

# Labour Market Impacts of Employment Protection

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# Labour Market Impacts of Employment Protection

- Introduction: Flexibility versus Security
- Law and Economics of Employment Protection
- Labour Market Impacts of Deregulation
- Conclusions: Need for further reforms ?

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# Do Regulations Matter ?

- Converging macro-policies of industrial countries
  - Fiscal policy is pursuing a course of budget consolidation
  - Monetary policy aims at price level stability
- Policy orientatation has brought the desired stability
- **But:** Comparable policies performed very differently
- Product and labour market regulations as a possible barrier?

### Economic Growth and Labour Market Indicators (1980-2000; Selected Industrial Countries)

Countries	Gross domestic product	Verdoorn's Law	Okun's Law
	Annual average growth rate (1980-2000)	Employment threshold <sup>1)</sup>	Unemployment threshold <sup>2)</sup>
USA	3,3	0,3	2,9
Netherlands	2,6	0,5	2,3
United Kingdom	2,4	2,0	2,5
Germany <sup>3)</sup>	2,1	1,4	3,0
France	2,1	1,4	2,5
Denmark	1,9	1,3	1,9

- 1) GDP growth rate from which employment begins to increase
- 2) GDP growth rate from which unemployment begins to decrease
- 3) Until 1991 Western Germany; from 1992 the whole of Germany

Source : European Commission (2001); own calculations

# Law and Economics of Employment Protection

## Labour market regulations

**aim at preventing  
market failures with respect  
to efficiency and equity**

**are a public intervention  
which may cause  
policy failures**

# Employment Security and Employment Protection

## Employment security at macro level

(Probability of being in work and remaining so)

## Employment security at micro level

(Probability of remaining in employment with the current employer)

### Employment security de facto

(Permanent contract in spite of a lack of regulations or contractual agreements)

### Employment security de jure

(Based on individual contracts, collective agreements or legal provisions)

<b>Employment security in an international comparison                      - OECD indicator on regulation strictness                      late 1980s and late 1990s -</b>		
Countries	Summary indicator <sup>1)</sup>	
	Late 1990s	Late1980s*
United States	0,2	0,2
United Kingdom	0,5	0,5
Ireland	0,9	0,9
Denmark	1,2	2,1
Hungary	1,4	..
Poland	1,6	..
Czech Republic	1,7	..
Finland	2,0	2,3
Netherlands	2,1	2,7
Belgium	2,1	3,1
Austria	2,2	2,2
Sweden	2,2	3,5
Germany	2,5	3,2
Norway	2,6	3,0
France	3,0	2,7
Spain	3,1	3,7
Italy	3,3	4,1
Greece	3,6	3,6
Portugal	3,7	4,1

1) The indicator is composed of three components: the regulations on individual dismissal protection, on temporary employment forms and on collective dismissals. \* so far as available  
 Source: OECD 1999

## Employment protection and labour market performance

- Strictness indicators for OECD countries -

	End of the 1980s Score <sup>1)</sup>	End of the 1990s Score <sup>2)</sup>
Regular employment	2,2	2,2
Collective dismissals		3,0
Temporary employment	2,5	1,9
- of which: fixed-term contracts	2,2	1,8
- of which: temporary work agencies	2,8	2,0
<b>Overall score <sup>3)</sup></b>		
Variant 1: without consideration of collective dismissals	2,3	2,0
Variant 2: with consideration of collective dismissals		2,2

*Notes:*

- Scores range from 0 to 6  
(a high score signals heavy restrictions)

1) For each category an arithmetic mean is formed from the score of all countries included in the study (n = 19 countries)

2) For each category an arithmetic mean is formed from the score of all countries included in the study (n = 26 countries)

3) In Variant 1 the main categories of individual dismissal protection and temporary employment forms are included with equal weights. In Variant 2 collective dismissals are additionally taken into account and then an arithmetic mean is formed from the scores of the three main categories.

Quelle: OECD 1999

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# Employment Protection: Cons

## ➤ The cost argument

Legal provisions have a negative effect on firms willingness to hire

## ➤ The structural change argument

„Strict employment protection may have been adequate in a static economy with relatively homogeneous labor and a Tayloristic work organization“

## ➤ The persistence argument

Protective regulations can oppose unprotected people outside the employment system (outsiders)

# Labour Market Impacts of a Strict Dismissal Protection

Indicators	Effects
Economic growth	negative, but weak
Level of employment and unemployment	almost neutral
Share of LTU and duration of unemployment	positive
Turnover in employment and unemployment	negative
Reemployment opportunities for outsiders	negative
Circumvention of standard work arrangement	positive

Source: OECD 1999; Walwei 2002

## "Standard Work Arrangements" in International Comparison (EU-countries; 1988 - 2000) - % total employment -

	2000	1988	Percentage change
Greece	49,7	40,9	8,8
Danemark	63,8	59,2	4,6
Portugal	56,1	54,3	1,8
United Kingdom	62,2	64,0	-1,8
Spain	51,1	53,1	-2,0
Irland	61,7	64,6	-2,9
Luxembourg	77,9	81,6	-3,7
Italy	60,4	64,9	-4,5
Germany *	61,3	67,4	-6,1
France	61,6	68,4	-6,8
Belgium	62,0	70,1	-8,1
Netherlands	46,5	58,2	- 11,7

\* 1988 Western-Germany

Source: Eurostat Labour Force Survey

# Assessing Labour Market Effects of Employment Protection: Empirical and Theoretical Contradictions

- Less employment protection would result in more hirings in a boom and more dismissals in a recession.
- Employment protection may not always stimulate individual effort but can also raise the workers efficiency.
- Employment protection can be used by insiders to enforce higher wages, but can also lead to wage concessions in the sense of „buying“ employment stability.
- Strict regulations must not be a problem from a labour-economic point of view if substitutes for flexibility are available.

# Employment Protection: Need for Further Reform?

- Legislation need to be geared more closely to the realities of the medium-sized firms of the service industry.
- Less protection would shift attention away from the preservation of existing jobs and more towards the creation of new jobs.
- Permanent employability gains in importance compared to job security.
- More flexible employment increases the possibility of entering the labour market.

# Employment Protection: Possibilities of Reform

## ➤ Partial deregulation

- **More contractual freedom with respect to fixed-term contracts and temporary work agencies**

***Advantage:*** More opportunities for outsiders;

***Disadvantage:*** More labour market segmentation

- **Increasing the threshold level for small firms**

***Advantage:*** Self-employment and structural change will be facilitated;

***Disadvantage :*** Polarization of legal provisions

# Employment Protection: Possibilities of Reform

## ➤ General deregulation

**Protection by severance payments instead of legal provisions (such as just-cause requirements or defined selection criteria)**

**Advantage:** necessary dismissals will be facilitated;  
more transparency and legal certainty

**Disadvantage:** need to fix a minimum payment;  
possibly more cases for severance payments