



ERC Working Paper in Economic 04/05
March 2004

Labor Market Policies and EU Accession: Problems and Prospects for Turkey

Erol Taymaz

Department of Economics
Middle East Technical University
Ankara 06531 Turkey

Şule Özler

Department of Economics
University of California, LA
LA 90095 USA

Labor Market Policies and EU Accession: Problems and Prospects for Turkey

Erol Taymaz

Department of Economics
Middle East Technical University
Ankara 06531 Turkey

Şule Özler

Department of Economics
University of California, LA
LA 90095 USA

Abstract

The process of European Union Accession has provided a strong stimulus for various institutional changes in Turkey. The European Council decision taken at Helsinki (10-11 December 1999) was an important turning point in this process. The Accession Partnership, which followed the Helsinki summit, identified short and medium term priorities, intermediate objectives and conditions on which accession preparations must concentrate in the light of the political and economic criteria. One of the most important issues for Turkey regarding the adoption and implementation of the Community *acquis* is related with the labor market regulations and employment policies. The adoption of the Community *acquis* will certainly bring radical changes in the functioning of the labor market in Turkey with vital consequences for firms, and workers, as well as the long-term performance of the economy. The aim of this study is to provide information for the use of these agents on the employment and labor market issues that are important during the EU accession process. Since the topic is rather broad, the current study has concentrated upon the possible effects of the adoption of the employment *acquis* regulating work and employment conditions, and issues like child labor, discrimination, social protection have been ignored.

Acknowledgements

An earlier version of this paper was presented at the Conference on *Turkey: Towards EU Accession*, Bilkent University, May 10-12, 2003. We would like to thank our discussant, Necdet Kenar, President of the Turkish Employment Organization, for his valuable comments and suggestions.

Contents

1. Introduction
 2. Labor Market Policies, Institutions and Economic Performance
 3. Labor Market Indicators for Turkey
 4. Turkey and EU Labor Market Policies
 - 4.1. The EU law
 - 4.2. Council Directives on Employment and the Turkish Labor Law
 - 4.3 European Employment Strategy
 5. Employment Protection and Labor Market Flexibility in Turkey
 - 5.1. Employment Protection Legislation
 - 5.2. Direct Measures of Labor Market Flexibility
 6. Problems and Prospects: An Assessment
 - 6.1. The Impact of the New Labor Law
 - 6.2. The Impact of Adopting and Implementing the Employment *Acquis*
 - 6.3. The Impact of Coordinating Employment Policies
 - 6.4. A Simulation Analysis
 7. Conclusions and Policy Implications
- References
Tables
Figures

1. Introduction

The process of European Union Accession has provided a strong stimulus for various institutional changes in Turkey. The European Council decision taken at Helsinki (10-11 December 1999) was an important turning point in this process. The Accession Partnership, which followed the Helsinki summit, identified short and medium term priorities, intermediate objectives and conditions on which accession preparations must concentrate in the light of the political and economic criteria. One of the most important issues for Turkey regarding the adoption and implementation of the Community *acquis* is related with the labor market regulations and employment policies. The adoption of the Community *acquis* will certainly bring radical changes in the functioning of the labor market in Turkey with vital consequences for firms, and workers, as well as the long-term performance of the economy.

The Accession Partnership (AP) identified a number of short term and medium term priorities and objectives on employment and social affairs. In the short term, Turkey was expected to strengthen efforts to tackle the problem of child labor, to ensure that the conditions are in place for an active and autonomous social dialogue, and to support social partners' capacity-building efforts to develop and implement the *acquis*. The AP envisaged, in the medium term, removal of all forms of discrimination, adoption of EU legislation in the fields of labor law, effective implementation and enforcement of the social policy and employment *acquis*, and preparation of a national employment strategy, with a view to later participation in the European Employment Strategy including through the launch of a joint employment review, and in this context, develop a capacity to monitor labor market and social developments, and development of social protection (the reform of the social security system and strengthening the social safety net). These institutional changes are expected to enhance Turkey's capacity to develop and to implement, together with the Member States and the European Community, strategies for "employment and particularly for promoting a skilled, trained and adaptable workforce and labor markets responsive to economic change" (the Treaty Establishing the European Community, Article 125).

The adoption of the Community *acquis* regarding employment and social affairs is likely to put a burden on firms and workers that need to adopt themselves to the new competitive environment. The adverse effects of this process of transformation could be minimized if the government, the private sector and the labor can understand what needs to be changed, and to adopt effective policies and strategies. The main aim of this study is to provide information for the use of these agents on the employment and labor market issues that are important during the EU accession process. A study of labor markets in the process of EU membership is crucial for Turkey because, as is the case in all other European countries, the labor market is the single largest market whose efficient operation has significant repercussions for the performance of the whole economy. Moreover, being a social institution, the labor market, and the rules and regulations defining how it should operate, have a direct impact on the lives of almost all citizens.

Since the topic is rather broad, the current study has concentrated upon the possible effects of the adoption of the employment *acquis* regulating work and employment conditions, and issues like child labor, discrimination, social protection have been ignored. Therefore, the paper is focused on employment protection and labor market flexibility issues, and organized as follows. After this introductory section, the literature on labor market policies, institutions and economic performance is briefly summarized in Section 2. Section 3 presents basic employment indicators for Turkey, the EU, and a number of accession countries to set the

background for the study. The EU and Turkish labor law are compared, and the main characteristics of the rationale and implementation of the European Employment Strategy (EES) are discussed in Section 4. The measurement of labor market flexibility and the flexibility of Turkish labor market is analyzed in Section 5. Section 6 discusses the impact of the accession process and the adoption of the *acquis*. Section 7 summarizes basic findings and policy proposals.

2. Labor Market Policies, Institutions and Economic Performance

Although the link between labor market institutions and economic performance has received considerable attention in the literature since the classical economists, it has become a major contentious issue since the mid 1970s among economists and policy makers. The OECD countries experienced a rapid increase in inflation and unemployment rates in the second half of the 1970s. Almost all the OECD countries (with a major exception, Turkey) were successful in curbing the inflation rate, but high unemployment rate has proved to be persistent in European countries.

The difference in labor market performances of the US and European countries has instigated an intensified debate on the link between labor market institutions and economic performance. Many economists and international organizations like the OECD had identified inefficient and inflexible labor markets as a reason for high and, in many cases, increasing unemployment in European countries. The concept of “labor market flexibility” has played the key role in these discussions.¹

The concept of labor market flexibility refers to the functioning of labor markets (“external flexibility”), and is mainly focused on wage and numerical flexibility. Wage flexibility stands for the speed of adjustment in wages in the labor market. What is usually meant by wage flexibility is the downward flexibility of real and/or nominal wages. Specific wage setting institutions (centralized collective bargaining, wage indexation and minimum wage legislation) and tax and social spending policies (high unemployment benefits, high non-wage labor costs, high marginal tax rates, etc.) are blamed for reducing wage flexibility. Numerical flexibility refers to how fast and how costly a firm can adjust by hirings, layoffs, and firings the composition and the number of workers it employs. Employment protection legislation (EPL) is one of the main institutions that determine numerical flexibility. Since numerical and wage flexibility are closely related with each other (as will be discussed later, rigidities in EPL may lead to higher wages), we will use only the term “labor market flexibility” hereafter to cover both aspects of external flexibility.

In the 1990s, some researchers have emphasized the importance of functional (or, “internal”) flexibility, flexibility in job boundaries and job design for multi-skilled workers. Although external and internal flexibility could be substitutes, or options for alternative corporate strategies, we will not study the issue of internal flexibility.

Article 125 of the Treaty Establishing the European Community calls for a coordinated strategy for promoting a “skilled, trained and adaptable workforce and labour markets responsive to economic change”. The concept of “adaptability” is certainly broader than the

¹ For a synthesis of views on labor market flexibility, see OECD’s influential *Jobs Study* (OECD 1994a and 1994b); for an overview of the evolution on the concept of labor market flexibility, see Brodsky (1994).

concept of “flexibility”. For example, it is suggested in a report financed by the European Commission that “adaptability” refers to “the broad process by which labour markets adjust to exogenous developments over a period of time”, whereas “flexibility” has come to be used “to refer to the short-term response of wages and labour costs, in particular, to variations in the demand for labour relative to supply, or to the ability of employers to adjust their work force to changes in economic activity”. Therefore, [w]hile flexibility defined in these terms may be an important part of the wider concept of adaptability, it is far from being the only aspect of labour market behavior which is of significance. Indeed, a high degree of flexibility so defined may not only conflict with the achievement of wider objectives than simply the maintenance of a high level of employment but might also make it more difficult to secure longer-term growth objectives.” (Algoé Consultants, 2002: 2) Keeping in mind these differences, our study is focused on labor market flexibility, especially on changes in EPL necessary during the accession process in Turkey.

There are opposing views on the effects of labor market flexibility on economic performance. On the one hand, a group of researchers claim that labor market flexibility is required for well-functioning of competitive markets, and, hence, for efficient allocation of resources. Since employment protection and rigidities in wage setting are costs incurred by firms, and they have profound effects on their decisions (OECD, 1994a, 1994b and 1999; Salvanaes, 1997; Blanchard, 2000; Heckman and Pagés, 2002; Scarpetta and Tressel, 2002).

First, it is suggested that stricter labor market regulations may lead to higher unemployment (and lower output) and change the composition of unemployment because they affect the flows to and from employment, i.e., hiring and layoffs. EPL costs affect layoffs directly because EPL costs are added to the cost of layoffs, and hiring indirectly, because firms will take into consideration the (potential) costs of layoffs (including EPL costs) in their hiring decisions. If the second effect dominates the first one, then the unemployment rate will be higher. EPL will also increase unemployment duration because of the decrease in the exit rate from unemployment.

Second, strict EPL is likely to strengthen the bargaining power of workers, and, depending on the structure of product and labor markets, may lead to wages higher than the market clearing wages, and higher unemployment. Moreover, EPL provides protection for “insiders”, those workers who have regular jobs in the “formal” sector. Thus, strict EPL may cause to the widening gap between “insiders” and “outsiders” and may encourage firms to operate in the “informal” sector.

Although there is almost a consensus on the effects of EPL on the composition and rate of unemployment among neo-classical economists, some researchers suggest that excessive labor market flexibility may hinder investment in training and innovative activities, diminish the accumulation of human and knowledge capitals, and, hence, have a negative impact on growth and employment in the long run. Michie and Sheehan (2003) state that “[t]he sort of ‘low road’ labor flexibility practices encouraged by labor market deregulation –short term and temporary contracts, a lack of employer commitment to job security, low levels of training, and so on- are negatively correlated with innovation”. Firms that rely on labor market flexibility to be more competitive will have weak incentives for conducting innovative activities. Moreover, reduced innovative activities, in turn, will have a negative impact on “employment and company profits” because “1) lower wage increases will lead to a slower replacement of the capital stock, 2) lower wages prevent the Schumpeterian process of creative destruction, and 3) lower wages will lead to a lack of effective demand” (Kleinknecht,

1998).² Patterns of sectoral specialization may also be influenced by labor market flexibility. For example, Bassanini and Ernst (2002) show in an empirical study that “countries with coordinated industrial relations systems and strict employment protection tend to specialize in industries with a cumulative knowledge base because coordinated industrial relations and employment protection encourage firm-sponsored training as well as the accumulation of firm-specific competencies.”

Rigidities and frictions in the labor market may reduce labor flows and lead to wage compression (lower wage differentials). These factors, however, may induce firms to provide more training for their employees, and contribute to the accumulation of human capital, both at the firm level and at the economy level (see, for example, Acemoglu and Pischke, 1998 and 1999; Agell, 1999; Ballot and Taymaz, 2001). The stability of employment relationship, complementarities between training and innovation activities, and wage compression all make training activities more profitable. Thus, firms will achieve higher productivity and higher rate of growth in productivity as a result of employing more skilled and well-educated employees.

Although the issue of the effects of labor market institutions on economic performance is yet to be resolved, there are some remarkable contributions in recent years that improve our understanding on how labor market institutions function. For example, Belot, Boonez and van Ours (2002) have developed a model that proves that there is an optimal degree of employment protection. In other words, both excessive and limited labor market flexibility could be detrimental for economic growth. More importantly, it is shown that the impact of labor market regulations and institutions depends on other market and technology conditions (Scarpetta and Tressel, 2002). Blanchard has developed a number of models in which he studies the interactions between labor and product markets (for example, see Blanchard, 2000). He shows that wage-setting institutions play a more important role if product markets are monopolistic or oligopolistic because only in those markets workers would be able to bargain over rents. Therefore, (de)regulation of labor and product markets needs to be implemented together. Finally, Belot (2002) develops the idea that labor market flexibility itself could be an endogenously determined variable, and shows in a model that countries with low migration costs and high economic heterogeneity (like the US) may prefer no employment protection.

There are numerous empirical studies that have attempted to test the effects of labor market flexibility on economic performance. Most of these studies show that the effect on the composition of unemployment is unambiguous: employment protection increases the duration of unemployment by slowing down the flows through the labor markets (more long-term unemployment and less short-term unemployment), but the effect on the rate of unemployment and output is ambiguous. It has adverse impact on specific groups of workers like youth, and marginal groups (for extensive surveys, see Nickell and Layard, 1999; Addison and Teixeira, 2001; Heckman and Pagés, 2002; Baker *et al.*, 2002). As far as growth and productivity is concerned, Nickell and Layard (1999) suggest that “there seems to be no evidence that either stricter labor standards or employment protection lowers productivity growth rates. If anything, employment protection can lead to higher productivity growth if it is associated with other measures taken by firms to enhance the substantive participation of the workforce”.

² Scarpetta and Tressel (2002) claim that “strict regulation may hinder the adoption of existing technologies, possibly because it reduces competitive pressures or technology spillovers”.

3. Labor Market Indicators for Turkey

Turkey, with its 64 million population, is the largest one among all 13 accession and candidate countries.³ Therefore, the eventual membership will have a profound impact on both Turkey and the EU countries, and the impact of membership will be determined, to a large extent, by the peculiarities of the structure of population and labor markets in Turkey.

One of the most important characteristics of the population in Turkey is observed in the age composition. The share of young people is relatively high thanks to its high birth rate. The birth rate tends to decline, but will remain higher than the European average in the coming decades (the population growth rate was about 1.8 % in the 1990s). High proportion of young people could be an advantage for Turkey because it leads to a dramatic rise in the share of active population, but imposes a heavy burden on the educational system, and makes employment generation one of the main social issues.

Employment rate as a percentage of population at the working age (age 15-64) is also lower in Turkey compared to the EU and other candidate countries (CCs). The employment rate is only 48.2 % in Turkey whereas it is 63.2 % in the EU, and it is well above 50 % in all CCs in 2000 (see Table 1 that presents the data on Turkey, the EU, and CCs with more than five million population). One of the main reasons behind low employment rate in Turkey is the fact that the participation rate is also low, especially for urban women. Turkey is expected to increase its employment rate in the future that intensifies pressures for employment generation.

Self-employment, and part-time and fixed-term employment rates⁴ seem to be quite high in Turkey (24.5 %, 20.7 % and 10.0 %, respectively). However, the majority of self-employed and part-time employed are working in agriculture, and the fixed-term employment is dominant in the construction sector. Therefore, these rates basically reflect sectoral specificities and the importance of these sectors (agriculture and construction) in total employment.

The share of agriculture in total employment is extremely high (34.5 %) and it is second to Romania (45.2 %) among all CCs. Since the share of agriculture is expected to decline in the future, this transformation may tend to lower the participation rate (because the participation rate for urban women is much lower than that of rural women), and add another source of demand for urban male jobs, mainly in the service sector. The share of services in total employment is much lower than the EU and CCs (again with the exception of Romania where the agricultural sector is predominant).

The unemployment data show that there could be substantial differences between labor markets in Turkey and the EU. The unemployment rate is relatively lower. Moreover, the youth unemployment rate is significantly lower, especially compared to major CCs, in spite of a huge influx of the young people into the labor force. Most interestingly, the long term unemployment rate⁵ (as a percentage of labor force) is very low, only 1.3 % although it is 3.7

³ At the time of writing this paper (Summer 2003), there were ten acceding countries (Cyprus, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Slovakia and Slovenia) and three candidate countries (Bulgaria, Romania and Turkey). For the sake of simplicity, we refer to all these countries as “candidate countries” (CCs) hereafter.

⁴ We define “part-time” employed in Turkey as those who work less than 25 hours per week. “Casual employment” (seasonal and temporary employment) as defined by the SIS is used for “fixed-term employment”.

⁵ “Long-term unemployed” refers to those unemployed at least one year.

% in the EU, 9.5 % in Bulgaria, 3.1 % in Hungary, 7.3 % in Poland, and 3.4 % in Romania. The proportion of long-term unemployed in total unemployed in Turkey is also very low: only 20 % in 2000. Among all large CCs, the lowest rate after Turkey is observed in Poland (45 %), and the EU average is about 47 %. These data seem to suggest that Turkey has maintained a high rate of labor market flows so that, in spite of a huge youth population and the growing demand for new jobs, the rate of long-term unemployment remains relatively low. In other words, Turkey has a quite dynamic labor market.

The labor market indicators summarized in Table 1 show that employment generation is a major issue in Turkey. The demand for labor has to increase at a high rate so that the rate of unemployment could be kept at the existing level. One of the main determinants of labor demand is, of course, the cost of labor. Table 2a presents the data on labor costs, income tax, and employees' and employers' social security contributions (SSCs) for a single individual without children in OECD countries in 2002. Table 2b presents the same data for various family types and wage levels. One can make three striking observations regarding Turkey from the data presented in Tables 2a and 2b.

First, average labor cost for the employer is substantially low in Turkey compared to the developed OECD countries, but it is relatively higher than some major CCs (Poland, Slovak Republic, and Hungary). The tax wedge (the proportion of income tax, and employer's and employee's SSCs in labor cost) for a single individual without children is close to the EU average and lower than the one observed in most of the CCs.

Second, the tax wedge does not differ much in Turkey across family-types and wage-levels. For example, the lowest tax wedge exists for an individual without any children earning 67 % of the average wage rate (41.3 %), and the highest for an individual without any children earning 167 % of the average wage rate (44.3 %); the difference is only 3 percentage points. In all EU countries (with the exception of Greece), the tax wedge differences between various categories of workers are much wider. These figures show that income tax and social security structures in Turkey do not have a social policy component that favors disadvantaged groups.

Third, there are significant differences across countries in terms of the shares of income taxes and SSCs. For example, the tax wedge is almost the same for Denmark and Austria, but the share of income tax is 32 % in Denmark, but only 8 % in Austria. In other words, there are substantial inter-country differences in the composition of cuts on labor costs.

These observations indicate that one should be extremely careful in making inter-country comparisons. There are significant differences in the institutional set-up: it seems that different institutions may have similar functions, and there could be complementarities/substitutions between various institutions and functions. Therefore, the issues like "labor market flexibility" need to be studied within a larger framework that encompasses all institutions interacting with each other.

4. Turkey and EU Labor Market Policies

Turkey needs to fulfill the EU's accession criteria and adopt the EU's regulatory framework for the EU membership. This process will lead to a rather dramatic transformation in the Turkish labor market through two channels. First, the membership process implies economic

integration with the EU, and competition in all markets will be intensified. Indeed, Turkey should ensure “the existence of a functioning market economy as well as the capacity to cope with competitive pressure and market forces within the Union” to satisfy the economic criteria for membership, i.e., the so-called *Copenhagen criteria*. Second, Turkey is required to apply fully the *acquis* of the EU in force⁶, including all rules and regulation in the field of employment and social policy that form Chapter 13 in accession negotiations.

Turkey has established a Customs Union with the EU since 1996. Therefore, the impact of the process of membership on the labor market through changes in product markets could be expected to be in a limited scale. The adoption of the *acquis* would have a direct impact on the labor market because it requires a new institutional setup and a new way of policy making. In this section, we will compare the labor law in Turkey with the EU directives and attempt to assess the effects of adopting the *acquis*. We will focus on the labor law and issues related with labor market flexibility.⁷ We will also briefly analyze how employment policies are formed in the EU (the European Employment Strategy), and how the candidate countries are expected to adjust and coordinate employment policies with the EU during the membership process.⁸

4.1. The EU law

The EU law is composed of three different types of legislation: primary legislation, secondary legislation, and the case-law. These types of legislation comprise the *acquis communautaire*.⁹

4.1.1. Primary Legislation

Primary legislation includes the Treaties establishing the Union and other agreements having similar status. The Treaties have been revised several times and the one that is in force now is the Treaty of Amsterdam. The Treaty of Amsterdam, signed by the Heads of State or Government of the Member States on October 2, 1997, and entered into force on May 1, 1999, following its ratification by the fifteen Member States. While the Treaty of Amsterdam does not change the basic principles of the earlier treaties, it promotes a series of social policy priorities at Community level, especially in the area of employment. The change in emphasis on “employment” is reflected in the fact that the Employment articles are included in the Treaty as a Title (like the monetary and economic articles), not as a mere Chapter. The Employment Title (Title VIII of the Treaty) lays down the principles and procedures for developing a coordinated strategy for employment. Article 125 sets the basic objectives as follows:

Article 125 : Member States and the Community shall, in accordance with this title, work towards developing a coordinated strategy for employment and particularly for promoting a skilled, trained and adaptable workforce and labour markets responsive to economic change with a view to achieving the objectives defined in Article 2 of the Treaty on European Union and in Article 2 of this Treaty.

The Treaty maintains the commitment to achieve a high level of employment as one of the key objectives of the EU, and calls attention to promoting “skilled, trained and adaptable

⁶ Of course, except in areas where transitional arrangements will have been granted during the accession negotiations.

⁷ For detailed descriptions of the legal framework in Turkey regarding the labor market and social protection system, see comprehensive studies by Tunali *et al.* (2003) and Adaman (2003).

⁸ Although the first pillar of European Union, the European Community, is analyzed in this study, we use only the term “EU” for convenience.

⁹ This section is based on information provided on the web site of DG for Employment and Social Affairs: http://europa.eu.int/comm/dgs/employment_social/index_en.htm

workforce and labour markets responsive to economic change". This objective is an issue of "common concern" for all the Member States.

The Treaty of Amsterdam, as in the case of earlier treaties, leaves the implementation of employment policy to the Member States, but obliges Member States and the Community to work towards developing a "coordinated strategy for employment" because labor market policies of a Member State will have a direct impact on other members as well. Article 128 sets out the specific steps leading to the formulation of such a strategy including, on an annual basis, guidelines for employment, possible recommendations to the Member States and a joint report by the Council and the Commission to the European Council, which describes the employment situation in the Community and the implementation of the guidelines. Each Member State is to provide the Council and the Commission with an annual report on the principal measures taken to implement its employment policy in the light of the guidelines for employment.

Finally, the Treaty provides a legal base for the analysis, research, exchange of best practice and the promotion of incentive measures for employment (Article 129), and establishes permanent, constitutionally-based institutional structures (Article 130, the Employment Committee) that will help to develop employment policies.

4.1.2. Secondary legislation

The EU secondary legislation is based on the Treaties and takes the following forms:

Regulations which are directly applicable and binding in all Member States without the need for any national implementing legislation.

Directives which bind Member States as to the objectives to be achieved within a certain time-limit while leaving the national authorities the choice of form and means to be used. Directives have to be implemented in national legislation in accordance with the procedures of the individual Member States.

Decisions which are binding in all their aspects for those to whom they are addressed. Thus, decisions do not require national implementing legislation. A decision may be addressed to any or all Member States, to enterprises or to individuals.

Recommendations and opinions which are not binding are recommendations to whom they are addressed.

The EU secondary legislation on employment is mainly regulated through the Council Directives that bind Member States as to the objectives to be achieved within a certain time-limit but leave them the choice of form and means to be used. In other words, the Directives are implemented in national legislation in accordance with the procedures of the individual Member States. Most of the Employment Directives can be implemented through collective agreements, provided such agreements can apply to all workers that the Directive intends to cover or to protect.

The secondary legislation, as the Treaty itself, directly confers certain individual rights to the citizens of Member States under the protection of the judicial system. Moreover, "Under article 226 EC (ex article 169 EC) the European Commission or a Member State may bring a complaint, alleging the failure by a Member State to fulfil an obligation under the Treaty,

before the European Court of Justice (ECJ or the Court). Grounds for a complaint may be, for example, the lack of transposition of a binding Directive, or the non repeal of a national rule that is not consistent with the Treaty or a Directive. If the Court finds that the obligation has not been fulfilled, the Member State concerned must comply without delay. If, after new proceedings are initiated by the Commission, the Court finds that the Member State concerned has not complied with its judgment, it may impose a fixed or a periodic penalty.” (Bronstein, 2003)¹⁰

4.1.3. Case-law

The case-law includes judgments of the European Court of Justice and of the European Court of First Instance, for example, in response to referrals from the Commission, national courts of the Member States or individuals. In this study, we will not cover the case-law on employment regulations.

4.2. Council Directives on Employment and the Turkish Labor Law

Turkey has started to change its laws and regulations in accordance with the *acquis*. In this section, we will compare the EC Directives on employment with the Turkish labor laws, both the new Labor Law N.4857 that was enacted by the Turkish Parliament on May 22, 2003, and the former Labor Law N. 1475 that regulated the labor market for decades. We will compare both the former and new labor laws because the new law has been in force for a few months, and the agents in the labor market are in the process of adapting themselves to new circumstances. This comparison will also make it possible to show how far the new Law goes in adopting the *acquis*. As mentioned previously, we will focus on only employment directives, and will not study directives on other labor-related issues like discrimination, free mobility of workers, health and safety regulations, etc. (for a comprehensive study, see Hermans, 2001.)

Table 3 compares EU Directives¹¹, the existing Labor Law N.4857 and the former Labor Law N.1475¹² The main issues and regulations addressed in the directive are summarized. A positive mark (+) for the Labor Laws shows that they are in conformity with the directive. A negative sign (-) represents either the Law does not satisfy the requirements set by the directive, or the issue is not addressed in the Law. A question mark (?) means the issue is not addressed in a well-defined way, or there are some differences between the Law and the Directive. The table provides references to relevant articles of the Labor Law as well.

Turkey, as the Member States, can comply with the directives either by adopting the laws, regulations and administrative provisions, or by introducing the required provisions through an agreement between the employers’ and workers’ representatives. For example, some Directives have been introduced in a number of Member States through collective agreements. However, the law-makers in Turkey seem to prefer to cover almost all provisions of the Directives in the new Labor Law. Therefore, the lack of regulations in the Labor Law may require further legislative work.¹³

¹⁰ Falkner *et al.* (2002) show in the case of labor law how this process works.

¹¹ For Council Directives on employment, see http://europa.eu.int/comm/employment_social/social/labour/index_en.htm

¹² We also analyzed the draft law prepared by the Scientific Committee, formed by the appointees of the Social Partners. Since there are some minor modifications in the draft, we use the one posted on the web site of the Confederation of the Turkish Employers’ Union (TISK), www.tisk.org.tr (downloaded on February 22, 2003).

¹³ The directives usually set the minimum conditions, and the Member States are not restricted to introduce laws, regulations or administrative provisions more favorable for workers.

Council Directive 93/104 concerning certain aspects of the organization of working time is one of the main directives regulating working conditions. The directive lays down minimum safety and health requirements for the organization of working time, and applies to minimum periods of daily rest, weekly rest and annual leave, to breaks and maximum weekly working time, and certain aspects of night work, shift work and patterns of work. The Directive brings flexibility to working time by setting the minimum requirements for the “average working time” for a reference period not exceeding four months. The Labor Law 1475 does not comply with the directive regarding the maximum average weekly working time (48 hours). Although the proposal for the new Law prepared by the Scientific Committee introduced the maximum limit to average weekly working time, the Parliament failed to adopt the provisions, and did not set any explicit limit for the weekly working time. This is surprising because the new Law was advocated by its proponents to introduce flexible work arrangements including *part-time* work. The new Law also failed to meet the requirement of the Directive regarding the annual leave. Although the directive requires that “every worker is entitled to paid annual leave of at least four weeks”, the new Law sets shorter periods on the basis of workers’ tenure (if a worker is employed 1-5 years, annual leave is only 14 days, for 6-14 years of employment 20 days, and more than 14 years of employment 26 days). The former Labor Law had a similar scheme, but two days shorter leave for all categories. Both the new and former Labor Laws fail also to take necessary measures “to ensure that an employer who intends to organize work according to a certain pattern takes account of the general principle of adapting work to worker, with a view, in particular, to alleviating monotonous work and work at a predetermined work-rate, depending on the type of activity, and of safety and health requirements, especially as regards breaks during working time” (Article 13).

Directives 97/81 on part-time work and *99/70* on fixed-term work have adopted the framework agreements on part-time and fixed-term work, respectively, between the general cross-country organizations, UNICE (Union of Industrial and Employers’ Confederations of Europe), CEEP (European Centre of Enterprises with Public Participation, and ETUC (European Trade Union Confederation). The social partners recognize that “contracts of an indefinite duration are, and will continue to be, the general form of employment relationship between employers and workers”, but follows the Essen European Council conclusions on the need to take measures with a view to “increasing the employment-intensiveness of growth, in particular by a more flexible organization of work in a way which fulfills both the wishes of employees and the requirements of competition”. Thus, the main aim of these directives to facilitate the development of part-time and fixed-term work on a voluntary basis and to contribute to the flexible organization of working time *by providing measures for the removal of discrimination against part-time and fixed-term workers* and by improving the quality of part-time and fixed-term work. These directives require that, in respect of employment conditions, part-time and fixed-term workers shall not be treated in a less favorable manner than compares full-time and permanent workers. The former Labor Law did not specifically define part-time and fixed-term contracts. Although the new Law complies with the directives to a large extent, it does not include the reference to the “applicable collective agreement” in the definition of “comparable worker”.¹⁴ The Directive on fixed-term work explicitly calls for the prevention of abuse arising from the “use of successive fixed-term employment contracts or relationships”.

¹⁴ For example, the Directive on fixed-term work defines “comparable worker” as a worker with “an employment contract of relationship of indefinite duration, in the same establishment, engaged in the same or similar work/occupation, due regard being given to qualifications/skills. Where there is no comparable permanent worker in the same establishment, the comparison shall be made by reference to the *applicable collective agreement*, or where there is no applicable collective agreement, in accordance with national law, *collective agreements* or practice” (emphasis added).

The new Law, however, does not impose any restriction on the cumulative duration or the number of successive contracts, but allows successive fixed-term if there is a “sound reason” (“esasli neden”) to do so.

Directive 98/59 on the approximation of the laws of the Member States relating to collective redundancies has introduced the procedures an employer should follow in contemplating collective redundancies. The former Labor Law has not envisaged any formal procedure in the case of collective redundancies. However, the Law on Employment Protection N. 4773, adopted by the Parliament on August 15, 2002, and entered into force on March 15, 2003, after a lengthy political struggle, replaced Article 24 in comply with the Directive. Law N. 4773 has been repealed by the new Labor Law that endorses the same procedure for collective redundancies (Article 29).

Directive 2001/23 (that has repealed Directive 77/187) and its amending directive (98/50) is related with the protection of workers’ rights in the event of transfers of undertakings, businesses or parts of undertakings or businesses. A related one, *Directive 80/987* (that was amended by the Directive 2002/74) regulates the protection of employees in the event of insolvency of their employers. The directive on transfers stipulates that the “transferor’s rights and obligations arising from a contract of employment or from an employment relationship existing on the date of transfer shall, by reason of such transfer, be transferred to the transferee”, and the transferor and the transferee shall be jointly and severally liable in respect of obligations, including collective agreements, which arose before the date of transfer from a contract of employment or from an employment relationship existing on the date of transfer (Article 3). Moreover, both the transferor and the transferee shall be required to inform the representatives of their respective employees affected by the transfer. The Labor Law and the Law on Collective Bargaining Agreements (Law 2822) have provided similar safeguards to protect employees’ rights. The new Labor Law complies with most of the provisions of the Directive, with the exception of those on “information and consultation” with employees (the Third Chapter).

Directives 80/987 and *2002/74* set rules to protect employees’ claims arising from contracts of employment or employment relationships in the event of their employer’s insolvency. The Directive explicitly states that the Member States may not exclude from its scope part-time employees, workers with fixed-term contracts and workers with a temporary employment relationship. Member States “shall take the necessary measures to ensure that guarantee institutions guarantee ... payment of employees’ outstanding claims, resulting from contracts of employment or employment relationships, including, provided for by the national law, severance pay on termination of employment relationships” (Article 3). The former Labor Law does not specifically address the issue of employees’ rights in the case of insolvency. However, the Law on Bankruptcy (no. 2004) assigns priority to workers’ outstanding claims. The new Law calls for the creation of a Wage Guarantee Fund as a part of the Unemployment Insurance Fund to protect employees’ claims, excluding the severance pay.¹⁵

Directive 94/33 sets the necessary measures to prohibit work by children (any person under 15 years of age or who is still subject to compulsory full-time schooling under national law), and minimum working conditions for young people (any person under 18 years of age). The Labor

¹⁵ The draft law prepared by the Scientific Committee envisaged the establishment of a Wage Guarantee Fund (WGF), and required employers to contribute to the Fund 0.5 % of the gross wage. However, the new Labor Law adopted by the Parliament has transferred the financial burden of the WGF on the Unemployment Insurance Fund

Law prohibits employment of any person under 13 years of age, and restricts employment of people under 15. The Law on Apprenticeship and Vocational Training (No. 3308) also regulates employment of children and young people. The new Law satisfies most of the provisions set by the Directive, and refers to the Ministry of Employment and Social Security for regulation the conditions of employment of young people.

Directive 91/833 requires that employers have an obligation to provide information to an employee on the essential aspects of the contract or employment relationship, not later than two months after the commencement of employment, in the form of a written document. The former Labor Law had a similar clause but did not specify the time limit in which the information has to be provided to the employee. The new Law, in accordance with the Directive, mentions that the document has to be handed over to the employee within two months if there is no employment contract signed by the employee and employer. Although the Directive requires that any change in the conditions referred to in the written document “must be subject of a written document to be given by the employer to the employee at the earliest opportunity and not later one month after the date of entry into effect of the change in question”, the new Law does not enforce this requirement.

A recent directive, published in the *Official Journal* on March 23, 2002, establishes a general framework for informing and consulting employees in the European Community (*Directive 2002/14*). The Directive requires all undertakings employing at least 50 employees, or all establishments employing at least 20 employees in any one Member State to adopt practical arrangements for exercising the right to information and consultation at the appropriate level. Information and consultation shall cover:

- “(a) information on the recent and probable development of the undertaking’s or the establishment’s activities and economic situation;
- (b) information and consultation on the situation, structure and probable development of employment within the undertaking or establishment and on any anticipatory measures envisaged, in particular where there is a threat of employment;
- (c) information and consultation on decisions likely to lead to substantial changes in work organization or in contractual relations.”

Information shall be provided by the employer “at such time, in such fashion and with such content as are appropriate to enable, in particular, employees’ representatives to conduct and adequately study and, where necessary, prepare for consultation.” A Related directive on the establishment of a European Works Council (*Directive 94/45*) sets the rules and procedures to improve the right to information and to consultation of employees specifically in Community-scale undertakings and Community-scale group of undertakings. Neither the existing Labor Law nor the proposal provide any provisions to establish the framework for informing and consulting employees within the context of these Directives.

There are directives on parental leave (96/34)¹⁶, health and safety conditions (89/391 and 91/383), and working conditions in specific sectors (93/104, 99/63, 2000/34, 2000/79, etc.). The Turkish Labor Law is in compliance with most of the provisions of these directives.

4.3 European Employment Strategy

¹⁶ Under the parental leave directive (Directive 96/34 of June 3, 1996, on the framework agreement on parental leave concluded by UNICE, CEEP and the ETUC), father and mother are given an individual right of at least 3 months parental leave to take care of their (natural or adopted) child. They have the right to return to the same or an equivalent work place.

4.3.1. The European Council Summits

The Treaties establishing the EU have considered the responsibility for employment and social protection under the exclusive responsibility of the Member States. The role of the Commission was to promote co-operation between the Member States at the EU level. In the early 1990s, persistent European-wide unemployment and structural problems in the labor markets together with the increased integration of national economies led to a process of finding European solutions through closer co-operation and convergence of structural policies, including the employment and social protection policies.

The famous Delors' White Book on *Growth, Competitiveness and Employment* in 1993 set the scene for the development of coordinated employment policies at the EU level. Inspired by the Delors' White Book, the European Council in Essen in 1994 agreed on five objectives¹⁷ and formulated the *Essen Strategy* that was reinforced by successive Council conclusions and resolutions. A permanent *Employment and Labour Market Committee* was created in 1996. The Essen Strategy declared political commitment to the issue of employment, but the strategy itself and its implementation was based on non-binding conclusions of the European Councils. The Amsterdam Treaty (signed in 1997 and entered into force in 1999) and the new Title on Employment provided the necessary legal framework for implementing a coordinated employment policy.

The European Council in Luxembourg (November 1997), which is now known as the *Luxembourg Jobs Summit*, launched the European Employment Strategy (EES) on the basis of the new provisions in the Employment title of the Treaty of Amsterdam before it entered into force. The following European Councils have provided additional orientations and targets for the EES and reinforced its links with other EU policies.

The European Council in *Lisbon* (March 2000) set a new strategic goal for the next decade for the EU ("to become the most competitive and dynamic knowledge-based economy in the world, capable of sustainable economic growth with more and better jobs and greater social cohesion"), and integrated the EES into a wider framework of policy coordination to achieve this strategic goal. The European Council agreed the objective of achieving an employment rate as close as possible to 70 % overall, and exceeding 60 % for women, on average in the EU, by 2010. Following the mid-term review of the first three years of implementation, the Council proposed strengthening the EES.

The European Council in *Nice* (December 2000) introduced the issue of quality as the guiding thread of the Social Policy Agenda, and in particular quality in work as an important objective of the EES.

Confirming the Union and the Member States' commitment to the goal of full employment, the European Council in *Stockholm* (March 2001) added two intermediate and one additional target: the employment rate should be raised to 67 % overall by 2005, 57 % for women by 2005 and 50 % for older workers (aged 55 to 64) by 2010.

The *Barcelona* European Council (March 2002) underlined that the goal full employment in the EU is at the core of the Lisbon strategy and constitutes the essential goal of economic and

¹⁷ These included the development of human resources through vocational training, the promotion of productive investments through moderate wages policies, the improvement of the efficiency of labor market institutions, the identification of new sources of jobs through local initiatives, and the promotion of access to the world of work for some specific target groups such as young people, long-term unemployed people and women.

social policies. It called for a reinforced Employment Strategy to underpin the Lisbon strategy in an enlarged EU. Following the 2002 evaluation, the Barcelona Council also urged the Council and the Commission to streamline the various policy coordination processes at EU level.

The *Brussels* European Council (March 2003) re-iterated that the Employment Strategy has the leading role in the implementation of the employment and labor market objectives of the Lisbon strategy, and that it and the Broad Economic Policy Guidelines (BEPG) should operate in a consistent way. The European Council called for guidelines to be limited in number, results orientated, allowing Member States to design the appropriate mix of action, and should be supported by appropriate targets.

4.3.2. The 2002 Evaluation of the European Employment Strategy

The EES, since its inception in 1997 until the evaluation in 2002, was based on four "pillars" (employability, entrepreneurship, adaptability, equal opportunities) together with horizontal objectives. In its fifth year, an extensive evaluation study was conducted to overview the objectives of the EES and to strengthen the policy formulation and implementation process. The study indicated that (European Commission, 2002a)

The comprehensive approach of the EES generally strengthened national employment policy coherence and framework. Policies under each pillar were progressively adjusted and employment priorities were mainstreamed into other policy areas like taxation and social security. In addition, the Strategy has brought about a gradual change in priority from managing unemployment to managing employment growth, and has become gradually embedded in national policy formulation.

Beyond the clear convergence towards the active labour market principles of the EES in the earlier years of the strategy, the evaluation shows that other policies were also significantly influenced by the EES (notably gender equality and social inclusion policies). ... Over the years, the EES has added momentum to longer term structural reforms in labour markets, not least through the use of recommendations, addressed to individual Member States, adopted by the Council on a proposal from the Commission.

The EES also fostered political agreement on new common paradigms, such as lifelong learning and quality in work. The need for lifelong learning, and the complementarity between education and training systems has become generally accepted and Member States are all in the process of re-designing their education and training policies in a more integrated way. Quality in work appeared as a new priority in the Employment Guidelines for 2000.

4.3.3. Streamlining Policy Processes

Following the Barcelona Council, the Commission adopted its Communication on streamlining the annual economic and employment policy coordination cycles (European Commission, 2002b). The main idea is to re-organize existing EU coordination processes around a few key points to make the coordination cycle more transparent and intelligible and strengthen its visibility and impact. In line with the overall Lisbon Strategy, this process is expected to reinforce the focus on the medium term and to improve policy coherence. Within the new approach the BEPGs are expected to provide the overarching economic policy coordination, while the leading role on employment policy coordination will lie with the Employment Guidelines (EGs) and Recommendations to Member States.

The main building blocks of a better and more clearly articulated policy coordination cycle can briefly be described as follows (European Commission, 2003a and 2003b):

(i) *Preparation of the Spring European Council:* The Commission would, in its Spring Report, highlight the main areas where further progress has to be made and the key policy orientations on which general guidance is required from the Spring European Council. The Spring Report would be complemented and presented together with the Implementation Package (including the Implementation Report on the BEPGs [Broad Economic Policy Guidelines] and the draft Joint Employment Report and the implementation report on the Internal Market Strategy). The Commission's various reports and scoreboards (including *inter alia* the Cardiff Report, the State aids, innovation and enterprise policy scoreboards) will feed into the Implementation Package and the Spring Report. This Commission input would assist different Council formations, as well as any other appropriate actor, in reviewing implementation in their specific policy areas.

(ii) *The Spring European Council:* The Spring European Council is a defining moment in the annual policy co-ordination cycle. It reviews implementation and, on that basis, gives general political orientations on the main policy priorities.

(iii) *Commission proposals for new guidelines and recommendations:* On the basis of the Spring European Council political orientations, the Commission would present its proposals for further action in the various policy areas together in a Guidelines Package (which would include the Commission drafts for general and country-specific policy recommendations as contained in the BEPGs; the EGs [Employment Guidelines]; and the annual employment recommendations to Member States). This Package, the first of which would be issued in April 2003, would, in principle, cover a three-year period, i.e. up to 2006. The guidelines would continue to be issued every year to take account of possible major new developments, but should otherwise remain stable until 2006, unless circumstances require otherwise. Consistent with the recommendations of the BEPGs and the outcome and conclusions of the Cardiff process, the Internal Market Strategy - which will accompany the Guidelines Package - would deal with internal market matters at Community level up to 2006, and would be adjusted in the intervening years only if necessary.

(iv) *Adoption of new guidelines and recommendations:* After, where appropriate, further preparation by the competent Council formations ahead of the June European Council and following the latter's consideration, the relevant Council formations would adopt the BEPGs, the EGs and the Employment Recommendations to Member States and/or endorse action plans (e.g. the Internal Market Strategy) in their competence areas.

(v) *Concentration of implementation review in Quarter 4:* A better streamlined review of implementation requires:

- Systematic information provision by Member States on the implementation of policies agreed at European level. In this context, there may be scope for rationalising and streamlining current national reporting requirements. Fewer and more comprehensive reports², allowing also for coverage of information on newly identified issues (thus avoiding the need to add new reports and procedures), might help in clarifying and ensuring the coherence of Member States' responses to policy recommendations issued by the Community; these reports should ideally be presented together in October at the latest. The National Employment Plans would be sent as a separate document around the same time.
- An implementation assessment by the Commission. On the basis of the available information (through reports, through bilateral contacts and through the results of various benchmarking exercises), the Commission services would assess implementation in the various relevant policy areas.

The Commission will present the findings of its review in the form of a new Implementation Package together with the Commission's Spring Report in mid-January, marking the start of a new cycle.

4.3.4. 10 Commandments, Targets and Indicators

The European Council has identified and confirmed three objectives for the EES:

1. *Full employment:* Employment rate overall (67 % in 2005 and 70 % in 2010 on average for the EU), for women (57 % in 2005 and 60 % in 2010), for older workers (50 % in 2010)

2. *Quality and productivity at work:* Satisfaction with pay and working conditions, health and safety at the work place, the availability of flexible work organization, working time arrangements and the balance between flexibility and security. Full attention is given to increasing productivity, in particular through continued investment in human capital, technology and work organization.

3. *Cohesion and an inclusive labor market:* The reduction of unemployment and of the remaining disparities in access to the labor market, both in socio-economic and regional terms, is a matter both of equity and of efficiency of the EES.

To support these three objectives, the Commission has identified 10 priorities (“10 commandments”) for action in the new guidelines. The 10 commandments are as follows:

1. help unemployed and inactive to find a job, prevent long-term unemployment
2. encourage entrepreneurship and improve climate for business start-ups
3. promote adaptability of workers and firms to change
4. provide more and better investment in human capital
5. increase labor supply and promote active ageing
6. promote gender equality in employment and pay
7. combat discrimination against disadvantaged groups
8. improve financial incentives to make work pay
9. reduce undeclared work substantially
10. promote occupational and geographical mobility

The Commission has also defined specific targets that could be used as a part of the assessment of progress on implementing the guidelines. The targets are as follows:

- personalized job search plan for all unemployed before fourth month of unemployment by 2005
- work experience or training for all unemployed before twelfth month of unemployment (before six months for young and vulnerable) by 2005
- 30% of long-term unemployed in work experience or training by 2010
- reduction of 15% in rate of accidents at work, and a reduction of 25% for high-risk sectors by 2010
- 80% of 25-64 year olds to have at least upper secondary education by 2010
- increase rate of participation of adults in education and training to 15% on average in the EU, and to at least 10% in every Member State by 2010
- increase in investment by companies in training of adults from the existing level of the equivalent of 2.3% of labor costs up to 5% of labor costs on average in the EU by 2010
- an increase in the effective average exit age from the labor market from 60 to 65 years on average in the EU by 2010
- elimination of gender gaps in employment and halving of gender pay gaps in each Member State by 2010
- childcare places available for 33% of 0-3 year olds and 90% of those from 3 years to mandatory school age in each Member State by 2010

- halving of the school drop-out rate in each Member State and reduction of EU average drop-out rate to 10% by 2010
- reduction by half in each Member State in the unemployment gaps for people defined as being at a disadvantage in accordance with national definitions by 2010
- reduction by half in each Member State in the employment gap between non-EU and EU nationals by 2010
- all job vacancies advertised by national employment services should be accessible and be able to be consulted by anyone in the EU by 2005
- national targets to be set for: business training; reduction of red tape for start-ups; per capita increase of public and private investment in human resources; tax burden on low-paid workers; undeclared work.

4.3.5. EU Labor Market Policies and Enlargement

The Commission initiated in 1999 a co-operation process on employment with the CCs. The objective of this process is to encourage CCs to define employment policies that prepare them for membership of the EU and progressively adjust their institutions and policies. Moreover, the financial support for accession would be directed towards the employment policy priorities identified in this co-operation process (European Commission, 2003c).

It was agreed that in a first step CCs and the Commission would analyze the key challenges for employment policies in Joint Assessments Papers (JAPs). The work was started with background studies funded by the Commission in co-operation with the European Training Foundation. The first JAPs were signed with the Czech Republic, Slovenia, Poland and Estonia in 2000 and early 2001, followed by Malta, Hungary, Slovakia, Cyprus and Lithuania in late 2001/early 2002 and by Romania, Bulgaria in Autumn 2002. The JAP with Latvia was signed in February 2003. Co-operation with Turkey is at an early stage; the background study for the Employment Policy Review was prepared in the early 2003 under the auspices of the Turkish Employment Organization (İŞKUR) (Tunalı *et al.*, 2003). This will form the basis of a JAP to be drawn up jointly with the European Commission.

The CCs and the Commission agreed to monitor the implementation of the JAP commitments. After the signature of the JAPs the main commitments were discussed in a series of technical seminars between Commission and representatives of different institutions in the CCs. The Göteborg European Council of June 2001 asked candidate countries to translate the EU economic, social and environmental objectives underpinning the *Lisbon Strategy* into their national policies and announced that the Synthesis Communication 2003 would include information on CCs in this respect.

5. Employment Protection and Labor Market Flexibility in Turkey

The growing interest in labor market flexibility has provided an impetus for empirical studies that aim at *measuring* the degree of labor market flexibility, mainly at the national and regional level. Researchers have developed two sets of measures. The first set of measures, pioneered by OECD's influential study on employment protection legislation, is based on a set of indicators of labor market regulation that summarize the information on the regulatory environments. OECD has constructed a database of internationally comparable data on certain economy-wide and industry-specific product market and labor market regulations (for the methodology, the database, and summary indicators, see Nicoletti, Scarpetta and Boylaud, 2000). Since the OECD database allows researchers to make international comparisons and to

analyze the impact of labor market regulations on economic performance in a cross-country setting, it led to a surge in empirical studies, and estimation of similar indicators for other countries. For example, Heckman and Pagés (2002), Riboud, Sánchez-Páramo and Silva-Jáuregui (2002), and Cazes and Nesporova (2003) have calculated EPL indicators for Latin American, CEEC, and transition countries, respectively. In a similar fashion, Betcherman, Luinstra and Ogawa (2001) present a detailed analysis of labor market regulations in 17 countries, including Turkey. In this section, we will compare the strictness of EPL in Turkey under the former Labor Law (that formed the basis for OECD indicators) and the new Labor Law, with the OECD countries.

The second set of measures, that we define as direct measures, is based on the estimation of various aspects of labor market flexibility by using the data on labor market variables. In this study, we will use three types of direct measures to assess the labor market flexibility in Turkey: wage differentials, job turnover, and mode-based indicators (employment and wage flexibility).

5.1. Employment Protection Legislation

The OECD EPL Index, calculated by Nicoletti, Scarpetta and Boylaud (2000), exploits the raw data published in the *OECD Employment Outlook 1999* (see OECD, 1999). The data cover two basic elements of the EPL system (restrictions on dismissals of workers with *regular contracts*, and restrictions on the use of *temporary forms of employment contracts*), and refer to the situation in most of the OECD countries in the late 1980s as well as in 1998.

Regulations for regular contracts (permanent employment) cover detailed indicators on

- procedural requirements (the process that has to be followed from the decision to lay off a worker to the actual termination of the contract),
- notice and severance pay (for three tenure periods beyond any trial period), and
- prevailing standards of and penalties for “unfair” dismissals.

The following elements were considered for regulations for temporary contracts (fixed-term contracts and contracts under temporary work agencies, TWAs):

- “Objective” reasons under which a fixed-term (or a TWA) contract could be offered
- The maximum number of successive renewals
- The maximum cumulated duration of the contract

Nicoletti, Scarpetta and Boylaud (2000) assigned a score from 0 to 5 for each indicator depending on the degree of strictness of employment protection implied by that indicator, and conducted a factor analysis to aggregate the detailed indicators of each domain (regular employment and temporary employment) into summary indicators of the strictness of regulation by domain. The overall index of stringency of EPL (the EPL Index) was obtained by simply averaging the two summary indicators for regular and temporary contracts. The factor analysis was conducted on the 1998 regulatory indicators for 21 OECD countries for which most information was available.

Table 4 presents the summary indicators for all 25 countries (ranked in descending order by the strictness of the EPL index) for the late 1990s. Turkey has a very high overall score (ranked 2nd), mainly because of the score it gets from temporary employment domain (index value 4.6, the highest among all countries in the table).

Table 5 presents basic indicators, EPL, and EPL index scores for regular employment for three countries, Germany (a leading country case from the EU, Turkey's main trade partner), Spain (a late comer in the EU), Poland (a case for CCs), the US (the extreme case among the OECD countries), and Turkey. The data for Turkey are presented in two columns. The first column refers to the situation prevailing under the former Labor Law N. 1475, and the data were taken from Nicoletti, Scarpetta and Boylaud (2000). The second column refers to the current situation with the new Labor Law N. 4857 (values of some indicators are based on our judgments). Table 6 presents the same data for temporary employment.

As can be seen in Table 5, the EPL Index for regular employment for Turkey had higher scores mainly because of high severance payments after 4 and 20 years of tenure, trial period before the eligibility arises, and unfair dismissal compensation (20 years of tenure). Since the new Labor Law changes these provisions, there is a significant reduction in the EPL index values for regular employment. The EPL Index for temporary employment had higher scores because of the restrictions on fixed-term contracts, and the lack of legal framework for TWAs. The draft Labor Law had special provisions regarding the TWAs, but these provisions were left out in the law adopted by the Parliament. The new Labor Law allows, with the written consent of the worker, for temporary transfer between enterprises belonging to the same holding company, or between different companies if the worker is employed in a similar position, up to 12 months in total. For fixed-term contracts, the Law does not impose any restriction on the maximum cumulative duration/renewal. Thus, the new Law provides flexibility, according to the OECD definition, for temporary employment.

Figure 1 shows the EPL Index for the same group of countries, and the contribution of each main category (factors) on the EPL Index. As evident in the figure, the changes introduced by the new Labor Law N. 4857 have dramatically reduced the EPL Index for Turkey, mainly by making temporary employment easier. If new regulations provide the legal basis for TWAs, the index value will be much smaller.

Although the EPL measures are extensively used in empirical studies, they have a number of known shortcomings. First, there are significant *measurement problems*. As Addison and Teixeira (2001) mention, measuring the stringency of employment protection merely from the legal texts may not provide a good indicator for the monetary costs to employers because the costs to employers depend on various other factors like voluntary turnover, the occupational and tenure distributions of the labor force that define the entitlements for severance pay, etc.

Second, the *coverage* of the law and regulations is very important. The OECD EPL Index ignores almost completely the coverage issue. The EPL Index is a simple average of the indices for regular and temporary employment, although temporary employment accounts only 20% of wage earners in Turkey. Moreover, the employment protection provisions of the new law do not cover establishments employing less than 30 workers that leaves more than 40% of workers registered at the Social Insurance Institution (Sosyal Sigortalar Kurumu, SSK) out of protection (2000 HLFIS data). The law also excludes certain sectors and activities.

Third, *enforcement and implementation* of the law is a major issue in countries like Turkey. As Bertola, Boeri and Cazes (1999) discuss in detail, the EPL is enforced in different degrees, and a simple ranking of countries on the basis of legal provisions may lead to misleading results.

Finally, the existing EPL measures neglect the *links and interactions* between EPL and other labor market institutions, such as unemployment benefit schemes, wage-setting institutions,

early retirement, pensions, etc. Some of these institutions could be substitutes, some others complementary. “Protection against job loss is all the more desirable when only scant unemployment insurance is available, and unemployment insurance is highly appreciated when weak job security provisions increase the risk of job loss. Indeed, in some countries job security - especially case law favourable to employees - does appear to be inversely correlated to the coverage and level of unemployment insurance (suggesting a trade-off between the strictness of EPL and the unemployment benefit system, as in Denmark, Italy or Spain, for example) or other adjustment tools such as early retirement provisions.” Bertola, Boeri and Cazes (2000). Blanchard (2002) observes that there is an inverse relation between the degree of employment protection and the generosity of the state unemployment insurance system in the Continental Europe. He explains this inverse relationship by suggesting that these institutions are two different ways of addressing the same failures, each one more appropriate to the circumstances of the country. This is exactly the case in Turkey. The unemployment insurance legislation was enacted in 1999 (Law N. 4447), and started to provide unemployment benefits for those eligible in 2002. Therefore, severance pay was considered as a kind of protection and insurance against unemployment in the implementation of the former Labor Law, and it proved to be easier to change the provisions on severance pay in the new Labor Law after introducing the unemployment insurance system in the country.

There is almost a consensus on the impact of EPL on flows from and into unemployment (Jackman, Layard and Nickell, 1996; Blanchard, 2000). On the one hand, higher EPL decreases hiring that makes it difficult to find a new job for the unemployed, and thus increases long term unemployment. On the other hand, higher EPL also decreases firing and decreases (short term) unemployment. The net effect on unemployment is ambiguous.

Blanchard (2000) shows that there is a negative correlation between flow into unemployment and the OECD EPL ranking (Figure 2), and a positive correlation between unemployment duration and the EPL (Figure 3), but no correlation at all between the unemployment rate and the EPL (Figure 4), as predicted by the theory. The Turkish data¹⁸, not available in Blanchard’s study, were also plotted on Figures 2-4. Turkey is an apparent outlier in Figure 2, and in Figure 3 to a lesser extent. In other words, the data on flow into unemployment suggest less strict employment protection than it is implied by the OECD index. This discrepancy could be regarded an indication of the caveats of EPL, as discussed above, for a country like Turkey.

5.2. Direct Measures of Labor Market Flexibility

Rigidities in labor markets are expected to change the behavior of economic agents, and labor market outcomes. In this study, we use three measures that could reflect the extent of labor market rigidities. Because of the lack of internationally comparable data, we focus on the manufacturing industries.¹⁹

Wage differentials tend to be lower in countries with rigid labor markets, because various labor market institutions, especially labor unions and minimum wage legislation, usually aim at wage compression across sectors and different categories of workers. If the labor market does not operate efficiently in the sense that wages are set completely by “market forces”, then wage differentials would be lower.

¹⁸ The Turkish data were calculated from the HLFS for the period 2000-2002.

¹⁹ Unless otherwise stated, the data from the UNIDO *Industrial Statistics Database* at the ISIC (Rev. 2) 3-digit level are used throughout this section.

Figure 5a depicts the data on the evolution of inter-industry wage differentials²⁰ for a selected group of countries for the period 1980-2000. Throughout the period, Turkey had a much wider inter-industry wage differentials than the US (the benchmark case for flexible labor markets), Greece and Spain (two EU countries), and Hungary and Poland (two CCs). As may be expected, Poland and Hungary had relatively low wage differentials in the 1980s, but they have experienced a widening gap in inter-industry wages since the late 1980s as a result of transition towards the market economy. Wage differentials in Turkey had increased in the late 1980s when real wages increased rapidly in the post-military period, and declined in the period of wage depressions in the late 1990s. The same data are presented for developed EU countries and the US in Figure 5b. Among all the developed countries depicted in Figure 5b, the US has the highest wage differentials in the manufacturing industry, and the Scandinavian countries have the lowest wage differentials. The data in Figures 5a and 5b seem to conform to the widely held beliefs that the Scandinavian countries have more equal income and wage distribution as a result of their specific centralized wage setting institutions.

Rigidities in labor markets make the cost of firing, and the potential cost of hiring higher. Thus, expansion and contraction of firms will be more costly, new firm formation will be limited, and the exit rate will be lower. All those factors will reduce *job turnover*. Table 7 presents the data on job turnover for a group of countries. The rate of job turnover for Turkey is calculated only for manufacturing establishments employing more than 10 workers. The data for the manufacturing industry are available for Chile, Columbia, and the US. For all other countries, the data are available for the whole economy. The US data seem to suggest that the job turnover rate is lower in the manufacturing industry than in other sectors.

The average job turnover rate for the Turkish manufacturing industry for the period 1980-2000 is 21%, i.e., the proportion of jobs created and destroyed in a year is 21 % of all jobs available. The rate for Turkey is somewhat higher than the one observed in the US, and slightly lower than those in Columbia and Chile. Although there are a number of problems in cross-country comparisons, one could claim that the job turnover rate in Turkey seems to be high. Table 8 presents the same data for the public sector and private sector by size categories for two sub-periods, 1980-1990, and 1990-2000. The job turnover rate is much higher in the private sector, especially among small establishments, because of high rates of entry and exit. Job turnover due to expansion and contraction dominates entry and exit in the case of medium-sized and large establishments. There seems to be a slight increase in the job turnover rate in the 1990s.

Model-based indicators are extensively used in empirical studies to assess employment and wage flexibility (for example, see Nickell and Layard, 1999; Fabiani and Rodriguez-Palenzuela 2001; Plasmans *et al.* 2002). These indicators are based on the coefficients of adjustment terms or elasticities in employment and/or wage equations.

Employment flexibility can be defined as the speed of adjustment of employment in a labor demand equation. A simple dynamic conditional labor demand equation can be written as

$$L_{t,i} = \beta_i + \beta_1 L_{t-1,i} + \beta_2 Q_{t,p} + \beta_3 w_{t,i} + \varepsilon_{t,i}$$

where L , Q and w refer to the number of employed, real output and real product wage, respectively. All variables are in log form. The subscripts t and i denote time, and the cross-

²⁰ Inter-industry wage differential is defined as the coefficient of deviation of (log) industry wages.

sectional unit (industry or firm), respectively. ε are the usual error terms. The coefficient of the lagged employment, β_1 , measures the speed of adjustment, and the coefficient of the wage variable, β_3 , the wage elasticity of labor demand.

The wage equation can be defined in a similar way, and can be used to estimate the effects of independent variables on wages. In real wage equations, the unemployment rate is usually included into the model to estimate the degree of real wage flexibility, because the coefficient of the unemployment term reflects how sensitive real wages are to the unemployment level. If the rate of unemployment is higher (than the NAIRU), then the real wage is expected to decline to clear the market, i.e., a statistically significant negative coefficient is expected for the unemployment term. The absolute value of the coefficient will indicate how fast the labor market adjusts.

Because of the lack of data, we estimated only the dynamic labor demand equation for a group of OECD and CCs by using panel data at the ISIC (Rev. 2) 3-digit level for the period 1980-2000. GMM is used to estimate the model in difference form. Figure 6 plots the adjustment parameter against the wage elasticity. Since a military government ruled the country in the early 1980s, we re-estimated the same equation for Turkey for the 1990s. As in the case of almost all measures, the US seems to have a flexible labor market for the manufacturing industries. The adjustment parameter is small that implies fast adjustment, and the wage elasticity is high. The rate of adjustment is rather slow in Turkey, but it seems to be getting faster in the 1990s.

There are only a few empirical studies that measure wage flexibility for Turkey. Onaran (2002) estimated a wage equation by using panel data at the industry level, and found that real wages are quite flexible in the post-1980 period.²¹ İlkkaracan and Selim's (2002) findings on the basis of a cross-sectional estimation of individual-level wage equation suggest that there is a statistically significant negative correlation between wages and regional unemployment rates. Separate regressions for men and women, however, show a wage curve to exist only in the male labor market. Unemployment elasticity is higher in the private sector, supporting the anecdotal evidence that the private sector has more flexible employment practices than the public sector does.

The evidence presented here suggest that the EPL in Turkey seems to be "rigid", but it excludes a large part of the economy, legally, small businesses and certain sectors, and illegally, the informal sector. There also seems to be some enforcement problems. A number of measures studied here shows that the labor market for the manufacturing industry, which is probably the most regulated and unionized sector, is quite flexible. Moreover, the new labor law provides legal basis for flexible employment practices, like part-time and fixed-term employment.

6. Problems and Prospects: An Assessment

The labor market institutions in Turkey face with four major challenges in the next couple of decades:²²

²¹ As shown by Agell and Binnmarker (2002) for the Swedish case, it is easier to achieve real wage flexibility even if nominal wages are "rigid" in an inflationary environment.

²² See also Tunali *et al.* (2003).

1. The share of agriculture in total employment will continue to decline, and more jobs, especially in the service sector, have to be created.
2. Employment rate has to be increased, most importantly by increasing the participation rate for urban women. This requires a substantial increase in employment opportunities for urban women, especially an increase in part-time jobs.
3. The share of young people will remain quite high compared to the EU and candidate countries. This demographic structure presents both a window of opportunity for the Turkish economy, but also a heavy burden, especially on the educational and training system.
4. The “informal sector” continues to be an important source of low quality, low wage jobs. It provides a room for survival for a huge number of small and medium-sized enterprises (SMEs) that enjoy flexible employment practices, and avoid paying taxes, SSCs, etc. Therefore, the “informal sector” helps to curb the pressures on employment, but at the same time hinder the generation of better jobs by the formal sector.

The prospect for EU membership has initiated a number of changes in the legal framework and labor market institutions in order to adopt the Community *acquis*. Against the background of these four challenges, the likely effects of adopting and implementing the *acquis* could be discussed under three levels: the impact of the new Labor Law that has introduced a number of directives (the short term), the impact of adopting and implementing all employment directives (the medium and long term), and the impact of designing and implementing employment policies in line with the objectives and targets of the EES.

6.1. The Impact of the New Labor Law

As the comparisons indicate, the new Labor Law (N. 4857) has introduced a number of changes in accordance with the EC Directives, but there is a need for further reform in the Labor Law and related regulations to comply fully with the *acquis*. The potential effects of the changes introduced by the new Labor Law can be summarized as follows.

First, the new Labor Law has provided a legal basis for “atypical” employment relationships, namely part-time and fixed-term employment. This is the most welcome aspect of the new law by employers. However, as mentioned in Section 2, part-time employment is not widespread in Turkey (except the agricultural sector). Moreover, average weekly working time is quite long, and there has been an effective lobbying against implementing the Directive’s provision (93/104) regarding the maximum average weekly working time (48 hours).²³ According to the SIS’s *Household Labour Force Statistics* (2000), 41.5 % of all paid workers work 50 hours or longer in a week. Therefore, the Law is not expected to have any significant impact on part-time employment. Given the emphasis on labor market flexibility, one may expect a tendency towards increasing use of fixed-term and subcontract labor. Although the directives on part-time and fixed-term employment require “that, in respect of employment conditions, part-time and fixed-term workers shall not be treated in a less favorable manner than comparable full-time and permanent workers”, it could be difficult to enforce these provisions in the

²³ In the former Labor Law N. 1475, “weekly working time” was 45 hours that had to be equally distributed over the week. The new Law N. 4857 defines “normal average weekly working time” for which the worker is paid at the “normal” wage rate (the average is calculated over two months) as 45 hours. The Law sets the maximum annual limit for the overtime work at 270 hours. Thus, if a worker works 50 weeks a year, then the maximum average weekly working time will be 50.4 hours.

Turkish context, at least in the medium-term, because the Turkish Labor Law does not provide sufficient safeguards to protect part-time and fixed-term employees. Moreover, the Law does not impose any restriction on the cumulative duration or the number of successive contracts. Thus, the employers are expected to lower labor costs by gradually switching to fixed-term contracts and subcontract labor. However, this strategy, if it is considered to be the main strategy to improve competitiveness, could easily turn out to be a “low road” labor flexibility practice that may lead to a neglect of accumulating human capital.

Second, the new Law reduces the cost of layoffs by establishing a special Severance Payment Fund (SPF). Firms are required to pay 3 % of the wage bill to the fund and the fund will cover all severance payments. Thus, the overall effect of the change in severance pay system is likely to reduce firms’ (hiring and firing) costs.

Third, the new Labor Law has included most of the articles of the Law on Employment Protection N. 4773, but reduced the coverage of employment protection by excluding those establishments employing less than 30 workers (the Law N. 4773 excluded only those employing less than 10 workers). Therefore, the new Labor Law has legally provided extensive flexibility to small establishments.

To summarize, the changes introduced by the new Labor Law N. 4857 address mainly the short-term concerns of employers to achieve labor market flexibility. However, as shown in our analysis in Section 5, even the labor market for the manufacturing industry seems to be quite flexible. Therefore, excessive emphasis on labor market flexibility may lead to the adoption of a “defensive strategy” by firms that ignores the importance of human capital, entrepreneurship, and innovativeness that the Turkish economy needs to be equipped with to tackle the challenges mentioned before. This process may also delay the restructuring of the corporate sector because it would tilt the field of competition in favor of less productive firms that reduce their costs by relying on atypical employment relations and avoiding all social expenditures.

The new Labor Law, by increasing flows from and to unemployment, is likely to change the structure of unemployment. The proportion of short-term unemployment may increase, as it is observed, for example, after the labor market reform in Columbia (Kugler, 1999; Kugler and Cárdenas, 1999).

6.2. The Impact of Adopting and Implementing the Employment *Acquis*

Although the new Labor Law has made some progress in the field of social policy and employment, it is still far from full alignment with the *acquis*. Therefore, Turkey needs to make extensive amendments to its laws and regulations in order to fully comply with the *acquis*. As the comparison between the new Labor Law and Directives indicates, those provisions that are not yet incorporated into the Labor Law are exactly those that add some costs on firms (for example, the provisions on maximum weekly working time, and minimum period of annual leave). These provisions, if implemented, may increase the costs of firms a few percentage point of the wage bill.

The most important discrepancy between the Turkish Labor Law (both the former one and the new law) and the Directives is the complete disregard of any social dialogue, employee participation and consultation, and employees’ right to be informed in the Turkish Labor Law. As can be seen in Table 3, the new Law does not refer to the provisions of Directives regarding informing workers, and does not address at all the Directive (2002/14) on

consultation and employee representation. Although the draft law prepared by the tripartite Scientific Committee referred to the employees' representatives, all these referrals were omitted in the final version of the law adopted by the Parliament. Therefore, it is no surprise that the European Commission's report on the progress towards accession by CCs emphasizes that "[s]teps have been taken in the field of social policy and employment [in Turkey], but are not always in full conformity with the *acquis*. There is an urgent need to develop and strengthen the conditions for a genuine social dialogue at all levels." (European Commission, 2002d) The *Regular Report on Turkey's Progress towards Accession* summarizes what needs to be done as follows:

As regards social dialogue, despite improvements for trade union rights in free trade zones, further progress needs to be made as a matter of priority to create the conditions for a free and genuine bipartite as well as tripartite social dialogue at all levels in line with the *acquis*. Turkey should make rapid progress towards establishing full trade union rights that includes elimination of restrictive thresholds for forming a trade union branch and requirement of 10% threshold for a trade union to be eligible for collective bargaining at company level. The law on public servants' trade unions, which was adopted in June 2001 and which is not in line with the Community *acquis* and the relevant ILO Conventions ratified by Turkey, has not been amended. The law contains a number of provisions which entail significant constraints on the right to organise in the public sector. Notably, there are restrictive provisions relating to the exclusion of the right to strike and to collective bargaining. The percentage of the labour force covered by collective agreements is extremely low; it is estimated to be below 15%. No social dialogue exists in most private enterprises, which may limit the proper implementation of the Community *acquis* at enterprise level. ... Promoting social inclusion and developing a national employment strategy in line with the European Employment Strategy is a matter of priority. (European Commission, 2002e)

Social dialogue and employee participation are crucial for the implementation of the *acquis*, but the current emphasis on short-term solutions makes it difficult to establish co-operative relationships between employers and employees (for the current level of social dialogue in CCs, see Rychly and Pritzer, 2003).

The Copenhagen criteria for membership include the *acquis* criterion that highlights the importance, not only of incorporating the *acquis* into national legislation, but also of ensuring its effective application through appropriate administrative and judicial structures.²⁴ The effective application of the *acquis* by extending the coverage to include the informal sector would be by far the most important impact of the accession process. In other words, the firms in the informal sector have to be forced to abide by laws and regulations, i.e., they will share the costs of taxes and SSCs with the formal sector firms. This process is likely to eliminate a part of firms operating in the informal sector, and lead to a painful adjustment process in the medium-term. With the gradual elimination of the informal sector, the long run effect is very likely to be positive for productivity, growth, and employment. A simple quantitative analysis is performed in Section 6.4 to assess the impact of this process.

6.3. The Impact of Coordinating Employment Policies

Turkey as a candidate country has committed itself to progressively adjust and coordinate its labor market institutions and employment policies with those of the EU. Turkey and the Commission are expected to analyze the key challenges for employment policies in a Joint Assessment Paper (JAP), and the JAP commitments will systematically be monitored. This

²⁴ This process may also help to fully implement ILO Conventions. For the ILO Conventions ratified by Turkey, see Bronstein (2003).

process of cooperation and coordination is likely to have two crucial effects in policy making in Turkey.

First, Turkey is to establish the institutional framework that is necessary for designing and implementing employment policies. This requires major improvements in the national statistical system, strengthening the Turkish Employment Organization (İŞKUR), etc.²⁵ Second, Turkey is hopefully going to implement, after decades of neglect and disorientation, consistent and systematic employment policies that bring forward long term objectives. These policies should be in conformity with the three objectives of the EES (full employment, quality and productivity at work, and cohesion and an inclusive labor market) that are also priority issues for Turkey. 10 Commandments (especially objectives on more and better investment in human capital, gender equality in employment and pay, eliminating undeclared work, promotion of occupational mobility) are likely to cause an upsurge in short-term adjustment costs of the corporate sector, although they would be extremely beneficial in the medium and long run. New employment policies are likely to have a significant positive impact on productivity and growth in the long-term if they are accompanied by coherent competition and technology and innovation policies.

6.4. A Simulation Analysis

Since the implementation of laws and regulations by covering the informal sector is likely to lead to by far the most important effect in the accession process, we conduct a simple simulation exercise to measure the order of magnitude of these effects in the private manufacturing industry.

The first step in any analysis on the informal sector is likely to start with an estimation of its size and characteristics. Since there is almost no data available for the informal sector, we make the following assumptions:

- The SIS's *Household Labor Force Survey* measures total manufacturing employment. The number of "informal workers" is equal to the number of people employed in micro-enterprises.
- The *Annual Survey of Manufacturing Industries* (ASMI) reflects the average characteristics of establishments categorized by size.
- Informal sector firms do not pay any tax (including the income tax for employees) and SSCs.
- Informal sector firms are as productive as "small" formal sector firms that employ 10-24 people.

Figure 7 depicts the distribution of employment, value added, and output in the private manufacturing sector in 2000. Firms are classified into four groups, large (employing 150 or more people), medium (employing 25-49 people), small (employing 10-24 people), and informal (small firms and informal sector firms). Under our assumptions, the share of informal workers is about 41 % in private manufacturing, and 40 % in all manufacturing.²⁶

²⁵ The Law establishing the Turkish Employment Organization (N.4904) was enacted by the Parliament on June 25, 2003.

²⁶ Since we assume that the number of workers employed in the informal sector is equal to the number of people employed in the micro-enterprises, the share of informal sector is likely to be overestimated. According to the HLFS, about one million people (29 % of the total) employed in the private manufacturing industry were not covered by any social insurance system. Since there is abundant anecdotal evidence on underreporting of wage income, the share of the informal sector has to be larger than 29 %.

This figure is comparable with the share of informal workers in Brazilian manufacturing (20.6%) and in Colombia (54.0) in the late 1990s (Goldberg and Pavcnik, 2003).

The share of the informal sector in total value added (and output) is estimated by assuming value added per employee in the informal sector is equal to the net value added (value added minus all taxes and social security expenditures) per employee in small formal sector firms (for the composition of output, see Table 9). Under these assumptions, the informal sector produces only 25 % of total value added in private manufacturing.

Figure 8 shows the structure of value added by four categories of firms. Since cumulative employment is plotted on the horizontal axis, the area under the line defines total value added produced by that category. Large firms are the most productive group. The informal sector firms are only 31 % as productive as the larger firms. The share of labor costs including severance payments in *value added* is 27.6 % for large firms, 26.3 % for medium-sized and 26.6 % for small firms. The informal sector firms pay only 16.2 % of value added as wages to their employees.

If all informal sector firms and workers start to pay income and corporate taxes, and SSCs, their sales price will increase about 6 % to earn the same amount of profit and to pay the same net wage. The value added tax will add another 5 percentage points. In other words, the benefit of operating in the informal sector is somewhat higher than 10 % of the sales price (including the value added tax).

We conduct five simulations: in the first simulation (*Case 1*), we assume that all informal sector firms pay taxes and SSCs, but there is no change in the nominal size of the manufacturing industry. Therefore, an increase in prices that is caused by the increase in the costs of informal sector firms leads to decline in demand in the same proportion. We also assume that the market shares of four categories of firms do not change.

When the informal sector firms pay taxes and SSCs, total revenue of the government and social security institutions will increase to a large extent. Therefore, we assume in *Case 2* that the government reduces tax and social security rates such that total tax and social security revenue remain the same. This policy will of course help formal sector firms by reducing their costs.

Since the assumption on constant market shares is not realistic given the fact that informal sector firms have to increase their prices, in the third simulation (*Case 3*), we assume that the informal sector firms lose half of their market shares. The next case (*Case 4*) introduces a reduction in tax and social security rates into Case 3 simulation.

Finally, in *Case 5*, we take into consideration long-term effects in Case 4 by assuming that total output increases by 10 % (as a result of productivity increases and other effects).

In all simulations, we assume that the structure and level of output remain the same for the formal sector firms. Nominal net wages and profits for the informal sector firms are assumed to remain constant. Thus, our analysis is limited to the effects of reallocation of output between formal and informal sector firms within the same industry.

Table 10 summarizes simulation results. The *Base Case* shows the current situation. When the informal sector firms start to pay taxes and SSCs (Case 1), the immediate impact will be

observed in a reduction in manufacturing employment (4.3 %; about 150,000 jobs are lost) following the decline in output. Total wage payments will also decline (3.0 %), but the average net wage will increase because it is the informal sector that will experience the highest employment loss. The share of profits in total output (the profit margin) declines by 3.2 %. There is a huge increase in tax and social security revenue (about 35 %). In the second case, the government reduces SSC rate by 28.5 %, income tax rate by 26.4 %, and value added tax rate by 29.8 % so that total revenue remain at the Base level. The reductions in tax and social security rates help to moderate employment losses (now only 1.5 %), and the decline in the profit margin (0.2 %).

If the informal sector firms exit *en masse* from the market as a result of their increasing costs (Case 3), the impact on employment will be dramatic: although we assume that there is no change in nominal output, the decline in employment will be 8.9 % because of lower output/labor ratio in the informal sector. Since low wage jobs will be lost, there will be a substantial increase in average wage rate (8.7 %) that will make, employees as a group, not much worse off. In this case, tax and social security revenue will increase more compared to Case 1 because of higher average wages and income in the formal sector. A reduction in tax and social security rates will again moderate employment losses.

If the manufacturing industry achieves to grow during this period (we assume 10 % growth), then employment will increase 4.2 % even if half of the informal sector firms would be eliminated, and the average wage rate and the profit margin will increase by 9 % and 2 %, respectively. The government, to get the same amount of revenue as it gets in the Base case, has to cut tax and social security rates substantially (36-38 %).

Our simple simulation exercise shows that there could be significant short-term, transitory costs, in terms of a loss in employment opportunities, in eliminating the informal sector. These costs could be reduced if the economy achieves a faster rate of economic growth.

7. Conclusions and Policy Implications

Turkey has embarked upon changing its institutional structure regarding employment and social affairs. The new Labor Law has introduced a number of changes in accordance with the Community directives, mainly those provisions that help to establish flexible employment relationships, but there is an apparent need for further reform in the Labor Law and other regulations to comply fully with the *acquis*. The adoption of the remaining regulations of the *acquis* regarding employment and social affairs is likely to raise the costs of adjustment especially for the informal sector firms. Moreover, it also requires a comprehensive change in the mindset of employers if the regulations (on equal treatment of fixed-term and part-time workers, employee participation and consultation, etc.) are to be implemented. Since Turkey needs to address all these issues in its Employment Strategy while paying attention to the EU's long-term objectives and targets (full employment, quality and productivity at work, and cohesion and an inclusive labor market), there is an opportunity to solve underlying problems that have plagued the processes of economic growth and employment generation for decades. There are four areas of action that need special consideration.

First, strengthening the institutional capacity (like the Turkish Employment Organization, İŞKUR) to develop and implement employment strategies is a priority. Moreover, there

should be an institutional framework that guarantees commitment, consistency, and continuity in employment policies.

Second, the costs of adjustment have to be reduced for the successful implementation of new regulations, and the gradual elimination of the informal sector. Temporary reductions in tax and social security rates for new firms and hiring new workers could be helpful in this regard.

Third, firms could be encouraged, supported, and even forced to adopt competitive strategies based on employing a “skilled, trained and adaptable workforce”, as in the spirit of Article 125 of the Treaty. These include various support schemes and initiatives for on-the-job training²⁷, and technology development, transfer and diffusion programs especially designed for SMEs.

Finally, employment generation and matching the demand and supply for skills would be important to confront with the main challenges summarized in Section 6 (urbanization, feminization, etc.). Special attention is due to be paid to providing part-time jobs (for urban women) by enforcing equal treatment for part-time workers, and strengthening and widening the scope of active labor market policies. The establishment of a national qualification and certification system could help to match the demand and supply for skills.

References

- Acemoglu, D. and Pischke, J. (1998). “Why Do Firms Train? Theory and Evidence”, *Quarterly Journal of Economics* (113): 79-119.
- Acemoglu, D. and Pischke, J. (1999), “Beyond Becker: Training in Imperfect Labor Markets”, *Economic Journal* (109): 112-142.
- Adaman, F. (2003). *Study on the Social Protection Systems in the 13 Applicant Countries: Turkey Country Study*, Study financed by the EC DG for Employment and Social Affairs.
- Addison, J.T. and Teixeira, P. (2001). *The Economics of Employment Protection*, IZA Discussion Paper No. 381, Bonn.
- Agell, J. (1999). “On the Benefits from Rigid Labour Markets: Norms, Market Failures, and Social Insurance”, *Economic Journal* (109): 143-164.
- Agell, J. and Bennmarker, H. (2002). *Wage Policy and Endogenous Wage Rigidity: A Representative View from the Inside*, Institute for Labour Market Evaluation (IFAU) Working Paper No. 2002:12, Stockholm.
- Algoé Consultans (2002). *The Construction of an Index of Labour Market Adaptability for EU Member States*, Report of a study funded by the European Commission and directed by Algoé Consultans in conjunction with Alphametrics Limited.
- Baker, D., Glyn, A., Howell, D. and Schmitt, J. (2002). *Labor Market Institutions and Unemployment: A Critical Assessment of the Cross-Country Evidence*, New School University Center for Economic Policy Analysis (CEPA) Working Paper 2002-17, New York.

²⁷ Recall that the EU aims at increasing investment by companies in training of adults (on-the-job training) from the existing level of the equivalent of 2.3 % of labor costs up to 5.0 % of labor costs on average in the EU by 2010. Although there is no reliable data on firm-sponsored training in Turkey, one could conjecture that the proportion of firm-sponsored training to labor cost is very small in Turkey.

- Ballot, G. and Taymaz, E. (2001). "Training Policies and Economic Growth in an Evolutionary World", *Structural Change and Economic Dynamics* (12): 311-329.
- Bassanini, A. and Ernst, E. (2002). "Labour Market Regulation, Industrial Relations and Technological Regimes: A Tale of Comparative Advantage", *Industrial and Corporate Change* (11): 391-426.
- Belot, M., Boonez, J. and van Ours, J. (2002). *Welfare Effects of Employment Protection*, CentER Discussion Paper, No. 2002-48, Tilburg University.
- Belot, M. (2002). *Why is the Employment Protection Stricter in Europe than in the US?* Unpublished paper, CentER, Tilburg University.
- Bertola, G., Boeri, T. and Cazes, S. (1999). *Employment Protection and Labour Market Adjustment in OECD Countries: Evolving Institutions and Variable Enforcement*, ILO, Employment and Training Papers No. 48.
- Bertola, G., Boeri, T. and Cazes, S. (2000). *Employment Protection in Industrialized Countries: The Case for New Indicators*, Paper presented at the EC workshop on "Concepts and Measurement of European Labour Markets Flexibility/Adaptability Indices", October 26-27, 2000, Brussels.
- Betcherman, G., Luinstra, A. and Ogawa, M. (2001). *Labor Market Regulation: International Experience in Promoting Employment and Social Protection*, World Bank Social Protection Discussion Paper Series No. 128, Washington, D.C.
- Blanchard, O. (2000). *Employment Protection, Sclerosis, and the Effect of Shocks on Unemployment*, LSE Lionel Robbins Lectures, Lecture 3, October, London.
- Blanchard, O. (2002). *Designing Labor Market Institutions*, Remarks at the conference "Beyond Transition", April, Warsaw.
- Brodsky, M.M. (1994). "Labor Market Flexibility: A Changing International Perspective", *Monthly Labor Review* (November): 53-60.
- Bronstein, A. (2003). *Labour Law Reform in EU Candidate Countries: Achievements and Challenges*, Paper presented at the ILO High-Level Tripartite Conference on Social Dialogue and Labour Law reform in EU Accession Countries, Malta, February 28–March 1.
- Cazes, S. and Nesporova, A. (2003). *Labour Market Flexibility and Employment Security in Transition Countries*, Geneva: ILO.
- European Commission DG for Employment and Social Affairs (2002). *Employment in Europe 2002: Recent Trends and Prospects*, Brussels: EC.
- European Commission (2002a). *Taking Stock of Five Years of the European Employment Strategy*, COM (2002) 416 final, Brussels: EC.
- European Commission (2002b). *Communication from the Commission on Streamlining the Annual Economic and Employment Policy Co-Ordination Cycles*, COM (2002) 487 final, Brussels: EC.
- European Commission (2002c). *Draft Joint Employment Report 2002*, COM (2002) 621 final, Brussels: EC.
- European Commission (2002d). *Towards the Enlarged Union: Strategy Paper and Report of the European Commission on the Progress towards Accession by Each of the Candidate Countries*, COM(2002) 700 final, Brussels: EC.
- European Commission (2002e). *Regular Report on Turkey's Progress Towards Accession*, SEC (2002) 1412, Brussels: EC.

- European Commission (2003a). *Proposal for a Council Decision on Guidelines for the Employment Policies of the Member States*, COM (2003)176 final Brussels: EC.
- European Commission (2003b). *Recommendation for a Council Recommendation on the Implementation of Member States Employment Policies*, COM (2003)177 final, Brussels: EC.
- European Commission (2003c). *Progress on the Implementation of the Joint Assessment Papers on Employment Policies in Candidate Countries*, COM(2003) 37 final, Brussels: EC.
- European Commission (2003d). *The Future of the European Employment Strategy (EES): "A Strategy for Full Employment and Better Jobs for All"*, COM(2003) 6 final, Brussels: EC.
- Fabiani, S. and Rodriguez-Palenzuela, D. (2001). *Model-Based Indicators of Labour Market Rigidity*, European Central Bank Working Paper No. 21.
- Falkner, G., Hartlapp, M., Leiber, S. and Treib, O. (2002). *Opposition through the Backdoor? The Case of National Non-Compliance with EU Directives*, Institute for Advanced Studies, Political Science Series No. 83, Vienna.
- Goldberg, P.K. and Pavcnik, N. (2003). *The Response of the Informal Sector to Trade Liberalization*, NBER Working Paper No. 9443, Cambridge, MA.
- Heckman, J. and Pagés, C. (2002). "Introduction", in J. Heckman and C. Pagés (eds.), *Law and Employment: Lessons from Latin America and the Caribbean*, NBER, forthcoming.
- Hermans, S. (2001). *Avrupa Birliği'nin Sosyal Politikası ve Türkiye'nin Uyumu*, Çev. H. Cansevdi, Istanbul: İktisadi Kalkınma Vakfı .
- İlkkaracan, İ. and Selim, R. (2002). *The Role of Unemployment in Wage Determination: Further Evidence on the Wage Curve from Turkey*, New School University Center for Economic Policy Analysis (CEPA) Working Paper 2002-11, New York.
- Jackman, R., Layard, R. and Nickell, S. (1996). *Combating Unemployment: Is Flexibility Enough?* LSE; Centre for Economic Performance Discussion Paper No. 293, London.
- Kleinknecht, A. (1998). "Is Labour Market Flexibility Harmful to Innovation?", *Cambridge Journal of Economics* (22): 387-396.
- Kugler, A.D. (1999). "The Impact of Firing Costs on Turnover and Unemployment: Evidence from the Colombian Labor Market Reform", *International Tax and Public Finance Journal* (6): 389-410.
- Kugler, A.D. and Cárdenas, M. (1999). *The Incidence of Job Security Regulations on Labor Market Flexibility and Compliance in Colombia*, Inter-American Development Bank Research Network Working Papers R-428.
- Michie, J. and Sheehan, M. (2003). "Labour Market Deregulation, 'Flexibility' and Innovation", *Cambridge Journal of Economics* (27): 123-143.
- Nicoletti, G., Scarpetta, S. and Boylaud, O. (2000). *Summary Indicators of Product Market Regulation with an Extension to Employment Protection Legislation*, OECD Economics Department Working Papers No. 226, Paris.
- Nickell, S. and Layard, R. (1999). "Labor Market Institutions and Economic Performance", in O. Ashenfelter and D. Card (eds.), *Handbook of Labor Economics*, Vol 3, Elsevier.
- Onaran, Ö. (2002), "Measuring Wage Flexibility: The Case of Turkey before and after Structural Adjustment", *Applied Economics* (34): 767-781.

- OECD (1994a). *OECD Jobs Study, Evidence and Explanations*, Part I: Labor Market Trends and Underlying Forces of Change. Paris: OECD.
- OECD (1994b.) *OECD Jobs Study, Evidence and Explanations*, Part II: The Adjustment Potential of the Labor Market. Paris: OECD.
- OECD (1999). *OECD Employment Outlook*, Paris: OECD.
- Plasmans, J., Meersman, H., van Poeck, A. and Merlevede, B. (2002). *The Unemployment Benefit System and Wage Flexibility in EMU: Time-varying Evidence in Five Countries*, University of Antwerp, Department of Economics Working Paper.
- Rychly, L. and Pritzer, R. (2003). *Social Dialogue at National Level in the EU Accession Countries*, ILO Working Paper, Geneva.
- Riboud, M., Sánchez-Páramo, C. and Silva-Jáuregui, C. (2002). *Does Eurosclerosis Matter? Institutional Reform and Labor Market Performance in Central and Eastern European Countries in the 1990s*, World Bank Social Protection Discussion Paper Series No. 0202, Washington, D.C.
- Salvanes, K.G. (1997). “Market Rigidities and Labour Market Flexibility: An International Comparison”, *Scandinavian Journal of Economics* (99): 315-333.
- Scarpetta, S. and Tressel, T. (2002). *Productivity and Convergence in a Panel of OECD Industries: Do Regulations and Institutions Matter?* OECD Economics Department Working Papers No.342, Paris.
- Tunalı, İ., Ercan, H., Başlevent, C., and Öztürk, O. (2003). *Background Study on Labor Market and Employment in Turkey*, Report prepared for the European Training Foundation and presented at the special seminar “On the Way to Integration with the EU, Labor Market and Employment in Turkey”, organized by İŞKUR, Ankara, February 27 [downloaded from www.iskur.gov.tr]

Web Sites

Laws and regulations in Turkey

http://www.yargitay.gov.tr/bilgi/kanun_liste/index.html

Council Directives on employment

http://europa.eu.int/comm/employment_social/soc-dial/labour/index_en.htm

EU DG for Employment and Social Affairs

http://europa.eu.int/comm/dgs/employment_social/index_en.htm

Tables

Table 1. Employment indicators, the EU and a selected group^a of candidate countries, 2000

	Turkey	EU	Bulgaria	Hungary	Poland	Romania
Total population (000)	64059	370914	6832	9927	30535	22338
Population aged 15-64 (000)	41147	247708	5502	6760	25652	15213
Total employment (000)	20579	165537	2872	3807	14518	10898
Employment rate (% population aged 15-64)	48.2	63.2	51.5	55.9	55.1	64.2
FTE employment rate (% population aged 15-64)*	49.3	57.9	50.3 ^b	56.0	53.0 ^b	63.8
Self-employed (% total employment)	24.5	15.0	14.7	14.5	22.5	25.4
Part-time employment (% total employment)*	20.7	17.8	3.4 ^b	3.6	10.6	16.4
Fixed-term contracts (% total employment)*	10.0	13.6	5.7 ^b	5.8	4.2	1.6
Employment in Services (% total employment)	47.3	69.0	54.0	59.8	50.3	29.0
Employment in Industry (% total employment)	18.2	26.7	32.8	33.8	31.1	25.8
Employment in Agriculture (% total employment)	34.5	4.3	13.2	6.5	18.7	45.2
Unemployment rate (% labor force)	6.6	7.9	16.2	6.6	16.3	7.0
Youth unemployment rate (% labor force 15-24)	13.2	15.5	33.3	12.3	35.7	17.8
Long term unemployment rate (% labor force)	1.3	3.7	9.5	3.1	7.3	3.4

a Candidate Countries with more than 5 million population in 2000

b 2001

* calculated from SIS, *HLFS 2000*.

Sources: Turkey from SIS, *HLFS 2000*; all other countries: EC DG Employment and Social Affairs, 2002.

Table 2. Income tax plus employees' and employers' social security contributions
(as % of labor costs), 2002^a

	Income tax	Social security contributions		Total	Labor costs ^b
		employee	employer		
Australia	24	0	0	24	33964
Austria	8	14	23	45	34030
Belgium	21	11	24	55	43906
Canada	18	6	7	31	34793
Czech Rep.	8	9	26	43	18631
Denmark	32	11	1	43	36690
Finland	20	5	20	45	35513
France	9	9	29	48	32856
Germany	17	17	17	51	42197
Greece	0	12	22	35	20570
Hungary	13	9	24	46	11934
Iceland	21	0	5	26	25379
Ireland	10	4	10	24	27775
Italy	14	7	25	46	35709
Japan	6	9	10	24	32287
Korea	2	6	8	16	32116
Luxembourg	7	12	12	32	37573
Mexico	2	1	13	16	10295
Netherlands	6	19	10	36	36019
New Zealand	20	0	0	20	26629
Norway	19	7	11	37	36262
Poland	5	21	17	43	16268
Portugal	4	9	19	32	15376
Slovak Rep.	5	9	28	42	13249
Spain	10	5	23	38	27156
Sweden	18	5	25	48	33345
Switzerland	9	10	10	30	37710
Turkey	12	12	18	42	17367
United Kingdom	14	7	8	30	32557
United States	15	7	7	30	34650

a. Single individual without children at the income level of the average production worker. Note that such workers do not receive family benefits.

b. Annual labor cost per worker, dollars with equal purchasing power

Source: OECD, *Taxing Wages*, 2002 (M00039058.pdf)

Table 2b. Income tax plus employee and employer contributions less cash benefits, by family-type and wage level (as % of labour costs), 2002

Family-type:	single no child.	single no child.	single no child.	single 2 child.	married 2 child.	married 2 child.	married 2 child.	married no child.
Wage level ^b	67	100	167	67	100-0	100-33 ^a	100-67 ^a	100-33 ^a
Australia	19.7	23.6	32.0	-10.5	14.7	16.8	19.2	20.3
Austria	39.9	44.8	50.0	16.3	29.6	31.9	34.4	42.5
Belgium	48.9	55.3	61.1	32.9	40.1	42.5	48.5	49.8
Canada	26.8	30.8	31.8	4.6	20.9	24.5	27.4	27.9
Czech Rep.	41.8	43.5	45.8	18.0	28.7	35.4	39.3	42.3
Denmark	40.4	43.4	51.2	15.8	30.9	35.7	38.4	40.5
Finland	40.4	45.4	51.2	26.7	38.5	37.4	39.3	42.5
France	37.8	47.9	50.5	30.1	39.2	37.8	39.9	43.0
Germany	45.9	51.3	55.8	29.1	32.5	38.7	43.0	45.9
Greece	34.3	34.7	40.2	34.3	35.1	34.9	34.8	35.3
Hungary	42.0	46.3	54.8	17.7	30.2	32.1	34.9	44.2
Iceland	19.4	25.8	31.0	-6.4	1.9	12.3	19.0	19.4
Ireland	16.6	24.5	34.4	-13.3	9.0	13.5	16.9	19.1
Italy	42.7	46.0	49.9	25.4	34.0	39.3	41.8	42.9
Japan	23.2	24.2	27.1	20.4	20.3	21.8	22.6	23.3
Korea	14.8	16.0	20.3	14.4	15.4	15.0	15.3	15.3
Luxembourg	27.3	31.5	39.0	1.3	9.0	12.8	15.4	25.9
Mexico	11.4	16.1	22.4	11.4	16.1	13.4	14.2	13.4
Netherlands	37.2	35.6	40.4	18.2	25.2	29.1	32.6	33.6
New Zealand	18.8	20.0	25.7	1.6	18.2	19.2	19.5	19.2
Norway	33.8	36.9	43.5	14.0	27.2	29.2	31.4	34.5
Poland	41.4	42.7	43.8	36.5	37.7	41.4	42.2	41.4
Portugal	29.5	32.5	38.0	18.9	23.4	24.6	27.1	30.2
Slovak Rep.	40.3	41.4	44.7	23.8	29.6	34.1	35.9	40.5
Spain	33.9	38.2	41.9	28.3	31.4	34.5	34.7	35.7
Sweden	45.9	47.6	52.0	35.3	40.5	41.3	42.7	46.6
Switzerland	27.0	29.6	33.8	12.6	18.1	20.5	23.6	27.3
Turkey	41.3	42.4	44.3	41.3	42.4	41.7	41.9	41.7
United Kingdom	24.7	29.7	32.9	-10.8	18.2	18.0	22.4	24.7
United States	27.3	29.6	35.2	5.0	17.6	22.7	25.0	27.8

a. Two-earner family

b. Percentage of the wage rate for an average production worker

Source: OECD, *Taxing Wages, 2002* (M00039058.pdf)

Table 3. EU directives and the Turkish Labor Law

Directive Date of issue [Enter into force]	Issues/Regulations	Labor Law Law 1475 [Relevant articles]	New Labor Law Law 4857 [Relevant articles]
93/104 Organization of working time 23 November 1993 [23 November 1996]	<ul style="list-style-type: none"> ● normal weekly work ● max weekly working time ● min period of daily rest ● min period of weekly rest ● min period of annual leave ● shift work ● night work (info / health) ● patterns of work 	<ul style="list-style-type: none"> ● + ● - ● + ● + ● - ● + ● - (excl. men) ● - <p>[A. 41, 43, 49, 61-65, 73]</p>	<ul style="list-style-type: none"> ● + (45 hours) ● - ● + ● + ● - ● + ● + ● - <p>[A. 41, 46, 53-70]</p>
99/70 Framework agreement on fixed-term work (UNICE/CEEP/ETUC) 28 June 1999 [10 July 1999]	<ul style="list-style-type: none"> ● definition of fixed-term work ● definition of “comparable permanent worker” ● abuse arising from the use of successive fixed-term contracts ● rights of fixed-term workers ● information / training 	<p>No specific clause on fixed-term work</p> <p>[A.8 defines only temporary and permanent work]</p>	<ul style="list-style-type: none"> ● + ● ? ● ? (no limit) ● + ● ? / - <p>[A. 11-12]</p>
97/81 Framework agreement on part-time work (UNICE/CEEP/ETUC) 15 December 1997 [20 January 2000]	<ul style="list-style-type: none"> ● definition of fixed-term work ● definition of “comparable full-time worker ● no shift from full-time to part-time work without consent ● rights of part-time workers ● information / training 	<p>No specific clause on part-term work</p> <p>[A.8 defines only temporary and permanent work]</p>	<ul style="list-style-type: none"> ● + ● ? ● + ● + ● ? / - <p>[A. 13]</p>
98/59 Collective redundancies 20 July 1998 [1 September 1998]	<ul style="list-style-type: none"> ● definition of collective redundancy ● information and consultation ● procedure 	<ul style="list-style-type: none"> ● - / + (changed by Law 4773) ● - / + (changed by Law 4773) ● - / + (changed by Law 4773) <p>[A. 24]</p>	<ul style="list-style-type: none"> ● + ● + (exc. A 2.3.b.v and vi) ● + <p>[A. 29]</p>
2001/23 Employees’ rights in the event of transfers 12 March 2001 [12 April 2001]	<ul style="list-style-type: none"> ● employees’ rights ● employers’ liabilities ● info and consultation 	<ul style="list-style-type: none"> ● + ● + ● - <p>[A. 14, 53, Law 2822 A. 8]</p>	<ul style="list-style-type: none"> ● + ● + ● - <p>[A. 6]</p>
80/987 Protection of employees in the event of insolvency [Amended by 2002/74] 20 Oct 1980/23 Sept 2002 [28 Oct 1983 / 8 Oct 2002]	<ul style="list-style-type: none"> ● claims ● guarantees (guarantee institution) ● coverage 	<p>No specific clause</p> <p>[Law 2004 on bankruptcy, A 206 workers’ claims have priority in the event of insolvency]</p>	<ul style="list-style-type: none"> ● + ● + ● + <p>[A. 33]</p>
94/33 Protection of young people at work 22 June 1994 [22 June 1996]	<ul style="list-style-type: none"> ● definition of “young” ● employers’ obligations ● restrictions 	<ul style="list-style-type: none"> ● - ● - ● - <p>[A. 67. Also regulated by the Law on Apprenticeship and Vocational Training, No. 3308]</p>	<ul style="list-style-type: none"> ● + ● + ● [to be regulated by the MESS] <p>[A. 71 -73, 85, 87]</p>
91/533 Information for employees 14 October 1991 [30 June 1993]	<ul style="list-style-type: none"> ● information content ● time limits ● enforcement 	<ul style="list-style-type: none"> ● +? ● - ● + <p>[A. 9 and 11]</p>	<ul style="list-style-type: none"> ● +? ● + ● + <p>[A. 8]</p>
2002/14 Consultation and employee representation 11 March 2002 [23 March 2005/2007]	<ul style="list-style-type: none"> ● information content ● coverage ● procedures / enforcement 	<ul style="list-style-type: none"> ● - ● - ● - 	<ul style="list-style-type: none"> ● - ● - ● -

Table 4. Employment Protection Legislation Index
OECD countries (late 1990s)

	EPL Index		
	Average	Regular contracts	Temporary contracts
Portugal	3.7	4.3	3.2
Turkey	3.6	2.6	4.6
Greece	3.5	2.6	4.5
Italy	3.3	3.0	3.6
Spain	3.2	2.8	3.7
France	3.1	2.5	3.7
Norway	2.9	2.9	2.8
Germany	2.8	3.0	2.5
Japan	2.6	3.0	2.3
Austria	2.4	2.8	2.0
Netherlands	2.4	3.2	1.5
Sweden	2.4	3.0	1.8
Belgium	2.1	1.6	2.6
Finland	2.1	2.3	1.9
Poland	1.9	2.3	1.4
Czech Republic	1.7	3.0	0.5
Denmark	1.5	1.7	1.2
Hungary	1.4	2.2	0.6
Switzerland	1.3	1.3	1.2
Australia	1.1	0.9	1.2
Ireland	1.0	1.7	0.3
New Zealand	1.0	1.6	0.5
Canada	0.6	0.9	0.3
United Kingdom	0.5	0.7	0.3
United States	0.2	0.1	0.3

Source: Nicoletti, Scarpetta and Boylaud (2000).

Table 5. Employment protection legislation for regular employment
(selected OECD countries)

		Germany	Poland	Spain	US	Turkey	
						L.1475	L.4857
Employment Protection Legislation							
<i>Regular procedural inconveniences</i>							
Procedures	Scale 0 to 3	2.5	2.0	2.0	0.0	2.0	1.0
Delay to start of notice	Days	17.0	13.0	1.0	1.0	1.0	1.0
<i>Notice and severance pay for no-fault individual dismissals by tenure categories</i>							
Notice period after							
9 months	Months	1.0	1.0	1.0	0.0	1.0	1.0
4 years	Months	1.0	3.0	1.0	0.0	2.0	2.0
20 years	Months	7.0	3.0	1.0	0.0	2.0	2.0
Severance pay after							
9 months	Months	0.0	0.0	0.5	0.0	0.0	0.0
4 years	Months	0.0	0.0	2.6	0.0	4.0	0.0
20 years	Months	0.0	0.0	12.0	0.0	20.0	0.0
<i>Difficulty of dismissals</i>							
Definition of unfair dismissal	Scale 0 to 3	2.0	0.0	2.0	0.0	0.0	0.0
Trial period before eligibility arises	Months	6.0	1.8	2.5		2.0	2.0
Unfair dismissal comp. (20 years)	Months	24.0	3.0	22.0		26.0	6.0
Extent of reinstatement	Scale 0 to 3	1.5	2.0	0.0	0.5	0.0	0.0
Employment Protection Legislation Index Scores							
<i>Regular procedural inconveniences</i>							
Procedures		5.0	4.0	4.0	0.0	4.0	2.0
Delay to start of notice		2.0	2.0	0.0	0.0	0.0	0.0
<i>Notice and severance pay for no-fault individual dismissals by tenure categories</i>							
Notice period after							
9 months		3.0	3.0	3.0	0.0	3.0	3.0
4 years		2.0	4.0	2.0	0.0	4.0	4.0
20 years		4.0	2.0	1.0	0.0	1.0	1.0
Severance pay after							
9 months		0.0	0.0	1.0	0.0	0.0	0.0
4 years		0.0	0.0	4.0	0.0	6.0	0.0
20 years		0.0	0.0	4.0	0.0	6.0	0.0
<i>Difficulty of dismissals</i>							
Definition of unfair dismissal		4.0	0.0	4.0	0.0	0.0	0.0
Trial period before eligibility arises		3.0	5.0	5.0	0.0	5.0	5.0
Unfair dismissal comp. (20 years)		4.0	0.0	4.0	0.0	5.0	1.0
Extent of reinstatement		3.0	4.0	0.0	1.0	0.0	0.0

Table 6. Employment protection legislation for temporary employment
(selected OECD countries)

		Germany	Poland	Spain	US	Turkey	
						L.1475	L.4857
Employment Protection Legislation							
<i>Fixed-term contracts</i>							
Valid cases other than the usual objective reasons	Scale 0 to 3	2.5	3.0	1.0	3.0	0.0	2.0
Max number of successive contracts	Number	4.0	2.0	3.0	No limit	1.5	No limit
Max cumulated duration	Months	24.0	No limit	36.0	No limit	No limit	No limit
<i>Temporary work agencies (TWAs)</i>							
Types of work for which TWA employment is legal	Scale 0 to 4	3.0	4.0	2.0	4.0	0.0	4.0
Restrictions on number of renewals	Yes/No	Yes	Yes	Yes	No limit		
Max cumulated duration of temporary work contracts	Months	12.0	No limit	36.0	No limit		
Employment Protection Legislation Index Scores							
<i>Fixed-term contracts</i>							
Valid cases other than the usual objective reasons		1.0	0.0	4.0	0.0	6.0	2.0
Max number of successive contracts		2.0	4.0	3.0	0.0	5.0	0.0
Max cumulated duration		3.0	0.0	2.0	0.0	0.0	0.0
<i>Temporary work agencies (TWAs)</i>							
Types of work for which TWA employment is legal		1.5	0.0	3.0	0.0	6.0	4.0
Restrictions on number of renewals		4.0	4.0	4.0	2.0		
Max cumulated duration of temporary work contracts		4.0	0.0	6.0	0.0		

Table 7. Job turnover in a selecte group of countries

	Period	Entry	Expansion	Exit	Contraction	Turnover
Turkey (M)	1980-00	4.8	6.7	4.1	5.5	21.0
Chile (M)	1980-95	4.7	9.1	4.7	7.2	25.8
Columbia (M)	1978-91	5.3	6.6	5.1	6.7	23.8
USA (M)	1984-88	1.4	6.7	2.7	7.7	18.6
USA	1984-91	8.4	4.6	7.3	3.1	23.4
Canada	1983-91	3.2	11.2	3.1	8.8	26.3
France	1984-91	6.1	6.6	5.5	6.3	24.4
Germany	1983-90	2.5	6.5	1.9	5.6	16.5
Italy	1987-92	3.8	7.3	3.8	6.2	21.0
UK	1985-91	2.7	6.0	3.9	2.7	15.3

Source: Bertola, Boeri and Cazes (1999) and our calculations from the SIS data.

M denotes manufacturing industries

Table 8. Job turnover in Turkish manufacturing industries

	Public	Private			Average
		Small	Medium	Large	
<i>1981-1990</i>					
Entry	1.6	14.5	7.1	3.0	4.4
Expansion	2.8	4.7	9.7	8.5	6.8
Contraction	4.5	8.0	6.3	3.4	4.7
Exit	1.3	14.9	5.4	2.7	3.8
Turnover	10.3	42.1	28.4	17.6	19.7
<i>1991-2000</i>					
Entry	0.4	20.2	8.5	3.1	5.2
Expansion	2.1	3.6	8.1	7.7	6.6
Contraction	6.5	10.3	6.8	5.4	6.2
Exit	2.6	17.9	5.7	2.6	4.4
Turnover	11.7	52.1	29.3	18.8	22.3

Source: Our calculations from the SIS data.

Table 9. Composition of output in private manufacturing (percentage), 2000

	Large	Medium	Small	Informal
Net wage	5.44	4.35	3.97	4.42
Income tax ^a	1.16	0.78	0.59	0.00
SSC - employee's share ^a	1.16	0.91	0.80	0.00
SSC - employer's share ^a	1.67	1.30	1.15	0.00
Severance payments ^b	1.59	1.53	1.50	0.00
<i>Total labor cost</i>	<i>11.02</i>	<i>8.87</i>	<i>8.02</i>	<i>4.42</i>
Interest payments	3.91	2.50	1.37	1.53
Taxes	2.55	1.54	1.46	0.00
Profit	22.50	20.84	19.25	21.47
Materials	53.78	61.07	65.09	72.59
Value added tax	6.24	5.18	4.82	0.00
Total	100	100	100	100
Total VA per employee (mil TL)	26561	14982	10149	9590
Share of VA in output (%)	40.0	33.8	30.1	27.4
VA per employee (Large =1)	1.00	0.56	0.38	0.31

Source: Large, medium and small establishments, SIS, *Annual Survey of Manufacturing Industries*, 2000. Informal sector, our estimates.

a Estimated

b Includes all compensation payments

Table 10. Simulation results

	Base Case	Case 1 Constant mrkt shr	Case 2 + Tax reduct.	Case 3 50 % lost in informal	Case 4 + Tax reduct.	Case 5 + 10% growth
	Percentage change relative to the Base Case					
Employment	3394000	-4.3	-1.5	-8.9	-6.0	4.2
Wage bill ^a	6433657	-3.0	0.0	-0.9	2.4	13.5
SSC ^a	2331012	35.7	0.0	39.2	0.0	0.0
Income tax ^a	2754916	31.6	0.0	36.8	0.0	0.0
VAT ^a	5347145	38.3	0.0	40.7	0.0	0.0
Profit ^a	29538664	-3.2	-0.2	-2.0	1.3	12.2
Average net wage ^b	1896	1.3	1.5	8.7	8.9	9.0
Profit margin	21.3	-3.2	-0.2	-2.0	1.3	2.0
SSC rate ^c	5.1	0.0	-28.5	0.0	-30.5	-37.3
Income tax rate ^c	6.0	0.0	-26.4	0.0	-29.4	-36.3
VAT rate ^c	11.6	0.0	-29.8	0.0	-31.3	-38.0

a Billion TL

b Million TL per employee

c Share in value added

Figures

Figure 1. Employment Protection Legislation, selected OECD countries

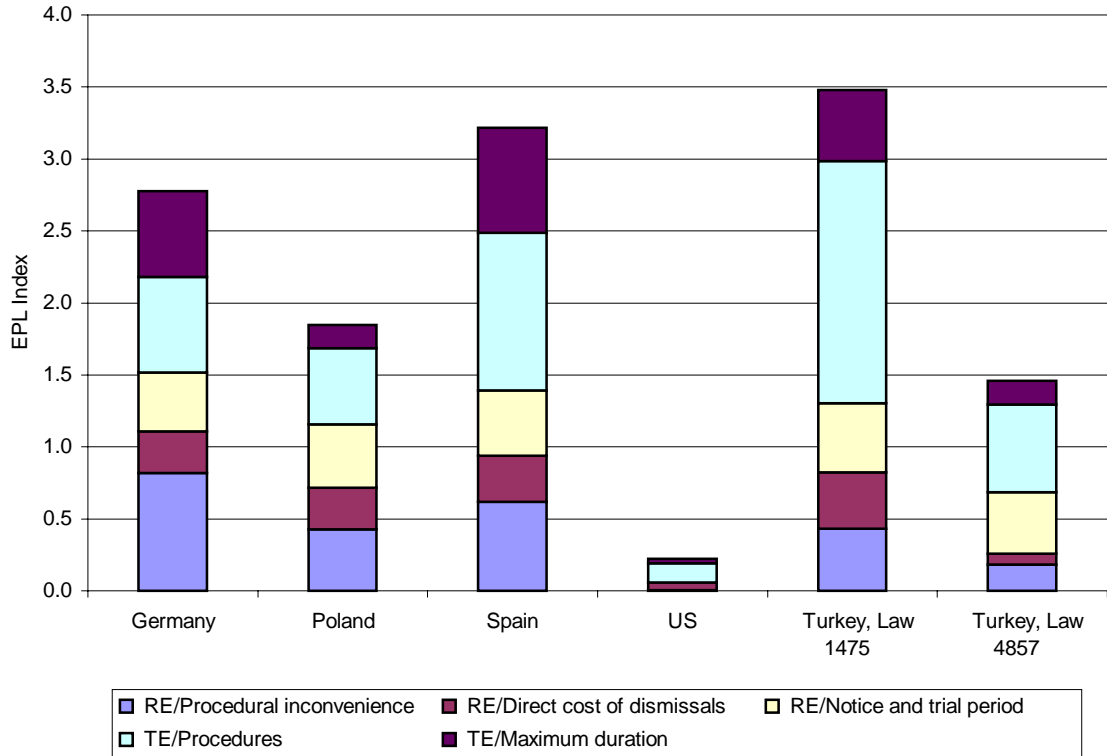


Figure 2. Flow into unemployment and employment protection

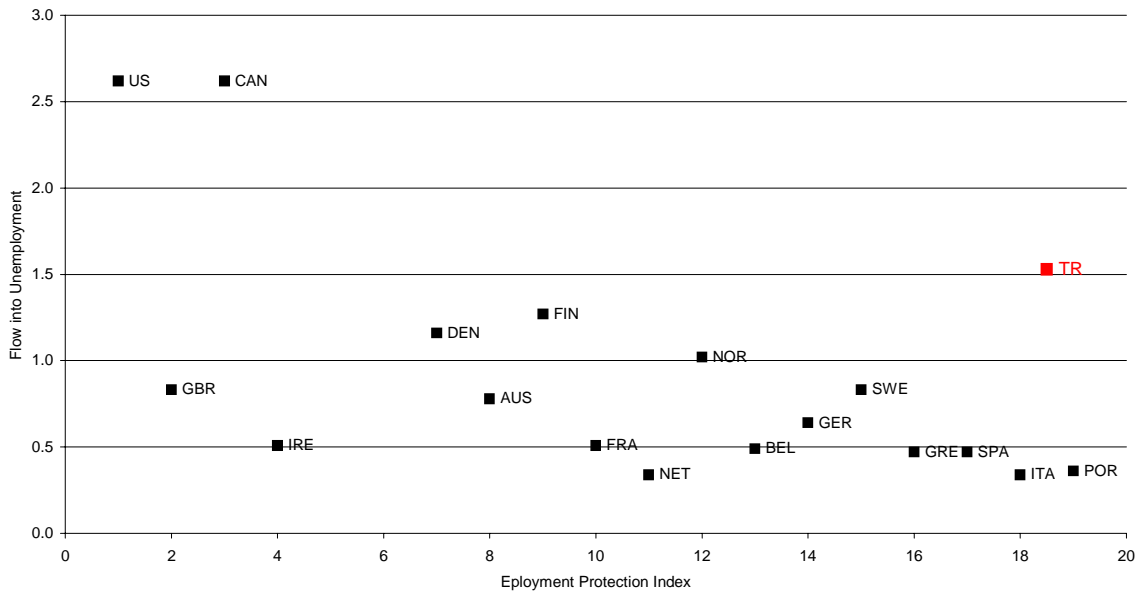


Figure 3. Unemployment duration and employment protection

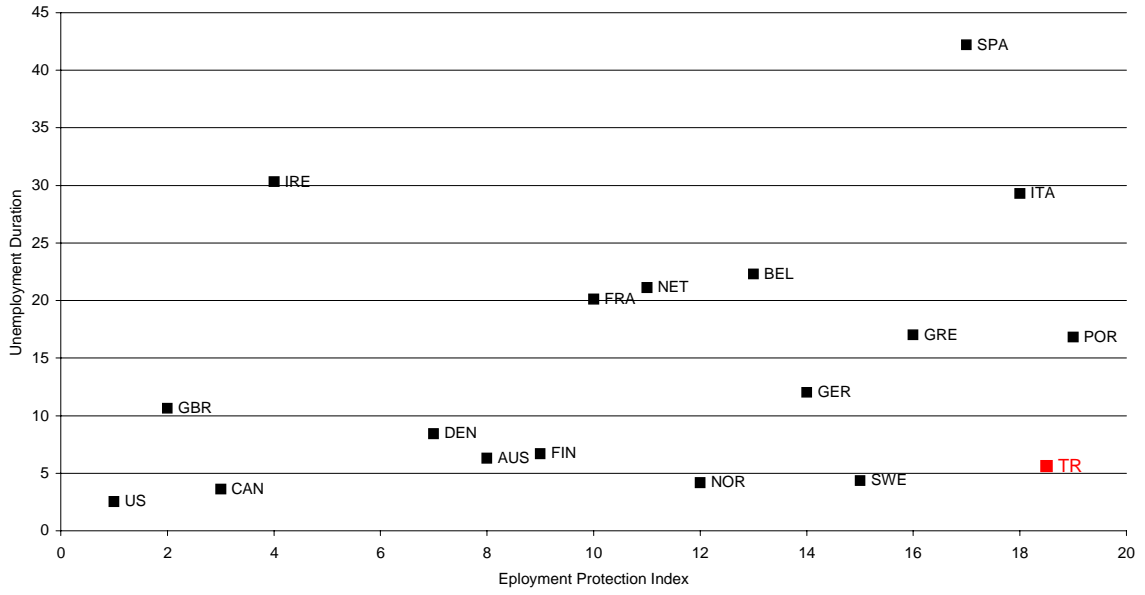


Figure 4. Unemployment rate and employment protection

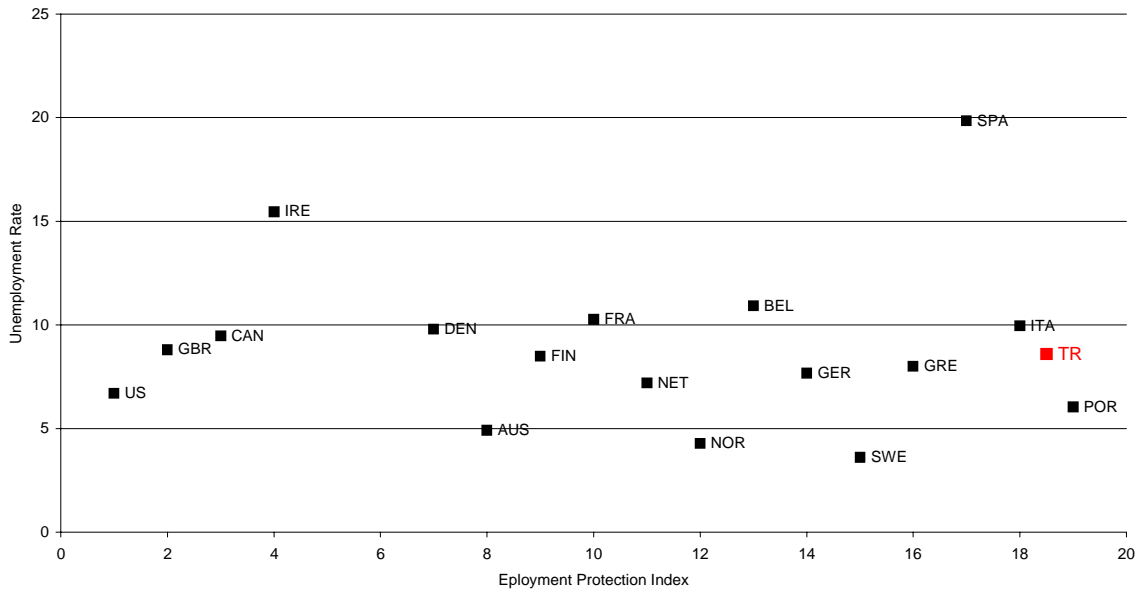


Figure 5a. Inter-industry wage differentials
Selected countries, 1980-2000



Figure 5b. Inter-industry wage differentials
Selected countries, 1980-2000

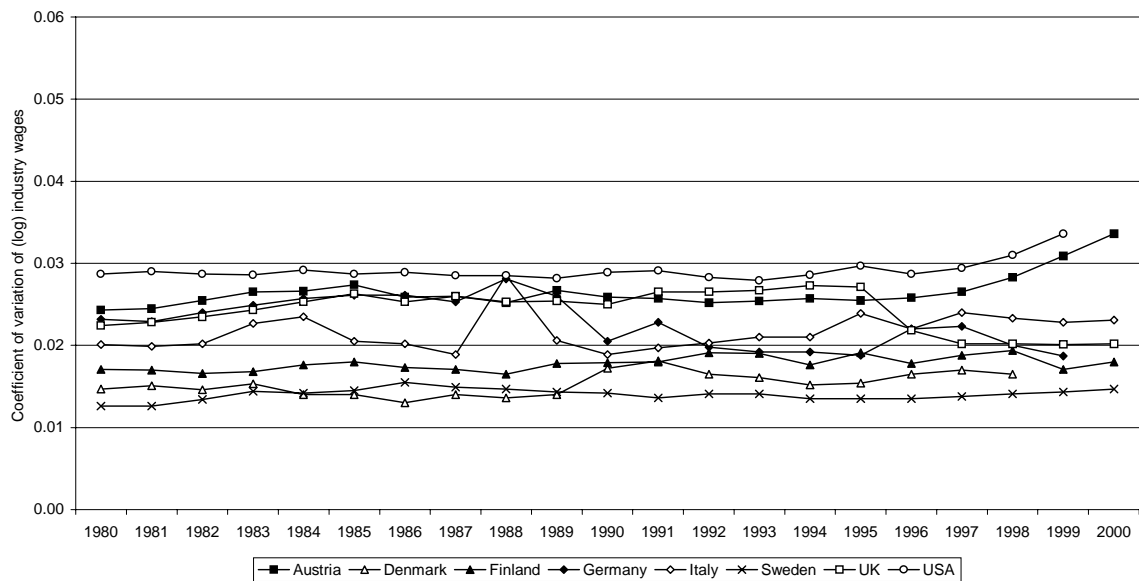


Figure 6. Labor demand adjustment speed and wage elasticity, selected group of countries, 1980-1997

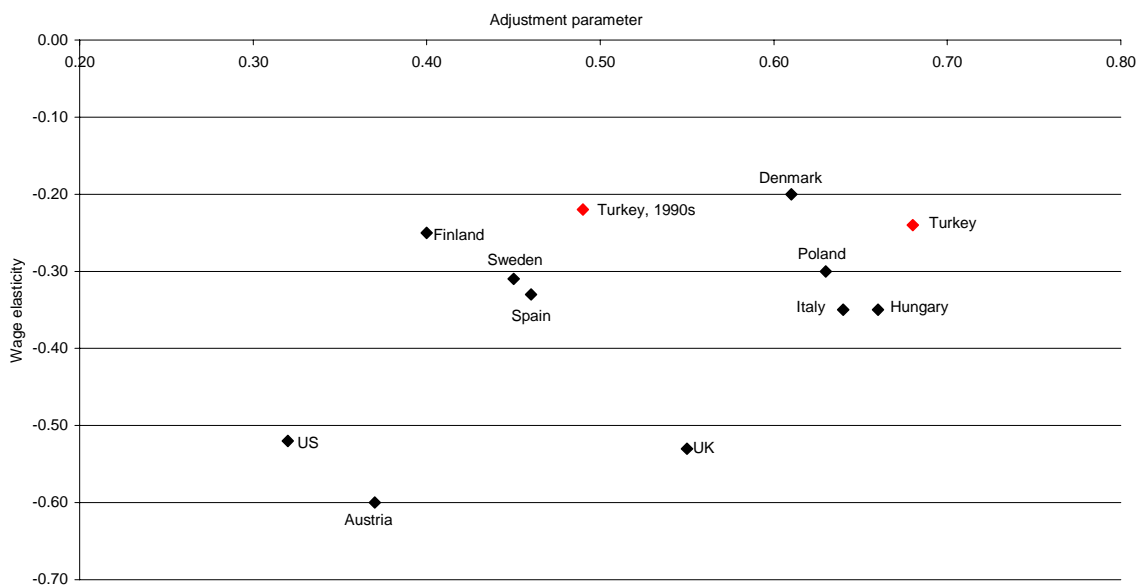


Figure 7. Sectoral distribution of employment, value added and output
Private manufacturing industry, 2000

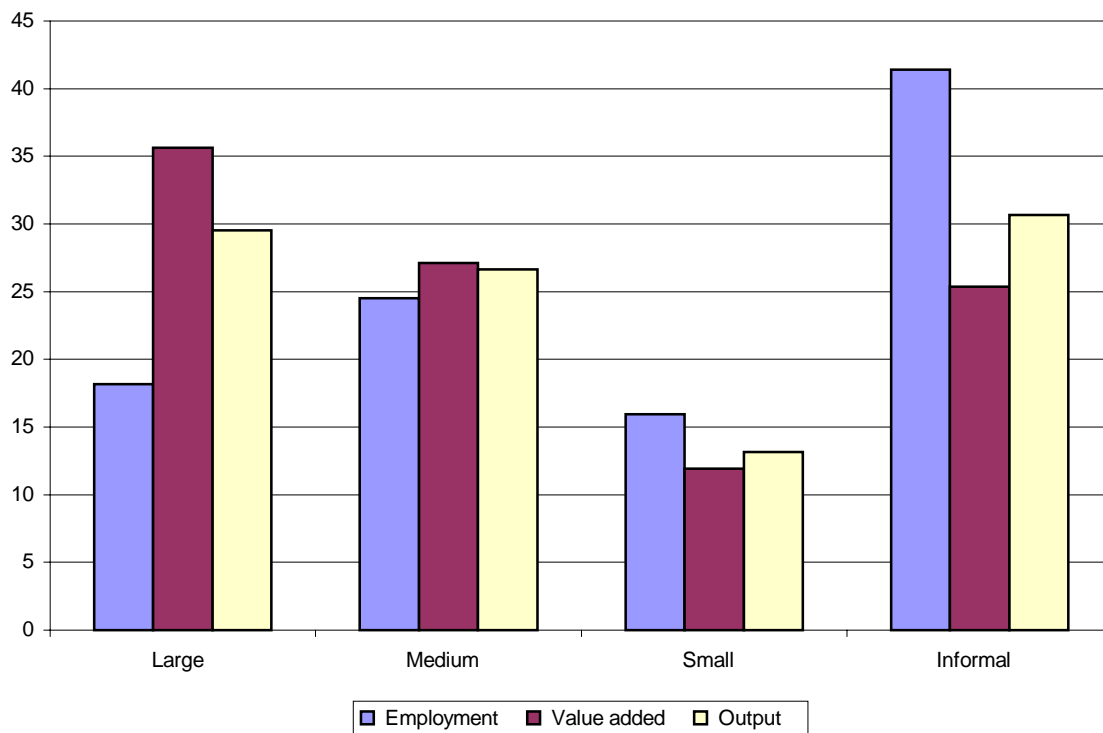


Figure 8. Structure of value added in private manufacturing, 2000

