997.

66 W. Arthur Lewis, *The Theory of Economic Growth* (Allen and Unwin, London, 1955).

One of the reasons that enterprises in informal economies find it difficult to participate in industrial upgrading is because they have limited access to capital. Their informality inhibits access to formalised credit from banks or other credit institutions. Much of the focus of development policy in recent years has thus been on increasing access to micro-credit and on strengthening property rights. A further, and equally important problem, however, is a consequence of the lack of access to skilled labour for entrepreneurs in both the formal and informal economies. Reducing overheads and labour costs are two means often promoted as ways to help develop greater efficiency. This, however, can only contribute to increases in efficiency to a limited extent, and generally only in low skill and low capital base production.<sup>67</sup> There is a high risk, as Wade put it, of low skill and low capital base production generating diminishing returns. This is because productive activities that are characterised by low skill and low capital base production are those for which entry is easiest. They are typical ‘start up’ industries. Clothing manufacture is a good example of such an industry. The ease of entry promotes overcrowding, creating a risk that more producers enter than there is demand for. Competition produced by large numbers of players is generally on price, since low skill and capital base goods are difficult to differentiate on other bases. This reduces the rate of profits. In contrast, high skill and capital base goods are generally subject to less competition, because entry is harder. For this and other reasons, they are thus higher value added products. Yet, in order for enterprises to undertake industrial upgrading, they must have access to skilled labour.

There is a related risk that the presence of a virtually unlimited pool of low wage labour can act as a disincentive to innovation or industrial upgrading. In conditions of underemployment, particularly where wages are not regulated either in formal or effective terms, wage rates are only weakly linked to the comparative skill level and productivity of workers.<sup>68</sup> This persistence of undervalued labour opens up the possibility of ‘predatory’ strategies by firms. Their profits can be based primarily upon efficiencies gained from low wage employees, instead of turning to other sources of efficiency. By being in a position to increase the degree of devaluation of the workers they employ, firms can avoid employing the techniques of industrial upgrading such as the restructuring of production, managerial reorganisation and the replacing of obsolete equipment. The incentive to develop the skills of workers is also reduced further hampering efficiency. Statistical analysis of the clothing and engineering industries in Sri Lanka, to cite just one example, showed that the skill and education levels of workers and entrepreneurs were positively related to the rate of technical change of the firm.<sup>69</sup> Underemployment and the prevalence of low wages contribute to a vicious cycle of underdevelopment, not only for the individuals whose labour is undervalued regardless of their efficiency, but also for the wider economy.

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<sup>67</sup> OECD, ‘Promoting Entrepreneurship and Innovative SMEs in a Global Economy: Towards a More Responsible and Inclusive Globalisation’ (Report of the Second OECD Conference of Ministers Responsible for Small and Medium Sized Enterprises (SMEs), Istanbul, Turkey, 3-5 June 2005) 6.

<sup>68</sup> C Craig, J Rubery, R Tarling, and F Wilkinson, ‘Economic, social and political factors in the operation of the labour market’, in B. Roberts, R. Finnegan and D. Gallie (eds), *New Approaches to Economic Life*, Manchester, University of Manchester Press [year?].

<sup>69</sup> S Deraniyagala, *Technical Change and Efficiency in Sri Lanka’s Manufacturing Industry* (Ph D Dissertation, Oxford University, 1995) cited in G. Ranis, ‘Human Development and Economic Growth’ (Centre Discussion Paper No.887, Economic Growth Centre, Yale University, May 2004).

Low wages generate low aggregate demand, stifling local demand for new industrial products, and thus further undermining the extent to which the local economy is integrated or interlinked.<sup>70</sup> Development depends in large part on fostering of ‘economically nutritious’ activities: that is, those that develop both forward and backward linkages into the local economy. Complex manufacturing activities, for example, are nutritious because enterprises do not develop capabilities in isolation. Rather, they operate (depending on the industry) in a dense network of formal and informal relationships with suppliers, customers, competitors, consultants, and technology research and educational institutions. These networks take the form of complex, long-lasting contractual and non-contractual relations. These linkages help firms to deal with each other, to gain access to expensive information and facilities, and to create information, skills and standards that all firms need but no individual firm will generate on its own.<sup>71</sup>

It is our view that informality increases the rigidity of the labour market. In the long term, development strategies must involve the integration of the economy, involving a shift to formality for enterprises, and industrial upgrading. This necessitates the fostering of high skilled and better-paid workers through the provision of and access to education and social services. The regulation of wages and other labour standards is an integral part of this strategy. However, as a consequence of the specific legal traditions and norms in developing economies and the challenges created by under-developed formal governance systems it is our contention that there is no single solution to labour regulation in less developed economies, particularly where informal economies are present.

## 2. THE ARGUMENT FOR CONTEXT-SPECIFIC LABOUR REGULATION

The new focus on regulatory systems, institutions and good governance by policy makers, found in the ‘Washington-Consensus-Plus’ policy recipe, has been influenced by work conducted under the auspices of New Institutional Economics, as seen in the work of Douglass North.<sup>72</sup> Whilst the World Bank’s *Doing Business* report thus represents an explicit recognition that ‘institutions matter’ (a point which was previously only implicit or, worse, ignored) it presents a hierarchy of institutions. At the same time as labour laws are to be reduced, other laws, such as property laws and securities regulation, are to be strengthened. It is our contention, however, that labour regulation is a more important institution in fostering development than is often assumed, because of its redistributive functions. A study conducted by Bardhan resulted in the conclusion that the ‘history of underdevelopment suggests that a major stumbling block to beneficial institutional change in many poor countries lies in the

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<sup>70</sup> Bob Sutcliffe, ‘100 Ways of Seeing an Unequal World (2002)

<<http://www.geocities.com/bobsutcl/>> at 15 August 2005.

<sup>71</sup> S Lall, ‘Imperfect Markets and Fallible Governments: The Role of the State in Industrial Development’, in Deepak Nayyar (ed) *Trade & Industrialisation* (1997) 43, 49.

<sup>72</sup> See, for example, D North, *Structure and Change in Economic History* (1981); D. North, ‘The New Institutional Economics and Third World Development’ in J Harriss, J Hunter and C Lewis (eds) *New Institutional Economics and Third World Development* (1995) 17.

distributive conflicts and asymmetries in bargaining power among social groups'.<sup>73</sup> A key insight of institutional economists is that institutions help to overcome collective action problems. However, institutions will not serve this purpose where institutions and regulators are distrusted, perceived to be predatory or believed only to operate in the interests of outsiders or elite groups in society. Labour regulation may thus be an important complimentary institution to other institutions which promote efficient markets by promoting greater equality and social cohesion and individual and collective freedoms.<sup>74</sup>

Beyond the individual protections provided by labour regulation, such as minimum wages, labour laws can also provide the basis for the enjoyment of collective freedom and social conversion.<sup>75</sup> The fostering of freedom of association and the political and technical roles of trade unions, employers' associations and tripartite institutions all contribute to the enjoyment of freedoms and increased social capital.<sup>76</sup> Participation in the institutions of industrial and also assist in the development of democratic skills which can be applied in other institutions. Social norms, legal rules and politico-legal institutions play a vital role in either extending, or diminishing, individual capability sets. On this basis, labour regulation plays an important role in constituting the market and determining the nature of individual's social exchanges. However, the complementarity *between* institutions is under-explored either in the institutional literature or in its adoption by the World Bank.<sup>77</sup> The Washington Consensus-Plus approach instead presumes the primary role of institutional arrangements is to minimise transactions costs in the immediate domain – without concern for potential interactions within institutional features elsewhere in the system.<sup>78</sup>

In any case, there are serious limitations to attempts at producing universal theories of efficient institutions in the face of the sheer complexity of society and the historical variation between different 'societies'.<sup>79</sup> It is simply difficult to predict what will happen when an institution is transplanted from one setting into another. In many countries, if conducted, the prescriptions made in the *Doing Business* report would entail highly significant changes to local regulatory systems so that they more closely resemble Northern American institutions. But how can it be foreseen whether regulatory reform will be successful? There is a significant body of literature debating regarding whether legal concepts and legal institutions be 'borrowed' from one environment and 'transplanted' into another, and if so, what may be the outcome in the field of comparative law. In comparative law in general, and in comparative labour law in particular, close attention is paid to the way in which changes to laws

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<sup>73</sup> Bardhan (2005) 521.

<sup>74</sup> Amartya Sen, *Development as Freedom* (1999), 75

<sup>75</sup> Simon Deakin and Frank Wilkinson, *The Law of the Labour Market: Industrialisation, Employment and Legal Evolution*, Oxford University Press, Oxford, at 277

<sup>76</sup> R Tipples, 'The Human Capability Framework – An Important and Useful Framework for Understanding the Labour Market' (2004) 29 *New Zealand Journal of Employment Relations*, 3, 57.

<sup>77</sup> For literature which explores this point see: Robert Boyer and J. Rogers Hollingsworth, 'The Variety of Institutional Arrangements and their Complementarity in Modern Economics' in J Rogers Hollingsworth and R Boyer (eds), *Contemporary Capitalism: the embeddedness of institutions* (Cambridge University Press, New York, 1997) 49-54. See also

<sup>78</sup> Dani Rodrik, *Second-Best Institutions*, (2008) <  
<http://ksghome.harvard.edu/~drodrik/papers.html> > at 14 October 2008, at 2.

<sup>79</sup> Ibid.

operate in practice. There is considerable disagreement and variation in opinion regarding whether transplantation is possible,<sup>80</sup> covering all possible views from denial that any legal transplantation is possible,<sup>81</sup> to the argument that *all* law is ultimately transplanted from somewhere else.<sup>82</sup> Teubner is perhaps the most influential thinker in this area. As a result of a study of the relationship between certain concepts in German and British business law, Teubner argued that legal concepts introduced from other jurisdictions do not operate as legal transplants, but rather as ‘irritants’: once introduced, they set off new and unpredictable dynamics.<sup>83</sup> Teubner’s concluded that it can be difficult to predict in advance how the adoption of any new legal rule, institution or culture will operate in practice. Whatever the outcome, there will *inevitably* be a ‘gap’ between a new law and its operation in practice.<sup>84</sup> In other words, it will *always* be the case that a transplanted or borrowed legal concept will not achieve its fully intended aim, or at least that it will not operate in the way that it did in its indigenous setting.

There are a number of factors which may impact upon the adoption of a new legal rule. One of the factors identified is legal culture: a matter that has been a particular focus of recent comparative legal scholarship.<sup>85</sup> While the idea of legal culture can be somewhat slippery, and the way in which it is used varies,<sup>86</sup> a significant body of work suggests that a ‘loosely anthropological’<sup>87</sup> idea of ‘culture’ may help to explain how and why legal concepts function as they do in new environments. Based on the findings of an East Asian study, Cooney and Mitchell argue legal ‘culture’ may be an important consideration in explaining the operation of laws in practice that have been adopted from other jurisdictions. One is the influence of indigenous legal traditions. Where these traditions endure they may, for example, lead people to prefer alternative means of resolving disputes to those that are provided in formal law, including labour law.

The strength of the legal system into which a law is being transplanted is also seen to be an important determinant of the success of transplantation. Cooney and Mitchell note that many East Asian legal systems, for instance, have been ‘destabilised relative to Western systems’. This has been the result of several different but related processes: laws (including constitutions and democratic institutions) have been suspended from time to time by non-democratic regimes; and law has been used

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<sup>80</sup> Tim Lindsey and Teten Masduki, ‘Labour Law in Indonesia After Soeharto’ in Sean Cooney et al, (2002) 27, and G Frankenburg, ‘Stranger Than Paradise: Identity and Politics in Comparative Law’ (1997) 2 *Utah Law Review* 259.

<sup>81</sup> Pierre Legrand, ‘The Impossibility of Legal Transplants’ (1997) 4 *Maastricht Journal of European and Comparative Law* 11.

<sup>82</sup> A Watson, ‘Aspects of the Reception of Law’ (1996) 44 *The American Journal of Comparative Law* 335, A Watson, ‘Legal Transplants and Law Reform’ (1996) 92 *The Law Quarterly Review* 79 and A Watson, *Legal Transplants* (1993).

<sup>83</sup> Gunther Teubner, ‘Legal Irritants: Good Faith in British Law or How Unifying Law Ends Up in New Divergences’ (1998) 61 *Modern Law Review* 11.

<sup>84</sup> Cooney et al (2002). The overview that follows of this work is based on a more detailed one in Fenwick and Kalulal (2005).

<sup>85</sup> Roger Cotterrell, ‘Law as Culture’ (2004) 17 *Ratio Juris* 1; L Friedman and Rogelio Perez Perdomo (eds) *Legal Culture in the Age of Globalization: Latin America and Latin Europe* (1993); P Legrand, *Fragments on Law-as-Culture* (2001); P Legrand, ‘What “Legal Transplants”?’ in D Nelken and J Feest (eds) *Adapting Legal Cultures* (1999).

<sup>86</sup> Cotterrell (2004).

<sup>87</sup> Cooney et al (2002).

in some cases primarily as a means of implementing State policy, rather than as a mechanism for protecting individual liberty and restraining State action that would adversely affect it. The outcome has been that legal systems have been reduced in their ability to generate and to enforce legal norms.<sup>88</sup> Where legal systems are weak, this will limit their ability to have an impact on other social systems, including, for example, the labour market.<sup>89</sup>

In addition to the slippery idea of ‘legal culture’ and a consideration of the over-all strength of the national legal system, Sir Otto Kahn-Freund argued strongly that ‘political’ factors would have a significant influence on whether a law borrowed from another jurisdiction would operate as it had in its original setting.<sup>90</sup> The likelihood of successful transplantation is enhanced when there is an ‘organic relationship’ between the law adopted and the social need to which it is addressed. It goes without saying that it is desirable that the new law has the capacity to contribute to national economic performance.<sup>91</sup> As a consequence, the design of labour law and the method of its application will need to be locally developed, and the level of their success are highly likely to depend heavily on whether they are apt for the particular social and economic circumstances in which they are to operate. This may include, among other things, whether the social partners are sufficiently skilled to operate in a new legal environment.<sup>92</sup> These considerations are outlined further in the final part of this paper.

### 3. DESIGNING CONTEXT-SPECIFIC, RESPONSIVE LABOUR MARKET REGULATION

Thus far we have argued that economic development and job quality are compatible and mutually reinforcing policy objectives. We further suggest that these ends are best pursued through regulatory intervention by the State. The purpose of that regulatory intervention is essential to create an environment in which the recognition and maintenance of labour standards and social rights are core aspects in the construction and regulation of the markets in which businesses operate. Putting to one side the wider regulatory framework applying to business, we argue in this section of the paper that an increased focus on the *design* of domestic regulatory regimes that are intended to improve job quality is a critical element in the successful achievement of economic development through the promotion of higher job quality and high rates of productivity.

In our view, ideas and perspectives drawn from regulatory theory can assist in generating ideas about the design of effective labour regulation, ideas which take account of the insights of comparative law and development theory outlined above. In particular, we suggest that what is needed is a holistic and *responsive* approach to

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<sup>88</sup> Ibid, 14-15.

<sup>89</sup> Cooney and Mitchell (2002) 258-263. See also Nicholson (2002) 133

<sup>90</sup> Otto Kahn-Freund, ‘On Uses and Misuses of Comparative Law’ (1974) 37 *Modern Law Review* 1.

<sup>91</sup> Bob Hepple, ‘Can Collective Labour Law Transplants Work? The South African Example’ (1999) 20 *Industrial Law Journal (South Africa)* 1, 2-3.

<sup>92</sup> Fenwick (2005).



regulatory design and application with respect to job quality in developing economies. As we explain below, in our view responsive regulation essentially means that the State is more sensitive to local environments in its harnessing and deployment of resources and application of different regulatory techniques to achieve particular policy goals.<sup>93</sup>

We noted earlier that the argument that regulation will have a negative impact on economic growth in developing economies, found in the World Bank's *Doing Business* report, is largely based upon a rather narrow conception of regulation. Essentially, this argument only sees State regulation in the form of a hierarchical 'command and control' model: legal rules backed by sanctions are set by government, and compliance with rules is monitored and enforced by government agencies. However, there is an extensive literature outlining the failure of hierarchical regulation in many contexts.<sup>94</sup> In particular, this model has proved problematic for labour regulation in the informal economy.<sup>95</sup> Nevertheless, many labour law frameworks have been designed according to this (traditional) model. Not surprisingly, difficulties arise in the application of labour law, especially where there are low levels of trade union activity and collective bargaining. However, it does not follow that 'deregulation' of markets, or the repeal of labour law and/or exclusion of MSEs from the application of labour law is the only alternative available to States. Indeed, as we showed at the outset of this paper, labour market 'deregulation' has frequently been associated with further growth in the informal economy.

As we have also observed, there is no such thing as 'deregulation' of the economy to the extent that this suggests the removal of all state regulation in favour of some pre-existing, self-constituting market order. Consistent with New Institutional economic analysis and the views of many industrial relations and labour market scholars and now labour lawyers,<sup>96</sup> regulatory scholarship does not view "markets" as naturally arising, self-ordering, mechanisms created "simply through the interaction of innate human characteristics."<sup>97</sup> Markets are not a given, nor are they self-ordering.<sup>98</sup> Rather, social order, and markets are constituted by both "cultural elements (i.e. beliefs about what one ought to do and how one ought to do it)" and secondly "by social structures of authority organised to establish, maintain, or change institutional rules or norms to support those beliefs".<sup>99</sup>

A more important question than *whether* to regulate, then, is *how* States regulate. In this paper we consider the ways in which States can improve the design of

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<sup>93</sup> As we explain later in the article, this means that although our approach is inspired by the notion of responsive regulation developed by Ayres and Braithwaite (above nXXX), we have made our own adjustments to the concept based on the insights of comparative law, development theory and subsequent criticisms of the Ayres and Braithwaite concept.

<sup>94</sup> See, for example, Ayres and Braithwaite; these problems are also discussed extensively in Eugene Bardach and Robert Kagan, *Going by the Book: The Problem of Regulatory Unreasonableness* (1982).

<sup>95</sup> [need a reference for this assertion]

<sup>96</sup> Howe J, Johnstone R, and Mitchell R, 'Constituting and Regulating the Labour Market for Social and Economic Purposes', in [Arup et al 2006].

<sup>97</sup> Shearing C, "A Constitutive Conception of Regulation" in Grabosky P and Braithwaite J (eds.), *Business Regulation and Australia's Future* (Australian Institute of Criminology, Canberra, 1993), p 68.

<sup>98</sup> *Ibid*, pp 68–71.

<sup>99</sup> Burk J, *Values in the Market Place* (Walter de Gruyter, Berlin / New York, 1988), p 8.

regulatory regimes designed to foster higher job quality, higher incomes and greater levels of productivity. What underpins our discussion of some of the innovative ways in which governments can create an enabling regulatory environment for business is a wide definition of what constitutes 'regulation'. A broad definition of regulation is 'the intentional activity of attempting to control, order or influence the behaviour of others according to defined standards or purposes'.<sup>100</sup> Thus, in seeking to analyse by what means State policy objectives are attained, it has been recognised that central governments are seldom willing or able to solve social problems solely by changing their own behaviour.<sup>101</sup> Central government is instead often dependent on finding ways of having other levels of government and private actors conform to State policy objectives and concerns.<sup>102</sup>

In short, this definition of regulation acknowledges that within any given 'regulatory space', resources are 'fragmented' or 'dispersed': the State is not the only actor with power to influence actions of others within that space.<sup>103</sup> Nor are State resources limited to formal, State authority to make legislation or enter into contracts, but also include information, wealth and organisational capacities.<sup>104</sup> Aside from State institutions and agencies, regulatory actors within any given regulatory space will include business, but also trade unions, NGOs and even individual citizens affected by regulation. It is recognised that:

Regulation is a two-way, or three or four-way process, between all those involved in the regulatory process, and particularly between regulator and regulatee in the implementation of regulation.<sup>105</sup>

Under this wider definition of regulation, regulatory reform 'might then focus not exclusively, or even mainly, on a single organisation, but rather on the whole configuration of resources and relations within the regulatory space'.<sup>106</sup>

Regulatory strategies based on this wider definition will be distinctive in that they are likely to be 'hybrid (combining governmental and non-governmental actors), multi-faceted (using a number of different strategies simultaneously or sequentially),

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<sup>100</sup> J Black, 'Critical Reflections on Regulation', (2002) 27 *Australian Journal of Legal Philosophy* 1.

<sup>101</sup> T Daintith, 'Techniques of Government', in J Jowell and D Oliver (eds), *The Changing Constitution* (3<sup>rd</sup> ed) (1994) 212. There are a number of reasons why this is so. For example, it may be a result of state reluctance to destabilise the capitalist economy, or because the state lacks the power to implement change because of the dominance of large corporations: JE Parkinson, *Corporate Power and Responsibility: Issues in the Theory of Company Law* (1993). See further C Offe, 'The Theory of the Capitalist State and the Problem of Policy Formation' in Leon Lindberg (ed), *Stress and Contradiction in Modern Capitalism: Public Policy and the Theory of the State* (1985) 125.

<sup>102</sup> Daintith, 'Techniques of Government' (1994) 212. Shearing has observed that 'an essential focus of regulation must be the shaping of motives or preferences': C Shearing, 'A Constitutive Conception of Regulation', in P Grabosky and J Braithwaite, *Business Regulation and Australia's Future*, (1993), 75. And see C Sunstein, *After the Rights Revolution: Reconceiving the Regulatory State* (1990) 60-61.

<sup>103</sup> C Scott, 'Analysing Regulatory Space: Fragmented Resources and Institutional Design' [2001] *Public Law* 329.

<sup>104</sup> Scott, 'Analysing Regulatory Space', 330.

<sup>105</sup> Black, 'Critical Reflections on Regulation' (2002) 7.

<sup>106</sup> Scott, 'Analysing Regulatory Space', 331.

and they are indirect'.<sup>107</sup> Thus State regulation co-exists with, and often facilitates, co-regulation and self-regulation within a given regulatory space.

This is not to say that command and control regulation is necessarily 'bad', or, as we emphasized earlier, that there is no room for State regulation, or for State regulation by means of formal law. What it means – and this is critical to our argument – is that there are *other modes and forms of regulation which may prove more effective* at achieving public policy objectives in a given social context. These modes should be more 'reflexive' or 'responsive' to actors, social facts and norms within a given regulatory space.<sup>108</sup> Regulatory design should seek to 'harness and develop the dispersed resources which would be likely to support the public policy objectives of the regulatory regime'.<sup>109</sup> As well as improving the effectiveness of regulation in achieving narrow policy goals, different modes and forms of regulation might also be better at encompassing other important values, such as the fostering of participatory democracy on behalf of groups with relatively little economic or political power.

The ideal of responsive regulation represents, among other things, a normative model which draws on the broader conceptualisation of regulation described above. *But this does not mean that the aim of regulating substantive ends disappears.* It does not mean that the policy goal is abandoned: only that it is pursued through a range of approaches, and drawing on the resources and/or capabilities of both state and non-state actors and institutions. This, we suggest, is a particularly important insight for States in developing economies, which in any case may have limited capacity to succeed in achieving their goals through command and control regulation. Advocates of responsive regulation have, in fact, emphasised the importance of retaining both institutional structures which regulate substantive ends, *and* sanctions for enforcing those ends as the apex of an 'enforcement pyramid', which is necessary to ensure that other techniques are effective.<sup>110</sup> In one sense this suggests a search for more innovative forms of command and control regulation; in another, it means thinking about ways that government can involve those affected by regulation in the making of rules as well as the processes of monitoring and enforcement of those rules. As we will see, some of the more effective regulatory innovations have succeeded precisely because they have been inclusive and participatory in their design and implementation. This would assist in overcoming the problems raised in criticisms of New Institutional Economics and by comparative legal theory regarding the difficulties entailed in successfully transplanting laws from one context into another, which is what a one-size-fits-all approach to labour laws involves.

Based on our analysis, States might take one of number of broad approaches to attempting to regulate informal economies based on the responsive recognition and application of labour rights and standards. Moreover, they might do so in addition to the adoption and promulgation of laws that set out minimum labour standards and recognise basic labour rights. Many of the practices we have outlined are already being utilised to encourage formalisation, and more specifically as innovative

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<sup>107</sup> Black, 'Critical Reflections', 8-9.

<sup>108</sup> R Ragowski and T Wilthagen, *Reflexive Labour Law*

<sup>109</sup> Scott, 'Analysing Regulatory Space', 330.

<sup>110</sup> The notion of an 'enforcement pyramid' was developed by Ayres and Braithwaite (1992). Later in this paper, we draw on this to develop a concept of a 'labour regulation pyramid'.

strategies in the promotion and enforcement of labour standards and rights in MSEs. Instances in which such approaches are being applied in the next part of this paper.

This section of the paper outlines some basic principles for improved design and application of labour laws for MSEs in informal economies. These principles facilitate the development of innovative labour regulation, which can be a key element of an enabling regulatory environment for achieving high job quality, while also encouraging MSEs to formalise.<sup>111</sup>

#### A. The objectives of labour regulation for informal economies

We suggest that States should have three primary objectives in designing labour regulation for informal economies:

1. redistribution and promoting social cohesion and human capabilities;
2. improving job quality; and
3. encouraging MSEs to formalise.<sup>112</sup>

It is virtually impossible to achieve these vital objectives if enterprises remain unregulated, unorganised and/or informal. So from a development point of view, regulation is essential: both to assure basic labour standards for workers, and also to control the harmful effects of competition based on low wages rather than on other means of increasing efficiency, and therefore value. The institutional and regulatory environment can make a significant difference to the way in which actors respond, and entrepreneurs develop their businesses: ‘well-functioning markets do not come about spontaneously but rather depend on various institutional arrangements and policy interventions.’<sup>113</sup>

We have observed that the ability of labour law to achieve [its] objectives is often seen as a function of the specific method of application and whether real efforts are made to enforce of labour laws to MSEs. But dealing with ineffectiveness requires something more than simply establishing a regulatory system based on rules and sanctions, leaving the issues of effective monitoring and enforcement of the system for separate and subsequent consideration. A more holistic and responsive approach to the design of labour law is needed: one that *incorporates* innovative approaches to monitoring and enforcement of labour law at the stage of regulatory design. This is likely to be a more successful strategy for confronting the challenges facing the application of labour law to MSEs in informal economies.

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<sup>111</sup> See, eg, ILO Recommendation 169, art 6(3): States should ‘include specific measures and incentives aimed at assisting and upgrading the informal sector to become part of the organized sector.’

<sup>112</sup> The first two objectives, at least, might also be pursued for labour regulation policy more broadly, but the focus here is on how to pursue these in a way that is responsive to the needs of MSEs and MSE workers in particular.

<sup>113</sup> G Reinecke and S White, *Policies for Small Enterprises: Creating the Right Environment for Good Jobs* (IFP/SEED, ILO, Geneva, 2004) 18. See also K Polanyi, *The Great Transformation* (Boston: Beacon Press, 1957) and J Burk, *Values in the Market Place* (Berlin; New York: W de Gruyter, 1988).

The concept of a ‘**labour regulation pyramid**’ is a tool that can be used in the design of responsive labour regulation for MSEs in informal economies.<sup>114</sup> A key aspect of the ‘labour regulation pyramid’ is that it assumes that regulation is likely to be more effective when regulators have a number of different options available to them in enforcing labour laws. The existence of legal rules and norms enshrining labour rights and standards as non-negotiable behavioural minimums, with non-compliance subject to non-discretionary punishment, are at the apex of the pyramid. These enshrine recognition of the development objectives of labour regulation, and the value of a rights-based approach as key elements of the regulatory approach. They serve as goal, guide, and ultimately as a source of sanction. However, frequently the most effective way for governments to achieve behavioural change in recognition of labour law is if MSEs themselves *choose* to comply with relevant rights and standards, *without* the application of sanctions. The pyramid therefore contemplates other regulatory strategies that the State might use, often in collaboration with other regulatory actors, to achieve the desired change in a manner that is responsive to the circumstances of MSEs.

A particular advantage of the labour regulation pyramid is that it is flexible: the pyramid will not necessarily be the same for every country. Thus, it is not a concept of optimal labour regulation that might be applied in any social, economic, cultural or political context. Rather, it is a way to conceptualise – and to depict graphically – a range of interlinked regulatory approaches that States might adopt, all of which reflect and promote key development objectives by working *both toward and from a rights-based approach*. Thus, an essential feature of each pyramid would be the ‘apex’ of substantive labour rights and standards, with sanctions for non-compliance. This is because in the absence of the apex, regulators will have far less capacity to apply any leverage against MSEs unwilling to comply with labour law. The rest of the pyramid, however, would be designed in different ways according to different circumstances.

The Ayres and Braithwaite ‘enforcement pyramid’ model is not without its problems particularly for those facing the momentous challenge of regulating an informal economy with few resources. For example, regulators often lack control over the escalation of sanctions.<sup>115</sup> This might be because the regulated firm possesses significant informal authority, power or resources, or because formal regulatory authority is fragmented between state organisations. For example, a state agency responsible for enforcement may have to rely on the courts to apply sanctions, not only limiting the control of the regulator over application of sanctions, but also limiting the credibility of any threat of sanctions by the regulator in the eyes of the regulated.<sup>116</sup> Nevertheless, having a range of regulatory tools available is arguably even more important in a developing context than in advanced economies.

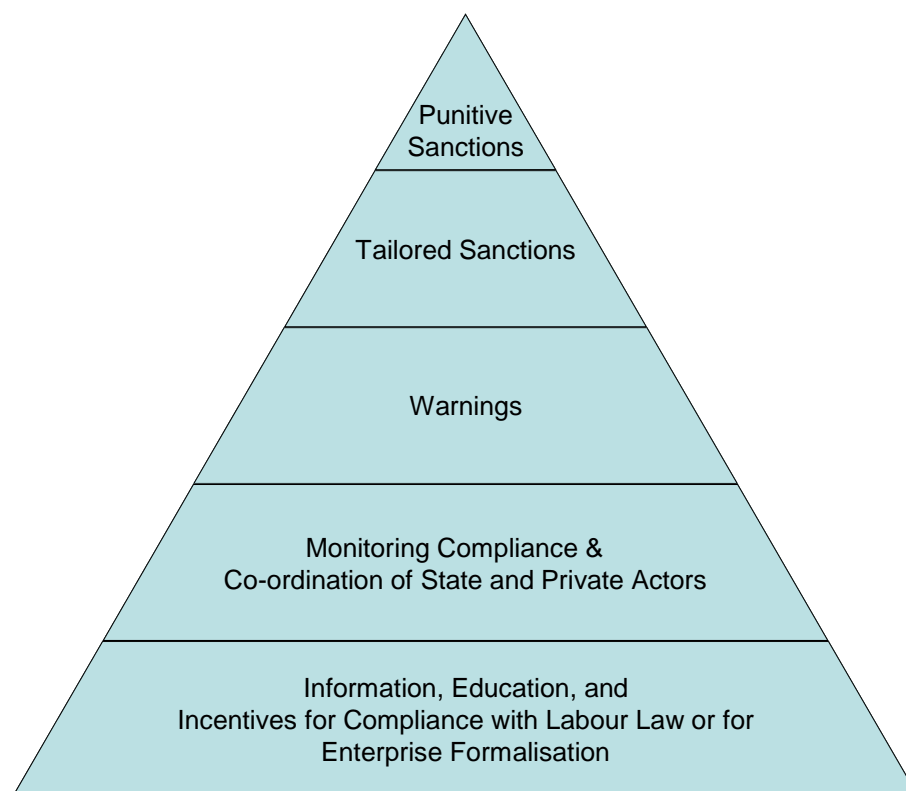
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<sup>114</sup> This concept is based on the idea of an ‘enforcement pyramid’, developed by Ayres and Braithwaite, *ibid.* The discussion in this section of the report draws extensively on their work.

<sup>115</sup> Scott, ‘Analysing Regulatory Space’, 346.

<sup>116</sup> Scott, ‘Analysing Regulatory Space’, 346.

**Figure 14: Pyramid of labour regulation strategies for MSEs<sup>117</sup>**



This diagram shows the layers of regulatory strategies that could be applied to MSEs and the informal economy. We discuss each of the layers of the labour regulation pyramid in further detail below.

Before doing so it is important to emphasize that the pyramid is a way of depicting two key things: the differences between levels of sanction in regulatory response, and the frequency with which different regulatory responses might be deployed. In other words, formal sanctions appear at the top of the pyramid because they are a more stringent response to failure to comply than is providing information and education. For the most part, it might be anticipated that the labour administration in its regulatory activity would emphasize the use of measures at lower levels of the pyramid.<sup>118</sup> However the pyramid is not intended to suggest a ‘linear’ approach to labour regulation: that is, States need not approach any particular situation starting from the bottom of the pyramid and working their way to the top. On the contrary:

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<sup>117</sup> In some regulatory scholarship, two ‘enforcement pyramids’ have been developed: in the area of environmental regulation, for example, Bridget Hutter used one pyramid for enforcement strategies, and another for sanctions: B Hutter, *Compliance: Regulation and Environment* (Oxford: Clarendon Press, 1997) 229–230.

<sup>118</sup> Ayres and Braithwaite, above n 394, Hutter, above n 396.

responsive regulation would be best designed in a way that utilised different elements of the pyramid in interlinked ways depending upon a range of particular circumstances.

*Information and education and incentives for formalisation*

This strategy recognises two key facts. First, a low level of legal literacy is a key obstacle to the application of labour law: for many MSEs and their workers, non-compliance with labour laws is a result of ignorance of regulatory requirements. Secondly, entrepreneurs make strategic choices about compliance with labour laws, and they may wrongly perceive labour regulation to be a constraint on enterprise growth, when in fact promotion of higher job quality (and human capability) is entirely consistent with economic development. In these cases, regulatory strategies such as providing advice or education to MSEs about labour rights and standards, together with incentives to formalise and recognise their obligations under labour law, can form the first stage in an overall enforcement strategy (the base of the pyramid). Education, information and incentive strategies promote voluntary formalisation together with recognition of labour rights and standards by MSEs, thus avoiding the simplistic and ineffective approach of simply excluding MSEs from the application of labour law.

The ILO's WISE Program is an example of this regulatory approach. The WISE (Work Improvements in Small Enterprises) programme seeks to improve working conditions in MSEs by educating MSE owners and managers of the link between improved working conditions and higher productivity. The programme is predicated on the recognition that one of the major problems with occupational health and safety in MSEs was that most workers and employers lack an understanding of the consequences and importance of improving health and safety at work. WISE focuses on simple, low-cost solutions to improving job quality. It involves the participation of state agencies, the ILO, bilateral donors, employers, NGOs and trade unions.

Evaluations of the programme to date suggest that it has had a beneficial impact on working conditions and productivity in MSEs. In South America, a WISE programme which reached 136 enterprises identified a total of 1042 different possible improvements. More than half of these were quickly implemented by the enterprises involved.<sup>119</sup> In the Philippines, an ILO report has identified a number of improvements in working conditions and productivity in MSEs that participated in the WISE programme.<sup>120</sup>

The WISE programme is currently limited to the formal sector as the absence of participation and partners limits its capacity to be implemented in the informal sector. While a strength of the WISE programme may be that it does not rely upon enforcement by regulatory authorities, this may also be a weakness: it relies largely upon the voluntary participation of employers and their willingness to implement

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<sup>119</sup> Cited in Scott (1998) 20.

<sup>120</sup> Richard D Rinehart, 'Designing Programmes to Improve Working and Employment Conditions in the Informal Economy: A Literature Review' (Conditions of Work and Employment Series No. 10, ILO, 2004) 31.

higher working standards. If it were linked to a larger regulatory programme it might result in higher levels of compliance.

There are other ways that governments can encourage regulated actors to comply with policies and rules. Government can deploy its wealth resource to modify the behaviour of other levels of government and private actors (both for-profit and non-profit organisations). The provision of financial subsidies or other mechanisms can provide incentives to comply with legal or regulatory requirements. The idea is basically to find a different way to encourage compliance than the incentives that underlie traditional command and control regulation, and overcome the perverse incentives associated with that regulatory style. If entrepreneurs think that formalising will give rise to the risk of penalties, they may wish to remain under the 'regulatory radar'. This means that the presence of legal sanctions has the opposite effect from that which was intended, i.e., that people will alter their behaviour to *conform* with legal rules in order to avoid sanctions against non-compliance. In traditional command and control regulation, the 'incentive' for compliance is the avoidance of financial costs. This is similar to the use of taxation to discourage undesirable behaviour, as well as to perform its revenue collection function.<sup>121</sup>

Research from various developing countries suggests that the risk of sanction alone is not enough to bring about formalisation. Evidence from Chile suggests that the risk of incurring fines or sanctions is not alone sufficient to motivate enterprises to formalise their business without concurrent benefits.<sup>122</sup> Similarly, from her research into the informal MSE sector in Lima, Peru, Zuin concluded that the simplification of, and cost reduction in registration was not sufficient to foster formalisation. Incentives, such as access to credit or to markets, were essential in inducing enterprises to join the formal sector.<sup>123</sup> State deployment of wealth can be used to implement the policies of government by altering the cost of the behaviour. This might happen by offering the 'reward' of a subsidy, or by reducing the 'disincentive' of taxation, *in return for* compliance. The use of these instruments is often justified on the basis that it involves the replacement of coercion and control with a system which offers market incentives in order to *encourage desired behaviour* and achieve regulatory goals. The use of financial incentives to promote desired behaviour has been observed in a number of different areas of government activity, including job creation and environmental protection.<sup>124</sup> Examples include financial subsidies, conditional grants, and access to government contracts, as well as instruments that involve government payments, and

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<sup>121</sup> Terence Daintith, 'Law as a Policy Instrument: A Comparative Perspective' in Terence Daintith (ed) *Law as an Instrument of Economic Policy: Comparative and Critical Approaches* (1988) 1 and A Ogus, 'Corrective Taxes and Financial Impositions as Regulatory Instruments' (1998) 61 *Modern Law Review* 767.

<sup>122</sup> G Reinecke, 'Labour and Labour Related Laws in Micro and Small Enterprises: Cases from Latin America' (Version 1, ILO SRO Santiago, Santiago, 2005), at 6.

<sup>123</sup> V Zuin, 'Business Strategies of Informal Micro-Entrepreneurs in Lima, Peru' (Decent Work Research Program, International Institute for Labour Studies, Geneva, 2004) 1.

<sup>124</sup> See, eg, R Howse, 'Retrenchment, Reform or Revolution? The Shift to Incentives and the Future of the Regulatory State' (1993) 31 *Alberta Law Review* 455; P Grabosky, 'Regulation by Reward: On the Use of Incentives as Regulatory Instruments' (1995) 17 *Law and Policy* 257; and R Baldwin, 'After Command and Control' in K Hawkins (ed) *The Human Face of Law: Essays in Honour of Donald Harris* (1997). A number of studies have identified financial subsidies as a common instrument of job creation policy: see, eg, J Howe, 'The Job Creation Function of the State A New Subject for Labour Law' (2001) 14 *Australian Journal of Labour Law* 242.



tax concessions or incentives, where the government waives full compliance with tax laws.<sup>125</sup> Where access to government contracts is concerned,

An example of such deployment of wealth is an experiment undertaken in Shanghai. In 1996, the Shanghai Municipal Government introduced a policy and regulatory regime to facilitate the development of the informal economy as a means of providing employment for unemployed workers<sup>126</sup>. The policy encouraged individuals to establish individual ventures or small firms in certain types of activities.<sup>127</sup> The enterprises established under the policy were called ‘informal labour organisations’. These enterprises were registered and regulated by state policies but were not registered with the Industrial and Commercial Bureau and did not have status as legal entities. The Shanghai Labour Bureau encouraged these ‘informal labour organisations’ to develop to a point where they could register with authorities and transfer to the formal economy.

As part of this regulatory experiment, informal labour organisations were promoted and assisted through special administrative organs, known as employment services organs. These organs, established at the city, district, county, street committee and town levels, assisted informal organisations by providing a variety of administrative and technical assistance.

Some of the preferential policies enjoyed by ‘informal labour organisations’ include:

- social insurance (employers and employees pay a lower base rate and lower contributions);
- free training opportunities;
- an exemption from local taxes for a period of 3 years. This exemption continues to apply to enterprise that have converted during the 3 year period into registered individual households or small enterprises;
- support for credit;
- the subsidy and employment of informal labour organisations that provide public works;
- risk insurance; and
- voluntary provision of advice and assistance by experts.

By September 2001, there were over 10 000 approved ‘informal labour organisations’, employing more than 150 000 people. At the same time, a survey by the Shanghai Bureau of Labour and Social Security of 500 ‘informal labour organisations’ found that 25 per cent of them had entered the formal economy.

There has been little systematic assessment of the impact of these Shanghai Municipal Government policies on job quality or on the extent to which they facilitate entry into the formal economy. Some indicators suggest that the experiment was not

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<sup>125</sup> The term ‘economic policy instruments’ is drawn from Daintith (1988).

<sup>126</sup> This section is drawn from J Howell, ‘Good Practice Study in Shanghai on Employment Services for the Informal Sector’ (Employment Paper 6, ILO, Geneva, 2002).

<sup>127</sup> The policy encourages the development of enterprises in 15 types of activities, including, for example, repairing and maintaining household equipment, sewing, washing clothes and public works labour.

altogether successful at attaining its goals. Some ‘informal labour organisations’ are not competitive, even after being stewarded through this system. In 2001, only between 40 and 50 percent of organisations could afford to purchase social insurance, even at the preferential rates. This means that many workers are still at risk of poverty in old age or in the case of illness or unemployment. Many informal labour organisations also still struggle to access credit. There is no system of employee representation in these organisations and existing research suggests males are benefiting considerably more from the scheme than women. In any case, there was no direct focus on labour standards or job quality within these informal organisations.

The Shanghai example illustrates the complexity inherent in designing an innovative approach to labour regulation for MSEs. On the one hand, the fact that 25 per cent of informal labour organisations had moved into the formal economy suggests a positive outcome from the point of view of encouraging MSE growth and formalisation. At the same time, however, there are evidently significant weaknesses with the system in practice, including major deficiencies in creating sustainable, quality jobs. Taken together, these findings illustrate at the very least that the development of a policy that promotes both the creation of Decent Work and the growth of MSEs requires more than an approach based on whether or not labour laws apply. In particular, it suggests the need for a strong State role in the facilitation of market access and growth.

Another way of using financial incentives as part of a regulatory strategy to achieve policy goals is to utilise government contracts with private, voluntary or quasi-public providers as a mechanism for achieving behavioural change.<sup>128</sup> This approach to regulation is based on the idea that private sector activity can be controlled through contractual or other agreements with government. Government contracts essentially involve exchange of public wealth for the provision of a good or performance of a service by a private actor.<sup>129</sup> The primary means by which the government secures the cooperation of an external actor is through the offer of a subsidy or fee, while the contract is the means of attaching conditions to, or ‘regulating’, that subsidy. The external organisation consents to the attachment of these conditions because of the incentive provided by the contract payments.

In the context of debates about the effectiveness of different forms of regulation, State deployment of wealth in the form of financial subsidies and incentives is frequently portrayed as ‘soft’ or ‘light-touch’ regulation, as distinct from ‘hard’ legal regulation.<sup>130</sup> Regulating by means of economic incentives or disincentives is a technique by which governments have endeavoured to promote

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<sup>128</sup> Although some scholars identify contracting out as a specific regulatory instrument, others see contracts as a ‘consensual constraint’ based on leverage created by the wealth of the state – thus making them a sub-category of economic instruments: Daintith, ‘Law as a Policy Instrument’ (1988) 30-32; A Ogus, ‘New Techniques for Social Regulation: Decentralisation and Diversity’, in H Collins, P Davies and R Rideout, *Legal Regulation of the Employment nRelation* (2001).

<sup>129</sup> Although some scholars identify contracting out as a specific regulatory instrument, others see contracts as a ‘consensual constraint’ based on leverage created by the wealth of the state – thus making them a sub-category of economic instruments: Daintith (1988) 30-32; Ogus, ‘New Techniques for Social Regulation: Decentralisation and Diversity’ (2001).

<sup>130</sup> The terms ‘soft’ and ‘light-touch’ regulation are frequently used in relation to legal instruments in Europe: see L. Dickens, ‘Problems of Fit: Changing Employment and Labour Regulation’ (2004) 42 *British Journal of Industrial Relations* 595, 608.

external satisfaction of public policy objectives where legal coercion is seen to be inappropriate or ineffective.<sup>131</sup> In other words, a perceived advantage of deployment of wealth as a form of state regulation of the private sector is the capacity of such instruments to be ‘responsive’ to existing values and social ordering.<sup>132</sup> It is argued that by advancing policy objectives based on the ideal of social or redistributive justice in a way which avoids ‘intrusive interference with private social and economic arrangements and market allocation decisions’, regulation is likely to be more effective.<sup>133</sup>

### *Monitoring*

States must address the challenges confronting monitoring and enforcement of labour rights and standards in the development of labour law and regulation itself. Most labour law regimes that depend on a ‘command and control’ model of regulation establish mandatory labour rights and standards, empower a regulatory agency to oversee the monitoring and enforcement of those standards, and provide for sanctions in the event of failure to comply.

However, empirical studies suggest that many States fail to monitor and to enforce labour laws in relation to MSEs, leading to greater levels of informality and a failure to extend basic labour standards to MSE workers.<sup>134</sup> There are problems of inconsistency - State authorities often selectively enforce some laws whilst ignoring breaches of others - and there are problems of corruption. There are also many practical obstacles to effective monitoring and enforcement, such as inadequate resourcing of regulatory agencies. Innovative methods are required to ensure that MSEs, not just large businesses, are inspected. Where the majority of organisations are micro-enterprises (often comprising less than 10 workers) this can be very challenging. Evidence suggests that state inspectorates cannot rely on complaints from workers, as low levels of legal literacy and suspicion of the State act as barriers to this mechanism functioning effectively.

The inspection system developed by Chile, which is adapted to the realities of MSEs, is an example of such a strategy. Inspections are scheduled, rather than being reliant upon complaints by workers. Moreover, inspection programs have focused on particular sectors with a high share of MSEs, such as clothing production. While, as in other countries, larger enterprises continue to be inspected more often than MSEs, a Chilean survey of 300 enterprises found that around 11 percent had been visited by labour inspectors during the previous 2 years.<sup>135</sup> Thus, the State has played a key regulatory role, but one that is responsive to the key interests of the regulated community: the need for workers to be protected by compliance with labour law, and the need for owner-managers of MSEs to have some degree of certainty in carrying on their work.

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<sup>131</sup> N Gunningham and P Grabosky with D Sinclair, *Smart Regulation: Designing Environmental Policy*, (1998) 70; Ogus, ‘New Techniques for Social Regulation: Decentralisation and Diversity’ (2002) 96; J Braithwaite, ‘Rewards and Regulation’ (2002) 29 *Journal of Law and Society* 12.

<sup>132</sup> C Parker et al, ‘Introduction’ in C Parker et al, *Regulating Law* (2004) 11. The notion of ‘responsive regulation’ is a consistent theme in the regulatory literature.

<sup>133</sup> Howse (1993) 471.

<sup>134</sup> [Need a reference]

<sup>135</sup> ILO/SEED survey, as cited in Reinecke (2005) 5.

In order to extend the coverage of labour regulation to MSEs, this level of the enforcement pyramid could also incorporate cooperation between State labour administrations and representative organisations such as trade unions in monitoring and inspection. An excellent example of such cooperation is the Regional Safety Representative Scheme in Sweden, under which trade unions play a prominent role in monitoring, and promoting compliance with, occupational health and safety standards in small businesses. Like many other countries, Swedish workplace health and safety legislation exempts enterprises with a number of workers below a certain threshold from formal workplace representation. In lieu of this, trade unions are given the right to appoint safety representatives from outside the enterprise workforce. This statutory entitlement forms the basis of the regional safety representative (RSR) scheme.

Evaluations of the scheme suggest that it has been successful.<sup>136</sup> The scheme now covers the majority of MSEs in Sweden and the RSRs generally enjoy good relations with the labour inspectorate and with employers. RSRs may only visit MSEs less than once every 2 years, but this compares very favourably with an average of one visit every 8 to 10 years by a labour inspector. The RSRs also play an important educative function for MSE employers and workers. The cost of the scheme is relatively low. Finally, sources suggest that the scheme makes a major contribution to improving the work environment and, consequently, to reducing the incidence of occupational injuries and diseases in MSEs.<sup>137</sup> The success of the scheme must be evaluated in the context of the unique institutional environment in Sweden, including a comparatively high trade union density in the MSE sector, a tradition of social dialogue, and acceptance of trade union representation and activity.<sup>138</sup>

There are programmes operating in less developed countries that suggest that where there is no tradition of unionism, other organisations can be called upon to promote job quality. One example is the work done by the ILO in the Philippines and Tanzania to improve workers' health and safety. These programmes focused on developing the capacity of City Council Health Services, as well as of other organisations that might have a role to play, including self-help associations and cooperatives. These programmes developed and delivered training, helped in the establishment of private first-aid clinics, and worked to link those in the informal to the established national health care systems.<sup>139</sup> These examples show that where there is no tradition of unionism, other organisations can be called upon to promote job quality. States can play a role in coordinating monitoring and enforcement between the State labour administrations and representative organisations.

### *Warnings*

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<sup>136</sup> See, eg, Felicity Lamm and David Walters, 'Regulating Occupational Health and Safety in Small Businesses' in Elizabeth Bluff, Neil Gunningham and Richard Johnstone (eds) *OHS Regulation for Changing World of Work* (2004) 94, 108.

<sup>137</sup> Frick and Walters (1988) 372.

<sup>138</sup> *Ibid* 376.

<sup>139</sup> George A Aryee, *Promoting Productivity and Social Protection in the Urban Informal Sector* (ILO, Geneva, 1996) 48-9.

An important stage in moving toward the imposition of formal sanctions for non-compliance might therefore be State labour administrations notifying MSEs of their non-compliance with labour laws. The notice would be accompanied by a warning which would make it clear that further non-compliance would lead to the imposition of targeted and/or punitive sanctions. Such an approach is adopted by the Philippines in relation to small enterprises. This strategy would be used in situations where education and monitoring had failed to bring about behavioural change with respect to labour law.

### *Tailored sanctions*

This strategy allows State labour administrations to impose sanctions on MSEs for non-compliance with labour law, but to do so in a manner that is accommodative to their context. For instance, MSEs could be subject to reduced fines based on their lower capacity to pay or an incremental approach to sanctions in the event of failure to comply with regulatory requirements.<sup>140</sup> An example is the Chilean programme under which an enterprise with fewer than 10 workers may participate in a compulsory training course on labour law as an alternative to paying fines for non-compliance.<sup>141</sup> This programme attempts to address lack of awareness as a common cause of MSE non-compliance.

### *Punitive sanctions*

The final strategy would be a sanctioning approach. This would most likely involve legal action taken by a State labour administration invoking and seeking the application of sanctions available under labour laws to a non-complying MSE. This approach would only be utilised where persuasion, warnings, and tailored sanctions were unsuccessful. There are, however, major problems with this element of the pyramid in many less developed countries in which the judicial system is corrupt or overburdened. In India, for instance, the State is likely to seek to avoid applying to courts for penalties. In 2000, 25 million cases were pending in the Indian court system. According to Bearak, if no new actions were filed, 324 years would be needed to clear the dockets.<sup>142</sup> Further, litigation patterns broadly reflect the concerns propertied or salaried classes. This bias means there is very little pressure generated from users to reform the law or reshape legal procedures in a way that will benefit the poor.<sup>143</sup>

This points to the need to establish semi-judicial bodies to arbitrate and enforce labour law sanctions, with standing rights for lay-representatives. Trade unions, for example, could be given specific standing rights to pursue sanctions. The Australian system of arbitration and conciliation is a possible model for such

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<sup>140</sup> See I Ayres and J Braithwaite, *Responsive Regulation: Transcending the Deregulation Debate* (New York: Oxford University Press, 1992) 38-41.

<sup>141</sup> **Reference? We don't have one in the ILO Global Issues report.**

<sup>142</sup> Barry Bearak, 'In India, the Wheels of Justice Hardly Move', *New York Times, The (NY)*, 2000.

<sup>143</sup> Michael R. Anderson, *Access to justice and legal process : making legal institutions responsive to poor people on LDCs*, (2003) < <http://www.ids.ac.uk/ids>, <http://www.ids.ac.uk/ids/bookshop/wp/wp178.pdf> >

tribunals. Although punitive sanctions form the peak of the enforcement pyramid, the fact that they are available to regulators contributes to the effectiveness of other strategies in the pyramid.

### B. Design and implementation must be participatory

It is our view that regulatory design and implementation is enhanced by the participation of those who are affected by the regulation. This is possibly the only way to better adapt regulation to its local context. There are three elements to this principle. First, that those who will most be affected by regulation, or their representatives, should be involved in its design. Secondly, that representative organisations, especially trade unions, should be involved in monitoring and compliance. Thirdly, that representative organisations should be involved in periodic assessment of the regulatory programme.

Those who will be affected by regulation or who will be involved in its enforcement should be consulted about its design. This includes both the development of rules and standards which businesses are expected to meet, as well as the regulatory structure for application and enforcement of those rules. Servais accurately observes that the challenge for States is 'to reinvent new institutions offering all those concerned the chance to take part, no matter at what level, in defining and implementing policies and programmes that provide them with decent work'.<sup>144</sup>

Optimal structuring of responsive regulation which takes account of local conditions is more likely to result from negotiations between governments, MSEs, and other interested organisations. Whilst deliberative democracy had considerable purchase in development literature in recent years, examples of its successful adoption in less developing country contexts are rare. In the context of Vietnam, for instance, Gillespie has argued that control over public discourse favours the interests of business elites, while small-scale entrepreneurs struggle to make their views known. As a consequence of this asymmetric discourse, rules rarely suit the transactional requirements of small-scale entrepreneurs, contributing to widespread non-compliance.<sup>145</sup> Workers in MSEs suffer a representation gap, particularly through trade unions and tripartite institutions. (MSE employers may also suffer a representation gap in this respect). Thus, it may be appropriate and necessary to involve other organisations than those typically envisaged by the usual scope of tripartite negotiation.<sup>146</sup>

Those consulted in the course of designing and implementing regulation might include local councils, community organisations, cooperatives, unions and employer organisations. At the beginning of the design and implementation process, the representational deficit may initially result in a lack of capacity by representative bodies.<sup>147</sup> However, studies of consultative processes suggest that the iterative

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<sup>144</sup> J M Servais, 'Working Conditions and Globalization' in R Blanpain and C Engels (eds) *Comparative Labour Law and Industrial Relations in Industrialized Market Economies* (7<sup>th</sup> ed) (The Hague; London: Kluwer Law International, 2001) 361.

<sup>145</sup> J. Gillespie, "Localizing Global Rules: Public Participation in Lawmaking in Vietnam" (2008) 33 *Law & Social Inquiry* 673–707.

<sup>146</sup> *Ibid.*

<sup>147</sup> For an assessment of tripartite consultation in Latin America during the transition from corporatism, see A Bronstein, 'Labour Law Reform in Latin America: Between State Protection and

process of repeated consultation, combined with education concerning the process, can assist in building the capacity of representative organisations which has positive flow on effects for monitoring and compliance.<sup>148</sup>

Consultation during design is also an important factor in generating demand for regulatory programmes. Rinehart's study, for example, found that local demand for change was essential to the success and sustainability of the programmes. He emphasised that policy-makers need to assess problems and solutions in an interactive way at the local level in order to allow project participants to develop a sense of ownership, awareness and respect of the programmes.<sup>149</sup> This is likely to foster cooperation with monitoring and enforcement of labour laws. Importantly, a transparent and well-designed consultative process can also assist in avoiding capture by dominant players or groups opposed to enforcement. It may also minimise the chances of labour regulation being rendered ineffective by corruption (or the perception of corruption).

Ensuring that representative organisations are involved in the compliance process is no simple task. Workers in MSEs are under-represented, and labour regimes often fail to ensure that workers in MSEs can exercise their rights to organise, and to bargain collectively.<sup>150</sup> It follows that labour laws should be changed to better facilitate freedom of association in MSEs, and labour organisations must be strengthened through education and training programmes.

Research conducted elsewhere has shown that attempts to improve the application of labour laws to MSEs will have greater success if worker – and often employer – organisations are in a position to represent the interests of their members in social dialogue processes. Policy-makers have recognized that ‘an existing level of organisation among workers is a prerequisite to effectively addressing the working condition issues of informal sector operators’.<sup>151</sup> More specifically, it has been noted that long-term representation and support provided by workers’ organisations are needed to ensure the success and durability of improvements to the conditions of workers in MSEs.<sup>152</sup>

The role of workers’ or self-employed workers’ organisations is also particularly important in the face of inadequate inspection by governmental bodies. A study on informal food sector workers in South East Asia, for example, reported that a

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Flexibility’ (997) 136 *International Labour Review* 1. For a similar discussion of transition economies, see D Ost, ‘Illusory Corporatism in Eastern Europe: Neoliberal Tripartism and Postcommunist Class Identities’ (2000) 28 *Politics & Society* 503. For comment on the effectiveness and outcomes of labour law reform through consultative processes with under-developed union structures see C Fenwick, ‘Labour Law in Namibia: Towards an “Indigenous Solution”?’ (Working Paper No 35, Centre for Employment and Labour Relations Law, Faculty of Law, University of Melbourne, 2005).

<sup>148</sup> G Baiocchi, ‘Participation, Activism and Politics: The Porto Alegre Experiment and Deliberative Democratic Theory’ (2001) 29 *Politics and Society* 43.

<sup>149</sup> R Rinehart, ‘Designing Programmes to Improve Working and Employment Conditions in the Informal Economy: A Literature Review’ (Conditions of Work and Employment Series No 10, ILO, Geneva, 2004) 11.

<sup>150</sup> See, eg, ILO, *Resolution concerning Decent Work and the Informal Economy*, ILC, 90<sup>th</sup> session, 2000, [17].

<sup>151</sup> Save the Children, *Occupational Safety and Health for the Urban Informal Sector: The Save the Children Experience* (1996), as cited in Rinehart, above n 402, 60.

<sup>152</sup> *Ibid.*

number of occupational health and safety issues in this sector would be more adequately addressed if vendors were organised and therefore ‘in a more spatially and economically secure position’.<sup>153</sup> Innovative ways of involving MSE employers and workers in representative organisations include the Self-Employed Women’s Association (SEWA) in India, and the efforts by trade unions in Kenya and South Africa. SEWA in India provides collective representation and security for women workers in the informal economy in India. This is a demographic group that is often excluded from trade union representation and activity, and subject to poor working and living conditions. Membership of SEWA consists of three broad categories of ‘self-employed women’: home-based workers; small petty traders, vendors and hawkers; and providers of services and manual labour. SEWA provides its members with supportive services such as savings and credit, health care, child care, insurance, legal aid, capacity building and communication services. SEWA has grown significantly since its inception in 1972: the national coverage now exceeds 200 000.<sup>154</sup> It provides services in a decentralised and low-cost manner and is promoted as a successful model for organising informal workers. The SEWA approach depends upon a relatively high level of political and social awareness among female workers. It also relies upon freedom of association. SEWA promotes self-reliance by private actors.

Another way that design of labour law can incorporate responsive regulation is by providing for periodic assessment of the regulatory framework that has been established, with specific reference to MSEs. The effectiveness of the regulation and its enforcement should be assessed after an initial period of implementation, in order to provide those affected an opportunity to comment and to propose ways in which the regulation could be more effectively enforced. The observations of representative organisations can be fed back into the design process to ensure that the regulatory programme applicable to MSEs is dynamic rather than static. This will help to prevent situations where labour laws remain ‘on the books’ for long periods, but are not enforced in practice. It will help to facilitate the sharing of institutional learning amongst State and non-State actors. Further, this strategy is particularly helpful where a staged implementation of regulatory techniques is envisaged (that is, where authorities plan to use regulatory strategies from different layers of the pyramid in turn). This might happen, for example, where a period of voluntary compliance is to be followed by mandatory enforcement in the event that voluntary compliance has not occurred.

One way of involving affected parties in regulation is through innovative procedural regulation.<sup>155</sup> This involves strategies that facilitate the participation of private regulatory actors, including MSEs, workers, NGOs and bodies such as the ILO in the formulation and implementation of policy.<sup>156</sup> These approaches are

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<sup>153</sup> See G Yasmessn, ‘Workers in the Urban “Informal” Food Sector: Innovative Organising Strategies’, as cited in *ibid* 94.

<sup>154</sup> ‘Women Organising for Social Protection: the Self-Employed Women’s Association Integrated Insurance Scheme, India’ (STEP Programme, ILO, 2001) 5. See also [www.sewa.org](http://www.sewa.org)

<sup>155</sup> Orly Lobel, *Interlocking Regulatory and Industrial Relations: The Governance of Workplace Safety*, University of San Diego (2006)

<sup>156</sup> R Mayntz, ‘The Conditions of Effective Public Policy: A New Challenge for Policy Analysis’ (1983) 11 *Policy and Politics* 123. The term ‘innovative command and control regulation’



sometimes referred to as ‘self-regulation’ or ‘co-regulation’, but these terms can be misleading where there is a clear role for the State in establishing and overseeing the procedures and institutions established. As Servais emphasises, the State still has an important role to play: ‘to recognize these actors, to promote their development and improve their access to information (by removing obstacles such as anti-union practices), to recognize the institutions they create (for example, by taking part in their creation) and to facilitate relations between them.’<sup>157</sup> Indeed, the State has a special, and often challenging role in facilitating the involvement of private actors in regulatory strategies targeting MSEs and the informal economy: ‘this mission [of the State] has a special dimension when it comes to specific kinds of activity, such as those in the informal sector or small-and medium-sized businesses, where social dialogue is more difficult to put into practice’.<sup>158</sup>

An example of these kinds of systems in a developing context are tripartite registration systems. In India there are a large number of head load workers or mathadi/hamal workers (who lift parcels/goods in the markets across India). Laws have been passed to regulate the employment relationship for this group of casual workers in the informal economy.<sup>159</sup> The law requires all existing workers and potential workers to register with an autonomous tripartite regulating board or authority; subsequently, all employment has to be routed through this regulating authority. Records are maintained of short-term, sporadic employment and, where social security benefits are to be provided, the employer’s contribution can easily be tracked. The regulation of employment involves a tripartite arrangement instead of the bilateral employer-employee relationship. One negative consequence has been that a further underground/shadow market has been created in the informal economy, although it is considerably smaller than the previously unregulated labour market for mathadi/hamal workers.

Innovative procedural regulation may include programs that encourage businesses and workers along with unions, local government agencies or NGOs to formulate compliance plans with respect to labour laws that are suited to the challenges facing businesses in particular contexts. This avoids the problems that arise from exempting or not enforcing labour laws against business, especially MSEs, while acknowledging the disincentives that often lead to avoidance of labour laws. It would also enable governments to ensure that compliance is supportive of economic development.<sup>160</sup> This regulatory approach also encompasses so-called ‘corporate social responsibility’ initiatives such as supply chain regulation. Corporate social responsibility initiatives have had a role to play in regulating working conditions in some parts of the informal economy, although admittedly it is not always clear to what extent States in developing economies have been involved in implementing them as a regulatory strategy.<sup>161</sup>

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could also be applied: N Gunningham and P Grabosky with D Sinclair, *Smart Regulation: Designing Environmental Policy* (1998) 47.

<sup>157</sup> Servais, (2001).357.

<sup>158</sup> Servais, (2001).357.

<sup>159</sup> This description is taken from K Shankaran, ‘Protecting the Worker in the Informal Economy: The Role of Labour Law’ (Paper presented at the Conference on the Scope of Labour Law: Re-drawing the Boundaries of Protection, Bellagio, 23–27 May 2005).

<sup>160</sup> Reinecke and White (2004) 67.

<sup>161</sup> **Insert references to articles which consider problems with Codes of Conduct**

It must be emphasised that we see these different regulatory instruments being used in a complementary way to further ‘responsive regulation’ without losing sight of the policy goals which they are intended to further. That is, without rules setting standards of expected conduct, and sanctions for non-compliance which can be enforced in certain circumstances, then the use of incentives and other forms of ‘self-regulation’ and ‘co-regulation’ are unlikely to be effective on their own. In short, States must adopt an integrated approach to the design and implementation of a labour law framework for Decent Work in MSEs, and one that must in turn be integrated into the broader policy agenda of creating an enabling regulatory environment.

Our strong emphasis on the role of the State and the complementarity between ‘command and control’ regulation and other forms of regulation distinguishes our approach from other theories of labour regulation, such as the ‘ratcheting labour standards’ (RLS) proposal developed by Charles Sabel and others.<sup>162</sup> The RLS approach is based on the idea that it is possible to establish a systematic, global competition between firms based on their labour standards performance, largely relying on the strength of transnational consumer movements. This approach has been criticised on the basis that it assumes a ‘regulatory void’ both at transnational level and in the domestic jurisdictions of states, ignoring institutions such as the ILO and the OECD, and advocating new structures built around ‘self-regulation’ by multinational firms.<sup>163</sup> This approach ignores the role that states can play in empowering worker representatives. Murray has argued that there is a risk that the new structures and processes proposed by RLS may simply turn out to be ‘another version of top-down rule imposition’, with the views of ‘wealthy consumers of consumer goods’ dominating the views of those whose labour is responsible for the production of those goods.<sup>164</sup>

Responsive regulation is more than just enforced self-regulation by firms. The retention of a command and control structure underpinning labour law ensures that the power differential between governments, owners of capital, unions and NGOs and workers.<sup>165</sup> Because comparative law scholarship has informed our research, we are sensitive to the warnings of Haines and others, who suggest that ‘regulatory reform’ must be sensitive to local conditions, the ‘dynamic of regulatory character’ of the country in which such reforms are to be implemented.<sup>166</sup> Moreover, because we do not see responsive regulation as necessarily a model of enforced ‘self-regulation’, we address the possible criticism that models of responsive regulation have been developed with large companies in mind, and are less applicable to MSEs.

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<sup>162</sup> See A Fung, D O’Rourke and C Sabel, ‘Realizing Labor Standards’ (2001) 26 *Boston Review* 1. For a critique of this proposal, see J Murray, ‘The Sound of One Hand Clapping? The “Ratcheting Labour Standards” Proposal and International Labour Law’ (2001) 14 *Australian Journal of Labour Law* 306.

<sup>163</sup> Murray, *ibid.* We note that Kuruvilla and Verma have argued that the RLS approach can be modified to allow national governments to play a key role in strengthening soft regulation methods: S Kuruvilla and A Verma, ‘International Labour Standards, Soft Regulation, and National Government Roles’ (2006) 48 *Journal of Industrial Relations* 41.

<sup>164</sup> Murray, *ibid.*

<sup>165</sup> Thus addressing criticisms of Ayres and Braithwaites’ model as obscuring or not paying sufficient regard to such power differentials: S Tombs, ‘Understanding Regulation’ (2002) 11 *Social & Legal Studies* 113.

<sup>166</sup> F Haines, ‘Regulatory Reform in Light of Regulatory Character: Assessing Industrial Safety Change in the Aftermath of the Kader Toy Factory Fire in Bangkok, Thailand’ (2003) 12(4) *Social & Legal Studies* 461, p 482 [upgrade to reference to her recent book].

### C. The design and implementation of the regulation should be specifically targeted at improving job quality in MSEs

There is a critical inter-linkage between the goals of job quality for MSE workers in the informal economies, and formalisation of MSEs. It is not sufficient for regulation to be aimed broadly at formalisation of MSEs without targeting job quality issues. Nor can it be broadly aimed at improving job quality, without targeting MSEs specifically.

Country-specific research undertaken for this paper suggests that even policies ostensibly directed toward ‘microenterprises’ can be rendered largely ineffectual by unrealistic definitions of what constitutes an MSE. In Indonesia, for example, post-Suharto governments have introduced six Action Plans directly focused on MSEs.<sup>167</sup> These initiatives, however, have shown little potential to improve conditions or opportunities for workers in micro-enterprises. This is in part attributable to the fact that the Action Plans are preoccupied with enhancing enterprise competitiveness, without a correlated concern for job quality. A second problem has arisen because the Government’s definition of an MSE is an enterprise with assets of more than 20 million rupiah (excluding land and building). In 2002, enterprises with assets of less than 20 million rupiah constituted 99.8 percent of all enterprises in Indonesia.<sup>168</sup> Anecdotal evidence suggests that those at the poorer end of this bracket are not accessing assistance and the bracket needs to be further disaggregated in order to target the varied problems experienced by enterprises that might be labelled ‘small’. Moreover, labour standards for MSE employment have not changed over the past ten years, despite new regulations and initiatives. This suggests that programmes require redesign in order to address various job quality and human capability issues.

The best-intentioned policy developments can under-perform if they are not carefully and precisely targeted at smaller enterprises and their specific needs. Nevertheless, it is our contention that carefully designed and targeted regulation can bring about positive change.

## 5. CONCLUSION

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<sup>167</sup> These are: Action Plan for creating a business-conducive environment (the government takes part in formulating regulations required by SMEs); Action Plan for market access (the government works to facilitate market access and opportunity); Action Plan for financial access (the role of the government is divided into two areas, the government can provide a special scheme for SMEs, setting up procedures and standard requirement, and it can cooperate with financial institutions to provide financial resources for SMEs); Action Plan for information access (this program is a part of marketing access plan, a current weak point in SME marketing, it is about business networking through information technology); and Action Plan for technology and technology sharing (the government can assist SMEs through increasing awareness of how to apply proper technology, with the aim of enhancing competitiveness).

<sup>168</sup> See ‘Indonesia: SME Profile’ <<http://www.actetsme.org/indo/indo2000.htm>> at 25 September 2005.

It is our view that regulatory theory provides a way forward in labour regulation for States which is consistent with the insights of comparative law and development theory which we discussed earlier. In other words, emphasising responsive regulatory design may assist in ensuring that even ‘transplanted’ labour law based on a command and control model can be effective in developing economies with under-resourced States. By ensuring that design and application of labour regulation is responsive to existing social norms and the particular challenges facing businesses and workers in developing economies, then it is more likely to be effective in improving job quality and fostering economic development, without the State abandoning its role in overseeing and enforcing labour standards.

Within the field of development studies, scholars have argued that developing nations are different from more advanced economies, and different styles of regulation may be more appropriate than those proposed in flagship documents such as *Doing Business*. Developing nations, especially those with large informal economies face significant challenges and more constraints than developed economies. Some development scholars have argued that self-enforcing regulatory mechanisms can be more efficient than formal regulatory institutions in the early stage of development due to the large set up and running costs of formal regulatory systems.<sup>169</sup> Yet this literature has had very little impact upon operational practices.<sup>170</sup> Institutions such as the World Bank, at least in certain flagship documents, assume that it is possible to find a single set of institutions upon which countries should converge in order to stimulate growth.

As we have sought to show in this paper, our view is that carefully designed labour law and labour regulation frameworks can play a useful role in promoting higher job quality for employees in developing countries with large informal economies. It is also our view that they are compatible with the pursuit of the key development goals of poverty reduction and improved enterprise productivity. The human capability approach to development suggests the need for emphasis on basic freedoms and rights, together with attention to development of skills. These are likely to be closely associated with higher productivity. Both skills and higher productivity are conducive to – and reinforced and required by – an approach to development that seeks to achieve industrial upgrading through the propagation of economically nutritious activity. This in turn suggests a need for sound market institutions, in order to moderate the functioning - and contribute to the efficiency - of complex market interactions. These will then have the effect of contributing to further economic development – particularly by the generation of skills and needs that individual actors may not have sufficient incentive to pursue - and thus further development of human capability.

So what is the role of law in general and of labour law in particular? We propose that labour law is one of the key institutions that can play a role in achieving these positive development outcomes, although it is often overlooked by economists. In its insistence on fundamental rights it is a basis for securing essential freedoms; in its guise as a means of regulating labour quality, it is a way of developing human

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<sup>169</sup> Avinash Dixit, *Lawlessness and Economics: Alternative Modes of Economic Governance* (2003) Princeton University Press, Princeton.

<sup>170</sup> Dani Rodrik, *Second-Best Institutions*, (2008) <  
<http://ksghome.harvard.edu/~drodrik/papers.html> > at 14 October 2008

skills and capabilities. Comparative law suggests, however, that it is not simply a matter of copying, or adopting, laws, legal institutions or concepts from other environments in which they may have been associated with positive outcomes, in the simple hope that they will operate similarly in a new environment. Rather, it is necessary to have a subtle understanding of the history, the politics and the ‘culture’ of the environment that is now to be developed, whether by labour law or otherwise. In other words, local or national conditions will be critical considerations in the design of a regulatory framework for labour law.

Here, then, we see the link to the role of regulation theory, which suggests that a responsive or flexible approach to regulation is likely to offer a better range of tools to achieve the policy goal – in this case the propagation of high job quality in informal economies. Just as comparative law shows that local conditions matter, regulation theory teaches that there are many and varied ways of pursuing policy goals. Indeed, regulation theory has much to offer those who would seek to reform law in developing economies, by suggesting a variety of techniques that might be adopted in preference (or addition) to the simple borrowing of legal institutions from elsewhere. Thus, regulation theory offers useful insights into how to achieve the policy goals of economic and human development. As we have stressed, these insights are particularly useful in their application to the case of developing economies, where the State is frequently unable to achieve its goals by traditional means of regulation in any event.

[Concluding remarks to be added]