

# Chapter 1

## Uses and abuses of the OECD's Employment Protection Legislation index in research and EU policy making

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### 1. Introduction

A new orthodoxy has emerged in labour market policy-making. Laws regulating employment protection are being blamed for high unemployment, for higher unemployment among particular groups and sometimes more generally for poor productivity and growth performance. As indicated in the Introduction, and despite substantial efforts by some researchers to show such causal relationships, supporting empirical evidence is at best inconclusive. Much of this research has relied on the comparative measures of employment protection provided by the OECD's EPL (Employment Protection Legislation) index.<sup>1</sup> This has come to prominence as a convenient numerical indicator which can be put into regressions comparing countries and time periods, giving an impression of rigour.

However, the indicator suffers from weaknesses in its construction such that it is an imprecise measure of legal protection for employment and an even less precise measure of the overall security of employment. Using it as a variable explaining labour market outcomes also requires a recognition of other causal factors, most obviously macroeconomic conditions and other labour market policies. Remarkably, the most serious economic studies, when taken together, do not show a consistent relationship between the EPL index and the hypothesised outcomes.<sup>2</sup> A reasonable conclusion would be that any effects of the elements included in the OECD's EPL index are small or non-existent, possibly because the indicator is a poor measure of legal protection, possibly because legal protection is a poor measure of actual employment protection or possibly because employment protection is anyway of minor importance to the investigated outcomes. Nevertheless, policy-makers continue to give advice, citing the EPL index, as if the alleged negative effects of EPL had been confirmed.

This chapter aims to assess critically the nature and use made of the index, starting in the first section with a description of how it is constructed followed in the second section

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1. Strictly speaking, there is a family of indexes. The singular is used here for simplicity except when distinctions are being made.
  2. A full discussion of all the existing academic studies would be beyond the scope of this chapter. The OECD's Employment Outlook of 2013 summarises some of the research results up to that year, accepting that 'many of the studies find no significant effects of EPL' on aggregate employment and on unemployment (OECD 2013: 71), while some studies, often of rather specific cases and time periods, are reported as pointing to other possible negative economic effects. There are indeed many studies that find no clear evidence of any detrimental effects (e.g. CIPD 2015), while the absence of effects both on unemployment and on unemployment for specific groups, notably the long-term unemployed, seems to be confirmed when use is made of a large sample of countries and a long time period (Avdagic 2015).

by a consideration of criticisms and reservations. The third section covers a discussion of the European Commission's use of the EPL index in general policy documents and the fourth section gives examples of specific policy recommendations. The conclusion leaves open the question of whether the EPL index should be abandoned completely, such that research would need to rely more on detailed country case studies, or whether it can and should be revised and improved.

## 2. Construction of the EPL indicators

Attempting to measure and compare employment protection legislation across countries began relatively recently. The first important step was Lazear's (1990) comparison of the statutory entitlement of severance payments and legally binding notice periods in cases of no-fault dismissals. This developed via the summary indicators published by Grubb and Wells (1993), taking in information on legal constraints in 11 European countries, into the well-known OECD index, using data from OECD countries since the mid-1980s.

The purpose of the measure can be interpreted in different ways. One EU publication presents the rationale as addressing 'the risks for workers associated with dismissal', thus setting requirements on 'the employer when dismissing workers'.<sup>3</sup> That would be in line with the view, again occasionally present in EU publications, that acknowledges the need for employment protection in view of 'the inherent inequality' in the relationship between employer and employee, giving the former a clearly stronger position (European Commission 2015: 79). Alternatively, the index can be seen as expressing the inconvenience and costs imposed on employers by legal restrictions. It will be argued here that some elements fit only with the second of these, particularly in relation to temporary contracts. In any event, it remains incomplete as an indicator of the protections employees enjoy in practice, be they on permanent or temporary contracts.

Following the OECD's *Employment Outlook* of 1999 (OECD 1999), the strictness of EPL is mapped as discrete indicators ranging from 0 to 6, with a higher value indicating a more stringent regulation of employment. Two major updates came in 2008 and 2013 bringing in further information on regulatory provisions, including some information from collective agreements and measures relating to temporary agency work (OECD 2013).

The overall summary indicator of EPL strictness comprises 21 items,<sup>4</sup> grouped into three sub-indicators:

1. Strictness of protection against individual dismissal of regular workers (EPR);
2. Strictness of protection due to additional regulations on collective dismissals (EPC);
3. Strictness of protection regarding temporary employment (EPT).

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3. [http://ec.europa.eu/europe2020/pdf/themes/23\\_employment\\_protection\\_legislation.pdf](http://ec.europa.eu/europe2020/pdf/themes/23_employment_protection_legislation.pdf)

4. Detailed information on all the sub-components of indicators can be found at [www.oecd.org/employment/protection](http://www.oecd.org/employment/protection)

A summary indicator of the first two sub-indicators (EPR & EPC → EPRC) and the indicator for protection under temporary employment (EPT) are the ones mainly used for policy analysis.

The computations of the indexes are based on standardised questionnaires, completed by government authorities of the respective states and the OECD Secretariat. The primary source is national labour law, supplemented by information from other sources such as collective bargaining agreements and case law. Specific regulations receive numerical scores according to the strictness of the legal provisions, and are assigned to one of the 21 items. Within each sub-indicator, weights are assigned to the individual components.<sup>5</sup>

Nine items fall under the provisions which aim to measure the strictness of the individual dismissal of workers on regular contracts (EPR). These cover the three different aspects; Procedural Inconveniences, Notice and Severance Pay; and Difficulty of Dismissal. The first, Procedural Inconveniences, includes provisions on notification procedures, such as how dismissals have to be communicated and who has to be notified in order to carry out a dismissal. The second grouping, Notice and Severance Pay, covers legal provisions on the length of the notice period and the extent of severance pay depending on the tenure. The last aspect, Difficulty of Dismissal, covers the definition of unfair dismissal; the period in which claims can be made; typical compensation after 20 years in a job; the possibility of reinstatement following an unfair dismissal; and the maximum time period in which it can be claimed. The respective sub-indicator of the strictness of the employment protection against individual dismissal of workers on regular contracts (EPR) is then obtained by simply averaging the three intermediate indicators.

The sub-indicator on the strictness of employment regulation in cases of collective dismissals (EPC) covers only the *additional* costs to the employer above the costs of the individual dismissals. Thus, the *overall* cost associated with collective dismissals results in adding up the two sub-indicators (EPR+EPC=EPRC).

The sub-indicator regarding regulations on temporary employment (EPT) is made up of eight items, two of which – items 16 and 17 – were added for the first time in 2008. These are grouped into two sub-categories: the regulation of fixed-term contracts (EPFTC); and the regulation of temporary work agencies (EPTWA). EPT is the average of EPFTC and EPTWA. The indicator on fixed-term contracts includes information about when, with how many repetitions and for how long a fixed-term contract can be used. The intermediate indicator for TWA employment includes information about the types of work for which TWA is legal, whether there are restrictions on the number of renewals, the maximum duration and whether authorisation is required for the use of TWA employment. The last item, 17, of the EPTWA concerns whether there is equal treatment in terms of pay and conditions for regular and agency workers within the same firm.

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5. For detailed methodology and the weighting of the construction of the indicators, see [www.oecd.org/els/emp/EPL-Methodology.pdf](http://www.oecd.org/els/emp/EPL-Methodology.pdf)

It should be noted that the indexes for permanent and temporary employees differ radically in their construction. The EPRC quantifies the ‘procedures and costs involved *in dismissing* individuals or groups of workers’. The EPT indicator instead measures ‘the procedures involved *in hiring* workers on fixed-term or temporary work agency contracts’.<sup>6</sup> In fact, even that second generalisation does not hold in full for EPT, which also includes a measure that could give protection to temporary employees, albeit not in a consistent way. Thus some indicators will be reduced in value when restrictions on taking on temporary employees are relaxed. The one relating to agency work will be increased when employers’ power to set their choice of pay and conditions is constrained.

The EU’s Directorate-General for Employment, Social Affairs and Inclusion acknowledges this significant measurement difference between the two employment categories and accepts that the interpretation and comparison of the two indices have to be treated with caution. Indeed, they are not both measures of protection for employees and should not be added to, subtracted from or compared if that is the subject under investigation. However, it is suggested that they can be seen to measure one phenomenon if interpreted as showing the ‘strictness or complexity that an employer has to deal with when faced with the two types of contracts’ (European Commission, 2015a: 78). It might therefore affect employers’ willingness to take on new recruits on permanent contracts and to allow transitions from temporary to permanent contracts. However, the difference between the two does not provide a measure of the differences in protection afforded to the two categories of employees, that element being largely absent from the EPT indicator. It therefore also remains an incomplete measure of employers’ inconvenience in managing fixed-term contracts.

### **3. Reservations – what the EPL index does not show**

Any attempt to use the EPL index should take account of a number of important reservations which mean that it will have greater or lesser reliability depending on the country and the exact comparison being made. A number of authors have, to varying degrees, criticised the OECD indicators (e.g. Bertola *et al.*; Boeri and Cazes 2000; Boeri and Jimeno 2005; Cazes *et al.* 2012; Cazes and Nesporova 2003). Unfortunately, as underlined by Bertola *et al.* (2000: 57), ‘empirical literature on the macroeconomic effects of employment protection has to rely on highly imperfect measures of the strictness of these regulations’. That, of course, assumes that empirical work has to find a simple quantitative measure before comparing countries. The validity of making do with so imperfect an indicator can be questioned in view of the five points set out below.

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6. <http://www.oecd.org/employment/emp/oecdindicatorsofemploymentprotection.htm>

### 3.1. How the numerical scores are set

A considerable degree of arbitrary estimation goes into deciding individual scores. This can be illustrated in the particular case of item 17 (Equal treatment of regular and agency workers within a firm). In the latest version (version 3) of the index, this item accounts for one-sixth of the EPTWA indicator while item 13 (Types of work for which TWA employment is legal) accounts for two-sixths of the total EPTWA indicator. Whenever TA workers are entitled to receive the same pay and conditions as regular workers in the user firm, this results in a score of 6 for item 17, contributing to a higher overall indicator. This is indeed the case for almost all European countries. The UK receives a score of 3, because its law apparently specifies equal treatment only for working conditions and not for pay.

These rankings are all derived from individual countries' laws and there are questions over interpretation and likely effects in practice. Thus for the UK, TA workers are entitled, after a 12 week qualifying period, to the same basic terms and conditions of employment as if they had been employed directly by the hirer. Pay is not explicitly mentioned but is implicit within 'terms and conditions'. There is a means within the law for agencies to avoid equal pay for their employees – the so-called Swedish derogation – if permanent employment is granted by the agency. This amounts to a serious reservation to the equal pay provision. It is permissible in terms of the relevant EU directive, and is allowed in a number of EU Member States' laws, but it is not taken into account in formulating the index.

Germany receives a score of 4.5. There is equal treatment for pay *and* conditions, but the principle of equal treatment can be waived when employees are protected by a separate collective agreement, even if such agreements in practice do not lead to equal conditions. It need not be difficult to find a union prepared to sign such an agreement for people facing the alternative of unemployment. The Swedish derogation also applies under German law. For Hungary, also given a score of 4.5, it is six months before equal pay is required, a period that could be longer than many temporary contracts, rendering the legal provision ineffective. For Portugal, also scoring 4.5, TA are entitled to the minimum wage defined in the collective agreement applicable to the temporary work agency or to the user, or to the same work, whichever is the more favourable.

These, then, are different laws, but leading to the same score in these three countries. The UK scores less, seemingly suffering for using a synonym for the word 'pay' in its law. The outcomes could be rather different, ranging between quite good protection to possibly largely ineffective protection, depending on what happens in practice. Using the EPL index as an analytical device would therefore seem potentially dangerous and no substitute for a detailed investigation of the functioning of temporary agency work in individual countries.

### 3.2. Variations in enforcement

A second important reservation is that legislation may never be enforced, or may be enforced unevenly. These are *de jure* measures only. When this issue is taken up in studies, the key issue is frequently seen as inefficiencies in civil justice systems, leading to lengthy trials with uncertain results. The argument has then been used that employers are unable to rely on the formal legal position and that the practical level of employment protection could therefore be higher than the law would suggest (Cf. European Commission 2015: 98-101).

The emphasis on this aspect of the issue seems surprising. There is no serious doubt that abuses of employment law, at least in some countries, are widespread, making formal legal protections of questionable value to substantial parts of their labour forces. Furthermore, enforcement is likely to vary between types of employment. Following on from the previous section, Czechia scores 6 on the item for equal treatment for agency workers, but the Labour Inspectorate is clearly sceptical that this applies in practice, reporting that it has no means of checking temporary agency workers' terms of employment (Drahokoupil and Myant 2015). It is also highly likely that enforcement varies between countries. However, there are immense practical difficulties in including these considerations, even if the case for doing so is beyond serious question.

Some numerical measures do offer potential, such as the number of cases that are taken to court, how long courts take to make a ruling and, above all, whether judges are more likely to favour employers or employees. However, information on enforcement procedures is scarce and difficult to compare (e.g. Venn 2009; Bertola *et al.* 2000). Judgements may also vary with the economic conditions, meaning that an index taking this into account should not, strictly speaking, be used as an independent variable. Thus, Ichino *et al.* (1998) showed courts to be more likely to rule in favour of employees when labour market conditions are precarious.

Bassanini *et al.* (2009) and Venn (2009) argue that the OECD indicator does to a *certain* extent take account of the actual operation of employment protection, since it encompasses measures for the extent of compensation (item 7) and the likelihood of being reinstated following unfair dismissal (item 8). These, however, relate only to what has come before the courts. We are therefore left to trust, without any clear evidence, that what is set out in law does relate to what actually happens, or at least that divergences between the two are not so great as to invalidate the use of the indicator for comparisons between countries.

### 3.3 To whom the law applies

There are often greater degrees of legal protection for particular professions or occupational groups. These are ignored in constructing the index, which follows only general employment law provisions.

Depending on the country, legal provisions may also have different effects on firms of different sizes. In these cases, the OECD indicator uses only the strictest level of protection applying to larger firms. This leads to an overstatement of the effective strictness of employment protection in countries where small and medium enterprises are excluded from full protection and important to the economy. According to Venn (2009), about 50% of the total numbers in employment are thus excluded from the effects of EPL in Italy and Spain, including a significant proportion of those on permanent contracts.

Applicability of the index is also clearly limited to formal employment, making it particularly problematic for countries with a large informal sector. It also excludes those who are not covered by an employment contract, as is the case for those with self-employment status and for those covered by commercial contracts only. This latter applies to an estimated 13% of the labour force in Poland, contributing to the exceptionally high levels of temporary contracts recorded in that country. This is a form favoured by employers because of the lower employment costs and the greater ease of dismissal. In other countries, notably Hungary, there are significant parts of the labour force working legally without written contracts and with minimal protection (Drahokoupil and Myant 2015).

The implication is that the EPL index overstates the true level of protection and overstates more in some countries – those with a high share of either informal, legally or *de facto* unprotected employment – than others.

### 3.4 Elements of protection omitted from general employment law

A further reservation that is even more difficult to take into account is the omission from the index of elements not derived from general employment laws that may imply a greater degree of employment protection, at least for parts of the labour force. This relates to the omission from the index of what may be included in employment contracts – or practices in some countries amounting to ‘implicit’ contracts as hypothesised in Okun’s analysis of employment behaviour (Okun 1981) – and of the results of collective bargaining which may or may not be legally enforceable, depending on the country. The first of these varies substantially between countries, depending on their kinds of legal system – whether it is a civil or common law system, and also the variations within those categories – and their inherited employment relations traditions. The last of these can be followed in some countries when collective agreements are centrally collected. Together, these factors could be influential enough to overrule any effects from general legal provisions. The EPL index would then be a valid enough indicator of differences in some written laws, but it would be a poor measure of factors that determine actual differences in employment stability.

From the 2008 update, some attempt has been made to incorporate and account for provisions set through collective agreements. In most countries where data can be accumulated – and that is itself a big restriction – they appear to be similar to the mandatory legal provisions. Denmark, Iceland and Italy are viewed as exceptional

cases, with collective bargaining agreements offering a substantially higher degree of protection than that set by the law (Venn 2009: 20). However, any systematic inclusion of the results of collective agreements runs into immense practical difficulties. Even where information is available, coverage rates can vary substantially, depending on the industry. Setting scores for a country as a whole is therefore problematic. Thus, for example, for the maximum cumulated duration of successive fixed-term contracts in Germany there are no legal limits, implying a score of 0 for this item. Legal limits can, however, be determined based on collective agreements, as is the case for the metalworking sector where the limit is 24 months. A final score of 1 has been chosen for this item, which would correspond to a maximum duration of 36 months.

This time, the implication is not necessarily that the EPL index overstates the amount of protection. The opposite may be the case, at least for that part of the labour force that has protection over and above the formal legal provisions. We are therefore left with an incomplete picture. The law is not the whole story and is likely to be of variable relevance within and between countries.

### 3.5. Weighting the elements

With such a wide range of sub-indicators, the weights chosen are likely to be important for the ordering and spread of countries. The OECD assigns weights to the sub-components such as ‘to reflect their relative economic importance when firms are making decisions about hiring and firing workers’ (Venn 2009: 17). However, it is accepted that there is no empirical basis for the chosen weights. They come from a subjective estimate within the OECD of what is likely to affect firms’ decisions. This leads, for example, in the summary indicator of the strictness of employment protection of temporary contracts (in the version updated in 2008), to the applicability of fixed-term contracts (item 10) being judged as twice as ‘important’ as their maximum-allowed duration (item 12). Similarly, the indicator on individual and collective dismissals of regular workers (EPRC) weights the additional provisions for collective dismissals only by two-sevenths; provisions on individual dismissals for regular employment accounting for the other five-sevenths. This appears a surprising balance, implying that individual rather than collective dismissals are a greater worry for employers, while, as indicated below, the numbers of job separations following redundancy can be far greater than the numbers dismissed.

It is claimed (e.g Nicoletti *et al.* 2000; Venn 2009) that the outcome barely changes when moving from the subjective weighting scheme used by the OECD to one that simply weights all items equally. The country rankings appear to be relatively robust and influenced only in the mid-range, with the ranking of the most and least regulated countries remaining stable. However, that only considers one line of variation from the chosen weights. Others are possible and might lead to more substantial movements of countries along the index. Indeed, with an acknowledgement that weighting is, to a great extent, a subjective operation, users are invited to ‘experiment’ with their own weights and interpretations of the importance of the different components (Venn 2009:12). That advice appears sensible, but it would also seem sensible to seek evidence



that the weighting corresponds in reality to the relative importance of the individual sub-indicators, both to employers and to employees.

Seeking evidence to support the weightings and on the effects of individual elements is particularly relevant in view of how the index has been used. Thus, elements are assumed to play a role in influencing labour mobility and this appears prominently in the hypothesised mechanisms behind the possible effects of EPL.

In fact, the available evidence on turnover raises doubts over the usefulness of the EPL index, placing as it does such an emphasis on dismissal. Two possible alternative indicators for turnover would be job separations and the length of time in a job. Both are clearly dependent to a much greater extent on other variables, including macroeconomic conditions, the sectoral structure of the economy, active labour market policies and social policy provision, such as maternity rights and pensions systems. EPL can, at most, be no more than a minor, additional contributory factor (cf. CIPD 2013).

Following job separations, for which comparable data is, unfortunately, not available across all EU Member States, also shows that the voluntary tends to be significantly more important than the involuntary. The former peak in times of high labour demand, when there are other jobs to go to, while the latter peak in times of low labour demand when voluntary separations are at a minimum. Dismissals appear as a very small proportion of separations – 2.9% in one year in the UK (Kent 2008) in which voluntary separations constituted 71% of the total. The main forms of involuntary separation were the ending of temporary contracts and redundancy, accounting for 12.1% and 13.9% respectively of all terminations. The latter, by definition, would not be expected to create new job opportunities for youth, the long-term unemployed or those on temporary contracts, although an important mechanism hypothesised for EPL's negative effects is precisely that it does limit new entries to employment.

These points raise serious doubts about the usefulness of hypothesising a causal relationship between the EPL index and phenomena that depend on labour turnover. Indeed, relating turnover more generally to the EPL index, by comparing across countries, provides little sign of a significant relationship. One European Commission publication, using a definition of turnover as the sum of transitions into and out of unemployment, shows quite wide variations between countries. These are both wider than, and do not obviously follow, the EPL index.<sup>7</sup> A rather similar picture emerges from a comparison of length of job tenure with the EPL index. There are differences between countries, but also changes between years which suggest, at the minimum, a much larger role for other causal factors than EPL. Moreover, to repeat, it remains very unclear whether high turnover rates should be judged positively in terms of enhancing productivity. For individual employers, they are often taken as a sign of a dissatisfied, and hence probably less productive, workforce (cf. CIPD 2013).

This last point adds weight to the preceding reservations on the use of the OECD's EPL index. Several aspects of its construction are questionable. If used in quantitative

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7. [http://ec.europa.eu/europe2020/pdf/themes/23\\_employment\\_protection\\_legislation.pdf](http://ec.europa.eu/europe2020/pdf/themes/23_employment_protection_legislation.pdf)

studies, it should be used with great caution, bearing in mind the possible impact of the reservations set out above, and in conjunction with other factors that could be expected to have much greater importance in determining labour market outcomes. It should certainly not be used to seek simple correlations with possible economic outcomes.

#### **4. The analysis behind EU policy thinking**

We indicated above that the enormous body of academic research that uses the OECD's EPL index has not provided clear evidence of the negative effects of employment protection. Results that do show an effect from EPL do not appear robust when time periods are extended and country observations or additional explanatory variables are added. The OECD itself is cautious when discussing research results, accepting the weak evidence of any effects on aggregate employment but still suggesting that 'recent research on the labour market impact of employment protection has found that overly strict regulations can reduce job flows, have a negative impact on employment of outsiders, encourage labour market duality and hinder productivity and economic growth' (OECD 2013: 68). It only says 'can' and not 'does'. The empirical evidence would certainly not justify a stronger conclusion.

Nevertheless, the message pressed by the international agencies is that research using the OECD's EPL index has demonstrated a case for reducing employment protection for those on permanent contracts. The European Commission is part of that trend. It should be added that it effectively implies that the degree of employment protection is adequately expressed within the OECD's index such that 'EPL' can be used to refer both to employment protection in general and to the specific indicator of its extent.

The most sophisticated research reported by the European Commission comes in larger publications from DG ECFIN (Directorate-General for Economic and Financial Affairs) and from the Directorate-General for Employment, Social Affairs and Inclusion. In 2012, it was confidently claimed that employment protection was 'linked to reduced dynamism of the labour market and precarious jobs'. Thus, EPL 'reforms' were seen to be 'a key driver for reviving job creation in sclerotic labour markets while tackling segmentation and adjustment at the same time' (European Commission 2012: 4). Much of the emphasis in the alleged negative effects of EPL has been narrowed down to the issue of segmentation, with references to the easily available quantitative indicator of the share of total employment taken by temporary contracts.

Demonstrating a link between segmentation and the EPL index logically requires two stages. It needs to be shown that the use of temporary rather than permanent contracts is influenced by the elements included in the EPL index; and it needs to be shown that the dividing line between the two types of contract marks a meaningful division in employment conditions and prospects. This, in turn, requires demonstrating that it is difficult to move from a hypothesised secondary sector into a hypothesised primary sector because of the high level of protection of permanent contracts. It is easy to demonstrate that part of the labour force appears trapped in a cycle of insecure employment, but there is no clear evidence that this is a result of the degree of protection

offered to permanent contracts. Research has focused only on the first stage, seeking a statistical relationship, a precondition for demonstrating a causal link, between EPL on permanent contracts and the share of temporary contracts in total employment.

The OECD's survey of research results shows that easing regulations which restrict the use of fixed-term contracts has been followed, in those cases that have been studied, by employers substituting temporary contracts for permanent ones with no overall increase in employment (OECD 2013: 72). Some research also suggests that 'stringent regulations on regular contracts tends to encourage the use of temporary contracts' (OECD 2013: 73). EU publications have tried to find more evidence in relation specifically to EU Member States, assuming that, rather than testing whether, they have an adequate measure for segmentation. Their claims on the links between EPL and segmentation show a mixture between support for policies that imply a clear link alongside more nuanced statements revealing a recognition that evidence for this is extremely weak.

In an information sheet on employment protection legislation, the European Commission puts the view that 'for countries with segmentation problems the priority may be to reduce the gap between EPL for permanent and temporary contracts. Excessive use of temporary contracts and low transitions to permanent contracts may be due by too strict legislative constraints to individual and collective dismissals and/or to relatively flexible regimes for fixed-term contracts' (sic).<sup>8</sup> Such careful wording is repeated in other policy documents with recurrence of phrases such as 'often it is argued' instead of a firm statement with reference to evidence (European Commission 2015a: 30).

Nevertheless, the objective of 'helping to combat labour market segmentation' (European Commission 2015a: 30) appears as the justification for why one-half of Member States have deregulated regular employment. A common feature of the argument is the use of the gap between the EPL indexes on permanent and temporary contracts. This comes with periodic warnings against its use as a precise measure, justified not least because, as indicated above, the two indexes measure very different things. Nevertheless, the gap is quoted at times as something that 'may generate a duality in the market' (European Commission, 2015b: 91) so that narrowing the gap 'may' lead to a reduction in segmentation (p. 96). As indicated below, those notes of caution have not stood in the way of clear policy recommendations.

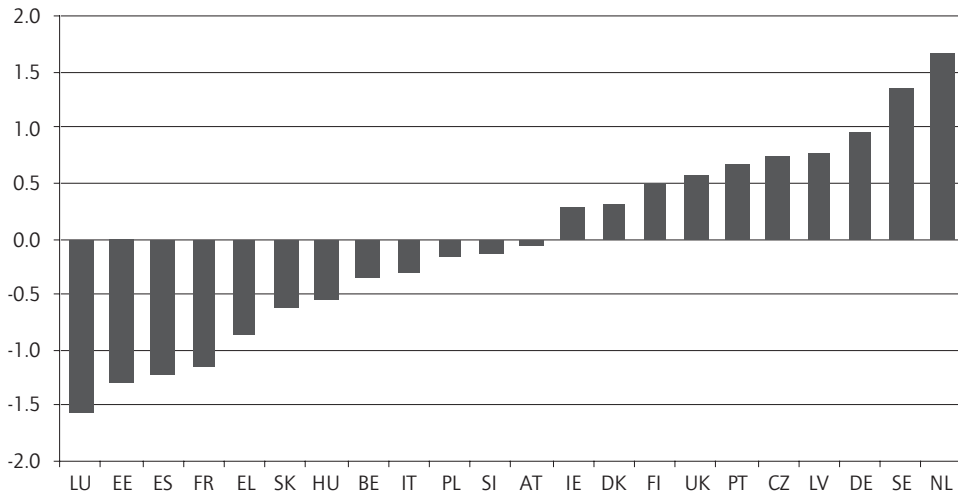
It is remarkable that countries pinpointed by the Country Specific Recommendations in 2014 for excessive dualism exhibit very different patterns in these gaps. The Netherlands showed the highest positive gap between the indicator of protection for regular and temporary employment, but is not singled out as a problematic case of dualism. On the other hand, the gap for Spain is negative, meaning that regulations for temporary employment are measured by the indicator as more rigid than those for regular jobs. However, it is Spain that is criticised for the gap between severance costs for fixed-term and indefinite contracts (Clauwaert 2015: 52 and 62). Figure 1 shows the results using

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8. [http://ec.europa.eu/europe2020/pdf/themes/23\\_employment\\_protection\\_legislation.pdf](http://ec.europa.eu/europe2020/pdf/themes/23_employment_protection_legislation.pdf)

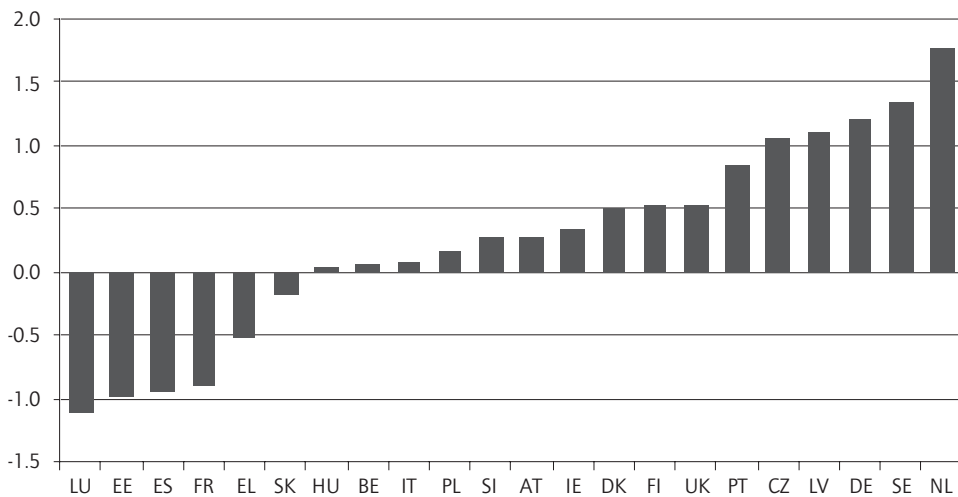
the gap between the index for temporary contracts and that for permanent contracts for individual dismissals only. Figure 2 shows that the picture changes only slightly when the gap is measured with the indicator including provisions for collective dismissals. For most countries, this simply raises the indicator for regular employment.

Figure 1 The arithmetical gap between the EPL index on regular (individual dismissal only) and temporary contracts, 2013



Source: calculated from OECD

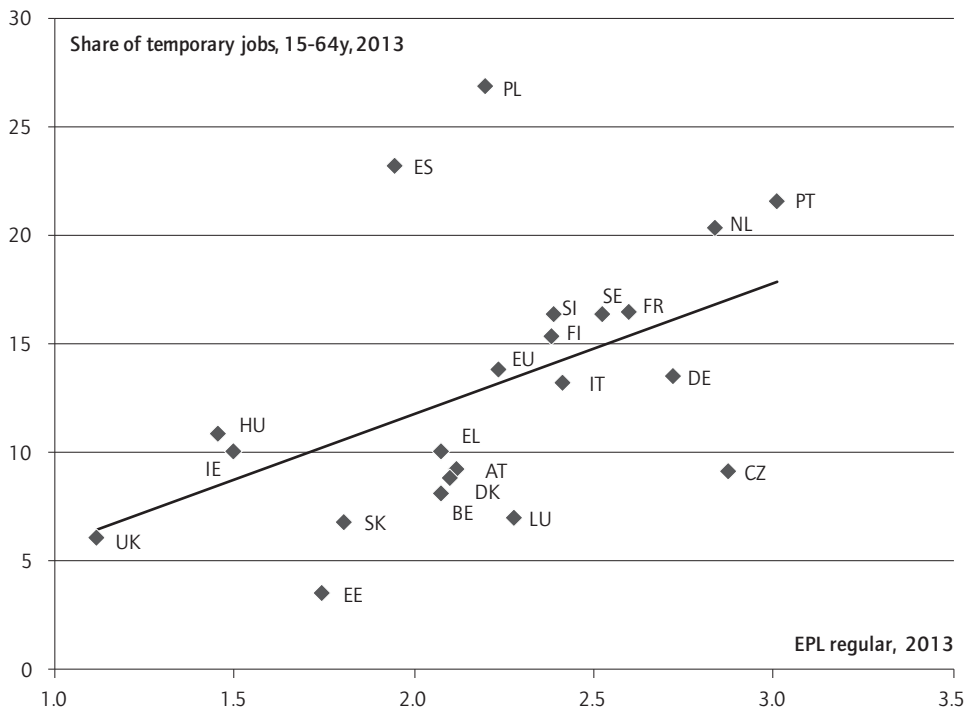
Figure 2 The arithmetical gap between the EPL index on regular (including collective dismissals) and temporary contracts, 2013



Source: calculated from OECD

One important publication from DG ECFIN affirms that, ‘strict EPL is linked to reduced dynamism of the labour market and precarious jobs’ (European Commission 2012: 4). The evidence cited for this includes a discussion of previous academic studies – for example acknowledging the absence of any significant effects of EPL on aggregate unemployment (European Commission 2012: 90) – and regressions using data from the experience of EU Member States. Many possible predicted relationships are weak or non-existent. A possible negative effect of EPL on segmentation, assumed to be measured by the relationship between EPL on regular contracts and the share of fixed-term contracts in total employment, shows up in regression results for the period 1999-2007, but the calculation does not include other, more likely, influences on the weighting between types of contract. Looking at the effects of past reforms also reveals, at best, a very weak relationship (European Commission 2012: 91). In fact, later publications seem to acknowledge that the results of policy changes give no confirmation to the primacy of EPL reductions in reducing segmentation. ‘Other drivers’ – mention is given to active labour market policies, lifelong learning and the structure of benefits – ‘appear to have a higher relevance’ (European Commission, 2015a: 90).

Figure 3 EPL index on regular employment, individual dismissals only, and the share of temporary employment



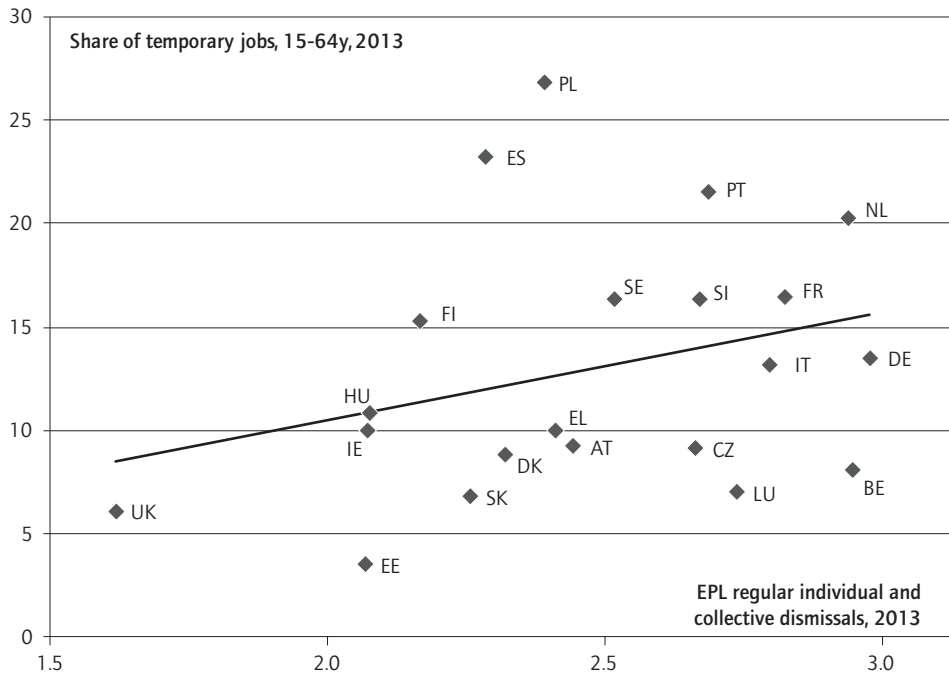
Source: European Commission 2015a: 31

The European Commission’s Employment and Social Developments in Europe 2014 report supports its argument that protection for permanent employees is leading to labour market segmentation with a single chart, reproduced in Figure 3. This shows

a visible positive correlation during a single year, with temporary employment higher in countries with stricter EPL for regular jobs, as measured by the OECD indicator. It is concluded that ‘a high level of employment protection helps explain the share of temporary jobs,’ so that ‘reducing EPL may be relevant’ (European Commission 2014b: 31). It adds a warning against reading too much into this, accepting that countries with a low level of EPL do not necessarily see more job creation. The need is apparently for ‘a broader approach’, accepting that a range of other policies may be needed.

Indeed, the evidence of this figure cannot provide serious backup to any deregulatory policy measures. The  $R^2$  for the relationship is 0.23. With the indicator for regular employment including provisions for collective dismissals, which would seem more justifiable if the likely cost to employers of permanent contracts is assumed to be the key issue, the relationship becomes weaker, as shown in Figure 4. The  $R^2$  for this relationship is 0.09. This leaves little doubt that other causal factors are considerably more important. The result is also sensitive to the countries included. Excluding the UK, which is set to leave the EU, would reduce the value of  $R^2$  to 0.04.

Figure 4 EPL index on regular employment, including collective dismissals, and the share of temporary employment



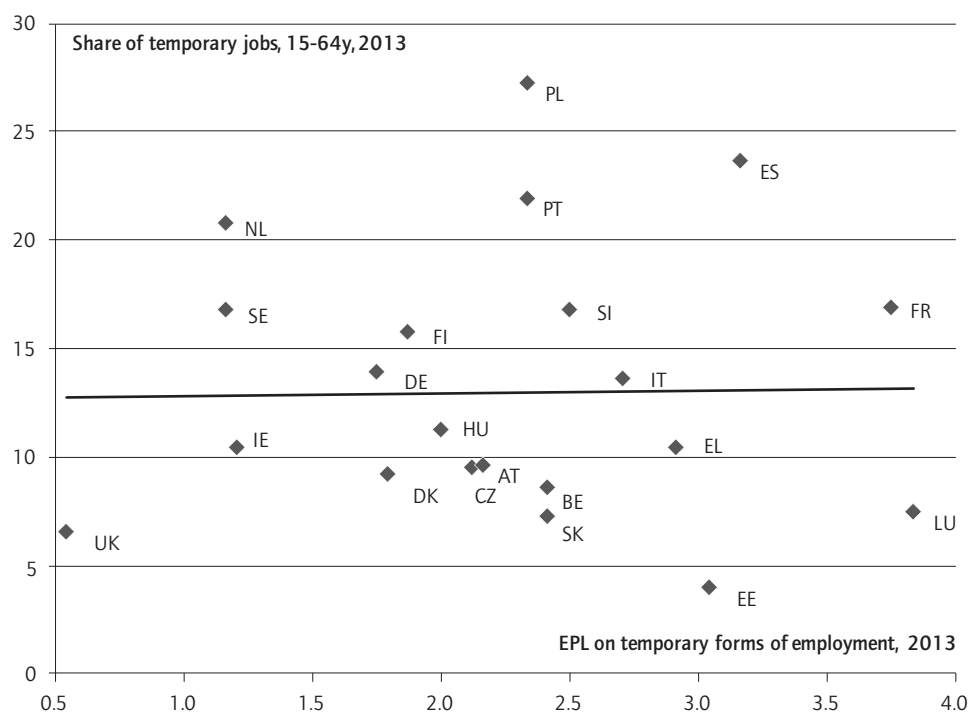
Source: OECD, Eurostat, Ifsa\_etpgan, own calculations

It is reasonable to hypothesise a relationship between employment protection for permanent employees and the share of temporary employment. Thus, the UK’s position could be explained by employment protection rules that only apply after two years in a post, such that temporary contracts may often be of little relevance. That,

however, cannot be taken to demonstrate limited segmentation. It rather suggests that the boundary between the primary and secondary sectors of the labour market, understood as relating to security and other employment conditions and the scope for moving between sectors, does not coincide with the boundary between these contract types. Some of those on permanent contracts could well belong in a secondary sector, with very limited job security, while others anyway enjoy the higher security associated with primary sector jobs even without the protection of the general employment laws represented in the OECD's EPL index. However, even if such reservations could be waived, the correlation results point at best to a weak relationship. Indeed, the enormous variation across countries in the use of temporary contracts suggests that causes should be sought elsewhere, including employers' strategies, sectoral structures, macroeconomics and labour market conditions, including the extent of irregular employment and the enforcement of laws in general, as well as legal restrictions on the use of temporary contracts.

In fact, the most obvious relationship to the share of temporary employees could be expected from the EPL index precisely as regards temporary employees. This is not emphasised in EU publications. Figure 5, matching Figure 4, shows a remarkably weak relationship when comparisons are made between countries. The  $R^2$  this time is 0.00.

Figure 5 EPL index on temporary employment and the share of temporary employment, 2013



Source: OECD, Eurostat, lfsa\_etpgan, own calculations

However, a relationship can be demonstrated by following changes over time in individual countries rather than comparisons between countries in one year. Thus, both Italy and Spain experienced a sharp increase in the percentages of the labour force employed on temporary contracts after changes in employment law relating to those contracts (Horwitz and Myant 2015; Piazza and Myant 2016), as also mentioned in the OECD (2013) publication referred to above. That greater security was available for permanent contracts was presumably relevant to employers' choice to make greater use of temporary contracts, but it cannot be seen as the primary reason for that change in employers' behaviour. The important factor was the new opportunity to insist on switching to a form of contract that gave less security to employees but that they considered more favourable to themselves.

## 5. The EPL index in EU policy recommendations

The European Commission's policy recommendations rely on, but are less nuanced than, their larger publications. They point generally to reductions of EPL on permanent contracts, albeit also with some recommendations for increases in EPL on fixed-term contracts. The central aim, as indicated above, has been presented as reducing labour market segmentation (European Commission 2014: 24) and the policy measures winning praise, both from the EU and from other international agencies, leave little doubt that reducing protection for permanent employees was perceived as crucial to overcoming this perceived problem. This comes through via the Country Specific Recommendations for individual EU Member States. Two examples can illustrate the direction of policy thinking, those of Poland and Slovenia.

Poland suffers from the highest incidence of temporary contracts in the EU. The EPL index for permanent contracts is not exceptional, but when employers do not see the need to offer permanent contracts, labour market conditions are such that candidates are disposed to accept conditions of extreme employment instability or the downgrading of permanent into less secure contracts. However, the European Commission looks for a completely different cause for precarious employment in Poland. Its conclusion is that 'Rigid dismissal provisions, long judicial proceedings and other burdens placed on employers encourage the use of fixed-term and non-standard employment contracts...'<sup>9</sup> No evidence is provided for this relationship which is presented in a form similar to a hypothesis in the OECD's review of the topic (OECD 2013: 80). However, the EU's argument is that the way to a solution for those in non-standard employment consists primarily in the deregulation of standard contracts. Curbing the use of temporary and civil law contracts has appeared in the past as an EU recommendation and legal changes to bring that about are not difficult to find. They include better enforcement of existing employment law, which sets the conditions under which commercial rather than employment contracts should be accepted, and equal financial obligations falling on employers for all kinds of employment.

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9. <http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52015DC0270>



Another example of the pressure for deregulation is the case of Slovenia where strong advice, pointing in the same direction, came from the OECD and IMF as well as the EU. In 2012, the OECD advised<sup>10</sup> Slovenia to combat its labour market dualism by reducing the strictness of EPL on regular contracts, pointing to the high value of the index. The rigidity would, it was claimed, hamper economic adjustment. In March 2013, the National Assembly introduced a new labour market reform which relaxed employment and dismissal procedures, while also introducing some new provisions regarding fixed-term employment.

In 2013, the IMF judged that ‘recent labor market and pension reforms are steps in the right direction. Labor market reform somewhat reduces the rigidity of permanent labor contracts and simplifies administrative procedures. With this reform, Slovenia’s employment protection index as measured by OECD will reach the OECD average.’<sup>11</sup> The European Commission also quoted the OECD’s EPL index for Slovenia, apparently ‘among the most rigid in the EU’ especially in relation to individual dismissals, as reducing ‘the adjustment capacity of the economy’ and causing ‘labour market segmentation’ (European Commission 2013: 16-17). No further evidence is provided to support these claims which, as argued above, deserve the status only of hypotheses for investigation. In fact, the favoured EU measure of segmentation as the share of temporary contracts sets Slovenia roughly in line with Sweden, Finland, France and Germany (see Figure 3). Nor is there evidence to suggest that specifically individual dismissals are important in the case of Slovenia. The evidence given above questions whether these are likely to make much difference to labour turnover.

It is worth noting at this point the implicit standard for judging whether an EPL level is too high – namely, the OECD average value for the index – although, in fact, a high score seems not to be a cause for criticism concerning countries not experiencing greater economic difficulties. Otherwise, the main targets should include Germany, Belgium and the Netherlands. There is nothing to suggest a serious assessment of the costs of and benefits from EPL or of particular items within the indexes. Despite those few recognitions in EU publications of the need for employment protection, in view of ‘the inherent inequality’ in the relationship between employer and employee (European Commission 2015: 79), the implication when it comes to policy is always that less is better. There are warnings to those – or, more precisely, to some of those – with high EPL index scores concerning permanent contracts. There are no warnings to those with a low index for permanent contracts that it should be increased.

## 6. Conclusion

The OECD’s EPL index has spawned a vast body of empirical research. It has caught on in the context of an advancing policy agenda that advocates laxer regulation of employment. The index is then fed into econometric studies, some of which give some support to that agenda by showing worse economic performance, and particularly

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10. <http://www.oecd.org/slovenia/theneedforstructuralreforms.htm>

11. <http://www.imf.org/external/np/ms/2013/031813d.htm?id=348978>

employment and unemployment levels, where regulation is stricter. However, unfortunately for advocates of that point of view, many studies point to the absence of any such relationship. A reasonable conclusion is that those positive results should not be taken as a guide to policy-making. It seems, however, that the sheer volume of empirical studies, even if they point in no clear direction, has been used to claim scientific backing for this particular policy direction.

However, even if the cumulative results of quantitative studies were to point in a clear direction, it remains unclear whether the EPL index measures the right things. It does not measure what may be the most important factors in determining employment stability, including macroeconomic conditions, the role of other institutions and practices and the enforcement of those laws that do exist. These reservations find some recognition in the publications of the EU and the other international agencies. There are frequently sections warning against reading too much into the EPL index and pointing to the ambiguity of the results of research derived from its use. However, the index is still freely used to back selective policy recommendations to individual countries.

It would seem better to view the EPL index as an approximate indicator of differences in some particular elements of employment law which are only one of several determinants of employment practice. There is little reason to expect it to have much importance for any aspect of economic performance and there is no persuasive evidence that it does have any such an influence. That leaves open the question of whether it can be adapted to take account of the criticisms listed above.

One alternative would be to use one of the alternative indexes, such as that developed at the Centre for Business Research of Cambridge University. Studies from that starting point seem to confirm the absence of links between employment law and unemployment (Deakin 2013). However, the same as with any synthetic index, it remains difficult to take account of the extent of the enforcement of laws and the importance of institutional factors not embodied in general legal frameworks. Another alternative, which also seems indispensable as support to any research method, would be to focus instead on the effects of particular laws and institutions through detailed country case studies.

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