Chapter 4
The Labor Market Regulation

Samir Amine
Université du Québec en Outaouais, Canada

ABSTRACT

This article aims to provide an analytical and critical reading of the state of knowledge on legislation relating to employment protection (EPL) and its impacts on unemployment, jobs creation, productivity and more generally efficiency of the labor market. We show that the construction of indicators of EPL adopted by the OECD is incomplete and does not take into account local specificities of each labor market. We also show that the dominant idea among liberals that any regulations impeding freedom of the labor market generates unemployment and loss of effectiveness is not so obvious to verify empirically and can even be contradicted. In this analysis, we rely on a critical review of theoretical and empirical studies which have examined the effects of EPL. We also discuss some alternatives such as bonus-malus system or the single contract that have been put forward to address the limitations of a relatively strict EPL.

INTRODUCTION

Persistent unemployment and rising wage differences at the expense of low-skilled workers characterize the labor market in most Western countries, particularly those in Europe. These, with the exception of England, are deemed to be rigid in terms of public policies considered generous for workers and binding for firms.

Moreover, since the last financial crisis in 2008, countries such as France, noted the difficulty of their institutions to quickly adapt to changes caused by the economic situation. In this sense, some studies have pointed out that a dual labor market, where the insiders are protected from much larger job than outsiders would generate negative externalities on job creation (Kirat, 2006). Thus, under the recommendations of the Organisation for Economic Co-operation and Development (OECD), more rigid economies have started a process of reforms aimed at increasing the flexibility of the labor market and reducing persistent inequalities, so questioning the rigid nature of the employment protection legislation (EPL).

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adopted by the OECD is incomplete and does not take into account local specificities of each labor market. We also show that the dominant idea among liberals that any regulations impeding freedom of the labor market generates unemployment and loss of effectiveness is not so obvious to verify empirically and can even be contradicted. In this analysis, we rely on a critical review of theoretical and empirical studies which have examined the effects of EPL. We also discuss some alternatives such as bonus-malus system or the single contract that have been put forward to address the limitations of a relatively strict EPL.

MAIN FOCUS OF THE CHAPTER

Indicators of EPL According to the OECD

The OECD EPL covers all legislative provisions that impose costs on employers when they wish to make labor adjustments (Organisation for Economic Co-operation and Development [OECD], 2013). These provisions are grouped into three categories. There is at first, the rules governing the protection of regular workers in the event of individual dismissals. This component is divided into sub-categories: procedural constraints, notice period, indemnity for the individual dismissals without fault, and difficulty dismissing. So, to be able to assess the rigor of this component, the OECD study including provisions on notification procedures, the duration of the notice period and the definition of a justified or unfair dismissal (Organisation for Economic Co-operation and Development [OECD], 2014).

Then, the second component is the regulation of temporary contracts (OECD, 2014). The latter is divided into two categories: fixed-term contracts and temporary contracts. For this category, OECD estimates, for example, the maximum number of successive fixed-term contracts that can make a firm and the types of jobs that temporary contracts are allowed (OECD, 2014).

Finally, the third category represents obligations relating to collective redundancies. To evaluate this component, the OECD based its analysis in particular on the definition of collective redundancy, on the obligations additional notifications to individual dismissals and on the specific costs for the employer for this type of dismissal (OECD, 2014).

Each of these three components, with respective weights (5/12, 5/12, 2/12) in the composition of the synthetic indicator, allows assessing the rigor of an EPL for a country. From 21 criteria classified into the three categories mentioned above, the OECD built in 2013 a summary indicator of EPL for each member of the G20. This composite index ranges from zero to six. When a country is close to “zero”, it means that it has a slightly restrictive EPL when the score “six” lead a very strict EPL. By compiling data from the OECD, we get Figure 1 which represents the overall indicators for the different countries.

According to this analysis, we see that Canada is among the countries with low EPL. Moreover, its synthetic index of 0.97 is widely found below the average of OECD member countries (which is of the order of 2.2). We also find the United States close to the Canadian situation with an index of 0.82. In contrast, we note that the indicator of EPL in France amounting to 3.2 is significantly higher than that of Canada. This finding is not surprising since the French legislation on employment protection is highly protective and restrictive for firms wishing to conduct workforce adjustments. One of the lessons of this graph is that, in general, Europe has a much stricter EPL on dismissal and use of temporary contracts than in North America. In fact, the OECD (2013) class two groups of countries according to strictness of EPL: firstly, the common-law countries (including Canada) who have no rigor facing to temporary
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