



PROTECTED PROFESSION AND UNITED DEAL: PROGRAM FOR DEREGULATION

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Abstract: *In the result of the global calamity, countries have curved progressively more towards amending labour market institutions, as easing regulations regarding the hiring and firing of workers is often seen as a way to encourage job creation. Meanwhile, there has also been further deregulation and decentralization of collective bargaining. Some of the decline is part of the broader trend that was already taking place before the crisis, while many others were accelerated by the financial and economic crisis. But, the empirical evidence on the link between EPL and employment outcomes is far from being conclusive and similar is the story with the link between collective bargaining and labour market outcomes. Situations show that there is no significant relationship between the EPL and unemployment outcomes, including youth unemployment. Likewise, the relationship between private sector investment and stringency of EPL is also non-linear and there is a weak negative relationship between EPL stringency and social wellbeing, and this holds for both developed and emerging economies. Also, highest employment rates are found in either a fully decentralized (but coordinated) bargaining and in fully centralized bargaining systems.*

Keywords: *Employment, regulation, labour, collective bargaining*

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INTRODUCTION

After exclusive administration interference following the worldwide crisis, job creation still leftovers sensible at best and labour markets are under a lot of pressure, mainly in developing economies. As countries are faced with the twin challenge of low growth and apparently impossible debt burden, deregulating the labour market is seen as a way to urge job creation and growth. This is particularly the case in the Indian economies as countries in the region continue to languish in the aftermath of the financial and economic crisis. Furthermore, the crisis has accelerated the longer-term trend towards the decentralization and deregulation of collective bargaining. Some of these efforts, however, may be counterproductive and exacerbate labour market outcomes.

Employment protection can be achieved either through legislation or collective bargaining. Moreover, these combined with effective labour policies ensure labour market security – a more comprehensive understanding of protection that goes beyond one job or employer. Labour market security provides protection combined with unemployment insurance, minimum wage, training and other labour policies that facilitate transition from unemployment and employment while providing protection to those who are already in employment. Because of the recent trend towards deregulation and decentralization, this paper only examines employment protection legislation and industrial relations, the other aspects of security are left out of the paper.

Section 1

Provides an overview of EPL and collective bargaining with a focus on their theoretical links with macroeconomic performance and labour market outcomes.

Section 2

Includes an overview of recent changes in EPL and collective bargaining – covering over 130 countries where qualitative data is available in terms of legislative changes. For 43 countries, the paper provides an update to the quantitative data on EPL available based on the OECD methodology and the ILO sources for 2010/2011.

Section 3

Assesses the impact of these changes across countries by exploiting the quantitative data on EPL to identify any causal links with employment, macroeconomic performance, and general well-being.



Section 4

Concludes by providing policy recommendations chiefly underscoring the need to move away from “more vs. less” regulation towards a collectively negotiated level of protection that would ensure job quality and satisfaction without preventing economic efficiency and employment growth.

1. EMPLOYMENT PROTECTION LEGISLATION AND COLLECTIVE BARGAINING: AN OVERVIEW

Employment protection legislation (EPL)

Employment protection legislation is one of the many labour market institutions in a country designed to give employees protection against unfair dismissals as well as from the fluctuations in earned income, which normally occur when the employee loses his job, individually or collectively. Generally speaking, EPL governs firms’ ability to fire employees, while it also regulates the use of temporary workers.

However, there are exemptions to EPL, which usually depend on the size of the firm. A well-functioning EPL –which balances the need to provide fair treatment as well as income security to workers and allow firms’ to adjust employment (hours and/or jobs) based on fluctuations in aggregate demand is an important determinant of a country’s ability to weather an economic downturn. Economic theory says that EPL has a direct impact on allocation of labour, but since internationally comparable quantitative measures of EPL have numerous problems, labour market impact of EPL remains mostly an empirical question. EPL has three main pillars:

- i) Termination of regular employment (permanent or open ended contracts),
- ii) Hiring of temporary workers, and
- iii) Collective dismissals

With respect to termination of regular employment, legislation addresses substantial and procedural requirements (administrative and legal), notice periods and severance pay. Severance pay is a direct cost of dismissals for employers, and it is usually defined as a number of wage days (or months) per seniority year. The legislation usually requires either a valid reason for a dismissal or for a list of valid reasons which generally include personal circumstances of the employee (e.g. conduct and capacity related reasons) and economic reasons (e.g. loss in revenues). If the dismissal is challenged and the employer cannot show



that there were valid reasons, the dismissal can be declared unjustified and gives rise to remedies in the form of reinstatement or compensation.

The second pillar of employment protection legislation covers temporary contracts designed to give firms flexibility in adjusting employment (by hiring temporary workers) during economic fluctuations. In order to prevent excessive use of temporary contracts, there are laws governing their use, the chief among which is the regulation that stipulates the reasons for which a firm can hire workers on temporary contracts. For example, temporary contracts are generally accepted for seasonal works, and also for employing specific groups of workers such as young people and new entrants to the labour market (Skedinger, 2010).

The primary restriction an employer faces is the length of time for which it can keep an employee on a temporary contract. Finally, the third pillar of EPL is regulation governing collective dismissals, which tend to be subjected to stringent restrictions because it entails additional requirements (information, consultation etc.). The definition of collective dismissal depends on the number of employees concerned and it tends to vary among countries. Collective dismissals have broader economic and social consequences hence regulation is meant to strike a right balance between the socio-economic costs of collective dismissals (on individuals, enterprises, and the community as a whole) and the need for employer to adjust employment. (Muller, 2011; Skedinger, 2010).

Employment protection legislation and the quest for a satisfactory indicator

Measuring employment protection is a difficult task and depends very much on the data availability. Some quantitative aspects can be easily computed, such as the number of months' notice required for individual dismissal and severance pay. But other aspects, such as the interpretation of the definition of "just cause" for termination, are more difficult to measure precisely. In order to carry out international comparisons of employment protection regimes, various summary indicators have been computed by academics and international organizations⁷ to describe the "strictness" of employment protection legislation in each country. But comparable datasets remain scarce: the OECD for example has developed such a methodology and compiled synthetic EPL indicators ranging from (0 to 6), with 6 being the most stringent legislation.

As highlighted by the ILO among others, this indicator suffered from a number of both conceptual and methodological flaws; in particular it relies on a simplistic "regulations are



costs” perspective (Berg and Cazes, 2008). While trying to influence policy changes in a country is a novel goal, doing it based on a narrow and unbalanced view of the labour market could lead to misleading and unfair policy recommendations with disastrous consequences. Enforcement plays a crucial role in the functioning of labour markets, notably in determining labour market flows such as job losses and inflows into unemployment (Bertola, Boeri and Cazes, 2000). In case of developing and emerging economies, the presence of large informal sector makes it difficult for the EPL indicator to be very meaningful. Moreover, many of the low and middle income countries generally provide *de jure* greater employment protection than the average for the OECD but this is mainly because the legislation is usually the only protection available for workers and in that, it covers only formal workers. Meanwhile, since enforcement of EPL is even more of a challenge in developing countries, formal workers are afforded little protection in practice. This gap in protection remains one of the key challenges facing policymakers in developing and emerging economies. The empirical evidence on the effects of EPL can be divided into the following three categories:

- i) Cross-country studies using aggregate data;
- ii) Cross disaggregate data; and
- iii) Within country commonly found empirical evidence is of the first type but in the been a notable shift towards using disaggregate reliance on within country evidence. However, irrespective of the methodology used, there is a general consensus that the mixed. But in terms of distribute the youth and women could changing regulations only for a subset of the workforce)



Figure 1: Empirical evidence on the effects of employment protection legislation

Cross-country studies using aggregate data	Cross-country studies using disaggregate data	Within country studies using mostly disaggregate data
<p>Mixed and rather small effects on aggregate levels of employment/unemployment</p> <ul style="list-style-type: none"> • Negative effects on vulnerable groups, especially youth • Hump-shaped relationship between EPL and growth 	<p>Mixed effects on aggregate levels of employment/unemployment</p> <ul style="list-style-type: none"> • Reduced employee turnover (job creation/destruction) • Negative effects on productivity • Weak/ negative connection between EPL and perceived job security 	<p>Mixed and rather small effects on aggregate levels of employment/unemployment</p> <ul style="list-style-type: none"> • Reduced employee turnover (job creation/destruction) • Negative effects on productivity • Increased worker absenteeism

But there are several problems with cross-country studies with aggregate data: first, there are measurement problems with the indices of EPL; OECD's EPL index is the most commonly used but it had very few observations over time until 2006, it's only recently that the data has gotten more extensive. Second, self-constructed indices – used by several studies– have comparability problems. Third, the problem of reverse causality is persistent across several studies (it is difficult to separate whether unemployment levels is affecting the stringency of EPL or vice versa). Given these weaknesses, one of the main strengths of cross country studies based on aggregate data is that they tend to capture general equilibrium effects which are not possible with disaggregated data without heroic assumptions.

Collective bargaining

Collective bargaining is a process of negotiation between employer and workers that determine employment relationship, in particular, wages, working time and working standards. By design, collective bargaining entails a process of joint decision making where work-related issues between employer and workers are negotiated. However, depending on the structure and coverage of collective bargaining, it can also be a means to regulate the labour market. In some countries EPL is mostly regulated through collective bargaining agreements. Therefore the conventional distinction between EPL as being



government enacted and collective bargaining as a result of negotiations between employers and workers does not always hold.

In fact, in many cases government set the rules for collective bargaining but allows the social partners to self-regulate. Meanwhile, collective bargaining occurs at several levels, namely inter-sectoral (or national), sectoral and firm level. The most prevalent types are multi-level bargaining, which involve national, sectoral and firm level bargaining (varies by country). Since wages and working time are important components of economic production, depending on the degree of coverage, collective bargaining over these factors has a direct impact on labour market and macroeconomic performance.

Table 2 : Collective bargaining over wages

Country	Inter-sectoral level	Sectoral level	Firm level
Australia	.	XXX	X
Belgium XXX	XXX	X	X
China	.	X	XXX
Denmark	XX	XX	X
France	X	X	XXX
Hungary	.	XXX	X
India .	.	XX	XXX
Japan	.	.	XXX

Note: X = existing level of wage bargaining,
XX = important, but not dominant level of wage bargaining
XXX = dominant level of wage bargaining.
Source: ILS based on EIRO, ICTWSS and national sources.

The information collected in Table 2 vastly reflects the experience of industrialized economies, where the strength of EPL tends to be highly correlated with other labour market institutions. On the contrary, in the case of developing and emerging economies, strictness of EPL is associated with low coverage of collective bargaining.

2. EPL AND INDUSTRIAL RELATIONS DURING THE GLOBAL CRISIS

In order to understand the changes in employment protection and collective bargaining in the last few years, it is key to look at the initial conditions that countries were faced with.

First, the existing industrial relation and collective bargaining framework played an important role in determining how countries responded to the crisis. For example, in



countries where collective bargaining was relatively strong (as measured by coverage rate and union density), the response to the crisis included extensive consultations with social partners.

Second, the severity of the crisis differed across countries and that played an important role in countries' response. Furthermore, the debt overhang exacerbated the response in many troubled economies.

Third, international pressures, most notably in the European Union have played an important role in steering some countries toward further deregulation of their labour markets. Given the initial conditions, the institutional response has greatly varied across countries.

3. EMPLOYMENT REGULATIONS: LABOUR MARKET AND MACROECONOMIC PERFORMANCE AND WELL-BEING

Impact on labour market performance

As Section I pointed out, a gamut of past studies on employment protection legislation (EPL) find rather ambiguous impact on aggregate employment rate. This could be due to the fact that most studies on the effects of EPL take a cross-country approach and concentrate on the link between EPL and aggregate stock data, e.g. the effects on employment or unemployment levels. Another possible explanation may be provided by the lack of satisfactory indicator. Empirical work exploring the effect of EPL based on disaggregated information (by gender or age; as well as within country studies) finds some impact of EPL on particular groups. In particular, Bassanini and Duval (2006) find no impact of EPL on male employment but a negative impact on female employment. Furthermore, the authors identify a positive relationship between EPL and the employment of older workers (male and female) but a negative or zero impact for younger workers. Indeed, the simulations conducted for this paper suggests that there is a non-linear relationship between EPL and employment rate.

Impact on macroeconomic performance

As Section I showed, most studies that examine the relationship between EPL and Macroeconomic performance tends to use GDP growth as the dependent variable. While it is a fairly straightforward indicator of macroeconomic performance, it is difficult to tease out the relationship between EPL and GDP growth. Not surprisingly, most studies find no or



insignificant relationship between the two variables. In this paper, a novel approach is employed by looking at the link between EPL and private business investment (i.e., private sector gross fixed capital formation as a percent of GDP). The impact on investment stems from the fact that decision regarding allocation of capital, besides labour, is also dependent on labour market regulation. The impact of EPL on investment could be either positive or negative. First, strictness of EPL might discourage businesses to expand production, resulting in a lower aggregate investment. Second, in industries where labour and capital are complementary factors of production, the impact of EPL on employment and investment would be in the same direction (either positive or negative depending on the employment intensity). Third, a relatively strict EPL might discourage the use of labour and encourage firms to adopt capital intensive

Technologies, therefore, increasing aggregate investment. In sum, all this points to the fact the net effect of EPL on investment is far from linear and simplistic.

Impact on life satisfaction

Previous studies have tried to examine the link between employment protection and perceived job security and psychological well-being, but the results have been largely inconclusive. Conventional wisdom says that perceived security increases with stricter regulation as the risk of being fired gets reduced (Skedinger, 2010). However, studies have shown that in fact permanent employees and the ones in temporary jobs feel more insecure with stricter EPL (see: Beckerman, 2004; Clark and Postel-Vinay, 2009); although this might be because the survey responses captured perceived labour market security instead of job security. This could stem from the so called “locking-in effect” where permanent employees feel like they cannot leave their current job because they perceive the likelihood of finding a new job to be low. Security can be perceived along many dimension, chief among which are two: job security, which refers to a particular job or employer; and second, labour market security, which is a comprehensive concept and goes beyond a particular job or employer and is supported by labour and social policies (Cazes and Verick, 2010; Auer and Cazes, 2003). Generally speaking a more stringent employment protection does not lead to increased security, quite the contrary. Empirical analysis of data on well-being (measured by life satisfaction data available from World Gallup Poll) and EPL corroborates these earlier



studies. In fact, there is a weak negative correlation between EPL stringency and life satisfaction, and this holds for both developed and emerging economies.

Policy considerations

As this paper has shown, while there have been very few cases of significant overhaul in employment protection legislations (EPL), there have been several marginal but important changes which are likely to have an enormous impact on labour market and macroeconomic outcomes for years to come. Furthermore, there has been a general trend towards decentralization (both organized and disorganized), and also collective bargaining coverage has been reduced. Meanwhile, all these changes rarely have been launched by taking into account a more comprehensive understanding of employment security. In fact, employment security is not only related to legislation governing dismissals and contract types, but it is also related to collective bargaining, unemployment insurance, active labour market policies (training and intermediation services), minimum wages, health and safety occupation standards etc. In other words, the interplay between all these institutional features plays a key role in either enhancing or hindering job security intended by EPL and collective agreements.

Employment protection for better labour market outcomes

First, labour market regulation did not cause the financial and economic crisis of 2008-09; among the main culprits, some include: lack of adequate financial regulation and oversight, loose monetary policy, and unbridled risk-taking in the financial sector. Despite this piece of economic history, there seems to be a consensus among policy circles that labour market regulation ought to be relaxed to reduce unemployment and spur job creation. In case of the EU, since both the monetary and fiscal policies now are effectively under the purview of the European Commission, countries in the region have a smaller set of policy choices, including labour market regulation, to tackle the elevated unemployment rates. But deregulation of the labour market is very unlikely to have the desired outcome. Indeed, as this paper has shown, the evidence on the link between employment protection legislation (EPL) and labour market outcomes is presumably far from linear. If anything, up to an average stringency of EPL, there is a not large but positive association between EPL stringency and employment. Similar is the story with macroeconomic outcome measured by gross fixed capital formation in the private sector. There is a need to strike the right balance



between employment protection and ability to respond to the crisis, but the slippery-slope on the path of deregulation is not the answer to high unemployment.

Tackling labour market duality

As this paper has shown, the gap between the stringency of EPL for regular and temporary contracts is non-linearly linked with labour market duality (high share of temporary employment out of total employment). The classic argument goes that 'higher the gap, higher the duality' but this does not always hold. In fact, the positive relationship between the size of the gap and labour market duality occurs only at the extremes, whereas most countries are in the middle, where the gap has almost no effect on the temporary employment rate. There are several other country specific factors driving dualism, particularly the lack of efficiency in judicial procedures, a distorted or strategic use of dismissals and temporary contract regulation, and the role played by collective bargaining (especially promoting or hindering internal flexibility in firms). Indeed, there are structural problems, particularly in Southern Europe, regarding declining (or stagnant) productivity and competitiveness that have played a more important role in making duality more persistent.

Infact, any EPL reform trying to address labour market duality should imply adjustments of other key labour market institutions – such as unemployment benefits, wage setting institutions, etc. – as closing the gap between EPL for regular and permanent workers will not be sufficient. Ultimately, it will be important to design the right institutional setting which will enhance the transitions from fixed-term contract to permanent ones, reducing labour market duality and its negative effects of workers' wellbeing and aggregate productivity.

Better industrial relations for a more equitable growth

Another victim to the financial and economic crisis has been collective bargaining. In particular, because of the crisis, the long-term trend towards decentralization and fragmentation has further accelerated. As it is the case with EPL, 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. As the empirical evidence in this paper shows, '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 bargaining 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 and not likely to yield desired employment objectives.

Harnessing the complementarities between labour legislation and collective bargaining

Generally speaking, during the recent period of deregulation and decentralization, there has been no serious attempt to consider how different aspects of employment security should be addressed, either through EPL or collective bargaining. There are significant complementarities (i.e. linkages) between the two and it is important to consider them together for better outcomes, both in terms of security and employment growth. In particular, responding to business cycle fluctuations by significantly altering legislation is usually very costly as it affects firms' long-term objectives and also workers' welfare. Employment security ought to be related to basic rights and conditions that do not fluctuate with the business cycle, and this of course is a matter of national political choice. Collective bargaining plays an important complementary role during macroeconomic shocks by adapting the level of protection to the economic constraints while ensuring that the basic rights and conditions are met.

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