The poor employment performance of European countries compared with that of the U.S. is often attributed to the strictness of employment protection in Europe. Many believe that differences in labour market regulations play an important role in explaining international differences in labour market outcomes. This argument clearly has strong implications for policy design. If tight rules governing employment protection are to be blamed for poor labour market performance, then conservative governments may reduce restraints on the ability of firms to hire and fire (by weakening trade unions and labour market regulations for example). This controversial proposition has generated a considerable literature and much debate. Theoretical models show that employment protection does tend to have a constraining effect on both layoffs and hirings, job creation and destruction, unemployment inflows and outflows, with the extent to which one effect dominates the other depending on the values of the parameters. It follows that the role played by employment protection in determining aggregate labour market outcomes is mainly an empirical question. However, the available empirical evidence on the relationship between employment protection and labour market performance is based on highly imperfect measures of the strictness of employment protection legislation (EPL).\(^1\) While considerable work – both theoretical and empirical – has been done on the subject, few studies have focused on how employment protection is measured. Previous research has circumvented measurement difficulties by using qualitative rankings of EPL stringency. But recent developments – notably ongoing reforms of employment protection in most countries and the expansion of non-standard forms of employment – have not only rendered existing information obsolete, they have also called into question the methodological basis of that empirical research.


\(^1\) For the purposes of this chapter, EPL is understood to refer to regulatory provisions that relate to “hiring and firing”, particularly those governing unfair dismissals, termination of employment for economic reasons, severance payments, minimum notice periods, administrative authorization for dismissal, and prior consultations with trade union and/or labour administration representatives.
While EPL rankings developed in the late 1980s are rather strongly correlated with employment stability in the 1980s, more recent evidence indicates that some innovative work is required to improve methods of measurement. What is needed is not only an update of EPL rankings to capture new legal provisions in the various countries, but also measures that reflect the increasing complexity of legal provisions in this area, their interactions and/or inconsistencies. Reforms of protective legislation have rarely addressed the whole set of relevant provisions but, more typically, only those applying to specific contractual types, e.g. by broadening the scope of some types of fixed-term contracts without reducing the protection afforded by contracts of unlimited duration. This increasing dualism of labour markets and institutional complexity (proliferation of different types of contract and ad hoc provisions) requires substantial revision of the methodology previously used to compute EPL rankings. Appropriate indicators should try to account not only for these various features of EPL, but also for their interactions – e.g. the fact that the increasing share of employment under fixed-term contract may also be a consequence of strict employment protection.

The purpose of this article is to highlight the need for new analytical and statistical tools for understanding and measuring labour market flexibility and performance. It opens with a short survey of existing theoretical and empirical work on the relationship between EPL and broad labour market performance indicators. It then illustrates some of the shortcomings of available measures of employment protection and suggests improvements, taking account of the increasing dualism of European labour markets (i.e. the existence of a large group of workers under fixed-term contracts alongside the protected segment of workers under regular contracts) and making better use of the limited available data on litigation and judicial decisions concerning individual dismissals. The strengths and weaknesses of existing measures are shown in the light of simple empirical evidence. The article concludes with reflections on how to move forward.

**Existing Evidence on the Effect of Employment Protection**

Measuring employment protection is a difficult task. Quantitative measures can be readily computed for some aspects like the number of months’ notice required for individual and collective redundancies. But other aspects are more difficult to measure precisely, such as the willingness of labour courts to entertain law suits filed by fired workers or judicial interpretation of the notion of “just cause” for termination.

Such problems have been circumvented in previous work by taking advantage of the fact that even partial and qualitative indicators of EPL provisions make it possible – when such indicators are positively correlated with each other – to produce qualitatively unambiguous cross-country rankings of EPL. Work along these lines has found that, in the late-1980s, countries mandating longer notice periods also tended to specify larger redundancy payments and more complex procedures for authorization and implementation of collective dismissals. Such measures were also consistent with survey assessment indicators of EPL stringency, especially those derived from the European Community’s 1985 survey of enterprises (see Emerson, 1988). Bertola (1990) used this evidence to draw up a ranked list of ten industrialized countries.