



LABOUR RELATIONS AND MODES OF EMPLOYMENT

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Abstract

An important component of the NEUJOBS project is its interaction with the policy community. The project is pursuing several avenues to ensure its results are properly “translated” and communicated to such audiences. One of them are policy briefs. This Policy Brief contains policy implications on labour relations and modes of employment (Work Package 6), a collaborative EU-funded research project.



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Introduction

In many European and other Western countries, labour markets will continue to be reformed in order to accommodate further adjustments to economic, demographic and socio-ecological developments. Moreover, labour market institutions and other aspects of labour markets receive a lot of attention in EU policy debates because they are regarded as key factors of innovation and economic growth. Indeed, our estimates indicate that generous unemployment benefit systems and stringent employment protection legislation lead to lower innovation intensity. These results suggest that high firing costs discourages investment in innovative activities. Interestingly, our case studies reveal that in Central and Eastern European countries institutions such as employment protection legislation and unemployment benefits appeared relatively unimportant to attracting large-scale inward investors. Instead, the lower wage level than in Western Europe appears to be a key factor, alongside the availability of large numbers of semi-skilled workers.

In Work Package 6, we analyze the relationship between labour market institutions and innovation. Furthermore, we examine how EU countries pursue labour market policy reforms, focusing on the key policies of the *flexicurity* model. Finally, we assess the relative importance of labour market institutions in transitions on the labour market.

The existing research on labour market institutions has been mainly focused on either West European countries or Central and East European countries. In the present study, we examine to what extent our findings apply to both old and new member states of the European Union. Therefore, we start with an overview of the labour market models in Central and Eastern Europe.

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In this part of our NEUJOBS research we:

- map existing labour market models.
- analyze the political economy of labour market models.
- analyze the impact of labour market models on innovation and adoption of new technologies.
- analyze the outcomes of labour market models by a variety of socio-economic indicators

Evidence, Analysis and Policy Implications

Labour market institutions in Western and Eastern European countries

First, the project provides a comparative mapping of labour market institutions in Central and East European countries, including laws and rules, the nature and extent of collective bargaining and other factors likely to provide incentives or disincentives to work. Subsequently, the project examines the sources of variation across West and East European countries and over time. Building on the political economy literature, hypotheses are tested on the role of partisan politics, employment relations and employment protection legislation and active labour market policies in unemployment benefit reform. These factors have been extensively studied in the political economy literature, but hardly for Central and Eastern European countries, because of a lack of data. The project employs pooled time series cross-section regressions to analyze newly constructed indicators for Western and Central and Eastern European countries.

Main results:

- There are broad similarities between Central and East European countries and other EU countries in terms of legal protection of employment, generally weaker evidence of protection by collective bargaining or trade union representation and evidence of somewhat tighter, and progressively tightening, conditions for receipt of unemployment benefits.
- Between 1990 and 2009, unemployment benefit levels have converged to some extent across European countries and other affluent democracies. This trend is relatively strong for Central and East European countries.

¹ The output of the study includes several deliverables: a comparative mapping of labour market institutions in Central and East European Countries; a longitudinal dataset on the generosity of unemployment benefits for 34 welfare states for the period 1971-2009; a panel data study on the relationship between employment protection legislation and innovation across countries and sectors; a comparative case study on the link between labour market institutions and innovation; and a multilevel analysis on the relationship between labour market institutions and labour market transitions.

- Left-wing governments have a positive impact on the generosity of unemployment benefit schemes. However, this effect depends on the economic situation. In periods of high unemployment and fiscal pressure, left-wing parties cut unemployment benefits. This effect is comparable across Western and Central and Eastern countries.
- Coordinated bargaining by strong and centrally organized labour unions has a positive impact on unemployment benefit generosity. This result has been found for both Western and Central and Eastern European countries. This is interesting, because the mapping suggests that social partners are less effective in influencing policy reforms in Central and Eastern than in Western Europe.
- In line with the flexicurity concept, the results indicate that more flexibility on the labour market is compensated with more generous unemployment benefits. In contrast, active labour market policies seem not to play a role in flexicurity reforms.

Policy implications

- *The political colour of national governments and the socio-economic situation matter in welfare state reforms. This is important for the implementation of EU-level labour market models such as flexicurity, which is an important pillar of the European Employment Strategy and the Europe 2020 strategy. Due to the national political and socio-economic situation, welfare state reforms might follow other paths than planned in the EU strategy.*
- Reforms of unemployment benefits and employment protection legislation are often politically difficult reforms. Because of – among other reasons - these political difficulties, it was proposed in the *flexicurity strategy* to *compensate employees with active labour market policies*. The results of our study suggest that *this type of compensation is not effective* in terms of fostering reforms of labour market institutions.

Labour market institutions and innovation

Employment Protection and Innovation Intensity

This research examines the relationship between the strictness of employment protection legislation (EPL) and innovation performance in a sample of OECD countries over the period 1990-1999. Modern economic theory has identified innovation as a major driver of economic growth. While there is a well-established literature on the effects of institutions on economic growth, there is little evidence about the effects of labour market institutions and labour market reforms on innovation. From a policy perspective, innovation is essential for sustainable economic growth and maintaining high living standards in advanced economies in the context of increased global competition and ageing population. Innovation is at the heart of *Europe 2020*, the European's strategy for smart, sustainable and inclusive economic growth. In the context of increased pressure on resources and the need for a more

sustainable economic growth, innovation can deliver a more resource efficient, greener and more competitive economy.

Market and systemic failures in the innovation process could lead to under-investment in innovation. To the extent that increasing innovation intensity is a desirable policy objective, there is a role for governments to improve framework conditions, including labour market institutions, that incentivise and enable investment in innovation.

This analysis provides empirical evidence to inform the design of economic policies on the role of labour market institutions and labour market reforms on innovation performance.

In theory, the effects of labour market institutions such as employment protection legislation on innovation are ambiguous. On one hand, a strong employment protection increases job security and incentivises employees to invest in firm-specific human capital and to engage in innovation activities. On the other hand, high hiring and firing costs increase the adjustment cost firms face when they need to adjust to idiosyncratic shocks and thus they discourage firms from innovating. Empirical analysis is key to distinguish which effect dominates overall.

Main results:

- Empirical estimates indicate that stricter employment protection legislation led to lower innovation intensity in industries with a higher job reallocation (layoff) propensity. In industries with higher job reallocation rates, the strictness of employment regulations on the use of temporary contracts had a stronger negative impact on innovation intensity than the strictness of employment protection for regular contracts.
- Over and above the effects of EPL on innovation intensity, the extent and duration of unemployment benefits led to lower innovation intensity in industries with a higher job reallocation propensity, while higher co-ordination and higher centralization of wage setting led to higher innovation intensity in the same group of industries.
- These findings are robust to sensitivity checks including additional covariates and alternative measures of employment protection and industry layoff propensity. Furthermore, our sensitivity analysis indicates that these findings were not driven by any country included in our sample.

Policy implications

- To the extent that fostering efficiency is a desirable policy objective, *targeted labour market deregulation* in industries with a high propensity to adjust to industry-specific technological and market driven factors through job reallocation or layoffs, *could foster innovation*.
- Labour market reforms *are likely to affect innovation performance significantly in the long-run*. Policy choices often imply trade-offs which should be carefully considered in strategy and policy development. *Any undesired effects of policies*

designed to improve the flexibility of labour markets should be addressed by appropriate social protection measures including income support and active labour market policies.

Case studies of automotive and software industries

Subsequently, the project examined whether labour regimes could help explain the apparently low levels of innovation in CEECs based on a comparative case study approach. The research focused on two different sectors, motor vehicles, in which the introduction of new technology was largely a matter of importing production processes by multinational companies, and software companies which, in the field of anti-virus technology, have proved capable of establishing themselves on the world stage. Labour regimes could be important for the technological advances that have taken place and could be a barrier to progression to a higher level.

Main results:

- The innovation process depends on a number of factors and labour-related issues are only one part of that picture. People with adequate qualifications clearly need to be present, but innovation also requires a process of development that is supported by past experiences, by availability of finance, by access to networks and more besides.
- In these cases, institutions such as employment protection legislation and unemployment benefits appeared relatively unimportant to attracting large-scale inward investors. The key factors here were the lower wage level than in western Europe, alongside the availability of large numbers of semi-skilled workers. Skill levels did not present a barrier that firms could not overcome relatively simply. In the automotive sector, bargaining with trade unions was necessary as they had a strong presence in these workplaces and managements needed agreement on work organization.
- Legal frameworks are important to achieve production flexibility, meaning the ability to respond to frequent variations in demand for particular products. Elements of dualism are common, including the use of fixed-term contracts and agency workers, mostly from other countries. Thus CEECs remain attractive due to the scope under existing laws to find an adequately large labour force with the required degree of flexibility. At the same time, companies have complained of the need for governments to do more to make it possible to recruit and use immigrant labour. In the automotive sector, their pay is frequently considerably lower than for indigenous workers.
- Motor vehicle companies do not bring high-level research into CEECs. The best that exists has developed from pre-1989 bases. Transferring high-level research would require transferring the necessary personnel. It therefore exists where it existed before with only incremental changes.
- Subsequently successful anti-virus companies developed in Slovakia and the Czech Republic in the 1990s, benefited from indigenous expertise and a degree of market protection. Their subsequent internationalization depends on bringing in additional expertise from outside those countries and on retaining and developing

the domestic skill base. Sufficient supply of adequately qualified labour can represent a barrier to further expansion. A key issue is the ability to recruit from outside the CEE region and to improve education systems to better serve the needs of labor markets.

- The respective governments including labour market institutions played a marginal role in this process, which took place without their direct support or intervention, and in spite of weaknesses in the legal and business environment and other barriers. This finding, together with the positive impact of the absence of foreign capital entry into the sector during the 1990s, is in stark contrast to the prevalent understanding of the key positive factors affecting the pathways of Central Europe's transition and integration into world markets.

Policy implications

- Across the technologies relevant for CEECs, existing *employment laws and regulations have not created significant barriers either to the inflow of new technology* or to indigenous innovation activity. Firms are able to find means to cope with apparent constraints from employment regulations and to achieve desired levels of flexibility such that CEECs have become attractive locations for continued investment by multinational companies and possible locations for some domestic innovation. However, in practical terms, overcoming particular gaps in highly-skilled areas and ensuring an adequate supply of less-skilled labour depends on the ease of immigration and the attractiveness of the location to highly-skilled workers from around the world.
- Methods of achieving flexibility by creating two categories of employees, a stable core and a flexible periphery, have proved acceptable to domestic labour forces and their representatives. However, they imply a degree of *instability and uncertainty for peripheral labour forces*, that carries a social cost and arguably discourages skill acquisition. Other means of achieving flexibility, including flexible work accounts for permanent employees, appear to spread costs more evenly across labour forces. Moves towards overcoming dualism in labour forces are dependent on legislation permitting flexibility in working hours of permanent employees and also on the genuineness of commitments from both employers and trade unions to providing opportunities to previously marginalized employees.
- The availability of highly-qualified labour has clearly not been an obstacle to development that has taken place, but it remains one possible barrier to development to a higher level. *Education systems should be institutionally adjusted* to provide skills needed at the labour market and of better quality, and enable *a closer interaction with the employers* with innovative capacity which seem to rely extensively on graduate labour market in their recruitment strategies.
- In the globalized economies, skill set conducive to innovation consists not only of technical skills but equally *requires a set of non-technical skills* and qualities which include management and team leadership and a set of soft skills and personal qualities. Training should therefore go beyond transposition of technical knowledge and offer a wider set of general and transferable skills.

- *Immigration* appears as an issue both for semi-skilled and for highly-skilled labour. In both cases the issue goes beyond employment law alone, including broader conditions for attracting new citizens and enabling them to feel comfortable. *Long-term success would seem to depend on the range of social policy measures* that would make younger professionals and younger manual workers willing to choose these countries as places of residence.

Labour institutions and labour market transitions

Labour market models vary considerably within the European Union. The project investigates to what extent these differences affect the labour market transitions of individuals of different age groups. The analyses focus on three different aspects of labour market institutions, namely Unemployment Replacement Rates (URR), Employment Protection Legislation (EPL), and Labour Market Policies (LPMs, both active and passive). In this study it is analyzed whether these labour market institutions influence some of the central work related transitions. The following transitions are distinguished: (1) from education to employment, (2) from employment to education, (3) from employment to unemployment, (4) from unemployment to employment, (5) from employment to employment, (6) from employment to retirement, (7) from retirement to employment. The central idea of the study is that labour market institutions can produce intended and unintended results. Intended results include outcomes as may be expected and unintended consequences counter expected policy outcomes. In that respect, Unemployment Replacement Rates, and Employment Protection may contribute to labour market stability (e.g. having a negative impact on the labour market transitions of individuals), while Labour Market Policies increase the likelihood of employment transitions. Multilevel models are constructed to investigate whether national level labour market institutions affect labour market transitions at the individual level. Each of the distinguished employment transitions, multilevel models are investigated aimed at establishing their relationship with labour market institutions.

Main results:

- The outcomes of these analyses are mixed as both intended and unintended consequences are found. For example, that strictness of employment protection is associated with more transitions between employment and unemployment suggests that employees and employers adapt to the institutional environment.
- Furthermore, based on the multilevel results it can be concluded that the institutional arrangements do not always lead to the intended result, indicating that it is not a simple job to influence labour market transitions with public policies.

Policy implication:

The interaction between different labour-market policy instruments is an important factor in policy reforms. Our findings underscore that it may be difficult for policy

makers to influence the labour market behaviour of individuals. On the one hand, intended outcomes are not always reached and on the other hand the application of one kind of public policy to affect certain kinds of labour market transitions can have consequences in other domains. Therefore, the general policy implication that follows is that policy makers have to carefully specify what the aim of a policy is, monitor its intended effects while also be aware of the possibility that unintended effects can occur. Policy researchers can support this process by providing as much information as possible about the functioning of these public policies.

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