

20 September 2011

Slovakia has the tenth most flexible Labour Code in the OECD since September

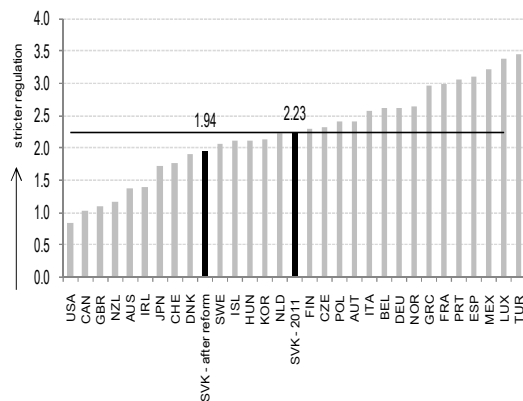
Authors: Peter Harvan and Gabriel Machlica

A new Labour Code came into force in Slovakia on the 1st of September 2011. In an international comparison, it moves Slovakia to among the top ten OECD countries with lowest strictness of employment protection. It strengthens flexibility of employing workers with regular contracts and lowers strictness of rules governing use of temporary contracts. A more flexible Labour Code should have a positive impact on creation of new jobs, particularly during economic boom. Moreover, labour market flexibility especially helps low income groups. This policy brief updates our previous [assessment of the draft proposal for Labour Code amendment](#).

The reform decreases labour market rigidity...

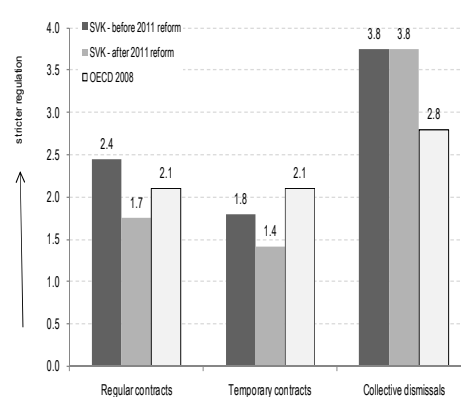
The adopted Labour Code amendment strengthens labour market flexibility in Slovakia. According to FPI calculations, the reform will **decrease labour market rigidity** as measured by OECD's Employment protection legislation summary index by 0.3 points to 1.94 points. In an international comparison¹, the EPL index for Slovakia will thus fall significantly **below the OECD average** (2.24 points) to the tenth lowest value from among the OECD countries (graph left below).

EPL index for OECD countries, (index ranges from 0 to 6, where 6 represents the strictest regulation)



Source: OECD, FPI calculation based on OECD methodology

Comparison of EPL sub-indices, (index ranges from 0 to 6, where 6 represents the strictest regulation)



Source: OECD, FPI calculation based on OECD methodology

... for example by shortening the notice period and abolishing simultaneous entitlement to both notice period and severance pay.

A fall in the overall rigidity is mainly due to a decrease in strictness of rules for regular contracts as well as for temporary contracts. The notice period for regular contracts lasting less than one year was shortened from two months to one month and simultaneous entitlement to both notice period and severance pay was abolished. As a consequence, the EPL sub-index for regular contracts fell below the OECD average (graph right above). The maximum cumulated duration of temporary contracts was lengthened from two to three years and also the maximum number of successive contracts was increased from two to three years. The EPL sub-index for temporary contracts thus decreased more significantly below the OECD average. Additional regulations for collective dismissals remain largely

¹ Latest available data for other OECD countries is from 2008.

unchanged. The EPL sub-index for collective dismissals remains unchanged above the OECD average.

The following table describes the changes in the Labour Code with impact on the employment protection index, which is described in greater detail in a box below.

Impact of Labour Code reform on EPL index ²					
Area	Description of changes	Old Labour Code	New Labour Code	OECD average in 2008	Impact on EPL
Length of notice period + severance pay (monthly wage)	Decrease for regular contracts lasting less than 1 year	4 months	1 month	1 to 2 months	Increased flexibility
	Decrease for regular contracts lasting more than 1 year and less than 5 years	4 months	2 month	1.75 to 3 months	Increased flexibility
	Decrease for regular contracts lasting more 20 years	6 months	3 month	5.75 to 11 months	Increased flexibility
Maximum number of successive fixed term contracts	Increased maximum number of successive fixed term contracts	3 times	4 times	4 times	Increased flexibility
Maximum duration of fixed term contracts	Increased maximum cumulated duration of fixed term contracts	2 years	3 years	3 years	Increased flexibility
Compensation after an unfair dismissal	Decrease from 12 to 9 months and 6 months for firms with less than 20 employees (monthly wage)	12 months	9 or 6 months	12 to 18 months	Increased flexibility
Impact of measures on summary EPL index		2.29	1.94	2.24	Increased flexibility

Source: FPI calculation based on OECD methodology

Labour market institution including the Labour Code influence unemployment levels. Their changes however explain only about half of the unemployment increases in Europe between 1960 and first half of 1990s, while most of the remaining increases were caused by deep recession in the second half of the period (Nickell et al. 2005). A correct set up of the Labour Code is important but not sufficient to ensure low unemployment. This also depends on the setting of other institutions (for example the minimum wage) as well as the aggregate demand.

International institutions including the OECD recommend a more flexible regulation of employment protection. While it is mostly assumed that a more flexible Labour Code inevitable leads to lower unemployment, the academic debate on this topic is not so conclusive. The existing empirical research assumes a perfectly functioning labour market when institutions do not exist (Freeman 2005).

A more flexible Labour Code should contribute to creation of new jobs and fall in unemployment particularly during economic expansion, which can be observed since second half of 2010. Strict regulation slows down flows in the labour market, which has a positive impact during a recession but can inhibit creation of new jobs (Messina & Valenti 2006). Economies with a more flexible employment protection experience greater volatility in the labour market and fall in employment during a recession.

Strengthening flexibility of employment protection will particularly help low income groups. Disadvantaged groups, like the youth and low skilled, with lowest income suffer from strict employment protection at most. A fall in expected severance costs of these groups will increase the willingness of firms to employ jobseekers who are perceived as riskier and thus with a higher chance that they will have to be dismissed (Venn 2009; Koeniger & Prat 2007). The new Labour Code should

² The impact of legislative changes is calculated by FPI and was not officially confirmed by the OECD.

A flexible Labour Code supports employment during economic expansion...

... and in particular helps low income groups.

thus increase the chances of youth and low skilled to find work. Currently, Slovakia has one of the highest unemployment rates in the EU.

FPI recommendations:

A number of further positive amendments can be made to the Labour Code. **FPI** (as well as the OECD) **recommends abolishing additional minimum wage** claims by classification level for employees not covered by collective agreements. The wage claims increase the minimum wage for selected employees and thus limit wage flexibility in the labour market³. We also recommend reducing additional regulation of firms for collective dismissals (for example, firms have to notify several institutions when planning collective dismissals).

BOX – Employment protection Index OECD

Employment protection Index OECD (EPL – Employment Protection Legislation) focuses on costs associated with employment and dismissals (Venn 2009). Values of the summary index and sub-indices are between 0 and 6, where the higher number represents stricter regulation. The EPL index is available for selected years only and the latest officially available update for all OECD countries is available for 2008. The index covers three areas:

- Dismissal of individual workers with regular contracts
- Regulation of temporary contracts (fixed term contracts and agency work)
- And additional regulation for collective dismissals

The index partly takes into account:

- Collective bargaining
- Implementation of legislative regulation in courts

The index however does not cover:

- The influence of unions and costs associated with their existence
- Internal flexibility of firms and regulation of working time
- Restrictions for using self-employed workers

Bibliography:

- Freeman, R.B. (2005) Labour Market Institutions Without Blinders: The Debate Over Flexibility And Labour Market Performance, Working Paper 11286, <http://www.nber.org/papers/w11286>
- Koeniger, W. and Prat, J. (2007) Employment protection, product market regulation and firm selection The Economic Journal, 117 (June), F302–F332.
- Messina, J. and Valenti, G. (2006) Job flow dynamics and firing restrictions: Evidence from Europe, Working paper series, ECB.
- Nickell, S., Nunziata, L. and Ochel, W. (2005) Unemployment in the OECD since the 1960s. What do we know? The Economic Journal, 115 (January), 1–27.
- OECD (2010) OECD Economic surveys: Slovak Republic 2010, OECD Publishing.
- Rutkowski, J. (2003) Does strict employment protection encourage discourage job creation? Evidence from Croatia, World Bank Policy Research Working Paper No. 3104.
- Venn, D. (2009) Legislation, collective bargaining and enforcement: Updating employment protection indicators, OECD, Paris.

³ Changes without impact on the EPL summary index.