

Labour market effects of employment legislation
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(Summary)

The macro-policies in the western industrial countries are converging and in the longer-term trend are pursuing aims such as budget consolidation and price level stability. Nonetheless the results vary with regard to growth and employment. One of the possible causes is institutional arrangements. Regulations influence the efficiency of macro-policies by defining the scope of action at micro-level. If they are too rigid, they lead to restrictions in the freedom of those who are responsible for economic decision-making and reduce market transparency, slow down the speed of adjustment of equalisation processes and reduce allocative efficiency. If, however, there is a case of market failure, then regulations make possible the leeway needed for markets to be able to function properly. The ambivalence described here concerns labour market regulations in general and dismissal protection in particular.

According to empirical analyses the labour market effects of dismissal protection are frequently overestimated. According to these analyses, regulation strictness has only little impact on the level of employment and unemployment. However, there is a weak statistical correlation between low regulation strictness in employment protection legislation and high economic growth. For a high level of regulation strictness in the area of dismissal protection is generally accompanied by a high level of regulation in a national economy overall. A low level of regulation strictness on goods and labour markets, such as can be found for example in Anglo-Saxon countries, would therefore increase the efficiency and productivity of the national economy and therefore also its growth dynamics.

Dismissal protection is of great importance for the structure of unemployment and employment, however. New entrants to the labour market, people returning to employment and unemployed people have greater difficulty on regulated labour markets. Comparative analyses at international level suggest moreover that stricter regulations are correlated with a lower level of labour mobility. However, fluctuation at micro- and macro-economic level is associated with expenditure (e.g. frictions due to search and settling-in) and returns (e.g. new ideas and better allocation).

The findings in this paper therefore do not call dismissal protection into question in general. However, in every legal system there is a need for reform, because the basic conditions are constantly changing. The following aspects say something for more flexibility on Europe's labour markets: if structural change is to be pushed ahead with the aim of strengthening economic growth, the stricter legislation which is probably more suited to large industrial enterprises and predominantly internal labour markets should be geared more towards the realities of the medium-sized services industry. A less strict dismissal protection and therefore more mobility on the labour market would contribute to a change in perspective and to high-quality products and services, thus encouraging structural change. Attention would be directed away from the preservation of existing jobs and towards the creation of new jobs (in new and expanding firms). Finally, revisions of employment legislation should take more into account the interests of outsiders, for whom protective regulations regularly lead to the "revenge of the well-meant". If the persistence of unemployment were also broken down with the aid of a deregulation of employment legislation, this would also have a macroeconomic dimension. A greater effective supply due to more movement on the labour market can have a

wage-moderating effect at least in the longer run, thus encouraging an increase in employment. However, if one expects the employees to accept a greater employment risk and therefore presumably more external flexibility, their protection should not be neglected in the reforms of the social security systems which are also on the agenda. Examples of this can be found in the Danish or also in the Dutch Flexicurity concept. Improved instruments for preserving and expanding employability (e.g. in the area of active employment policy) would then take the place of individual employment security.