

## The Paradox of the Baltic States: Labour Market Flexibility but Protected Workers?

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Postprint / Postprint

Zeitschriftenartikel / journal article

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### Empfohlene Zitierung / Suggested Citation:

Eamets, R., & Masso, J. (2005). The Paradox of the Baltic States: Labour Market Flexibility but Protected Workers? *European Journal of Industrial Relations*, 11(1), 71-90. <https://doi.org/10.1177/0959680105050403>

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## **The Paradox of the Baltic States: Labour Market Flexibility but Protected Workers?**

**ABSTRACT** ■ This article assesses the strictness of employment protection legislation and its actual enforcement in the Baltic States. We use information from the applicable legislation as well as employer surveys, data on the coverage of labour legislation and the practice of law enforcement. Overall strictness is close to the average of EU countries and relatively well aligned with EU regulations; individual and collective dismissals are relatively heavily and temporary forms of employment relatively weakly regulated. However, effective flexibility is increased by problems of enforcement: there is much evidence of violations of statutory regulations at enterprise level. In addition, the proportion of the workforce actually covered by the regulations is relatively low. In the Baltic States temporary employment is more widespread, implying a higher level of flexibility than the EU average.

### **Introduction**

A key determinant of labour market flexibility is employment protection legislation (EPL). This includes protection against dismissals, limitations on temporary forms of employment, and more broadly regulation of working time and health and safety. Such regulations are viewed positively by those defined by Freeman (1993) as ‘institutionalists’, for whom EPL is necessary to offset the weak bargaining position of employees, protect against the risk of unemployment, moderate effects of down-swings in aggregate demand and enhance investments in human capital (and thus productivity growth). By contrast, ‘distortionists’ argue that EPL increases labour market dualism by favouring insiders, increases effective labour costs, discourages hiring and impedes adjustment to economic shocks.

In this article we estimate the strictness of EPL, and its actual enforcement, in the countries of Central and Eastern Europe (CEE) and more specifically the Baltic States. Under a centrally planned economy,

workers in CEE enjoyed a high degree of employment protection (Kuddo, 1995). Together with high wage compression this led to extreme labour market rigidity and inefficiency. In the 1990s, rapid structural adjustment in the transition economies was reflected in drastic amendments to national EPL. This was particularly significant because trade unions — an alternative mechanism of employment regulation — are weak and often absent in many CEE enterprises.

The Baltic States form a special regional cluster. They have made remarkable progress in restructuring the economy, reorienting to new markets and reallocating resources to new sectors. We thus investigate how far this has been enabled by labour flexibility, and to what extent labour market regulation accords with EU norms. Several studies have reported very high labour market flexibility in the Baltic States, particularly in Estonia (Eamets et al., 2003; Haltiwanger and Vodopivec, 1999; Juraida and Terrell, 2001; Paas et al., 2003). One of our tasks is to investigate how workers are actually protected in this very flexible framework.

Much of the literature on labour market flexibility in CEE countries has been very narrow in the data used. We apply a broader analysis, including the share of the workforce covered by regulations; violations of the legal provisions in enterprises and the procedures of enforcement agencies. Our empirical analysis of labour laws is based on the OECD methodology (Nicoletti et al., 2000; OECD, 1999). Unfortunately the available aggregate measures of EPL strictness neglect some aspects of legislation, e.g. the regulation of overtime. In order to analyse the enforcement of regulations, we use data from national labour inspectorates and courts, the survey by the European Foundation and the worldwide Executive Opinion Survey by the World Economic Forum (Global Competitiveness Report, 2001–2002).

## Concept and Measurement of Labour Market Flexibility

From the point of view of general equilibrium theory, the flexibility of labour markets may be understood as the speed with which they adjust to the external shocks and changing macroeconomic conditions in order to achieve Pareto-efficient resource allocation. This definition is very broad and it is difficult to measure empirically such effects as adjustment speed. Most analyses therefore focus on labour market regulations and institutions that are assumed to inhibit adjustment (Berthold and Fehn, 1996; Jackman et al., 1996; Lazear, 1990; Siebert, 1997). In all OECD countries, there are rules and regulations that govern the employment relationship. Those defined as EPL consist of laws and administrative procedures governing unfair dismissals, restrictions on lay-offs for economic reasons, compulsory severance payments, and minimum notice

periods. Whether and to what extent job security regulations affect labour market flexibility remains a matter of continuing controversy. Critics have claimed that strong EPL prevents employers from adjusting to economic fluctuations, and that by preventing layoffs during downturns, job security provisions inhibit employers from hiring during upturns, thus increasing unemployment (OECD, 1999). A counter-argument is that EPL encourages long-term employment relationships, leading employers to invest in more training. Enhanced skills in turn boost labour productivity and may also increase internal (functional) flexibility (Piore, 1986).

Various empirical studies in western Europe (Bentolila and Saint Paul, 1992; Bertola, 1990; Grubb and Wells, 1993) have concluded that the extent of EPL results in relatively inflexible labour markets. However, Baker et al. (2002) conclude that empirical findings do not support the common argument that deregulation improves labour market performance. They stress that it is even less evident that further weakening of social and collective protections for workers will have a significant positive impact on employment prospects. Hence there is no clear agreement in the literature on the interaction between EPL and labour market performance.

In our view, labour market flexibility should be measured at two different levels: the macro level and the micro-level (Eamets, 2004). The former can be further divided into institutional flexibility (the extent to which state institutions and trade unions are involved in the regulation of the labour market) and wage flexibility (how responsive wages are to market fluctuations). Micro flexibility relates to the flows of workers (transitions between labour market states, occupational mobility and geographical mobility) and by jobs flows (job creation and job destruction).

These different aspects of flexibility can be assumed to be related. If institutional involvement is very high, workers' transition rates are likely to be low. If trade unions are weak, then wages are more flexible etc. Thus there are likely to be important complementary or interaction effects which condition the labour market impact of EPL (Belot and van Ours, 2000).

Employment protection encompasses any regulation, through law or collective bargaining, which limits the employers' ability to dismiss a worker (Pissarides, 2001). In this article we concentrate on legal measures. These can regulate a variety of issues: hiring standards; dismissal rights; notice requirements for severance; administrative requirements for layoffs; fixed term contracts; temporary agency work; and collective dismissals. Some regulations are designed to cushion the effect of a fall in demand for labour while others are to protect employees from arbitrary dismissals; some imply transfers from employer to employee (notice and severance pay), others are a form of tax to imposing a cost (procedural requirements).

Different indicators have been used to assess the strictness of EPL

provisions. The best known is from Lazear (1990): the statutory compensation in case of no-fault individual dismissal for economic reasons. Summary indicators of strictness obtained by compressing the information from a list of detailed indicators greatly facilitate the analysis of EPL, but their construction raises difficult choices of quantification and weighting and both ordinal and cardinal approaches have been used. Grubb and Wells (1993) and OECD (1994) first computed a rank for each of the first-level indicators for each country in the sample of countries under investigation, then calculating the average of these ranks across indicators. But this can lead to implausible results if national rankings differ too much across basic indicators, and it is difficult to update the information and evaluate changes in EPL over time. The OECD (1999) developed cardinal summary indicators allowing somewhat more meaningful comparisons (though still open to criticism) across countries and over time. Since the theoretical analysis emphasises the analogy of EPL to taxation on employment adjustment to be paid by the employer, the overall intent was to reflect the cost implications of various regulatory provisions.

Research developed indices based on surveys of employers, assessing the restrictions they perceive in dismissing workers (OECD, 1999). Surveys of employers from a rather long list of countries are also included in the economic freedom indexes by World Competitiveness Report, Fraser Institute, the Heritage Foundation/Wall Street Journal and Freedom House (Addison and Texeira, 2001). Finally, Heckman and Pages (2000) tried to calculate the costs of complying with EPL by creating a job security index to measure the expected future cost, at the time of hiring, of dismissing the worker for economic reasons.

Despite methodological advances, these indices remain open to criticism. It is unclear what is the estimated effect of a unit increase/decrease in the labour law index on some labour market performance variable, or what are the causes of any change, and Bertola et al. (2000) have emphasized several other drawbacks (the failure of indices to capture atypical forms of employment and that they ignore the links between EPL and other labour market institutions).

## **EPL Strictness in the Baltic States and CEE Countries**

We estimate the strictness of EPL in three areas: regular employment (indefinite duration), temporary employment and regulation of collective dismissals. As well as comparing legislation in 2002, we take account of changes over time. Data for the Baltic States are based on analysis of national legislation, and for other CEE countries are from Riboud et al. (2002) and OECD (1999). We note that in the Baltic countries these regulations do not apply to civil servants, whose status is regulated

separately. The calculations follow the methods used in the OECD *Employment Outlook* (1999) and by Nicoletti et al. (2000). The final measure of indices varies from 0 (flexible EPL) to 6 (strict legislation). Table 1 summarizes previous information.

This reveals that EPL strictness in Baltic States and in CEE countries more generally is close to the EU average, though high compared to the USA (and many other OECD countries). That is because in the 1990s the transition countries established various forms of EPL similar to continental European practice (Riboud et al., 2002). There are still steps to be taken to enforce the labour law *acquis* in certain areas (e.g. gender equality) in the Baltic States, but in general the implementation of EU labour law is well advanced.<sup>1</sup> The regulation of collective dismissals is perhaps even stricter than the minimum required; that of fixed term employment was not entirely in compliance with the directive 99/70/EC in the old codes (in particular, the measures against the abuse of successive fixed-term contracts), but the new codes (adopted in Latvia and Lithuania in 2002 and 2003 respectively, still in draft in Estonia) are more in line.

Not all components of EPL contribute equally to the cross-country variation in strictness. In Latvia dismissals are less regulated than in Estonia and Lithuania; the average in the Baltic States is higher than for the EU15 (2.8 as against 2.4). The differences in the regulation of temporary employment reflect a rule still in force in Estonia and Lithuania, inherited from the Soviet Union, that workers can be engaged on temporary contracts for up to 5 years, while Latvia reduced the limit to 2 years in 2002. The relatively loose regulation of regular employment in Latvia is mainly due to shorter advance notice of economic dismissals and smaller severance payments.

The use of temporary employment is significantly less restricted in the

**TABLE 1. Summary Indicators of EPL Strictness**

	Strictness indicators (0–6) <sup>a</sup>				
	ILO conventions ratified	Regular contracts	Temporary contracts	Collective dismissals	Overall EPL strictness
Latvia	45	2.8/2.3	3.2/2.1	4.0	3.3/2.5
Lithuania	34	1.8/3.0	1.1/1.4	4.9	1.1/2.7
Estonia	31	2.3/3.1	2.2/1.4	4.5	2.2/2.6
CEE average	62	2.5/2.7	0.8/1.2	4.1	1.7/2.4
CEE cv <sup>b</sup>	31%	25/16%	125/87%	12%	47/24%
EU15	88	2.4/2.6	2.3/2.3	3.2	2.4/2.5
USA	14	0.1/0.2	0.3/0.3	2.9	0.2/0.7

Notes: <sup>a</sup> Nicoletti et al. (2001), OECD (1999). Collective dismissals: OECD only.

<sup>b</sup> Coefficient of variation.

Baltic States and other CEE countries than the EU15. In Lithuania and Estonia the use of temporary employment is less restricted than in Latvia. This is mostly due to the lack of regulations on the use of temporary work agencies in most CEE countries. Though the law allows fixed-term contracts for short-term temporary work only, at least in Estonia there is anecdotal evidence that this restriction is not enforced.

In all Baltic countries the regulation of collective dismissals is even stricter than the EU15 average, mainly because of strict notification requirements and lengthy cooling-off periods. In Estonia some of the changes in legislation since 2002 have made collective dismissals more costly, increasing the value of the index from 2.6 to 4.5, but others have decreased it; in particular, severance payments in case of collective dismissals are now covered not by employers but by the unemployment insurance fund. Indeed, many enterprises postponed dismissals until these provisions came into force.

## **Enforcement of EPL**

Previous literature on labour market flexibility in CEE countries (Cazes, 2002; Orenstein and Wilkens, 2001; Riboud et al., 2002; Svejnar, 2002) has focused on formal legislation (measured by the OECD EPL strictness index), and neglected the actual enforcement of these regulations. Even strict labour laws may have little effect, if economic agents violate them, if law enforcement agencies are weak or if these laws cover only a small proportion of the total workforce, as Betcherman et al. (2001) argue is the case in many developing countries. This is also relevant for transition economies. For example, in Estonia there is anecdotal evidence that employers force redundancies to be classified as voluntary terminations, thus avoiding statutory compensation payments. More generally, the Working Life Barometer (WLB) for the Baltic Countries (Antila and Ylöstalo, 2002) show that employers can press employees to waive their statutory rights in respect of dismissal.

The frequency of such derogations declined in Estonia from 10 to 6 per cent of new contracts between 1998 and 2002; but Latvia and Lithuania saw an opposite trend, increasing from 6 to 9 per cent and 4 to 9 per cent, respectively. However, Antila and Ylöstalo (2002) argue that since many respondents (15 per cent) declined to answer this question, the actual frequency of waiver clauses could be higher than indicated.

Labour market flexibility is also affected by the proportion of the workforce with 'standard' employment contracts, since these are normally most strictly covered by EPL. Table 2 indicates the prevalence of different types of employment contract in the Baltic States compared with other CEE countries and the EU15.

TABLE 2. Different Types of Employment Status (%), 2001

	Self-employed and other	Regular contracts (unlimited duration)	Fixed term contracts	Temporary agency contracts	All temporary contracts	Part-time work	EPL strictness, standard employment (and adjusted)	EPL strictness, temporary employment
Latvia	13.7	55.4	20.1	5.7	25.8	10	2.3 (1.3)	2.1
Lithuania	19.7	62.9	13.8	0.4	14.2	11	3.0 (1.9)	1.4
Estonia	10.1	75.6	10.7	1.2	11.9	8	3.1 (2.3)	1.4
Baltic States	14.5	64.6	14.9	2.4	17.3	9	2.8 (1.8)	1.6
Bulgaria	17.4	56.4	20.7	1.4	14.5	10	2.8 (1.6)	2.7
Czech Republic	15.9	72.1	9.5	0.9	10.4	8	2.8 (2.0)	0.5
Hungary	17.4	73.4	8.4	0.0	8.4	6	2.1 (1.5)	0.6
Poland	33.5	54.8	7.8	2.5	10.3	6	2.2 (1.2)	1.0
Slovakia	12.7	75.0	10.6	0.8	11.4	7	2.6 (2.0)	1.4
Slovenia	21.9	66.7	10.1	0.0	10.1	9	3.4 (2.3)	2.4
CEE average	18.0	65.8	12.4	1.4	13.0	8.2	2.7 (1.8)	1.5
EU15	16.6	68.1	8.3	1.8	10.1	18	2.6 (1.8)	2.3

Source: own calculations; European Foundation (2001), Franco and Jouhette (2002).

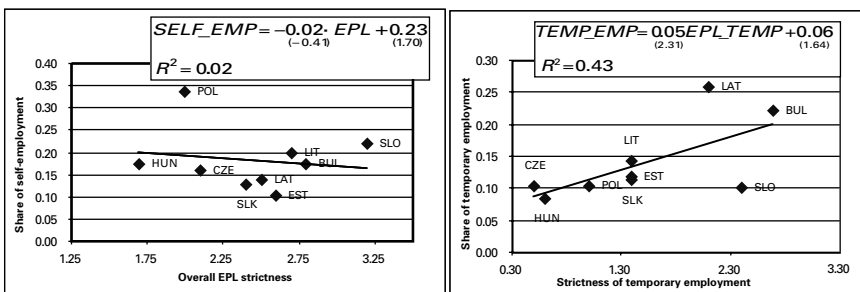


Previous studies have shown that stricter EPL is associated with higher shares of self-employment (OECD, 1999), but our data do not confirm this. Self-employment in the Baltic States is only slightly below that in the EU15 (14.5 and 16.6 per cent respectively). A more important influence appears to be the size of the agricultural sector, which can explain why the share of self-employment is 19 per cent in Lithuania as against only 10 per cent in Estonian. Table 2 shows that across the CEE countries, stricter overall EPL is not associated with higher a share of self-employment (see Figure 1).<sup>2</sup>

As Table 2 shows, the proportion of regular (unlimited-term) contracts is highest in Estonia (76 per cent), followed by Lithuania (63 per cent) and Latvia (55 per cent). The unweighted average (65 per cent) is close to the EU15 average (68 per cent). As these percentages affect the proportion of the workforce enjoying protection against dismissals, Bertola et al. (1999) present an adjusted EPL index multiplying the OECD strictness index by the share of regular employment. Among the Baltic States, the value of this index is highest in Estonia and lowest in Latvia. The averages for the Baltic States and the EU15 are still similar.

Although overall EPL strictness should theoretically increase the share of temporary employment, the OECD's own data (1999) show the relationship to be statistically insignificant. In the Baltic States, the proportion of temporary contracts is in all cases above the EU average (10 per cent), and double this figure in Latvia (where in addition the proportion of workers on agency contracts is three times the EU average) — despite the relatively strict regulation of temporary contracts there. Somewhat puzzling is the positive relationship between the share of temporary employment and the rigour of the relevant legislation in the CEE countries (see right panel of Figure 1). This could well reflect the

**FIGURE 1. Self-employment, Temporary Employment and EPL Strictness in CEE Countries**



Source: own calculations, European Foundation (2001), OECD (1999), Riboud et al. (2002).

poor enforcement of legislation in some of the CEE countries, in particularly Latvia and Bulgaria, where the share of temporary employment is the highest. It is also relevant that in the 1990s the legislation often contained deficiencies, for example permitting the abusive use of successive fixed-term contracts (only in Poland was this prohibited). Part-time employment is also much less widespread in the CEE than the EU15, though the proportion of involuntary part time employment increased in Estonia from 42 per cent in 1993 to 51 per cent in 2002 (authors' calculations based on Estonian Labour Force Survey, LFS).

The above analysis has been based only on one point of time. However, longitudinal data on four countries (Estonia, Czech Republic, Poland, Slovenia) presented by Casez and Nesporova (2001) did not reveal any increase in temporary employment or tendency towards more flexible forms of employment.

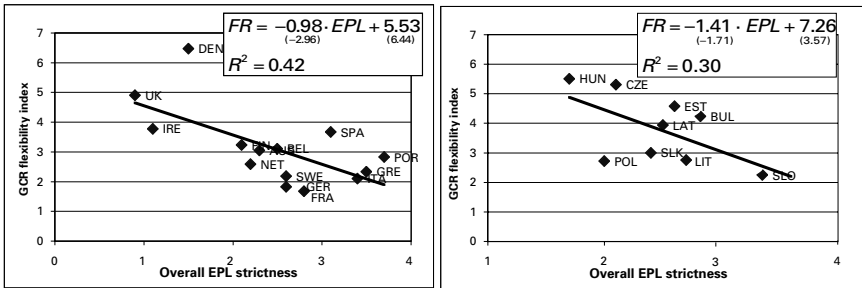
The frequency of different types of employment is just one measure of the coverage of employment security laws. Dasgupta (2001) argues that other relevant features are proportion of workforce in particular sectors, age distribution, size of establishments covered by legislation, the percentage of people covered by collective agreements and rate of unionization. Unions can monitor compliance with the law and help members pursue legal complaints. In Latvia before 2002 the labour code did not allow dismissals without the consent of the trade union. The rate of unionization and the coverage of collective bargaining are both rather low in the Baltic States: roughly 15 and 29 per cent in Estonia, 30 and 29 per cent in Latvia, 15 and 10–15 per cent in Lithuania, as against 44 and 78 per cent in the EU15 (Carley, 2002; EEAG, 2004). Low unionization thus contributes to high labour market flexibility in the Baltic States.

## Employer Estimates of EPL Strictness and the Problem of Enforcement

Surveys of employers provide further information on labour market flexibility, taking account (at least to some extent) of the actual enforcement of legal provisions. Managers consider not only the formal strictness of laws, but also the extent to which official agencies actually enforce them. We present here the data from the Global Competitiveness Report (GCR) 2001, based on the executive opinion survey carried out by the World Economic Forum. This asked whether 'hiring and firing practices by companies are determined by employers' on a scale of 1 ('strongly disagree') to 7 ('strongly agree'); higher figures thus indicate higher flexibility.

Figure 2 shows the relationship between the OECD and GCR indices of labour regulation. A negative correlation can be expected, because the

FIGURE 2. OECD EPL Strictness Index and GCR Hiring and Firing Practices Index



Note: FR denotes the index of employers' opinion on the flexibility of firing and hiring from Global Competitiveness Report. EPL denotes the OECD employment protection regulation strictness index.

Source: own calculations, Cazes (2002), Gwartney et al. (2002), OECD (1999), Riboud et al. (2002).

OECD index measures EPL strictness and the GCR, flexibility. Despite of the statistically significant correlation between the two indexes, a significant portion of the variation in the GCR index is unexplained by the OECD index, and this may well reflect variations in law enforcement. For the small sample of CEE countries the relation seems even weaker and the variation in GCR index compared to the variation in the OECD index is greater.

The average GCR index value is higher for CEE countries than for the EU (4.5 and 3.1 respectively). Among the Baltic States, Estonia has the most flexible hiring and firing practices (4.6), followed by Latvia (3.9) and Lithuania (2.8). Though the OECD index shows slightly stricter legislation in Estonia than the EU15, managers consider labour regulations more flexible. Even more striking differences between the two indices can be seen in Russia, where the OECD index shows stricter regulation than the EU average (3.2 compared to 2.5), but the GCR index shows a high level of flexibility (ranking 10 in the sample of 74 countries), which may indicate poor law enforcement.<sup>3</sup> The evidence confirms that labour markets can be more flexible than appears when considering only formal legislation.

This demonstrates that it is vital to extend analysis from legal prescription to enforcement procedures (inspectorates and court procedures). There is considerable evidence of violations of EPL. Due to the focus of the article, only violations of labour legislation are reviewed and violations of labour protection legislation are left aside. Reports by the national labour inspectorates in the Baltic States<sup>4</sup> show that violations are discovered in roughly half the enterprises investigated (with a range between 46 per cent of enterprises in Estonia and 61 per cent in Lithuania). These figures are likely to underestimate the extent of the

problem, since only a minority of firms are inspected in any year (37 per cent in Estonia, 18 per cent in Lithuania, 7 per cent in Latvia). Surveys of employees yield similar results: in a study in Latvia only 8.7 per cent of employees reported that their employment rights were at least quite well protected, and many complained of a variety of violations of labour laws (Social Report, 2001).

There are parallels in other CEE countries; for example, 85 per cent of private-sector employers in a Hungarian survey reported that they had no serious constraints in dismissing workers (Kuddo, 1995). This means that whereas employers in many west European countries need to introduce 'atypical' employment contractual arrangements (temporary contracts, agency employment) in order to attain flexibility, employers in transition countries can often achieve the same result by simply disregarding the legal regulations.

Though we do not have data by enterprise size, it is reasonable to assume that EPL is particularly poorly enforced in small firms. Labour inspectorates are likely to concentrate their resources on larger firms and neglect SMEs, while in most countries the trade unions are either weak or non-existent in small firms.<sup>5</sup> Cazes and Nesporova (2001) show that employees in larger establishments in transition economies have significantly longer job tenure than those in smaller establishments. In many countries, particularly those with relatively strict EPL (Germany, Italy, Portugal), firms below a certain size (from 5 to 25 employees) are exempt from some of the statutory provisions (Scarpetta et al., 2002). This is not however the case in the Baltic States.

An important issue is how to evaluate the policy implications of labour law violations in small enterprises. The OECD (2003) argues in favour of better enforcement in the Baltic States on the grounds that when different types of enterprise follow different rules, this distorts the functioning of competition. Conversely, Burda (1998) regards the ability of small firms to evade EPL in a positive light: small enterprises and new firms face particular risks and often fail, and rules for example requiring compensation for workers dismissed in adverse economic circumstances have a serious disincentive effect and may force small firms out of business or into the black economy.

Important evidence from a range of labour market surveys<sup>6</sup> shows that a minority of workers in the Baltic States have no written employment contract: their conditions are only agreed verbally. According to the WLB, the figure in Estonia 11 per cent in 1998 and 5 per cent in 2002; in Latvia 8 and 10 per cent, in Lithuania 13 and 5 per cent (Antila and Ylöstalo, 1999 and 2002), showing some trend of improvement overall. The LFS and NORBALT surveys give lower figures for the absence of a written contract, approximately 4 per cent. Even though these numbers are relatively small, such practices are clearly against the law, which insists

on the agreement of a written contract. The incidence of this practice varies across enterprises and regions. There is conflicting evidence on the regional dimension: according to the WLB survey, in Estonia the lack of a written contract is most frequent in Tallinn (14 and 7 per cent in 1999 and 2001), but according to the LFS data this situation is twice as frequent in rural than in urban areas. This latter evidence is perhaps more plausible. However in Latvia, verbal agreements were more widespread in the capital region; in Lithuania that was true in 2002 but not in 1999.

For those with written employment contracts, protection against job loss is often weakened by waiver clauses agreed with the employer (as noted above) and also by the relatively common practice of many employers to pay officially only a minimum wage but to supplement this by unreported additional compensation. The consequence is that in case of dismissal such employees are entitled to receive as compensation a severance payment based only on the reported amount, not on the actual wage, making termination of employment less costly for the employer. According to the WLB survey, the share of employees sometimes receiving undeclared income in 1999 was 19 per cent in Estonia, 22 per cent in Latvia, 12 per cent in Lithuania; in 2002 the figures had fallen to 10, 16 and 7 per cent, respectively (Antila and Ylöstalo, 2002). Those receiving such income *every* month in 1999 amounted to 9, 8 and 3 per cent, respectively. Almost certainly such survey responses understate the real numbers receiving illegal payments; Antila and Ylöstalo (2002) suggest that the figure may be two to three times those reported.

Procedures for the resolution of employment disputes vary across the Baltic countries. In Estonia, such disputes may be settled either by special commissions established by the local labour inspectorates, or by the courts. The former are made up of representatives of both employees and employers and are the first step in the settlement procedure; they are not courts but a unique arrangement for solving employment disputes, introduced because of the slow treatment of cases in courts. There is also provision for mediation by the employees' representative organization or another authorized person, and for the establishment of a reconciliation commission, but neither is commonly used (Masso and Philips, 2004). Similarly in Lithuania, disputes may be heard by the courts or by an enterprise-level commission for labour disputes consisting of employee and employer representatives. In Latvia, according to the former Labour Code, disputes were heard either by the courts or by employment dispute commissions elected by the employers and the employees, the latter being normally the compulsory first step in the process. The new Latvian labour law in force since 2002 no longer mentions the dispute commissions, but the new 'labour disputes law' specifies that individual rights disputes are settled by negotiation, a labour dispute commission or by a court. In all three countries, there are deadlines for appeals to the courts

or commissions: in Latvia one month, in Lithuania three months (formerly one month), and in Estonia four months.

Bertola et al. (1999) have noted that measuring the enforcement of EPL is difficult as statistical information is relatively scarce and is seriously affected by selection bias; and jurisprudence may be affected by underlying labour market conditions (for example, court rulings may become more favourable to employees under tight labour market conditions). With these caveats in mind, we may infer from the information presented in Table 3 that in the Baltic States employees are relatively active in submitting complaints to labour inspectors, and win a relatively high percentage of cases. What is unclear from the statistics is whether this indicates that the dispute resolution regime is relatively favourable to employees, or simple that serious violations of the law are relatively widespread in the first place. Also the limited court capacity may be the problem. In the case of Latvia it has been noted that dispute resolution with the assistance of labour dispute commissions or the courts is not common (Social Report, 2001). A widespread problem in CEE countries is that litigation in the courts over individual labour disputes is extremely time-consuming (EIRO, 2003). In Hungary, more than 10 per cent of cases last over a year; in Estonia between 2001 and 2003 there were similar delays in 20 per cent of cases reaching the courts, while in labour dispute commissions 1998 and 2003, 18–35 per cent of all sessions were postponed (Masso and Philips, 2004).

Though Bertola et al. (2002) concluded that in countries with a high number of cases submitted to tribunals there was also a high percentage

**TABLE 3. EPL Enforcement**

	Year	Complaints per 1000 employees <sup>a</sup>	Cases won by workers (%)	Strictness of dismissal criteria <sup>b</sup>
Latvia	2000	1.9	88	2
Lithuania	2000	2.2	68	1
Estonia	2000	5.4	65	2
Hungary	2000	6.2	n.a.	0
Slovenia	2000	6.4	n.a.	2
EU15	1995	2.1	50	0.9
USA	1995	0.2	48	0

Notes: <sup>a</sup> Number of cases at the first stage of the dispute resolution process (except Hungary). In the Baltic States the number of cases reaching the courts is much lower because commissions are the first step in the dispute resolution process.

<sup>b</sup> Definitions of strictness of legislation on unfair dismissals, based on OECD (1999): 0 = least restrictive, 3 = most restrictive.

Source: own calculations; Bertola et al. (1999), EIRO (2003), national inspectorates.

of outcomes favourable to employees, this does emerge from the statistics for the Baltic States. Strict legal constraints on unfair dismissal may both encourage workers to appeal, and encourage employers to reach agreement before a formal appeal, so there may be a contradictory causal relationship between EPL stringency and the rate of appeals in the Baltic States. Our conclusion, based on the limited empirical evidence on the actual enforcement of EPL, is that the high level of appeals in Estonia in particular is primarily attributable to the frequent violation of the regulations.

Finally, we add that one reason for the weak enforcement of EPL is workers' poor awareness of their rights. For instance, though it is not permitted for the terms of employment contracts or collective agreements to be less favourable than those specified in the laws, Kallaste (2004) has presented evidence that in a number of cases the provisions of collective agreements fall below the legally prescribed standards.

## Conclusion

The aim of this article was to estimate the strictness of EPL and the enforcement of legal provisions in the Baltic States. EPL forms one component of institutional labour market flexibility or rigidity, together with trade unions and labour market policies, and it also affects micro-level flexibility by reducing turnover in the labour market: both job tenure and duration of unemployment tend to last longer with stricter regulation.

The Baltic States have ratified the main international labour standards as well as adopting most of the EU regulations on employment protection; the overall strictness of EPL is close to the EU average. However, there cross-country differences also exist. Individual dismissals are more constrained in Latvia than in Estonia and Lithuania, while in this respect the index for all the Baltic States is higher than the EU average. On the other hand, the use of temporary employment is less restricted in the Baltic States than in the EU15, and even less so in Latvia than in Lithuania and Estonia. (Among the group of CEE countries, cross-national variation is greatest in this area.) In all three Baltic countries the regulation of collective dismissals is stricter than the average in the EU15 (this is also true for the whole set of CEE countries). Despite differences in most of the detailed indicators, overall EPL strictness seems to be not very different across the Baltic States (though in Latvia, the regulations are possibly more favourable to employers). Compared with other CEE countries, EPL regulation in all three areas is slightly stricter in the Baltic States; despite some differences they seem to constitute a relatively homogenous group.



From a formal point of view the legal regulation of the labour market seems to be in place and the worker is not less protected in the Baltic States than in EU15. But in practice, it appears that state regulations are often disregarded in the private sector. There is considerable evidence of violations of these regulations in enterprises in the Baltic States, and workers' complaints to labour inspectors are rather frequent and often successful. This might indicate that law enforcement is not too weak; but conversely, appeals may represent only a small proportion of all breaches of the law. There are other reasons to believe that the number of unreported violations is even higher, for example in many cases so-called voluntary terminations of employment are in reality involuntary. There is also considerable evidence of employees being obliged to waive some of their rights to the benefit of the employer.

It is also important in evaluating the strictness of EPL to take account of the proportion of the workforce that is actually covered by the regulations. In the Baltic States the share of workers on unlimited contracts is close to the EU15 level, but temporary employment is more widespread (implying a higher level of flexibility). The positive correlation between the share of temporary employment and the strictness of relevant legislation in the CEE countries may reflect the poor enforcement of legislation in some these countries. The latter may also be the reason why employers' evaluations of the flexibility of employment does not match the strictness of formal legislation.

It is possible that in the future the gap between formal EPL and its enforcement in the Baltic States may be narrowed, through a strengthening of the institutions responsible for implementing the regulations. Increasing administrative capacity is likely to be reflected in a growth in the efficiency of the judicial process in the courts. We can expect an improvement in the operation of labour dispute commissions, and enhanced awareness of workers about their rights. The trade unions, which have participated actively in discussions on a new draft law on employment contracts in Estonia (EIRO, 2004), may become more effective in defending employees' statutory rights. If so, it is likely that labour markets in the Baltic States will become more rigid. Nevertheless, it is important to echo the argument of Bertola et al. (2000: 99) when considering possible policy implications: these 'should not be based on any of the indicators available to date', since the data 'are too imperfect and imprecise to inform the debate on EPL reforms and cannot be attached a normative content when monitoring structural reforms in the labour markets'.

## ACKNOWLEDGEMENT

We acknowledge financial support through the European Union 5th Framework Programme project 'The Eastward Enlargement of the Euro-zone (Ezoneplus)'



and from the Estonian Ministry of Education and Science. We are grateful for comments made by two anonymous referees, by Alena Nesporova, Karsten Staehr and participants at presentations in Tallinn, Łódź and Helsinki. The usual disclaimer applies. A longer and more detailed version of this paper is published as IZA Discussion Paper 1147 and is available at [www.iza.org](http://www.iza.org).

## NOTES

- 1 The European Commission has noted that progress is needed in the following areas: in Estonia, gender equality, prohibition of discrimination, information and consultation of workers; in Latvia, adopting directives on information and consultation of workers, amending law on labour disputes, enforcing *acquis* in gender equality and health and safety at work; and in Lithuania, transposing directives on European Works Council, posting of workers, the right to information and consultation of workers.
- 2 The results remain the same if Poland (which has the largest proportion of agricultural employment in the CEE) is excluded from the sample. The results are also similar when using figures for self-employment from Eurostat (given in Cazes and Nesporova, 2003) rather than the EIRO survey.
- 3 Denisova et al. (1998) report that half of the disputes related to unfair dismissals are not concluded within the deadline stipulated by the law.
- 4 Tööinspektsioon ([www.ti.ee](http://www.ti.ee)), Lietuvos Respublikos Valstybinė darbo inspekcija ([www.vdi.lt](http://www.vdi.lt)), Valsts darba inspekcija ([www.vdi.lv](http://www.vdi.lv)).
- 5 According to Kallaste (2004) the Estonian LFS data show that in 1999, workers in enterprises with up to 10 employees made up 25.7 per cent of all non-unionized employees and only 9.1 per cent of union members.
- 6 The information originates from the following surveys: Statistical Office of Estonia, *Estonian Labour Force Survey (LFS) 1989–2003*; Norwegian Research Council, *Living Conditions Study in Estonia 1994 and 1999* (part of the survey NORBALT I and II, Living Conditions in the Baltic Countries); Finnish Ministry of Labour, *Working Life Barometer in the Baltic Countries (WLB) 1999 and 2002*; European Foundation, *First candidate countries survey on working conditions 2001*.

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