

EMPLOYMENT PROTECTION LEGISLATION AND ATYPICAL EMPLOYMENT

Andreea Claudia Serban

Abstract

This paper analyse the employment protection legislation as labour market rigidity and its role in explaining different labour market evolutions in European Union countries over the last period, both before and during the economic crisis. There are substantial differences across countries in employment protection measures in terms of hiring and firing protection legislation and different forms of atypical employment. This paper aims to analyze in this context the labour market rigidities in Romania, focusing on employment protection legislation and atypical employment pursuing how they follow the trend of the European Union countries and their specific impact on the labour market.

Key words: Atypical employment, employment protection legislation index, full term contracts, part-time employment, temporary employment

JEL Code: J11, J21

Introduction

The shock in demand associated with the financial crisis and expressed by decreasing economic growth inevitably reflected in the labour market, where demand for labour reduction has reduced the number of jobs. Labour markets respond to overall economic activity evolution with changes in employment and unemployment, specific developments showing, generally, higher rates of unemployment in the context of the contraction in economic activity.

Employment protection measures are considered to be the cause for differences in labour market performance across countries (OECD 2004, 2).

Employment protection measures are the result of labour market legislation and agreements resulting from collective bargaining. They refer to the legal framework governing hiring and firing workers. Mainly they restrict freedom of formal economy employers to dismiss, thereby reducing the job-findings but also the separation rates. The ultimate goal is to improve employment conditions of workers and enhance their welfare.

Strict hiring/firing measures and hiring employees with permanent contracts reduce *labour market flexibility* especially when they have to face recession. Even in periods of economic growth, anticipating restrictions on layoffs, firms may be reluctant to hire new workers which means rising unemployment due to the small number of those who find work. Employment protections may cause in these conditions, discourage to create jobs. For example, European countries have strict laws on fixed-term contracts hiring and firing (temporary). Therefore employers in these countries will be less flexible in adapting to situations such as economic crises, this behaviour leading to increased unemployment by reducing employment rates (Tasci, Zenker, 2011), slowing labour market flows (Salvanes, 1997). It also highlights the negative effect on youth unemployment, because such legislation protects employees but companies are reluctant to employ new entrants to the labour market reducing employment and increasing unemployment among young people (Lehmann, Muravyev, 2011).

The paper aims to analyze in this context the labour market rigidities in Romania, focusing on employment protection legislation and atypical employment pursuing how they follow the trend of the European Union countries and their specific impact on the labour market.

Employment protection measures

It is estimated that the need for employment protection measures is not given only by contractual elements, but also social. The main argument is that the social value of a job may be higher than private. This is because governments use resources to finance unemployment insurance. Thus, a job can become inefficient for an employer but can still generate resources for society. Therefore, without government intervention through these measures, the number of redundancies would be too much to what may be desirable economically and socially. In such a view, the primary purpose of employment protection measures is to give firms the correct incentive to internalize the cost of redundancies to ensure economic efficiency (OECD, 2004, 2).

OECD has developed a composite indicator that assesses strict legislation on employment protection, Employment Protection Legislation (EPL) Index. The 18 components (referring to notifications about dismissals and collective redundancies, severance payments, trial period and temporary contracts) are grouped into three categories: protection of workers against individual dismissals, specific requirements for collective dismissals and temporary forms of employment regulation. Measures on individual dismissals relate to advance notice and

severance payments which are employer costs. Measures on collective redundancies are more regulated than the individual dismissals and they also involve costs for employers.

According to this index, countries with the greatest freedom to hire and fire were UK, Ireland, Slovakia, Bulgaria, Hungary. France, Spain, Romania and Portugal were at the opposite side of the scale. During 2000-2007 the most significant relaxation of legislation had Bulgaria, Slovakia, Greece and Italy. Poland, Hungary and Romania have tightened legislation on employment protection, registering increases of EPL index (Table 1).

Table 1: EPL Index, OECD, version 2

Country	2000	2003	2007	Evolution 2000-2007
UK	1,1	1,1	1,1	0,0
Ireland	1,2	1,3	1,3	0,1
Slovakia	2,2	1,7	1,7	-0,5
Bulgaria	2,8	2,0	1,9	-0,9
Hungary	1,5	1,8	1,9	0,4
Czech Republic	1,9	1,9	2,0	0,1
Denmark	1,9	1,9	2,0	0,1
Finland	2,2	2,1	2,1	-0,1
Austria	2,4	2,2	2,2	-0,2
Netherlands	2,3	2,3	2,2	-0,1
Poland	1,9	2,1	2,2	0,3
Estonia	2,4	2,6	2,3	-0,1
Italy	2,9	2,3	2,3	-0,6
Germany	2,6	2,4	2,4	-0,2
Belgium	2,5	2,5	2,5	0,0
Sweden	2,5	2,5	2,5	0,0
Latvia	2,5	2,5	2,6	0,1
Slovenia	3,3	2,5	2,6	-0,7
Greece	3,5	2,8	2,8	-0,7
Lithuania	2,7	2,8	2,8	0,1
France	2,8	2,9	2,9	0,1
Spain	3,0	3,0	3,0	0,0
Romania	2,0	2,8	3,0	1,0
Portugal	3,5	3,5	3,4	-0,1

Source: Fialova, Schneider, 2011

Employment protections measures operate in two directions. On the one hand, they recognize the *need for long-term mutual commitment between employees and employers* and encourage the latter to improve employees who otherwise may become less useful in terms of technological change that requires a constant adaptation of professions and qualifications. Stimulating investment in human capital results in an increase in labour productivity. On the other hand, if firms receive signals that security measures force them to keep workers that are no longer needed, *they are cautious in making hiring* and assess applicants more carefully, a

situation which is detrimental to those seeking work and are in a labour market disadvantage (too young or too old, workers with low education level, women, etc.) (OECD, 2004).

Employment protection legislation includes a set of laws governing dismissal of employees, including provisions relating to compensation payments. Most of the cost of dismissal is a transfer from employer to employee (compensation, severance payments). This transfer can be over passed by changes in wages (in case of flexible wages). Employer reduces the worker's entry salary by an amount equal to anticipated future payments (severance payments) so that payments to employees, the total wages and compensation (severance payments) remain unchanged. Such a theory would predict a decrease in wage labour market entry (Leonardi, Pica, 2006), but transferring costs to the employee would have the effect of their migration to the informal sector. In reality, nominal wages are rigid to decrease, making severance payments to increase the redundancy costs and therefore *reduce the flow to unemployment*.

By increasing the cost to the company and, more importantly, by increasing the bargaining power of employees, employment protection measures can increase negotiated revenues and as a result, *increase unemployment duration*. The two effects, reducing flows to unemployment and increasing unemployment duration, act in different directions on unemployment rate. From this point of view, the effects of employment protection legislation can compensate each other in terms of influence on unemployment (plus and minus), generating ambiguous effects (Blanchard, 2006).

There are other employment protection measures such as regulating *the trial period*. Its importance is given to the fact that during these periods, even permanent contracts are not fully covered by employment protection measures. The law provides a maximum, but the actual duration is determined by individual contracts. *Length of notice period* is another measure that is governed by the laws of each country.

Employment protection legislation may induce **labour market rigidity** *preventing increased labour force participation*. These laws should be reformed so as to reduce excessive protection of workers on permanent contracts and provide protection to those left out or on the border between formal and informal labour market. Although attenuate adjustments as response to labour market shocks (economic crisis), employment protection legislation has strong negative effects on **flexibility at the enterprise level** in terms of their ability to adapt to changing economic conditions. Furthermore, it increases the gap between "insiders" and "outsiders" on the labour market, reducing the possibilities of the latter to join, thereby increasing the rigidity and unemployment. The effects of employment protection

legislation spread on *employment, unemployment, labour cost and productivity* (Fialova, Schneider, 2008).

It should be a balance between the need to leave employers freedom to take decisions to hire and fire and security of employment for both firms and workers so that they are willing to invest in continuous learning and, in addition, workers are protected against unfair dismissal (OECD, 2004). Propensity to invest in human capital increases in case of longer employment periods because the payback period and income flow generated by this investment is longer as well.

Atypical employment

Important rigidity of labour law refers to restrictions to use fixed-term contracts. Weakening the power of legislation on employment protection was made through the existence of two types of work arrangements, traditional permanent contracts and **fixed-term contracts** that provide a **security** level lower than the first. Restrictions to fire and hire can mitigate by using temporary or fixed-term contracts. Temporary employment may affect professional development and efficiency of workers trapped in temporary forms of employment. The transition from non-standard forms of employment to traditional employment (permanent) contract is more difficult. People who have been permanent employment contracts before are more likely to find such forms of employment in the future, situation explained by the continuity of employment. Therefore, new social risks occur due to changes in lifestyle and new social policies need to be developed. Therefore, trade unions place particular emphasis on advising workers engaged in atypical employment, to continue qualifications and to better understand the right to insurance. Studies have shown a strong link between ‘mini-jobs’ and lower wages, meaning that ‘mini-jobs’ are associated with low wages.

Despite the increase in temporary employment in recent decades, permanent contracts remain common form of labour contract. It is important therefore to emphasize *the value of the full time and permanent contract as a cornerstone of EU labour relations*, while other types of flexible contracts are important to meet certain needs and specific situations. The focus should be places on **providing skills necessary for people to remain adaptable throughout their working lives**, and not on protecting individual jobs.

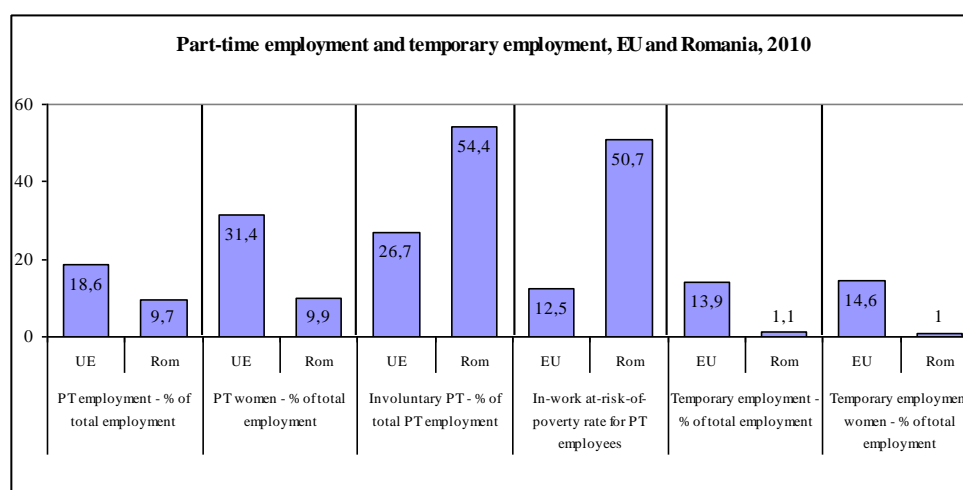
Because of some problems that persist and amplifies, i.e. long-term unemployment and increased risk of poverty, standard forms of employment for most people has diminished, atypical forms of employment having effects on social security, income and working

conditions. While atypical forms of employment increase labour market flexibility, they are often associated with low job security, reduced career opportunities, low incomes and poor access to social benefits (Eurofound, 2007).

The share of part-time or temporary employment in total employment is not constant in different countries. In Romania the share of part-time employment (PT) and temporary employment remain low despite the Labour Code amendments (which came into force in 2011) that refer precisely at these aspects.

Data presented for comparison refers to 2010 and shows that part-time employment in Romania stands at low level, almost half the level of European Union. In our country there is no significant difference between part-time employment for men and women, as is the case of EU, which, in our opinion, indicates that atypical forms of employment are not necessarily used to deal with family situations (eg childcare) but are a response to limited employment opportunities or a cover to permanent full-time contracts to qualify for tax cuts. This is also explained by the fact that more than half (54.4%) of part-time employment in Romania is involuntary. The link between ‘mini-jobs’ and low level of wages is reflected by the high risk of poverty in work of PT employees in Romania that far exceeds the EU average (12.5%) standing at 50.7%. Temporary employment contracts are underused in Romania (1.1% of total employment) comparing to the EU (14.6%), and there is no significant difference between men and women (Figure 1).

Figure 1: Temporary employment and PT employment, Romania and EU, 2010



Source: Eurostat Statistics

More flexible labour commitments regarding working time and employment period contracts can come from both the needs of employers and employees, allowing employers to exploit the production capacity more closely to changes in demand and allowing employees to adapt to

individual preferences and family circumstances and to open to new structures of lifelong learning. The two objectives of employees and employers do not coincide, more often. Improving flexibility on working time and duration of employment contracts for those who voluntarily accept such forms, both employees and employers, increase employment (OECD, 2004.1).

Conclusion

Employment protection legislation is multidimensional, and reducing it to quantitative factors may be difficult. That is why EPL index is a useful tool for comparing countries in terms of employment protection. Even in these conditions it is difficult to compare some components. For example, fixed-term contracts can differ in terms of nature of working task, i.e. permanent or temporary, maximum cumulative duration of a fixed-term employment relationship, including number of renewals.

A particular emphasis on part-time employment and temporary contracts in certain sectors of the economy, gender, area of residence or ethnic group may mean that those affected by the atypical forms of employment have been *forced to accept this situation*, sometimes contrary to the level of knowledge or individuals needs. From a certain perspective, on the one hand we must assess the number of part-time or temporary employees who are involuntarily in this situation. On the other hand, a higher proportion of workers with part-time or temporary employment contract may reduce the willingness of employers to provide training and staff development opportunities that they consider likely to remain in the organization long-term.

Labor market rigidities have multiple preconditions, not only employment protection legislation and even not only labour market institution (trade unions, unemployment benefit, minimum wage, collective bargaining etc.). Other issues are particularly important and require parallel approaches. In a next step we address the other labour market institutions and wage rigidities (nominal and real) seeking to highlight their impact on macroeconomic variables in a model adapted to this purpose.

Acknowledgments

This work was supported by the project “Post-Doctoral Studies in Economics: training program for elite researchers – SPODE” co-funded from the European Social Fund through the Development of Human Resources Operational Programme 2007-2013, contract no. POSDRU/89/1.5/S/61755.

References

- Blanchard, Olivier (2006), *European Unemployment: The Evolution of Facts and Ideas*, Center for Economic Policy Research, *Economic Policy*, vol. 21, no. 45 (January 2006).
- Eurofound (2007), *The changing labour market in Germany in time of crisis, Approches to flexicurity: EU Models*, Luxembourg, Available online, www.eurofound.europa.eu/.../ef0784en.pdf, [Retrieved 1st October 2011]
- European Commission, Directorate General for Economic and Financial Affairs and Economic Policy Committee LABREF database
- European Commission (2010), *Annual Growth Survey: advancing the EU's comprehensive response to the crisis*, Brussels, http://ec.europa.eu/europe2020/pdf/en_final.pdf
- European Commission (2011), *Labour Market Development in Europe, 2011*, Bruxelles, http://ec.europa.eu/economy_finance/publications/european_economy/2011/ee2_en.htm
- Fialova, K.; Schneider, O. (2011), *Labor Institutions and Their Impact on Shadow Economies in Europe*, The World Bank Europe and Central Asia Region Human Development Economics Unit December 2011
- Fialova, K.; Schneider, O. (2008), *Labor Market Institutions and their Effect on Labour Market Performance in the New EU Member Countries*, CESIFO WORKING PAPER NO. 2421 CATEGORY 4: LABOUR MARKETS OCTOBER 2008
- Guerrazzi, M; Meccheri, N (2010), *From Wage Rigidities to Labour Market Rigidities: A Turning-Point in Explaining Equilibrium Unemployment*, <http://www.dse.ec.unipi.it/publicazioni/dsedps/files/2009-94.pdf>
- Layard, R., Nickell, S., Jackman, R. (1991), *Unemployment: Macroeconomic performance and the labour market*, Oxford. Oxford University Press
- Lehmann, H.; Muravyev, A (2011), *Labor Markets and Labor Market Institutions in Transition Economies – Discussion Paper No. 5905*, August 2011 IZA, Bonn, Germany – folder Institutii
- Leonardi, Marco and Pica, Giovanni (2007), *Effects of Employment Protection Legislation on Wages: a Regression Discontinuity Approach*, IZA, www.iza.org/conference.../pica_g1513.pdf
- OECD (2004,1), *The OECD Jobs Study Facts, Analysis, Strategies*, www.oecd.org/dataoecd/42/51/1941679.pdf
- OECD (2004,2), *Employment Outlook 2004*, http://www.oecd.org/document/24/0,3746,en_2649_33927_31935102_1_1_1_1,00.html
- Pissarides C.A. (1997), *The Need for Labor-Market Flexibility in a European Economic and Monetary Union*, Swedish Economic Policy Review, Vol.4, pp. 513-546
- Salvanes, Kjell (1997), *Market Rigidities and labour Market Flexibility: An International Comparison*, Scand. J. of Economics 99(2), 315-333, 1997

The 6th International Days of Statistics and Economics, Prague, September 13-15, 2012

Solow R.M. (1998), *What is Labour-Market Flexibility? What is it Good for?*, Proceedings of the British Academy, Vol. 97, pp. 189-211

Tasci, Murat and Zenker, Mary (2011): *Labor Market Rigidity, Unemployment, and the Great Recession*, Economic Commentary, Number 2011-1, June 29, 2011

Contact

Andreea Claudia SERBAN

Academy of Economic Studies, Bucharest

Piata Romana no6, Bucharest, Romania

Andre_serban@yahoo.com