The Assessment of Labor Code Impact on Vulnerable Groups in the Armenian Labor Market

Armenia Social Protection Systems Strengthening Project

USAID SO 3.4

USAID Armenia 111-C-00-06-00067-00

AECOM International Development

November 2008

USAID

FROM THE AMERICAN PEOPLE

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I. Introduction

The question of the effect of employment protection legislation (EPL) on labor markets is a hotly debated one in both policy and economic circles. Broadly defined, EPL is designed, in the words of the World Bank, to "create conditions that are more conducive to job creation, protecting employment, and improving working conditions" (World Bank 2007). In practice, this usually means a package of legislation that governs hiring and firing of workers, treatment of workers on the job (including holidays, sick leave, and maternity issues), and other related issues.[1]

While the justification for EPL usually rests on some conception of "market failure," with legislation needed to protect workers from the depredations of employers in a situation of informational asymmetry, there are strong economic arguments against the adoption of EPL. Theoretically, interference in the labor market could increase costs to hiring and thus create or maintain unemployment, advantaging those who already have a job at the expense of those who are still looking. Other economists argue, however, that EPL can be expertly designed in such a way as to improve the welfare of workers while not impacting the labor market in a negative manner (these assumptions mainly are based on a Coasean view of the world – that is, in a world of low transaction costs, negotiations can lead to redistribution without loss of efficiency).[2]

A growing literature, typified by the OECD's major initiatives over the past 4 years (see Bassanini and Duval 2006), has attempted to quantify the effect of EPL on labor market performance, but has thus far yielded mixed results. Much of this work has been done at the cross-country level, but restricted to developed economies, ostensibly to research differences in labor market performance connected with continuing stagnation in Europe, but also because labor market regulation data is much more prevalent in developed countries. A much more interesting case can be made for attempting to observe the effects of EPL in emerging and transition economies, however, as their labor markets are still developing; thus, changes in EPL could be expected to have larger effects than in a developed economy and can help our understanding of the transmission channels of labor market policy. This, in turn, can offer more accurate policy prescriptions for both transition and developed economies.

[1] Botero e. al (2003) separate EPL into three distinct areas: employment law, industrial and collective relations law, and social security law. For the purposes of this paper, we will focus on employment law.
[2] See especially Freeman 2005 for an overview of proponents of this viewpoint.

Sadly, little is known about the effects of EPL on the labor market in emerging market economies, and even less about how EPL can change the market in a specific country over time. The purpose of this paper is to help redress this lack of knowledge by examining the effect of EPL particularly in Armenia's transition economy. The Armenian Labor Code, introduced in late 2004, is a modern piece of employment protection legislation that sets restrictions on hiring and firing and represents a comprehensive package of EPL, which ever existed in Armenia.

II. EPL, the Labor Code and Armenia

Armenia has a labor market typical to post-Soviet countries early in their structural (as opposed to macroeconomic) transition, with high informality and hidden unemployment that is not captured by official figures. While the country showed impressive macroeconomic gains, posting GDP growth on average of 12% over the past 8 years (leading the World Bank to dub the country a "Caucasian Tiger"), these gains have not been distributed through the labor market nor the country (most of the growth is centered in the capital, Yerevan). Indeed, the largest problem Armenia has seen since independence is a steady "brain drain," with migration from the country spreading the Armenian Diaspora far and wide. This in turn has led to a large flow of remittances to the country (see Roberts 2004).

Labor relations and employment in Armenia are governed by the Labor Code, enacted in 2004 as part of a broader effort to unify labor legislation and replace many of the Soviet-era codes that were still governing employer-employee relations at the time. Since the fall of the Soviet Union Labor legislation was done in a desultory manner and was reactive to both international donors and the desire for EU accession, with only two major pieces of legislation enacted in this sphere: the Law on Employment Promotion (1996) and the Law on Work Remuneration (2001). Previous EPL in the country was rated by the World Bank (using OECD methodology) as somewhat restrictive, reaching 3.2 on a 6 point scale and surpassed only by Portugal, Mexico, and Turkey (World Bank 2007). Using this same ranking system, the World Bank estimated that the new Labor Code was much less restrictive, at a level of 2.2 (similar to the labor laws of Austria and the Netherlands).

Despite this move towards ostensibly more flexible labor laws, there is still a good deal of evidence in the country that the legislation is not working as planned. Survey evidence of Armenian firms has shown that many employers feel there are still significant problems with the Code, including worries that it has unclear or contradictory on several provisions and a belief that it tends to regulate areas that are best left to the market (as in the case of overtime – see VGM Partners 2008). Other survey evidence, such as the World Bank/EBRD Business Environment and Enterprise Performance Survey (BEEPS) from 2005, showed that the amount of firms indicating labor regulations as a problem to doing business doubled from 2002, from 5% of the sample to 10% (World Bank 2005). More significantly, especially when compared to other CIS countries, Armenian firms noted in the 2005 BEEPS that they would increase their existing workforce by an average of 16% if they "didn't have any [formal] restrictions (i.e. didn't have to seek permission, make severance payments, etc.)." Granted, this may have been a backlash to the

imposition of any requirements, given the relatively free-wheeling labor market before the Labor Code, but the continuing agreement on the stringency of the Code across the business community may point to deeper problems.

In addition to the legal requirements of the Labor Code, Armenia also faces difficulties in the area of administration and implementation of the Code. New Institutional Economics (NIE), especially as applied to transition economies (North 1997), has demonstrated that formal institutional development can influence growth patterns in a country by influencing incentives and transaction costs, and the labor market is no exception to this influence. The gulf in CIS countries between all policy and implementation is wide, but Armenia is particularly striking in the government's lack of capacity to enforce its labor laws. First, the State Labor Inspectorate (SLI) is a new organization, hived off of other ministries and agencies in 2005, that has an excellent charter and law regarding its organization but has thus far failed to develop into a modern organization. Additionally, the State Employment Services Agency (SESA), the keeper of unemployment registration and delegated provider of job matching services, is also lacking in capacity and is seen more as a provider of passive labor measures (unemployment payments) than active measures (job re-training). Given this disparity, part of the dissatisfaction of employers in Armenia may not be due to the Code itself, but its implementation.

III. Conclusions

The effect of employment protection legislation is ambiguous in economics literature, but earlier studies have disaggregated the effects of EPL into a stock and a flow component. It is in the flow of workers that EPL makes its greatest difference, and this is not different in Armenia. The results of our analysis in Armenia confirms both earlier studies done on EPL at the annual level and those done regarding employment flows over seasons. The picture painted is of significant disparities in the flows of workers both before and after the Code was instituted. These results argue for a loosening of restrictions of some provisions of the Labor Code. As noted above, this analysis has not attempted to show the specific aspects of the Labor Code that have caused the most difficulty in worker flows.

As noted above, data in Armenia is a great limitation, and with time and the amassing of a greater time series, along with the sponsorship of more and better labor force surveys, more analysis can be undertaken on the effect of EPL. In particular, the odd behavior of the tax wedge and its impact (or lack) on the labor market needs more analysis, perhaps in the context of remittances and Armenia's deep informal economy. Beyond these issues, this first attempt to quantify the labor market in Armenia has shown that in just 3 short years, the Labor Code has had a significant impact on the flow of workers across seasons. In a country with a tight labor market and fledgling labor market institutions, it would make sense to move towards more liberalization and to worry less about turnover and more about job creation.

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Table 1 - Labor Code Effects on Male Unemployment

Dependent Variable: Total Number of Unemployed Males		
	1	2
Labor Code Dummy	-0.14	-0.42
	0.24	1.23
Time	-0.34	-0.39
	9.91	19.57
Output Gap	0.01	0.00
	2.89	1.08
Tax Wedge	137.82	16.97
	6.70	1.17
Number of People Receiving Benefits		0.40
		13.96
C	11.86	48.71
	1.66	10.08
N	96	96
Adjusted R^2	0.987	0.996

Table 2 - Labor Code Effects on Female Unemployment

Dependent Variable: Total Number of Unemployed Females		
	1	2
Labor Code Dummy	-3.23	-3.65
	3.03	4.80
Time	-0.35	-0.41
	5.69	9.41
Output Gap	0.00	-0.01
	0.22	4.17
Tax Wedge	165.65	-15.36
	4.59	0.48
Number of People Receiving Benefits		0.60
		9.45
C	49.54	104.73
	3.94	9.80
N	96	96
Adjusted R^2	0.975	0.987

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