

LABOUR MARKETS IN TRANSITION: BALANCING FLEXIBILITY AND SECURITY IN CENTRAL AND EASTERN EUROPE

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The article, based on a recent book by the two authors, attempts to give the answer to the question whether persistently high unemployment in Central and Eastern Europe is to be attributed to the rigidity of their labour markets. After defining the concept of labour market flexibility, the article discusses the incidence of flexible forms of employment in the region. The analysis shows that Central and Eastern European labour markets have increased their flexibility, but the forms of flexibility are different from those to be found in the OECD countries. Correlation of labour turnover with business cycle suggests a counter-cyclical movement of labour turnover, which is opposite to developments in the OECD countries. This is to be explained by high job, employment and income insecurity perceived by workers in transition countries contrasting with much higher confidence in the labour market and in assistance provided by labour market and social welfare institutions enjoyed by their colleagues in industrialized countries. Comparisons of the strictness of employment protection legislation in the group of selected transition countries with the EU countries indicate that on average employment protection legislation is similarly liberal/rigid as the EU average. The econometric analysis identifies significant correlation between the level of employment protection on the one hand and the employment rate and the labour market participation rate on the other but with opposite signs for the two groups of countries. While in the OECD countries stricter employment protection tends to have a negative effect on employment and labour market participation, in transition countries the results indicate that more protection could contribute towards improving employment performance and higher economic activity of people in the formal sector of the economy. All selected labour market indicators—labour market participation, employment, unemployment, youth unemployment and long-term unemployment—are positively affected by collective bargaining and active labour market policies,

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while unemployment and in particular long-term and youth unemployment tend to rise with higher payroll taxes.

Labour markets of the former command economies of Central and Eastern Europe have gone through profound transformation since the start of political, economic and social reforms. Until 1990, enterprises had been largely protected against the impact of the world markets through centrally organised production and distribution and the dominance of producers in the home market. In addition, labour markets were also strongly regulated so that workers enjoyed very high employment security and job stability. The opening up of the national economies of transition countries to global competition has forced domestic enterprises to adjust their inputs (including labour), production technology and outputs to market demand.

In the early nineties, it was broadly accepted by policy-makers and the population at large that full employment and the relatively generous previous social protection systems could no longer be maintained. Within the structural adjustment package, introducing employment flexibility and lowering social protection were in most cases offered as the sole means with which to transform labour markets in the new market conditions. Amended national labour legislation, newly established public employment services and labour market policies have facilitated these changes by reducing high employment protection in existing jobs inherited from the previous regime.

However, after twelve years of transition, persistent high unemployment remains a major problem throughout the region. While in some countries this problem was to some extent explained by slow economic recovery, there is enough evidence that even in those countries where economic growth has been relatively high over a longer period, employment, after a large initial decline, has continued to stagnate (see Nesperova, 1999). What are the reasons for such persistently high unemployment? Is it to be explained, as suggested by neo-liberal economists, by the rigidity of their labour markets for Europe as opposed to the United States with generally lower unemployment? The question then is how flexible or rigid the labour markets of transition countries actually are and what is understood by labour market flexibility.

This article, based on a recent book by the two authors (Cazes and Nesperova, 2003), attempts to give the answer to this question and aims to derive relevant policy recommendations to improve employment performance in these countries, a number of which will soon accede to the European Union. After defining the concept of labour market flexibility, the article discusses the incidence of flexible forms of employment. It then assesses the levels of employment stability and labour market flexibility and tries to identify to what extent labour market flexibility is caused by structural changes and by other,

non-structural, factors. It also analyses fluctuations in labour turnover as a measure of flexibility in connection with the business cycle. It then goes on to examine the strictness of employment protection legislation and its effect on the level and structure of employment and unemployment. The impacts of labour market institutions, social dialogue and labour taxation on several aggregate labour market indicators are tested with the help of an econometric analysis. Finally, it draws general policy conclusions.

1. The concept of labour market flexibility and its relation with employment security

At the macro-level, flexibility refers to the speed of adjustment to external shocks or changing labour market conditions. Therefore, labour market flexibility means the degree to which employment and/or working time (labour input adjustment) or wages (labour costs adjustment) adjust to economic changes. There are indeed different definitions of labour market flexibility: external versus internal flexibility, the former referring to job changes involving new employment with a different employer and relating to labour turnover and geographic mobility, while the latter refers to job changes within the same enterprise. There is also numerical versus functional flexibility, the former relating to changes in the number of workers, while the latter means occupational changes and mobility within the enterprise. This article focuses on external numerical flexibility, from both a macro- and micro-economic perspective, with a particular emphasis on labour market regulations and institutions. The reason for this choice is, first, because we believe these are among the most relevant aspects of labour market flexibility; and second, because of the current unavailability of data on functional flexibility.

For trade unions but also for many politicians and labour market experts, flexibility is considered a synonym for de-regulation, i.e. for reduction of workers' employment protection. However, Auer and Cazes (2003) give examples of Western industrialised countries that have organised their systems of employment and social protection in a way that allows flexibility for firms while ensuring income (and broader social) protection to workers at the societal level. These examples strongly suggest that it is not one component of the institutional setting alone which determines the question of flexibility and security, but the interactions of the main national labour market institutions, such as the unemployment benefits schemes, the wage-setting institutions and early retirement schemes.

Choices thus have to be made on the basis of various combinations of the different components of the employment and social protection systems, which need to be identified to allow and ensure a balance between labour market flexibility and employment security. Policy-makers in transition countries have therefore wider choices at their disposal within a given macro-economic, institutional and political context. The social partners in these countries are also recognising that without competitive enterprises, which are able to adjust their workforce in numbers, structure and quality to market conditions, employment performance will be poor. At the same time, workers need reasonable employment and income security if they are to be motivated to accept higher mobility and flexibility, to increase their productivity and to lower their opposition to change.

2. Development of flexible forms of employment

By flexible forms we understand here labour contracts with limited duration (fixed-term and short-term contracts), agency work (work for a fixed short-time period arranged by a manpower agency), part-time employment, multiple-job holding and work agreements between two parties for a certain task/activity (so-called civil contracts, regulated by the Civil Code). In particular, the last two forms are closely interrelated with informal employment. Also self-employment is often considered as another flexible form of work. The reason for the expansion of flexible forms of work is the need on the side of employers to relatively smoothly adjust their production profile and costs to the market conditions as termination of employment relations is easier, faster and less costly.

With the exception of Estonia, the general trend in all the transition countries has been towards an increase in the proportion of *temporary contracts* in employment contracts in the 1990s. The most marked change has occurred in Slovenia and the Czech Republic, which also have the highest shares of temporary contracts among the Central European countries, respectively 12.9 per cent and 8.1 per cent in 2000. In contrast, the proportions of temporary contracts in Estonia, Lithuania and Romania did not exceed 3 per cent in 2000 and, moreover, Estonia even experienced a slight decline in this indicator between 1993 and 2000. Nevertheless, comparisons with the EU countries show that the incidence of temporary contracts is still much lower in the transition countries, where their share in all employment contracts is in general well below 10 per cent. In the majority of the EU countries the overall tendency is also towards higher use of time-limited contracts, facilitated by deregulation of employment relations. By the end of the 1990s their share exceeded 10 per cent in the EU countries, with particularly

high levels in Spain, Portugal and Finland (see, e.g., European Commission, 2001). The reason for the so far relatively low application of temporary contracts in transition countries may be the opposition of trade unions, certain legislation rigidities but also a significant decline in the length and costs of employment termination for employers. However, in a number of transition countries the share of temporary contracts among newly concluded contracts has recently much increased, which may lead to a significant rise in their proportion of all contracts in the future.

No data on staffing *agency work* (such as Manpower) are provided by national statistics, but anecdotal evidence shows very limited use of agency work to date in any transition country for groups of people other than students (of secondary schools and universities). The exceptional character of temporary agency work is also the reason why thus far no transition country has regulated it through special legislation.

As to *part-time employment*, unlike in the industrialised countries, only less than 10 per cent of workers work part-time in transition countries, with the exception of Romania (16.4 per cent), Latvia (10.7 per cent) and Poland (10.6 per cent)¹. Workers are not very interested in shortening their working hours and earnings because the low level of wages means that any wage reduction has an impact on the household budget, while the amount of work usually remains the same. Employers also prefer full-time employment, claiming that part-time contracts do not usually bring sufficient cost reduction to counterbalance the negative effect of the unavailability of part-time employees to their colleagues and clients during regular working hours, while job sharing in fact poses additional costs.

Differences among the countries in the incidence of part-time employment are probably to be attributed to the extent of underemployment in the country, although unfortunately few data are available to confirm this hypothesis. The only available data for the Czech Republic and Estonia indicate that in the former country the share of involuntary part-time employment² was around one quarter of total part-time employment, while in the latter this proportion was already around or slightly over one-half during the 1990s. Ostensibly, the sole reason for part-time employment in the Russian Federation is temporary or permanent lack of work (see Tchetvernina *et al.*, 2001). Higher part-time employment may therefore indicate higher involuntary underemployment in the country.

Indeed, many enterprises in transition countries faced with financial problems turn to shorter working hours of all or certain categories of

1. All data are for the year 2000.

2. Involuntary part-time employment means that job holders have had to accept part-time employment because they could not find full-time employment.

workers to bridge this difficult period. This reduction is often recorded in labour force surveys as part-time employment, regardless of whether the affected workers hold part-time contracts or are forced to work shorter hours without any change in their (full-time) labour contract. This practice of short-time work or even administrative leave is a well-known feature of the CIS countries but it is not uncommon in other transition countries. The CIS countries collect and publish separate data on the number of workers involved in short-time work and administrative leave, based on establishment surveys, while labour force surveys in other transition countries probably mix together short-time workers with part-time workers.

The Russian Federation provides a good illustration of the use of temporary reductions in work hours. The annual share of persons forced to take administrative leave there reached the highest level in 1996 with 16 per cent of average payroll numbers in large and medium-sized enterprises, falling to 11 per cent in 1998 and 8 per cent in 1999. Of these workers, 48 per cent did not receive any compensation. The average length of administrative leave per worker was almost stable: 318 hours in 1996 and 311 in 1999. The proportion of workers on the payroll put on a short-time work regime at the initiative of enterprise management rose from 7.2 per cent in 1996 to 10.1 per cent in 1998 and 6.5 per cent of the payroll numbers. The number of hours lost per worker due to short-time working was 332 in 1997 and 188 in 1998 (see Tchetvernina *et al.*, 2001).

There was also no general trend in part-time employment over the 1990s. Some countries have experienced a certain increase in the share of part-time employment in total employment (most notably Estonia and Romania), while others have recorded a decline (Czech Republic and Latvia) or almost no change. While women workers are over-represented among part-time workers in the majority of the selected transition countries, as is the case in industrialised countries, in Bulgaria and Slovenia there are more males than females working part time. A more frequent incidence of part-time work among women is connected with their primary responsibility for childcare and care of the elderly, still rarely done by men, and this arrangement enables them to combine employment with family responsibilities. Moreover, in some transition countries women can combine part-time employment with maternity/parental leave without losing entitlement to allowances, and this is quite often utilised.

Multiple-job holding is another form of flexible work arrangement, where workers hold a second, usually part-time, activity besides their main job. Multiple-job holding is closely interrelated with *informal employment*. With the exception of unregistered foreign migrant workers, the extent of informal employment performed as a primary activity is rather limited in the transition countries, as it often prohibits

access of such informal workers to social security and health care insurance. Therefore the vast majority of informal workers perform this activity as a second job beside their main formal employment, registered unemployment or inactivity, combined with some sort of welfare transfer. This is particularly characteristic of Central Europe. In Poland the proportion of persons performing informal work in 1998 was 4.8 per cent of the population aged 15 and over, while 5.5 per cent of employed persons had an informal activity as their second job. Among the registered unemployed, 14.6 per cent revealed informal activity and 2.4 per cent of informal workers were among those formally recorded as economically inactive.

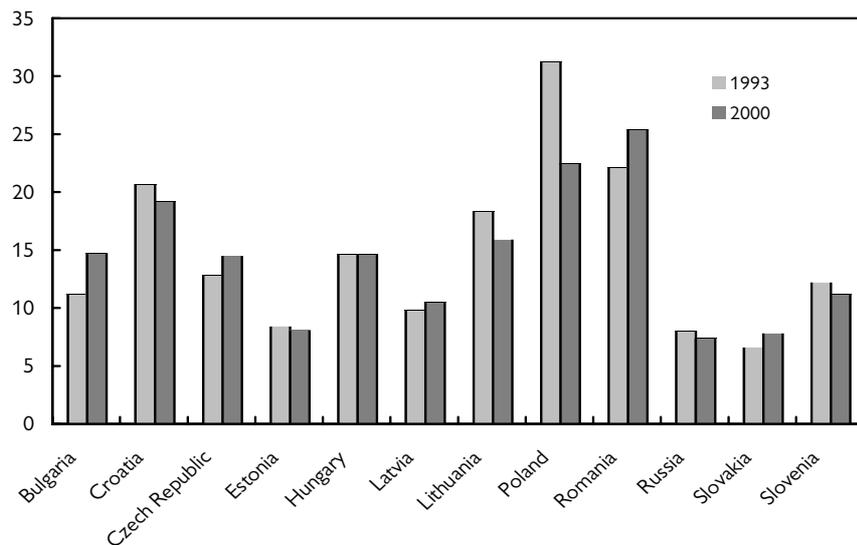
With regard to informal employment, the Polish LFS figures on multiple-job holding given above seem to seriously underestimate its scale. A survey undertaken for a research project "Social Stratification in Eastern Europe after 1989" provides much higher figures for secondary activities: 5 per cent for the Czech Republic, 9 per cent for Slovakia, 17 per cent for Poland and 27 per cent for Hungary in 1993 (Vecernik, 2001, p.9). Although these figures were collected in 1993 when the four countries had just emerged from the transition crisis they still indicate higher actual shares of multiple-job holders among all workers. Indeed, another survey on Economic Expectations and Attitudes, conducted by the Czech Academy of Sciences in 1994 and covering a wider range of activities, both formal and informal, revealed even higher figures for the Czech Republic. In 1994, a total of 35 per cent of the economically active population declared a supplementary activity: 27 per cent active in a second job, 28 per cent self-employed and the remainder earned in "some other way". A repeat survey in 1998 as part of the same project reported a decline in the share of secondary activities to 28 per cent, which was still ten times higher than the "official" figures of the labour force survey.

Also the incidence of "*civil contracts*", concluded between two parties for a certain task or activity within an agreed period of time and regulated by civil rather than labour law, and other *non-employment contracts* has much increased, although statistical evidence is very scarce. Unlike in the case of regular employment contracts, by concluding civil contracts employers do not need to cover social contributions for such workers, are not obliged to provide them with safety aids, and in principle they are not responsible for their occupational disease or work accidents. Many employers thus endeavour to save on non-wage costs by replacing regular employment contracts by non-labour ones in order to save on non-wage labour costs and other related costs despite their ban under such circumstances in a number of transition countries.

Finally, the number of *self-employed workers* (see figure 1) has sharply increased in all the transition countries in the initial period of economic transformation as a consequence of both pull and push factors. Later,

however, their share in total employment more or less stabilised everywhere, due to a combination of persistent administrative barriers for small business development; limited new opportunities for small businesses facing saturated demand for products and services at such a low level of income of the population and corporate profits; and the low quality of many non-wage jobs. As a result, with increasing demand for wage employees and offers of higher wages, many self-employed workers are returning to wage employment.

1. Self-employment as a share of total employment, selected transition economies (percentages)



Sources: Labour force surveys, authors' calculations.

An analysis of statistical data on flexible forms of employment has thus confirmed the hypothesis that the pressure on enterprises to adjust their production patterns and costs to changes in market demand has indeed contributed to the increasing shares of flexible forms of employment. However, there are some distinct features in this overall trend in the transition countries, compared with the Western ones. Part-time contracts are not widespread in the region, mainly because of the low level of wages. In contrast, workers in the CIS countries in particular are often forced to accept shorter working hours or administrative leave. While in general the use of temporary labour contracts has increased in the majority of the transition countries, their share is still much lower than in the EU countries. However, temporary employment often takes the form of civil contracts or other types of non-employment, which are convenient for employers for administrative and financial reasons but hard data for their spread are rarely

available. Nevertheless, the major form of flexible employment after 1989 seems to be multiple-job holding or second jobs, formal but more often informal, performed beside main formal employment, registered unemployment or formal inactivity.

3. Labour market flexibility

The transition process exposed firms to new economic conditions and forced them also to adjust their labour input. The level of labour mobility and intensity of labour reallocation can be measured by labour turnover as a sum of recruitments and separations from enterprises divided by employment. For calculating recruitments and separations we used two sources of employment flow data: those based on establishment surveys and those originating in labour force surveys, which both have their advantages and shortcomings³.

Labour turnover data from both sources of information reveal a substantial increase in labour turnover for our sample of transition countries after 1989, as can be seen in table 1. This reflects not only a reduction of the formerly widespread practice of labour hoarding as enterprises cut their labour costs, but also the growing incidence of voluntary quits by people deciding to start their own business or to join a newly established firm. This initial phase of intensive labour reallocation occurred in the first couple of years following the introduction of economic reforms— in 1990-92 in central and south-eastern Europe and about two years later in the countries of the former USSR. During that phase separation rates markedly exceeded hiring rates, indicating widespread downsizing in large and medium-sized enterprises. It should also be noted that downsizing was often connected with the splitting of large enterprises into two or more new firms, and with the outsourcing of production support services and services for workers. Labour turnover subsequently declined and stabilised, though all countries have since continued to experience periodic surges in labour turnover (as did Bulgaria in 1997 and 1999 and the Czech Republic after 1998, for example). These reflect further structural changes connected with economic imbalances and remedial policy packages.

There were also significant inter-country differences in labour turnover. We wondered to what extent they reflected structural changes in the economy, i.e. the process of job creation and job destruction, and to what extent labour mobility connected with other, non-structural reasons. For data on job turnover as a sum of job creation and job destruction rates we used estimates provided by Faggio

3. For comprehensive discussion of the two sources of employment flow data and explanation how labour turnover was calculated see Cazes, Nesporova (2003).

and Konings (2000) and Gimpelson and Lippoldt (1997) based on enterprise surveys for five countries: Bulgaria, Estonia, Poland, and Slovenia over the period of 1994-97 and the Russian Federation in 1994-95. The comparisons of job turnover with labour turnover are given in table 2.

1. Labour turnover for selected transition countries in the 1990s (percentages)

Country	Source	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
Bulgaria	ES	48.9	50.9	43.7	45.0	43.9	43.4	46.1	59.3	55.8	67.5	
Czech Republic	LFS				44.5	36.1	30.3	24.8	24.7	22.3		
Estonia	LFS	30.8	38.4	54.4	55.6	55.3	31.0	42.9	36.2	35.0		
Poland	ES	35.2	42.9	40.3	41.6	41.7	45.2	47.3	37.1	47.4		
Poland	LFS			35.7	44.1	54.2	47.1	53.4	40.1	38.2		
Russian Fed.	ES			49.8	46.2	48.2	48.3	42.8	44.4	45.9	48.7	
Slovenia	ES	27.1	34.2	31.6	32.2	32.0	31.4	31.2	29.3	28.8	31.1	30.1
Ukraine	ES						38.8	37.6	35.3	35.2	37.4	

ES = establishment survey; LFS = labour force survey.

Sources: National statistics. LFS data from Arro, Eamets et al., (2001), Vecernik (2001), and Kwiatkowski, Socha and Sztanderska (2001).

2. Comparison of labour turnover and job turnover for selected transition economies, 1994-1997 (percentages)

Country	Labour turnover	Job turnover	Share of job turnover in labour turnover
Poland	42.8	8.5	19.9
Estonia	41.4	16.0	38.6
Slovenia	31.0	9.5	30.6
Bulgaria	48.2	8.1	16.8
Russian Federation*	48.2	6.5	13.5

* Only 1994-1995.

Sources: Labour turnover data see Table 1, job turnover data for Poland, Estonia, Slovenia and Bulgaria from Faggio and Konings (2000), for the Russian Federation from Gimpelson and Lippoldt (1997).

Table 2 shows that Estonia is characterised by relatively high job turnover, accounting for almost 40 per cent of overall labour mobility in the period under review. This supports the views of many economists that liberal economic reforms have significantly contributed to the acceleration of structural adjustment of the Estonian economy, resulting in the highest economic dynamics achieved in the region⁴. Slovenia, although often criticised for the slow restructuring of its large state enterprise sector, can actually boast the second highest rate of job

4. See e.g. Arro, Eamets et al. (2001) with references to other literature.

creation/destruction among our group of transition countries. Structural changes also explain this country's satisfactory economic performance in the 1990s, which has puzzled many experts who considered its low labour turnover to be a symptom of the slow pace of its economic transformation.

In contrast, low job turnover in Bulgaria and the Russian Federation is clear evidence of delayed restructuring of the enterprise sector resulting in poor economic performance for both countries. The wide gap between job turnover and labour turnover thus reflects the unduly high incidence of workers' moves among "old" jobs with low productivity and remuneration, rather than any positive reallocation of labour to new industries and enterprises. Rather surprisingly, Poland comes close to these two slow reformers in terms of both low job turnover and the latter's small contribution to labour mobility. The main reason seems to be that the enterprise survey used for calculating job turnover covered only large and medium-sized enterprises, which, at that time, faced serious economic problems due to pending privatisation and structural reforms. Robust economic growth was mainly driven by newly established enterprises attracting many workers from ailing state firms but their job creation capacity is not reflected in the estimation of job turnover. This is also confirmed by the difference between accession and separation rates taken from establishment and labour force surveys, as presented earlier.

4. Labour turnover and the economic cycle

Labour turnover is of course significantly affected by economic fluctuations. In industrialised countries, it typically accelerates in periods of economic growth: enterprise start-ups and expansions create new jobs, attracting newcomers to the labour market and increasing hires of unemployed job seekers. At the same time, as dismissals for economic reasons abate, the growing number of job opportunities encourages more people to change their jobs voluntarily. In contrast, in economic downturns, enterprises seek to cut costs by reducing new hires and by resorting to redundancies, yet the consequent sharp reduction of voluntary quits more than counterbalances the increase in dismissals. Largely for supply-side reasons, labour turnover thus tends to behave pro-cyclically (Boeri, 1995; International Labour Office (ILO), 1996).

The correlation coefficients of labour turnover to GDP growth rates for the selected countries are presented in table 3. There is always a certain time lag between a change in a country's economic performance and the translation of that change into decisions by enterprises to adjust

their workforce and decisions by workers to change their job or stay put. The same correlations have therefore also been calculated with a time lag of one year. Cross-country comparisons are impaired by the fact that the labour turnover data series are rather short for some countries and the results therefore have to be interpreted with caution.

Correlation coefficients of labour turnover to GDP in the second column of table 3 indicate a negative correlation for Ukraine, Estonia and the Russian Federation— albeit not very strong in the latter two cases— and a positive correlation for Poland. For the other countries there seems to be no correlation between the two indicators. However, the time-lagged coefficients in the next column show the correlation to be negative and generally stronger for almost all the countries— the exceptions being Bulgaria and Poland (establishment survey data). Overall, the calculations presented in table 3 invite the tentative conclusion that *labour turnover tends to have a counter-cyclical development in transition countries*, which indeed contrasts with the situation in industrialised countries. The explanation lies in the structural imbalances accumulated under the command system due to distorted relative prices and poor economic performance of many investment projects. Hence, when these economies were suddenly opened to global competition, industries with excessive capacity or non-competitive industries were hard hit while underdeveloped services and competitive manufacturing expanded. Outcomes differed country by country, depending on the initial economic conditions, the adequacy of economic reforms undertaken and certain other factors. Nevertheless, unlike industrialised countries, labour reallocation has in general been more driven by the demand side than by workers' voluntary decisions.

3. Correlations between GDP and labour turnover (LT)

Country	LT vs. GDP	LT vs. GDP (- 1)
Bulgaria	0.1977	0.0257
Czech Republic	0.0572	- 0.4832
Estonia	- 0.4616	- 0.7574
Poland (ES)	0.4927	0.2650
Russian Federation	- 0.3993	- 0.2789
Slovenia	- 0.0382	- 0.4673
Ukraine	- 0.7266	- 0.6367

Source: Authors' calculations based on data from Table 1 (labour turnover) and UNECE, 2000 (GDP).

5. Employment stability

Job tenure— the length of time currently employed individuals have spent with their present employer— is a variable commonly used in studies that focus on labour market stability. Average job tenure and the distribution of employment by class of job tenure are used as indicators of job stability and can indicate differences across countries. Table 4 presents these indicators for six Central European countries in 1999. Average job tenure in these countries was 9.3 years in 1999, slightly below the average of 10.5 years of the “triad” (the European Union, the United States and Japan). This finding is not surprising, considering the high labour turnover that characterises the majority of labour markets in transition economies. The two Baltic States have the lowest job tenures of 6.9 years for Estonia and 7.6 years for Lithuania (close to the US level of 6.6 years), followed by the Czech Republic and Hungary with tenures below 10 years (levels similar to Denmark, the Netherlands and the United Kingdom). The longest average tenures are found in Poland and Slovenia.

4. Distribution of employment by job tenure, 1999 (percentages)

	Czech Rep	Estonia	Hungary	Lithuania	Poland	Slovenia	Un-weighted average	Standard Deviation	Selected OECD ^(a)
Average tenure (years)	8.2	6.9	8.8	7.6	11.9	12.1	9.3	2.2	10.5
Under 1 year (%)	14.6	18.4	12.6	12.8	10.5	12.0	13.5	2.7	16.3
Over 10 years (%)	25.5	19.9	30.9	24.1	44.2	48.2	32.1	11.5	40.9

(a) 1998: For average tenure: European Union, the United States and Japan; for the distribution of employment by tenure: European Union and the United States.

Sources: EUROSTAT; Czech data from the Statistical Yearbook of the Czech Republic, 2000.

An analysis of tenure profile of different groups of workers⁵ also showed some interesting findings. First, the distribution of job tenure by industry in transition countries is very similar to that of industrialised countries. The sectoral structure of a country and its changes produce a significant effect on the average job tenure of a country. In tendency, a higher share of personal, producer and distribution services contributes to greater instability of employment while countries with large shares of agriculture and higher proportions of civil and social services in employment tend to have longer average job tenures. Second, job tenure sharply increases with age in all countries reviewed. Hence, the demographic composition of the working population also

5. For detailed information see in Cazes and Nesporova (2003).

partly explains differences in job stability by country. In the 1990s a lot of young people entered the labour market. This factor, linked to a sharp increase in resignations and the early retirement of older workers, contributed to a general decline in job stability. Third, women tend to have slightly higher job tenure than men in most transition countries, with the exception of the Czech Republic. This confirms that gender has come to play a more decisive part in the availability and quality of employment during economic transition.

6. Concluding remarks on the relationship between labour market flexibility, employment stability and job security

The introduction of economic and social reforms initiated long-delayed structural adjustment of the former centrally planned economies to world markets. This was facilitated by significant changes in labour legislation and labour market institutions as well. The weaknesses of newly established or refurbished institutions further enhanced adjustment flexibility for firms, which used not only direct staff cuts and real-wage reduction but also shortening of working time, delayed wage payment or informal work, as documented by our findings. The latter four practices actually helped enterprises to merely cut the labour costs, while often contributing towards delays in the necessary restructuring of poorly performing enterprises. The protection of workers at enterprise level was considerably reduced and was to be compensated by institutional assistance, labour market policy and social protection. As a result of these reforms and the underdeveloped enforcement mechanisms, insecurity of employment and income has sharply increased in transition economies, compared with the past.

In the initial period of economic transformation, economic reforms stimulated restructuring connected with massive job destruction and reallocation of labour. Economic stabilisation and recovery might have been expected to bring fluctuations of labour market flows roughly into line with those prevalent in industrialised countries, i.e. increasing moves of people among jobs to capture better jobs with higher earnings, besides more hires of people from the unemployment pool or those previously inactive, and less redundancies and resignations. However, workers in transition countries behave differently and, even in an improved economic situation, many seem hesitant to quit their jobs voluntarily and move on to other jobs. The main reason is the heightened perception of job insecurity. Reluctance to quit voluntarily

is justified by the fact that labour demand is in general weak, many large and medium-sized companies are still or again cutting staff, while small firms are often fragile. Despite rather low average wage levels in all transition countries, a decline in income due to unemployment is critical and for the majority of unemployed persons it means a fall into poverty. This was confirmed by our findings of a tendency towards a counter-cyclical movement of labour turnover in transition countries, which is opposite to developments in industrialised countries.

7. Employment Protection legislation (EPL) in CEE countries

7.1. Development of EPL over the 1990s: a cross-country comparison in CEE countries

Under the centrally planned economic system, workers enjoyed a fairly high degree of employment protection in their jobs. In general, the Labour Code did not allow enterprises to lay off workers for economic reasons. In (rather rare) cases of enterprise restructuring or relocation connected with the abolition of certain jobs, the enterprise was obliged to offer another job internally (combined with internal retraining if necessary) to the workers concerned. This was usually to be agreed with the worker and the trade union organisation, and supplemented by compensation for hardship caused by the job transfer. Where internal redeployment was not possible, labour departments of local authorities had to find for these workers other jobs of similar quality, skill requirements and level of remuneration, as under the policy of full employment it was the State's responsibility to provide employment to all able-bodied persons of working age.

Employment protection in concrete jobs was so strong that, for example, women returning after extended maternity leave (up to three years in a number of transition countries) not only enjoyed guaranteed employment with the same employer but also guaranteed return to their previous job. Unless the reason for employment termination was a criminal offence or a serious breach of labour rules, the latter termination requiring approval by the trade union, the enterprise could not end the employment contract other than by agreement with the worker. Conversely, if the worker wished to leave the enterprise, unless the reason was among those listed in the Labour Code as legal reasons for regular employment termination (such as change of residence or under-utilisation of education), the worker had to reach an agreement with the enterprise or be penalised by an extended notice period. The

negative effect of the workforce stabilisation policy, combined with the low level and limited differentiation of wages, was extreme labour rigidity, inefficient labour allocation and a low level of labour productivity.

The need for rapid structural adjustment of the transition economies after the introduction of economic and social reforms was reflected in profound amendments to national EPL immediately thereafter. The objective was to facilitate workforce adjustment for firms in order to make enterprises more flexible and economically competitive, while guaranteeing solid employment protection comparable with that prevailing in developed market economies. In reality, it meant substantial reduction in workers' protection in general, made possible through the weakening of trade union power. Over the 1990s, EPL was amended several times after heated discussions with the social partners, resulting in the re-tightening of employment protection in some countries and its further reduction in others. Nevertheless, the differences among the transition countries persist. A detailed cross-country comparison of national EPL in five transition countries, Bulgaria, the Czech Republic, Estonia, Poland and the Russian Federation, based on the expertise of national lawyers, can be found in Cazes and Nesperova (2003).

7.2. Measuring EPL strictness

Measuring employment protection is a difficult task, so different indicators of EPL strictness have been developed and applied according to ad hoc specific research needs. 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. However, these problems have been partly overcome by the positive correlation of the different indicators to each other to produce unambiguous cross-country rankings of EPL. The OECD has produced EPL indicators (for both regular and fixed-term contract workers) to study the relationship between EPL and labour market outcomes for its member countries: these indicators consider a whole set of regulations that are weighted according to their importance. This methodology has been updated and enlarged to consider regulation concerning collective dismissals (OECD, 1999), and this is the version used here for the transition countries⁶.

6. Based on 22 different items describing various aspects of legislation protecting employment, covering both permanent and temporary contracts, as well as collective dismissals. These items are aggregated in three steps, from one level to the next, using a set of weights. Level 1 refers to updated (1999–2000) and detailed information collected by national experts and presented in the previous section. Some of the components can be easily quantified (for example, the length of notice period), but some others need to be transformed into quantitative terms (for example, difficulty of dismissals), using a subjective conversion scale. In level 2 several sub-indicators are

The results of measuring EPL strictness for selected transition countries are presented in table 6, which also compares the average level of EPL strictness for these countries with the EU average and the OECD average. Basically, the indicators range in integer values from 1 to 6: countries with very flexible EPL have a low overall value (close to 0 or 1), and those with very strict legislation have a high value (5 to 6). Table 5 indicates that transition countries do not constitute a homogeneous group. When the indices of EPL strictness in *regular employment* in the selected countries are compared (third column), Hungary, Bulgaria and Poland are amongst the most flexible, followed by Estonia and the Czech Republic, while the Russian Federation is the most restrictive. If regulations on regular and temporary employment are considered together, Hungary takes the lead as the least restrictive country, closely followed by Poland and the Czech Republic, with the Russian Federation and Slovenia at the opposite end of the scale. The indicator measuring *overall* EPL strictness again shows the lowest values for Hungary and Poland and the highest values for the Russian Federation and Slovenia.

These indicators show that employment protection rules differ across transition countries, but on average at the end of the 1990s the EPL rules of the group of CEE countries were found to be as liberal as those of the EU and only slightly stricter than those of the selected OECD countries: for the indicators covering legislation on regular and temporary contracts and those covering regular and temporary contracts plus collective dismissals, the average of our selected transition countries is at the same level as the EU countries and slightly above the OECD average (respectively, a value of 2.2 compared with the same level for the EU and 1.9 for the OECD; and 2.5 compared with 2.4 for the EU and 2.0 for the OECD). However, if the Russian Federation and Slovenia are excluded (and EPL has indeed been relaxed there very recently), the average of the transition countries is well below the EU average, as can be seen again in figure 2. Moreover, after the latest Labour Code amendments in Poland, Slovenia and the Russian Federation, on average legislation in the CEE countries seems to be becoming more liberal than the EU and close to the average of the OECD countries.

Finally, it is important to bear in mind that most EPL indicators are based on the *legal* constraints that apply in each country. They are hence ill-suited to tracking asymmetries in the degree of enforcement of employment protection across countries and over time. There are

obtained referring to major components of the legislation. These include procedural inconveniences, notice and severance pay for no-fault individual dismissals, and the difficulty of dismissals. Level 3 provides three groups of indicators: one describing legislation for regular contracts; one covering temporary contracts; and one capturing the collective dismissals procedures. In a final step, these three sub-indicators are aggregated in an "overall summary indicator" using different weights.

several important indications that asymmetries in enforcement may be more marked than differences in regulations per se; moreover, these may play a crucial role in affecting the work of labour markets, notably the extent of job losses and the incidence of unemployment. Bertola *et al.* (2000) point out these caveats and provide interesting evidence on the role of jurisprudence in interpreting the laws.

5. EPL indicators in selected transition countries, late 1990s¹

Country	Maximum pay and notice period (months) ²	Difficulty of dismissal (summary score) ³	Index for regular contracts (0–6) ⁴	Index for regular and temporary contracts (0–6) ⁵	EPL overall summary indicator (0–6) ⁶
Bulgaria	7	2.9	2.3	2.5	2.8
Czech Republic	5	3.2	3.0	1.8	2.2
Estonia	8	2.9	2.9	2.1	2.4
Hungary	8	2.5	2.1	1.5	1.8
Poland	3	2.7	2.3	1.7	2.0
Russian Federation ⁷	5	3.5	3.3	2.9	3.2
Slovakia	4	2.4	2.6	1.9	2.3
Slovenia	16	4.5	3.4	3.0	3.3
Transition average⁷	-	3.1	2.7	2.2	2.5
EU average⁸	-	-	2.4	2.2	2.4
OECD average⁹	-	-	2.0	1.9	2.0

1. Estimates are given for 1999, i.e. before the recent revisions of the labour codes of Poland, the Russian Federation and Slovenia.

2. The sum of maximum notice and severance pay (authors' calculations).

3. Covers the strictness of the legal definitions of unfair dismissal, the frequency of verdicts involving the reinstatement of the employees and the monetary compensations typically required in the case of unfair dismissals.

4. Summary score for overall strictness of protection against dismissals.

5. Weighted average of indicators for regular contracts and temporary contracts.

6. Weighted average of indicators for regular contracts, temporary contracts and collective dismissals.

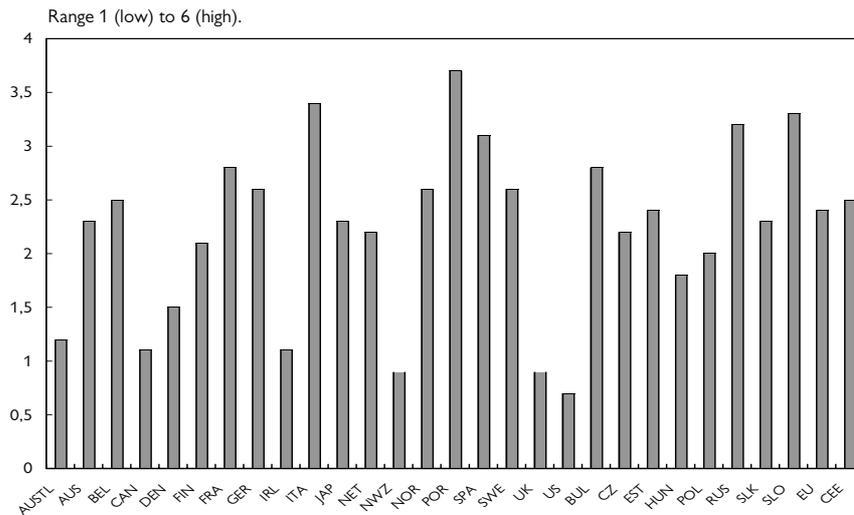
7. Unweighted averages for transition, EU and OECD countries.

8. Does not include Greece and Luxembourg.

9. Selected OECD countries.

Sources: Authors' calculations; OECD, 1999; and Riboud *et al.*, 2002.

2. EPL index in selected OECD and transition countries, late 1990s



Sources: Authors' calculations based on OECD, 1999, and Riboud et al., 2002.

8. Do labour market institutions matter in CEE countries?

The “Eurosclerosis” debate (the European labour market has been said to be “sclerotic”, because of the full range of labour protection schemes) has renewed relevance with the forthcoming enlargement of the EU to CEE countries, in particular in a context of poor employment performance and persistently high unemployment in the transition countries of Eastern Europe⁷ (see table 6). As the candidate countries are required to harmonise their laws and regulations with those of the EU (“*acquis communautaire*”), it is interesting to examine where the CEE countries stand in terms of labour market flexibility/rigidities. The two key issues here are therefore: first, to assess the extent to which these accession countries— and the transition countries in general— have adopted the same set of labour market institutions and policies as the EU; and second, to assess the impact, if any, of these institutions on labour market performance. The “institutional package” considered here refers to the following provisions: the legislation protecting employment (discussed in previous section); various features of the unemployment insurance schemes and active LMP; indicators of trade union strength; and the tax burden (payroll taxes).

7. Including the Baltic States and the Commonwealth of Independent States.

6. Unemployment rates of selected transition countries over the 1990s

In %

Country	1994	2000	2002
Bulgaria	20.5	18.7	17.6
Czech Republic	4.1	8.8	7.3
Estonia	7.6	13.5	10.3
Hungary	10.7	6.6	5.8
Poland	13.9	16.6	19.9
Russian Federation	8.1	13.4	n.a.
Slovakia	13.7	19.1	18.5
Slovenia	9.0	7.1	6.4
Ukraine	n.a.	11.9	11.1*

* 2001.

Sources: national LFS.

8.1. Labour market institutional settings in the late 1990s

8.1.1. Unemployment insurance systems and active labour market policies

The transition economies have introduced a wide range of labour market programmes, both active and passive. The aim of these policies has been to relieve tensions in the labour market and provide income support. Passive policies include unemployment insurance schemes and early retirement, while active policies encompass job mediation, labour market training, public works, job creation, subsidised employment or mobility measures, as presented in more detail below. Over the decade, unemployment insurance systems have increasingly become less generous. This tendency can be demonstrated by the reduction of the level of benefit payments in real terms and in their duration, as well as the tightening of eligibility conditions. Table 7 presents the main features of the unemployment insurance systems in nine selected transition countries in the late 1990s: replacement rates (the share of income that is replaced by the unemployment benefit); the length of the benefit payment; and the share of benefit recipients in total registered unemployment. Again, diversity prevails. Table 7 shows that initial benefit replacement rates (the ratio of initial – and therefore highest – benefits to previous earnings) in the selected countries ranged from 40 to 75 per cent in 1998, with the exception of the two extremes: Estonia (7 per cent) and Ukraine (100 per cent). An alternative way to compare the benefit level across countries is to express the average benefit as a percentage of the average wage. Countries also differ in terms of benefit duration, ranging from six months in the Czech Republic or Estonia to 24 months in Slovenia or the Russian Federation,

in line with those of the EU and the Western OECD countries (some EU countries even offer benefits of unlimited duration). Another interesting feature of unemployment insurance refers to the coverage rates of the system, that is, the percentage of registered unemployed persons receiving unemployment benefits. These rates also vary widely across countries, from 25 to 90 per cent. Moreover, the development of the rates over the decade— not shown here— was different. While they remained fairly stable in the Czech Republic, Estonia and Hungary, the coverage rates have fallen continuously in Poland and Slovakia (and to a lesser extent in Slovenia).

7. Characteristics of the unemployment insurance system in selected transition countries, 1998

Country	Benefit replacement ratio (%) ¹	Benefit as percentage of average wage (%) ²	Benefit duration ³	Coverage rates (%) ⁴
Bulgaria	60	32	6–12 months depending on age and length of employment	24.8
Czech Republic	60	24	6 months	48.8
Estonia	7 ⁵	7.5	6 months	59.3
Hungary	65	28	3–12 months depending on length of employment	73.9 ⁶
Poland	40	36 ⁷	12 months	23.1
Russian Federation	75	26 ⁸	12–24 months within 36 months	89.5
Slovakia	60	33	6–12 months depending on length of employment	27.0
Slovenia	63	44	3–24 months depending on length of employment	32.6
Ukraine	100	23	180–360 days within 2 years	53.1

1. Unemployment benefit replacement rate is measured by the initial benefits level divided by previous earned wage.

2. Average benefits as a percentage of gross average wage.

3. Duration of payment.

4. Percentage of unemployed receiving unemployment insurance benefits.

5. Flat rate of EEK300.

6. The ratio includes means-tested unemployment assistance, once benefits are exhausted. In contrast with other transition countries, this de facto social assistance is paid from the labour market fund, while in other countries it usually is paid from social budgets.

7. Flat rate of PLN393.60 in June 1999.

8. It broadly corresponds to 42 per cent of the national subsistence level in 1997.

Sources: O'Leary et al., 2001; Riboud et al., 2002; communication from the national employment services.

These differences in unemployment insurance systems are reflected in the level of spending on passive LMP, as presented in table 8. Despite the generally modest level of expenditure— transition countries spend less than 1 per cent of their GDP on unemployment insurance— differences are quite marked between Slovenia or Hungary (respectively spending 0.9 and 0.56 per cent of their GDP on passive programmes) and Estonia (spending less than 0.10 per cent). Generally, these figures are considerably lower than those of the EU countries, which devote on average 1.73 per cent of their GDP to income support for the unemployed. The same conclusions can be drawn by comparing the spending per unemployed person.

8. Spending on passive and active LMP in selected transition countries, 1998

Country	LMP expenditure as percentage of GDP ¹			LMP expenditure per unemployed person ²		
	Total	Passive policies	Active policies	Total	Passive policies ³	Active policies
Bulgaria	0.80	0.46	0.12	0.056 ⁴	0.029 ⁴	0.007 ⁴
Czech Republic	0.40	0.26	0.05	0.055	0.036	0.007
Estonia	0.20	0.10	0.07	0.020	0.010	0.007
Hungary	1.30	0.91	0.28	0.167	0.117	0.036
Poland	1.00	0.59	0.30	0.095	0.056	0.028
Russian Federation	0.20	0.13	0.02	0.015	0.010	0.002
Slovakia	1.10	0.56	0.32	0.088	0.044	0.026
Slovenia	1.72	0.89	0.83	..	0.110	0.110
Ukraine	0.30	0.19	0.03	0.027	0.017	0.003
EU average	..	..	..	..	1.16	0.16
OECD average	..	..	..	..	0.92	0.14

1. The difference between the sum of passive and active policies and the total spending on LMP relates to the costs of running national Public employment services.

2. Ratio of GDP spending on LMP to LFS unemployment rates.

3. Passive policies refer here to unemployment insurance.

4. Using LFS total unemployment rate from 1997.

.. = not available.

Sources: O'Leary et al., 2001; national employment services; Riboud et al., 2002.

Most of the transition countries reviewed have adopted a package of active LMP similar to those in the OECD countries, including job mediation and counselling, vocational guidance, labour market training, employment subsidies, direct job creation, small business promotion and measures targeted at young people or disadvantaged groups (a detailed presentation of the programmes can be found in Nesperova, 1999).

There are substantial differences with regard to the number of participants in, and resources devoted to, active LMP, as well as the distribution between different active programmes by country. Given the wide range of programmes, the scope of this cross-country comparison is limited to the spending on active LMP, and these results are also presented in table 8. Among the transition countries, Slovenia is the leader in expenditure on active labour market programmes, while Estonia spends ten times less. However, on average the level of expenditure on active LMP is rather low, ranging between 0.07 per cent (Estonia) and 0.83 per cent (Slovenia) of GDP. Adjusting these figures for the unemployment rate⁸ confirms that transition countries do not spend large amounts on active policies: from about 0.002 per cent (the Russian Federation) to 0.11 per cent (Slovenia) of GDP for 1 per cent of the (LFS) unemployment rate in 1998. These figures are close to some OECD countries that have low expenditures on active LMP, such as the United States or Japan, but below both the EU and the OECD average spending levels⁹.

8.1.2. Trade unions and wage bargaining

In most countries, trade unions play a major role in the collective bargaining process and are therefore likely to influence wage formation and labour costs (wage flexibility) in response to economic shocks. Depending on certain characteristics and factors, trade unions may influence the wage negotiation process through the setting of the minimum wage, bargaining over wage increases and the shaping of the wage structure. Even in countries where the number of unionised workers is low, as in France and Spain, collective agreements can in fact cover a large share of workers. Co-ordination amongst unions is another particularly important aspect of ensuring consensus in bargaining on macroeconomic objectives: wage increase negotiations may, for example, take precedence over negotiations on other issues, creating upward wage pressure and higher equilibrium unemployment (see, for example, Bertola, 1990). However, unions may also set employment goals and accept wage restraint, trading wage moderation against additional employment creation (see Hartog, 1999, for example, on the importance of the social partners in the Dutch labour market success story). Another relevant aspect to consider regarding unions is the extent to which they manage to co-ordinate their wage-setting activities together with employers' organisations. The government involvement in the negotiation process is another relevant aspect, as is

8. By calculating the ratio of GDP spent on active LMP to LFS unemployment rate (both in percentage terms).

9. Indeed, there are substantial differences among OECD members: the Netherlands and Denmark are among the "high spending" OECD countries, with 0.55 and 0.34 per cent of GDP spent on active policies per unemployed person (against 0.16 and 0.14 per cent on average for the EU and the OECD respectively; see Riboud *et al.*, 2002).

the case in France. Table 9 summarises the key features of the trade unions in our sample of transition countries: namely, the union density, collective agreement coverage, and levels of co-ordination. Co-ordination may be distinguished from centralisation, which refers to the level of bargaining (plant, firm, industry, region or country). Highly co-ordinated bargaining is not necessarily centralised, as in Germany or Denmark, for example. While empirical research has generated datasets on unions and employers' organisations for OECD countries (see Calmfors and Drifill, 1988; Layard *et al.*, 1991; ILO, 1997; and Traxler and Kittel, 1997), few data are available for transition countries.

9. Trade unions and collective bargaining in selected transition countries, mid-1990s

Country	Union density (%) ¹	Collective bargaining coverage ²	Degree of coordination ³
Bulgaria	58.2	2	3
Czech Republic	42.8	2	1
Estonia	36.1	2	1.5
Hungary	60.0	3	1.5
Poland	33.8	3	1.5
Russian Federation	74.8	3	3
Slovakia	61.7	3	2
Slovenia	60.0	3	3
Ukraine	100	3	3
EU average	44.4	..	..
OECD average	39.6	..	..

1. Percentage of salaried workers that belong to a trade union.

2. Collective bargaining coverage index takes a value of 1 when collective agreements cover less than 25 per cent of all salaried workers unionised or non-unionised, 2 if this number is between 26 and 69 per cent, and 3 when coverage is above 70 per cent.

3. The degree of trade union and employers' organisation co-ordination is measured through an index that ranks from 1 (low) to 3 (high). The overall co-ordination is obtained as the average of workers' and employers' co-ordination. .. = not available.

Sources: Data on union density taken from ILO, 1997; Visser, 1990; and OECD, 1999. Collective bargaining coverage and degree of co-ordination taken from Riboud *et al.*, 2002, and authors' calculations based on Arro *et al.*, 2001; Beleva *et al.*, 2001; Kwiatkowski *et al.*, 2001; Tchetvernina *et al.*, 2001; and Vecernik, 2001.

Before 1990, the industrial relations systems of the transition countries were characterised by central political and managerial control exercised by the State. During the decade, efforts were made to develop industrial relations typical of a market economy. CEE countries have all started to move away from a centralised wage-setting system, towards a collective bargaining system in the enterprise sector¹⁰. According to available data, the percentage of trade union membership

10. See, for example, the publications of the ILO-CEET office, Hungary, on social dialogue in CEE countries (<http://www.ilo-ceet.hu>).

ranges from about 34 per cent in Poland to over 74 per cent in the Russian Federation. Table 9 shows that collective bargaining coverage (i.e. the number of workers, unionised or not, who have their pay and working conditions determined by collective agreements in the enterprise sector), however, is high (over 70 per cent) in most transition countries, except in Bulgaria, the Czech Republic and Estonia. Yet, despite a relatively homogeneous cross-country picture indicating a rather high level of union membership and coverage, significant differences have emerged between the public and the private sectors, with much lower unionisation of workers in the latter sector. Moreover, unions' negotiating power depends very much on their ability to coordinate with employers, which is now actually rather low in most of the transition countries¹¹. However, it could be said that workers in transition countries are still more unionised than in the EU or Western OECD countries, while the strength of trade unions and co-ordination of collective negotiations in these countries falls more or less within the average of the OECD.

8.1.3. Taxes on labour

The impact of taxation on labour market outcomes operates via the wedge between the real labour cost for the employer and the real consumption wage received by the worker. As it is extremely difficult to construct a tax wedge based on reliable and consistent information on value-added taxes (VAT) and income taxes for all the selected transition countries¹², only payroll taxes data— defined as the sum of employers' and employees' social security contributions— are presented here. Moreover, it could be argued that not only workers but also unemployed and inactive persons pay income and consumption taxes. Figure 3 shows that payroll taxes in transition countries are high, even by EU standards. Rates range from 33 per cent in Estonia to as high as 50 per cent in Slovakia. While these rates vary enormously across the OECD, they do not exceed 40 per cent: payroll taxes stretch from almost zero in Denmark to 38.8 per cent and 40.2 per cent in France and Italy respectively in the mid-1990s. In transition countries, deteriorating labour market outcomes push governments to increase the levels of public expenditures on unemployment insurance systems and active LMP. The ageing population, declining employment rates and elevated poverty levels place additional constraints on the funding of public pension schemes, health care and social welfare. At the same

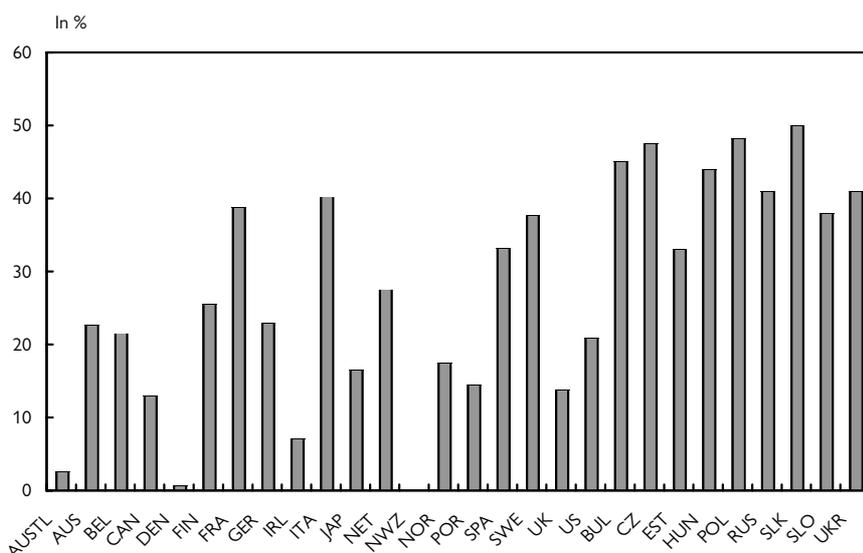
11. The level of coordination was quite high until the mid-1990s, paradoxically thanks to a tax-based income policy imposed by the government. When this policy, much opposed by the social partners, was eventually abolished around 1995, the coordination ability of the trade unions began to suffer.

12. The income tax schedule is progressive in all the countries and the degree of progressiveness is important. In a number of countries, in particular small firms officially pay the minimum wage to their employees for tax reasons while paying another part of the wage under the table.

time, fiscal revenues fall considerably, particularly in periods of economic contraction, generating very strong pressure to maintain high payroll taxes. With respect to the negative effects of high taxation on employment and business development, some countries started to lower their payroll taxes and saw amendments and fiscal reforms taking place, though at a slow and gradual pace over the decade. Recently in Hungary, for example, employers' social contributions were cut by 2 percentage points to 31 per cent at the beginning of 2001.

To summarise this section, it could be said that by the end of the 1990s the selected transition countries had adopted a set of labour market institutions and policies that broadly resembled those in the Western OECD and EU countries. In general, transition countries have opted for a rather average "institutional package": neither the most nor the least flexible model (as we saw in the previous chapter, the transition countries are in the middle range of the flexibility scale with regard to EPL). One exception to this pattern concerns payroll taxes, which are clearly much higher (in relative terms) in the transition countries.

3. Tax burden on labour in selected OECD and transition countries



Sources: OECD, 1999; Riboud, et al., 2002; national sources.

8.2. Preliminary evidence in transition countries

Based on theoretical and empirical evidence for Western OECD countries—referring to the expected effects on job search behaviour, bargaining power, turnover, and so forth—an econometric analysis was conducted to assess the potential effects of labour market institutional settings on labour market outcomes and test the assumption of similar responses in the transition countries (see Cazes & Nesporova, 2003). Simple cross-country regressions have been conducted to address various aspects of unemployment (total unemployment, long-term and youth unemployment rates)¹³ and aggregate labour input (employment rate and labour force participation rate), based on the information presented in the previous section. As it was impossible to conduct an econometric analysis on the sole group of transition countries, the hypothesis tested statistically was that the labour markets of the OECD countries and the OECD plus transition countries have similar behaviour vis-à-vis labour market environments using a Chow test¹⁴.

The hypothesis of non-stability of the coefficients of the two different groups of countries was rejected for all the three unemployment variables and the employment variable. In other words, it could be said that the labour markets of these two groups of countries follow the same pattern in their adjustment (reaction) to the institutional setting of the labour market. This finding seemed particularly robust for unemployment variables. However, for labour force participation rates the hypothesis of non-stability was accepted, suggesting that labour force participation rates have to be explained by another set of variables. Moreover, EPL was positively correlated with labour force participation rates in transition countries, while it was negatively correlated for OECD countries. This result was on the same lines as one of our previous key findings, namely the tendency towards a countercyclical pattern of labour turnover, the opposite of what happens in the Western industrialised countries. Previously in this article we explained these differences by the fact that labour reallocation in the transition countries has generally been driven more by the demand side (employers) than by workers' voluntary decisions, because of workers' heightened perception of job insecurity. The results obtained for labour force participation rates seemed indeed to confirm this hypothesis.

Our analysis also found statistically significant and positive coefficients of collective bargaining and ALMP indicators in regressions run

13. Due to time and data constraints, we could not make estimations for the unskilled unemployment rate. In the future however, we are planning to extend our research to other dependant variables, such as unskilled unemployment rates, prime age employment rates as well as flows variables.

14. The methodology as well as the summary regressions can be found in Cazes and Nesporova, 2003.

for all the five labour market indicators analysed. Labour market participation, employment, unemployment, youth unemployment and long-term unemployment are thus positively affected by collective bargaining and active labour market policies. In addition, the analysis also showed that unemployment, and in particular long-term and youth unemployment, tend to rise with higher payroll taxes.

All these findings should of course be interpreted with caution: the scope of the analysis is restricted to the formal economy only, although the strong growth of the informal economy could be interpreted as part of the process of labour market flexibilisation. Moreover, the indicators are far from perfect: for example, EPL indicators do not address exemptions from the application of EPL in small enterprises or the enforcement procedures (existing indicators are based on the legal constraints that apply in each country and do not capture the degree of enforcement of the laws).

Finally, it should be noted that the direct impact of the minimum wage on labour market outcomes was not considered in the analysis, for several reasons: first, because the main focus of this article was on numerical (external) flexibility, leaving aside other types of flexibility such as functional flexibility or flexibility in working hours; and second, because both the level of the minimum wage¹⁵ and the percentage of workers actually earning it were still very low in most transition countries, meaning that the minimum wage did not play an important economic or social role there¹⁶.

9. Conclusions

Labour markets of CEE countries have undergone profound changes since the beginning of their transition to a market system. While the intention was to direct labour market developments in these countries towards the situation common in the industrialised world by modelling the transformation of national labour market institutions and policies on similar, mostly Western European, institutions and policies, the outcomes have been to a large extent different from the expectations.

Based on our statistical and econometric analysis, two different models of labour management can be broadly distinguished in transition countries— one for the Central and South-East European countries (CSEE), including the Baltic States, and another one for the CIS countries.

15. In the vast majority of transition countries, the minimum wage is set by statute or decree.

16. In this respect, Poland may be an exception, as some recent analyses (World Bank, 2001, for example) suggest a negative impact of the minimum wage— set at around 40 per cent of the average wage— on the employment of low-skilled workers in less-developed Polish regions due to much lower wage and price levels there.

CSEE countries have opted for a model that largely shifts responsibility for supporting redundant workers away from enterprises and onto public institutions, similar to practice in the EU countries. As described in this article, EPL has been greatly relaxed, while national PES have been established, active LMP launched, unemployment insurance schemes introduced and social welfare programmes reshaped. Instead of maintaining labour hoarding, enterprises wishing to economise on labour costs dispose of excess workers either by directly laying them off with certain financial compensation fixed by law and collective agreement or push them to agree to leave voluntarily. In addition, enterprises have heavily reduced their human resource programmes and social services for workers. In the current situation of high unemployment, firms often prefer to recruit new workers with the desired work experience rather than invest in the retraining of their own staff or hiring school leavers with no work experience. Redundant workers then have the possibility of turning to the PES for re-employment assistance and income support, but whether or not they do so much depends on the access to and quality of employment services and LMP, as well as on the eligibility rules and the level of received income support, which vary greatly between countries. Similarly, the extent of workers' protection against lay-offs also varies between countries, as does the enforcement of national labour legislation.

The CIS countries, in contrast, continue to rely mainly on employment protection within enterprises, while assistance provided by PES is relatively poor. EPL tends to be rather restrictive, but employers themselves do not wish to escalate social tensions by firing redundant workers and rather opt for other forms of labour cost adjustment, such as short-term work, administrative leave or delayed wage payment while keeping workers on the payroll. Given the low labour demand, coupled with the inferior quality of available vacant jobs, this solution appears more acceptable for all the parties.

In theory, the first model facilitates better and faster adjustment flexibility for enterprises and stimulates more effective allocation of labour among sectors, with gains in terms of higher overall labour productivity. However, workers can benefit from the system only when the income support gives them good protection against any sharp fall in earnings and when re-employment assistance is efficient enough to help them quickly find new jobs, otherwise it will lead to wider unemployment and lower participation rates. This is exactly the case of some CSEE countries, struggling with extremely high unemployment and inactivity levels that place a very high burden on their social welfare systems and still leave parts of their population in poverty. Our analysis has clearly shown that the level of employment security perceived by workers is low and adversely affects their behaviour, with negative consequences for desirable labour mobility and flexibility. There is now an urgent need

in the transition countries to establish a new reasonable balance between adjustment flexibility for enterprises and employment and income security for workers, which would be acceptable to both sides and financially feasible and sustainable for public social funds. The approaching dates of the accession of ten transition countries from the CEECA to the EU make this goal even more imminent, as the national legislations and institutions have to comply with the European Social Charter.

In contrast, the model largely applied in the CIS tends to delay labour reallocation to new enterprises and trades, offering more productive jobs, at the cost of lower labour productivity at the enterprise and the national level. While employment rates are in general higher and unemployment rates lower in this model, this does not mean that human capital is much better utilised than in the first case or that this combination would lead to higher income levels. Instead, workers remain in old, low productivity jobs and supplement their incomes by work in second jobs of similarly low quality resulting in a waste of human resources, while new high-quality jobs are lacking well-qualified applicants or may not be created at all because of a lack of workers with relevant skills.

Therefore, policies promoting social dialogue, but extending it to pay greater attention to employment promotion and unemployment reduction and to ensure increased labour market stability, rather than pure deregulation, should clearly be on the political agenda of the transition countries. Reforming labour legislation should also be considered, in some countries more urgently than in others. However, this should be done while considering and combining the complete labour market institutional setting, to find the right balance between the need for flexibility (desired by employers) and security (desired by workers). Finally, it should be noted that this analysis is strongly focused on aggregate labour market outcomes, such as unemployment and labour input. It is very important that further research be developed on the adjustment of labour markets (labour market dynamics) to the macroeconomic and structural reforms that have taken place in these countries, as there have been many changes in this respect over the last decade.

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