

# THE INTERNATIONAL METHODOLOGIES OF ASSESSMENT OF EMPLOYMENT PROTECTION

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## Otenko P. V. The International Methodologies of Assessment of Employment Protection

*This article is concerned with International methodology of assessment of employment protection. The main problem that is raised in this article is the following one – what indicator and criteria should be used in order to determine the degree of employment protection in a particular country? Author outlines and comprises the basic indicators that were created by the leading institutions: the OECD, the World Bank and Cambridge Center for Business research. The positive as well as negative consequences and also an influence of having a stringent degree of employment protection on the areas like productivity, labor market, labor market flows, etc. are described and discussed. Author also suggests different steps that should be taken in order to reform the current situation and solve problems in the labor area. Three possible ways of how to reform and enhance employment protection are analyzed and characterized.*

**Keywords:** employment protection, International Labor Law, criteria and indices, methodology of assessment, ways of reform.

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### Отенко П. В. Міжнародні методології оцінки захисту персоналу

*Дана стаття присвячена аналізу міжнародних методологій оцінювання корпоративного захисту персоналу. Основна ідея – обґрунтування вибору індикаторів і критеріїв для оцінювання рівня захисту персоналу. Автор проводить порівняльний аналіз індикаторів і критеріїв, які використовуються в методологіях міжнародних інституцій – ОБСЄ, Світовим банком і Кембриджським центром бізнес-досліджень. Виявлені позитивні й негативні наслідки, а також вплив ступеня захисту персоналу на продуктивність, трудовий ринок, потік працівників і т. ін. Відповідно до результатів оцінювання запропоновано можливі організаційні способи розв'язку проблемних питань у трудовій сфері захисту персоналу підприємств корпоративного сектора.*

**Ключові слова:** захист персоналу, міжнародне трудове право, критерії й індикатори, методологія оцінювання, способи реформування.

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### Отенко П. В. Международные методологии оценки защиты персонала

*Данная статья посвящена анализу международных методологий оценивания корпоративной защиты персонала. Основная идея – обоснование выбора индикаторов и критериев для оценивания уровня защиты персонала. Автор проводит сравнительный анализ индикаторов и критериев, которые используются в методологиях международных институций – ОБСЕ, Мировым банком и Кембриджским центром бизнес-исследований. Выявлены позитивные и негативные последствия, а также влияние степени защиты персонала на продуктивность, трудовой рынок, поток работников и т. д. В соответствии с результатами оценивания предложены возможные организационные способы решения проблемных вопросов в трудовой сфере защиты персонала предприятий корпоративного сектора.*

**Ключевые слова:** защита персонала, международное трудовое право, критерии и индикаторы, методология оценивания, способы реформирования.

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Employment protection plays an important role both for employees and employers. The degree of development of this institute can be used as a criterion for distinguishing one country from another one, and it also reflects the level of development of a particular country. So it is vital to understand how we can assess the rate of employment protection in a country and what criteria should be used. Creating and developing a common, internationally recognized indicator would simplify the assessment process and show advantages as well as possible drawbacks in the labor policy of a country.

The problem was examined by the following authors and institutions: OECD, World Bank, Cambridge Center for Business Research, G. Bertola, T. Boeri, S. Cazes, A. Muravyev, E. Belzar, O. Blanchard, S. Scarpetta and others. The topic is very urgent and widely discussed nowadays.

The OECD compiles such indicators for most OECD countries (so-called OECD Employment Protection Legislation Index), on the basis of the codification of 21 elements of legislation. The index has a round number scale between 0 and 6, where the highest number represents the most stringent legislation. OECD indicators of employment protec-

tion legislation (EPL) have limits and are to be interpreted with caution. First of all, not all changes in the legislation modify the OECD indicators of EPL. This may occur either because a change is insufficient to modify the scoring given to a particular characteristic of government regulation, or because specific aspects of legislation are not considered in the calculation of the index (e. g. the length and uncertainty of judicial procedures in case of unfair dismissal, treatment of self-employed). Moreover, aspects related to enforcement of EPL are also not fully captured by the indicators [1].

Another index, called Employing Workers Indicators, was produced by the World Bank that has been collecting data on several aspects of labor regulations since 2006. It contains an aggregate indicator of employment rigidity that is based on three aggregate sub-indicators: difficulty of hiring, rigidity of hours, and difficulty of redundancy. It also contains a separately reported indicator Redundancy Cost. The Employing Workers Indicator concerns mainly notification procedures, notification requirements, and severance pay for individual and certain group dismissals, and partly touches upon valid ground for termination [2].

An alternative index was composed by Cambridge Center for Business Research. This center produced Labor Regulation Index which includes the following sub-indicators: alternative employment contracts, regulation of working time, regulation of dismissal, employee representation, industrial action, for a selection of countries, between 1970 and 2006. Developed by legal specialists, these indicators capture the extent to which regulations protect the interests of workers as opposed to those of employers. Among the main features of these indicators is accounting for both formal laws and self-regulatory mechanisms, including collective agreements, which play a functionally similar role to that of the law in certain systems [3].

There can be raised an interesting question – is it good or bad to have a relatively high degree of strictness of employment protection, and how this situation influences other related areas? For instance, there is an impact of EP on job and worker flows. OECD (2010) presents an empirical analysis of worker flows using industry-level data (averaged over the period 2000-07) for 24 business- sector industries and 24 OECD countries. The study focuses on EP for regular contracts (including additional restrictions for collective dismissals) and adopts a difference-in-difference estimation procedure. The latter relies on the assumption that employment protection has a potentially stronger impact on firms' behavior – and thus on worker flows – in industries that tend to have, in the absence of regulation, a greater need to adjust their workforce because of technological and market factors. The empirical results in OECD (2010) suggest that EP on regular contracts has a statistically significant negative direct effect on worker reallocation – once the impact of demographic characteristics and the share of temporary workers have been controlled for. Moreover, EP has a strong and statistically significant effect mainly on job-to-job separations, with little or no impact on job-to-jobless separations. This could be taken as evidence that, at least in normal times, those workers who may end up being displaced in the aftermath of a reform easing EP for regular workers but would not have been displaced without the reform, are likely to find another job within a relatively short period of time [1, 4].

**Effects of EP on productivity.** Recent cross-country studies have found robust evidence of a negative effect of EP on productivity. In particular, exploiting industry-level data for a sample of 19 industries in 11-16 OECD countries over the period 1982–2003 and using a difference-in-difference approach, they found evidence that labor productivity tends to be weaker in industries with greater layoff propensity, the more stringent the level of EP. Also the results of studies of several market reforms implemented in the past 20 years suggest that the gap between restrictions on open-ended contracts and those on temporary ones depresses productivity growth. Furthermore, cross- country evidence shows that productivity growth has been slower in countries that weakened regulations on temporary contracts while maintaining stringent restrictions on regular ones.

The impact of EP on investment could be either positive or negative. First, strictness of EP might discourage businesses to expand production, resulting in a lower ag-

gregate investment. Second, in industries where labor and capital are complementary factors of production, the impact of EP on employment and investment would be in the same direction (either positive or negative depending on the employment intensity). Third, a relatively strict EP might discourage the use of labor and encourage firms to adopt capital intensive technologies, therefore increasing the aggregate investment [5].

Many empirical studies have assessed the impact of employment protection on the labor market and broader economic outcomes. The early publications were focused on the potential impact on aggregate employment and unemployment, generally relying on cross-country time-series data. Unsurprisingly, given what theory predicts, the empirical evidence is not clear-cut: some studies found no significant effects of employment protection on employment or unemployment outcomes while others found that stricter regulations reduce employment and increase unemployment. More recently, several studies have exploited the fact that certain employment protection reforms were targeted at specific groups of workers or firms or undertaken at different times in different states or regions, thereby generating quasi-natural experiments. These studies typically found small, but often significant, negative effects of stricter employment protection rules on aggregate employment.

The impact of employment protection on labor market segmentation also can be emphasized. To enable firms to respond more flexibly to technological changes, crises and fluctuations in demand, many advanced economies and some emerging market economies have liberalized temporary contracts while leaving more rigid regulations on permanent contracts in place. This liberalization “at the margin” has increased dualism in the labor market. Workers on temporary contracts tend to bear the brunt of labor market adjustments while workers on permanent contracts enjoy greater protection and job stability. Workers tend to become trapped in fixed-term contracts, often going from temporary contract to unemployment, and back to temporary contract [6].

To sum up the above-mentioned, we can say that stringent employment protection, in particular stringent EPL, hinders the effectiveness of labor market flows and the allocation of labor to the most productive jobs, harming productivity and growth. In general, workers benefit from a more efficient allocation of labor through higher real wages and better career progression, but some displaced workers may suffer longer unemployment spells and lower real wages in their new jobs.

As with most labor market regulations, EPL was first introduced with the aim of enhancing workers' welfare and improving employment conditions. However, the same provisions that protect employees translate into a cost for employers and thus could have a negative impact on hiring. The literature on EPL highlights positive and negative effects on labor market performance. Among the former, it highlights the benefits of long-term employee- employer contracts including greater willingness to invest in on-the-job training; It can also be justified by the need to protect workers from arbitrary actions by employers and workers are risk-averse – they do not have the possibility to privately insure them-

selves against market uncertainty; Moreover, there are some countries lacking unemployment benefits, severance pay can sustain job search by dismissed workers and improve job matching. Among the latter, is the concern that workers hired on regular contracts may enjoy a high degree of employment security to the detriment of other workers hired on temporary contracts; stringent employment protection reduces the ability of economies to redirect labor resources to the most productive uses; also, in many developing and emerging economies, stringent employment protection is weakly enforced. In addition, employment protection may diminish firms' ability to cope with a rapidly changing environment driven by globalization, technological change and the derived organizational innovation [7].

The effects of EPL on labor market performance are a controversial subject, both in theory and in applied research. Most available studies have looked at employment protection as an additional labor cost for firms, and have studied the effects of this cost on employment and joblessness, but two important and related aspects have often been left aside: 1) the rationale for the existence of employment protection; and 2) its welfare consequences. Some recent studies have sought to address these issues by considering employment protection not just as an exogenous cost for employers, but as a comprehensive policy instrument, able to resolve certain market imperfections, with potential positive welfare implications. Policy recommendations have also evolved towards a more balanced view of the dilemma opposing the need for flexibility expressed by firms to the importance of protecting workers against labor market risks. The ILO has set similar objectives with the aim of promoting employment stability while maintaining a sufficient level of labor market flexibility [3].

As we can see, there are a lot of positive consequences of having a high degree of employment protection, but also we are facing a large amount of negative effects due to this fact. Now we would like to outline different steps that should be taken in order to reform the current situation and solve the above-mentioned issues.

**W**hat should be taken in order to boost productivity growth and living standards? First, the OECD research for the Reassessed Jobs Strategy (RJS) of 2006 stresses that any such reforms should be tackled as part of a comprehensive strategy, not viewed as an end in itself. A comprehensive strategy has to include appropriate macroeconomic policies to deal with demand-side shocks – an important lesson from the recent Great Recession – and vigorous steps to strengthen product market competition. It should also seek to secure a new “flexicurity-type balance”, taking into account each country's specific starting points and institutions, in order to ensure that the benefits and costs of the reforms are equitably shared between workers, firms and taxpayers. A key factor in any such flexicurity bargain should be a reasonably generous social safety net that is backed by an effective activation regime which assists benefit recipients to get back into work. Such a cost-effective activation regime does need to be adapted to the specific circumstances of a steep downturn and OECD (2009, 2010) highlights some of the elements in this adaptation and how

countries have responded to the jobs crisis and current recovery [8].

At least three possible reform approaches could be considered. One, which has been championed by a group of European economists including Pierre Cahuc, Francis Kramarz, Samuel Bentolila, Juan Dolado and Tito Boeri, is to move sharply away from a two-tier EP system of the type which exists in many (mostly European) countries today, with relatively strict EP for permanent workers and relatively lax EP for temporary workers. Instead, they call for a single EP contract, with firing costs being set at initially low levels and rising with firm tenure. A second type of reform owes its inspiration to the Austrian reform of 2003 that converted uncertain firing costs for employers into a system of individual savings accounts, funded by an employer payroll tax. From the employer's perspective, this system guarantees certainty about the cost of any future dismissal at the time of hiring. For the workers, costs associated with labor mobility are reduced because they do not lose their entitlement to severance pay when quitting to take a new job [9].

**E**nhancing flexibility for specific types of contracts without modifying the rules for permanent contracts or for collective dismissals has led in the past years to segmentation in a number of countries. In addition, modern social protection systems, including unemployment benefits, cost-effective active labor market policies and lifelong learning support the quality of transitions. The problem of labor market segmentation (the gap between employment protection for permanent and temporary contracts) can be solved by relaxing the stringency of EP for the permanent contracts while at the same time increasing the degree of stringency for the temporary contracts.

We can't reform EPL in one way, we should take into consideration characteristics and traditions of different countries – the specific scope and direction of reforms depend on the ranking of the labor market problems to be tackled, on the features of EPL that can better contribute to pursue the reform objectives, on the need to address other issues than EPL (e.g. unemployment benefits) to ensure effectiveness or feasibility of the reform path, and also on the great differences of national employment protection legislation systems and the need to preserve their internal coherence, including in view of their interaction with other labor market policies such as unemployment benefits, job-search assistance and support [10].

After the global economic crisis in 2008, there is a tendency concerning collective bargaining towards decentralization and fragmentation. As it is the case with EPL, the collective bargaining mechanism did not cause the financial and economic crisis. In fact, their existence is indicative of democratic traditions prevalent in a country, and they represent a potentially powerful tool for achieving policy coordination across the economy. ‘Fragmented’ collective bargaining is related with lower employment levels, and beyond this lowest level of coordination there is a U-shaped relationship between coordination over wage bargaining and employment rate. Moreover, “coordinated” collective bargaining can have a positive impact on employment rates at the aggregate level. This refers to company-level bargain-



ing within the framework of rules and standards set by (inter) sectoral agreements. On the other hand, moving toward full coordination has a clear rationale for achieving higher employment rates. In addition, when an economy is affected by a generalized shock (as the global financial crisis, for example) centralized or fully coordinated collective bargaining can be a useful tool, as all firms will have to face similar set of problems. Therefore, the indiscriminate trend towards decentralization is questionable [11].

Over recent years, several countries have reformed their EPL. Indeed, these alterations mainly consisted in liberalizing or tightening some of the existing regulations. By contrast, the reforms undertaken in Austria and New Zealand have been of a more fundamental nature. Austria has recently transformed its severance pay legislation into a system of individual savings accounts. Severance pay entitlements were previously based on the length of the employment relationship between a worker and a firm. Legislation stipulated that severance pay had to be paid to private sector employees in the event of termination of the employment contract by the employer, if the employee had worked for the employer at least for the previous three years. Since 2003, employers have to contribute 1.5377% of the payroll to an individual account (managed by a fund that invests the balance in private capital markets), from the first day of employment until contract termination. In the case of dismissal by the employer, an employee with at least three years of job tenure can choose between receiving his/her severance payment from the account at once, or saving the entitlements towards a future pension. From the employer's standpoint, this new system suppresses the specific monetary cost of a dismissal, while it tends to increase labor costs in general. From the employee's standpoint, it reduces the cost of job mobility, in that workers do not lose anymore all of their entitlement to severance payments when taking a new job. In the new system, entitlement starts on the first day of employment and does not depend on the way the employment contract is terminated.

In New Zealand, the Employment Relations Act (ERA), which came into force in 2000, has marked a significant departure from the previous legislation in that it promotes collective bargaining as a positive basis for employment relationships. The ERA requires to bargain in "good faith" on the basis of a Code of Good Faith. It also requires mediation as a first step in the event of disputes. The principle of good faith means that before employers can dismiss an employee, they must give trade unions and / or the employee in question explicit, reasonable notification of the reasons as well as reasonable notice. But the ERA does not state clearly what reasonable means [10; 11].

Another interesting approach to achieving a good employment protection is as following: when an employer is deciding on whether to lay off a worker, a firm should take into account the social costs of this decision. This means taking into account the unemployment benefits that the unemployment insurance fund will have to pay the laid off worker. And for the workers with seniority in the firm it means also taking into account the psychological costs associated with the loss of a long held job. This can be done in the follow-

ing way – if a firm dismisses a worker, it should pay a layoff tax equal, at least on average, to the unemployment benefits that will be paid the laid off worker and to compensate the psychological costs, it should pay severance payments increasing in seniority. Thus, if under these conditions a firm decides to lay off a worker, it should be free to do so.

For example, in France and Austria unemployment contributions are collected through a payroll tax, not through a layoff tax. And this means that firms that lay off more workers do not pay more. But this is wrong – firms that lay off more workers should pay more. All in all, employment the protection reform should involve a shift from a payroll tax to a layoff tax. A prominent example is the USA where financing of unemployment insurance is done through layoff taxes [12].

The effectiveness of employment protection depends not only on provisions that are enshrined in particular pieces of legislation, collective agreements, employment contracts, health and safety occupation standards but also on the interpretation of rules by courts and tribunals and enforcement of these rules. Jurisprudence may be affected by underlying labor market conditions; for instance, there is evidence that judges' decisions tend to be particularly favorable to workers when unemployment is high. Moreover, compensations for unfair dismissals can deviate largely from the minima set out by legislation because judges may account in their final decision for damages corresponding to past and future financial losses and psychological damages. There are also very large differences across sectors and countries in the number of cases brought to labor courts, the percentage of cases won by workers and the length of the legal procedure. That's why it is important to reform not only the legislation but also the procedural part of it.

To sum up, we would like to highlight most arguable moments concerning employment protection. The most important question is whether or not we need employment protection at all, or good results can be just achieved without having so stringent rules and procedures?

Through employment protection legislation and regulations, governments can strongly influence labor market adaptability. The design and enforcement of the EPL can affect the turnover in the labor market, which, in turn, can have significant effects on productivity growth. The debate on the appropriate set of laws and regulations affecting the hiring and firing of workers has become more urgent following the global financial crisis, as several (mainly European) countries have sought to enhance their competitiveness by easing employment protection provisions for workers through liberalizing requirements and conditions for applying fixed-term contracts and decentralizing collective bargaining. But the debate should be based on more hard evidence on both the impact of EPL on labor market and economic outcomes and on different groups of workers and firms. Recent empirical evidence has focused on the impact of strictness of employment protection on labor market dynamics and, ultimately, on productivity, investment, job flows and worker's welfare. The evidence also shows that while many workers benefit from a more dynamic labor market through higher real wages and better careers, some displaced workers lose

out because of longer spells of unemployment and lower real wages in post-displacement jobs [9].

Reform of EPL should not be conducted piecemeal but should be part of a comprehensive reform package to promote greater adaptability of the labor market and better allocation of labor. Measures should include an adequate safety net, backed up by effective re-employment services, to assist displaced workers in finding new jobs that pay well and lead to stable job opportunities [11].

## SUMMARY

Summarizing, we can say that there is no clear answer to the question about which indicator for assessment of the degree of employment protection development should be applied. Each indicator has got its own advantages and disadvantages. At the same time, most institutions and organizations apply the OECD indicator in order to identify the level of employment protection in a particular country. The question concerning an impact of stringent employment protection on the different areas cannot be answered in one way. There are a lot of positive consequences of having a high degree of employment protection, but also we are facing a large amount of negative effects. Also, there is no common approach concerning the way of reforming and enhancing employment protection. ■

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