

EMPLOYMENT PROTECTION REGULATIONS: RULES FOR HIRING AND TERMINATIONS

Introduction

Employment protection – the set of rules governing hiring and terminating employees – is a key feature of any country’s labor market. What types of contracts will be permitted between employers and employees? Under what conditions can the relationship be terminated? What are the requirements for providing advance notice? What are the obligations of the employer regarding severance or termination payments?

Employment protection practices in any country are determined by a mix of cultural norms, collective bargaining, and legislation. This primer note focuses on the *statutory regulations* affecting employment protection. It provides a basic overview of the policy options and a summary of what is known about their impacts on workers and on the labor market. It also addresses the institutional and political aspects of employment protection.

The note is based on international experience, both in terms of hiring and termination regulations and evidence on their labor market impacts.¹ For more details on the employment protection issues addressed in this note, [hot-links](#) to relevant reports and an annotated set of key references are included.

In the end, policy -makers must grapple with two overarching issues. How much protection will be provided to workers against the uncertainties of job loss? What is the balance between providing this protection inside the firm through job security rules or outside the firm through social protection instruments such as state unemployment benefits and re-employment programs?

Background

In traditional and informal economies, employers and workers are engaged on an “at

- redundancy procedures; and
- special rules for mass layoffs.

Economists and some policy-makers often characterize employment protection arrangements along a “rigidity/flexibility” continuum. However, those emphasizing the protective nature of job security rules are more likely to consider the continuum as “protective/deregulated.”

Box 1: The Employment Protection Continuum

RIGID OR
PROTECTIVE

FLEXIBLE OR
UNREGULATED

Fixed-term contracting restricted
 Temporary agency work restricted
 Hiring standards
 Employer dismissal rights restricted
 Substantial severance and advance notice required
 Substantial administrative requirements for layoffs

Unrestricted fixed-term contracting
 Unrestricted temporary agency work
 No hiring standards
 Unrestricted dismissal rights
 No severance or notice required
 Simple administrative procedures

There is considerable variation in terms of where countries fit on the spectrum illustrated in Box 1. An important determinant is the national legal and cultural tradition. In countries with Anglo-Saxon heritage where common law principles prevail, statutory regulation plays a smaller role in directly providing employment protection than it does in countries with civil law principles (e.g., French or Spanish tradition) or in countries that have or recently had planned

destruction; levels of employment and unemployment; productivity, wages, and profits; and the degree of social protection and justice afforded workers. Later in this note, we summarize the findings of empirical studies into these effects.

Employment protection regulations

Hiring

The most important issue on the hiring side concerns the rules for *non-standard* workers – i.e., workers who are contracted for a temporary or fixed duration. Where these forms of employment are restricted, employers are legally obliged to offer workers indeterminate contracts with the statutory job security (and attendant costs) these contracts afford. On the other hand, employers have complete flexibility to terminate fixed-term (at term end) or temporary agency employees. Restrictions on these forms of contracts usually pertain to the types of work (e.g., occupations) and the maximum duration allowed.

Table 1 summarizes the statutory rules in these areas for a set of countries selected to illustrate the range of approaches and to offer some geographical variation.² The table demonstrates the considerable variation that exists. During the 1990s, at least in developed countries, there generally was a loosening of restrictions on non-standard contracting.

Table 1: Legal Arrangements for Fixed-Term Contracts and Temporary Agency Work, Selected Countries

	Fixed-Term Contracts	Temporary Agency Work
Ethiopia	Permitted only in the following cases: <ul style="list-style-type: none"> • specified piece work; • temporary replacement of absent worker; 	Licenses for private employment agencies are required from regional or national authorities, depending on scope of activities

	<ul style="list-style-type: none"> disabled persons 	
Spain	Permitted for various reasons (e.g., specific projects; temporary replacements; training contracts; production eventualities; special categories of workers; long-term unemployed)	Legal for justifiable cases
Japan	<ul style="list-style-type: none"> < 1 year duration without restriction up to 3 years for particular types of workers 	Restricted to specific occupations
Germany	<ul style="list-style-type: none"> Widely possible without justification Maximum number of 4 contracts/24 months (no limits in justified cases) 	Generally approved except for construction
United States	No restrictions	No restrictions

Source: Betcherman, Luinstra, and Ogawa (2001)

Termination

The key policy issue here concerns how difficult and/or costly it is for employers to terminate *indeterminate* employees for *economic* reasons.³ Restrictions can take various forms including: what is considered to be a justifiable reason for termination; severance obligations upon termination; advance notice requirements; and necessary administrative procedures for laying off workers. There may also be special requirements in the case of mass layoffs.

Table 2 provides examples of statutory arrangements regarding what are legally acceptable reasons for economic dismissals; what severance requirements exist; and what advance notice is required for the same set of countries included in Table 1. There are significant variations across these countries. During the past decade or so, there has been no clear trend in regulating dismissals in developed countries: some have strengthened protections, others have eased them, but in most cases arrangements have remained relatively stable. In some developing countries – including many in Latin America – job security rules have been scaled back.

	<p>the products or services of the employer;</p> <ul style="list-style-type: none"> • Alteration in work methods or new technology to increase productivity. 	<p>first year of service.</p> <ul style="list-style-type: none"> • 1/3 monthly salary for every additional year of service (12 month limit) • Additional 60 days pay if mass layoff. 	<p>year;</p> <ul style="list-style-type: none"> • 2 months if employed > 1 year; • plus? 1 month if reduction of workforce
Spain	Economic redundancy	20 days' wages for each year of service (up to 12 years)	<ul style="list-style-type: none"> • 30 days notice • for mass layoffs, consultation required for 15/30 days in firms with <50/>50 employees
Czech Republic	<ul style="list-style-type: none"> • Employer shuts down or relocates; • Employer ceases to exist or merger or acquisition • New technology or reorganization to increase efficiency 	2 months pay, in case of shut down, relocation, transfer of employer, or redundancy.	<ul style="list-style-type: none"> • 3 months if employer shuts down or relocates and for redundancy; • 2 months for other reasons.
Germany	Compelling business or operational needs	No legal entitlement but often included in collective agreements	<ul style="list-style-type: none"> • Progressive in crease based on years of service (from 2 weeks to 7 months for >20 years of service) • 1 month delay required after public notice for mass layoffs
Japan	<ul style="list-style-type: none"> • Rational restructuring reason or unavoidable redundancy (court precedence, not law) • Reasonable selection criteria 	No legal entitlement but most large enterprises have voluntary plan	<ul style="list-style-type: none"> • 30 days notice • Notification also to Public Employment Security Office in mass layoff (>30 workers)

labor market dynamics (e.g., turnover, job creation/destruction, response to shocks, etc.). They also can have significant effects on the forms of employment, the labor market situation of different types of workers, and the size of the informal sector.⁶

Table 3 summarizes the research findings. The largest body of evidence concerns the experience of developed countries. There has been less empirical analysis in developing and transition countries,. However, some recent studies have assessed the labor market impacts of employment protection regulations in Latin America (Heckman and Pages 2000 – HOTLINK) and Eastern Europe (Riboud et al. 2002, HOTLINK).

Table 3: Summary of Impacts of Employment Protection Regulations

	Impacts of strict limitations regarding:	
	Fixed-term and temporary agency work	Terminating indeterminate ? employees for business reasons
Employment	Somewhat lower	Somewhat lower
Labor force participation	N/a	Somewhat lower
Unemployment	Insignificant	Insignificant
Unemployment duration	Longer	Longer
Non-standard employment	N/a	Probably higher
Informal employment	Higher	Higher
Job creation	Lower	Lower
Job destruction	Lower	Lower
Turnover	N/a	Lower
Job tenure	N/a	Longer
Group s benefiting		Prime-age males, skilled,
Groups losing	Women, youth	Women, youth, unskilled

informal sector. This has to be weighed against weaker job protection rules that do not discourage formal sector job creation but provide a lower level of protection in these jobs.

Enforcement and dispute resolution

Reform of employment protection laws should not ignore enforcement and dispute resolution. In many developing and transition countries, these features are weak and, as a result, hamper the effectiveness of labor market regulations.

Enforcement is a longstanding concern in most developing countries. Informal sectors, largely outside the reach of inspectors, are large – often representing a significant share, if not the majority, of the labor force. Developing countries typically allocate too few resources to enforce labor market regulations, even to police the most visible employers (e.g., the public sector). For this reason, it is important for the regulatory framework to be realistic so that self-compliance will be high and the enforcement challenge moderated. That does not mean that labor codes should have no protections for employees but rather that they should accord with good business practices in the specific national context.

Many types of labor regulations are enforced through inspections, as well as by responding to complaints. Both approaches apply, for example, to occupational health and safety.⁷ The hiring and termination rules that are the subject of this note are enforced through complaint procedures. For example, where employees believe that employers have violated hiring or dismissal obligations, efficient and fair dispute-resolution procedures are required. This can happen in various ways: labor/management enterprise committees; government arbitrators; and labor or civil courts. There has not been rigorous evaluation of the effectiveness of these approaches. However, a good rule of thumb is to resolve as many disputes as possible through pre-judicial procedures. In fact, many developed countries are relying increasingly on alternative dispute resolution which emphasizes fact-finding, mediation, and conciliation as opposed to binding decisions made by government inspectors, arbitrators, or judges. While these approaches can reduce the number of complaints that cannot be resolved by the parties, there is still a need

Termination of Employment Convention (No. 158) obliges ratifying states to meet various standards for dismissal, including termination for economic reasons:

- In cases of termination for economic/structural reasons, employers must (a) notify workers representatives; (b) allow for consultation with workers on measures to limit layoffs, mitigate impacts, retrain workers, and find alternative employment; and (c) notify government authorities of planned terminations;
- Notice of termination or compensation in lieu thereof must be given “in a reasonable period,” except in cases of serious misconduct;
- Terminated workers are entitled to “(a) severance allowance or other separation benefits, the amount of which shall be based *inter alia* on length of service and the level of wages, and paid directly by the employer or by a fund constituted by employers’ contributions; or (b) benefits from unemployment insurance or assistance or other forms of social security, such as old-age or invalidity benefits, under the normal conditions to which such benefits are subject; or (c) a combination of such allowance and benefits;” and
- Casual, fixed-term, and probationary workers can be excluded from these provisions.

Private Employment Agencies Convention (No. 181) obliges ratifying states to provide certain protections for workers employed by private employment agencies and establishes standards for regulating these agencies:

- Agencies should not deny freedom of association and collective bargaining rights; they should not abuse child or migrant workers and they should adopt equal opportunity and anti-discrimination practices;
- Agencies should not charge fees of workers (except with government permission);
- States should ensure that temporary agency workers have adequate protection in terms of rights, conditions and work (e.g., access to training, maternity leave, minimum wages, etc.);
- States can restrict the operation of temporary employment agencies in specific sectors; and
- Certain types of temporary agency work can be exempted from the standards established

Countries that are considering reforms to employment protection regulations must address various issues.

First are the likely labor market impacts of different regulatory options. To the extent that the findings from developed countries can be generalized to developing countries, we know that stricter employment protection regulations will indeed make jobs more secure but with apparent costs: more long-term unemployment and less opportunity for regular employment in the formal sector. This latter cost is likely to disproportionately affect vulnerable groups of workers including women and youth, and the unskilled or poorly educated. However, country characteristics such as the structure of the economy, the size of the informal sector, and enforcement effort can affect what the labor market impacts will be.

Second, political economy is a key aspect of labor market regulation. There are always winners and losers when labor market regulations are reformed and, because of the employment impacts hit especially close to home, changes will be hotly contested. When policy-makers are considering reform options, they must communicate the aggregate benefits clearly; they must understand who will benefit and who will not; and they may have to compensate the losers.

Third, policy-makers need to consider job security regulations in conjunction with other policy options that provide protection for workers – in particular, the collective bargaining framework and programs for unemployed workers. Where collective bargaining is well developed and has a wide reach, appropriate job security arrangements can be negotiated between employers and workers (with labor law providing a basic minimum). Similarly, unemployment benefits and effective active labor market programs can help workers manage the risks of unemployment and, as such, can be substitutes for strong employment protection regulation.

Annotated bibliography (to be completed)

Betcherman, Luinstra, and Ogawa (2000). “Labor Market Regulation: International Experience in Promoting Employment and Social Protection.”

OECD (1999a). *Employment Outlook*. Paris. Add specific citation within primer? [LINK](#).

Survey of employment protection legislation (EPL) in OECD countries and changes over the last decade. Evaluates the relationship between strictness of EPL and labor market performance. Finds little relationship to overall unemployment. Finds that stricter EPL may be associated with the following: increasing employment levels of prime-age males; lower employment levels for women and youth; expansion of self-employment; lower job turnover; more stable jobs; and longer spells of unemployment.

Riboud, M, Sánchez-Páramo, C., Silva-Jáuregui, C. (2001). “Does Eurosclerosis Matter? Institutional Reform and Labor Market Performance in Central and Eastern European Countries in the 1990s.” Unpublished paper. World Bank. [LINK](#)

Evaluates the labor market institutions of EU accession countries, compares them to those of Western European and other OECD countries, and discusses the impact of macro and structural reform on the labor market compared to institutional changes. Finds that while economic reform had the most impact on labor market outcomes, relatively inflexible labor market institutions contributed to low employment creation, a rising proportion of long-term unemployed, specific patterns of laborforce participation and growth in the informal economy.