УДК 811.111

CREATING AN ENABLING ENVIRONMENT THROUGH INNOVATIVE LABOUR REGULATION

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Improvements in job quality are inextricably bound up with the need to pursue the twin goals of alleviating poverty while increasing enterprise productivity. As these are the two major preoccupations of development economics it is necessary to recall that some in this field argue that the simplification of

business regulation and increased labour flexibility (amongst other measures) offer the most likely route to improved economic performance.

Keywords*: *ecology, innovation, labor, poverty.

This view is advocated, for example, in the recent report of the Commission on the Private Sector and Development entitled Unleashing Entrepreneurship: Making Business Work for the Poor, which relies on the World Bank's regular review of doing business. The World Bank's report Doing Business in 2005 asserts: '[with] rigid employment regulation, few people will be hired, with women, young and low-skilled workers hurt the most. Their only choice is to seek jobs in the informal sector.'

In a global survey of States' practices in relation to employment termination regulation, the ILO has previously identified significant flaws with this concept of perceived rigidity in employment regulation. Among other things, it overlooks the critical question of whether this type of increased flexibility will lead to the creation of jobs of sufficient quality – that is, of Decent Work. Often the work that is created by greater flexibility is insecure, casual and/or part-time work. It is also true that employment protection measures can stimulate longer-term positive benefits by giving employers an incentive to invest in the training and skills of their workers (and therefore their productivity), and so also in the profitability of their enterprise. It should also be noted that the OECD has suggested that dismissal costs alone may not be a significant factor in determining levels of employment, when wage levels and the macroeconomic environment are taken into account.

The findings of this study into the scope and design of labour law and its application to MSEs also show that there are several major flaws with an approach that sees regulation as causing unnecessary rigidity in the labour market. Firstly, many countries have already introduced considerable flexibilities, and the labour supply has become more elastic, but this has not led to employment growth in the formal economy. Instead, there has been growth in the informal economy, accompanied by decreasing real wages, contributing to a vicious cycle of underdevelopment and increased vulnerability. Secondly, given low levels of enforcement and compliance with labour laws, it is difficult to conclude that labour laws are to blame for the relative size of the formal and informal economies, or for the proportion of MSEs in the economy. Indeed, there are various economic explanations for the growth of the informal economy in many countries around the world that are unrelated to the nature of the labour laws. Thus there is no reason to think that labour regulation cannot help to facilitate development.

It should also be noted that limiting regulation of employment security in the name of greater labour market flexibility (a key example for the World Bank's case that regulation should be wound back) may lead to unanticipated types of rigidity in the labour market. ILO research carried out in Central and Eastern Europe, for example, suggests that workers may not have trust that new jobs are quality and sustainable, which can discourage them from taking up new employment opportunities. This can lead to inefficiency if it prevents workers from moving to more productive forms of work as they become available.

These considerations suggest again that the question for States is not whether to regulate, or how much to regulate labour markets, but rather what sort of regulation will be simplest and most effective. As the World Bank itself has noted, a positive climate for doing business – one that is cost-effective – is not one without protection, or without regulation.

New Institutional Economics suggests that legal and other institutions – including, for example, labour regulation – have an important role to play in shaping a regulatory environment that can lead to development. In a large-scale complex economy, for example, networks of interdependence widen. While this increases the possibility of developing economically nutritious activity, it also creates risks of significant inefficiency: the impersonal exchange process gives considerable scope for opportunistic behaviour, and unnecessarily high transaction costs. In developed countries there are complex institutional structures that constrain participants' behaviour, reduce the uncertainty of social interaction, and prevent transactions from being too costly. Thus, economic institutions are necessary to capture the productivity gains of larger scale and improved technology. In under-developed economies, by contrast, these institutional structures are often non-existent, weak or poorly devised due to lack of State capacity (or legitimacy) to act as guarantor of rights and institutions. In some cases, the problem is that the State is too predatory in its own demands, or is captured by special interest groups or lobbies that do not have an 'encompassing interest' in the productivity of the society and may prolong inefficient property rights.

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