



International  
Labour  
Organization

## Executive Summary

### **From conflict to cooperation: Labour market reforms that can work in Nepal**

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*From conflict to cooperation* examines the rhetoric and evidence concerning labour market rigidities in Nepal. The study provides a comprehensive review of the Nepalese labour market over the last twenty years, looking at the impact of historical, political and employment relations developments on the working environment. It presents both objective evidence concerning the relationship between labour market developments and broad economic trends as well as the subjective views of employers, workers and trade union leaders on labour legislation and the functioning of the labour market. The key labour market constraint to increased investment and faster growth in Nepal appears to be the adversarial nature of employment relations and the propensity of both employers and trade unions to adopt a winner-takes-all approach when in a position of power; the study thus calls for critical revision and reinforcement of the institutions that govern industrial relations.

#### **Politics and economics of labour**

Between 1996 and 2005 Nepal was ravaged by war and on the threshold of “failed state” status. Although in 2006 the country pulled itself back from the brink, the momentum towards political and economic stability has stalled more recently. Since 2006, there have been widespread demonstrations, road blocks and wider blockades or *bandhs* of markets, enterprises, industrial units, schools and universities. In the past organized by trade unions (particularly the Maoist trade union ANFTU) and more recently by a broad range of interest groups, *bandhs* are frequently accompanied by implicit or explicit threats of violence to those who ignore the disruptive action. Political tensions have been exacerbated recently by bitter disputes about the system of federalism to be adopted and the process for electing representatives to a national Constituent Assembly. These elections were postponed twice in 2007.

An economic recession in Nepal commenced in 2001 and the country has remained in deep recession, with economic growth decelerating further in 2007. Following the onset of this recession, the labour market of Nepal became the subject of detailed discussion and policy recommendations from several international organizations critical of so-called rigidities in the labour legislation. The analysis underpinning many of the more radical proposals for reform from international organizations was limited and

relied heavily on evidence from the World Bank *Doing Business* report. The ILO, having long recognized that the labour legislation and labour market institutions in Nepal were not delivering fair and efficient outcomes, attempted to facilitate discussions between trade unions and employers over a balanced and comprehensive package of labour market reforms over the period 2002–06. This process was protracted and the consensus necessary for change failed to materialize.

Shortly thereafter, in 2006 when the democratic process was suspended, the King of Nepal unilaterally imposed far-reaching reforms to the labour legislation that were bitterly rejected by all trade unions in Nepal. These reforms were rapidly rescinded when democracy was restored a few months later. Unfortunately, this attempt at radical deregulation of the labour market intensified political sensitivities and led to a lack of trust on the subject of labour market reform.

Re-energizing the impetus towards political transition and a stronger economy is now required. The Comprehensive Peace Agreement of November 2006 recognized that increased harmony at the workplace and the implementation of worker rights will have an important role to play in this process.

## **Evidence reviewed**

Nepal started the process of economic development late. The country made steady progress in building up the non-agricultural sector of the economy from the mid-1980s until 2001, albeit from an extremely low base. There is no clear evidence that the introduction of labour legislation and other labour market institutions between 1989 and 1992 hindered this process, contrary to the analysis and consequent policy advice of several international organizations. However, economic growth came to an abrupt halt just after the turn of the century and remained subdued thereafter. The political upheavals and increased intensity of the insurgency and related security problems are the obvious primary causes of this sudden downturn. It is difficult to discern any significant changes in the labour legislation or institutional reforms in the labour market in 2001 that could help explain the economic contraction and subsequent slow growth.

This general analysis of economic and industrial relations trends over the past 20 years suggests that the so-called rigidities in the labour laws and institutions which govern the Nepalese labour market have been compatible with both economic booms and busts. Thus, the legislation is probably not the economic deal breaker that some have suggested. Other factors and policies are more critical determinants of investment and growth. An enterprise survey of past and future investment intentions presents results that are broadly consistent with this conclusion.

Considered from this perspective, the case for radical deregulation of the labour market is unconvincing. In particular, it is difficult to justify on economic grounds a move away from collective bargaining towards individual contracts or restrictions on workers' rights, such as those implemented through recent adjustments to the definition of "essential services" or the proposals to restrict workers' rights in economic processing zones. The economic case for radical reforms of this nature is particularly weak when considering such changes would exacerbate existing tensions at the workplace, with adverse consequences for productivity.

When one moves from a narrow focus on the economic arguments to consider important social and political concerns, the case against radical labour market deregulation is considerably strengthened. One of the central complaints of the rebels in the decade-long insurgency was the massive inequalities of income, resources and power that characterize Nepal. Unfortunately, in the last decade income inequalities have widened further and poverty remains pervasive. The limited labour market data available indicate that poor families have to work more intensively simply to survive, which often entails sending children to work rather than to school and accepting jobs without decent conditions. These labour market developments do not bode well for a sustainable peace.

### **Recommendations for reform**

Although radical deregulation of the labour market should be rejected, more modest and moderate adjustments to the labour legislation and a significant revision and strengthening of the country's labour institutions are required. Employers are concerned about high levels of absenteeism, low levels of motivation and low productivity. Most employers believe that this is related to shortcomings with sections of the labour legislation which deal with dismissal and retrenchment. The relevant sections of the Labour Act are highly prescriptive by international standards and careful consideration should be given to providing employers with more discretion over dismissal. This could be achieved by bringing these sections of the Labour Act fully into accord with the ILO Termination of Employment Convention, 1982 (No. 158), and Termination of Employment Recommendation, 1982 (No. 166).

Simultaneously, reforms are required to transform the current hostile industrial relations environment into a more productive and harmonious climate. To reduce the reliance on strikes, more moderate and consensual mechanisms must be found to diffuse workplace tensions and resolve legitimate worker grievances. Institutional reforms need to address at least five critical shortcomings in the way industrial relations currently operate.

- The mechanisms for monitoring the implementation of labour legislation and collective agreements need to be substantially upgraded.
- Consideration should be given to supplementing the public labour inspection system by giving greater authority to the trade unions so that they can monitor compliance with labour laws and bring complaints to the Labour Court.
- The Labour Office, which is responsible for labour inspection, is theoretically also expected to provide mediation, conciliation or arbitration services in the event of an industrial dispute. It is essential that these functions be separated.
- Recourse to justice through the Labour Court, in the event of persistent non-compliance of the labour laws, must be made more efficient and timely.
- The status and support available to the Ministry of Labour and Transport Management in the fields of labour administration and labour management relations must be upgraded.

In order to broker a compromise deal among unions, employers and the administration, it would appear wise to expand the list of issues under review to go beyond labour legislation and labour market institutions to include social security. In the past, several trade unions in Nepal have indicated that they were prepared to consider reforms that would provide greater labour market flexibility, providing there was some form of social safety net for those workers adversely affected by such reforms. Proposals have been made for a three-pronged adjustment to social security. This could involve the introduction of a new social insurance unemployment benefit scheme to help cope with any increase in unemployment resulting from changes in the dismissal laws; improvements in tax-financed benefits for the elderly; and the introduction of tax-financed benefits for young children.

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