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## Employment Protection Legislation: New Approaches to Measuring the Institution<sup>1</sup>

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This policy brief presents an overview of employment protection legislation levels and coverage in 95 countries, in the period from 2009 to 2013. The overview is based on a new set of EPL indicators – the *ILO EPLex indicators*, launched in 2015, as well as accompanying data on EPL coverage recently collected by the ILO.

### 1. Introduction

Employment protection legislation (EPL) is a key labour market institution. Over the past decades, demand for knowledge and advice on the role of EPL and on setting its level has grown in the global context of heightened competition, pressure for greater labour market flexibility, and especially the jobs crisis of 2008-2015. Indeed, many countries have adopted reforms of EPL in the hopes of boosting employment creation and reducing unemployment, especially amongst most vulnerable groups.

While the role of employment protection legislation has been studied in various contexts, EPL remains one of the most controversial labour market institutions, with some arguing that it deters employment creation and others arguing that it

contributes to labour market stability, training and productivity growth (for an overview of the debate see Betcherman, 2012; 2014). Problems with measuring EPL have added to the controversy. Various existing indices have been limited to a partial coverage of EPL aspects, or have been concerned only with developed countries.

Against this background, the ILO has recently launched a series of new indicators - Employment Protection Legislation Summary Indicators in the Area of Terminating Regular Contracts, Individual Dismissals, called *EPLex indicators* (ILO, 2015a). These indicators are based on the legal information collected by the ILO and contained in the ILO EPLex database<sup>2</sup>. They reflect legislation of around 95 jurisdictions, thus covering developed and developing countries, over 2009-2013. The key feature of these indicators is that the methodology for their coding is based on the relevant international labour standards, in particular ILO Termination of Employment Convention, 1982 (No. 158). This feature allows reducing the subjectivity bias in constructing these indicators, and ensures that they cover to the extent possible all areas of employment protection systems, beyond aspects such as severance pay. While these indicators, like many other indicators in this field, show the *de jure* level of protection afforded to workers by national labour laws on employment protection, they are also complemented by indicators of EPL coverage. This allows analysing how many workers are protected by the EPL regulations, and to what extent EPL systems are actually relevant. This policy brief presents an overview of some of the main findings.

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<sup>1</sup> This document was prepared by Mariya Aleksynska.

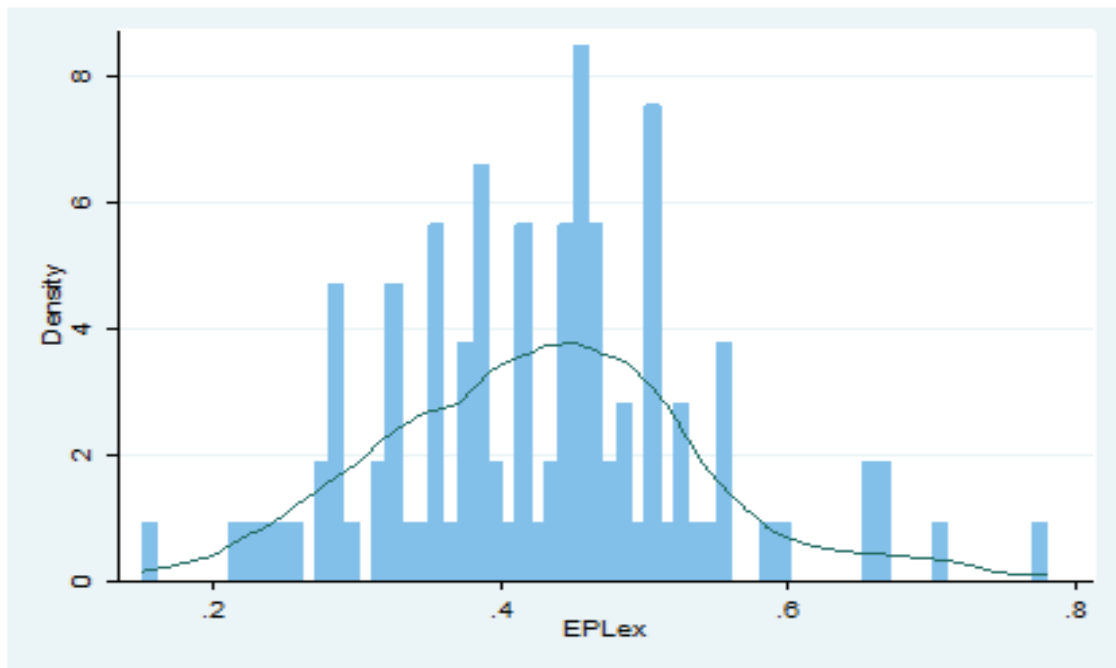
Helpful comments were kindly provided by Janine Berg, Angelika Muller, Sean Cooney and Steven Tobin.

<sup>2</sup> <http://www.ilo.org/dyn/epllex/termmain.home>

## 2. Level of Employment Protection throughout the World

The *ILO EPLex* indicator is a summary indicator of eight topical sub-components, each describing a particular aspect of worker termination at the initiative of an employer. These sub-components include: (1) valid grounds for dismissals, (2) prohibited grounds for dismissals, (3) probationary period, (4) procedural notification requirements for dismissals, (5) notice periods, (6) severance pay, (7) redundancy pay, and (8) avenues for redress when workers wish to contest the dismissal. These components and the composite indicator are distributed on a 0-1 scale, with higher values measuring higher levels of protection afforded to workers. Each component has a variation within this scale, reflecting different degrees of the level of protection. The *ILO EPLex* indicator is a simple average of its sub-components.

Figure 1. Distribution of the aggregate *EPLex* indicator around the world



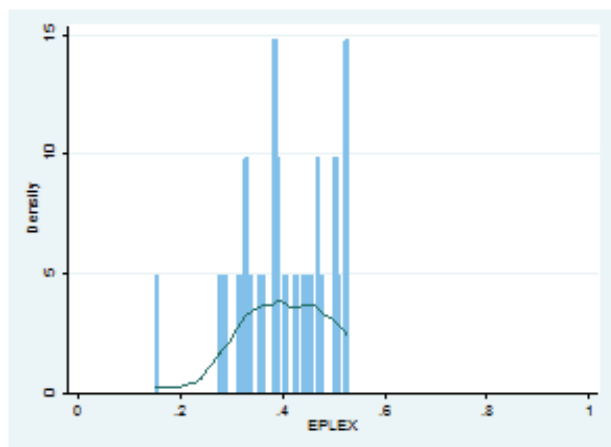
Source: ILO, 2015a.

Figure 1 shows the distribution of EPL regulations around the world, showing their substantial diversity across countries. Almost every country has its unique score of EPL level, and the majority of countries are found in the mid-range of protection levels. Figure 2 further confirms that there is a significant variation in the overall *EPLex* score both across and within regions. In Europe, while there is a wide array of possible scores, there are also quite a few countries with a relatively similar overall score in the mid-range of the distribution. At the same time, Europe's *EPLex* distribution, based on the largest number of countries, also exhibits the highest variability. *EPLex* score ranges from low levels for Georgia (before the 2013 reform of the Labour Code), Switzerland, and Finland, to high levels in Slovakia and Portugal. Comparable variability of the *EPLex* distribution

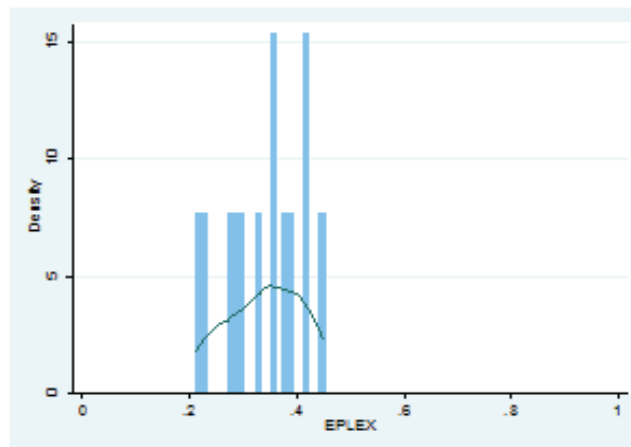
can also be observed in Asia, and, to a certain extent, Africa. In Asia, the highest levels of the *EPLex* score are observed in Indonesia and the Islamic Republic of Iran; the lowest levels are in Singapore and Malaysia. In Africa, the lowest score is in Nigeria, and the highest is in Egypt. Variability within Africa could also be explained in part by the variety of legal traditions involved, which is certainly less true of Latin America, and largely not of Asia, either. In the Americas, the overall *EPLex* score is most homogeneous. These variations in EPL suggest that much is still to be learned from including countries from different regions, with different legal traditions, and different levels of development into studies of the effects of EPL on various labour market outcomes, as well as in the overall debate on the role of legal origins. In this first release, *EPLex* indicators cover only 4 years of data, between

Figure 2. Distributions of *EPLex*, regional disparities, 2010

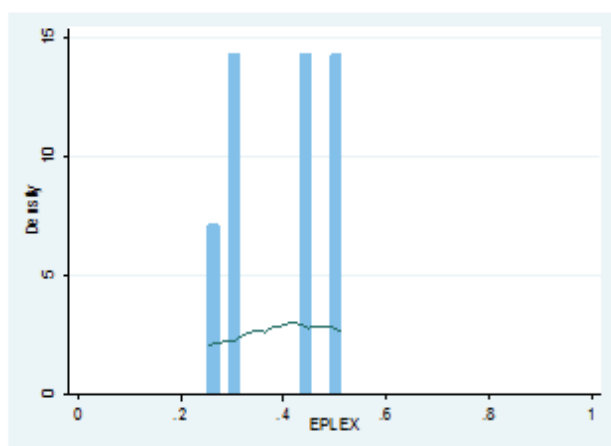
Africa



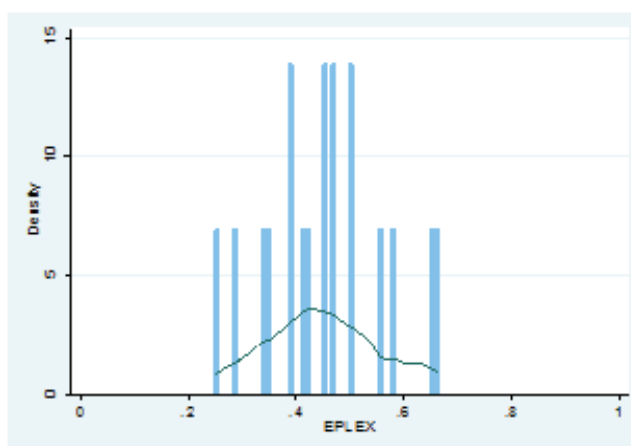
Americas



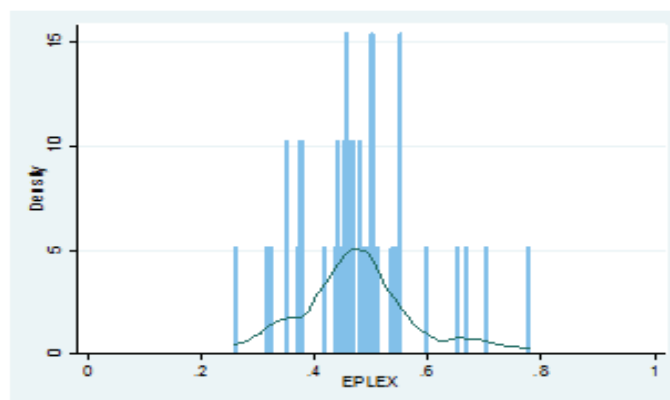
Arab States



Asia



Europe



Note: Definitions of regions follow the ILO regional cut. Source: ILO, 2015a.

2009 and 2013. Despite its relatively short span, this period was quite rich in the number of EPL reforms that countries undertook. The composite *EPLex* indicator allows tracking the EPL evolution over time, as well as understanding the nature and the timing of the reforms. Figure 3 tracks how these changes affected the overall *EPLex* score for some countries, including into the selection those countries in which reforms were undertaken either in response to the economic crisis, or as a reflection of longer-term political, social, and legal processes. The former countries include Greece (for white-collar workers), Slovakia, and Spain, where the EPL score was decreased as a result of reforms, though to a different degree. The latter include the Netherlands and the UK with a decreasing score, and Montenegro with a substantially rising score. The ILO (2015a) report and the ILO *EPLex* database allow tracking precisely the reforms of which EPL areas took place, thus allowing also for a nuanced impact and evaluation analysis of these reforms.

For meaningful comparisons of various *EPLex* components, it is also helpful to examine their median values (median values are less sensitive to outliers than means, and thus are a better descriptive statistic of skewed distributions). Figure 4 confirms that, generally, *EPLex* composite indicator's medians are relatively similar across regions, though the Americas' median *EPLex* value is the lowest. Some disparities, however, are exhibited in topical indicators: median scores for trial periods and severance/redundancy pay are the highest in the Arab States, median scores for prohibited grounds and notification requirements are the highest in Europe, while median scores for procedural requirements are the highest in Asia. In the Arab States, valid grounds get the lowest scores as compared to other parts of the world. In the Americas, the lowest scores on severance and redundancy are observed. African *EPLex* scores are found in the mid-range for all components.

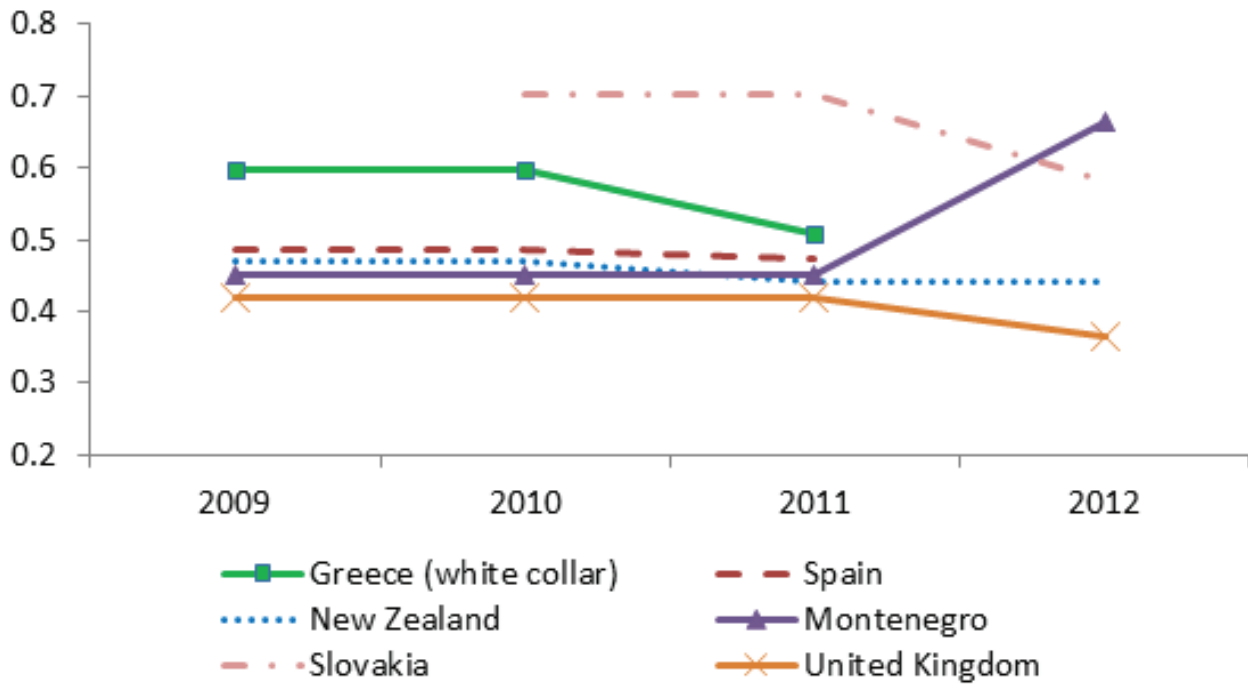
In Figure 5, countries are grouped by income level, using the World Bank classification. Valid grounds, trial periods, and procedural requirements exhibit the same medians across all income groups. In contrast, regulation of prohibited grounds is the area that has clearly the highest score in high-income countries,

while severance pay score is higher in low-income and lower-middle income countries. The latter observation most likely reflects how in lower-income countries unemployment benefit schemes are less developed, and worker protection is primarily achieved through payments by an employer at the time of separation. The biggest variation can be observed in the regulation of redundancy pay.

It is also instructive to look at the interrelationships between various *EPLex* sub-components, or pillars of the EPL system. Table 1 summarizes simple correlations between topical sub-components that constitute the aggregate *EPLex* indicator. Each component correlates well with the aggregate *EPLex* indicator. In contrast, with the exception of severance pay and redundancy pay, correlations between the components are low, and in some cases almost inexistent. This suggests that each component is important in its own right and measures a different aspect of EPL. Being a system, employment protection legislation rests on each of its pillars, and leaving one of the pillars aside from an EPL analysis may result in a loss of comprehensiveness.

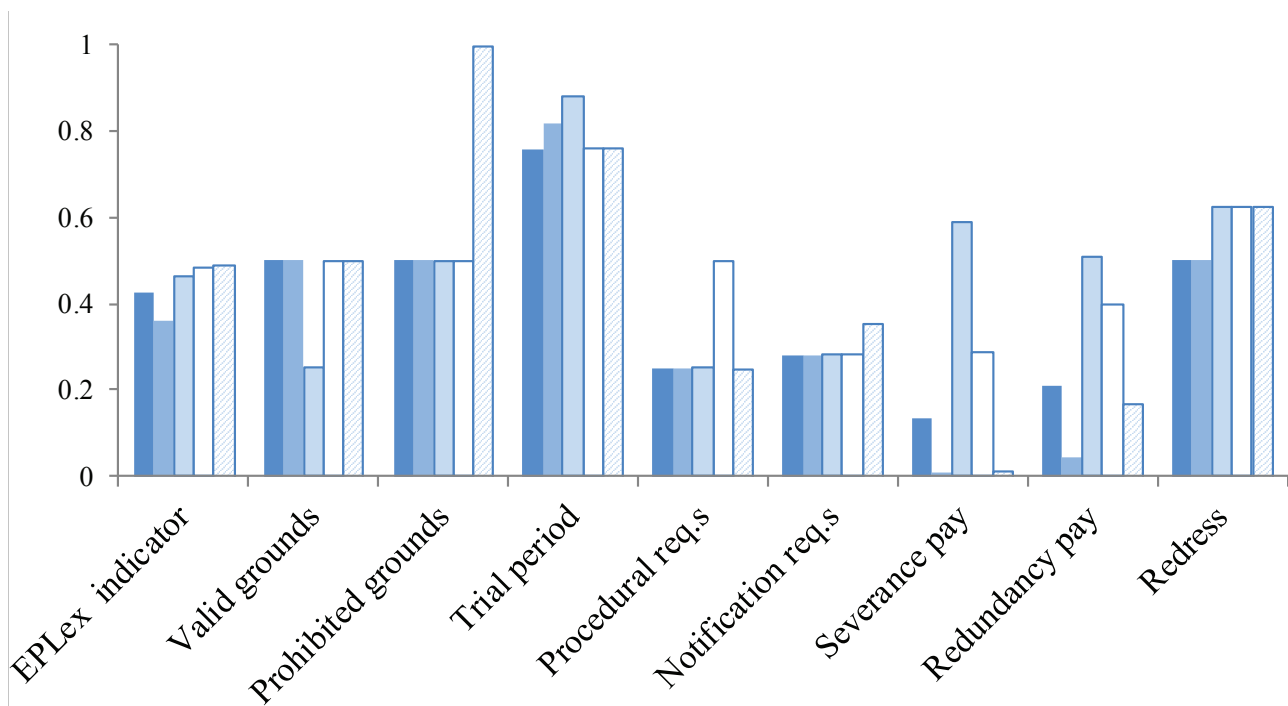
Several negative correlations can also be observed. They suggest that countries rarely design their employment protection systems in a way to excessively or moderately regulate all EPL aspects. Rather, different EPL areas represent trade-offs. More protective regulations of some of the EPL aspects are often compensated by less protective regulations of other aspects. Such trade-offs, which may or may not be intentional, are apparent in regulating notice requirements (notice periods) versus severance or redundancy pay, for example. This finding suggests that the same, or similar, overall *EPLex* scores can be reached through a combination of different policy packages. The choice of the package depends on historical and societal preferences or developments of each country. It is based on national practice and reflects country-specific differences in regulating employment relations. In fact, this outcome also reflects the principle of the ILO Employment Termination Convention, 1982 (No. 158) which affords considerable flexibility in applying the instrument by leaving the ratifying States the choice between different methods of implementation. Given this, policy advice for reforms should always consider all of the different aspects of EPL provisions jointly.

Figure 3. Evolution of the *EPLex* indicator in some selected countries



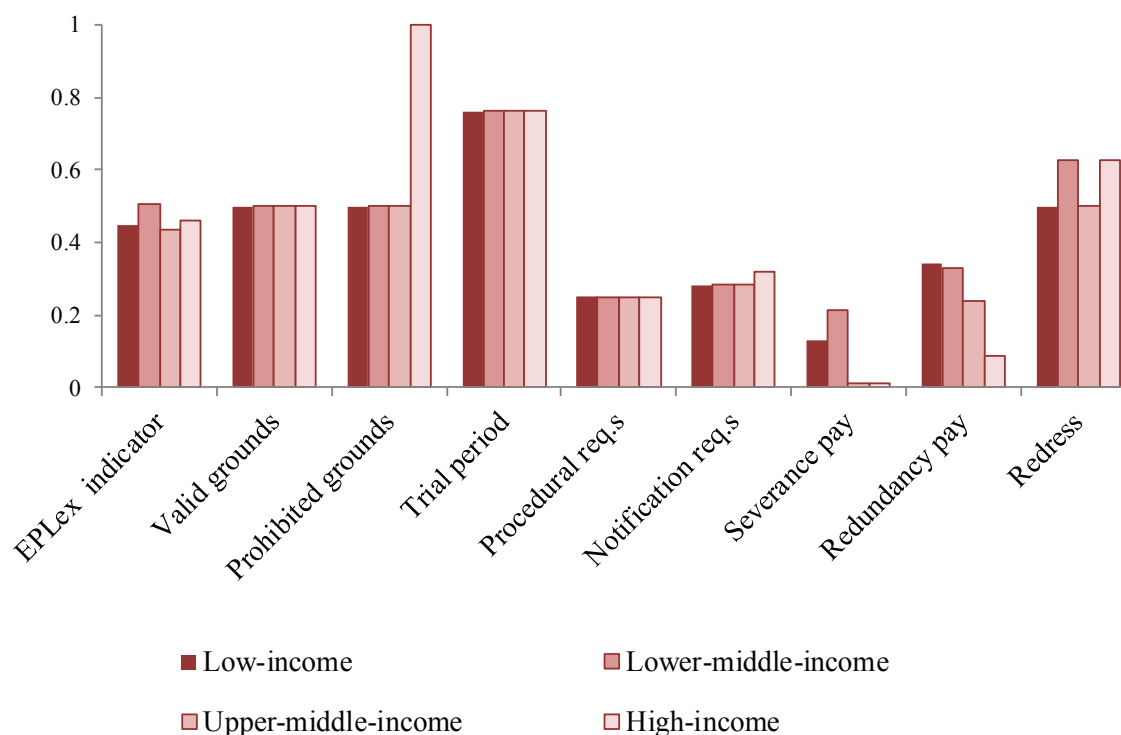
Source: ILO, 2015a.

Figure 4. *EPLex* Summary indicator and its components: Medians by region



Source: ILO, 2015a.

Figure 5. *EPLex* summary indicator and its components: Medians by income group



Source: ILO, 2015a.

### 3. EPL: from Levels to Coverage

A common assumption of studies on the macroeconomic impact of EPL is that EPL applies to the whole labour market. Although some authors do warn that labour markets differ from other markets because different rules may govern employment of different workers (Boeri, 2011), this issue remains largely out of the scope of the analysis. Indeed, the vast majority of studies assume that the existing measures of EPL apply to all workers, or generalize the rules that apply to a “typical” worker to the whole workforce. In addition, many indicators have the shortcoming of only accounting for the legal dimension of this institution, such as the level of protection afforded to workers, and not considering enforcement or coverage issues which are also essential for understanding the effect of labour regulations (Bertola et al., 2000). The new *EPLex* indicators share the common limitation of considering only de jure levels of protection, although, wherever possible, two *EPLex* indicators per country are computed, to reflect different rules that apply to different workers (ILO, 2015a). To overcome this limitation, *EPLex* indicators are also being complemented by indicators of EPL coverage, collected by Aleksynska and

Eberlein (2016). There is also an on-going work to create enforcement indicators, a concept that is difficult to measure systematically. Coverage, enforcement, and levels of protection afforded by EPL are the three pillars that allow for a comprehensive understanding of a real functioning of this institution.

Legal coverage defines those categories of workers and firms that are concerned by the provisions. Coverage indicators are constructed by collecting data from labour force surveys and other relevant micro data on all those workers and firms that are formally, by law, excluded from the scope of EPL provisions. The number of excluded workers is summed up, and then subtracted from the number of all employees and of all employed, to obtain coverage indicators. Newly collected data confirm the suspicion that coverage varies substantially across countries. In some countries, legal coverage of employees by the general EPL regime is complete (i.e., Armenia or Romania), while in others it is relatively low (i.e., Turkey, which excludes domestic workers, agricultural workers, managers/executives, some other worker categories, but also enterprises with less than 30 workers from general EPL provisions). Countries that contain too many

**Table 1. Correlations between EPLex components, all years and countries**

	EPLex	Valid grounds	Prohibited grounds	Trial period	Procedural requirements	Notification requirements	Severance pay	Redundancy pay	Redress
EPLex	1.00								
Valid grounds	0.47	1.00							
Prohibited grounds	0.25	-0.09	1.00						
Trial period	0.56	0.34	-0.01	1.00					
Procedural requirements	0.51	0.12	0.02	0.20	1.00				
Notification requirements	0.14	-0.04	0.09	0.16	0.01	1.00			
Severance pay	0.29	-0.05	-0.21	0.04	0.05	-0.08	1.00		
Redundancy pay	0.34	0.16	-0.24	0.04	0.16	-0.11	0.65	1.00	
Redress	0.65	0.15	0.07	0.09	0.24	-0.16	0.05	0.06	1.00

Source: ILO, 2015a.

exclusions may be artificially creating labour market segments, in which some workers are protected against dismissals, while others are not. Naturally, because by definition EPL only applies to workers who are in subordinate employment relationship (wage employees), and does not apply to self-employed, EPL coverage for employees is always higher than EPL coverage of all employed. In developed countries, where wage employment represents a large share of total employment, EPL coverage of employed is close to that of employees, and both tend to be very high, ranging from 90 to 100%. In lower-income developing countries, however, where wage employment remains limited, EPL concerns only a very small portion of all employed, being less than 5% in a country like Niger (see Figure 6 for 95 countries, and Figure 7 for a sub-sample of G-20 countries). Given this, studies looking at the macroeconomic effects of EPL level and not accounting for EPL coverage are likely overestimating the role of this institution.

The reported numbers provide measures of *legal* coverage of workers, in other words, they show the proportion of workers that at least in principle can be covered by EPL.

In many countries of the world, however, numerous employees are engaged in non-standard employment relationships, such as casual work. For example, in Mali or Kenya, casual employees represent over 30 % of all employees (ILO, 2015b). These workers are de facto excluded from EPL provisions. In other countries, such as Guatemala, Morocco, or Cameroun, over 60% of workers do not have written contracts (ibid), making it difficult for them to claim any EPL entitlements even if the law in principle provides for them. Thus, the *effective* EPL coverage would be even lower in these countries, depressing the aggregate role of EPL even further.

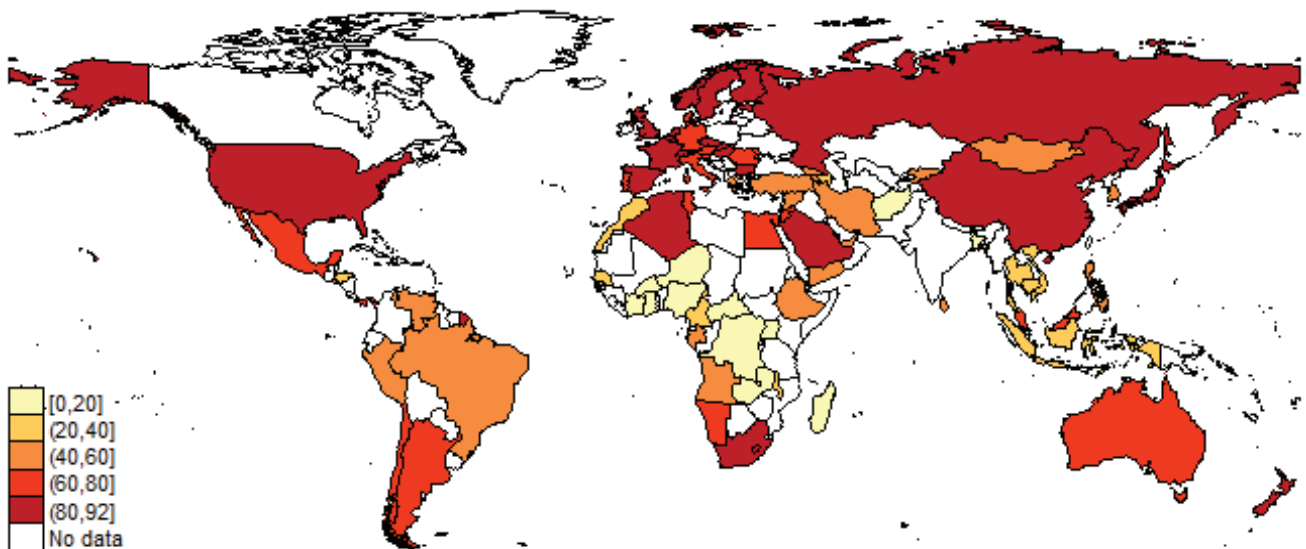
Coverage of employment protection is a specific aspect of this institution, determining, together with the level of protection afforded by the institution, the degree to which this institution actually matters. Some observers, however, may be concerned that coverage and level of protection should necessarily embed trade-offs. They may worry that high levels of protection cannot be afforded to all, while relatively low levels of protection can be granted to a larger group of workers more easily. To touch-base on this issue,

Figure 8 plots the *EPLex* aggregate indicators against legal coverage of all employed for the full sample of countries. It shows that the correlation between EPL levels, as measured by *EPLex* indicator, and EPL coverage, if anything, is positive. This result suggests that rather than being a substitute for the degree of protection, legal coverage represents yet another pillar of the employment protection legislation that co-exists with the protection's level. Because correlation between EPL level and coverage is non-negligible (0.19), failure to account for EPL coverage in studies looking at aggregate effects of EPL level may lead to omitted variable bias. As shown in Aleksynska and Eberlein (2016), this bias may be especially important for lower-income countries. Conversely, extending results of empirical findings on the role of EPL based on developed-countries samples to developing countries should be done with great caution.

#### 4. Concluding remarks

Employment protection legislation is one of the most controversial labour market institutions. It is a system of norms and procedures regulating dismissals, the comprehensiveness of which is not always properly reflected in quantitative measures. Much is yet to be understood about the functioning of this system, both in developing and developed countries. While much of the past and on-going debates focus on the role of EPL levels of protection, especially those afforded by specific EPL components such as severance pay, it is time to start shifting the debate to a more nuanced understanding of EPL, ensuring that all EPL pillars are considered in a meaningful way and are functioning effectively. It is equally important to ensure that not only the EPL level is set appropriately, but also that an EPL system is an inclusive and a relevant institution for as many workers as possible.

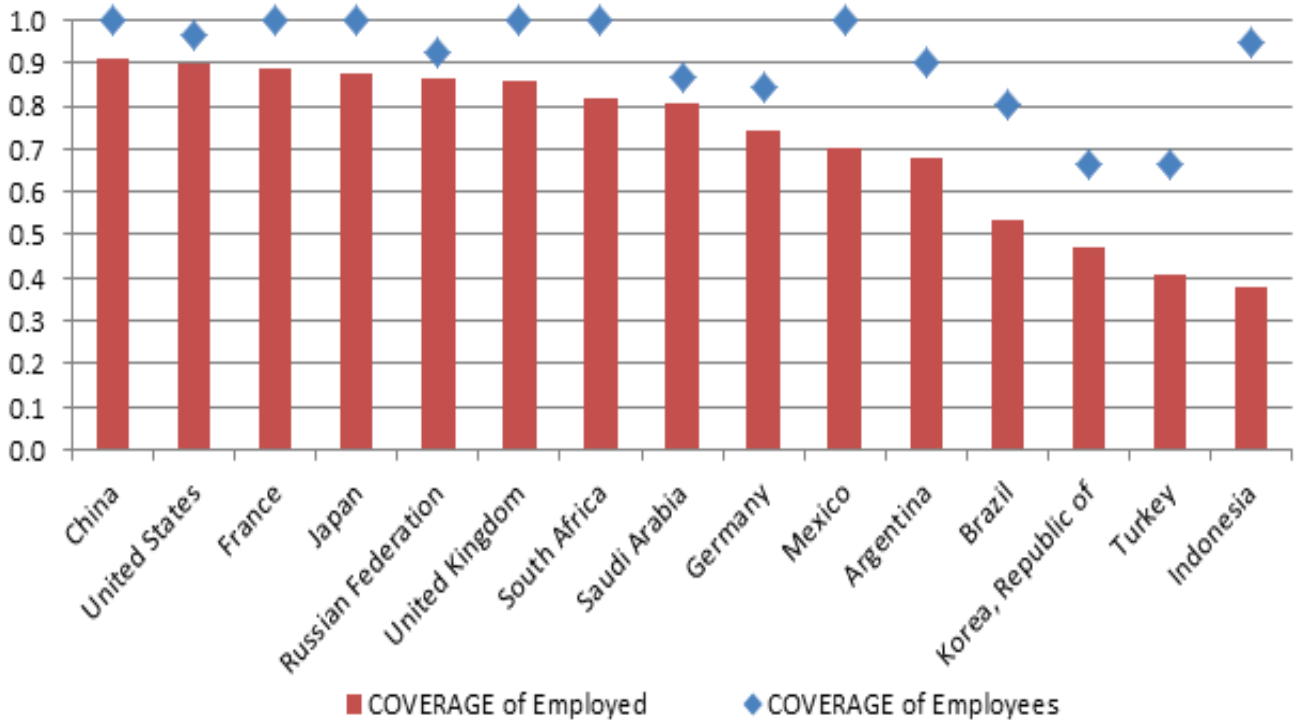
Figure 6. World map of EPL legal coverage of all employed, 2010



Source: Aleksynska and Eberlein, 2016.

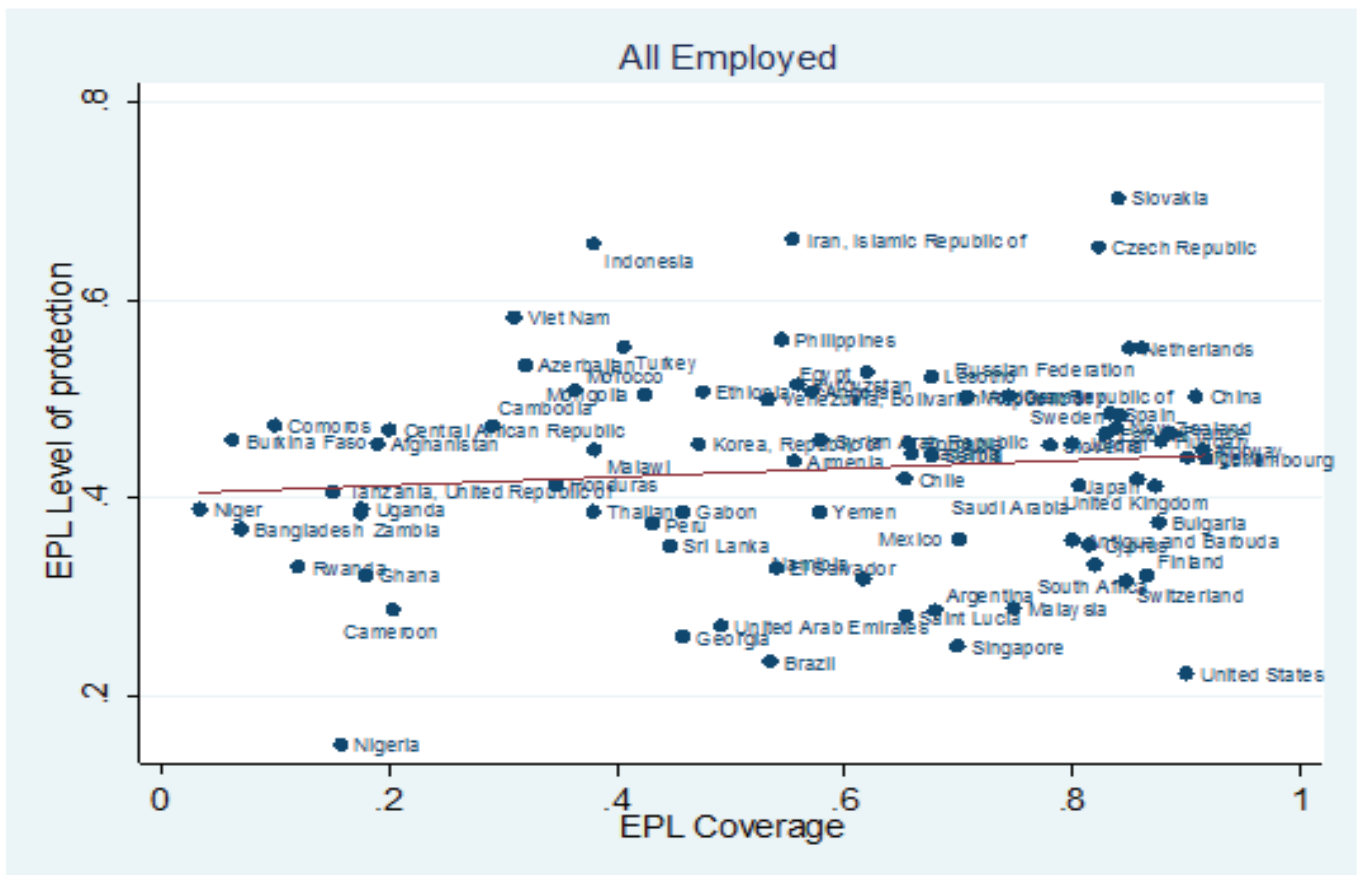


Figure 7. Some country-specific examples of legal coverage (Countries of G-20 sub-sample)



Source: Aleksynska and Eberlein, 2016.

Figure 8. EPL level and coverage: Are there trade-offs?



Source: Aleksynska and Eberlein, 2016.



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