

# Labor Reform in a Dysfunctional Labor Market

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# Historical Background

- The main features of the Portuguese Labor Market Institutions were designed immediately after the end of the dictatorship (1974-75)
  - Employment protection
  - Minimum wages
  - Role of social partners
  - Wage setting system
  - Union monopoly over wage negotiations
  - Restrictions on work councils
  - Financing of unions activities and union leaders

# Legal Background

- Many of those features were crystallized in the Portuguese Constitution that, over time, proved to be a major obstacle to labor reform:
  - Dismissal clauses (article 53 of the Constitution)
  - Ability of work councils to conduct wage negotiations (articles 54, 55, and 56)
  - Possibility of nominal wage cuts (Confidence rule)
  - Some reforms are not even attempted because are seen in contradiction with the Constitution

# The Law in Practice

- Judges often take the labor law as a way to protect the “weak part”
  - not the least, because being unemployed is such an ordeal
- The Ministry of Employment always extends collective agreements to workers and firms that were not represented at the bargaining table
  - among other reasons because proceeding this way politicians protect the weaker trade union confederation
- The incidence of fixed-term contracts became widespread because employers learned that the penalties for misuse of FTC were not
- Union leaders are exempted from work irrespective of the level representation (“liberados”)

# Political Dynamics: The evolution of the Unemployment Insurance System

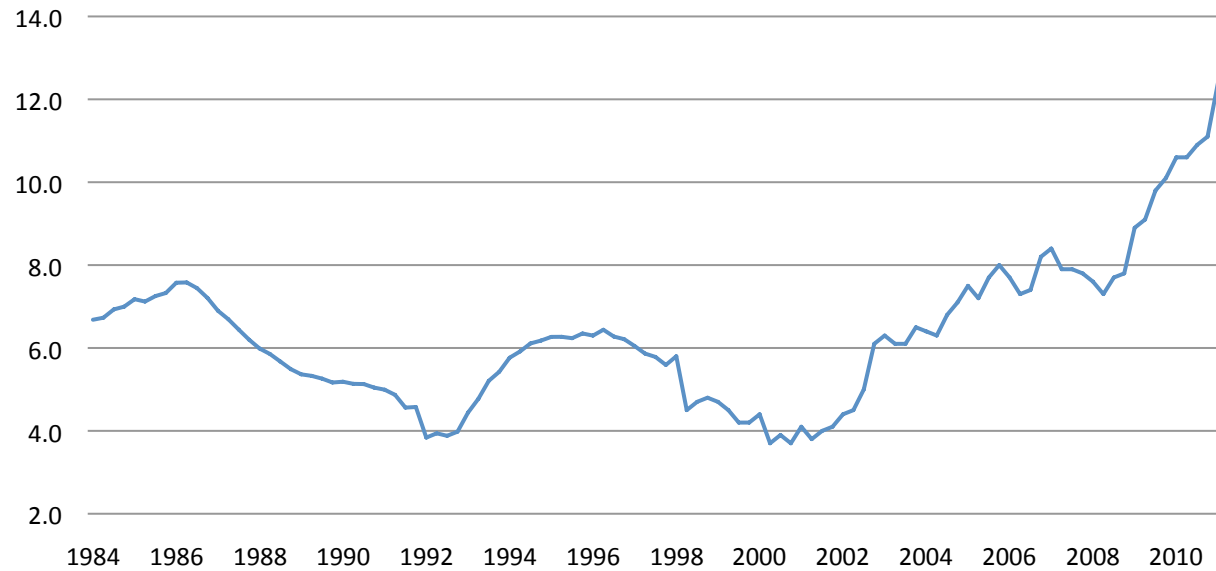
- Was introduced fairly late, in 1985
  - Eligibility was strict
  - Duration of benefits reasonable (one month for each year of work)
- Maximum duration of benefits was made successively more generous
  - Disconnecting time worked from UB duration
  - Now, the most generous among OECD countries
- Eligibility conditions were successively made easier to verify
- Unemployment tunnels were enhanced
- Generating replacement rates close to 100% for low wages

# A dysfunctional labor market

- Poorly designed labor market institutions
  - Wage setting, job protection, unemployment protection, etc.
- Sclerotic labor market
- Highest mean unemployment duration among OECD countries
  - and, thus, the highest incidence of long-term unemployment
- The lowest arrival rate of job offers
- A chronic productivity problem
  - And, consequently low wage
- A two-tier labor market
  - High fraction of fixed-term contracts
  - A low conversion rate of fixed-term contracts into open-ended-contracts

“...a period of high sustained unemployment.”

**Unemployment rate**  
(quarterly data; up to 2011Q2)



# Extreme employment protection

**Table 20 - Employment protection legislation**

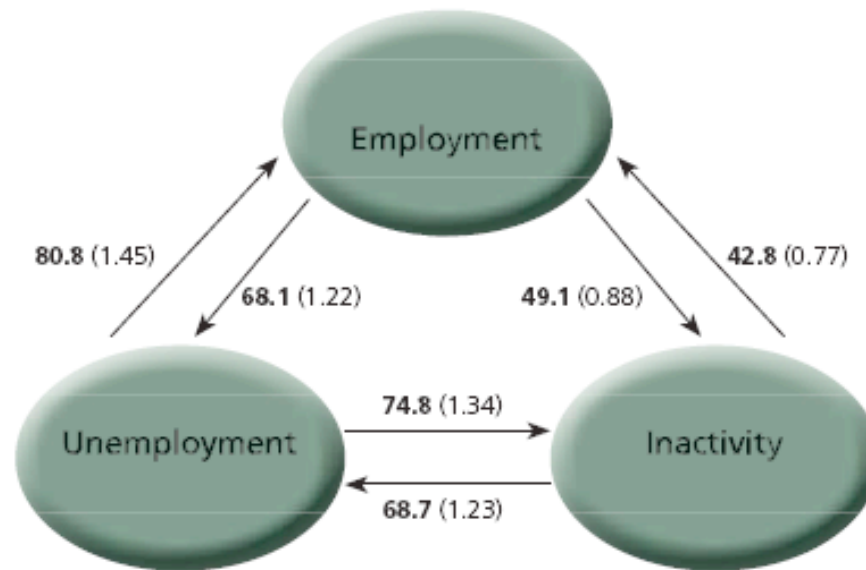
	1990		2008	
	Regular contract	Temporary Contract	Regular contract	Temporary Contract
Italy	1.8	5.4	1.8	2
Sweden	2.9	4.1	2.9	0.9
Germany	2.6	3.8	3	1.3
Belgium	1.7	4.6	1.7	2.6
Denmark	1.7	3.1	1.6	1.4
Greece	2.3	4.8	2.3	3.1
Portugal	4.8	3.4	4.2	2.1
Netherlands	3.1	2.4	2.7	1.2
Slovak Republic	2.5	1.1	2.5	0.4
Spain	3.9	3.8	2.5	3.5
Finland	2.8	1.9	2.2	1.8
Austria	2.9	1.5	2.4	1.5
France	2.3	3.6	2.5	3.6
United Kingdom	1	0.3	1.1	0.4
Czech Republic	3.3	0.5	3.1	0.9
Ireland	1.6	0.3	1.6	0.6
Hungary	1.9	0.6	1.9	1.4
Poland	2.1	0.8	2.1	1.8
Average	2.5	2.5	2.3	1.7
Standard deviation	0.9	1.7	0.7	1.0
coeff of variation	0.4	0.4	0.3	0.6

Source: OECD



# Leads to low worker flows

QUARTERLY AVERAGE FLOWS IN THE LABOUR MARKET<sup>(a)</sup> | VOLUME IN THOUSANDS AND, IN BRACKETS, PERCENTAGE OF LABOUR FORCE<sup>(a)</sup>



Sources: INE and Banco de Portugal.

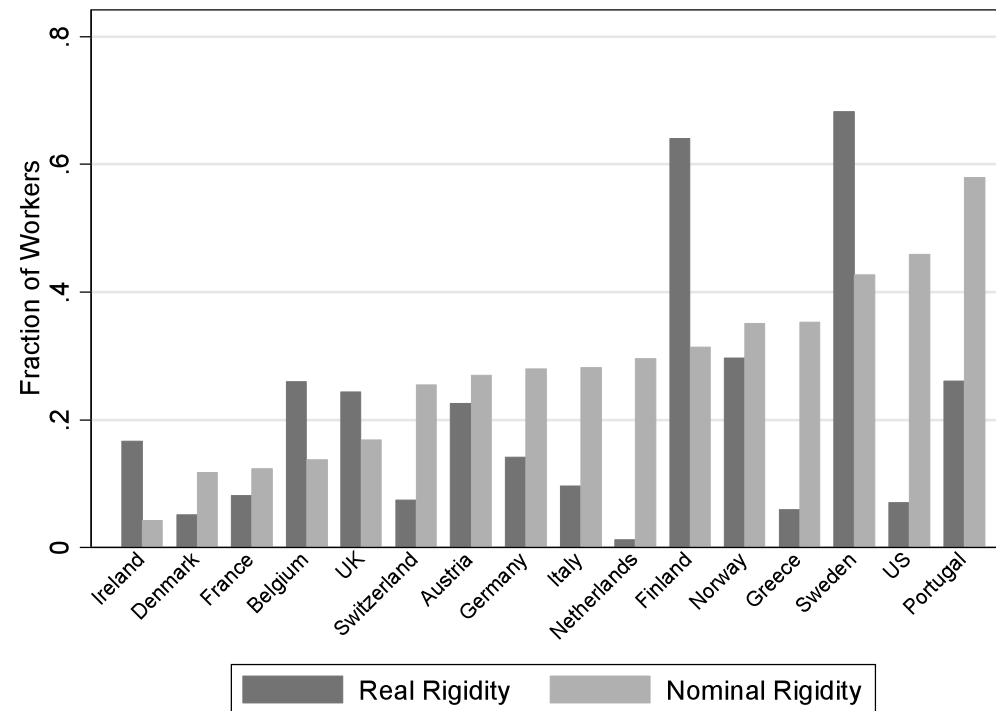
Notes: (a) Considering the common sample component of quarter t and quarter t-1, and using the population weights for quarter t. Average values for the four quarters of 2010.

# Makes being unemployed nearly unbearable

- A personal and family tragedy
  - loss of self-esteem
  - loss of social networks
  - loss of income
  - stigmatization
- A prospect of 25 months of unemployment or longer
- A fraction will never find a suitable job

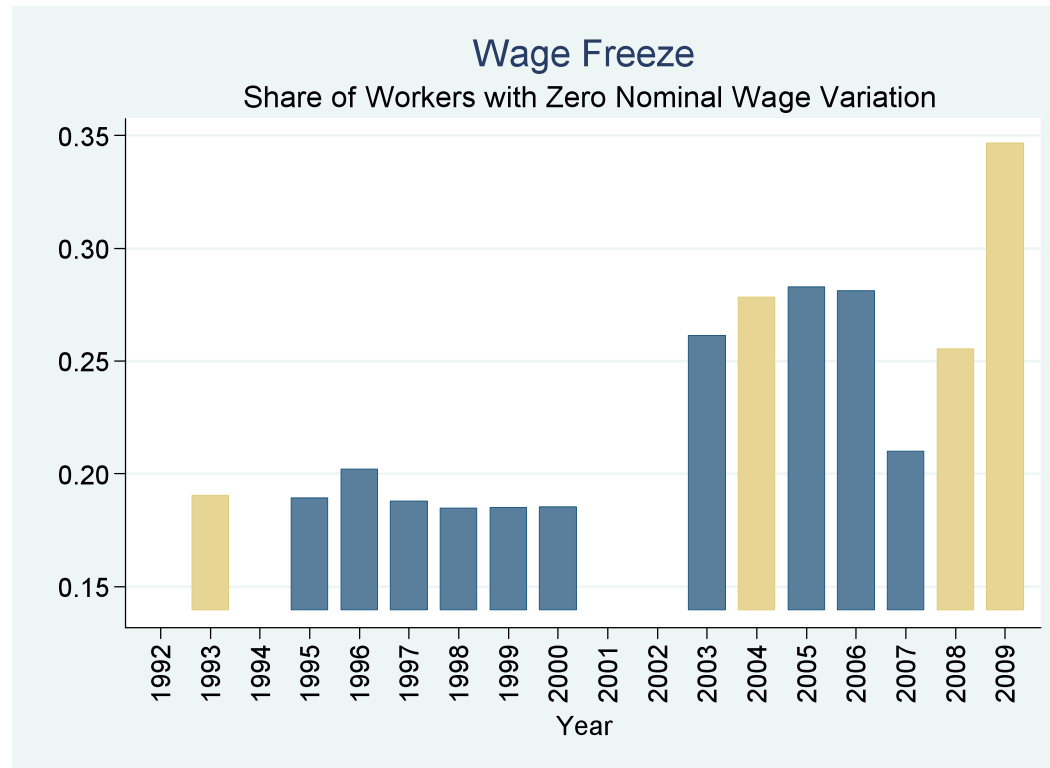


# Nominal wage rigidity is severe

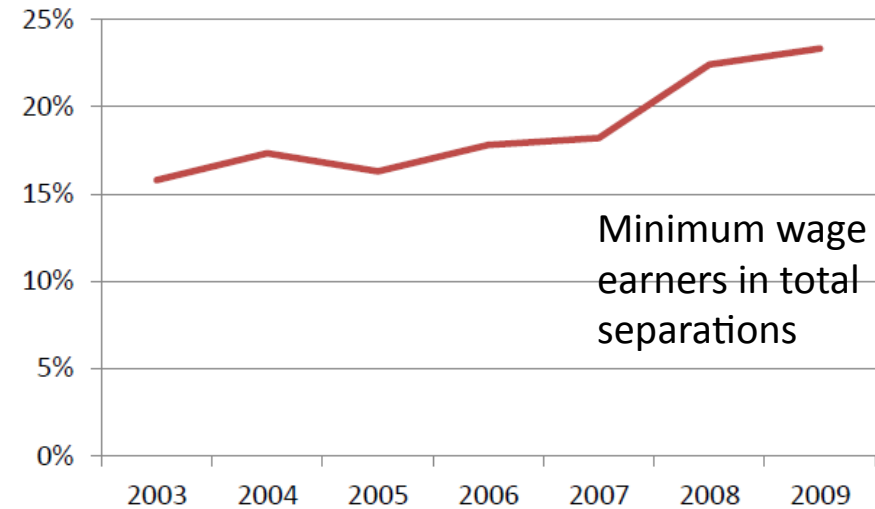
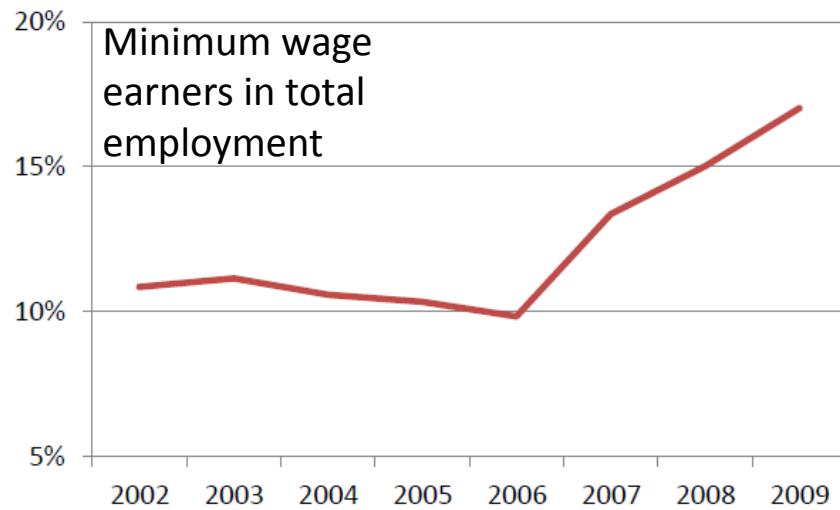


Dickens et al., JEP, 2006

# Wage freezes are common



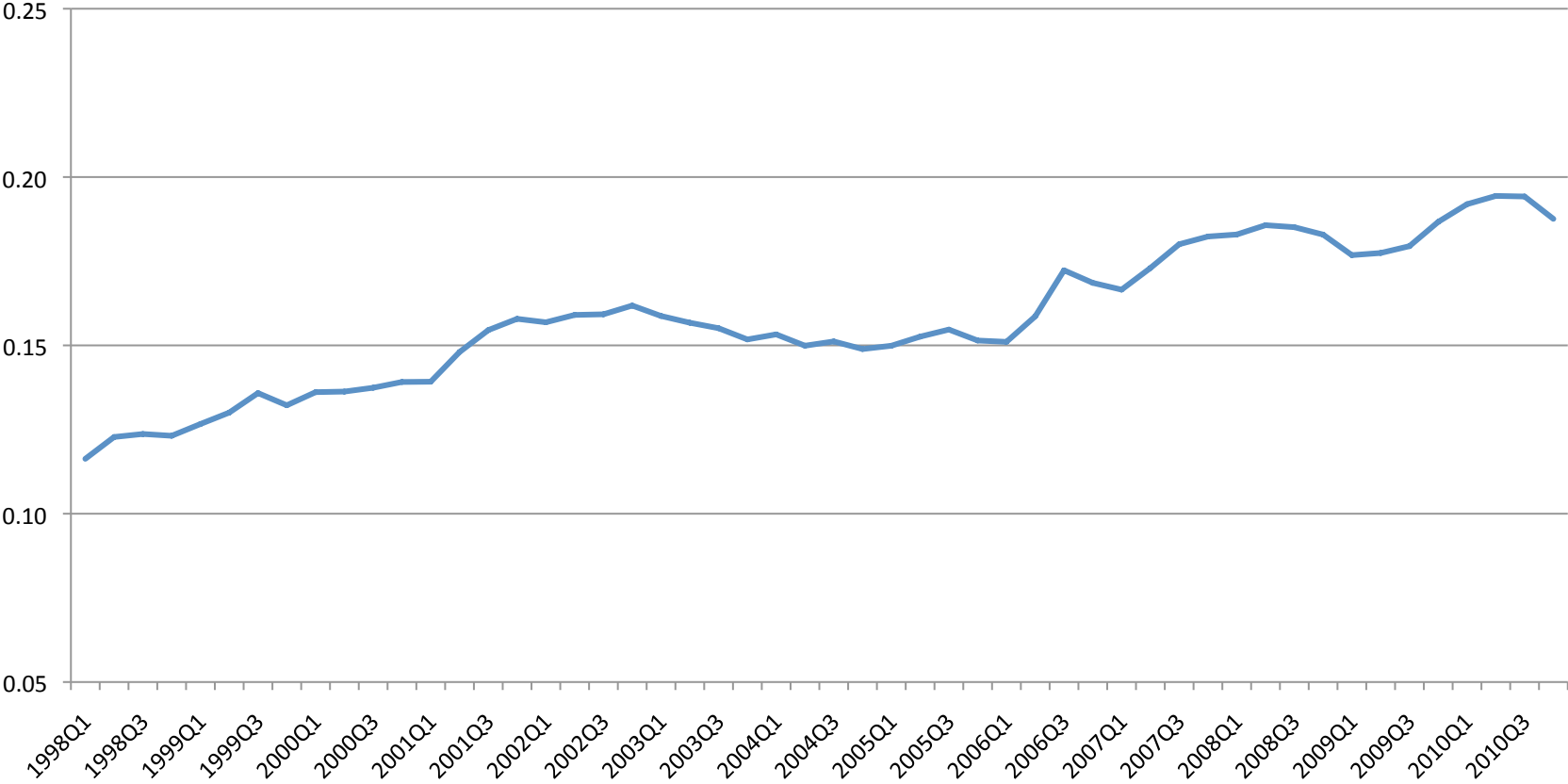
# The minimum wage is increasingly binding



Carneiro et al. (2011)

# The incidence of temporary employment has been increasing

Share of FTC in total employment



# Changes in the labor code

Law 99/2003

1st Labor Code

Major innovations:

Dismissals

Fixed-term cont.

Trial Period

Hours of work

Collective barg.

Law 9/2006

Reverses some provisions adopted in 2003

Changes concentrated in collective bargaining topics

Law 7/2009

Types of contracts

Fixed-term c.

Short-term c.

Intermittent c.

Hours of work

Hours banks

Absenteeism

Dismissals

- 2003 reform:
  - Conservative government
  - Unemployment rate 6%
  - Minor changes in employment protection and collective bargaining
  - The most important change (trial period) **ruled out by the Constitutional court**
- 2006 counter-reform:
  - Leftwing government
  - Unemployment rate 6%
  - Undo the changes in 2003
- 2008 reform:
  - Leftwing government
  - Unemployment rate 10%
  - Under pressure from EC and ECB
  - The most important change (reinstatement) **ruled out by the Constitutional court**
  - The incredible power of OECD



# The three fairies magic wands

- Why previous attempts did failed?
  - Political reasons
  - The nature of unemployment: incidence and duration
- Would these reforms be implemented without the conditionality of the financial assistance program?
- The information asymmetry in the design of labor market reform program
- Will it work this time?

# The 2011 reform: the unemployment insurance magic

- Changes in unemployment insurance:
  - Cap at the maximum amount (close to 2.3 minimum wages)
  - Cap at maximum duration of benefits (18 months)
  - Introduce a declining replacement rate rule
  - Decrease eligibility criterion (1 year of work)
  - Extension to a group of self-employed
  
- NO CHANGE IN THE RULE OF UB ACCUMULATION
- ACCRUED RIGHTS WERE PROTECTED

# The 2011 reform: the severance pay magic

- Changes in severance pay:
  - Decreasing the amount of severance pay from 30 days to 20 days per each year of work
  - Removing the minimum of three months of severance pay (mostly for FTCs)
  - Extending to other workers
  - Approximating the EU average (10 days?)
  
- ACCRUED RIGHTS PROTECTED
- FIRST FOR NEW HIRES ONLY

# The 2011 reform: the wage setting magic

- Changes in the wage setting system:
  - A freeze in minimum wages
  - A cautionary approach to extension mechanism
  - A request to reveal the actual constituency of unions and employer associations
  - Allow opting-out for firms with more than 250 workers
  - Prepare opting-out options for smaller firms
  
- STUDIES TO DEFINE RULES OF EXTENSION

# The 2011 reform: the magic of firing

- Changes in the dismissal clauses:
  - Extend somewhat the reasons for “just cause”
  - Eliminate some safeguards
  - Eliminate rules of choice of the displaced workers
  - Prepare alternatives to courts to rule on dismissals (independent agency)
  
- THE PORTUGUESE CONSTITUTION AND THE OIT CONVENTIONS MUST BE OBEYED

# The 2011 reform: the fiscal devaluation magic

- Fiscal devaluation:
  - Sharp decrease in social security taxes (between 10 to 20 percentage points)
  - Making in fiscal neutral with an increase of VAT taxes (namely, on goods and services paying low and intermediate taxes)
  - Described as a game changer
  - Expected to boost competitiveness
  - And to improve the trade imbalances
  - Supposed to be implemented in 2012
  
  - ABANDONED
  - Replaced by a 30 minute increase in the work time

