# Employment protection legislation in Croatia

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Article**
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**Abstract**

*According to business climate and competitiveness indicators published by international organisations, Croatia is a country with a rigid labour market and a high level of the legal protection of employees. Given that an Act on Amendments to the Labour Act (OG 73/13) entered into force in Croatia in June 2013, this paper examines changes in employment protection legislation in Croatia and Central and Eastern European (CEE) countries, as well as in Croatia's main trading partners during the period between 2008 and 2013. A cross-country comparison shows a strong downward trend in legal employment protection in most CEE countries during the observed period, primarily as concerns individual dismissal in the cases of regular employment contracts, while in the case of temporary employment the protection strengthened slightly. On the other hand, despite the adoption of amendments to the Labour Act (LA), Croatian labour legislation governing employment protection for regular employment contracts remains relatively inflexible compared to that in other countries.*

*Keywords: Employment Protection Legislation Index, labour market rigidity, Labour Act, regular and temporary contracts, collective dismissals, Central and Eastern Europe, Croatia*

## 1 INTRODUCTION

Changes in the labour legislation aimed at labour market flexibilisation have been among the most popular structural reforms in Europe after the outbreak of the financial and economic crisis. Croatia is no exception in this regard. The Act on the Criteria for Participation in Tripartite Bodies and Representativeness for Collective Bargaining, passed in mid-2012, repealed the possibility of an open-ended application of legal rules from expired or terminated collective agreements. In the same year, an Employment Promotion Act was passed, expanding the previous active labour market policy measures with a view to reducing both cyclical and structural unemployment through employment promotion programmes for long-term unemployed persons and a "vocational training without employment relationship" programme. A new Act on Amendments to the Labour Act (OG 73/13) was introduced in June 2013, whose main purpose was not only to harmonise the Croatian labour market regulations with those of the EU but also to increase labour market flexibility. Moreover, the second phase of the LA reform has been announced, expected to result in further flexibilisation of labour legislation. Despite initial announcements that the second part of amendments to the LA would be adopted by end 2013, this has not come true yet, neither was it clear, at the time of writing this paper, when further changes to the Act could be expected.

Many international institutions reiterate the importance of implementing structural labour market reforms in Croatia. The International Monetary Fund, for example, within its regular consultations, emphasizes the necessity for labour market

FINANCIAL THEORY AND PRACTICE
38 (2) 139-172 (2014)



reforms[1], and the European Commission, in its Recommendations (2013:19), suggests that it is the labour market reforms that should be given greater importance within the 2013 Economic Programme for Croatia. It is a common perception among professionals but also the wider public that Croatia's labour market is inflexible and burdened by heavy hiring and dismissal costs.

Taking this into consideration, the author assesses different employment protection legislation indexes for Croatia before and after the adoption of Amendments to the Labour Act in June 2013, and analyses the flexibility of Croatian labour legislation as compared to that in other countries. The paper assesses the OECD[2] Index of Employment Protection for regular open-ended contracts, including collective dismissals (EPRC) and Index of Employment Protection for temporary contracts (EPT), based on an analysis of the Labour Act. Moreover, the Ease of Employment Index has been estimated, based on a data base published by the World Bank.[3]

It has been estimated that the EPRC index for Croatia declined slightly, from 2.9 in 2008 to 2.7 in 2013, as a result of reforms in the area of collective dismissals. If only regular contracts are taken into account, this area of labour legislation has remained unchanged from 2008, which is in contrast with the reforms carried out in most other countries (Slovakia, Hungary, Czech Republic, Estonia, Italy and Slovenia), which decreased employment protection for regular contracts in the reference period. By contrast, due to a revision of Article 10 of the LA which governs fixed term contracts, the Employment Protection Index for temporary contracts dropped from 2.2 in 2008 to 2.0 in 2013, so that in 2013, Croatia's EPT was in line with the peer countries' average.

The assessment of the employment protection legislation indexes for Croatia was followed by their detailed analysis aimed at establishing which legal provisions resulted in labour market inflexibility even after the adoption of amendments to the LA. It was found that Croatia was more rigid than other countries in respect of employment protection for regular contracts, due to complicated hiring and dismissal procedures, according to which employment contract cannot be terminated before the person is retrained and reassigned to another position, and in the case of termination of an employment contract, the employer is obliged to take into account the person's age and length of service. In the case of reemployment, priority rules for redundancies apply, i.e. where an employee is dismissed on business grounds, the employer is not allowed to hire another employee for the same job for six months. Furthermore, the employer is required to notify not only the employee but also the workers' council of his/her intention to terminate an em-

[1] For more information, see the IMF website at: http://www.imf.org/external/country/HRV/index.htm; IMF Staff visit reports on Article IV Consultations, Croatia.
[2] For more details, see: OECD (2013) and (2013a).
[3] For more details, see: World Bank (2014).

ployment contract. These procedures are more rigid in Croatia than in other CEE countries.

In addition to the OECD EPRC and the EPT indexes, this article briefly analyses the World Bank's Ease of Employment Index which allows a comparison with a larger number of countries. It has been estimated that Croatia ranked 161th on the ease of employment among 189 countries at the beginning of 2013, and 146th after the adoption of Amendments to the LA in June 2013 (this estimations are based on the assumption that the labour legislation in all peer countries remained unchanged during 2013). The findings of the Ease of Employment Index analysis also show that the Croatian labour market is extremely rigid compared to peer countries, especially as concerns hiring and firing regulations.

This article complements the existing literature (Biondić et al., 2002; Matković and Biondić, 2003; Tonin, 2009; and CNB, 2013) on the (in)flexibility of labour legislation and labour market in Croatia. Biondić, Crnić and Martinis (2002), assess the flexibility of labour legislation on the basis of the Labour Act of 2001 (OG 82/01), Matković and Biondić (2003) on the basis of the LA of 2003 (OG 114/03), and Tonin (2009) on the basis of the LA of 2004 (OG 137/04), while CNB, makes the assessment on the basis of the LA of 2009 (OG 149/2009). To the knowledge of the author, this is the first research work dealing with labour market flexibility which takes into account changes resulting from the Act on Amendments to the Labour Act in 2013 (OG 73/13). Furthermore, the article provides a detailed description of the OECD EPRC and EPT indexes, as well as the World Bank's Ease of Employment Index, used as indicators of the strictness of labour legislation, which is also a novelty in the relevant domestic literature. Therefore, this article features the latest and most comprehensive assessment of the available international labour market rigidity indexes.

## 2 EMPLOYMENT PROTECTION LEGISLATION

The legal framework regulating the hiring, dismissal and other procedures related to the labour market is supposed to ensure timely adjustment of the labour market to fluctuations in the economic activity, while maintaining an adequate level of protection of employees (OECD, 2013).[4] Given the variety of current legal systems and individual laws governing the labour market, the OECD used to assess and publish an Employment Protection Legislation Index (EPL) which allowed a cross-country comparison of the labour legislation. The EPL index comprised a wide range of indicators that could be grouped into three main employment protection categories: regular contracts, temporary contracts and collective dismissals. The overall index was calculated as the weighted average of these indicators. The relative significance of individual indicators was determined using a detailed methodology.[5] The overall EPL index could have values from 0 to 6, where a low

[4] For more details, see OECD (2013).
[5] For more details, see Venn (2009:39-45) and CNB (2013).

index value indicated flexible labour legislation, and vice versa. The index was assessed at a four-year interval for the previous four-year period, and was published in the above-described form from 1985 to 2008. While the OECD published no EPL index for Croatia, its values were estimated at three occasions, suggesting extremely strict labour legislation. The EPL index for Croatia was first estimated in 2002, when it stood at 3.58 (Biondić, Crnić and Martinis, 2002), and then in 2003, after the passing of the Act on Amendments to the Labour Act (OG 114/03), when it dropped to 2.76 (Matković and Biondić, 2003), mainly due to the introduction of legislation on temporary work agencies, the activities of which have not been previously regulated by law. Tonin (2009) estimated the EPL index for Croatia using the LA of 2004, i.e. its articles relevant for the determination of the EPL index which were the same as those used in the paper by Matković and Biondić (2003). However, due to a slightly different interpretation of some articles, the obtained EPL value was slightly lower, 2.7. During 2008, the OECD modified its EPL index assessment methodology, by including three additional indicators. As a result, the index assessed on the basis of the LA (OG 149/2009) and the new methodology stood at 2.61 (CNB, 2013).

In July 2013, after a four-year break, the OECD published its updated information on employment protection legislation for the previous four-year period, based on a new approach regarding the assessment of individual indicators relevant for the evaluation of employment protection legislation. According to the new approach, the labour market legislations were primarily examined by OECD experts, while in the previous cases, data had been obtained by the competent national institutions. This change resulted in the uniform interpretation of the relevant laws and application of the OECD methodology itself, which allowed a better cross-country comparison of the labour market legislation. Due to changes in data collection and the evaluation of indicators, the already published data for 2008[6] have been revised. Hence, it is worthy of note that the estimates for Croatia deviate from those based on the OECD methodology, since they were not made by OECD experts. Instead of this, the values of individual indicators for Croatia are author's estimates based on the relevant provisions of the Croatian LA and her interpretation of the OECD methodology.

Besides this methodological change, another novelty, crucial for the interpretation of employment protection legislation was introduced in 2013. While the availability of underlying indicators for the assessment of the EPL index remained unchanged from 2008, the EPL value was no more available and was not published. Instead, two summary indexes were considered alternatively: the index of employment protection for regular contracts, including collective dismissals (EPRC) and index of employment protection for temporary contracts (EPT). The new me-

[6] For further details about methodological changes in the assessment of the Employment Protection Legislation Index, see OECD (2013:76-77).

thodology for calculating the two key summary employment protection indexes is presented in tables 1 and 2.

**Table 1**

*Construction of the summary Index of Employment Protection for regular contracts, including collective dismissals*

| | | | |
|---|---|---|---|
| **Index of Employment Protection for regular contracts, including collective dismissals (EPRC)** | **Index of Employment Protection for regular contracts (EPR) (5/7)** | Procedural inconveniences (1/3) | Notification procedures (1/2)<br>Delay involved before notice can start (1/2) |
| | | Notice and severance pay for no-fault individual dismissals (1/3) | Notice period after 9 months tenure (1/7)<br>Notice period 4 after years tenure (1/7)<br>Notice period after 20 years tenure (1/7)<br>Severance pay after 9 months tenure (4/21)<br>Severance pay after 4 years tenure (4/21)<br>Severance pay after 20 years tenure (4/21) |
| | | Difficulty of dismissal (1/3) | Definition of justified or unfair dismissal (1/5)<br>Length of trial period (1/5)<br>Compensation following unfair dismissal (1/5)<br>Possibility of reinstatement following unfair dismissal (1/5)<br>Maximum time to make a claim of unfair dismissal (1/5) |
| | **Index of Employment Protection against collective dismissals (EPC) (2/7)** | Collective dismissals | Definition of collective dismissal (1/4)<br>Additional notification requirements (1/4)<br>Additional delays involved before notice can start (1/4)<br>Other special costs to employers (1/4) |

*Source: OECD (2013a).*

**Table 2**

*Construction of the summary Index of Employment Protection for temporary contracts*

| | | |
|---|---|---|
| **Index of Employment Protection for temporary contracts (EPT)** | Fixed term contracts (1/2) | Valid cases for use of fixed-term contracts (FTC) (1/2)<br>Maximum number of successive FTC (1/4)<br>Maximum cumulated duration of successive FTC (1/4) |
| | Temporary work agency employment (1/2) | Types of work for which temporary work agency (TWA) employment is legal (1/3)<br>Restrictions on number of renewals (1/6)<br>Maximum cumulated duration of TWA assignments (1/6)<br>Does the set-up of a TWA require authorisation or reporting obligations (1/6)<br>Do regulations ensure equal treatment of regular and agency workers at the user firm (1/6) |

*Source: OECD (2013a).*

According to OECD (2013), the main reason for non publishing of the overall EPL index is the fact that all implemented reforms do not have equal effects on the labour market, neither can these effects be unambiguously quantified and measured. Therefore, introducing two alternative indexes should provide a better insight into the labour market flexibility. Thus, for example, the results of the flexibilisation of employment protection for temporary contracts will depend on the concurrent employment protection for regular contracts. Aoyagi and Ganelli (2013) demonstrate on a panel of OECD countries that a high level of employment protection for regular contracts combined with a low level of protection for temporary contracts results in labour market dualism. Literature offers many studies on adverse aspects of dual labour markets. Khan (2010), for example, shows that deregulation of temporary contracts increases the share of such contracts in total employment, yet without any major influence on the total number of employed persons. Boeri and Garibaldi (2007) came to the same conclusion, showing that the flexibilisation of the labour market "at the margin" (only for temporary forms of employment, such as fixed term contracts) initially results in higher overall employment, but this "honey moon effect" wears off eventually and regular employees are replaced by those employed on temporary contracts. Furthermore, numerous studies (Bentolila and Dolado, 1994; Blanchard, 2002) suggest that labour market dualism results in lower productivity, which, in the long run, reduces economic growth rates. Dualism also has a strong effect on wage dynamics in the labour market. Boeri (2011) demonstrates that there is a wage premium for regular employment contracts, as opposed to temporary contracts. The premium ranges from 6.5% in England to a high of 45% in Sweden.[7]

The substitution between temporary and regular employment can be avoided if the relative flexibility of both types of contracts is equal. Otherwise, dual markets will develop, with outstanding protection of persons employed on regular contracts and poor protection of those employed on temporary contracts, who will bear the full burden of a possible adjustment in the number of employees in times of crisis.

With all this said, in an environment of inflexible labour legislation, the flexibilisation of only the part of the legislation which governs temporary employment will have no major effect on the labour market, but it can lead to a decrease in the EPL value, which, in turn, can distort conclusions about the desirability of certain reforms for labour legislators. Therefore, the OECD has recommended that the EPL index, as an indicator of employment protection legislation be abandoned, and that the EPRC and EPT indexes be used, as they provide a parallel insight into the movements of employment protection legislation for both regular and temporary contracts.

[7] In contrast to the above mentioned papers, the author of this article assesses some labour market flexibility indicators, but the article does not explore the interconnection between the values of selected flexibility/rigidity indicators and labour market outcomes (employment dynamics, employment rate, unemployment rate, etc.).

Another motive for introducing the two alternative summary indexes which provide a better insight into the labour market flexibility is the fact that, during the recent crisis, many countries carried out labour legislation reforms in order to remove rigidities, improve their international scores and, consequently, become more attractive to investors. Therefore, such indexes make it easier to detect the areas of labour legislation which have been reformed.

Each of the indicators included in the assessment of summary EPRC and EPT indexes, as well as the summary indexes themselves, can take on a value between 0 and 6, where low-value indicators or indexes are assigned to countries with flexible labour legislation, and high values of indicators/summary indexes suggest inflexible legislation[8].

Using the relevant versions of the LA, the summary EPRC and EPT indexes for Croatia have been estimated, and the country's position has been analysed in relation to comparable countries and the main trading partners in 2008 and 2013, i.e. immediately before and after the outbreak of the crisis. CEE countries – new EU Member States with similar transition processes, in terms of institutional and economic characteristics, were choosen as comparable countries for Croatia. Also included were Croatia's main trading partners, given that labour cost is one of the key determinants of cost competitiveness, and high level of employment protection results in high employer costs of hiring/dismissal. This implicitly increases labour cost and distorts a country's cost competitiveness relative to its trading partners.[9]

The 2008 data for Croatia were taken from the LA (OG 149/09) and the sources of data for 2013 were all the relevant amendments to the LA, adopted by July 2013. This made it possible to quantify the effects of reforms carried out pursuant to Amendments to the Labour Act, adopted in June 2013 (OG 73/13). Although this paper is based on the 2009 LA (OG 149/09), which became applicable as late as January 2010, as all the relevant items used for calculating the summary employment protection indexes are the same in both the LA of 2009 (OG 149/09) and LA of 2004 (OG 137/04), the results are considered valid for 2008 as well. Moreover, given that most other observed countries implemented labour legislation reforms in the specified period, with a view to increasing labour market flexibility, the analysis was focused on the relative change in Croatia's position compared to the selected countries.

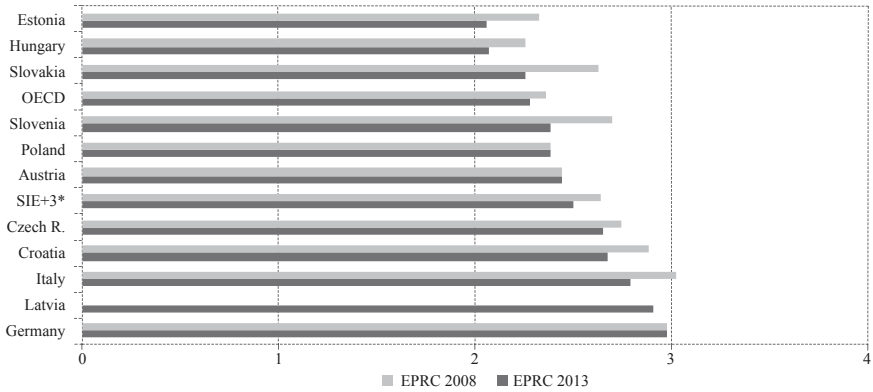
[8] The OECD compiles and publishes 21 indicators and two aggregate indexes for the OECD members, as well as Argentina, Brazil, China, India, Indonesia, Latvia, Russia, South Africa and Saudi Arabia.
[9] The main trading partners have been determined on the basis of direct import and export competitiveness and export competitiveness in third markets. The OECD publishes data for Slovenia, Poland, Estonia, Czech Republic, Slovakia, Hungary and Latvia (post-communist EU Member States), as well as Italy, Austria and Germany (Croatia's main trading partners).

## 3 CHANGES IN EMPLOYMENT PROTECTION FOR REGULAR CONTRACTS, INCLUDING COLLECTIVE DISMISSALS

As shown in chart 1, in the period immediately before the crisis, Croatian employment protection legislation for regular contracts, including collective dismissals was stricter than that in other countries, with the EPRC index standing at 2.9 (the observed countries' average was 2.6 and the average for OECD countries 2.4). Accordingly, Croatia was among the most rigid countries in the observed group, along with Italy and Germany, while new EU Member States were much more flexible.

**Chart 1**

*Summary Index of Employment Protection for regular contracts, including collective dismissals for Croatia and selected countries, 2008 and 2013*




**SIE+3 stands for a simple value average for Czech Republic, Estonia, Latvia, Hungary, Poland, Slovakia, Slovenia and Croatia (CEE countries) and Austria, Italy and Germany (Croatia's main trading partners).*
*The value of 4 indicates extremely strict labour legislation and the value of 0 extremely flexible legislation.*

*Sources: OECD (2013c) and author's estimate for Croatia.*

Amendments to the Labour Act (OG 73/13) led to a change in the collective redundancy procedure, which had a direct effect on the EPRC index because of a change in the indicator measuring additional delays in the start of the notice period in the case of collective dismissals. According to the OECD methodology, where an additional delay in the notice period in the case of collective dismissals (respective to regular dismissals) is not possible, the relevant indicator takes on the value of 0. For possible delays of 25, 30, 50, 70 and 90 days, the relevant indicators take on the values of 1, 2, 3, 4 and 5 respectively. If the possible delay is longer than or equal to 90 days, the indicator takes on the value of 6. Since the public employment service was authorised to order an additional 3-month delay in the notice period in the case of collective dismissals, this indicator for Croatia took on the value of 6. Pursuant to Amendments to the LA (OG 73/13), the addi-

tional delay in the notice period, to be determined by the public employment service in exceptional cases, for all employees who are offered a redundancy programme, has been reduced from 90 to 30 days. However, besides this additional delay of notice period decided by public employment service, pursuant to Article 112, paragraph (3) of the Act, an employer may not dismiss employees who have been offered a redundancy programme before the expiry of thirty days from the delivery of the programme to the competent public employment service. Thus, it can be concluded that the total additional delay period in the case of collective dismissals is 60 days. If the total delay period in the case of collective dismissals is compared with regular delays in the start of the notice period for regular employment contracts (10 days[10]), the additional delay in the case of collective dismissals in 2013 was 50 days. With this delay period, the indicator reflecting additional delays in the start of the notice period for collective dismissals had the value of 3. Owing to this change, the summary EPRC index dropped from 2.9 to 2.7. Other implemented amendments to the LA had no effect on the EPRC index.

**TABLE 3**

*Subindex of employment protection for regular contracts (EPR) and subindex for employment protection against collective dismissals (EPC) for Croatia and comparable countries, 2008 and 2013*

| | EPR 2008 | EPR 2013 | EPC 2008 | EPC 2013 |
|---|---|---|---|---|
| Austria | 2.12 | 2.12 | 3.25 | 3.25 |
| Czech R. | 3.00 | 2.87 | 2.13 | 2.13 |
| Estonia | 2.56 | 1.74 | 1.75 | 2.88 |
| Croatia | 2.55 | 2.55 | 3.75 | 3.00 |
| Italy | 2.60 | 2.41 | 4.13 | 3.75 |
| Latvia | – | 2.57 | – | 3.75 |
| Hungary | 1.82 | 1.45 | 3.38 | 3.63 |
| Germany | 2.72 | 2.72 | 3.63 | 3.63 |
| Poland | 2.20 | 2.20 | 2.88 | 2.88 |
| Slovakia | 2.19 | 1.81 | 3.75 | 3.38 |
| Slovenia | 2.43 | 1.99 | 3.38 | 3.38 |
| OECD | 2.15 | 2.04 | 2.90 | 2.91 |
| SIE+3* | 2.42 | 2.22 | 3.20 | 3.22 |

** For the explanation of SIE+3, see footnote below chart 1.*

*Sources: OECD (2013c) and author's estimate for Croatia.*

[10] According to the OECD methodology, the delay in the start of the notice period for regular employment contracts is 6 days, if it is necessary to, give a written warning prior to the employee prior to the dismissal, in the case of dismissal on grounds of employee conduct. An additional delay of 3 days is granted if the notice of dismissal must be in writing. According to the LA, prior to a regular dismissal on grounds of employee conduct, the employer is obliged to warn the employee in writing of a possibility of dismissal. The notice of dismissal must be in a written form and it must include a written statement of reasons. The workers' council must be notified of the intention to dismiss an employee.

Slovakia, Hungary, Czech Republic, Estonia, Italy and Slovenia also increased the flexibility of their employment protection regulations for regular contracts, including collective dismissals in the said period, so that the average EPRC index for these countries stood at 2.5 in 2013 (2.3 for OECD countries). The relative position of Croatia with respect to the EPRC value remained the same as in 2008. The reforming economies have addressed all areas of law governing regular contracts, facilitating the dismissal procedures, reducing notice periods and severance payments, but also redefining the terminology related to unfair dismissals.

Since the EPRC index comprises the overall legal framework governing rights and obligations arising from regular contracts and those related to collective dismissals, the subindex of employment protection for regular contracts (EPR) and the subindex of employment protection against collective dismissals (EPC) can be analysed separately. This analysis shows a marked deterioration in the relative position of Croatia according to the EPR index in 2013 relative to 2008.

By separating the EPRC index into two subindexes (EPR and EPC), we find that through a recent reform, Croatia reduced the subindex of employment protection against collective dismissals from 3.75 in 2008 to 3.0 in 2013. The selected countries' average was 3.2 and was not significantly changed (see table 3). In contrast to the reforms of employment protection for regular contracts in Slovakia, Hungary, Czech Republic, Estonia, Italy and Slovenia which have made this area of labour legislation more flexible, the reforms of legislation governing collective dismissals in Czech Republic, Slovenia, Estonia and Hungary have not brought any changes in collective dismissals. Moreover, collective dismissals in Estonia and Hungary have become relatively more inflexible as compared to regular terminations of employment contracts. Besides in Croatia, collective dismissals became more flexible only in Italy and Slovakia. It is evident that collective dismissal regulations remained relative inflexible in all the countries, suggesting that there is a consensus that collective dismissals should be regulated more strictly, since mass redundancies can have extremely negative effects on community welfare (OECD, 2013:86).

The subindex of employment protection for regular contracts for Croatia stood at 2.55 in 2008 and remained at that level in 2013, given that the 2013 reform brought no changes regarding regular contracts. The labour legislation reforms in most of the selected countries were mainly targeted at this area, and consisted primarily in facilitating hiring and dismissal procedures (Estonia, Slovenia and Hungary), as well as in significant shortening of notice periods and reductions in severance pays (Slovenia, Slovakia, Estonia and Czech Republic). As a result, the subindex of employment protection for regular contracts for selected countries dropped from 2.4 in 2008 to 2.2 in early 2013, while the early-2013 average for OECD countries stood at 2.0.

**Table 4**

*Details of the calculation of EPC index for Croatia, based on the analysed amendments to the LA*

| | | 2008 | | | 2013 | | |
|---|---|---|---|---|---|---|---|
| | **Weights of individual indicators in total EPC index (in %)** | **Value pursuant to the LA (OG 149/09)** | **Contribution to total EPC index** | **Share in total EPC index (in %)** | **Value according to the LA (OG 73/13)** | **Contribution to total EPC index** | **Share in total EPC index (in %)** |
| Index of Employment Protection against collective dismissals (EPC) | 100 | | 3.75 | 100 | | 3.00 | 100 |
| Definition of collective dismissal | 25 | 3 | 0.75 | 20 | 3 | 0.75 | 25 |
| Additional notification requirements | 25 | 3 | 0.75 | 20 | 3 | 0.75 | 25 |
| Additional delays involved before notice can start | 25 | 6 | 1.50 | 40 | 3 | 0.75 | 25 |
| Other special costs to employers | 25 | 3 | 0.75 | 20 | 3 | 0.75 | 25 |

*Source: Author's estimates.*

Slovenia, for example, reformed its Labour Act (Zakon o delovnih razmerjih), with a view to increase flexibility. Employee dismissal procedures were streamlined, notice periods were shortened and severance pays in the case of unfair dismissal were cut. Estonia also reduced notice periods and severance pays and facilitated hiring and dismissal procedures. Moreover, Estoina made considerable changes in the "possibility of reinstatement following unfair dismissal" procedure. Consequently, the reinstatement of an employee in the case of unfair dismissal is now subject to mutual consent of both the employer and employee (before the reform, the employee's reinstatement was subject to a court ruling).

Despite the reform, Croatia's employment protection legislation on regular contracts still deviates sharply from the observed countries' average. Therefore, we will analyse in detail which indicators of the EPR index contribute to its high value.

**TABLE 5**

*Details of the calculation of EPR index for Croatia, based on the analysed amendments to the LA*

| | | 2008 | | | 2013 | | |
|---|---|---|---|---|---|---|---|
| | **Weights of individual indicators in total EPR index (in %)** | **Value pursuant to the LA (OG 149/09)** | **Contribution to total EPR index** | **Share in total EPR index (in %)** | **Value according to the LA (OG 73/13)** | **Contribution to total EPR index** | **Share in total EPR index (in %)** |
| Index of Employment Protection for regular contracts (EPR) | 100 | | 2.55 | 100 | | 2.55 | 100 |
| Notification procedures | 17 | 4 | 0.67 | 26 | 4 | 0.67 | 26 |
| Delay involved before notice can start | 17 | 1 | 0.17 | 7 | 1 | 0.17 | 7 |
| Notice period after 9 months tenure | 5 | 2 | 0.10 | 4 | 2 | 0.10 | 4 |
| Notice period after 4 years tenure | 5 | 3 | 0.14 | 6 | 3 | 0.14 | 6 |
| Notice period after 20 years tenure | 5 | 2 | 0.10 | 4 | 2 | 0.10 | 4 |
| Severance pay after 9 months tenure | 6 | 0 | 0.00 | 0 | 0 | 0.00 | 0 |
| Severance pay after 4 years tenure | 6 | 3 | 0.19 | 7 | 3 | 0.19 | 7 |
| Severance pay after 20 years tenure | 6 | 2 | 0.13 | 5 | 2 | 0.13 | 5 |
| Definition of justified or unfair dismissal | 7 | 4 | 0.27 | 10 | 4 | 0.27 | 10 |
| Length of trial period | 7 | 3 | 0.20 | 8 | 3 | 0.20 | 8 |
| Compensation following unfair dismissal | 7 | 3 | 0.20 | 8 | 3 | 0.20 | 8 |
| Possibility of reinstatement following unfair dismissal | 7 | 4 | 0.27 | 10 | 4 | 0.27 | 10 |
| Maximum time to make a claim of unfair dismissal | 7 | 2 | 0.13 | 5 | 2 | 0.13 | 5 |

*Source: Author's estimates.*

A detailed analysis of the situation in Croatia shows that the indicator measuring the notification procedures in the case of regular dismissal, accounts for 26% of the total value of EPR subindex in 2013. According to the OECD methodology,

the notification procedures where it is sufficient that the employer orally communicates his/her decision on dismissal to the employee are scored as the most flexible (the score of 0). Where the employer is required to hand to an employee a dismissal with the statement of reasons in a written form, the indicator takes on the value of 2, and where it is required that the dismissal should be notified by the employer not only to the employee but also to a third party (e.g. the workers' council), the indicator takes on the value of 4. The notification procedures where the employer must obtain permission from a third person to make the dismissal valid are rated as the most inflexible (rating 6). According to the LA (OG 73/13), the notice of dismissal must be delivered to the employee in writing (Article 112), and the intention to cancel an employment contract must be notified to the workers' council (if any). The employer is required to consult with the council about the decision (Article 118). As a result of the above mentioned legal procedures, this indicator for Croatia took on the value of 4 in 2013.

Moreover, the indicator measuring flexibility in the definition of justified or unfair dismissal accounted for 10% of the total value of EPR subindex in 2013. If an employee's competence (dismissal on personal grounds) or the cessation of the need for certain jobs (dismissal on business grounds) are sufficient reasons for the termination of a regular employment contract, the index takes on the value of 0. It takes on the value of 2 if the termination of an employment contract requires from an employer to take into account the employee's age and length of service. The indicator is scored as 4 if an employment contract cannot be terminated before the employee is retrained and reassigned to another job, and the indicator stands at 6 if the law does not provide for dismissal on grounds of an employee's (in)competence. According to Article 107 of the LA (OG 73/13), dismissals on personal and business grounds are permitted only where the employer cannot reassign the employee to another job (retrain him/her for another job). When deciding on such dismissals, the employer must take into account the length of service, age, disability and maintenance obligations of the employee. As a result of this, the indicator took on the value of 4 in 2013.

While dismissals on personal and business grounds are allowed in Croatia only in the above mentioned cases, in Czech Republic, Estonia, Poland, Slovakia and Slovenia, a dismissal is considered as unfair only if it results from the discriminatory treatment of employees (discrimination based on religion, ethnicity, trade union membership, etc.).

The indicator measuring the incidence of court rulings ordering the reinstatement of dismissed employees accounts for another 10% of the total EPR subindex value. This indicator takes on value 4, as in Biondić et al. (2002), Matković and Biondić (2003) and Tonin (2009). (The score of 0 is given to the labour legislation under which courts are not inclined to cancel a dismissal and reinstate an employee to his/her former job, and the score of 6 to the legislation where such court

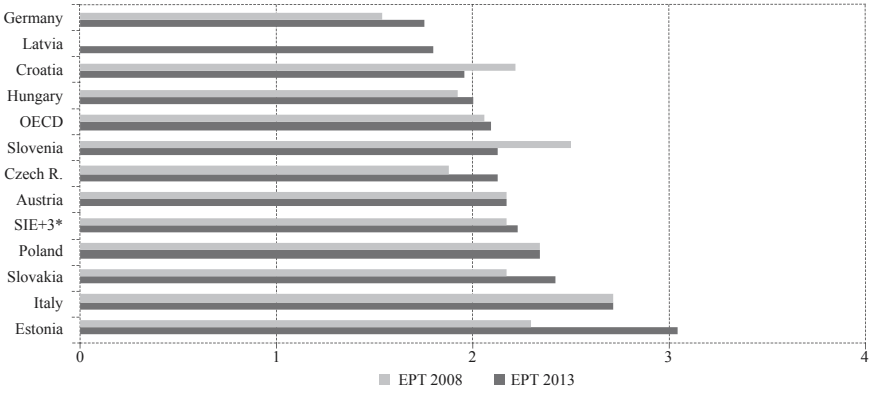
rulings are exceptionally frequent.)[11] The more frequent the reinstatement of dismissed employees and cancelling of dismissals by courts, the higher the value of this indicator. Nevertheless, the amendments to the LA have no direct influence on this indicator, at least unless the judicial authority to reinstate employees to their former positions is abolished. In Estonia, for example, the reinstatement of an employee is subject to a mutual agreement between the employee and employer, but this is the only country among analized countries providing for such an option. In all other countries, the competent court may adjudicate that an employee should be reinstated in the case of unfair dismissal. The above mentioned three indicators together account for one third of the EPR subindex value, which leads to the conclusion that complex dismissal procedures and a broad interpretation of unfair dismissals are the sources of inflexibility of regular employment legislation in Croatia compared to other countries.

## 4 CHANGES IN EMPLOYMENT PROTECTION FOR TEMPORARY CONTRACTS

In 2008, employment protection for temporary contracts in Croatia was around the average for comparable countries. The EPT index for Croatia and comparable countries was 2.2 (2.1 for OECD countries).

**CHART 2**

*Summary Index of Employment Protection for temporary contracts for Croatia and comparable countries, 2008 and 2013*




** For the explanation of SIE+3, see footnote below chart 1.*

*Sources: OECD (2013c) and author's estimate for Croatia.*

[11] Biondić, Crnić and Martinis (2002) indicate that the score assigned to Croatia is in line with the transition countries' average. A new assessment of this indicator is currently impossible, due to unavailability of public data on court judgements in labour disputes. As an approximate indicator, annual reports on the work of the State Attorney's Office of the Republic of Croatia (DORH) in the period from 2006 to 2012 have been analysed, showing that labour disputes decided in favour of employees account for 2/3 of total labour disputes involving the DORH, which is in line with the score assigned to Croatia. This analysis is incomplete, because it leaves out judgements in private sector disputes, and because it relates to all labour disputes, regardless of their types, but, due to a lack of other data, it is the only one possible.

The indicator measuring validity of the use of fixed term contracts accounts for the bulk of the value of this summary index for Croatia (45%). According to the LA (OG 149/09), an employment contract could be concluded for a definite period of time only in exceptional cases, when the end of employment relationship has been pre-determined for objective reasons, such as the meeting of a specific deadline, completion of a task or occurrence of a specific event (Article 10). According to the OECD methodology, fixed term contracts that are valid only if used for "objective reasons" are scored as the most inflexible (the score of 6). Where such contracts additionally involve exceptions on the part of either the employer or the employee which are allowed for concluding a fixed term contract, then the relevant indicator is assigned the score of 4, and where exceptions are allowed simultaneously for both the employer and employee, the score is 2. Where there are no legal constraints on the conclusion of fixed term contracts, the indicator takes on the value of 0. Given that the Croatian LA provided for conclusion of fixed term contracts where this was justified by objective reasons, with an explicit exception for employees (first employment, employment of a probationer or trainee), regulated by Article 37, paragraph (3) of the LA, this indicator for Croatia was assigned the score of 4.[12]

As a result of amendments to the LA from July 2013 (OG 73/13) relating to fixed term contracts, EPT index dropped from 2.2 in 2008 to 2.0 in 2013. This change was due to a reform of Article 10 on fixed-term employment. The first use of fixed term contracts was no more subject to time limits. However, in order to protect employees' rights, in the case of successive fixed term contracts, the maximum duration of contracts remained limited to three years. Moreover, restrictions with respect to reasons for the conclusion of the first fixed term contract were lifted, whereas the possibility of concluding successive fixed term contracts was only allowed if the employer had objective reasons for that which he had to clearly state in writing. Austria and Hungary also have no restrictions as to the objectivity of reasons for the first use of fixed term contracts (although this restriction does exist for each subsequent fixed term contract). Therefore, according to OECD re-

[12] It is noteworthy that this indicator for Croatia is scored as 6 in Tonin (2009), but it is assigned the score of 4 in Matković and Biondić (2003). Moreover, during consultations with legal experts, opposing opinions were expressed, so that the value of this indicator, according to some interpretations, might be higher than 4. The effective assessment regarding fixed term contracts should be interpreted with caution, because, according to the OECD methodology, the weight assigned to this indicator is the highest, i.e. its value is the most significant for the assessment of the total EPT index (the weight makes up 25% of the index). Equally ambiguous is the interpretation of the question regarding the maximum duration of employment via temporary work agencies. Specifically, an assessment is made of the allowed maximum cumulative duration of employment through temporary work agencies. According to the LA, there is no limit in this respect, but there is a one-year limit on the allowed maximum cumulative duration of successive contracts. However, the term successive is not specified in the OECD methodology. In earlier studies by Matković and Biondić (2003) and Tonin (2009), this indicator was assigned the score of 4, although Tonin (2009) notes that the required period of break after one year of employment through an agency (one month) can be considered as a relatively non-rigid limit imposed by legislators. Given that the weight assigned to this indicator is 8%, this question is not crucial for the assessment of the EPT index.

commendations, after the amendments to the LA, this indicator was assigned the score of 1.[13]

**Table 6**

*Details of the calculation of EPT index for Croatia, based on the analysed amendments to the LA*

| | | 2008 | | | 2013 | | |
|---|---|---|---|---|---|---|---|
| | **Weights of individual indicators in total EPR index (in %)** | **Value pursuant to the LA (OG 149/09)** | **Contribution to total EPT index** | **Share in total EPT index (in %)** | **Value according to the LA (OG 73/13)** | **Contribution to total EPT index** | **Share in total EPT index (in %)** |
| Index of Employment Protection for temporary contracts (EPT) | 100 | | 2.21 | 100 | | 1.96 | 100 |
| *Fixed term contracts* | | | | | | | |
| Valid cases for use of fixed-term contracts (FTC) | 25 | 4 | 1.00 | 45 | 1 | 0.25 | 13 |
| Maximum number of successive FTC | 13 | 0 | 0.00 | 0 | 4 | 0.50 | 26 |
| Maximum cumulated duration of successive FTC | 13 | 1 | 0.13 | 6 | 1 | 0.13 | 6 |
| *Temporary work agencies* | | | | | | | |
| Types of work for which temporary work agency (TWA) employment is legal | 17 | 1.5 | 0.25 | 11 | 1.5 | 0.25 | 13 |
| Restrictions on number of renewals | 8 | 2 | 0.17 | 8 | 2 | 0.17 | 9 |
| Maximum cumulated duration of TWA assignments | 8 | 0 | 0.00 | 0 | 0 | 0.00 | 0 |
| Does the set-up of a TWA require authorisation or reporting obligations? | 8 | 2 | 0.17 | 8 | 2 | 0.17 | 9 |
| Do regulations ensure equal treatment of regular and agency workers at the user firm? | 8 | 6 | 0.50 | 23 | 6 | 0.50 | 26 |

*Source: Author's estimates.*

[13] For more details on the regulation of fixed term contracts in Austria and Hungary, see OECD (2013b).

In 2013, the indicator measuring the maximum number of successive fixed term contracts took on the value of 4 (0 before the reform). To be more specific, although the Croatian legislation does not envisage any maximum number of successive fixed term contracts, according to the amended Article 10, an extension of the first temporary contract is only allowed if there are objective reasons for that. In addition, where the first employment contract is concluded for a period of more than 3 years, the employer cannot conclude the next consecutive fixed term contract with the same employee (Article 10, paragraphs (2) and (4)). Based on a comparison with Austria and Hungary which apply similar solutions in the case of successive fixed term contracts, this indicator is assigned the score of 4.

Thanks to the reform of Article 10, this issue was brought into line with the EU practice, where the use of fixed term contracts is not conditioned by objective reasons, which makes it easier for employers to hire employees. However, in order to protect the rights of employees, such contracts are restricted by the maximum duration or maximum number of successive contracts.

In contrast to Croatia and Slovenia which reported falls in their EPT indexes, the value of the index increased in Estonia, Hungary, Slovakia, Czech Republic and Germany, so that the average for selected countries stood at 2.2 in 2013. The growth in this index was primarily due to the harmonisation of the temporary work agencies' regulations with the applicable EU directives. However, through the flexibilisation of the first use of fixed term contracts, Croatian legislation became more convergent with that of Austria, Czech Republic, Germany, Hungary, Poland and Slovakia which impose no "objective reasons" constraints on the use of fixed term contracts.

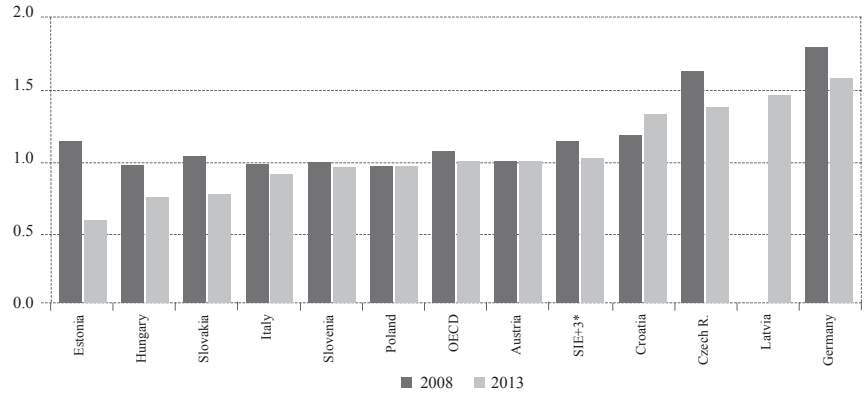
Another indicator having a significant influence on the value of the summary EPT index for Croatia in 2013 was the one relating to the regulation of temporary work agencies. This indicator measures equality of pay and other work conditions between persons employed through temporary work agencies and other workers performing the same jobs. According to the OECD methodology, where there is no legal obligation to give the temporary work agency employees the same treatment as that given to other employees the indicator takes on the value of 0. Where the law prescribes equality with respect to pay or other work conditions, the indicator is scored as 3. Where it prescribes equality of pay and other work conditions, the score is 6. According to the LA (OG 73/13), the contracted salary and other work conditions for assigned workers in Croatia may not be lower or less favourable, than the pay and other work conditions for workers employed with the user at the same jobs (Article 26). However, as shown by a cross-country comparison, similar regulations were in force in most of the CEE countries, as well as in most OECD member countries. Hence, this indicator had the maximum value for as many as 23 countries in 2013. This is not surprising, given that all the

EU Member States should define their respective temporary work agency legislation by applying the EU Temporary Agency Work Directive.[14]

A detailed analysis of employment protection legislation for regular and temporary contracts (on the basis of EPR and EPT indexes) shows that inequality of protection between the two types of employment became even more pronounced after the adoption of amendments to the Croatian LA. The 2013 EPR index remained unchanged from 2008 (2.55), while the EPT index declined, from 2.2 in 2008 to 2.0 in 2013.

**Chart 3**

*Ratio between EPR and EPT indexes for Croatia and selected countries, 2008 and 2013*




** For the explanation of SIE+3, see footnote below chart 1.*

*Sources: OECD (2013c) and author's estimate for Croatia.*

In all other reforming countries, the difference in employment protection between the two types of contract has been reduced (chart 3), mainly through flexibilisation of regular (permanent) contracts. Consequently, increasing the flexibility of regular employment and reducing inequalities in employment protection between different types of employment remain as challenges for the second phase of the LA reform, announced for 2014.

At this point, it should be noted that a comparison between the EPRC and OECD EPT indexes makes it possible to analyse formal rigidity of the labour market, but not the effective one, which may depend on many factors, some of which are not determined by law. Thus, for example, regardless of the labour legislation, labour market rigidity largely depends on how this legislation is implemented by the competent institutions, since the rigidity of implementation may vary considera-

[14] European Commission Directive (104/2008/EC).

bly from country to country. Moreover, many aspects of the labour market regulation remain outside the scope of the analysed indexes, e.g. the regulation of working hours which influences the flexibility of working time organisation, or the manner of conclusion and implementation of collective agreements, representing the main determinant of labour market rigidity in the peripheral countries of the eurozone. In this respect, the LA reform in 2013 led to reduction of minimum uninterrupted daily rest period from ten to eight hours, in order to better organise the work in agriculture, tourism and catering which, require split shift working time due to their specific nature. This change increased the flexibility of operation of enterprises, but is not reflected in the OECD indexes. Also, as a result of the Act on Amendments to the Act on Mediation in Employment and Rights during Unemployment (OG 153/13) passed in December 2013 the rights during unemployment of persons employed in crafts, trades and free lancers, and private farmers became equal to those of employees with legal entities, which is again not shown in the OECD indexes. Hence, it is important to note that, due to their format, the OECD indexes provide only a general picture of labour market flexibility which also has some drawbacks. In addition, even those labour legislation aspects that are included in the index are not fully comparable. In Croatia, for example, the determinants of flexibility in the definition of unfair dismissal (priority rules for redundancies and the obligation to retrain or reassign an employee to another job) apply only if the employer has more than 20 employees. The structure of the OECD index is inappropriate to distinguish between the uses of these rules depending on the size of an enterprise. However, the effects on the labour market will not be the same if enterprises with 5, 10, 20, 50 or 200 employees are excluded. Therefore, absolute and uncritical interpretations of the EPRC and EPT indexes should be avoided.

## 5 EASE OF EMPLOYMENT INDEX

Another labour market flexibility indicator which is much wider in scope than the EPL index, and, given the availability of the data, can be estimated for most countries in the world, is the World Bank's Ease of Employment Index. Unlike the OECD indexes, this one measures strictness of a country's legislation related to working hours, but it does not analyse collective dismissals or the operation of temporary work agencies. Furthermore, the World Bank methodology assumes that an "average worker" representing a country earns an average wage, that his/her religion and race are the average religion and race in the analysed country, that he/she works in the largest city in the country, in a manufacturing company with 60 employees which is exclusively in domestic ownership, and that he/she is not a member of any trade union.[15] In view of all this, as well as the fact that manufacturing in Croatia accounted for 15.6% of gross value added in 2013, it is evident that these assumptions undermine the representativeness of employees in the economy. Hence, despite being based on a considerably larger sample of countries,

[15] For more details, see World Bank (2012).

which makes it more valuable than the OECD indexes, this index gives only a partial picture of labour market flexibility.

The Ease of Employment Index has been originally intended for measuring employer costs arising from labour legislation, whereas the utility of an employee arising from the employment protection legislation was neglected. Due to widespread criticism of this approach, the World Bank set up a working group to include a minimum level of workers' rights in the calculation of the index, in line with ILO standards. After the inclusion of a minimum level of workers' rights, if a country's labour legislation is too flexible to the detriment of workers, the country will be assigned unfavorable score. For example, a country's score will be lower if its labour legislation provides for an annual leave of less than 15 days, while countries the legislation of which does not provide for at least 1 day of weekly rest will be scored unfavourably for such over-flexibility. If a country's legislation does not provide for a minimum wage, the country cannot be assigned the best score on the indicator measuring the ratio of the minimum wage to the value added per employee, etc.[16]

Despite the efforts to improve the index, the World Bank has not published the Employment Protection Legislation Index on its Internet site since 2011, but has published the data base pertaining to it, so that the index can be estimated. However, all the results obtained by the estimation of this index must be taken with extreme caution.[17] Having in mind the above mentioned shortcomings of this index, but also the extreme popularity of all the Doing Business indexes, below follows a brief analysis of the Ease of Employment Index.[18] The data are taken from the World Bank and there is no detailed analysis of individual legal provisions, but only a commentary on the final results.

The Ease of Employment Index is calculated on the basis of two main indicators: the Rigidity of Employment Index and Firing Costs Index, where the Employment Rigidity Index is the average of three subindexes: the Difficulty of Hiring Index, Rigidity of Hours Index and Difficulty of Redundancy Index. Each of the subindexes contains several components which are scored in accordance with the World Bank methodology, regardless of the characteristics of a given labour legislation. The components of the World Bank's Ease of Employment Index are presented in table 7.

[16] For further information, see the World Bank Group (2013).
[17] Moreover, in view of the previously mentioned non-publishing of the EPL index, another criticism of the Ease of Employment Index may be that its aggregate form does not allow to distinguish between the labour legislation providing only marginal flexibility from that where employment protection is equal for both regular and temporary forms of employment.
[18] World Bank (2013).

**TABLE 7**

*Components of the World Bank's Ease of Employment Index*

| | | | |
|---|---|---|---|
| **Ease of Employment Index** | 1. Rigidity of Employment Index | 1.1 Difficulty of hiring | a) Fixed-term contracts prohibited for permanent tasks |
| | | | b) Maximum length of fixed-term contracts, including renewals (months) |
| | | | c) Ratio of minimum wage to value added per worker[a] |
| | | 1.2 Rigidity of hours | a) Are there restrictions on night work? |
| | | | b) Are there restrictions on weekly holiday work? |
| | | | c) Can the workweek consist of 5.5 days or can it consist of more than 6 days? |
| | | | d) Can the workweek extend to 50 or more hours (including overtime)? |
| | | | e) Is the average paid annual leave for a worker with 1 year of tenure, a worker with 5 years and a worker with 10 years more than 26 working days or fewer than 15 working days? |
| | | 1.3 Difficulty of redundancy | a) Is redundancy allowed as a basis for terminating workers? |
| | | | b) Should an employer notify a third party (such as a government agency) to terminate one redundant employee? |
| | | | c) Does an employer need approval from a third party to terminate 1 redundant employee? |
| | | | d) Should an employer notify a third party to terminate 9 redundant employees? |
| | | | e) Does an employer need approval from a third party to terminate 9 redundant employees? |
| | | | f) Does the law require the employer to reassign or retrain an employee before making the employee redundant? |
| | | | g) Do priority rules apply for redundancies?[b] |
| | | | h) Do priority rules apply for reemployment? |
| | 2. Firing costs | The cost of the notice period, severance pay and penalties due when terminating a redundant employee, expressed in weeks of salary | |

[a] *The average value added per employee is the ratio of an economy's gross national income (GNI) per capita to the working-age population as a percentage of the total population. The idea is to highlight the labour costs borne by employers.*

[b] *For example, employees with the longest tenure will be the last dismissed.*

*Sources: World Bank (2014). The assessment methodology for individual indicators can be found in World Bank (2012).*

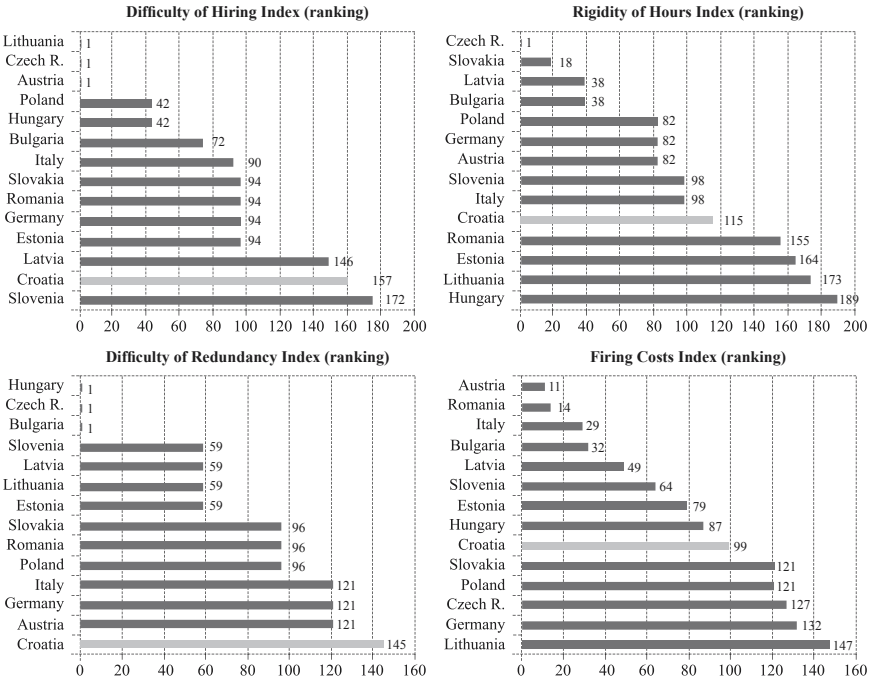
The World Bank data suggest that Croatia's labour market is rigid in comparison with the markets of other countries included in the analysis. It has been estimated that Croatia is rated the worst compared to peer countries and main trading partners (chart 4) holding the 161st position among 189 observed countries.

Compared with peer countries, Croatia ranks the worst according to the Difficulty of Redundancy Index (dismissing one or more workers). This is due to the fact that Croatia has the largest number of restrictions on redundancy dismissals. Thus,

for example, a third party (workers' council) must be notified of the intended dismissal of a redundant employee, the employer is required to reassign to or retrain a worker for another job before making the worker redundant, and priority rules for redundancies apply (depending on the worker's length of service, age, disability and maintenance obligations), and for reemployment (in the case of a dismissal on business grounds, the employer is obliged to offer the dismissed employee a new employment contract where a need for reemployment at the same job occurs in the next six months from the dismissal).

**CHART 4**

*Components of the Ease of Employment Index (ranking), early 2013*




*A country's ranking is obtained by calculating the averages of indicators relevant to a particular index (see table 7) which are then used to assess the position of each country in the group of countries as a percentage of the total value for the group. Then a list of countries by rankings (from 0 to 189) is compiled. The ranking of 0 represents extremely flexible and the ranking of 189 extremely rigid labour legislation. The World Bank data for Croatia are shown in annex, table A2. The assessment methodology for individual indicators is presented in World Bank (2012).*

*Source: World Bank (2014).*

Croatia holds the second-last position among the observed countries in terms of the Difficulty of Hiring Index. Specifically, at the beginning of 2013, only in Croatia, Slovenia, Romania, Estonia and Latvia fixed-term employees were prohibited from performing permanent tasks. The maximum cumulative duration of fixed-term contracts was shorter than in Romania, Czech Republic, Hungary, Au-

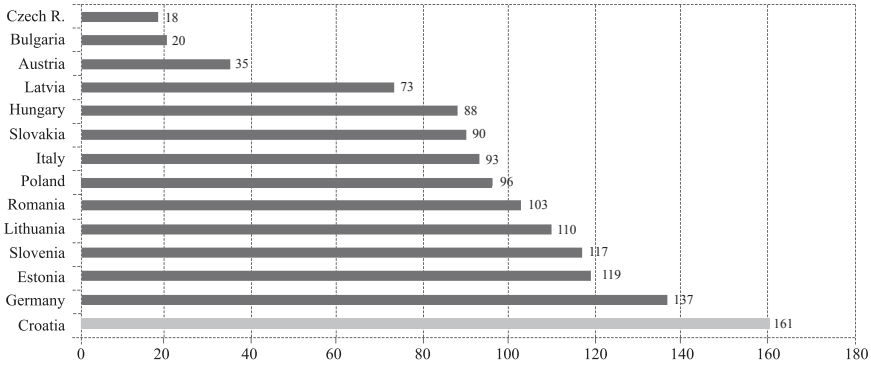
stria, Italy, Poland, Lithuania and Estonia, and the ratio of the minimum wage to the average value added per employee was higher than in all the observed countries except Slovenia and Italy. Although not significantly higher, this ratio ranks Croatia among lower-rated countries.

Redundancy costs (average notice period and severance pays for workers with 1.5, 5 and 10 years of tenure) are lower in Croatia (15 average week salaries) than in Slovakia, Poland, Czech Republic, Germany and Lithuania, but considerably higher than the averages for Austria and Romania (2 and 4 week salaries respectively).

The relative rigidity of Croatian labour legislation in comparison with peer countries is also reflected in the Rigidity of Hours Index: according to the World Bank, there are restrictions on night and weekly holiday work (in the case of continuous work) in Croatia. Among the observed countries, only Estonia, Hungary, Lithuania and Romania rank worse than Croatia on this indicator.

**Chart 5**

*Ease of Employment Index (ranking), early 2013*




*See explanation below chart 4.*

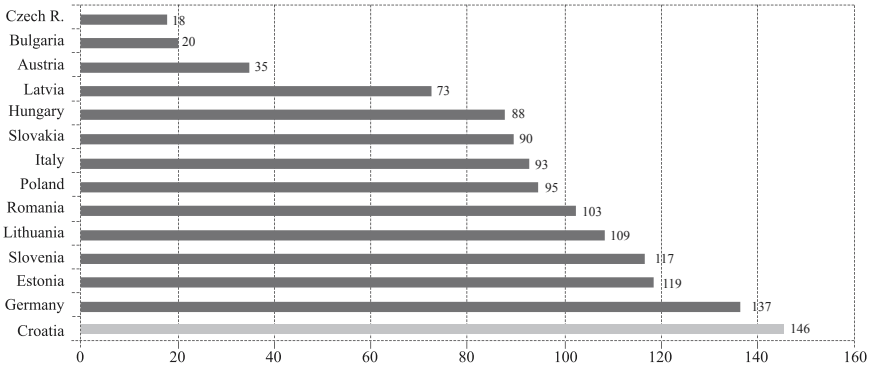
*Source: World Bank (2014).*

Given that the World Bank's database has been created in early 2013, it does not take account of the previously mentioned amendments to the LA. In the following, we therefore examine how these amendments were reflected in the Ease of Employment Index. In view of the design of implemented reforms and the construction of the World Bank indexes, only the flexibilisation of the use of fixed-term contracts, as the consequence of the LA amendments, affected the World Bank's Ease of Employment Index. Other changes in the LA related to areas not relevant to this index (such as the regulation of collective agreements).

Comparing the data for Croatia with Austria and Hungary, regarding the question: Are fixed-term employees prohibited from performing permanent tasks? showed that recorded answer in World Bank data set is "no", even though such persons are allowed to perform permanent tasks but only under the first contract, as is the case in Croatia after the adoption of Amendments to the LA. We therefore analyse the extent of change in the Ease of Employment Index as a result of this legislative change. However, we only make a direct assessment without including some indirect effects. Thus, for example, an improvement in the index, resulting from a potentially more flexible application of fixed-term contracts may be partly offset, if their share in total employment increases due to the flexibility of this type of contracts, which may lead to a decline in productivity in the economy and, consequently, to a rise in the Difficulty of Hiring and Ease of Employment Indexes. Taking into account only the direct effects, we estimate that, after the amendments to the LA, Croatia moved to the 146th position in terms of the Ease of Employment Index. It should be borne in mind, of course, that the new ranking for Croatia assumed that no labour legislation reforms took place in other countries in 2013. If some other countries also flexibilised their labour legislation, the relative improvement in Croatia's ranking would be smaller. Other changes in the LA, implemented in the first phase of the reform had no effect on the Ease of Employment Index, because this index, unlike the OECD indexes, does not cover collective dismissals.

**Chart 6**

*Ease of Employment Index after Amendments to the Labour Act (OG 73/13)*




*The ranking of 0 represents extremely flexible and the ranking of 189 extremely rigid labour legislation.*

*Sources: World Bank (2014) and author's estimate for Croatia related to the indicator measuring "Whether fixed-term employees are prohibited from performing permanent tasks".*

However, even after the adoption of Amendments to the Labour Act, ranking according to the Ease of Employment Index for Croatia remained relatively high (146). The continuously poor performance of the index is even more obvious if

compared with countries in the region. In early 2013, Macedonia, Montenegro, Serbia and Bosnia and Herzegovina ranked 31th, 61th, 71st and 81st on the list respectively.[19] Before the LA reform, only Serbia had a lower ranking in terms of the Difficulty of Hiring Index (172) than Croatia (157). After the reform, Croatia's ranking was upgraded to 90 (assuming the absence of reforms in the rest of the countries during the same period), and the country currently ranks more favourably than both Bosnia and Herzegovina (151th) and Montenegro (125th); while Macedonia ranks 1st. As concerns other subindexes, Croatia lags noticeably behind countries in the region. Thus, it ranks 115th on the Rigidity of Hours Index, while Macedonia ranks the worst (98th) among other countries in the region. According to the Difficulty of Redundancy Index, Croatia again ranks the worst among countries in the region (145th), followed by Bosnia and Herzegovina (96th). Croatia's ranking on the Cost of Redundancies Index is also the most unfavourable (99), slightly more unfavourable than that of Macedonia (81). Interestingly, Macedonia belongs to the world's most flexible countries in terms of difficulty of hiring and redundancy. In 2010, this country reformed these procedures and in addition it increased the possibility of using fixed-term contracts. However, it is difficult to assess the labour market effects of these radical reforms in an economy with a pre-crisis unemployment rate amounting to 35%. Nevertheless, the unemployment rate did not go up further and stood at 31% at end-2012. For details of the Ease of Employment Index for all the EU member States and countries in the region, see table A3.

## 6 CONCLUSIONS

After the implementation of amendments to the LA, Croatia's employment protection legislation converged with that in peer countries and trading partners. As there was no significant further relaxation of employment protection for fixed-term contracts in the analized countries, the flexibilisation of Croatia's LA through expanding the valid use of fixed-term contracts has put the country closer to the already existing practices in the analized countries. On the other hand, the flexibilisation of employment protection legislation for regular contracts, including collective dismissals took place in almost all the observed countries. In Croatia, however, except for the flexibilisation of employment protection legislation for collective dismissals, nothing was done to adjust the employment protection legislation for regular contracts. Therefore, some of the hiring and dismissal procedures remain more complex in this country than in the observed countries. Moreover, as the reform failed to increase the flexibility of employment protection for regular contracts, it deepened the inequality of protection between different types of employment in Croatia.

[19] In contrast to the OECD which analyses labour market rigidity only for the selected countries, the World Bank compiles the Ease of Employment Indexes for 189 countries, which allows a comparison with countries in the region.

Additional changes, to be introduced during 2014, are likely to bring further liberalisation of the Croatian labour market and, consequently, more flexible employment protection legislation for regular contracts. As this article only deals with formal measures of labour market flexibility, it is worthy of note that the final labour market outcomes may be markedly different, especially in countries with high levels of grey economy and in times of economic crisis. Therefore, the effects of inflexible labour legislation on labour market outcomes remain a challenge for future research.

## APPENDIX

### Table A1

*EPRC and EPT indexes as sources for assessing employment protection legislation pursuant to the Labour Act*

| **Index of Employment Protection for regular contracts, including collective dismissals (EPRC)** | |
|---|---|
| **Index of Employment Protection for regular contracts (EPR)** | |
| Notification procedures | Articles 112 and 118 |
| Delay involved before notice can start | Articles 111, 112 and 118 |
| Notice period after 9 months tenure | Article 114, paragraph (1) |
| Notice period after 4 years tenure | Article 114, paragraph (5) |
| Notice period after 20 years tenure | Article 114, paragraph (6) |
| Severance pay after 9 months tenure | Article 119 |
| Severance pay after 4 years tenure | Article 119 |
| Severance pay after 20 years tenure | Article 119 |
| Definition of justified or unfair dismissal | Article 107, paragraphs (2), (3), (4) and (7) |
| Length of trial period | Article 35 |
| Compensation following unfair dismissal | Article 117, paragraph (1) |
| Possibility of reinstatement following unfair dismissal | Article 116, estimates from Biondić et al. (2002), Matković and Biondić (2003) and Tonin (2009) |
| Maximum time to make a claim of unfair dismissal | Article 129, paragraphs (1) and (2) |
| **Index of Employment Protection against collective dismissals (EPC)** | |
| Definition of collective dismissal | Article 120, paragraph (1) |
| Additional notification requirements | Article 120, paragraph (2); Article 122, paragraph (1) |
| Additional delays involved before notice can start | Article 122, paragraphs (3) and (5) of the LA (OG 149/09); Article 122, paragraphs (3) and (5) of the LA (OG 73/13); delays in the start of the notice period for regular termination of employment contracts according to Article 111, Article 112 and Article 118, and according to the OECD methodology are assessed at 10 days |
| Other special costs to employers | Article 121 |
| **Index of Employment Protection for temporary contracts (EPT)** | |
| *Fixed term contracts* | |
| Valid cases for use of fixed-term contracts (FTC) | Article10 of the LA (OG 149/09); Article 10 of the LA (OG 73/13) |
| Maximum number of successive FTC | None for LA (OG, 149/09); Article 10, paragraphs (2) and (4) of the LA (OG 73/13) |
| Maximum cumulated duration of successive FTC | Article10, paragraph (3) of the LA (OG 149/09); Article10, paragraph (3) of the LA (OG 73/13) |
| *Temporary Work Agency* | |
| Types of work for which temporary work agency (TWA) employment is legal | Article 24; Article 25, paragraph (4) |
| Restrictions on number of renewals | None |
| Maximum cumulated duration of TWA assignments | Article 28, paragraphs (1) and (2) |
| Does the set-up of a TWA require authorisation or reporting obligations | Article 24, paragraphs (2) and (3); and Article 32 |
| Do regulations ensure equal treatment of regular and agency workers at the user firm? | Article 26, paragraph (5) |

*Source: Labour Acts (OG 149/09 and OG 73/13). The articles of the LA with no references to the specific LA are those which remained unchanged after the Amendments to the LA in June 2013.*

**TABLE A2**
*World Bank data for Croatia*

| | | |
|---|---|---|
| 1.1 Difficulty of hiring | a) Fixed-term contracts prohibited for permanent tasks | YES – WB data, NO – simulated change in the LA (OG 73/13) |
| | b) Maximum length of a single fixed-term contract (months) | 36 months |
| | c) The ratio of the minimum wage of a trainee or first-time employee to the average value added per employee | 0.31 |
| 1.2 Rigidity of hours | a) Are there restrictions on night work? | YES |
| | b) Are there restrictions on weekly holiday work? | YES |
| | c) Can the workweek consist of 5.5 days or can it consist of more than 6 days? | 6 days |
| | d) Can the work week extend to 50 or more hours (including overtime)? | YES |
| | e) Is the average paid annual leave for a worker with 1 year of tenure, a worker with 5 years and a worker with 10 years more than 26 working days or fewer than 15 working days? | 20 days |
| 1.3 Difficulty of redundancy | a) Is redundancy allowed as a basis for terminating workers? | YES |
| | b) Should an employer notify a third party (such as a government agency) to terminate one redundant employee? | YES |
| | c) Does an employer need approval from a third party to terminate 1 redundant employee? | NO |
| | d) Should an employer notify a third party to terminate 9 redundant employees? | YES |
| | e) Does an employer need approval from a third party to terminate 9 redundant employees? | NO |
| | f) Does the law require the employer to reassign or retrain an employee before making the employee redundant? | YES |
| | g) Do priority rules apply for redundancies? | YES |
| | h) Do priority rules apply for reemployment? | YES |
| The cost of the notice period, severance pay and penalties due when terminating a redundant employee, expressed in weeks of salary | | 7.9 weeks (notice period) |
| | | 7.2 weeks (severance pay) |

*Source: World Bank (2014).*

**TABLE A3**

*Components of the Ease of Employment Index (rankings) for EU and countries in the region*

| | Difficulty of Hiring (ranking) | Rigidity of Hours (ranking) | Difficulty of Redundancy (ranking) | Redundancy costs (ranking) | Ease of Employment Index (ranking) |
|---|---|---|---|---|---|
| Austria | 1 | 82 | 121 | 11 | 35 |
| Belgium | 42 | 38 | 1 | 30 | 10 |
| Bosnia and Herzegovina | 151 | 16 | 96 | 46 | 81 |
| Bulgaria | 72 | 38 | 1 | 32 | 20 |
| Croatia | 90 | 115 | 145 | 99 | 146 |
| Cyprus | 94 | 1 | 121 | 24 | 48 |
| Czech R. | 1 | 1 | 1 | 127 | 18 |
| Denmark | 1 | 18 | 1 | 1 | 1 |
| Estonia | 94 | 164 | 59 | 79 | 119 |
| Finland | 125 | 115 | 145 | 54 | 141 |
| France | 160 | 177 | 121 | 72 | 167 |
| Germany | 94 | 82 | 121 | 132 | 137 |
| Greece | 94 | 175 | 96 | 106 | 151 |
| Hungary | 42 | 189 | 1 | 87 | 88 |
| Ireland | 42 | 1 | 50 | 74 | 27 |
| Italy | 90 | 98 | 121 | 29 | 93 |
| Kosovo | 1 | 75 | 96 | 69 | 50 |
| Latvia | 146 | 38 | 59 | 49 | 73 |
| Lithuania | 1 | 173 | 59 | 147 | 110 |
| Luxembourg | 172 | 164 | 96 | 133 | 178 |
| Macedonia | 1 | 98 | 1 | 81 | 31 |
| Malta | 90 | 82 | 59 | 31 | 58 |
| Montenegro | 125 | 16 | 59 | 67 | 61 |
| Netherlands | 72 | 115 | 174 | 37 | 121 |
| Poland | 42 | 82 | 96 | 121 | 96 |
| Portugal | 157 | 111 | 121 | 143 | 168 |
| Romania | 94 | 155 | 96 | 14 | 103 |
| Serbia | 172 | 26 | 59 | 33 | 71 |
| Slovakia | 94 | 18 | 96 | 121 | 90 |
| Slovenia | 172 | 98 | 59 | 64 | 117 |
| Spain | 172 | 82 | 59 | 118 | 139 |
| Sweden | 95 | 82 | 121 | 93 | 115 |
| UK | 42 | 38 | 1 | 36 | 12 |

*The ranking of 0 represents extremely flexible and the ranking of 189 extremely rigid labour legislation.*

*Sources: World Bank (2014) and author's estimate for Croatia related to the indicator measuring "Whether fixed-term employees are prohibited from performing permanent tasks".*

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