Employment Protection Regulations and Their Impact on Employment

Wolfgang Pointner[1]

Employment protection legislation (EPL) forms part of the institutional framework governing labor market allocation processes. It increases the costs enterprises incur when terminating contracts, either directly via severance payments or indirectly via procedural costs (e.g. notice periods or court trials). EPL is often considered to be the main reason for the high unemployment level in several euro area countries. While the empirical evidence for this correlation is generally rather weak, more robust results are found for its adverse impact on the employment opportunities of certain sociodemographic groups – especially women and the young. Another means to reduce the income risk associated with job loss are unemployment insurance benefits, which – contrary to employment protection – do not affect the employment opportunities of specific sociodemographic groups.

An analysis of the effects of EPL on employment certainly needs to take into consideration other labor market institutions, too, as they are often highly correlated and their effects interact. Insofar as employment protection not only stabilizes the protected employees' income, but also serves as an incentive to acquire firm-specific human capital, a certain degree of employment protection can also contribute to gross domestic product (GDP) growth.

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1 Introduction

After the oil price hikes of the 1970s, all industrialized countries reported higher unemployment levels. While in the U.S.A. the unemployment rate increased more strongly initially than in the European Union (EU), it shrank below the pre-1970s-level in the late 1980s and 1990s. In Europe, by contrast, unemployment has persisted on relatively high levels (see chart 1, left panel). These diverging trends have been pinpointed to several factors: productivity differentials, a different monetary and fiscal policy stance and, last but not least, differences in the realm of labor market institutions. In this context, institutions are the rules of the game of a society or the humanly devised constraints that structure political, economic and social interaction (North, 1991). As such, labor market institutions not only create a framework for matching labor supply and demand, but they also impact the transmission of monetary and fiscal policy measures and influence the adjustment processes of an economy after a shock. Important labor market institutions are the wage formation system, the unemployment insurance system, the regime for the taxation of labor and, last but not least, employment protection regulations; for a comprehensive overview of institutions, see the study by Stiglbauer in this issue.

The European labor markets and their institutions have often been called inflexible compared with the deregulated labor market in the U.S.A. This is not correct, however, as there is no uniform European

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Alfred Stiglbauer, OeNB.

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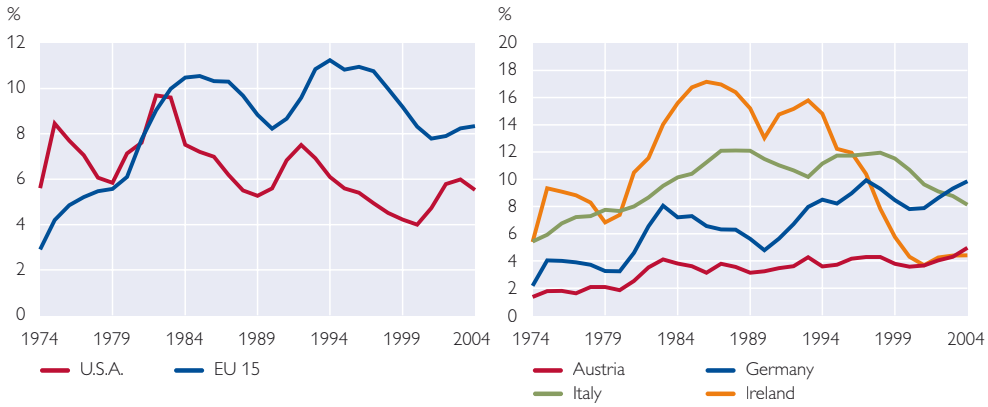
Chart 1

Unemployment Rates – An International Comparison



Source: OECD.

model of labor market regulation.[2] The EU labor markets are characterized by a high level of institutional heterogeneity, and some Member States seem to have adopted more effective labor market strategies than others (see chart 1, right panel, for the unemployment rates in four selected euro area Member States). Furthermore, it should be noted that the different developments in the period under review reflect more than just the institutional design; they are to a certain extent also attributable to idiosyncratic shocks or reform projects in the individual countries.

Employment protection legislation (EPL) and other labor market institutions have an influence on monetary policy insofar as they alter labor force participation and the patterns of employment in an economy, thus also impacting GDP. Furthermore, through their influence on wage setting, these institutions play a significant role for price stability, as wages and other labor costs are key determinants of price developments. Given the absence of exchange rate autonomy for the Member States of a monetary union, they have to rely on other instruments in the event of an idiosyncratic shock; labor market institutions are of key importance in that they codetermine the labor markets' ability to absorb such shocks.

In this study, we focus on EPL to highlight the influence labor market institutions can have on employment and unemployment. Section 2 summarizes the various approaches to employment protection adopted in the euro area and describes the range of indicators selected to compare the respective regulations. Section 3 gives a brief overview of empirical surveys on employment protection, focusing especially on its effects on certain sociodemographic groups, and outlines how labor market institutions interact. Section 4 addresses the reasons why different types of institutions have emerged in different parts of the euro area.

[2] *"In contrast to what is commonly perceived, European social systems display more diversity than uniformity, with differences within Europe often greater than those with other advanced countries."(IMF, 2006; p. 26).*

2 Types of Employment Protection

Employment protection regulations comprise all institutions that impose costs on employers for terminating an employment contract, thus limiting the availability of labor in the production process. The Organisation for Economic Co-operation and Development (OECD, 2004) has categorized these costs as an "employer-borne tax on employment adjustment." EPL institutions are typically established by law, but they may also be agreed by the social partners. In one of the first empirical comparative country studies examining the effects of EPL on employment, Lazear (1990) used two parameters to determine EPL strictness in 22 countries: (1) the size of the severance payment an employer has to make when laying off a worker after ten years of job tenure and (2) the period of notice required before employment termination. These two indicators, however, do not cover all aspects of EPL.

2.1 Indicators of EPL Strictness

The OECD attempted to bridge this gap by creating synthetic summary indicators of EPL strictness for its member countries,[3] distinguishing between (1) employment protection of regular workers against individual dismissal, (2) specific requirements for collective dismissals and (3) the regulation of temporary employment (specifically fixed-term contracts and temporary work agency employment), as employers increasingly use such arrangements to circumvent EPL for regular contracts. Chart 2 shows the current values of these indicators for the euro area Member States (except Luxembourg) and for the U.S.A.

For regular contracts, the indicator takes into consideration the required length of the notice period, the size of the severance pay depending on the period of tenure as well as the required notification procedure (i.e., oral or written statement, notification of a third party, e.g. a works council, or authorization from a third party). Furthermore, the indicator reflects the conditions under which a dismissal is considered justified or unfair, the length of a trial period in which regular contracts are not or not fully covered by employment protection provisions as well as compensation following unfair dismissal.

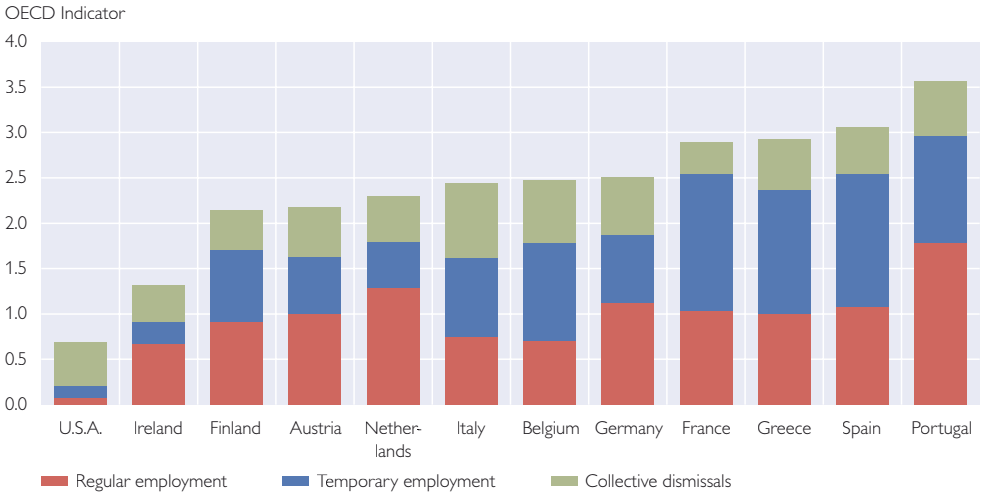
The indicator for collective dismissals considers the number of dismissals that invoke additional regulations, e.g. the notification of certain organizations (such as public employment offices) or higher severance pay requirements; some countries also require the employer to provide social compensation plans in case of collective dismissals. The indicator for temporary employment, finally, reflects restrictions on the use of fixed-term contracts and temporary work agency employment as well as restrictions on the maximum number and maximum cumulated duration of such contracts.

An essential weakness of the OECD's summary indicators is that they do not consider one factor that seems to have a substantial impact on the effects EPL has on employment: the threshold value for the number of employees above which an enterprise is subject to national EPL. Such thresholds – which, at varying levels,

[3] *See OECD Employment Outlook 2004, Annex 2.A1 for a detailed description of these indicators.*

Chart 2

EPL Strictness in 2003



Source: OECD Employment Outlook (2004), p.117.

apply in all euro area countries – are meant to take account of the fact that the labor adjustment costs resulting from unfair dismissal protection are a higher impediment for smaller enterprises. Yet awareness of these thresholds may be limited, as surveys among small enterprises in Germany[4] suggest that many respondents are uncertain as to whether or not EPL applies to them.

There are several other approaches to measuring the intensity of EPL in addition to the OECD's summary indicators. In their data set on hiring and firing restrictions, Di Tella and MacCulloch (2005) rely on the results of surveys conducted for the World Competitiveness Report (WCR) in the period 1984–1990. In the context of the WCR, respondents were asked to indicate how flexible business leaders were in adjusting e.g. compensation and employment levels to economic realities. The drawback of this method lies in the limited comparability of the replies, as the sample of respondents is not representative and their assessments do not refer to a common reference value. This notwithstanding, Di Tella and MacCulloch underline that the survey respondents (managing directors, economic experts, social partners) are particularly well placed to judge the impact of the applicable rules. At any rate, the survey results broadly match those obtained with the OECD indicators; the WCR's flexibility measure is highly correlated with the EPL indicator for the late 1980s. The largest deviation in this period was found for Austria, which was the second-least regulated country in terms of employment protection after Ireland according to the OECD, while ranking seventh in the WCR's classification.

[4] *Bothfeld and Ullmann (2004) found in their survey that 66% of German enterprises with up to five employees in 2003 mistakenly believed that the national EPL was applicable to their employees.*

2.2 Objectives of Employment Protection

The constraints imposed on employers, as reflected by the OECD indicators, mainly aim at securing existing jobs (by requiring employers to notify a third party or seek its authorization and by enabling dismissed employees to bring their case before a labor court) and at providing a certain degree of income security (through notice periods and severance pay). The differences in the mix of disincentives for employers and income support measures for employees are fairly big across the euro area, as are the effects of these measures. For instance, the average duration of legal proceedings in employment protection cases is three to four months in Germany, one year in France and two years in Italy according to the OECD (2004). While employees in Spain and Portugal are entitled to redundancy payments of one year or more after 20 years tenure, e.g. employees in Finland do not benefit from such provisions. The German EPL relies more on renewing employment relations than on compensating dismissed employees for income loss. In Belgium, finally, enterprises can choose between a three-month notice period and a severance payment.

In some ways, employment protection regulations can be seen as a substitute for unemployment benefits, as they help reduce the income uncertainty associated with job loss. Compared with the euro area average, the countries of the Mediterranean tend to have more restrictive EPL and lower unemployment insurance benefits, while the Scandinavian countries have a lower level of employment protection and higher unemployment replacement rates (see chart 2). Arpaia and Mourre (2005) expand the scope of this substitutive relationship in the labor markets' institutional design to include also other instruments of income security and redistribution; the weaker a country's instruments are in this respect, the more restrictive its EPL.

Severance pay entitlement may negatively affect labor mobility as termination benefits are often based on the seniority principle (i.e. they increase in line with the period of tenure at a single employer) and withheld if an employee quits his or her job. In such case the cost of job mobility can rise considerably especially for older employees.

In Austria, this problem was solved with the 2003 reform of the severance pay legislation, which requires employers to contribute around 1.54% of employees' paychecks to individual savings accounts managed by severance funds starting on the first day of employment. Employees keep their entitlement to the amount regardless of who terminates the employment contract. In the case of dismissal by the employer, employees with a job tenure of more than three years can choose between receiving the accumulated amount at once and carrying the balance over to the next employer. The amount is not paid out if the employee quits the job or job tenure is shorter than three years. The new legislation, moreover, provides an incentive for employees to save the entitlements toward a future pension by levying taxes on interim payouts. While employees thus no longer lose out on severance pay when they decide to take a new job and the employer does not face additional costs in case of a dismissal, severance pay regulations can no longer be re-

garded as an instrument of employment protection.[5]

By way of conclusion, EPL aims at providing job and income security by imposing costs on enterprises that lay off employees. These costs can be direct (severance pay) or indirect (e.g. court costs), with the latter involving a high degree of uncertainty, as it is impossible to predict both the probability of a former employee taking legal action and the outcome of such a labor lawsuit. Ichino et al. (2003) show that Italian court rulings in such cases typically depend on the overall economic climate. What remains to be explored is the extent to which employers pass through the costs connected with EPL to their employees.

3 Effects on Employment and Joblessness

EPL restricts the ability of employers to reduce labor costs by laying off employees when demand for their products and services is decreasing; in times of full capacity utilization, employers will thus also be reluctant to hire new workers. Even though its effects on employment and joblessness are by no means uniform, EPL tends to reduce employment volatility over the business cycle – it can lead to labor hoarding. In theory, employers could cut wages to reduce labor costs without cutting staff, but this option conflicts with existing wage rigidities.

As mentioned above, EPL increases labor costs, which in turn decreases labor demand. In a static labor market model, the equilibrium outcome of higher employment protection regulations is a decline in employment rates and a rise in unemployment rates. The size of these effects depends on EPL strictness, its interaction with other labor market institutions and its possible welfare-enhancing effects.

3.1 EPL and Short-Time Working

Given the low flexibility of employment and wages, putting employees on short-time working is an option to adjust labor costs to entrepreneurial needs. The negative correlation between EPL and hours worked was already described by Lazear (1990). Houseman and Abraham (1993) show that, when confronted with negative demand shocks, enterprises in the U.S.A. tend to reduce the labor factor by cutting staff numbers, while German employers prefer cutting working hours. The total effect of dismissals and short-time working is only slightly higher in the U.S.A. than in Germany. Enterprises in Italy, Spain and Belgium also use short-time working to smooth cyclical fluctuations.[6] Bonin (2004) underscores that adjusting working hours is a suitable solution to buffer changes in capacity utilization levels especially if the qualification structure of employees is relatively homogenous. Thus, the workload can be distributed flexibly among the employees.

A number of studies – e.g. Addison and Teixeira (2003), Cahuc and Zylberberg (2004) and the OECD (2004) – have empirically explored the negative correlation between EPL

[5] *Accordingly, the OECD has set to zero the 2003 value of the "severance pay" indicator of EPL strictness for Austria (OECD, 2004; p. 111). The new severance pay system is only binding for employment contracts concluded after December 31, 2002. For contracts concluded before that date, the employment protection effect of the old severance pay provisions continues to exist.*

[6] *See Lodovici (2000), p. 38.*

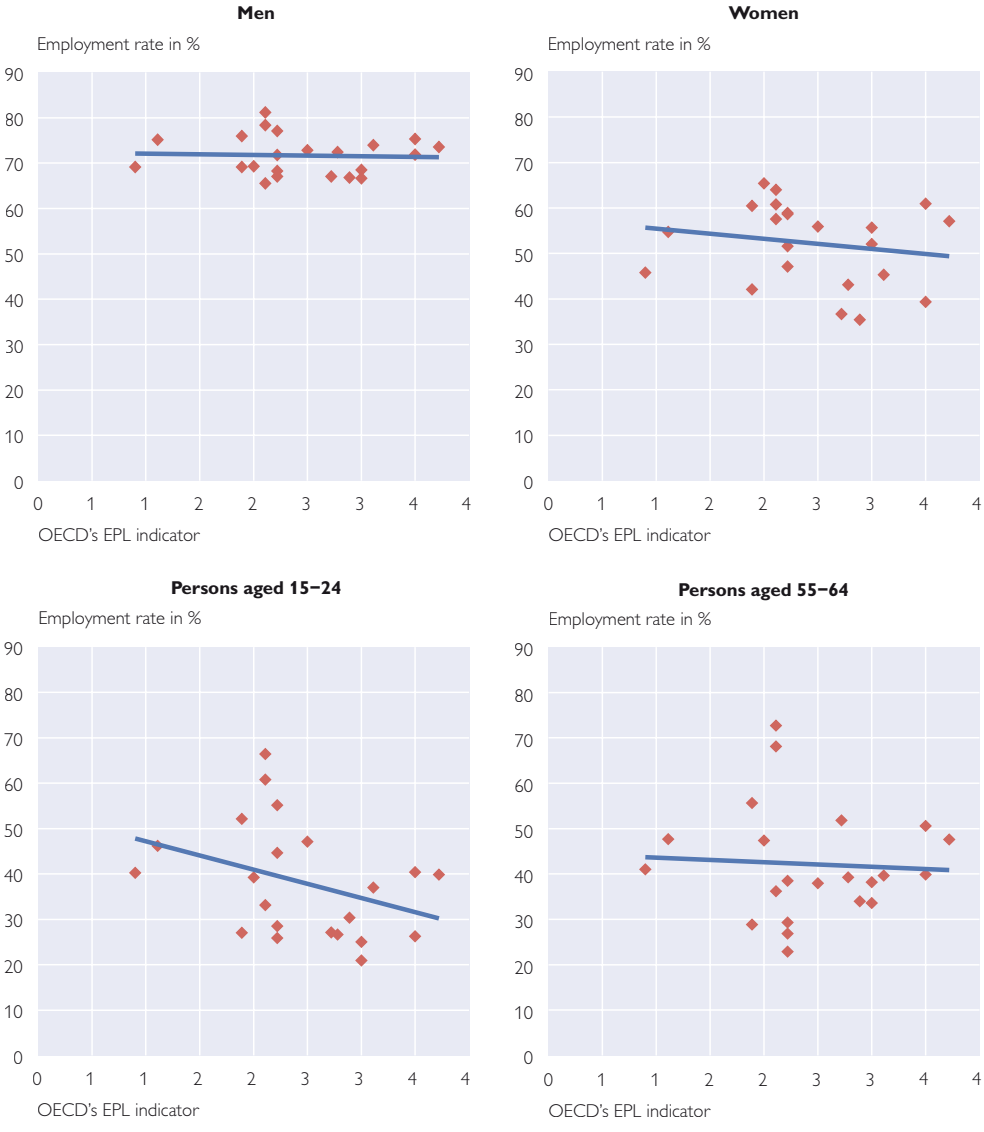
and unemployment without finding conclusive evidence.[7] Elmeskov et al. (1998), however, find a significant negative impact on the level of structural unemployment; several studies also suggest that the duration of unemployment may increase with stricter EPL, which is probably attributable to its dampening effect on hiring. The longer a jobless person fails to reenter the labor market, the bigger the potential loss of human capital and the lower the chance of finding a job.

3.2 Age- and Gender-Related Effects

EPL increases the stability of existing employment relationships, while at the same time reducing hiring rates.

Chart 3

EPL and Employment



Source: OECD.

[7] *Nickell and Layard (1999) conclude that "Time spent worrying about strict labor market regulations, employment protection and minimum wages is probably time largely wasted."*

The effects of EPL thus vary across labor market groups. Chart 3 shows the average employment rate (number of employed persons as a percentage of the labor force) and the indicator of EPL strictness for four sociodemographic groups (men, women, persons aged 15–24 and persons aged 55–64) in all euro area countries except Luxembourg in the periods 1995–1999 and 2000–2004. The correlation between the two variables is strongest for female employees and the young. The reason for this is that persons aged 15–24 are often just entering the workforce and thus do not benefit from EPL, while women have more spells of nonemployment in their employment history and face reentry problems associated with the dampening effects of strict EPL on hiring. By contrast, persons aged 55–64 are protected by EPL, especially by the fact that severance pay entitlement increases with tenure.

The national differences in employment rates and other labor market indicators are, however, not exclusively ascribable to the degree of EPL strictness. Other institutions such as the unemployment insurance system, the wage setting process or the taxation of wage income also play a key role in this context. The OECD (2004) conducted a regression analysis that reflects additional group-specific explanatory variables (e.g. childcare facilities and maternity leave for women or retirement regulations for older employees) in addition to the above-mentioned explanations. The analysis results still suggest that EPL has a significant negative impact on the employment of women and the young.

3.3 Interaction with Other Labor Market Institutions

Taking into account other relevant labor market institutions makes sense, given the possible interactions between the individual institutions and their effects on employment and joblessness. As mentioned before, there is a substitutive relationship between EPL on the one hand, and the unemployment insurance system and the redistribution effects of the tax system on the other hand. A complementary relationship between wage compression[8] and employment protection is found by Bertola and Rogerson (1997). The stronger wage compression is in a country, the harder it will be for enterprises to cut labor costs by lowering wages in the event of a shock to the extent warranted by the profit situation. Employers will therefore aim at lowering costs by reducing the labor force, and employees will try to protect themselves with stricter EPL. Bertola and Rogerson emphasize that the process of job creation and destruction in countries with high wage compression and high EPL is similar in scope to that in countries with low wage compression and low EPL.

It is difficult to produce econometrically significant evidence on the effects of EPL because, among other reasons, labor market institutions tend to change only little over time. The OECD's national indicators of EPL strictness for 2003, for instance, are highly correlated with those of the late 1990s; the variance is also quite low in a longer-term comparison. Blanchard and Wolfers (2000) therefore raise the question how these comparatively constant variables are

[8] *Wage compression is a matter of wage income distribution; wage compression is high when the wage gap between the lowest and the highest paid employee is narrow.*

supposed to explain the in part drastic increase in unemployment observed in Europe. They conclude that the different labor market developments are not so much attributable to the impact of institutions or their reforms, but to the combined effect of institutions and macroeconomic shocks (e.g. the productivity decline since the 1970s). Two factors determine the impact that a given shock has on the unemployment rate in a labor market: it will be stronger if wage setting reacts only with small adjustments to increasing unemployment and if the risk of long-term unemployment is high. Given the group-specific effects of EPL mentioned above, we may assume that shocks in a labor market with strict EPL will cause especially female and youth unemployment to rise in the event of a shock. Blanchard (2006) tests the hypothesis that employment protection regulations – that were just as strict as today some 30, 40 years ago, but had no binding effect on allocation processes in the labor market at the time – are causing unemployment to rise, as the pace of job allocation has increased in our globalized economy. However, he finds no empirical proof of an increase in the pace of allocation in the labor market: Blanchard shows that the speed at which jobs are created and destroyed has not increased in France since 1985; there are no reliable data available for earlier periods.

Another factor adds to the difficulty of empirically analyzing the effects of EPL on employment: the correlations between institutions are not restricted to labor market institutions, but also involve product market regulations, which makes it virtually impossible to distinguish between the effects of individual institutions. Freeman (2005) underscores that it is not possible to single out institution-specific effects by country with econometric methods as long as specific combinations of institutions occur only in certain countries. Arpaia and Mourre (2005) point out that regression analyses that examine the impact of institutions on unemployment will produce insignificant results if they reflect period- and country-specific effects.

3.4 Flexibility and Security

The employees' perceived job security is another interesting aspect of EPL apart from its direct impact on job creation and destruction. Clark and Postel-Vinay (2005) use European Community Household Panel (ECHP) data to assess employees' perception of job security in a multivariate probit model. They regress data obtained in 12 EU Member States for the ECHP on variables such as the regional unemployment rate, previous spells of unemployment, education, marital status and age as well as indicators of national EPL strictness and unemployment insurance benefit generosity. The authors distinguish between permanent public sector jobs, permanent private sector jobs and temporary jobs. The employees' perceived job security is positively correlated with generous unemployment insurance benefits for all types of jobs. It is negatively correlated with strict EPL for private sector jobs, while no correlation was ob-

served for public sector jobs.[9] Clark and Postel-Vinay argue that for the majority of employees, employment protection does not lead to higher perceived job security; they suggest addressing the issue with different instruments.

In order to increase job security, Clark and Postel-Vinay propose the Scandinavian "flexicurity" model which combines high labor market flexibility (easy hiring and firing) with generous unemployment benefits and a proactive labor market policy. The OECD (2004) refers to this approach as the "golden triangle." The concept of *flexicurity* has recently become the focus of policy discussions in Austria and in the EU; Denmark – which has a low unemployment rate also by international standards – is often cited as an example for this approach.[10] While enterprises in Denmark enjoy a relatively high degree of flexibility when cutting jobs, the associated income loss for the affected employees is comparatively small, as they receive high wage replacement rates also in case of longer-term unemployment and their chance of finding a new job quickly is high, given the proactive Danish labor market policy. The design of unemployment insurance benefits and the proactive labor market policy serve as incentives for unemployed persons to increase their employability; for instance, if they refuse to attend qualification courses, their unemployment benefits will be reduced. To avoid a segmentation of the labor market, the Council of the European Union (2006) also recommends increasing labor market flexibility and promoting employment security for an improved implementation of the Lisbon strategy. In addition, it suggests that the European Commission establishes common principles of flexicurity in cooperation with the EU Member States and the social partners.

4 Heterogeneity of Existing Institutions

In the following, we will explore possible reasons for the emergence of highly heterogeneous EPL in the euro area. A country's institutional framework represents the outcome of political redistribution conflicts according to a number of economists. Saint-Paul (2002), for instance, develops a model in which EPL strictness is attributable to two factors: the productivity gap between employed and unemployed persons on the one hand, and the unions' bargaining power on the other. Employees acquire firm-specific human capital that increases with job tenure, thus making their input in their current job more productive than with another employer. As they receive higher wages in return for their higher level of productivity, they will advocate strict EPL as this helps them keep their jobs. Assuming that trade unions primarily aim at maximizing the employees' income and pay less attention to unemployed persons, they optimize the "rents" enjoyed by protected employees; in this context, rent denotes the amount an employee earns in

[9] *The EPL coefficient on perceived job security for temporary employees is insignificant in the original specification. The result was only significant and negative on the assumption that workers actively self-select into one of the three job types according to their sentiment of job security.*

[10] *At 4.5% of GDP, the share of labor market expenditure is significantly higher in Denmark than in the other euro area countries (OECD, 2006; p. 271).*

excess of alternative income, i.e. unemployment insurance benefits or the wages earned in a new job. According to Saint-Paul, this is the reason why EPL is stricter in countries with strong labor unions.

Efficiency considerations are another possible explanation for the origins of EPL. They concentrate mainly on employees' risk aversion in view of income uncertainty associated with job loss. While Saint-Paul's model postulates that employees hardly consider the possibility of losing their job and their demands even contribute to an increase in unemployment figures, Agell (2002) assumes that the fear of unemployment has been a key factor in the creation of labor market institutions such as EPL. From a historical perspective, the costs of unemployment were lower when the division of labor was less developed, as people had a better chance of finding a similarly well-paid job. With growing specialization, employees were forced to acquire firm- or sector-specific knowledge; this human capital is lost when the employee is laid off. As the private insurance industry does not accommodate the demand for insurance against the associated income risk, employees will try to minimize this risk with EPL. Belot et al. (2006) find that employment protection has welfare- and growth-enhancing effects, as it serves as an incentive for employees to acquire firm-specific human capital.[11] This is, however, only true for a low level of EPL strictness – the effect on GDP growth is not linear; the optimal degree of employment protection also depends on the employee's qualification level. Given the increasing international division of labor, which requires a higher level of specialization in order to maintain and improve competitiveness, incentive systems in the euro area should aim at promoting the formation of firm- and sector-specific know-how also in the future.

Another approach to explaining the large differences in labor market institutions underscores the importance of national legal traditions. It postulates that the labor markets in Anglo-American countries mainly rely on private-law agreements and market mechanisms, while the legal systems in continental Europe tend to rely on direct government interventions and regulations such as EPL. Botero et al. (2004) test this hypothesis with a dataset of 85 countries and arrive at the conclusion that this factor contributes significantly to the heterogeneity of labor market institutions in addition to the factors mentioned above.

The open method of coordination, which is used for policy exchanges between EU Member States, makes it possible to learn from the experience of the other members. This does not imply, however, that best practice examples of institutions can simply be duplicated. Just like all other economic policy institutions, labor market institutions are the result of social developments and thus reflect the path of development realized so far. This path dependence can be attributable to positive feedback between existing regulations and individual routines on the one hand, and to a high level of compatibility of institutions from different areas on the other. Hence, reforms should be viewed within the entire institutional

[11] *The authors also point out that this incentive to acquire firm-specific know-how may be partly offset, as severance pay cuts the costs connected with dismissals for employees.*

context of a country.[12] Algan and Cahuc (2006) present an example of the feedback mentioned above: They maintain that the successful implementation of the flexicurity model requires a high level of public-spiritedness by all stakeholders, as the risk of moral hazard would be high otherwise; the authors believe that this attitude is present in the Scandinavian countries, but has no tradition in the Mediterranean and continental EU Member States. Accordingly, adopting the flexicurity model would only increase the cost of unemployment insurance benefits in these countries. Ochel (2004) challenges the concept of path dependence, citing the reforms of the labor market institutions in Denmark[13] and the United Kingdom. Still, he also concludes that reforming EPL will prove difficult if the losers of such reforms by far outnumber the beneficiaries.

5 Conclusions

Employment protection regulations aim at securing jobs and stabilizing wage income with a range of different instruments, e.g. regulations governing severance pay, notice periods or fixed-term contracts. While severance payments make sense in that they help compensate the income loss associated with spells of unemployment, the prospect of possible court trials tends to increase insecurity for both employer and employee. The effectiveness of strict EPL is even more doubtful if we consider that it does not raise the perceived level of job security for the majority of employees according to survey results. Still, the costs resulting from EPL force enterprises to internalize a part of the negative macroeconomic effects of layoffs; merely dispensing with EPL might increase the incentive for enterprises to dismiss employees, as the associated costs would be carried by private and public households alone. In the U.S.A., this issue is addressed with an "experience rating" system, in which a company's tax rate is linked to its layoff history. The OECD recommends implementing an analogous solution in Austria.[14]

Stringent EPL reduces employment volatility over the business cycle, as enterprises dismiss fewer employees in an economic downturn and hire fewer people in a cyclical upswing. While there is little empirical support for the assumption that strict EPL has a negative impact on aggregate employment or leads to an increase in unemployment, it seems to reduce the employment opportunities of two labor market groups: women, as they tend to have more interruptions in their employment history than men, and young people, who do not benefit from EPL when they are about to take up their first job. The Lisbon strategy aims at increasing the labor participation rate and at reducing gender-related differences in this rate. Therefore, countries with particularly strict EPL should consider reforming the system with the flexicurity approach, i.e., relaxing employment protection regulations while at the same time increasing the generosity of unemployment

[12] *See Janger (2006) on the political economy of reforms especially in the context of the Lisbon strategy.*

[13] *While certain labor market reforms were implemented in Denmark (the maximum duration of benefit entitlement was reduced, among others), they do not necessarily qualify as drastic changes; unemployment insurance benefits are still very generous by EU standards.*

[14] *See OECD (2005), p. 101.*

insurance benefits and adopting a proactive labor market policy. However, these measures alone are unlikely to increase the female labor participation rate; in the Scandinavian countries, where the flexicurity model was developed, they are complemented with a system of childcare facilities that is more comprehensive than the EU average.

Given the increasing specialization of production processes, the welfare-economic effects of EPL have gained importance, too, as a certain degree of employment protection increases the incentive for employees to acquire firm-specific human capital. Therefore, labor market reforms that aim at reducing EPL should be accompanied by measures that promote the qualification and training of staff.

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