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# Labor Flexibility, Legal Reform and Economic Development

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# Labor Flexibility, Legal Reform, and Economic Development

ALVARO SANTOS<sup>\*</sup>

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## INTRODUCTION

In light of the recent financial crisis, the need for better regulation in capital markets is painfully clear. The crisis has challenged the longstanding assumption that, on its own, the market can rein in short-term opportunistic behavior and even outright fraud, while maximizing societal wealth in the long term. As legal scholars and policymakers blame rampant flexibility of capital markets for the crisis, they begin to advocate for greater restrictions and monitoring on investment and lending. They hope that the United States government's rescue plan will not only help reactivate the economy, but also provide an opportunity to reshape financial markets to more clearly benefit society at large. In the midst of this economic collapse, however, the assumption that unbridled flexibility is the optimal form for the labor market has gone largely unchallenged, despite a pervasive sense of job insecurity, gloomy forecasts about impending job losses, and record unemployment levels.

That labor flexibility has not lost its appeal in the face of the labor market meltdown is a testimony to the virtues associated with it by many scholars and policy-makers. In good times, many economists heralded little or no labor market regulation as the engine for job creation,

greater participation of women and youths in the workforce, and lower unemployment levels. Flexibility meant a regime of employment at will, where the government imposed no restrictions on hiring, firing or working conditions. Rather, employers and workers were free to choose terms that were convenient for them.

This understanding of flexibility, however, overlooks one of the main lessons of twentieth-century American legal scholarship, namely the idea that legal rights are relational and not absolute. This regime of labor flexibility gave unparalleled strength to employers. It also meant high wages for some employees. With flexibility, however, also came the rise of a contingent workforce and precarious jobs. Labor flexibility came to mean jobs below the living wage, degrading working conditions, and informal, undocumented jobs where agreed-upon contract terms were honored in the breach.

In this Article, I argue that labor flexibility involves the interests of both employers and employees, which may coincide but are often in tension. Flexibility for one of the parties in the employment relationship can indeed translate into rigidity for the other party. In good times, the asymmetrical character of labor flexibility may go unnoticed, but in bad times, it becomes all too clear that employers and employees experience labor flexibility differently. When firms begin to cut wages or fire en masse to reduce costs, this flexibility for employers looks like nothing more than insecurity for employees.

I argue that the dominant understanding of labor flexibility—a binary between flexibility and rigidity—is misguided and should be revised. This is particularly important as the one-sided conception of labor flexibility has been translated into influential legal reform projects worldwide through the policy recommendations of the World Bank and other international financial institutions. To illustrate the shortcomings of the dominant conception of labor flexibility, I turn to the highly influential World Bank project, “Doing Business” (DB).<sup>1</sup> The Doing Business reports propose legal “best practices” in labor and employment regulation, heralding so-called labor law “flexibility” as a recipe for economic development. Based on a set of indicators that correlate labor “flexibility” with better economic performance, the reports advise countries around the world to strip down their labor regulations into flexible ones.

DB’s assessment of labor law flexibility contains a number of very serious omissions that seem to stem from a flawed understanding of regulation. I demonstrate that the Doing Business indicators fail to consider the full range of legal sources by relying primarily on the written

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1. The Doing Business Project maintains an archive of Doing Business reports on its website at <http://www.doingbusiness.org/> (last visited Sept. 19, 2009).

law, while remaining blind to the reality of law in action and to widespread economic informality. On the whole, *Doing Business* promotes a conception of legal flexibility that fails to capture the insight that flexibility for some may mean rigidity for others.

In contrast to the dominant flexibility-rigidity conception, I develop an alternative framework that unpacks the concept of labor flexibility by assessing the respective entitlements of employers and employees in the labor market. The framework I propose shows the need for two analytical steps that are currently missing in the literature. First, it is necessary to undertake a doctrinal assessment of the respective rights, duties, and privileges of the different players in the labor market. We need to ask: flexible for whom? Second, we need to pay attention to the social links between the legal regime and the realities of economic life, with particular attention to the differences between the formal and informal economic sectors.

Based on this analysis, I lay out a typology of three different labor regimes that combine flexibility and rigidity in different ways and can coexist within the same economy and the same country. These regimes, which I call the employee-friendly, employer-friendly, and free-for-all regimes, describe the full range of legal entitlements available to employers and employees in the employment relationship. They underpin different sectors of the economy, which vary in size and in contribution to a country's overall economic performance.

This framework provides a better comparative description of countries' current labor regimes, as well as their size and distribution in the economy. It can serve as a better lens through which to analyze the labor regimes that underpin successful development experiences. It could, therefore, also provide better guidance for labor regulatory strategies.

I should note that this Article is not a global defense of protections of labor regulation as they currently exist. The point is that we need to move beyond the flexibility/rigidity framework that has dominated analysis of labor regulation's relationship to development. My Article takes seriously the idea that we can learn about the relationship between labor regimes and economic performance through comparison, but challenges DB's methodology and the "one size fits all" prescriptions that flow from it. Not only because the legal reform recommendations may expend countries' scarce economic and political capital without delivering, but also because they may prevent countries from engaging in a more accurate analysis of their own regulation, from experimenting with the gamut of imaginable institutional arrangements to designing reforms that respond to their context and to their own compromises and aspirations.

Part I of this Article discusses the theoretical and empirical background of the labor regulation debates. Part II turns to the Doing Business report's methodology and proposals. Part III critiques the problematic assumptions that the Doing Business authors make about employment regulation, which both overstate and understate the role of law in economic performance. Part IV argues for the development of a new approach in assessing flexibility in labor and employment regulation and the relationship between flexible labor regulation and economic growth. To this effect, Part IV also offers a typology of labor law regimes that I believe can help us move in a more helpful direction in the debates on comparative labor law regulation. Specifically, I develop three ideal types that can help generate a contextually thicker and analytically more accurate description of labor law regimes. Part V concludes by applying this alternative framework and highlighting the lessons for legal and policy analysis in the law and development community.

## I. THE DEBATE OVER LABOR MARKET INSTITUTIONS

Law's relevance in countries' economic development is widely accepted in the academic and policymaking communities.<sup>2</sup> Law matters. How it matters, however, is hotly debated.<sup>3</sup> In recent years, one of the areas where this debate has been particularly intense is labor and employment law.<sup>4</sup> At the height of enthusiasm for free markets in development theory, the choice was seen as one between regulation and dere-

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2. See THE NEW LAW AND ECONOMIC DEVELOPMENT: A CRITICAL APPRAISAL 3, 7–9 (David M. Trubek & Alvaro Santos eds., 2006). There is a growing consensus in the development economics literature about the relevance of institutions, and particularly legal institutions in economic development. See, e.g., DOUGLASS NORTH, INSTITUTIONS, INSTITUTIONAL CHANGE AND ECONOMIC PERFORMANCE (1990); WORLD BANK, WORLD DEVELOPMENT REPORT 2002: BUILDING INSTITUTIONS FOR MARKETS (2002); Daron Acemoglu, Simon Johnson & James A. Robinson, *The Colonial Origins of Comparative Development: An Empirical Investigation*, 91 AM. ECON. REV. 1369 (2001); Dani Rodrik, Arvind Subramanian & Francesco Trebbi, *Institutions Rule: The Primacy of Institutions over Geography and Integration in Economic Development*, 9 J. ECON. GROWTH 131 (2004).

3. See Kevin E. Davis & Michael J. Trebilcock, *The Relationship Between Law and Development: Optimists Versus Skeptics*, 56 AM. J. COMP. L. 895, 917–19 (2008). Davis and Trebilcock frame the debate as one where scholars either believe that law matters or not. But the debate can be more accurately characterized as one where scholars disagree not about whether law matters, but about *how* law matters. The optimism and skepticism they describe is really about particular assumptions about law and modes of legal intervention, not about law's ability to impact social behavior in general or about its potential to foster development.

4. For examples of labor law scholarship analyzing the debate about labor markets regulation, see SIMON DEAKIN & FRANK WILKINSON, THE LAW OF THE LABOUR MARKET: INDUSTRIALIZATION, EMPLOYMENT AND LEGAL EVOLUTION 2–4, 303–42 (2005); Richard B. Freeman, *Labour Market Institutions Without Blinders: The Debate over Flexibility and Labour Market Performance*, 19 INT'L ECON. J. 129, 129–30 (2005).

gulation.<sup>5</sup> Today, as scholars recognize the need for regulation in the face of market failures, they present a choice between flexibility and rigidity in labor regulation. Thus, the question now is not whether regulation is desirable, but rather what kind of regulation is needed.<sup>6</sup>

The debate regarding what kind of labor market regulation leads to better economic outcomes has been particularly intense in Europe over the past fifteen years, as the region has experienced rising unemployment levels.<sup>7</sup> This debate, however, is not limited to the European situa-

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5. For a paradigmatic example of this position, see WORLD BANK, *WORLD DEVELOPMENT REPORT 1996: FROM PLAN TO MARKET* 72–77 (1996). For positions against labor regulation, see MILTON FRIEDMAN & ROSE D. FRIEDMAN, *FREE TO CHOOSE: A PERSONAL STATEMENT* 228–47 (1980); RICHARD A. EPSTEIN, *FORBIDDEN GROUNDS: THE CASE AGAINST EMPLOYMENT DISCRIMINATION LAWS* (1992); Richard A. Epstein, *A Common Law for Labor Relations: A Critique of the New Deal Labor Legislation*, 92 *YALE L.J.* 1357 (1983). In response to these critiques and in defense of important aspects of the New Deal-era regulatory efforts, see Julius G. Getman & Thomas C. Kohler, *The Common Law, Labor Law, and Reality: A Response to Professor Epstein*, 92 *YALE L.J.* 1415 (1983); John J. Donohue III, *Advocacy Versus Analysis in Assessing Employment Discrimination Law*, 44 *STAN. L. REV.* 1583 (1991). For a detailed survey of the regulatory landscape in the United States, as well as several proposals for regulation reform, see PAUL C. WEILER, *GOVERNING THE WORKPLACE: THE FUTURE OF LABOR AND EMPLOYMENT LAW* (1990). For an analysis of the economic benefits of unions and collective bargaining regulation, see generally RICHARD B. FREEMAN & JAMES L. MEDOFF, *WHAT DO UNIONS DO?* (1984), and the reappraisal in Richard B. Freeman, *What do Unions Do? The 2004 M-Brane Stringtwister Edition*, in *WHAT DO UNIONS DO?: A TWENTY-YEAR PERSPECTIVE* 607 (James T. Bennett & Bruce E. Kaufman eds., 2007).

6. See, e.g., Kenneth G. Dau-Schmidt, *Employment Security: A Comparative Institutional Debate*, 74 *TEX. L. REV.* 1645, 1646 (1996) (summarizing arguments challenging the efficiency of employment at will and analyzing how different types of legal institutions can maximize employers' and employees' preferences); Simon Deakin & Frank Wilkinson, *Labour Law and Economic Theory: A Reappraisal*, in *LEGAL REGULATION OF THE EMPLOYMENT RELATION* 29, 29–31 (Hugh Collins, Paul Davies & Roger Rideout eds., 2000) (showing that labor regulation can have positive economic effects in the market); see also John J. Donohue III, *Understanding the Reasons for and Impact of Legislatively Mandated Benefits for Selected Workers*, 53 *STAN. L. REV.* 897, 897–98 (2001) (analyzing positive and negative economic effects of statutory labor rights); Cynthia L. Estlund, *The Ossification of American Labor Law*, 102 *COLUM. L. REV.* 1527, 1611–12 (2002); Julius Getman, *The National Labor Relations Act: What Went Wrong; Can We Fix It?*, 45 *B.C. L. REV.* 125, 138–39 (2003). See generally KATHERINE V.W. STONE, *FROM WIDGETS TO DIGITS: EMPLOYMENT REGULATION FOR THE CHANGING WORKPLACE* (2004) (exploring a variety of legal institutions that can strengthen workers' position in a flexible labor market).

7. See ORG. FOR ECON. COOPERATION & DEV., *OECD EMPLOYMENT OUTLOOK* 4 (1993); ORG. FOR ECON. COOPERATION & DEV., *OECD EMPLOYMENT OUTLOOK* 16 (1990); Dean Baker et al., *Labor Market Institutions and Unemployment: Assessment of the Cross-Country Evidence*, in *FIGHTING UNEMPLOYMENT: THE LIMITS OF FREE MARKET ORTHODOXY* 72, 74 (David Howell ed., 2005); Olivier Blanchard & Justin Wolfers, *The Role of Shocks and Institutions in the Rise of European Unemployment: The Aggregate Evidence*, 110 *ECON. J.* 1, 1–4 (2000); Stephen Nickell, *Unemployment and Labor Market Rigidities: Europe Versus North America*, 11 *J. ECON. PERSP.* 55, 55–59 (1997); Horst Siebert, *Labor Market Rigidities: At the Root of Unemployment in Europe*, 11 *J. ECON. PERSP.* 37, 37–39 (1997). See generally RICHARD LAYARD, STEPHEN NICKELL & RICHARD JACKMAN, *UNEMPLOYMENT: MACROECONOMIC PERFORMANCE AND THE LABOUR MARKET* (2005) (includes previous papers that became influential in the debates of the 1990s); Jonas Agell, *On the Benefits From Rigid Labour Markets: Norms, Market Failures, and*



tion, and has important implications for the regulation of labor markets elsewhere. The protest of French youths against a law that would create a “flexible” labor contract for employees below age twenty-six attracted much media attention and brought to life the implications of the projects and the political weight they carry.<sup>8</sup> We know that labor market institutions create costs and incentives and affect behavior—that they matter. But how do they matter? What do we know about their impact on job creation, unemployment duration, productivity, investment in research and development, and, ultimately, on economic growth? Judging from the state of the debate, we know less than we might think.

#### A. *The Case for Flexibility of Labor Institutions*

The view that labor institutions create rigidities that favor workers who are ‘insiders’ to organized labor while disenfranchising the ‘outsiders’ became a popular theoretical view in the 1970s.<sup>9</sup>

More broadly, the neoclassical economics school argued that labor rigidities create market inefficiencies which should be eliminated through deregulation.<sup>10</sup> At the policymaking level, the Organisation for Economic Cooperation and Development (OECD) articulated one of the clearest positions in favor of flexible employment and labor legislation more than a decade ago, in its famous 1994 Job Study.<sup>11</sup> This work attributed Europe’s rising unemployment levels to “poorly functioning labour markets,”<sup>12</sup> characterized by burdensome regulations that made hiring and firing costly for employers, did not allow firms to adjust to economic cycles, and prevented further job creation.<sup>13</sup> This view assumes that restrictions on hiring and firing through employment protection legislation (EPL) create a labor market with higher entry and exit costs, dividing the market into “insiders” and “outsiders.” The problem with this legally-mandated structure, according to this view, is that the

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*Social Insurance*, 109 ECON. J. 143 (1999) (arguing in favor of labor market regulation in the face of European unemployment).

8. See, e.g., Anthony Giddens, *French Riots Show Need to Reform European Social Model*, 23 NEW PERSP. Q. 44, 44 (2006); Elaine Sciolino, *Chirac Will Rescind Labor Law That Caused Wide French Riots*, N.Y. TIMES, Apr. 11, 2006, at A1.

9. For a review of this theory, see Assar Lindbeck & Dennis J. Shower, *Insiders Versus Outsiders*, 15 J. ECON. PERSP. 1, 165–88 (2001).

10. See, e.g., FRIEDMAN & FRIEDMAN, *supra* note 5. The leading exponent of labor deregulation in legal scholarship is Richard A. Epstein. See, e.g., RICHARD A. EPSTEIN, IN DEFENSE OF THE CONTRACT AT WILL 947 (1984).

11. See ORG. FOR ECON. COOPERATION & DEV., THE OECD JOBS STUDY: EVIDENCE AND EXPLANATIONS PART I, at viii (1994); ORG. FOR ECON. COOPERATION & DEV., OECD JOBS STUDY: FACTS, ANALYSIS, STRATEGIES 43–49 (1994) [hereinafter OECD JOBS STUDY: FACTS, ANALYSIS, STRATEGIES].

12. OECD JOBS STUDY: FACTS, ANALYSIS, STRATEGIES, *supra* note 11, at 1.

13. *Id.* at 4–6.

stability and security of the employment relationship comes at a high cost, namely the unwillingness of employers to hire.<sup>14</sup>

*B. Skeptics of Labor Flexibility*<sup>15</sup>

The labor flexibility position may have been widely accepted by institutional actors, but it was met with important theoretical objections. First, critics pointed out that the connection between labor flexibility and unemployment was at best tenuous and that labor flexibility was unlikely to have any important effect on unemployment levels. Second, they cast serious doubt on the idea that government intervention in labor markets is generally and always inefficient. Indeed, labor regulation can enhance efficiency. Finally, they brought up broader normative objections to the deregulatory agenda beyond efficiency.

As regards the first argument, labor flexibility proponents argued that EPL could negatively affect job creation even if it helps avoid sudden declines in employment.<sup>16</sup> Critics of the pro-flexibility position, however, pointed out that the overall impact of EPL on employment levels would be minimal, since the decrease in short-term unemployment and the rise in long-term unemployment tend to offset each other.<sup>17</sup> This leads to the conclusion that EPL would have more impact on the composition of the workforce rather than on the levels of unemployment.<sup>18</sup> Similarly, other scholars pointed to the experience of countries that have gone through the deregulatory agenda without results as to unemployment.<sup>19</sup>

More importantly, various scholars have highlighted that EPL can enhance efficiency by reducing transaction costs and increasing productivity.<sup>20</sup> According to this view, labor market transactions under at-will employment regimes are not perfectly competitive, as modeled by neoclassical economists, but often entail structural problems such as high le-

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14. See *id.* at 46; Siebert, *supra* note 7, at 49.

15. In this Section, I am using the term “flexibility” in the sense used by DB, although I elaborate upon the concept in Part IV.

16. See DIAMOND ASHIAGBOR, *THE EUROPEAN EMPLOYMENT STRATEGY: LABOUR MARKET REGULATION AND NEW GOVERNANCE* 47 (2005); see also CENTRE FOR ECONOMIC POLICY RESEARCH, *UNEMPLOYMENT: CHOICES FOR EUROPE* 65 (1995).

17. See ASHIAGBOR, *supra* note 16, at 47. See also Gøsta Esping-Andersen, *Who is Harmed by Labour Market Regulations? Quantitative Evidence*, in *WHY DEREGULATE LABOR MARKETS?* 66, 85 (Gøsta Esping-Andersen & Marino Regini eds., 2000) (arguing that the deregulatory agenda is only tenuously anchored to economic theory and empirical research).

18. See ASHIAGBOR, *supra* note 16, at 47; Esping-Andersen, *supra* note 17, at 67.

19. See PAUL GREGG & ALAN MANNING, *LABOUR MARKET REGULATION AND UNEMPLOYMENT* 409–10 (1997).

20. See Esping-Andersen, *supra* note 17, at 71.

vels of uncertainty, asymmetrical information, and sunk costs.<sup>21</sup> Under these conditions, arising conflicts create the need for constant renegotiation of the “necessarily incomplete” employment contract, which is, in turn, inefficient.<sup>22</sup> EPL in this case provides the governance structure that makes long term cooperation and trust between employers and employees possible.<sup>23</sup>

The development of institutions such as internal labor markets and collective bargaining is not—as neoclassical economists would have it—an inefficient government intervention, but an efficient solution arising out of real needs that cannot be served by individual market transactions. Without EPL, employees and employers will negotiate inefficient contracts which do not encourage the development of skills or the internal flexibility necessary for adaptation to changing external markets.<sup>24</sup> The point is to emphasize that even within the framework of economic efficiency, regulation cannot be dismissed out of hand and can often have positive economic effects for the targeted groups.

Finally, scholars have made clear that economic efficiency is not the only normative criterion that should be considered when deciding the merits of regulation.<sup>25</sup> There are, of course, important considerations of equity, justice, and fairness that are equally worthy of attention. These are values which may coincide with economic efficiency.<sup>26</sup> But when these values conflict with efficiency goals, a society may legitimately wish to sacrifice greater wealth maximization.<sup>27</sup>

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21. See ASHIAGBOR, *supra* note 16, at 48; see also Deakin & Wilkinson, *supra* note 6.

22. See ASHIAGBOR, *supra* note 16, at 48; see also Christoph F. Buechtemann, *Introduction: Employment Security and Labor Markets*, in EMPLOYMENT SECURITY AND LABOR MARKET BEHAVIOR: INTERDISCIPLINARY APPROACHES AND INTERNATIONAL EVIDENCE 3, 12–13 (Christoph F. Buechtemann ed., 1993).

23. Deakin & Wilkinson, *supra* note 6.

24. See generally ASHIAGBOR, *supra* note 16 (explaining that governance mechanisms such as an internal labor market, vertical integration, and collective bargaining can actually improve private law by compelling workers to internalize their work obligations and cooperate in exchange for job security and efficiency wages); PETER B. DOERINGER & MICHAEL J. PIORE, *INTERNAL LABOR MARKETS AND MANPOWER ANALYSIS* (1971). Moreover, it is argued that the stability in long-term relationships provided by EPL facilitates a higher degree of internal (functional) flexibility and acceptance of technological changes. Durable relationships encourage firms to invest in human capital and training, leading to important increases in productivity and competitiveness. ASHIAGBOR, *supra* note 16, at 48.

25. See ASHIAGBOR, *supra* note 16, at 50–51.

26. See Karl Klare, *Countervailing Workers' Power as a Regulatory Strategy*, in *LEGAL REGULATION OF THE EMPLOYMENT RELATION* 63 (Hugh Collins, Paul Davies & Roger Rideout eds., 2000) (examining various goals of labor regulation and arguing that equity and efficiency considerations can sometimes coincide).

27. See Simon Deakin & Frank Wilkinson, *Rights vs Efficiency? The Economic Case for Transnational Labour Standards*, 23 *INDUSTRIAL L.J.* 289 (1994). See generally Donohue, *supra* note 6.

### C. *The State of the Empirical Evidence*

Advocates of employment and labor deregulation rely on a variety of studies showing that countries with more flexible labor markets tend to fare better.<sup>28</sup> These studies argue that certain features of labor market regulation, such as generous unemployment benefits, explain the increasing asymmetry between European and U.S. employment rates.<sup>29</sup>

Other studies, however, have cast doubt on the strength of the flexibility claims.<sup>30</sup> Economic studies sponsored by the International Labour Organization (ILO) have argued that rates of unemployment have increased independently of the degree of market regulation.<sup>31</sup> Moreover, they claim that whenever “flexibilization” of labor regulation has been implemented, it has not yielded the promised results.<sup>32</sup> In many countries, the power of unions effectively decreased, unemployment benefits were reduced, and minimum wages were, in some cases, curtailed with scant, if any, positive employment effects.<sup>33</sup> Labor economist Richard B. Freeman argues that critics of the orthodoxy have successfully demonstrated that the data are more ambiguous than what promoters of this orthodox view claim.<sup>34</sup>

As Freeman notes, these challenges have impelled “even the OECD to retreat from its strong Jobs Study claim to a more equivocal position

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28. See Nickell, *supra* note 7, at 55–59; Stephen Nickell, Luca Nunziata & Wolfand Ochel, *Unemployment in the OECD Since the 1960s: What Do We Know?*, 115 *ECON. J.* 1, 10–11 (2005).

29. *Id.* at 72.

30. See Baker et al., *supra* note 7. Richard Freeman gives this article credit for documenting that “the findings in several time series models, that find that institutions adversely affect aggregate outcomes, are not robust. The estimated coefficients on labor institutions disappear or become statistically insignificant when the researchers made modest changes in measures of institutions, countries covered, and time periods of analysis. Models that covered more years, countries, and measures than earlier studies ‘provide little support for those who advocate comprehensive deregulation of OECD labor markets.’” Freeman, *supra* note 4, at 135 (footnote omitted).

31. The Jobs Letter, The 1996–97 ILO Jobs Report: There’s Plenty of Work to Do!!, (Letter No. 52, Dec. 20, 1996), <http://www.jobslatter.org.nz/jbl05210.htm> [hereinafter The 1996–97 ILO Jobs Report] (summarizing the ILO’s report on world employment for 1996–97).

32. *Id.* Consistent with the ILO findings, an empirical study compared the impact of hiring, firing, and unemployment regulations on employment levels, actors’ behavior, and productivity in seven Latin American countries. The study found no identifiable effect on economic performance, specifically as regards productivity. See Adriana Marshall, *Consecuencias económicas de los regímenes de protección del trabajo. Un estudio comparativo*, in LAS INSTITUCIONES LABORALES FRENTE A LOS CAMBIOS EN AMÉRICA LATINA 391, 415–16 (José B. Figueiredo ed., 1996). Another example comes from Card and Krueger’s famous study of the employment effects of minimum wage increases. Comparing New Jersey fast food restaurants where an increase of minimum wages occurred with Philadelphia where it did not, the authors concluded that the increase did not negatively affect employment. See DAVID CARD & ALAN B. KRUEGER, MYTH AND MEASUREMENT: THE NEW ECONOMICS OF THE MINIMUM WAGE 25–69 (1995).

33. The 1996–97 ILO Jobs Report, *supra* note 31.

34. See Freeman, *supra* note 4, at 136; Freeman, *supra* note 5, at 614–16.

about the impact of institutions on outcomes.”<sup>35</sup> The 2004 OECD Employment Outlook admitted that the “evidence of the role played by EPL on aggregate employment . . . rates remain[ed] mixed . . . .”<sup>36</sup> Thus, these studies have demonstrated that the evidence is far from conclusive and that, at the very least, the burden of proof now lies with the proponents of comprehensive labor deregulation. This mixed and inconclusive evidence would seem to warrant some caution towards legal reform projects that push for the removal of protections in the employment contract as a panacea for better economic performance. Still, the Doing Business project seems to push precisely for such removal of protections.<sup>37</sup>

In the face of theoretical disagreements and mixed empirical evidence, scholars have turned to measuring law as a way to assess its impact on social and economic outcomes. Scholars are trying to evaluate how law matters and, more specifically, what kind of legal institutions are best for economic performance.<sup>38</sup> This inquiry has caused scholars and international development institutions to produce a wealth of legal indicators, attempting to deliver an answer.<sup>39</sup>

Among these attempts, the leading indicators have been built by DB.<sup>40</sup> This project examines legal regimes around the world and proposes legal “best practices” in a variety of different domains. In the area of labor market regulation, DB has promoted labor law “flexibility” as a necessary part of the recipe for economic development.<sup>41</sup> Based on a set of indicators that correlate labor “flexibility” with better economic per-

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35. Freeman, *supra* note 4, at 136.

36. ORG. FOR ECON. COOPERATION & DEV. OECD EMPLOYMENT OUTLOOK 81 (2004).

37. The overall thrust of DB in the field of labor and employment is to recommend that countries dismantle labor protections. See WORLD BANK, DOING BUSINESS IN 2006: CREATING JOBS 26 (2005) [hereinafter DOING BUSINESS 2006]. For an example of DB encouraging “flexibilization” that leads to less labor protection, see WORLD BANK, DOING BUSINESS 2007: HOW TO REFORM 19–20 (2007) [hereinafter DOING BUSINESS 2007] (lauding Macedonia for flexibilization of “overtime” regulation and simplification of redundancy procedures).

38. See generally Kevin E. Davis, *What Can the Rule of Law Variable Tell Us About Rule of Law Reforms*, 26 MICH. J. INT’L L. 141 (2004) (critically reviewing a variety of legal indicators).

39. See, e.g., Rafael La Porta et al., *Law and Finance*, 106 J. POL. ECON. 1113, 1152 (1998); Daniel Kaufmann, *Rethinking Governance: Empirical Lessons Challenge Orthodoxy* (March 11, 2003) (Discussion Draft, World Bank), available at [http://siteresources.worldbank.org/INTWBIGOVANTCOR/Resources/rethink\\_gov\\_stanford.pdf](http://siteresources.worldbank.org/INTWBIGOVANTCOR/Resources/rethink_gov_stanford.pdf); Daniel Kaufmann, Aart Kraay & Pablo Zoido-Lobaton, *Governance Matters* (World Bank, Policy Research Working Paper No. 2196, 1999); see also Daniel Kaufmann et al., *Governance Matters IV: Governance Indicators for 1996–2004* (World Bank, Policy Research Working Paper No. 3630, 2005).

40. For more general information, see the World Bank’s Doing Business Project, <http://www.doingbusiness.org/> (last visited Sept. 19, 2009).

41. See DOING BUSINESS 2006 *supra* note 37; WORLD BANK, DOING BUSINESS IN 2005: REMOVING OBSTACLES TO GROWTH 30–32 (2005) [hereinafter DOING BUSINESS 2005]; WORLD BANK, DOING BUSINESS IN 2004: UNDERSTANDING REGULATION 30–38 (2004) [hereinafter DOING BUSINESS 2004].

formance, the DB reports advise countries around the world to strip down their labor regulations into flexible ones.<sup>42</sup>

These indicators have been both praised<sup>43</sup> and criticized<sup>44</sup> by the policymaking and academic communities, but praise and critique alike have largely taken for granted these indicators' characterization of labor regulation as a binary choice between flexible and rigid rules. Advocates hail the report as the best available demonstration of the economic virtues of flexibility, while critics show the social and economic benefits of labor protections.<sup>45</sup> This Article contributes to the law and development debate by offering a critique of these prominent labor flexibility

42. DB ranks countries' performance based on a rigidity/flexibility score and encourages labor market reforms. Each year, DB includes accounts of both successful country reforms towards more labor flexibility and also counterproductive rigid reforms. *See, e.g.*, WORLD BANK, DOING BUSINESS 2009, 19–23 [hereinafter DOING BUSINESS 2009].

43. *See* Josette Sheeran, Under Sec'y for Econ., Bus. & Agric. Affairs, U.S. Dep't of State, Remarks at the U.S. Department of State: Doing Business in the World 2007: A New Emphasis for the U.S. Government (Sept. 8, 2006), <http://2001-2009.state.gov/e/rm/2006/72879.htm> (“[T]his report with its detailed, objective indicators gives us a unique comparative view of microeconomics—looking at 10 areas of everyday business, from registering property to getting credit and enforcing contracts. . . . I actually keep the Doing Business report by my bedside. This report tells me more about a nation's economy and its potential, than anything else I've ever seen written.”).

44. In this Article, I join efforts with the critics of the Doing Business project. *See, e.g.*, Benito Arruñada, *Pitfalls to Avoid When Measuring the Institutions: Is Doing Business Damaging Business?* 35 J. COMP. ECON. 729, 735–44 (2007); Kevin E. Davis & Michael B. Kruse, *Taking the Measure of Law: The Case of the Doing Business Project*, 32 L. & SOC. INQUIRY 1095, 1104–16 (2007). Janine Berg & Sandrine Cazes, Int'l Labour Org., *The Doing Business Indicators: Measurement Issues and Political Implications*, at 5, Economic & Labour Market Paper 2007/6 (2007), available at <http://www.ilo.org/public/english/protection/condtrav/pdf/rdwbpaper07.pdf>. I also join scholars who have criticized the “legal origins” literature that underpins the Doing Business project. In particular, see Detlev Vagts, *Comparative Company Law – The New Wave*, in Festschrift für Jean Nicolas Druey zum 65. Geburtstag 595, 597–605 (Rainer J. Schweizer, Herbert Burkert & Urs Gasser eds., 2002); Daniel Berkowitz, Katharina Pistor & Jean-Francois Richard, *Economic Development, Legality, and the Transplant Effect*, 47 EUR. ECON. REV. 165, 192 (2003); John K.M. Ohnesorge, *China's Economic Transition and the New Legal Origins Literature*, CHINA ECON. REV. 485, 487–90 (2003); Mark J. Roe, *Legal Origins, Politics, and Modern Stock Markets*, 120 HARV. L. REV. 460, 465 (2006); KENNETH W. DAM, THE LAW-GROWTH NEXUS: THE RULE OF LAW AND ECONOMIC DEVELOPMENT (2006). In addition, a few papers have responded to the argument that legal origin determines divergence in labor regulation. *See* Beth Ahlering & Simon Deakin, *Labor Regulation, Corporate Governance and Legal Origin: A Case of Institutional Complementarity?* 14–32 (Eur. Corp. Governance Inst., Working Paper No. 72/2006, 2005) (challenging the alleged connection between the type of legal tradition and labor regulation using historical and contemporary examples); David E. Pozen, *The Regulation of Labor and the Relevance of Legal Origin*, 28 COMP. LAB. L. & POL'Y J. 43, 45–55 (2006) (challenging the legal origins coding methodology). My Article joins efforts with these responses but attempts to go beyond correcting this methodology. It lays the groundwork for a different analytical framework to enable a more contextual description of labor regimes, their relation to economic life, and the potential effects of prescribed reforms.

45. Compare Sheeran, *supra* note 43, with Berg & Cazes, *supra* note 44, at 5–7.

indicators and proposing a new analytical framework that can be a sharper tool for legal and policy analysis.

In this Article, I develop insights gained from comparative law and legal theory to challenge the World Bank project's theoretical assumptions, pointing out its methodological flaws and showing its potentially misleading recommendations for legal reform. The endeavor has global significance, since these indicators seem to gain credibility by claiming to objectively describe regulatory frameworks around the world.

## II. THE WORLD BANK'S DOING BUSINESS PROJECT

### A. Background

Doing Business is now the World Bank's most widely circulating report, and has received ample publicity in international policymaking circles and developing countries.<sup>46</sup> Even though the report is not legally binding upon borrowing countries, it exerts increasing sway on the World Bank's own diagnosis of the problems in countries' regulation and on the Bank's prescriptions in a variety of regulatory fields.<sup>47</sup>

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46. See, e.g., PETER BAKVIS, INT'L CONFEDERATION OF FREE TRADE UNIONS, HOW THE WORLD BANK & IMF USE THE *DOING BUSINESS* REPORT TO PROMOTE LABOUR MARKET DEREGULATION IN DEVELOPING COUNTRIES 2, 5, 7–12 (2006), available at <http://archivio.rassegna.it/2006/europamondo/articoli/doingbusinessicftuanalysis0606.pdf>.

47. I do not mean to suggest that all groups in the World Bank unequivocally accept this methodology or that there are not other methodologies at work in the institution. Indeed, there are groups in the Bank that have analyzed labor regulation in a quite different way. See e.g., TOKE AIDT & ZAFIRIS TZANNATOS, WORLD BANK, UNIONS AND COLLECTIVE BARGAINING: ECONOMIC EFFECTS IN A GLOBAL ENVIRONMENT (2002). This report found that "at the macroeconomic level, high unionization rates lead to lower inequality of earnings and improve economic performance (in the form of lower unemployment and inflation, higher productivity and speedier adjustment to shocks)." Press Release, World Bank, Economies Perform Better in Coordinated Labor Markets, Press Release No. 2003/211/S (Feb. 12, 2003), available at <http://go.worldbank.org/DCFCSPIJL20>. In contrast to DB, this report neither identifies nor recommends best regulatory practices. Instead, it calls attention to countries' context and institutional setting. The report emphasized that "[w]hile the available evidence from comparative studies of the OECD countries is fragile, two general features should be emphasized. First, the impact of collective bargaining on various aspects of macroeconomic performance depends on the economic, legal, and political environment in which collective bargaining takes place and can vary over time. Second, important complementarities exist between key aspects of the bargaining system. . . . It is the package of institutions that matters." AIDT & TZANNATOS, *supra*, at 5. The Doing Business project, however, seems to be the most influential, and its indicators are having great impact on recommendations for legal reform. For an institutional analysis of the World Bank describing the variety of theoretical frameworks within which different groups operate in promoting regulatory reform, see Alvaro Santos, *The World Bank's Uses of the "Rule of Law" Promise in Economic Development*, in THE NEW LAW AND ECONOMIC DEVELOPMENT: A CRITICAL APPRAISAL 253 (David M. Trubek & Alvaro Santos eds., 2006).

The DB project is the translation into policy of a theoretical claim generated by what has become known as the “legal origins” literature,<sup>48</sup> whose influence in the field of economics lends DB credibility. The legal origins scholarship, first advanced in the field of comparative corporate finance, has emerged as an increasingly dominant analytical framework for law reform aimed at stimulating economic development.<sup>49</sup> The authors of this scholarship argue that legal tradition explains differences in countries’ approaches to regulation.<sup>50</sup> Adopting the conventional categorization of legal systems into “legal families,” these authors assert that regulation in common law countries is more efficient and leads to better social and economic outcomes than in civil law countries.<sup>51</sup> Consequently, the authors of DB, some of whom participate in the legal origins scholarship, recommend that countries adopt the employment laws of countries whose legal systems originated in common law, by which they mean an at-will employment regime.<sup>52</sup> According to DB, since the type of labor regulation that exists in a country is the result of historical accident rather than political choices, countries can and should transform their legal regimes by adopting whatever best-practice rules would work better for any given regulatory area, even if this adoption is piecemeal.

The DB authors are not alone in coding countries’ regulatory systems and correlating them with economic performance in an attempt to explain the relationship between labor and employment regulation and economic growth. There are a number of important indicators that seek to provide countries with guidance on how to regulate their labor markets to promote development.<sup>53</sup> Indeed, the results of these various indi-

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48. See, e.g., Edward L. Glaeser & Andrei Shleifer, *Legal Origins*, 117 Q.J. ECON. 1193, 1223–24 (2002).

49. See La Porta et al., *Law and Finance*, *supra* note 39, at 1114–17 (1998). These theorists have produced a vast “legal origins” literature, rapidly expanding from the field of corporate finance to other areas of regulation like administrative law, bankruptcy, labor and employment, and civil procedure. See Simeon Djankov et al., *Courts*, 118 Q.J. ECON. 453, 453–59 (2003); Simeon Djankov et al., *Debt Enforcement Around the World*, 116 J. POL. ECON. 1105, 1146–48 (2008); Simeon Djankov et al., *The Regulation of Entry*, 117 Q.J. ECON. 1, 1–5 (2002); Rafael La Porta et al., *The Quality of Government*, 15 J.L. ECON. & ORG. 222, 224, 231–33, 261–62 (1999); Aron Balas et al., *The Divergence of Legal Procedures* 2–5 (Nat’l Bureau of Econ. Research, Working Paper No. 13809, 2008), available at <http://www.nber.org/papers/w13809>.

50. See La Porta et al., *The Quality of Government*, *supra* note 49, at 222, for an argument that the common law legal tradition goes with less interventionist regulatory attitudes.

51. See Glaeser & Shleifer, *supra* note 48.

52. See Juan C. Botero et al., *The Regulation of Labor*, 119 Q.J. ECON. 1339, 1375–80 (2004).

53. See, e.g., JAMES J. HECKMAN & CARMEN PAGÉS, LAW AND EMPLOYMENT: LESSONS FROM LATIN AMERICA AND THE CARIBBEAN 39–65 (2004); Alvaro Forteza & Martín Rama, *Labor Market “Rigidity” and the Success of Economic Reform Across More than One Hundred Countries* 21–31 (World Bank, Policy Research Working Paper No. 2521, 2002); James Heck-



cators are often inconsistent.<sup>54</sup> I focus on DB because it is the leading project in the field and it enjoys the support of the principal international development institution in the world, making it highly influential.

In 2004, at a time when the strongest claims supporting labor flexibility had been challenged and the empirical evidence in countries' experience remained mixed, DB began to make a forceful intervention to push the scales in favor of labor flexibility.<sup>55</sup> DB is an ambitious enterprise. So far, it has released six annual reports that include quantitative indicators on about a dozen topics regarding the legal business environment, ranking now 181 countries. After beginning with the fundamental aspects of the firm's life cycle—starting a business,<sup>56</sup> hiring and firing workers,<sup>57</sup> enforcing contracts,<sup>58</sup> getting credit,<sup>59</sup> and closing a business<sup>60</sup>—DB has since expanded to the areas of registering property,<sup>61</sup> issuing government licenses and conducting inspections, protecting investors,<sup>62</sup> paying taxes,<sup>63</sup> and trading across borders.<sup>64</sup> In employment law, the DB indicators consider countries' employment regulation and correlate the scores with economic performance. The underlying idea is that such correlation will allow scholars and policymakers to draw conclusions about the relationship between labor regulation and economic performance. To corroborate results, the study relies on the support of a network of local law firms and business consultants around the globe.<sup>65</sup>

According to DB's own website, the purpose of the whole endeavor is legal reform based on objective data that can produce replicable formulas:

The analysis in Doing Business has direct relevance for policy reform. It reveals the relationship between business regulation indicators and economic and social outcomes, allowing policymakers to see how particular laws and regulations are associated

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man & Carmen Pagés, *The Cost of Job Security Regulation: Evidence from Latin American Labor Markets* 28–30 (Nat'l Bureau of Econ. Research, Working Paper No. 7773, 2000), available at <http://www.nber.org/papers/w7773>.

54. See Gordon Betcherman, Amy Luinstra & Makoto Ogawa, *Labor Market Regulation: International Experience in Promoting Employment and Social Protection* 1–4 (World Bank, Social Protection Discussion Paper Series No. 128, 2001).

55. See, e.g., BAKVIS, *supra* note 46, at 6–13.

56. DOING BUSINESS 2004, *supra* note 41, at 17–28.

57. *Id.* at 29–39.

58. *Id.* at 41–54.

59. *Id.* at 55–70.

60. *Id.* at 71–82.

61. DOING BUSINESS 2005, *supra* note 41, at 33–40.

62. *Id.* at 49–58.

63. DOING BUSINESS 2006, *supra* note 41, at 45–52.

64. *Id.* at 53–60.

65. See *id.* at 77; DOING BUSINESS 2009, *supra* note 42, at 62.

with poverty, corruption, employment, access to credit, the size of the informal economy, and the entry of new firms. Also, the analysis provides guidance on the design of reforms. . . . Governments can identify, after reviewing their country's Doing Business indicators, where they lag behind and what to reform.<sup>66</sup>

Elsewhere, DB has identified four project goals, three of which relate to legal reform: (1) “motivating reforms through country benchmarking,” (2) “informing the design of reforms,” (3) “enriching international initiatives on development effectiveness,” and (4) “informing theory.”<sup>67</sup>

Regarding labor market regulation, DB promotes five reform efforts: (1) reduce the scope of employment regulation; (2) introduce flexible part-time and fixed-term contracts; (3) reduce or lower the minimum wage for new entrants; (4) allow employers to shift work time between periods of slow demand and peak periods, without the need for overtime payment; and (5) ease regulations on firing by cutting severance payments, easing or eliminating notice, and increasing the number of ‘fair causes’ for dismissal.<sup>68</sup> These reforms, in turn, will “ease the burden on businesses and provide better job opportunities for the poor.”<sup>69</sup>

The DB project authors have maintained from early on that they support basic ILO conventions on labor rights, prohibiting discriminatory practices, enabling freedom of association and collective bargaining, and prohibiting forced and child labor.<sup>70</sup> As it becomes obvious however, from the indicators themselves as well as from the accompanying explanatory text of the DB reports, the DB authors distinguish between ‘flexible’ and ‘rigid’ labor regulation, claiming that the former is preferable to the latter because flexible regulation leads to better economic performance:

[I]f regulation in other aspects of the employment relation is too rigid, it lowers labor force participation, increases unemployment, and forces workers into the informal economy. . . . [I]f the average Latin American country were to reduce its employment protection to the level found in the United States, estimated total employment would rise by almost six percentage points. In some countries, the negative effects of rigid employment regulation are even larger. A 10 percent increase in dismissal costs in Peru is

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66. Ask a Question — Doing Business — The World Bank Group, <http://www.doingbusiness.org/AskQuestion> (last visited Sept. 19, 2009) (click on “Can *Doing Business* help design reforms?” hyperlink).

67. DOING BUSINESS 2004, *supra* note 41, at ix–x.

68. *Id.* at xix–xx.

69. *Id.* at xix.

70. *See id.* at 29.

associated with an estimated increase in long-term unemployment of 11 percent, and in India and Zimbabwe of about 20 percent.<sup>71</sup>

At times, DB has more directly blamed unemployment on “rigid employment regulation.” In the 2005 *Doing Business* report, the World Bank authors sympathetically follow “Yasmine,” a young, educated female worker in Burkina Faso who cannot find a job and is relegated to the informal sector. They then go on to assert that “Yasmine’s plight can be explained by rigid employment regulation.”<sup>72</sup> The obvious solution for governments is then to reform in the flexible direction.

To illustrate the frenzy of reform that the DB indicators seem to have provoked in developing countries, as well as the logic of regulatory competition these indicators feed into, consider the following quote from the 2007 DB report, “How to Reform”:

Publishing comparative data on the ease of doing business inspires governments to reform. Since its start in October 2003, the *Doing Business* project has inspired or informed 48 reforms around the world. Mozambique is reforming several aspects of its business environment, with the goal of reaching the top rank on the ease of doing business in southern Africa. Burkina Faso, Mali and Niger are competing for the top rank in West Africa. Georgia has targeted the top 25 list and uses *Doing Business* indicators as benchmarks of its progress. Mauritius and Saudi Arabia have targeted the top 10.

Comparisons among states or cities within a country are even stronger drivers of reform. Recent studies across 13 cities in Brazil and 12 in Mexico have created fierce competition to build the best business environment. . . .

To be useful for reformers, indicators need to be simple, easy to replicate and linked to specific policy changes. Only then will they motivate reform and be useful in evaluating its success.<sup>73</sup>

DB recommends that countries start with reforms that involve administrative, not legislative, changes, although its highest laurels go to countries that do attempt the whole package:

The 3 boldest reforms, driving the biggest improvements in the *Doing Business* indicators:

- Mexico’s increase in investor protections, in its new securities law.

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71. *Id.*

72. *DOING BUSINESS* 2006, *supra* note 37, at 21.

73. *DOING BUSINESS* 2007, *supra* note 37, at 3–4.

- Georgia's flexible labor rules, in its new labor code.
- Serbia's easing of exporting and importing procedures, in its new customs code.<sup>74</sup>

In addition, the U.S. Agency for International Development (USAID) has strongly supported the DB indicators.<sup>75</sup> A USAID official asserted that "countries that are willing to embark on serious reforms in these areas will find ready and willing support from the donors," and that "[t]hose countries and leaders willing to undertake significant reform and governance improvement will be recognized and will receive substantial and appropriate support."<sup>76</sup> Thus, besides the World Bank's own support for reforms undertaken to improve a country's DB indicators, the project enjoys full support from one of the biggest development assistance donors in the world.<sup>77</sup>

DB's recommendations largely boil down to a simple legal reform proposal: turn civil law labor regulation into common law rules. DB has boldly declared that, in the case of business regulation, "One Size Can Fit All."<sup>78</sup> In the case of employment and labor regulation, that means a blanket endorsement of what DB calls a "flexible" regime.<sup>79</sup> But how does DB measure flexibility in legal regimes?

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74. *Id.* at 3.

75. USAID has sponsored several events publicizing the DB reports. *See, e.g.*, Regional World Bank's Doing Business Report Identifies Necessary Reforms for Kazakhstan, Kyrgyzstan, and Uzbekistan, [http://www.usaid.gov/locations/europe\\_urasia/press/success/2006-06-15.html](http://www.usaid.gov/locations/europe_urasia/press/success/2006-06-15.html) (last visited Sept. 19, 2009) (noting that USAID sponsored events that introduced the "Doing Business in 2006: Creating Jobs" report in Kyrgyzstan and Kazakhstan to "representatives of government, private sector, academia, donors, and media . . ."); USAID, World Bank, IFC Mark the Release of the 2008 Doing Business Report, Oct. 17 2007, (<http://www.prnewswire.com/cgi-bin/stories.pl?ACCT=104&STORY=/www/story/10-19-2007/0004686038>). USAID frequently refers to DB indicators to highlight the success of its foreign aid to countries that have moved up in the DB rankings. *See e.g.*, USAID, Afghanistan Land Titling and Economic Restructuring Activity, World Bank 2008 Doing Business Report, [http://www.ltera.org/index.php?option=com\\_content&id=99-world-bank-2008-doing-business-report/](http://www.ltera.org/index.php?option=com_content&id=99-world-bank-2008-doing-business-report/) (last visited Sept. 19, 2009) (noting that the 2008 DB report recognized "Afghanistan's great progress with the simplification of the registration process for immovable property with USAID/LTERA's support"). USAID is not the only U.S. government agency that supports the DB indicators. The State Department has also voiced strong support for DB. *See* Sheeran, *supra* note 43 (noting that "the U.S. government sees [the DB report] as an important economic diplomacy tool").

76. Andrew S. Natsios, Adm'r, U.S. Agency for Int'l Dev., Keynote Speech to the Corporate Council on Africa (Sept. 14, 2005), <http://www2.reliefweb.int/rw/RWB.NSF/db900SID/EGUA-6GLNRB/>.

77. The United States is one of the most important development assistance donors in absolute dollar numbers, although it pales in comparison with other major donor governments when the assistance provided is taken as a percentage of the national domestic product. *See* CURT TARNOFF & LARRY NOWELS, FOREIGN AID: AN INTRODUCTORY OVERVIEW OF US POLICY AND PROGRAMS (Cong. Research Serv., CRS Report for Congress Order Code 98-916, Apr. 14, 2004).

78. DOING BUSINESS 2004, *supra* note 41, at xvi.

79. Each DB report includes a section on hiring/firing, now called "employing workers," in

### B. Methodology

DB identifies three categories in the legal regulation of employment: hiring, working conditions, and firing. It then formulates under each category a series of questions aimed at clarifying the legal regimes of the countries studied. Each category is the basis for an index.<sup>80</sup> Hiring, for instance, is divided into part-time contracts and fixed-time contracts. The task is to measure how flexible or rigid a country's employment law is by looking at how much its rules depart from parties' total freedom of contract. Based on its "yes" or "no" answers to the questions for each category, the country receives a score of zero or 100, signifying flexibility or rigidity respectively, for each question. The averages of these scores yield the flexibility indicator for each aspect—hiring, working conditions, or firing. An overall average represents the country's employment law flexibility index. Averages closer to 100 indicate more rigidity, and averages closer to zero indicate more flexibility.<sup>81</sup>

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which the authors assess how far countries have gone toward implementing flexible labor regulation. See *DOING BUSINESS 2009*, *supra* note 42, at 19–23. The 2009 report claims that a 20% decrease in industrial output in the Indian state of West Bengal could be attributed to a reform of labor regulations in the rigid direction, further blaming these reforms for an estimated additional 1.8 million urban poor. *Id.* at 20.

80. See *infra* Table 1 for the components of each index.

81. For an explanation of the most current methodology, see *Doing Business*, <http://www.doingbusiness.org/MethodologySurveys/EmployingWorkers.aspx> (last visited Sept. 19, 2009).

TABLE 1: RIGIDITIES IN EMPLOYMENT REGULATION<sup>82</sup>

Hiring	Part-time contracts	Is part-time employment prohibited? Are part-time workers exempt from mandatory benefits of full-time workers? Is it easier or less costly to terminate part-time workers than full-time workers?
	Fixed-term contracts	Are fixed-term contracts allowed only for fixed-term tasks? What is the maximum duration of fixed-term contracts (in months)?
	Hours of work	What is the mandatory minimum daily rest? What is the maximum number of hours in a workweek? What is the premium for overtime work? Are there restrictions on night work? Are there restrictions on weekly holiday work?
Conditions of employment	Leaves	What is the number of legally mandated days of annual leave with pay in manufacturing? Is paid time off for holidays mandatory?
	Minimum wage	Is there a mandatory minimum wage? Are conditions of employment specified in the constitution?
	Grounds for firing	Is it unfair to terminate the employment contract without cause? Does the law establish a public policy list of "fair" grounds for dismissal? Is redundancy considered a fair ground for dismissal?
Firing	Firing procedures	Must the employer notify a third party before dismissing one redundant employee? Does the employer need the approval of a third party to dismiss one redundant worker? Must the employer notify a third party before a collective dismissal? Does the employer need the approval of a third party before a collective dismissal? Does the law mandate retraining or replacement prior to dismissal? Are there priority rules applying to dismissal or layoffs? Are there priority rules applying to re-employment?
	Notice and severance payment	What is the legally mandated notice period (in weeks) after 20 years? What is the severance pay as a number of months for which full wages are payable after covered employment of 20 years?
	Job security	Is the right to job security specified in the constitution?

Source: Doing Business database.

Here is an example of how the methodology works, as explained by the report:

If the regulation restricts the ability of managers and workers to negotiate the employment contract, a value of 100 is entered, zero otherwise. For example, fixed-term contracts are allowed in Venezuela only for temporary tasks, while in Vietnam they are allowed for any task. On this component of the hiring index, Venezuela gets a 100, Vietnam a 0. Similarly, managers have to give fair cause for dismissal in Cameroon, but not in Jamaica. On this component of the flexibility-of-firing index, Cameroon gets a 100, Jamaica a 0. The scores are averaged across the components of each index, to get the value of the index itself.<sup>83</sup>

The results are reflected in Table 3.2, which shows how countries scored in each of these three indices.<sup>84</sup> The upper part of the table shows the most flexible countries and the lower part the least flexible ones. These are some of the results:

- Employment regulation is more flexible in developed

82. DOING BUSINESS 2004, *supra* note 41, at 35.

83. *Id.* at 34.

84. *Id.* at 36.

countries.

- The countries with the most rigid employment regulation include six Latin American countries (Brazil, Mexico, Panama, Paraguay, Peru, and Venezuela), and Angola, Belarus, Mozambique, and Portugal.
- Some countries have very strong protection in one of the indices but not in the others. . . . In general, however, the indicators of labor regulation tend to move together: restrictions on hiring go with restrictions on firing as well as with more rigid conditions on employment.
- Rich countries have the lowest average scores in all indices. Nordic-origin countries regulate employment relations the least in conditions of employment but less so in dismissals, in which English-origin countries have the lightest regulation.
- Across regions East Asian economies regulate the least and Latin American countries, the most . . . .<sup>85</sup>

TABLE 2: INDEXES ON EMPLOYMENT REGULATION<sup>86</sup>

Flexibility of hiring		Conditions of employment		Flexibility of firing		Employment laws	
Most-flexible regulation							
China	17	Hong Kong (China)	22	Hong Kong (China)	1	Singapore	20
Czech Republic	17	Zimbabwe	22	Singapore	1	United States	22
Namibia	17	Denmark	25	Uruguay	3	Malaysia	25
Nigeria	17	Malaysia	26	Papua New Guinea	4	Denmark	25
Papua New Guinea	17	Singapore	26	United States	5	Papua New Guinea	26
Australia	33	United States	29	Japan	9	Hong Kong (China)	27
Canada	33	South Africa	36	United Kingdom	9	Zimbabwe	27
Denmark	33	Sweden	39	Australia	13	United Kingdom	28
Poland	33	Norway	39	Austria	14	Austria	30
Uganda	33	Kuwait	40	Malaysia	15	New Zealand	32
Least-flexible regulation							
Brazil	78	Nicaragua	90	Brazil	68	Paraguay	73
Chad	78	Mongolia	90	Panama	68	Peru	73
Greece	78	Paraguay	90	Peru	69	Mozambique	74
Guinea	78	Turkey	91	Ukraine	69	Venezuela, RB	75
Thailand	78	Poland	92	Mexico	70	Belarus	77
Venezuela, RB	78	Hungary	92	Belarus	71	Mexico	77
El Salvador	81	Ukraine	93	Russian Federation	71	Angola	78
Mexico	81	Chad	93	Paraguay	71	Brazil	78
Panama	81	Rwanda	94	Portugal	73	Portugal	79
Taiwan (China)	81	Bolivia	95	Angola	74	Panama	79

Note: Indexes range from 0 to 100, with higher values indicating more-rigid regulation. The employment-laws index is the average of the flexibility-of-hiring, conditions-of-employment, and flexibility-of-firing indexes.

Source: Doing Business database.

Based on these results, the authors promote an agenda for flexibility in labor regulation that means ridding the system of many restrictions and compulsory clauses in the employment contracts.<sup>87</sup>

85. *Id.* at 34–35 (internal citations omitted).

86. DOING BUSINESS 2004, *supra* note 40, at 36.

87. This is evident even in the way in which DB ranks countries' labor regulations. For in-

Since 2004, DB has effectuated several changes to its methodology, initially in the direction of more accurately trying to capture what it considers a “rigidity,” and later on responding to critiques coming from the ILO in the opposite direction. In 2005 and 2006, DB added a cost of firing index and a cost of hiring index, respectively. The cost of hiring index measured all social security payments and payroll taxes associated with hiring an employee.<sup>88</sup> The cost was expressed as a percentage of the worker’s salary. The cost of firing index measured ‘rigidity’ in terms of weeks of wages that were due to a fired worker. Thus, in 2006, the overall employing workers’ index was comprised of the employment regulation index (hiring, conditions of employment, and firing) and the hiring and firing cost indicators. In 2007, DB removed the hiring cost indicator (now renamed nonwage labor costs) and included it instead in the “paying taxes” indicator.

In 2007, two researchers of the ILO published an article that criticized the Doing Business report for discouraging countries from abiding with the ILO convention obligations they have undertaken:

The employing workers’ index clearly does not encourage countries to abide by many of the International Labour Conventions of the International Labour Organization (ILO). In many instances, countries score worse if their national labour legislation reflects the provisions set forth in the ILO Conventions concerning termination of employment, minimum wages, working hours and annual leave, even though these are international treaties ratified and adopted by many countries. Moreover, countries that abide by the conventions on Fundamental Principles and Rights of Work do not score better than countries that have not adopted these conventions.<sup>89</sup>

In response, the 2008 DB report effectuated two main changes, which it asserted would assure that “it is possible for an economy to receive the highest score on the ease of employing workers—indicating the most flexible labor regulations—and comply with all 187 ILO conventions.”<sup>90</sup> First, employment provisions providing for up to eight weeks of worker compensation are given a score of zero in the ease of employing workers index, and restrictions on night work, such as higher over-

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stance, the more a country’s regulatory framework provides for worker compensation upon dismissal, the worse it fares in the cost-of-firing index. *See* DOING BUSINESS 2009, *supra* note 42, at 67.

88. For a critique of the idea that cutting payroll taxes helps lower the unemployment rate, see BRIAN BELL & STEPHEN NICKELL, CUTTING PAYROLL TAXES ON THE UNSKILLED 320–22 (1997).

89. *See* Berg & Cazes, *supra* note 44, at 3.

90. WORLD BANK, DOING BUSINESS 2008, at 68 (2008).



time premiums or limitations on scheduling work hours, are no longer coded as rigidities.<sup>91</sup> Second, DB no longer gives a score of 100 (the worst score) to countries whose employers need to either notify or get approval for laying off a group of more than 20 workers. The cutoff point has now been increased to 25.<sup>92</sup>

In 2008, the Independent Evaluation Group of the World Bank asserted that even though the DB methodology conforms to the letter of the ILO conventions, it did not assure conformity with the spirit of the conventions because it penalized countries that offered greater job protection than that stipulated by the conventions.<sup>93</sup>

### III. CRITIQUES OF THE DOING BUSINESS METHODOLOGY

DB makes very strong claims about the potential effects of labor law reform on economic development, and these claims increasingly influence international policymaking. Some of the most active groups in the World Bank very strongly support the DB indicators as a tool for regulatory reform. Unlike past lending projects in the 1990s, in which the World Bank would tie its loans to reform conditions, the DB indicators are not part of the loan conditionalities.<sup>94</sup> Nonetheless, the World Bank promotes the project through press releases, a highly visible website on the World Bank portal, where “top reformers” are lauded, and prominent placement of the DB reports on the World Bank’s “Rapid Response Unit,” a website that has described its aims as seeking to “offer[] best practice public policy advice for private sector led growth . . . in developing countries” and help seekers “[f]ind expert analysis, powerful databases, quick solutions, and comprehensive ‘how-to’ guides.”<sup>95</sup>

Furthermore, the DB has created a “Reformers Club” to celebrate the top reformers in its rankings. Each year, DB invites government officials from the top reformers to an awards ceremony to honor their achievements and further stimulate reform based on the DB reports.<sup>96</sup>

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91. *Id.*

92. *Id.* at 72.

93. INDEPENDENT EVALUATION GROUP, WORLD BANK, DOING BUSINESS: AN INDEPENDENT EVALUATION: TAKING THE MEASURE OF THE WORLD BANK-IFC DOING BUSINESS INDICATORS, at xvi (2008), available at [http://siteresources.worldbank.org/EXTDOIBUS/Resources/db\\_evaluation.pdf](http://siteresources.worldbank.org/EXTDOIBUS/Resources/db_evaluation.pdf).

94. For a discussion of the earlier World Bank and IMF loan conditionality practices, see Jeffrey Sachs, *Conditionality, Debt Relief, and the Developing Country Debt Crisis* (Nat’l Bureau of Econ. Research, Working Paper No. 2644, 1988), available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=261258](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=261258).

95. Private Sector Development Home – Private Sector Development – The World Bank Group, <http://web.archive.org/web/20070609131513/http://rru.worldbank.org/> (last visited Sept. 19, 2009).

96. See Reformers Club – Doing Business – The World Bank Group,

Finally, the World Bank's Country Economic Memoranda (CEM), which form the basis for its policy recommendations, regularly cite the DB indicators.<sup>97</sup> In addition, the U.S. government, one of the most important development assistance donors in the world, seems to have adopted the DB indicators as part of its development assistance handbook.<sup>98</sup>

Therefore, we should seriously consider both DB's descriptions of labor law regimes around the world and the policy proposals they derive from these descriptions. In this Part, I develop critiques of the DB project, drawing insights from comparative law and legal theory. My argument is that a series of very serious omissions that seem to come from a flawed understanding of regulation mars the way in which DB sets out to compare labor law "flexibility." If DB's flexibility-rigidity index took into account several lessons from legal scholarship, it would likely look very different. Part III.A, below, describes the omissions and misunderstandings built into the DB project's methodology. Part III.B illustrates how a specific labor law regime may be dramatically misrepresented in DB's index because of these methodological flaws.

#### A. *Three Lessons from Comparative Law*

Any study seeking to determine whether a given type of regulation is flexible or rigid across countries must consider basic lessons of comparative methodology. Comparative lawyers generally accept the premise that a meaningful comparison between two legal rules must pay attention to the function that the rule performs.<sup>99</sup> Norms with the same name can have different functions. Similarly, legal institutions that at first seem unrelated can play the same role in their respective contexts. These lessons concerning the functional equivalence of legal norms are missing in the DB methodology. Further, any comparative study ought to consider the following three factors.

##### 1. *Attention to the Full Range of Legal Sources*

The normative order in operation stems from a variety of legal sources, not only the law as it exists on the books. The employment

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<http://www.doingbusiness.org/Reformers/ReformersClub.aspx> (last visited Sept. 19, 2009).

97. See BAKVIS, *supra* note 46, at 7–12.

98. See Sheeran, *supra* note 43.

99. This idea, which is hardly controversial, was heralded by Rudolf Schlesinger and has come to be known as the Cornell comparative law approach. See RUDOLF B. SCHLESINGER ET AL., *COMPARATIVE LAW: CASES, TEXT, MATERIALS* 2–3 (6th ed. 1998). See generally O. Kahn-Freund, *On Uses and Misuses of Comparative Law*, 37 MOD. L. REV. 1 (1974) (emphasizing the importance of context in the analysis of legal institutions and warning against misusing comparative law for law reform, particularly in the area of labor regulation).

contract can be modified by a variety of statutes, with restrictions or compulsory clauses that affect the parties' rights and obligations. Moreover, judicial decisions can modify or invalidate contract rules in whole or in part. This is true in every legal system, where judicial interpretation fills in gaps, conflicts, and ambiguities present in the legal materials.<sup>100</sup> In the field of employment and labor law, courts have played a crucial role in defining the extent and limits of employers' and workers' rights.<sup>101</sup> Finally, collective agreements, where employers and employees bargain to increase or decrease their respective rights and obligations, can govern employment relations in a whole industry or region, adding a layer of regulation to the respective common law rule or employment statute. DB does not fully account for these alternative sources.

## 2. *Attention to Law in Action*

Comparing legal institutions requires considering not only formal law but also its enforcement to determine the actual normative order in effect.<sup>102</sup> If we want to know how law is affecting the behavior of employers and employees, we will need to know something about how well institutions and affected parties enforce that law. How effective are the mechanisms of enforcement? How costly are they when compared to the alternatives? What is the incidence of offended parties obtaining legal remedies?<sup>103</sup>

## 3. *Attention to Informal or Nonlegal Norms*

The legal order interacts with other social norms that significantly affect behavior. Legal sociology has made us aware of the fact that informal norms play an important role in enforcing expectations and in providing certainty and calculability in transactions.<sup>104</sup> These norms can be

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100. For classic statements of this proposition, see Karl N. Llewellyn, *A Realistic Jurisprudence—The Next Step*, 30 COLUM. L. REV. 431 (1930); Roscoe Pound, *Law in Books and Law in Action*, 44 AM. L. REV. 12 (1910).

101. Karl E. Klare, *Judicial Deradicalization of the Wagner Act and the Origins of Modern Legal Consciousness, 1937–1941*, 62 MINN. L. REV. 265 (1978); see generally Estlund, *supra* note 6, at 1530–35; Getman, *supra* note 6, at 126–27.

102. In June 2008, the Independent Evaluation Group of the World Bank confirmed that the Doing Business indicators can be misleading because they only measure the law as it is written. See INDEPENDENT EVALUATION GROUP, *supra* note 93, at xv. The group also warned “that most of the methodological limitations can and should be addressed promptly, lest they undermine [the indicators’] credibility. Inaccurate nomenclature should be rectified and the DB reports should not overstate claims of causality and the indicators’ explanatory power.” *Id.* at xvii.

103. See Llewellyn, *supra* note 100; Pound, *supra* note 100.

104. For a classic study in this tradition, see Stewart Macaulay, *Non-Contractual Relations in Business: A Preliminary Study*, 28 AM. SOC. REV. 55 (1963).

as important as formal norms in defining the regulatory floor that parties consider binding upon them at any given moment.<sup>105</sup> A comparison that ignores this normative order is at risk of missing an important layer of regulation affecting social behavior.<sup>106</sup>

*B. The Method's Problems: The Examples of the United States and Mexico*

In order to illustrate how these omissions can translate into misrepresentations of rigidity or flexibility, I take a few examples from Mexico and the United States, two countries that DB places on opposite sides of the flexibility spectrum. While DB considers the United States to have one of the most flexible employment regulation environments,<sup>107</sup> Mexico scores very high in labor rigidity.<sup>108</sup> Mexico is also situated in the region that scores the lowest in labor flexibility,<sup>109</sup> and it belongs to the civil law tradition, which (according to DB) is a bad omen for economic performance.

Consider each of the categories of employment regulation analyzed by DB: hiring, working conditions, and firing.

*1. Hiring*

DB classifies Mexico as having rigid employment regulation, enshrined in a default permanent employment contract.<sup>110</sup> The Mexican labor law allows for fixed-term contracts only for a year and under the condition that the nature of the job be temporary.<sup>111</sup> On this feature, Mexico would score a 100.<sup>112</sup>

If we look at other sources of law,<sup>113</sup> however, we find that fixed-term contracts are more common than we might imagine. The civil code

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105. See ROBERT C. ELLICKSON, *ORDER WITHOUT LAW: HOW NEIGHBORS SETTLE DISPUTES* 1–11 (1991).

106. Marc Galanter, *Why the "Haves" Come Out Ahead: Speculations on the Limits of Legal Change*, 9 *LAW & SOC'Y REV.* 95 (1974).

107. In 2009, DB ranked the United States first in the employing workers index, which measures flexibility in hiring and firing, among other things. See *DOING BUSINESS 2009*, *supra* note 42, at 143.

108. *Id.* at 120 (ranking Mexico 141 out of 181 countries in the employing workers index, which means high labor rigidities according to the DB methodology).

109. For the region's rank in DB, see *WORLD BANK, DOING BUSINESS 2009: LATIN AMERICA* 2–10 (1998).

110. *DOING BUSINESS 2004*, *supra* note 41, at 34. For Mexico's score, see *supra* Table 2.

111. See *Ley Federal del Trabajo [L.F.T.] [Federal Labor Law]*, *as amended*, arts. 35–39, 40, *Diario Oficial de la Federación [D.O.]*, 17 de Enero de 2006 (Mex.) [hereinafter *FLL*].

112. See *DOING BUSINESS 2004*, *supra* note 41.

113. Mexico's *FLL* is a comprehensive regulation that establishes minimum labor protections, but some scholars have estimated that it does not encompass more than twenty percent of labor relations. The remaining eighty percent would be comprised of collective agreements, labor

contains several provisions that, while not specifically intended for employment relationships, are very often so applied. An employee may be hired under the guise of being self-employed and offering a service to a buyer for an honorarium, with a temporary contract in which the employee receives no employment benefits since she is outside the protective ambit of labor law.<sup>114</sup> The Federal Labor Law (FLL) presumes an employment contract subject to all rights and obligations recognized by the law whenever there is an employment relationship.<sup>115</sup> Employers, however, often resort to civil contracts to bypass labor legislation and reduce costs.<sup>116</sup> The use of these practices has increased considerably, with companies employing more than eighty percent of their labor force through hiring “confidential” employees, who occupy a position of trust and are therefore exempt from the just-cause regime, or using civil contracts.<sup>117</sup> Similarly, it has not been uncommon for unions to agree to fixed-term and temporary contracts in collective agreements for a percentage of the workforce, even when the duration of the job could be indeterminate.<sup>118</sup>

Furthermore, even though the FLL explicitly seeks to avoid the use of intermediation or subcontracting to impinge upon employees’ benefits,<sup>119</sup> firms often bypass their statutory employment obligations by establishing subsidiaries, thereby weakening the unions and substantially

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customs, or informal agreements. See Arturo Alcalde & Bertha Luján, *Cómo viven la democracia los trabajadores mexicanos*, in LA DEMOCRACIA DE LOS ABAJO 91, 103 (Jorge Alonso & Juan Manuel Ramírez eds., 1997).

114. See GRACIELA BENSUSÁN, EL MODELO MEXICANO DE REGULACIÓN LABORAL 263–264 (2000) [hereinafter BENSUSÁN, EL MODELO MEXICANO].

115. See FLL art. 35.

116. As is evidenced by the radical reduction in the number of formal, written labor contracts in small and medium-sized businesses, as well as in the *maquiladora* sector. A *maquiladora* is a factory or assembly plant, operating under a preferential tariff program, which imports inputs to manufacture or assemble products that are then exported out of the country. One of its main objectives is to take advantage of comparatively cheaper labor in the assembling country. See JANINE BERG, CHRISTOPH ERNST & PETER AUER, MEETING THE EMPLOYMENT CHALLENGE: ARGENTINA, BRAZIL, AND MEXICO IN THE GLOBAL ECONOMY 137–38 (2006).

117. Alcalde & Luján, *supra* note 113, at 100.

118. See BENSUSÁN, EL MODELO MEXICANO, *supra* note 114, at 263–64; Alfonso Bouzas & Enrique de la Garza, *Flexibilidad del Trabajo y Contratación Colectiva en México*, 60 MÉXICO IIE-UNAM-CAMBIO XXI (1998).

119. According to the FLL, in cases of intermediation, when a person hires or helps to hire employees to work for an employer, the beneficiary firm acquires responsibility as employer over the employment contract and is required to grant these employees the same benefits as those enjoyed by its employees performing the same job. FLL art. 14. In the case of outsourcing, if the service provider does not fulfill the requirements to fully comply with its obligations as employer, the beneficiary firm is jointly responsible. Otherwise, it is the provider and not the beneficiary who bears full responsibility over the employment obligations. FLL art. 15. The law requires that employees working for the provider enjoy similar conditions to the employees of the beneficiary firm. FLL art. 15.

reducing labor costs.<sup>120</sup> Moreover, outsourcing has often been used as a way to mask intermediation and substantially decrease labor costs.<sup>121</sup>

Additionally, firms have found mechanisms to restructure by severing their relationship with employees who are then rehired by downsized firms on a nonpermanent basis. This, in turn, allows firms to avoid legal responsibility for the employment contract, substantially reducing costs concerning employment benefits and eliminating potential severance payments.<sup>122</sup>

If we turn to the enforcement of the permanent employment contract, we realize that employers' margin of maneuver to decide employment duration is in fact extended through a number of channels, such as "imprecise legislation, judicial interpretation of labor rights, and the lack of strong unions that are ready to demand performance and further specify those rights in collective agreements."<sup>123</sup> An employer, for instance, can impose a temporary contract for what would seemingly be a permanent activity, despite a DB score of 100 on this front. This phenomenon explains why, despite legal rigidity, using temporary contracts is an extended practice in small and medium-sized firms.<sup>124</sup>

Finally, although the law presumes an implied permanent employment contract whenever there is an employment relationship, there is an extended practice in some sectors of the economy by which parties do not resort to formal law at any level of their relationship. In these cases, hiring conditions are indeed quite flexible, according to the DB authors' definition of flexibility.<sup>125</sup>

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120. Alcalde & Luján, *supra* note 114. See BENSUSÁN, EL MODELO MEXICANO, *supra* note 114, at 287.

121. Alcalde & Luján, *supra* note 113, at 98–99. See BENSUSÁN, EL MODELO MEXICANO, *supra* note 114, at 287–89.

122. See BENSUSÁN, EL MODELO MEXICANO, *supra* note 114, at 289 (observing that in the privatization process in the mid-1980s, many firms bypassed statutory protections for employees, which guarantee employer responsibility in case of employer substitution, by closing off and reopening firms with new, more flexible, contracts modifying working conditions and the number of jobs).

123. BENSUSÁN, EL MODELO MEXICANO, *supra* note 114, at 263 (author's translation).

124. *Id.* at 263. (noting that this practice was adopted to decrease labor costs, even in big state-owned enterprises as in the case of temporary workers in the state-owned oil company PEMEX). Bensusán also notes that the use of temporary contracts reached 12% of manufacturing workers in the 1990s, which would situate Mexico in an intermediate position among OECD countries. *Id.* at 263–64.

125. See William F. Maloney, *Informality Revisited*, 32 WORLD DEV. 1159, 1159–60, 1173 (2004) (arguing that the informal sector is the "unregulated, developing country analogue of the voluntary entrepreneurial small firm sector found in advanced countries").

## 2. Working Conditions

DB considers three main aspects of working conditions: hours of work, leaves, and minimum wage. The less the law imposes requirements on any of these fronts, the more flexible it is. There is a great variety of other legal sources dictating employment conditions, however, with significant costs for which DB does not account. Consider safety, health, and benefits regulations, or think of sexual harassment regulations, anti-discrimination laws, and accommodation mandates. In the United States, one of the most flexible countries in the sample, such workplace requirements meaningfully affect the employment contract and often impose significant costs on employers. DB, however, does not account for this pool of regulations. If it did, the United States would receive a lower flexibility score than it currently does, and Mexico's score would be higher, since Mexican protection on these fronts is rather weak.<sup>126</sup>

Furthermore, even if we were to focus solely on hours of work, attention to enforcement is crucial. In Mexico, it is not uncommon to find employees working long hours, beyond the maximum number allowed, without sanctions for the employer or effective remedies for the employee.<sup>127</sup>

Finally, an increasing array of employment practices such as corporate codes of conduct,<sup>128</sup> which constitute the core of some of the most successful transnational strategies by NGOs, labor and consumer groups to improve working conditions,<sup>129</sup> again create important costs to employers.<sup>130</sup> These norms are often conceived of as soft regulation (in contradistinction with hard formal law), but they are binding in the sense that they effectively structure parties' behavior.<sup>131</sup>

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126. See, e.g., Patricia Kurczyn Villalobos, *Propuestas para Reformar la Ley Federal del Trabajo en Temas de Equidad y Género*, in *LA REFORMA LABORAL QUE NECESITAMOS* 145 (José Alfonso Bouzas ed., 2004) (arguing for the need to strengthen labor regulation and enforcement with respect to anti-discrimination and benefits to achieve gender equality).

127. Enrique de la Garza Toledo, *Estructura industrial y condiciones de trabajo en la manufactura*, in *LA SITUACIÓN DEL TRABAJO EN MÉXICO*, 2003, at 251, 263 (Enrique de la Garza & Carlos Salas eds., 2004).

128. See generally Rhys Jenkins, U.N. Research Inst. For Soc. Dev., *Corporate Codes of Conduct: Self Regulation in a Global Economy*, Tech., Bus. & Soc.'y Programme Paper No. 2 (Apr. 2001), available at [http://www.unrisd.org/unrisd/website/document.nsf/0/e3b3e78bab9a886f80256b5e00344278/\\$FILE/jenkins.pdf](http://www.unrisd.org/unrisd/website/document.nsf/0/e3b3e78bab9a886f80256b5e00344278/$FILE/jenkins.pdf).

129. See, e.g., Bob Hepple, *A Race to the Top? International Investment Guidelines and Corporate Codes of Conduct*, 20 COMP LAB. L. & POL'Y J. 347 (1999).

130. For an analysis on the increasing use and potential problems of corporate codes of conduct, see Int'l Labor Org., *Corporate Codes of Conduct*, <http://actrav.ilo.org/actrav-english/telearn/global/ilo/code/main.htm> (last visited Sept. 19, 2009).

131. See, e.g., JOHN BRAITHWAITE & PETER DRAHOS, *GLOBAL BUSINESS REGULATION* 19–20 (2000); Cynthia Estlund, *Rebuilding the Law of the Workplace in an Era of Self-Regulation*,

### 3. *Firing*

In countries with at-will employment contracts like the United States, there are a host of regulations that restrict employers' leeway to fire, such as the National Labor Relations Act and a variety of antidiscrimination laws regarding gender, race, age, and disabilities.<sup>132</sup> Dismissing an employee in a manner contrary to any of these laws would be functionally equivalent to unjust dismissal, and would trigger the employer's obligation to reinstate or compensate.<sup>133</sup> Compensation in these cases can of course be quite expensive.<sup>134</sup> In contrast, in countries that, like Mexico, have a default just-cause dismissal regime, there are provisions in the labor statute or in collective agreements that allow temporal suspension or dismissal in case of economic downturns or technological change, making adjustment more flexible (in the DB sense) than surface appearances might show.<sup>135</sup>

Additionally, looking at enforcement is indispensable for understanding the true costs of firing. In Mexico, for example, it is estimated that only six percent of workers who have been unjustly dismissed file a suit against their employer.<sup>136</sup> This estimate presents a rather different picture of employers' burden on firing. Finally, informal practices on firing must be considered. Informal practices under a just-cause dismissal regime can establish a de facto contract at will, where no obligation to reinstate or pay severance is expected from the employer. For instance, despite the law's stringent compensation requirements for unjust dismissal, employers have found ways to cut jobs without paying the price. This practice has been particularly visible in simulated bankruptcies

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105 COLUM. L. REV. 319, 322 (2005). For a critical assessment, see generally Adelle Blackett, *Global Governance, Legal Pluralism and the Decentered State: A Labor Law Critique of Codes of Corporate Conduct*, 8 IND. J. GLOBAL LEGAL STUD. 401 (2000–01).

132. See Cynthia L. Estlund, *Wrongful Discharge Protections in an At-Will World*, 74 TEX. L. REV. 1655–92 (1996) (discussing the multiple exemptions to employment at will emerging from common law and statutory regulation).

133. *Id.*

134. See JAMES N. DERTOUZOS ET AL., *THE LEGAL AND ECONOMIC CONSEQUENCES OF WRONGFUL TERMINATION* (1988); DAVID J. JUNG, PUBLIC LAW RESEARCH INSTITUTE, *JURY VERDICTS IN WRONGFUL TERMINATION CASES* (1997), available at <http://w3.uchastings.edu/plri/96-97tex/jury.htm>; David H. Autor et al., *The Costs of Wrongful-Discharge Laws*, 88 REV. ECON. & STAT. 211, 212–14 (2006).

135. FLL arts. 426, 434, 437.

136. GRACIELA BENSUSÁN, *DISEÑO LEGAL Y DESEMPEÑO: INSTITUCIONES LABORALES EN AMÉRICA LATINA* 326 (2006) [hereinafter BENSUSÁN, *DISEÑO LEGAL Y DESEMPEÑO*]; see also Graciela Bensusán, *La Distancia Entre Normas y Hechos: Instituciones Laborales en América Latina*, 2 ARGENTINA MINISTERIO DEL TRABAJO: REVISTA DE TRABAJO 115, 126 (2006), available at [http://www.trabajo.gov.ar/left/estadisticas/descargas/revistaDeTrabajo/2006n02\\_revistaDeTrabajo/2006n02\\_a09\\_gBensusan.pdf](http://www.trabajo.gov.ar/left/estadisticas/descargas/revistaDeTrabajo/2006n02_revistaDeTrabajo/2006n02_a09_gBensusan.pdf) [hereinafter Bensusán, *La Distancia*].



when firms close down plants only to reopen with fewer personnel and less favorable employment contracts.<sup>137</sup>

#### IV. TOWARD A NEW APPROACH FOR ANALYZING THE RELATIONSHIP BETWEEN LABOR LAW AND ECONOMIC GROWTH

The analysis above highlights DB's shortcomings on the count of descriptive inaccuracy. If one were to recode the DB indicators on employment regulations, taking into account such factors as other legal sources and enforcement levels, it is likely that countries would fare quite differently, and the correlation between legal families (common law versus civil law) and economic performance would become less significant. Indeed, scholars who have recoded DB indicators in corporate governance have found that the legal origins factor is not relevant.<sup>138</sup>

In addition to the inaccurate diagnosis, the further leap to prescription on this basis is unwarranted. In this respect, it is crucial to note that even though DB readily suggests that civil law countries should reform their labor law regimes to mimic common law countries,<sup>139</sup> they only correlate a country's regulatory flexibility with that country's overall wealth, using gross national income per capita as an indicator.<sup>140</sup> All this correlation tells us, however, is the relationship between a given regulatory framework and a country's *current* income level. DB's reform proposals amount to extracting whatever legal rules the richest countries currently have in place and then asking developing countries to mimic them. There is no reference to countries' historical growth rates.<sup>141</sup> More im-

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137. See BENSUSÁN, BENSUSÁN, *EL MODELO MEXICANO*, *supra* note 114, at 266; Alcalde & Luján, *supra* note 113, at 100–01.

138. See Roe, *supra* note 44, at 516; Holger Spamann, *On the Insignificance and/or Endogeneity of La Porta et al.'s 'Anti-Director Rights Index' Under Consistent Coding* 69–70 (Harvard Law Sch. John M. Olin Ctr., Discussion Paper No. 7, 2006), *available at* [http://www.law.harvard.edu/programs/olin\\_center/fellows\\_papers/pdf/Spamann\\_7.pdf](http://www.law.harvard.edu/programs/olin_center/fellows_papers/pdf/Spamann_7.pdf).

139. The link here is that common law countries are less heavy regulators, and less heavy regulation is correlated with higher income per capita. The project's recommendations are in line with these observations.

140. See *DOING BUSINESS 2009*, *supra* note 42, at 62; *DOING BUSINESS 2004*, *supra* note 41, at 105.

141. After World War II, for instance, when the United States was experiencing a significant economic boost, thirty percent of the workforce in the private sector was unionized. This means that one in three employees was subject to just cause dismissal, not contract at will. Similarly, Britain had an extensive just cause regime, along with many other restrictions on the employment contract, which were dismantled by the Thatcher government. It would be reasonable to expect that a regulatory reform promoted as a strategy for growth, like that of DB, would pay heed to the relationship between moments of high economic growth rates and the existing legal framework.

portantly, DB pays no attention to how moments of growth have correlated with changes in regulatory frameworks.<sup>142</sup>

Taking these critiques into consideration would make the task of comparison more complicated. This, however, is only because the critiques shed light on the complexities of law and of the impact of law on social behavior. Therefore, they cannot be ignored if the goal is to recommend what kind of regulation countries should adopt. Bringing these challenges to the debates and policy proposals in economic development could help revamp the projects in more promising, if humbler, ways. At any rate, these challenges may at least help reduce the confidence with which programs like DB are promoted and the appeal they arouse in many developing countries.

Simply improving the DB indicators, however, is not what I am after here. For a project that wishes to pursue a comparison of countries' employment law regimes and to investigate their relation to economic growth, a different approach altogether is warranted. No matter how sophisticated the DB indicators become in capturing law in action, their monodimensional definition of "flexibility" is doomed to lead to reductive description and therefore, problematic prescription. "Flexibility" can be understood in many different ways, depending on which characteristics of the legal system or the economy itself are at issue. In the following Sections, I lay the foundations for an alternative descriptive approach that seeks to capture some of the complexity involved in labor regulation in different sectors of the economy. The first step is to unpack the various conceptions of flexibility at play.

#### A. *Unpacking the Legal Meaning of Flexibility*

The DB methodology could be significantly improved if it took into account the critiques raised in the previous Part. Even then, though, its analytical framework for thinking about flexibility would be of only limited use because it is limited conceptually, empirically, and programmatically.

The framework is limited conceptually because it obscures the meaning of flexibility. From the point of view of the parties to the employment relationship, the DB methodology takes a one-sided perspective that looks only at the employer's ability or disability to define the terms

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142. Dani Rodrik has challenged a similar methodology in the debate about the effects of openness on free trade and economic development. See DANI RODRIK, UN DEV. PROGRAMME, THE GLOBAL GOVERNANCE OF TRADE: AS IF DEVELOPMENT REALLY MATTERED (2001), available at <http://ksghome.harvard.edu/~drodrik.academic.ksgh/UNDPtrade.PDF>; Dani Rodrik, *Why We Learn Nothing from Regressing Economic Growth on Policies* (UCLA Int'l Inst., 2005), available at <http://www.international.ucla.edu/media/files/rodrik.pdf>.

of the contract. From the point of view of the legal regime underpinning the employment contract, DB misses the abilities and disabilities that the employer has regarding different aspects of that employment contract. By averaging these different abilities and disabilities in the employment contract (hiring, conditions of employment, and firing) into a general flexibility-rigidity indicator, the framework misses the interplay between these forms and the tradeoffs that their different combinations represent. A labor regime can give employers much flexibility in the firing and hiring processes, while being quite rigid regarding work hours, other employment conditions, and levels of remuneration for preexisting employees. What kinds of tradeoffs have labor regimes made, and with how much success?

The DB framework is limited empirically because, as I have shown, the flexibility-rigidity scores and rankings tell us very little about what type of regime is actually in operation in a given country. Moreover, this approach overlooks what seems to be a crucial phenomenon of modern economies in both developed and developing countries: every country may have several labor regimes coexisting within the same economy.<sup>143</sup> Each of these regimes may have distinct flexibility features, and each may underpin several different economic sectors that vary in size, importance, and contribution to any given economy. As will become clear, the DB framework not only misses a rich contextual analysis, but also moves us further away from one.

Finally, the DB approach is limited programmatically because its reform proposals stem from a confused conceptual analysis and description of labor regimes. A reform proposal that is based on such study is doomed to be limited at best. Despite the enthusiasm and self-confidence surrounding the study (which have made DB a best seller)—or because of the enthusiasm and self-confidence—I engage in a careful consideration of the reform proposals and warn against unwarranted expectations.

In Part IV.B, I analyze the different conceptions at play in the flexibility rhetoric, which I call formal, substantive, and organizational. The analysis of these conceptions will help clarify and delimit the specific sense in which DB conceives of flexibility.

In Part IV.C, I construct a typology of three kinds of labor regimes that legal norms can create, by combining flexibility and rigidity, for the parties involved in the employment contract. I use these ideal types to argue that different labor regimes may and often do co-exist within the same economy.

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143. See, e.g., ROBERTO MANGABEIRA UNGER, *DEMOCRACY REALIZED: THE PROGRESSIVE ALTERNATIVE* 30–41 (1998).

In Part V, I illustrate the existence of these ideal types by looking at the case of Mexico. This is a particularly useful example because the country has undergone a process of economic liberalization and restructuring that has integrated its market into the global economy. At the same time, the country's labor and employment regulation was long considered inherently progressive and instrumental in creating the corporatist system under which the country industrialized during the period of import substitutions. Moreover, in the last two decades, there has been an ongoing debate about the reform of Mexican labor law, which has provoked bitter disagreements and many reform proposals. By many accounts, including DB's, Mexico's regulation—with its just-cause dismissal regime and generous workers' rights—is considered to have one of the most rigid labor regulations in the world and to be in urgent need of flexibility to make the economy internationally competitive. For all these reasons, this case presents a fertile ground for analysis considering the relationship between labor regulation and economic development in the context of increasing market liberalization.

#### *B. Three Conceptions at Play in the Flexibility Rhetoric*

The aim of this Section is to unpack the concept of flexibility and analyze its various legal meanings. What do scholars and policymakers mean when they talk about more or less flexible legal regimes? Is this vocabulary helpful? Both proponents and opponents of flexibility proceed as if there existed, legally speaking, a single type of flexible or rigid rules. Instead, I identify three conceptions of flexibility at play in current debates about labor market regulation. I call these conceptions (1) formal flexibility, (2) substantive flexibility, and (3) organizational flexibility. These distinctions are important from an analytical point of view because they enable a clearer discussion of what the claims for flexibility stand for, and how they translate into a legal regime.

##### *1. Formal Flexibility*

The first conception of flexibility, which I call formal, refers to the internal characteristics of the legal norms. These characteristics determine whether a norm is clear and cognizable in the abstract, or whether it calls for a contextual analysis. In legal theory, rules and standards are representative of the most common differences among formal characteristics. Whereas rules are usually considered easy to interpret and enforce, standards are deemed to require a contextual analysis that takes

into consideration a broader set of factors.<sup>144</sup> Thus, from a conceptual perspective, rules are rigid and standards are flexible.<sup>145</sup>

## 2. *Substantive Flexibility*

In this conception, flexibility refers to the ways in which a norm enables or restricts the conduct of the parties in a legal relationship recognized by law. This analysis looks, from the participants' point of view, at the legal regime that regulates the employment relationship. Understood in this sense, flexibility becomes a matter of perspective, and the question "flexibility for whom?" appears unavoidable.<sup>146</sup> This conception of flexibility ultimately refers to power and its allocation. A given norm could give more or less power and, hence, more or less flexibility to the employer or the employee in interactions at every level of the employment relationship.<sup>147</sup>

## 3. *Organizational Flexibility*

The third conception of flexibility refers to organizational changes in the production process resulting from technological developments, new forms of industrial organization, greater international competition, and changes in the configuration of the labor market. Firms need to be more flexible if they want to succeed in this post-Fordist era: quicker in adjusting to economic cycles, readier to cope with international competition, and lighter, in order to move wherever costs are cheaper.<sup>148</sup> Changes in the organization of production include new ways of managing employment relations. Often, firms will require a more participative workforce, with a richer set of skills, involved in decision making. Hierarchical relations are less vertically and more horizontally organized, with work resembling team work.<sup>149</sup> Two prominent reasons for restruc-

144. For a classic discussion of the difference between rules and standards, see Duncan Kennedy, *Form and Substance in Private Law Adjudication*, 89 HARV. L. REV. 1685 (1976).

145. See Carol Rose, *Crystals and Mud in Property Law*, 40 STAN. L. REV. 577, 577-79 (1988) (discussing the substitution of standards for rules in property law); Pierre J. Schlag, *Rules and Standards*, 33 UCLA L. REV. 379, 379-90 (1985) (examining the characteristics of rules and standards).

146. For a discussion of this type of analysis, see, for example, Robert L. Hale, *Coercion and Distribution in a Supposedly Non-Coercive State*, 38 POL. SCI. Q. 470, 471-74, 492-94 (1923).

147. For an excellent analysis of the labor market "flexibility" agenda promoted by international development institutions, understood in this substantive conception, see Kerry Rittich, *Core Labor Rights and Labor Market Flexibility: Two Paths Entwined?*, in *LABOR LAW BEYOND BORDERS: ADR AND THE INTERNATIONALIZATION OF LABOR DISPUTE SETTLEMENT* 157, 172-79 (Int'l Bureau of the Permanent Court of Arbitration ed., 2003).

148. See Michael Storper & Bennett Harrison, *Flexibility, Hierarchy and Regional Development: The Changing Structure of Industrial Production Systems and their Forms of Governance in the 1990s*, 20 RES. POL'Y 407, 420 (1991).

149. See MICHAEL J. PIORE & CHARLES F. SABEL, *THE SECOND INDUSTRIAL DIVIDE*:

turing the production process are the need for cooperation and the desire to innovate.<sup>150</sup>

#### 4. *DB's Uses of Flexibility*

The three conceptions of flexibility I have described are analytically distinguishable, and their exposition aims to clarify DB's claims about labor market flexibility. When DB claims that a more flexible legal regime will lead to higher employment levels and economic development, it is not clear that it refers to all three of these conceptions. Even when the appeal to labor flexibility may seem to refer to all three levels, flexibility for contextual interpretation, flexibility for the employer to act as she pleases, and flexibility in the firm's productive process need not be—and indeed often are not—consonant with one another.

At first sight, the DB arguments for labor flexibility do not seem to refer to the formal characteristics of the legal norms. After all, what DB considers to be the most rigid legal provision, the just-cause dismissal norm,<sup>151</sup> is a standard that allows for plenty of flexibility in interpretation. Similarly, many compulsory clauses in the employment contract introduced by statute or case law, such as good faith or presumption of implicit contract, are formally flexible standards.<sup>152</sup> DB, however, deems these flexible standards to be “rigid” labor rules. In contrast, it considers the legal provision for dismissal at will, which is formally a rigid rule that allows little room for interpretation, to be a flexible labor provision.<sup>153</sup> Thus, the conception of flexibility used by DB does not refer to the formal characteristics of legal commands that rules or standards embody.

DB, however, draws on a larger scholarly project in comparative law, called legal origins theory, which asserts the importance of the formal characteristics of norms in development.<sup>154</sup> More concretely, this theory argues that a crucial difference between common law and civil law is that the former is composed of general principles or standards, whereas

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POSSIBILITIES FOR PROSPERITY 28–31 (1984).

150. *Id.*; STONE, *supra* note 6, at 92–96.

151. This is reflected by the fact that when measuring the rigidity of firing rules, DB gives a score of 100 (the worst) to countries that include a “fair cause” for dismissal requirement. *See* DOING BUSINESS 2004, *supra* note 41, at 34.

152. *See* *Fortune v. Nat'l Cash Register Co.*, 364 N.E.2d 1251, 1256 (Mass. 1977) (holding that an employer's decision to terminate an at-will employee must be made in good faith); *Woolley v. Hoffmann-La Roche, Inc.*, 491 A.2d 1257, 1264–65 (N.J. 1985) (holding that the content of employee manuals could be contractually enforceable).

153. DB gives a country with an at-will regime the best score (zero). DOING BUSINESS 2004, *supra* note 41, at 34.

154. Glaeser & Shleifer, *supra* note 48, at 1211.

the latter contains bright-line rules.<sup>155</sup> This difference, according to the theory, has important implications for the functioning of legal systems, particularly in terms of the degree of discretion in adjudication and control over the judiciary by the executive power. These differences in legal systems, in turn, allegedly produce important social and economic consequences, which manifest themselves in better overall performance in common law countries.

According to the DB work on labor law, common law or English-origin countries have the most flexible regulation and perform better than civil law countries.<sup>156</sup> Absent from this discussion, however, is the argument that standards are better, because they enable more room for interpretation, are more contextual, and allow a legal evolution that responds to local needs. In this case, DB champions the legal norm of dismissal at will,<sup>157</sup> which is a bright-line rule and not a just-cause standard.

The formal characteristics of norms and, in particular, the distinction between rules and standards have played an important role in other areas of the law and development literature.<sup>158</sup> In the labor aspect of DB, however, the norms' formal characteristics—whether they allow more or less room for interpretative discretion, or whether they are more or less open to contextual analysis—do not seem to be important. What matters most seems to be what the norm—rule or standard—enables the contracting parties to do: the contract practices opened or foreclosed by the norm. The focus is on the relative positions of employers and employees in a legal regime, and the foreseeable economic outcomes that such a position would yield in the productive process.<sup>159</sup> Thus, in the DB proposals to make labor regulation more flexible, the *substantive* conception of norms seems more important.

DB proposes that economic development requires a labor law regime that gives flexibility—that is, more power—to employers in the em-

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155. *Id.*

156. *Id.* at 1220. DB claims to have identified the common law or civil law origin of a legal system as an independent variable in the existence of heavy and therefore inefficient regulation. DOING BUSINESS 2004, *supra* note 41, at xiv.

157. Again, this is reflected in the description of countries' economies and the encouragement of legal reforms in the direction of labor flexibility.

158. For instance, it has been argued that when establishing the legal framework of a market economy, what poor countries need is clear and secure property rights and contract rules. According to this view, these norms should be enacted in the form of rules rather than standards, because the former are easier to adjudicate and enforce than the latter. The explicit assumption is that developing countries' judiciaries are highly deficient due to scant resources, poorly-trained judges, or lack of independence from the executive power. Thus, the argument goes, clear rules would be less amenable to judges' discretion and more easily enforceable. Richard A. Posner, *Creating a Legal Framework for Economic Development*, 13 WORLD BANK RES. OBSERVER 1, 1–5 (1998).

159. See DOING BUSINESS 2004, *supra* note 41, at 35.

ployment contract. In other words, the argument is that increasing the power of employers to hire and fire employees without restrictions, to organize the workplace with no limitations, and to pay the wages they wish, will improve firms' economic performance thereby creating jobs and allowing the country's economy to grow. It is important to clarify that when DB proposes to make labor law more flexible, it uses a substantive conception of flexibility, and is, in effect, arguing for increasing employers' power, although it presents the case for flexibility in more ambiguous terms.

As regards organizational flexibility, DB very often uses "flexibility" interchangeably in the substantive and organizational aspects. For instance, DB claims that flexibility on the part of the employer in determining contract terms leads to an adaptable firm.<sup>160</sup> For DB, more power to employers means more adaptability. Therefore, substantive flexibility equals organizational flexibility. Adaptability in the new economy, however, is a separate claim for which DB ought to be able to argue rather than gesture towards by rhetorically conflating these two different concepts of flexibility. Indeed, it is possible to imagine an employer who enjoys considerable flexibility in employment relationships, while simultaneously having a rigid production process, with a command-and-control organization characterized by workers' repetitive deployment of very limited skills. This firm is unable to cope with increasing market competition and technological innovation. By the same token, one could imagine an employer with a more rigid employment contractual framework, but with a more flexible mode of production, heavy investment in employees' skills, and a cooperative workplace where workers participate in decision-making. This firm could be successful at innovation.

In the next Section, I will analyze in more depth the substantive conception of flexibility, developing more fully the varieties of flexibility possible in the employment contract from the point of view of both employers and employees. The point is to prepare the ground for an approach that will offer the opportunity to capture the coexistence of multiple labor law regimes within the same country.

### *C. Multiple Combinations of Substantive Legal Regimes*

The substantive conception of flexibility is central to the proposals to make labor regulation more flexible. At the core of the DB reform agenda for flexibility lies an interest in how rules affect the relative position of the parties in the bargaining situation. The goal is to eliminate

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160. DOING BUSINESS 2005, *supra* note 41, at 31.



current legal restrictions on employers' bargaining power in the employment contract. The legal framework structuring the employment contract is deemed rigid because it limits employers' ability to hire, fire, and establish employment conditions according to their own preferences.

What I propose in this Section is to embrace the interest in the effects of legal norms on bargaining, but remedy the one-sided perspective with which it is currently expressed. This analysis draws on a legal realist methodology in order to investigate how norms structure the bargaining possibilities for parties in an employment relationship.<sup>161</sup> The goal of this Section is to clarify that a legal regime cannot generally be deemed more or less flexible. A key question becomes: more flexible or more rigid for whom? In this way, we can begin to understand more clearly what DB means when it diagnoses a particular country's regulation as having a high overall rate of flexibility or rigidity. A proposal to move towards flexibility in any direction would need to justify why giving more flexibility to one party would be more desirable than the alternative.

In order to capture this bargaining perspective, we need a more complex approach than the DB rigidity-flexibility index. I suggest that we consider regulation as composed of ideal types, which combine flexibility and rigidity in different ways. This approach entails reconceptualizing flexibility and rigidity in terms of the full set of options available to employers and employees in their employment relationships. I offer three possible legal regimes, according to how norms operate to grant flexibility or rigidity to employers and employees.

*Type I: Employee Friendly—Maximizes Bargaining Power of Workers*

This regime includes legal rigidities that exert considerable pressure on employers' freedom of contract. These rigidities include compulsory clauses and statutes that impose restrictions at every level of the employment relationship. On the other hand, this regime also contains rules that grant considerable flexibility to workers in setting contract conditions for hiring, hours, wages and nonwage benefits, and firing.

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161. For an example of this type of analysis, see DUNCAN KENNEDY, *SEXY DRESSING ETC.* 83, 87–89 (1st ed. 1993). See also Joseph William Singer, *Legal Realism Now*, 76 CAL. L. REV. 465, 530–32 (1988) (discussing the main methodological elements of American Legal Realism). For a classic socio-legal analysis of this type, see generally MAX WEBER, *ON LAW IN ECONOMY AND SOCIETY* 188–97 (Max Rheinstein ed. & trans., Edward Shils trans., Harvard Univ. Press 1968) (1925).

*Type II: Employer Friendly—Maximizes Bargaining Power of Employers*

Rules that give employers flexibility compose this ideal type. In this regime, employers have them substantial control over many aspects of the employment relationship, such as hiring, working conditions, and firing, while limiting worker resistance through rigid rules. These rules include restrictions on forms of union organization, limits on engaging with union activities, and limitations on the right to strike, such as the imposition of restrictions or criminalization.

*Type III: Free-for-all—All Privileges and Relatively Few Rights*

This ideal type is a regime that, in Hohfeldian terms, grants privileges and only few rights to each party.<sup>162</sup> Both employers and workers are free to use their power as they please in their employment relationship, while neither group has an entitlement to demand state protection from the other party's actions. This does not mean, however, that this regime operates in a vacuum. Quite significantly, relations in this regime operate in the context of background rules of private law—such as property, contract, and torts—and criminal law, which affect parties' bargaining possibilities.

These three models can coexist within a single economy. The descriptive task is to map their size and distribution among different sectors. The typical scenario in a developing country is a dual economy composed of vanguard and rearguard sectors.<sup>163</sup> The vanguard sector is closer to an employee-friendly regime (Type I), characterized by high capital investment, such as the manufacturing and energy industries. The rearguard sector has an employer-friendly regime (Type II), where labor and capital inputs are more elastic, and a free-for-all regime (Type III), which is generally associated with the informal economy.

DB's proposals for labor flexibility argue—implicitly yet decidedly—for the introduction of an employer-friendly regime, resembling Type II. The implicit assumption behind this proposal is that the more leeway employers enjoy, the more productive firms will be, but it is far from clear that a regime giving all powers to employers and none to employees would actually achieve this outcome. Such an underlying claim does not seem to enjoy full or undisputed theoretical or empirical support. It is not hard to imagine that high levels of productivity can be

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162. See Wesley N. Hohfeld, *Some Fundamental Legal Conceptions as Applied in Judicial Reasoning*, 23 YALE L.J. 16, 32 (1913).

163. See ROBERTO MANGABEIRA UNGER, *DEMOCRACY REALIZED: THE PROGRESSIVE ALTERNATIVE* 30–41 (1998).

achieved under different combinations of legal regimes. Arguably, quite different legal regimes could enable comparably productive outcomes.

The analysis I propose is useful for at least three reasons. First, it shows how current proposals to introduce flexibility in the labor market embody a very narrow view of flexibility. These proposals consider only one side of the relationship: that of the employers. My framework, in contrast, forces proponents of flexibility to make their position explicit amidst a set of other flexible alternatives. Second, this analysis clarifies that a variety of labor legal regimes, exemplified by the ideal types, can coexist within the same economy and the same country. This insight shows that using aggregate national scores to describe legal regimes may be misleading. It may lead us to inaccurate characterizations as to whether a country's labor market is flexible or rigid, obscuring the different ways in which these types of regulation can combine. Finally, this analysis could illuminate how countries that have experienced significant growth rates have combined these different pockets of legal regimes across sectors, and with what results. This provides a different way of comparing countries' regulations and experiences. It allows insight on how different legal regimes have combined to yield productive scenarios and may serve as better guidance for development strategy. Thus, the key question may be not whether given levels of productivity can be achieved, but who bears the costs of those productivity levels. Proponents and opponents of a given legal regime would need to argue in detail why their favored arrangement would be more attractive than its alternatives.

The labor market comprises a set of legal institutions that can take different forms depending on each country's economic conditions and political regime. Thus, the analytical framework proposed here rejects the insistence on the need for harmonization and the promotion of a one-size-fits-all approach to legal reform. The legal rules underpinning the market take different forms as they embody each society's own ideals and aspirations as to how to organize production and distribution of resources.<sup>164</sup> Moreover, economic growth seems to have been achieved through a variety of different arrangements, which need not converge in all countries.<sup>165</sup> On the contrary, these arrangements would likely differ depending on each country's preexisting framework. The first step in the analysis would, therefore, consist of breaking down each

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164. See, e.g., MICHEL ALBERT, *CAPITALISM VS. CAPITALISM: HOW AMERICA'S OBSESSION WITH INDIVIDUAL ACHIEVEMENT AND SHORT-TERM PROFIT HAS LED IT TO THE BRINK OF COLLAPSE* 14 (Paul Haviland trans., Four Walls Eight Windows 1993) (1993).

165. See Dani Rodrik, *Introduction: What Do We Learn from Country Narratives?*, in *IN SEARCH OF PROSPERITY: ANALYTIC NARRATIVES ON ECONOMIC GROWTH* 1, 5–9 (Dani Rodrik ed., 2003).

country's economy into its constitutive sectors. I will discuss the case of Mexico here in order to illustrate the importance of capturing the existence of a dual economy with a rearguard and a vanguard sector for better understanding labor law regulation. Finally, I will analyze how the DB reform proposal would transform the existing legal regimes and what its possible effects on the related economic sectors may be. The analytical framework shows how "flexibility" does not have a single meaning with regard to labor regimes.

## V. APPLYING A NEW ANALYTICAL FRAMEWORK

My objective in this Part is to illustrate the importance of a thicker description of the actual legal regimes in force in a given market. Taking the case of Mexico, I highlight the differences between an account of the country's regulation that relies on the DB methodology and one that is more contextual. I use my typology to look at how Types I, II, and III are distributed within the same economy. I then contrast this approach to the flexibility-rigidity index used by DB and argue that the latter does not provide a helpful diagnosis on which to base a legal reform, or even simply compare. Finally, I conclude by exploring the claims that motivate DB's research and reform proposals. I argue that neither these claims nor their reform proposals are warranted. I contend that these claims can raise misleading expectations about results that may be impossible to obtain through the particular reforms that DB proposes. There may be, in addition, important downsides to the type of reform advanced by DB, which are not explicit in the project and are in need of serious consideration, such as an increase in social insecurity and dislocation, with potential negative effects. Lastly, there are huge opportunity costs for countries with limited public budgets.

### A. *Law in Action*

As previously noted, DB ranks Mexico's labor regulation as highly rigid.<sup>166</sup> Indeed, according to the DB indicators, it has one of the most rigid regulations in Latin America,<sup>167</sup> the region with the most countries with rigid labor regulation in the world.<sup>168</sup> This discouraging score would suggest that employers' ability to contract in terms that are favorable to them is utterly restricted, and that firms face serious operational limitations. To begin with numerical flexibility, DB's indicators would suggest that firms are severely restricted in the terms in which

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166. DOING BUSINESS 2004, *supra* note 41, at 36.

167. *Id.*

168. *Id.* at 34.

they can hire employees, the default rule being on a permanent basis.<sup>169</sup> Similarly, low scores in flexibility in firing would indicate that dismissing an employee is difficult and costly. Employees can only be fired for a just cause, and discharging a worker has important compensation deterrents for the employer. The result of such a regime would be an economy where firms employ their workers on a permanent basis, and where there are large barriers to entering and exiting the labor market. There would be very limited mobility from the wage-based workforce to the self-employed or unemployed workforces and vice versa. Consequently, most employees would have a permanent job, there would be relatively low discharges, and overall, firms' turnover rate would be low.

In operation, Mexico's law interaction with labor actors and labor institutions looks strikingly different. Indeed, it has often been observed that Mexico's is among the most protective labor regulations, but that these regulations remain largely under-enforced. During the North American Free Trade Agreement (NAFTA) negotiations, the lack of worker protection and labor standards, at least as compared to the United States, was often considered to be an unfair advantage of Mexico vis-à-vis the United States. This de facto "flexibility" of employers in the Mexican labor system prompted bitter opposition to NAFTA from United States producers and the American labor movement, who feared that jobs in the United States would be lost to cheaper labor in Mexico.<sup>170</sup> In response, the Clinton administration proposed the North American Agreement on Labor Cooperation (NAALC),<sup>171</sup> entrusted with the task of helping monitor and enforce each country's own labor regulations.<sup>172</sup>

In accordance with this observation, the apparent rigidity in hiring that DB describes (a score of 77)<sup>173</sup> contrasts with the considerable size of the wage-based population working temporary or part-time jobs with no stability in employment.<sup>174</sup> Regarding firing, moreover, dismissals seem to be much more common than such rigid indicators would pre-

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169. FLL Art. 35.

170. See Lance Compa, *NAFTA's Labour Side Agreement Five Years On: Progress and Prospects for the NAALC*, 1 CAN. LAB. & EMP. L.J. 1, 1-30 (1999); Rainer Dombois et al., *Transnational Labor Regulation in the NAFTA—A problem of Institutional Design? The Case of the North American Agreement on Labor Cooperation Between the USA, Mexico and Canada*, 19 INT'L J. COMP. LABOUR L. & INDUS. REL. 421 (2003).

171. North American Agreement on Labor Cooperation, Sept. 14, 1993, U.S.-Can.-Mex., 32 I.L.M. 1499.

172. For a review of NAALC, see Stephen F. Diamond, *Labor Rights in the Global Economy: A Case Study of the North American Free Trade Agreement*, in HUMAN RIGHTS, LABOR RIGHTS, AND INTERNATIONAL TRADE (Lance Compa & Stephen Diamond eds., 1996).

173. DOING BUSINESS 2004, *supra* note 41, at 36.

174. See De la Garza, *supra* note 127, at 263. See also BENSUSÁN, *EL MODELO MEXICANO*, *supra* note 114, at 281.

dict.<sup>175</sup> The average cost of discharging a worker without just cause turns out to be low on average.<sup>176</sup> Finally, the country actually has one of the highest turnover rates in the region, reaching almost 45% per year.<sup>177</sup> This mobility across sectors indicates that wage, labor, and employment benefits are insufficient incentives to prevent workers from leaving the formal sector for other less-protected sectors. This phenomenon would seem to suggest that firing and mobility across the formal and informal sectors are far more common than depicted by DB.

As for conditions of employment, the DB indicators show Mexico as a country with rigid regulations, imposing limitations on the maximum workable number of hours per day and requiring overtime pay if hours are exceeded or if work is performed on nonworking days. These rigidities are intended to contribute to workers' welfare, but in reality, DB argues, they affect employers' capacity to adjust to demand and supply cycles, many of which are related to seasonal production.<sup>178</sup> The implication is that, in DB's view, workers would rather work long hours or at unusual times in formal jobs than work in the informal economy. Upon closer inspection, however, Mexico's labor force registers very high rates of working hours.<sup>179</sup> At the same time, a significant part of the working population works fifteen hours or less a week.<sup>180</sup> While the normal working schedule, comprising thirty-five to forty-eight hours a week, represents 55% of the population, 21.5% work more than forty-eight hours a week, and 20.5% work less than thirty-five hours.<sup>181</sup> These data suggest that firms enjoy much more leeway in their use of labor than DB recognizes.

Finally, concerning wage-based flexibility, DB argues that minimum wage laws artificially inflate the price of labor over the market price and thus prevent firms from hiring more workers, hurting especially women and young would-be workers.<sup>182</sup> Mexico has a variety of minimum wage laws depending on region and sector, and on this category, the DB

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175. DOING BUSINESS 2004, *supra* note 41, at 36.

176. BENSUSÁN, DISEÑO LEGAL Y DESEMPEÑO, *supra* note 136 (arguing that only six percent of all employees unjustly dismissed file a suit against their employer).

177. BENSUSÁN, *La Distancia*, *supra* note 136, at 122. See David S. Kaplan et al., *Worker- and job-flows in Mexico* (2003), available at <http://www.iadb.org/res/laresnetwork/projects/pr191finaldraft.pdf>.

178. The bad side effects of "rigid" regulation are discussed in DOING BUSINESS 2004, *supra* note 41, at 36–37.

179. De la Garza Toledo, *supra* note 127, at 263.

180. *Id.*

181. INSTITUTO NACIONAL DE ESTADÍSTICA, GEOGRAFÍA E INFORMÁTICA, ENCUESTA NACIONAL DE EMPLEO 2002 § 2.1 (México, 2002) [hereinafter ENCUESTA NACIONAL DE EMPLEO 2002].

182. DOING BUSINESS 2004, *supra* note 41, at 32.

indicators give it a high rigidity ranking.<sup>183</sup> Nevertheless, real wages in the country have dramatically declined in the last twenty-five years, due to a series of economic crises: real minimum wages in 2000 were a third of what they were in 1980.<sup>184</sup> This decline in real wages has made labor costs quite low for firms, giving them ample flexibility to hire according to their needs. Indeed, the decline has been so stark that many scholars call this phenomenon the precarization of labor,<sup>185</sup> and it has dramatically decreased income levels of wage workers with permanent jobs.<sup>186</sup>

Comparing a country's formal law with its law in operation raises important questions about the accuracy with which indicators based on law in the books, like the DB indicators, can capture and describe an existing labor legal regime. Thus, the differences between the indicators and the actual legal regime in place may cast doubt upon the reliability of the description as a basis for a country's diagnoses and its reform prognosis. What can we learn from the relationship between a country's economic performance and its alleged degree of flexibility or rigidity according to these indicators? These indicators also raise questions of comparability between countries. If they do not accurately describe a country's existing legal regime, how can they be useful in comparing two different legal regimes?

A recent study of labor regimes in four Latin American countries concluded that the usefulness of indicators like those constructed by DB remains limited, even when they come close to accurately reflecting the rights and conditions formally protected by law. This is because they obscure important factors about the hold of these legal protections in the reality of employment relations.<sup>187</sup> The study looks at the labor regimes of Argentina, Brazil, Chile, and Mexico. These four Latin American

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183. *Id.* at 158.

184. Carlos Salas & Eduardo Zepeda, *Empleo y salarios en el México contemporáneo*, in LA SITUACIÓN DEL TRABAJO EN MÉXICO, 2003, *supra* note 127, at 55, 65 [hereinafter Salas & Zepeda, *Empleo*]. In 2000, wages in big manufacturing firms were less than 40% of their value in 1990. *Id.*

185. Alcalde & Luján, *supra* note 113, at 97; see Salas & Zepeda, *Empleo*, *supra* note 184, at 61–64; see also STONE, *supra* note 6, at 70–86 (analyzing “the rise of precarious employment,” which severely undermined job security, wages, benefits, and advancement opportunities at work in the United States).

186. See Salas & Zepeda, *Empleo*, *supra* note 184, at 65–69. It is important to note that Mexico's average economic growth during the period 1980–2007, although low, has been positive, reaching about 2.9%. Accordingly, while the economy has grown during the last three decades, real wages have dramatically decreased. This suggests an important redistribution of resources from workers to employers through the decline in the cost of labor. See Enrique Hernández Laos, *La productividad en México: origen y distribución 1960–2002*, in LA SITUACIÓN DEL TRABAJO EN MÉXICO, 2006, at 161, 168–69 (Carlos Salas ed., 2006) (arguing that although productivity has remained low in Mexico during 1988–2002, workers have transferred much of their productivity gains to employers).

187. See Bensúsán, *La Distancia*, *supra* note 136.

countries share important commonalities in their legal systems and their recent economic and political transitions. They all introduced labor-related laws early in the twentieth century and have gone through democratic and market-oriented reforms that have exerted significant pressures on their labor laws and institutions.<sup>188</sup> Considering the average of individual and collective rights indexes, as built by Botero and others,<sup>189</sup> the study obtained scores indicating which countries would arguably have the highest levels of protection. Mexico came first (1.24), followed by Chile (1.06), Brazil (0.98), and Argentina (0.92).<sup>190</sup> As the authors of this study make clear, though, these averages hide important differences.

The study highlights the paradox that Chile appears to rank higher in levels of protection than Argentina and Brazil, two countries that actually have higher levels of protection in individual and collective rights.<sup>191</sup> In contrast, although Mexico comes first in levels of protection, it is generally recognized that it has the least effective labor laws.<sup>192</sup> This situation is recognized by the highest labor authorities in the government and is a shared perception, as interviews with representatives of professional, business, and union circles indicate.<sup>193</sup>

The study builds a complementary index aimed at measuring the effectiveness of legislation based on how laws are actually implemented. This index contains seven indicators relating to: social security coverage rate; coverage of the inspection system, capacity to detect nonregistered jobs or jobs without benefits; and labor justice (length of trials, judgments in favor of workers, enforced judgments, and rate of individual conflicts).<sup>194</sup>

Once the cost indicators for compliance and effectiveness levels are combined, it turns out that degree of effectiveness is generally not related with a high or low degree of legal protection.<sup>195</sup> For instance, Chile and Mexico have the lowest degrees of effectiveness. Whereas Chile has the lowest degree of legal protection in several categories, Mexico enjoys the highest. Legislation in both countries is weakly enforced, however. In contrast, Argentina and Brazil both have medium labor protection costs and enjoy a high level of effectiveness. The study attributes these results to stronger unions and higher effectiveness of la-

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188. *See id.* at 116.

189. *See* Botero et al., *supra* note 52, at 1339–40.

190. Bensusán, *La Distancia*, *supra* note 136, at 120.

191. *Id.*

192. *Id.*

193. *Id.* at 122.

194. *Id.*

195. BENSUSÁN, *DISEÑO LEGAL Y DESEMPEÑO*, *supra* note 136, at 420.



bor inspection and labor justice in these countries. Conversely, Mexico and Chile's minimal effectiveness is related to poor performance in labor inspection and labor justice, in addition to Mexico's low degree of union autonomy and democracy and Chile's weak union movement.<sup>196</sup>

As this comparative analysis makes clear, indices that are exclusively based on the law as it exists in the books are clearly insufficient and potentially misleading if they are not corrected by the actual enforcement of such norms. Moreover, in looking at the legal regimes in operation, the study points out important actors, such as unions, and institutions, such as labor inspection and labor courts, that determine the effectiveness of the labor regime.<sup>197</sup> This conclusion should come as no surprise. After all, socio-legal studies have long made us aware of the importance of looking at actors and institutions to understand how a given legal regime affects behavior.<sup>198</sup>

Understanding that there are gaps between the law in books and the law in action, however, is not sufficient for studying the relationship between labor regulation and economic development. Our contextual examination is still in need of better analytics for describing and categorizing a country's labor law regime. We need to distinguish between the three different types of possible labor law regimes and try to understand into which type each sector of the economy falls.

### *B. Mapping Multiple Labor Regimes in Mexico*

In contrast to the DB indicators, which assume a single national labor regime that can be deemed rigid or flexible in the aggregate, I argue that different labor regimes can coexist within a single country. In Mexico, for instance, we can discern three types of labor regimes underpinning different sectors of the economy, each contributing in a different way to the country's economic performance.

There is considerable evidence of a phenomenon of polarization in Mexico's economy in which a few firms have been able to take full advantage of global markets while others have largely lagged behind. For instance, a study about the models of industrialization in Mexico concluded that "the industrial system was highly polarized measured by levels of technology, workforce organization and management, labor rela-

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196. *Id.*

197. *Id.*

198. See, e.g., Galanter, *supra* note 106, at 97; Michael J. Piore & Andrew Schrank, *Trading Up: An Embryonic Model for Easing the Human Costs of Free Market*, BOSTON REV., Sept.–Oct. 2006, available at <http://bostonreview.net/BR31.5/pioreschrank.php> (arguing that, in contrast to the United States, inspection systems in Latin America provide considerable flexibility to the labor market. A unified enforcement system gives inspectors discretion and decision-making powers to more easily balance economic and social objectives).

tions, labor force characteristics, and firms' forward and backward linkages."<sup>199</sup> The purpose of this Section is to analyze how these three operating labor law regimes connect to these different poles of the economy.

This process of polarization is reflected in an economy divided between vanguard and rearguard poles.<sup>200</sup> In Mexico, this division usually takes place along firm size lines. Firms of different size stand in stark contrast to one another regarding capital investment, technological development, and modes of production. Generally, firms in the vanguard have undergone economic restructuring, boast greater investment in technology, and have adopted "total quality" and "just in time" systems of production.<sup>201</sup> These firms comprise a small percentage of large-scale firms, which have reaped the benefits of freer trade and economic liberalization. They compete in the global economy and finance themselves in the international markets. These firms are dynamic exporters but also active importers of their inputs. In fact, they are largely disconnected from the domestic industrial sector.<sup>202</sup> In contrast, the rearguard is comprised of large and medium-sized firms that continue to use Fordist or Taylorist modes of production, and have not undergone economic restructuring. It also comprises medium and small-sized firms with unscientific modes of production and low to medium technology.<sup>203</sup> These firms produce primarily for the domestic market.<sup>204</sup>

I argue here that the small vanguard pole of the economy is underpinned mostly by an employee-friendly regime, which is significant in that it directly contradicts DB's prediction. The most productive sector of the economy seems to be in fact the most rigid. The vast rearguard pole of the economy comprises all types of labor regimes: the em-

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199. De la Garza Toledo, *supra* note 127, at 260.

200. Mexico's economy seems strongly divided into vanguard and rearguard sectors. I take these terms from ROBERTO MANGABEIRA UNGER, *DEMOCRACY REALIZED: THE PROGRESSIVE ALTERNATIVE* 32–35 (1998). Unger compares the vanguard and rearguard sectors along two dimensions: the physical-economic and the spiritual-organizational characteristics. In the vanguard sector, the physical-economic features include large investments of capital per worker, top-notch technology, and access to world markets of capital, technology, and expertise. The spiritual-organizational characteristics turn production into a learning enterprise, allowing good firms to function like good schools. Hierarchical control is minimized, and work routines are more provisional and open to revision. The work organization resembles teamwork, with more horizontal relationships. Specialization in knowledge and skills is fluid and oriented towards the development of multiple technical and conceptual capacities. In contrast, in the rearguard sectors, the spiritual-organizational characteristics include vertical hierarchies and a mode of mass production based on repetitive tasks over which the worker has no control. In Mexico, these distinctions are generally associated with firm size, although there is nothing inherent in this connection.

201. See De la Garza Toledo, *supra* note 127, at 260.

202. *Id.*

203. *Id.*

204. *Id.* at 253–55.

ployee-friendly, employer-friendly and free-for-all, which underpin different economic sectors. It is important to note that these types of labor regimes are ideal types, which find no exact match in reality. However, they are useful analytical tools to understand the various labor regimes operating in Mexico and their connection to various economic sectors.

### 1. *The Employee-friendly Regime*

Characteristic sectors in this labor regime include manufacturing, extractive industries, electricity, and the public sector. These sectors employ about 20% of the workforce. The manufacturing industry is the most important sector in the economy and has become the main engine of economic growth since the country opened its economy to the global market.<sup>205</sup> In 2000, production in the manufacturing industry represented 28.7% of total domestic product, surpassed only by commerce, restaurant, and hotel services.<sup>206</sup> The manufacturing industry contributes the most to the country's exports. In 2000, it represented 87.3% of total exports.<sup>207</sup> Within the manufacturing industry, the most dynamic sectors are automobile and auto-parts, electric and electronic, and machinery and special equipment, which represent 67.3% of total exports.<sup>208</sup> Within the manufacturing sector itself, we can find firms divided between vanguard and rearguard poles of the economy, often along size lines.<sup>209</sup>

Permanent jobs, under a just-cause dismissal rule, characterize the employee-friendly labor regime. Long-term employees are still a majority in the manufacturing industry, with no significant growth in other types of contracting such as temporary, hourly, subcontracting, or hono-

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205. *Id.*

206. *Id.* at 251–52.

207. *See id.*

208. *Id.* at 252.

209. *Id.* The vanguard pole is formed by about 10% of large firms. *Id.* At the other extreme of the continuum, in the rearguard, we find the microenterprises. In the 1990s, the percentage of large firms in the manufacturing sector dropped considerably while the share of microenterprises surged. *Id.* at 254. The number of medium-sized and small firms also declined considerably. While the share of large firms dropped from 1.5% to 0.9%, microenterprises grew from 86.9% to 92.6%. *Id.* Large firms' contribution to employment remained considerable, since large firms provided about 50% of the manufacturing jobs. However, microenterprises' employment share increased significantly, from 14.1% in 1988 to 20.8% in 1998. *Id.* If we look at the firms' contribution to total gross productivity in manufacturing, large-scale firms remain by far the most productive ones. In the period 1988–98, large firms' contribution grew (from 69.1% to 70.3%), medium and small firms' contribution dropped (from 14.2% to 13.3%, and 13.3% to 11.5% respectively), and microenterprises' contribution grew slightly (from 4.4% to 4.9%). *Id.* The polarization of the economy, exemplified by firms that differ drastically in size and productive capacity, is also reflected in the type and quality of the jobs. While large firms were more likely to provide stable jobs with benefits, many microenterprises represent subsistence strategies for a population that cannot find well-remunerated jobs. *Id.* at 253–54.

rarium.<sup>210</sup> Firms appear to have little incentive to move toward a scheme of greater flexibility and the job instability that comes with it. Firms' lack of interest may be explained by widespread low wages, training problems, and the prevalent corporatist unionism which offers little protection to the rank and file, making the status quo more appealing.<sup>211</sup>

Labor flexibility has been available through the decline of real wages despite the formal rigidity of legal protections on hiring, firing and working conditions. Total remuneration for employees in the manufacturing sector decreased 45.9% in real terms between 1988 and 1998 in all firm sizes, hitting employees in the smaller firms harder.<sup>212</sup> Even when real wages began to rise in 2000, recovering from the 1995 crisis, by 2001, wages had not regained 1994 levels.<sup>213</sup> The fall of real wages benefited manufacturing firms by significantly decreasing their labor costs. Indeed, during the 1990s, labor costs as a proportion of total overall manufacturing costs registered a considerable decline. In large-scale firms, labor costs represented only 16.9% of total costs in 1994, compared to 24.7% in 1989.<sup>214</sup>

## 2. *The Employer-friendly Regime*

The employer-friendly legal regime underpins sectors such as professional services, wholesale commerce, hotels and restaurants, construction, and transportation and communications. Together, these sectors represent about 35% of the economically active population.<sup>215</sup> Even though these sectors are regulated by the same statute and, thus, the same formal law as the employee-friendly regime, they enjoy considerably more flexibility. This flexibility comes from the operation of law in action, rather than from the formally recognized law.

Commerce and services alone employ about 60% of the economically active population.<sup>216</sup> But these sectors are broad categories that aggregate very diverse economic activities where different labor relations prevail. It is therefore useful to distinguish between wholesale and retail

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210. *Id.* at 256.

211. *Id.* at 256–57.

212. *Id.*

213. *Id.* at 257 (noting that the maximum historic wage was reached in 1976 and that between that year and the end of the twentieth century, real wages decreased 80%). See ENRIQUE DUSSEL, POLARIZING MEXICO: THE IMPACT OF LIBERALIZATION STRATEGY 160–61 (2000) (noting that by 1998, “real wages and real minimum wages equaled only an estimated 57% and 29% of their respective levels in 1980”).

214. De la Garza Toledo, *supra* note 127, at 257–58.

215. See *infra* Table 3.

216. See José Luis Galván & Chris Tilly, *Trabajadores en el comercio y los servicios en México: trabajo marginal*, in LA SITUACIÓN DEL TRABAJO EN MÉXICO, 2006, *supra* note 186, at 355, 355.

commerce and between professional and personal services.<sup>217</sup> Professional services include administration, accounting, financial, legal, information technology, marketing, and media businesses. It is also useful to look at firm size, which is generally a good indicator of job permanence, with big firms more likely to formally hire employees on a permanent basis.<sup>218</sup> If we follow these distinctions, it can be inferred that a segment of the service sector related to big firms and to professional services operates in the ideal Type II (employer-friendly), while personal services and small firms are more likely to operate in an ideal Type III (free-for-all) labor regime. For commerce, wholesalers and big firms are more likely to operate in the employer-friendly regime, while small firms and retail commerce are more likely to exist in the free-for-all regime.

Wholesale commerce and professional services have among the highest rates of salaried labor in the country with 69% and 84% respectively in 2003.<sup>219</sup> In contrast, retail commerce and personal service categories have the highest proportion of self-employed workers in these sectors with 29% and 33%, respectively. Unpaid work is also high in retail commerce, reaching 10%, behind only hotels and restaurants.<sup>220</sup> High levels of self-employment and unpaid work are usually a good indicator of informality associated with the free-for-all regime.

In addition, firms tend to be larger and concentrate a greater proportion of employment in wholesale commerce and professional services than in retail commerce and personal services. In 2003, large firms (those with more than one-hundred employees) employed 42% of workers in big commerce and 56% in professional services.<sup>221</sup> In the service sector, big firms comprise activities such as real estate leasing, financial, educational, health, and recreational services. In contrast, firms of up to five employees provided 65% of the jobs in small commerce and 79% in personal services.<sup>222</sup> In the service sector, smaller firms are usually in the business of repair and household tasks.

Even when jobs in the employer-friendly regime may be formally permanent, they are dramatically flexible in terms of benefits, working hours, and wages. Real wages have declined substantially in these sectors as well. For their part, working hours have shown considerable var-

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217. *Id.* at 356. Galván and Tilly include education and health services under the category of “professional services.” Similarly, personal and entertainment services are included under the “personal services” category. *Id.*

218. Salas & Zepeda, *Empleo*, *supra* note 184, at 61–63.

219. Galván & Tilly, *supra* note 216, at 364.

220. *Id.*

221. *Id.*

222. *Id.*

iation. Indeed, a substantial proportion of employees work way below or above the average hours per week. At one extreme, working hours have increased significantly, with more than a fifth of urban employees working more than forty-eight hours a week.<sup>223</sup> At the other extreme, about 7% of urban employees work less than fifteen hours a week, a characteristic scenario for women working in the commerce and service sectors.<sup>224</sup> This reflects the ability of employers to establish different kinds of working schedules and to hire part-time employees.

Moreover, many workers with permanent jobs in these sectors have no access to health care, social security, paid vacations, or other non-wage benefits established by law. The percentage of employees not receiving the legally mandated benefits has remained high in the last two decades, and more than a fifth of all entitled employees receive no benefits.<sup>225</sup> Of all salaried workers in 2009, 46.5% had no access to health institutions, and 40% had no benefits.<sup>226</sup> To further illustrate this phenomenon, consider that of all salaried jobs generated between 2000 and 2004, about 2,803,908—62%—enjoyed no benefits.<sup>227</sup> Of that percentage, 49% of employees had only a verbal contract, a signal for nonpermanent jobs despite the labor law's mandate for permanency of employment relationships without written contract.<sup>228</sup> The difference between these two figures implies that 13% of employees with written contracts, employed under a permanent basis, still enjoyed no benefits.<sup>229</sup> The decline in the protection of employees' entitlement to living wages, working hours limits, and indicates considerable employer flexibility with regard to the use of labor and employment costs.

### 3. *The Free-for-all Regime*

The free-for-all labor regime includes sectors like personal services, retail commerce, food preparation and sale on the streets, and domestic services. These sectors operate in what is often considered the informal economy. Although estimates about the size of the informal economy

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223. Salas & Zepeda, *Empleo*, *supra* note 184, at 64.

224. *Id.* at 63–64.

225. *Id.* at 61–64.

226. See SECRETARÍA DEL TRABAJO Y PREVISIÓN SOCIAL, INDICADORES ESTRATÉGICOS DE OCUPACIÓN Y EMPLEO, <http://www.stps.gob.mx/DGIET/web/ENOETRIM/nal.xls> (last visited Sept. 19, 2009) [hereinafter INDICADORES].

227. Carlos Salas & Eduardo Zepeda, *Ocupación e ingresos en México: 2000–2004*, in LA SITUACIÓN DEL TRABAJO EN MÉXICO, 2006, *supra* note 186, at 125, 131–33 [hereinafter Salas & Zepeda, *Ocupación*].

228. *Id.*

229. *Id.* at 133.

vary (partly due to differing conceptions of informality), this part of the economy employs nearly half the country's labor force.<sup>230</sup>

This regime includes firms that are not registered under the relevant administrative regulations and thus operate extra-legally, escaping the gamut of regulations ranging from tax, health and safety, and social security to labor laws. In contrast, the employee-friendly regime above includes registered firms that often skirt their labor law obligations. While employees seldom exercise their labor rights and settle for much less of their entitlement's value, they could still exert legal pressure on the employer. In addition, employees may enjoy the protection of the firm's compliance with other regulations such as health and safety.

On the contrary, in the free-for-all regime, parties operate outside the purview of the typical labor rights and administrative regulations. Parties can exercise pressure on one another as they see fit, and are limited only by the background norms of contract, property, torts and criminal law, to which they rarely resort.

Many workers in the informal economy are self-employed, but there are also a considerable number of salaried workers. Indeed, the firms that comprise this informal economy are mostly managed by self-employed individuals who often employ relatives.<sup>231</sup> Most of the employees in the informal economy work in small and micro enterprises with five or fewer employees.<sup>232</sup> These firms have very small levels of investment and productivity, and the average income of employees is low.<sup>233</sup>

Self-employment has become a pillar of the economy: of all jobs created between 2001 and 2004, 54% consisted of salaried jobs, 4% were employers, and about 42% consisted of self-employed jobs.<sup>234</sup> The role played by microenterprises in job creation has reached unprecedented levels. These firms created 72% of all jobs in this period, and were responsible for 54% of newly created salaried jobs.<sup>235</sup>

Jobs in the informal economy, however, are not generally a cause for celebration. Jobs in informal firms are often precarious, characterized by low wages, no benefits and even unpaid work. This type of employ-

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230. See ENCUESTA NACIONAL DE EMPLEO 2002, *supra* note 181, § 3.27. See generally SANTIAGO LEVY, GOOD INTENTIONS, BAD OUTCOMES: SOCIAL POLICY, INFORMALITY, AND ECONOMIC GROWTH IN MEXICO 87 (2008) (estimating that 58% of the workforce in Mexico is informal).

231. See Salas & Zepeda, *Empleo*, *supra* note 184, at 61–63.

232. Salas & Zepeda, *Ocupación*, *supra* note 227, at 135. See ENCUESTA NACIONAL DEL EMPLEO 2002, *supra* note 181, § 3.27.

233. Salas & Zepeda, *Ocupación*, *supra* note 227, at 136–37.

234. *Id.* at 133.

235. *Id.*

ment rises as growth levels in the country remain low or decrease, implying that this type of employment is not very productive.<sup>236</sup>

It should be noted that the standard view advanced by DB that the informal economy is the product of rigid labor regulations has been seriously challenged. According to this view, the high barriers erected by rigid hiring and firing rules, as well as generous working conditions, exclude workers currently outside formal employment and condemn them to the informal economy. Studies of informality have shown, however, that contrary to this standard assumption, there is a great degree of mobility between the formal and informal sectors.<sup>237</sup> Workers enter and exit the formal economy with relative ease, casting doubts on the firmness of the supposed barriers. Thus, the claim advanced by DB that informality can be eliminated simply by making labor regulation more flexible is rendered illusory.<sup>238</sup>

These studies show that the complex incentives that make rational firms and entrepreneurs work in, or contribute to the growth of, the informal economy have deeper roots, such as the form of a country's social insurance, its relationship to formal employment, and the interaction between different programs of social security.<sup>239</sup>

Moreover, in Mexico, the nonwage costs of firing and severance pay regulations represent about 3.2.% of wages, compared with 39.5% of social security contributions.<sup>240</sup> This contrast points to social security as a considerably more important source of informality than firing regulations.<sup>241</sup> Accordingly, it underscores the importance of looking at the labor market and the laws that constitute it in a comprehensive way.

The following chart illustrates the three labor regimes described alongside the economic sectors and the percentage of the labor force each of these regimes comprises. This is a preliminary attempt to capture the coexistence of these legal regimes and their relation to economic life.

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236. *Id.* at 136–37.

237. *See* Maloney, *supra* note 125, at 1159–60, 1173. *See also* LEVY, *supra* note 230, at 85–129.

238. *See* LEVY, *supra* note 230, at 39 (pointing out that even under full labor mobility there will always be an informal sector because some economic activities are more efficient under informal arrangements).

239. *See generally id.*

240. *Id.* at 25.

241. *Id.* at 45.



TABLE 3: COEXISTING LABOR LEGAL REGIMES<sup>242</sup>

NAME	SECTORS	% TOTAL LABOR FORCE
<b>I. Employee-friendly</b>	Manufacturing Extractive industries Electricity	20%
<b>II. Employer-friendly</b>	Professional services Wholesale commerce Hotels and restaurants Construction Transportation and communications	35%
<b>III. Free-for-all</b>	Personal services Retail commerce Food preparation and sale on the streets Domestic services	45%

### C. *The Problems with DB in Light of the New Framework*

The importance of this analytical and descriptive task will become clear by focusing on what DB proposes and what the possible effects of the proposals might be when analyzed in light of the ideal types. The existence of multiple labor regimes in different sectors of the economy means that the proposals for flexibilization will have an asymmetrical impact on employees and employers, depending on what sector and which labor regime the reforms affect. DB recommends that Mexico make its labor regulation more flexible in order to attract capital investment and foster economic development.<sup>243</sup> According to DB, this change would create more jobs, reduce the duration of unemployment, increase investment in research and technology, increase firms' productivity, and ultimately lead to economic growth.<sup>244</sup>

Given that a large portion of the labor market, namely, the employer-friendly and the free-for-all regimes, is supported by already-flexible labor relations, the main target for reform would be the employee-friendly regime. According to the DB proposal, this should be converted into an employer-friendly regime.

242. This Table reflects the author's own estimates, which are based on the Employment and Occupational Strategic Indicators, INDICADORES, *supra* note 262; LEVY, *supra* note 230; Galván & Tilly, *supra* note 216; Salas & Zepeda, *Empleo*, *supra* note 184; and Salas & Zepeda, *Ocupación*, *supra* note 227. Estimates may vary but it is clear that the majority of the economically active population already works under flexible labor relations, in the DB sense.

243. This is a recommendation to all countries across the board. DOING BUSINESS 2004, *supra* note 41, at 35–38.

244. *Id.*

To see the potential effects of such reform, we look at sectors in the employee-friendly regime: manufacturing, extractive industries, and electricity. Although labor relations differ by firm size and economic activity, these sectors have the most rigid employment relations in Mexico. The vast majority of their workers are employed on a permanent basis—job tenure—and enjoy mandatory conditions such as maximum number of hours per workweek, premium for overtime work, restrictions on night work and holiday work, paid leaves and holidays, and minimum wage. So, we begin to see that contrary to DB, which gives the impression that its reforms concern the whole economy, only a slice of the economy would be targeted. In addition, once we look to the operation of the law in action, we realize that DB is suggesting flexibilization in a sector that has already experienced a dramatic fall in real wages and should have already seen benefits in productivity and growth.

The DB claim that increased employer-side flexibility would create jobs and increase output assumes that the demand for labor is quite elastic. The economic sectors under analysis are in fact quite capital intensive, however, with labor costs representing a small share of the total cost of production, and often with fixed capital costs. When the share of labor costs—such as wages and labor protections—in the firm's total costs is small, the labor demand tends to be inelastic. Under this scenario a decrease in labor costs, due to more flexible regulation, is unlikely to have a significant impact on job creation.<sup>245</sup>

Even if cheaper labor costs may create a limited number of jobs in these industries, these may come at the expense of a significant deterioration of wages and working conditions. Given fixed capital costs and a small share of labor in total costs, lower wages and labor benefits may not guarantee higher overall productivity. Moreover, even if we were to see an increase in productivity, past experiences with productivity increases due to lowered wages do not confirm the link between higher productivity and job creation.<sup>246</sup> We can only see this by matching the

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245. See, e.g., GEORGE FARKAS & PAULA ENGLAND, *INDUSTRIES, FIRMS, AND JOBS: SOCIOLOGICAL AND ECONOMIC APPROACHES* (1988) (expounding the Hicks-Marshall laws of elasticity of demand for labor). For empirical evidence that the effects of labor regulation on capital-intensive industries may be quite different from those on labor-intensive industries, see Ahmad Ahsan & Carmen Pages, *Are All Labor Regulations Equal? Evidence from Indian Manufacturing*, 37 J. COMP. ECON. 62, 71–75 (2009).

246. The physical volume of manufacturing output in Mexico increased considerably in the late twentieth century. However, this productivity increase has not had an impact on employment levels. In the year 2000, employment levels had not recovered from 1993 levels, despite significant growth in the *maquiladora* industry in the same period. Lower levels of employment can be attributed to an increase in labor productivity, which grew 46.3% from 1993 to 2000, massive layoffs in the non-*maquiladora* manufacturing sectors due to an increase in competition from imports, and dismemberment of chains of production in the domestic market. See De la Garza Toledo, *supra* note 127, at 254–55. In the U.S. automobile industry, for instance, Detroit's Big Three

employee-friendly regime with the specific sector it regulates and looking at the operation of the law in action, not by treating it in the abstract.

Further, the high turnover rate in these sectors indicates that economic incentives (wages and benefits) are not high enough to retain employees from moving to other, less protected sectors. This phenomenon suggests that firms are losing their investment in workers' training, a loss that may be accelerated, rather than reduced, if labor relations are made more flexible. Fewer incentives for job stability and benefits in these sectors may increase turnover, pushing current employees to work in the informal sector or to migrate north to the United States.

Moreover, it is often the case that in these sectors, both firms and employees prefer stable long-term relationships to flexible ones. Even if labor regulation were relaxed, employers still might prefer to keep stable relationships. In fact, the coexistence of the employee-friendly and employer-friendly regimes in the Mexican labor market seems to suggest that there is much more employer agency involved in this regulation than we would understand from reading the DB reports.<sup>247</sup> Recent reforms in Argentina and Brazil offer comparative support for this suggestion. Changes to the labor laws in the 1990s introduced atypical employment contracts such as temporary and fixed-term contracts, but several years after the reforms, employers in the employee-friendly regime have made relatively little use of these new types of contracts.<sup>248</sup>

Assuming substantial economic activity in sectors where labor could substitute for capital, cheaper labor would probably increase investment in labor relative to capital. In this scenario, increased productivity would come as a result of cheaper labor, not more investment in capital goods. It is unclear, then, how more flexibility would encourage higher investment in technology and research and development, as DB claims it would.

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manufacturers (Ford, General Motors, and Daimler-Chrysler) employ 15% fewer workers than a decade ago and half the number they employed forty years ago. Posting of Robert Reich, *The Future of American Auto Making*, <http://robertreich.blogspot.com/> (Sept. 18, 2006, 20:47 PST).

247. As Katherine Stone has documented, from the early twentieth century up to the 1970s, firms in the United States—especially in the manufacturing sector—created internal labor markets, characterized by secure, life-tenured jobs, with stable wages, internal job promotion ladders, and welfare benefits. What is striking is that these firms, which built their labor relations into the prototype employee-friendly regime, did so under an at-will legal framework. STONE, *supra* note 6, at 51–63. Renowned economists like Gary Becker and Oliver Williamson have accounted for this regime as an economically rational decision on the part of employers, who were trying to prevent turnover, to stimulate in-the-firm training, facilitate knowledge transfer, and increase productivity. See GARY S. BECKER, *HUMAN CAPITAL* 29–51 (3d ed. 1993); OLIVER E. WILLIAMSON, *THE ECONOMIC INSTITUTIONS OF CAPITALISM: FIRMS, MARKETS, RELATIONAL CONTRACTING* 249 (1985).

248. Bensusán, *La Distancia*, *supra* note 136, at 123–24.

We can now use this same framework to analyze DB's claim that countries should bring their informal sectors into the formal economy by turning the informal sector into an employer-friendly regime. To see the potential effects of such a reform, we look now at the sectors that comprise the free-for-all regime: commerce, food preparation and selling in the streets, repair shops, and domestic services. The claim for conversion to a formalized legal regime is that such a regime would guarantee tax payment, and that workers would be better off because they would have health insurance and other nonwage benefits that are unavailable in the free-for-all regime.<sup>249</sup>

The lack of benefits, however, is one of the reasons why the employer-friendly regime is more flexible and less costly for employers than the employee-friendly regime. So, it is hard to see the benefits that workers would gain if an employer-friendly regime replaced a free-for-all regime. In short, DB makes two simultaneous claims: it argues that employer-friendly regimes should be substituted for employee-friendly ones in order to make labor less costly (through part-time, temporary contracts, and less benefits), and that the free-for-all regime should also be replaced with an employer-friendly regime so that unprotected employees get benefits.<sup>250</sup> Taken together, these simultaneous claims seem contradictory.

Moreover, one might expect that many of the activities currently undertaken in the labor free-for-all regime, characteristic of the informal economy, would evaporate if obliged to operate in the formal economy. In many cases, they would simply not be profitable. What makes these activities profitable is precisely that they operate at the margins, profiting from some public service or private right upon which they can free-ride. Indeed, it has been documented that most of these microfirms constitute more a strategy of subsistence and survival than a productive enterprise. The challenge seems to lie not in formalizing survival strategies, but in creating productive alternatives that would make these strategies unnecessary and unprofitable.

The following chart summarizes the multiple coexisting legal regimes and possible resulting changes with DB flexibility reform.

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249. DOING BUSINESS 2004, *supra* note 41, at xv.

250. *Id.* at 37.

TABLE 4: DOING BUSINESS FLEXIBILITY REFORM OF LEGAL REGIMES

LABOR REGIME	1. EMPLOYEE-FRIENDLY	2. EMPLOYER-FRIENDLY	3. FREE-FOR-ALL
<b>DB characterization</b>	Rigid	Flexible	Unregulated
<b>DB proposed reform</b>	Move from Employee-friendly →→→→ to Employer-friendly	Goal	Move from Free-for-all ←←←← to Employer-friendly
<b>DB recommended action</b>	Deregulate	Recognize	Formalize

DB has also emphasized creating the appropriate investment climate in developing countries through a series of legal reforms to entice foreign capital.<sup>251</sup> The DB insistence on making labor regimes flexible shares that objective. As the Mexico example demonstrates, however, many of the industries under the rigid/employee-friendly regime seem to be in the vanguard economy, and already enjoy cheap labor costs and high levels of productivity. It is unlikely that further incremental gains in productivity would viably result from worsening working conditions or decreasing wages. Absent from DB are the upsides of an employee-friendly regime, in terms of cooperation, human capital investment, and important potential increases in productivity.

The authors of DB have not targeted organizational flexibility. They are not advising firms on new modes of production and flexible management techniques to stimulate innovation and productivity. This effort would aim at gaining flexibility not through cheap labor, but through organizational and technological innovations. Studies of the Mexican labor markets suggest that although many successful firms already enjoy considerably cheap labor and a moderately flexible legal regime, they are quite rigid in their management and organization of production. Many firms are still organized in a Fordist model of production, with vertical hierarchical relations and very little worker involvement in task design and decision making. This aspect—organizational flexibility—seems both most promising and largely unexplored.

Pushing for organizational flexibility might require changes in the labor law regime as well, but those changes would be tied to a vision

251. Even if these reforms do not actually entice foreign capital, hopes are that the reforms will at least not block foreign investment. See DOING BUSINESS 2004, *supra* note 41, at 67.

about what firms are doing to innovate production processes and increase output. In its present form, the agenda of labor flexibility constitutes no more than a plea to give more power to employers and, thereby, to cheapen labor. It does not convincingly show why moving in that direction would produce the desired results.

Analyzing labor regimes with a framework like the one I propose, could give us not only a better descriptive idea of the legal fabric woven into a country's economy, but also a better sense of the potential effects of the reforms prescribed. The DB program, interesting as it is, actually takes us away from policy questions and the hard choices we should be addressing when thinking about labor regulation. It does this by appealing to an easy and technical best practice that is not only inaccurate but also may not deliver. My project aims at providing some analytical tools to mediate between DB's best practice abstractions and a world of infinite contextual details.

Recently, the political pressures of the financial crisis seem to have done more than either academic critique or even internal critique to convince groups inside the World Bank that the DB project is misguided as far as its labor indicators are concerned. As this Article was being prepared for publication, the DB group announced forthcoming revisions to its methodology, which, if adopted, could constitute a significant change of its labor indicators. More specifically, the DB group announced that it would revise the DB 2010 report so that countries whose labor laws comply with the letter and spirit of the relevant ILO conventions would receive favorable scores, thus "recognizing that well-designed worker protections are of benefit to society as a whole."<sup>252</sup>

The World Bank also declared that "the Employing Workers' Indicator (EWI) does not represent World Bank policy" and announced the removal of the EWI from the World Bank's Country Policy and Institutional Assessments (CPIA) as a guidepost for reform in its borrowing countries.<sup>253</sup> This is indeed a significant shift that seems to signal more about the financial and political circumstances of the moment than any deep reconceptualization of DB's understanding of labor flexibility and its overall project of urging reforms based on these indicators.<sup>254</sup>

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252. World Bank Group, Revisions to the EWI Indicator (released on April 27, 2009), [http://www.doingbusiness.org/documents/EWI\\_revisions.pdf](http://www.doingbusiness.org/documents/EWI_revisions.pdf) (last visited on Sept. 19, 2009) [hereinafter Revisions to the EWI Indicator].

253. *Id.*

254. The hypothesis that political reactions to the financial crisis have forced this dramatic turn is further supported by the fact that a 2008 article published by Simeon Djankov, the leader of the Doing Business project, advocates flexible labor regulations without mentioning any of the ILO core labor standards or otherwise addressing any of the positive externalities of labor regula-

The revisions by DB seemed to be an anticipated response to the recent explicit repudiation of key DB indicators by the U.S. Congress. On June 12, 2009, the House of Representatives passed a supplemental appropriations bill for the fiscal year ending September 30, 2009 directing the U.S. Executive Directors at the World Bank to “use the voice and vote of the United States to actively promote and work to achieve” the following goals: (1) the suspension of the Employing Workers Indicator as a tool for ranking country performance in the DB report; (2) the elimination of the Labor Tax and Social Contribution Subindicator from the DB report; and (3) the removal of the Employing Workers’ Indicator as a “guidepost for calculating the annual Country Policy and Institutional Assessment Score for each recipient country.”<sup>255</sup>

It is worth noting that the bill has pushed the World Bank, and more particularly the authors of the DB report, to at least formally recognize the potential positive effects of labor regulations on private investment. It has also encouraged DB to look at regulation according to countries’ context and to collaborate with the ILO, private companies, and unions.<sup>256</sup>

Perhaps not surprisingly, given U.S. economic and political pressure, DB has acted promptly on each of the fronts highlighted by the House bill and has promised changes in the upcoming DB report. According to its recent memo, the new DB report will make clear that the EWI “does not represent World Bank policy and should not be used as a basis for policy advice or in any country program documents that outline or evaluate the development strategy or assistance program for a recipient country.”<sup>257</sup> The memo announced that the Bank “will convene a working group including representatives from the ILO, . . . trade unions, businesses, academics and legal experts.”<sup>258</sup> This is an important change, brought about by successful pressure, and it is certainly not the way the DB group is used to “doing business.”

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tions that the group seems to be subscribing to in the announced change. See Simeon Djankov & Rita Maria Ramalho, *The Regulation of Labor in Developing Countries* (2008), available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1162238](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1162238).

255. H.R. REP. NO. 111-151, at 44–45 (2009).

256. Accordingly, the House has instructed the U.S. representatives at the Bank to seek the suspension of the Employing Workers’ Indicator “until a set of indicators can be devised that fairly represent the value of internationally recognized workers’ rights, including core labor standards, in creating a stable and favorable environment for attracting private investment.” *Id.* at 45. These indicators should take into account the experiences of the Bank member governments in “dealing with the economic, social and political complexities of labor market issues.” *Id.* Finally, the new indicators “should be developed through collaborative discussions with and between the World Bank, the International Finance Corporation, the International Labor Organization, private companies, and labor unions.” *Id.*

257. Revisions to the EWI Indicator, *supra* note 252.

258. *Id.*

I do not mean to suggest that the withdrawal of these indicators is solely the result of the present political circumstances. Criticism of DB has become more visible only in recent years, both in the academy and policy debates, but it has been mounting for some time.<sup>259</sup>

### CONCLUSION

In this Article, I develop an alternative analytical framework for thinking about labor regulation and its relationship to economic development. In my framework, I construct three regulatory types that reflect several labor regimes already in operation. Each of these labor regimes, which I call employer-friendly, employee-friendly, and free-for-all, combines flexibilities and rigidities in a variety of ways. This framework exhibits several advantages over the traditional flexibility-rigidity model. First, this framework calls for a description that takes into account not only the law on the books, but also the law's actual effects.

Second, the framework moves beyond the prevailing flexibility-rigidity dichotomy, illuminating the relational character of flexibility. While law creates entitlements that seem flexible for some parties in the employment relationship, these same entitlements are experienced as rigid by others. I argue that, contrary to this unstated assumption in the literature, we cannot deem a given labor regulation to be more rigid or flexible overall. My framework is attentive to the *distributional* character of labor flexibility.

Third, this framework provides a more contextual approach, calling for an analysis of the relationship between these multiple labor regimes and economic life. It examines the economic sectors that these different regimes underpin, the size and composition of the labor force, and the contribution of the different labor regimes to the economy as a whole.

For these reasons, the framework I have developed provides a better analytical tool to describe and assess countries' labor regimes. In addition, it can also help to clarify the potential impact of currently proposed labor flexibility reforms. It helps underscore that these reforms can affect established labor regimes asymmetrically, with distinct consequences for workers and firms operating in different sectors of the

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259. Perhaps no other group has been more steady and vocal in its criticism of the DB indicators than the International Trade Union Confederation (ITUC). See ITUC, *Online*: ITUC Welcomes World Bank's Suspension of "Doing Business" Labour Indicator, <http://www.ituc-csi.org/spip.php?article3505> (last visited Sept. 19, 2009). Thus, the Bank's repudiation of the DB labor indicators can be read as the result of direct political pressure from the U.S. Congress, enabled by a successful strategy by the ITUC, the AFL-CIO, and other interested parties. This pressure has no doubt been made possible by the coincidence of a Democratic Congress and the reputational damage that the current economic crisis has inflicted upon market deregulation theories as the orthodox solution to economic problems.



economy. Ultimately, this framework could help to clarify the plausibility of proposed reforms in terms of their contribution to productivity and economic growth.

I have developed this framework in contrast to the Doing Business proposal for making labor law regimes more flexible. At first, DB seems rather appealing. It suggests that by changing labor regulations to make them less rigid, a country can create more jobs, reduce the duration of unemployment, increase productivity and ultimately achieve economic growth. The project uses rankings suggesting that the most economically successful countries all have flexible labor regimes and that countries with rigid labor regulations do not fare as well. Thus, the reforms for labor flexibility seem promising as a strategy for economic development. These reform proposals currently enjoy not only the World Bank's support, but also the enthusiastic endorsement of the biggest development assistance donors.

Nevertheless, appealing as DB may seem, it relies on seriously flawed assumptions about law and its operation. From the point of view of legal scholarship, the methodology faces significant criticism. DB's coding of labor regulatory regimes across countries relies primarily on formal law—the law as it is found in codes and statutes. In understanding a legal regime in operation, legal theory and legal sociology have long made us aware of the importance of accounting for the full range of formal legal sources, law in action, and informal norms. In this Article, I have shown how these insights remain largely overlooked by DB, which seriously undermines DB's descriptive account of countries' regulations, and consequently the power of its comparative analysis.

Furthermore, I argue that even if we took these elements into consideration in an effort to improve the DB work, the linear flexibility-rigidity index would still face very important limitations. The most important limitation is that this model does not account for, and indeed obscures, the coexistence of multiple labor regimes within a single economy that underpin different sectors of a country's labor market. Countries regulate their labor markets differently. The rich North Atlantic democracies, which achieved remarkable economic success during the twentieth century, exhibit a contrasting array of labor and employment rules and institutions. These countries have combined crucial characteristics of labor regulation, such as security and flexibility, in a variety of ways. Undoubtedly, there is much to learn from these experiences, but under the DB analytical framework, the existence of such regulatory variation becomes obscured, and its relation to economic and social outcomes harder to assess.

My hope is that by using the analytical framework I have developed, we can study how such countries have combined their different labor regimes, as well as the size and distribution of these regimes, across various sectors of their economies. Learning from these countries' experiences, this analysis can lay the groundwork for context-specific regulatory strategies.