Labour market transition in Portugal, Spain, and Poland[§]

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Abstract

This paper analyses the impact of economic transition on labour market institutions and labour market outcomes. The focus is, in particular, on the transition processes that have occurred in Portugal and Spain towards a modern system of industrial relations. Analysis of the effects of structural reforms on major labour market outcomes in the two Iberian countries is then used to discuss the case of Poland, with an emphasis on the process of labour adjustment required by increased European economic integration and industrial restructuring.

JEL classification: E24, J23, J53.

[§] This research was undertaken with support from the European Union's Phare ACE Programme. We are especially thankful to participants at the Phare Workshops on "Labour Market Flexibility in the Wake of EU Accession" (Universidade de Coimbra, Portugal, 17-18 September, 2000, and the Institute of Labour and Social Studies, Warsaw, 9-10 July, 2001) for their helpful comments.

1. Introduction

In the second half of the 1970s, after almost fifty years of authoritarian rule, the longest lasting European dictatorships of the twentieth century were finally replaced by democratic governments. An intense program of structural reforms was then initiated in Portugal and Spain which intended to rescue the two countries from chronic, long-standing backwardness. The primary goal was of course to restore democracy and the democratic institutions, including free trade unionism and free collective bargaining. The second major goal was EEC membership, which required the introduction of comprehensive free-market mechanisms.

These were indeed the two crucial aspects that framed the first phase of the transition program in the Iberian Peninsula, that is, the period before EEC accession in 1986. The post-1986 period was a time when both countries intensified their programs of reform in order to narrow the gap, in per capita income, between themselves and the more advanced and industrialised central and northern European countries.

In this paper we analyse the impact of economic (and political) transition in Portugal and Spain on labour market institutions and employment regulations and, subsequently, on labour market outcomes. We focus, in particular, on the transition process towards a modern system of industrial relations. Analysis of the effects of structural reforms on major labour market outcomes in Portugal and Spain will then be used to discuss the case of Poland, with an emphasis on the process of labour adjustment and labour reallocation following 1989's breathtaking transition program.

The paper is organised as follows. In section 2, we summarise the main changes in labour market regulations and institutions that have occurred in the Iberian countries, especially in terms of employment protection rules. In section 3, we discuss the major labour market outcomes during the transition period, including the role of fixed-term contracts in employment adjustment and labour reallocation issues, namely in relation to the overall measures of job protection. Section 4 puts Poland in perspective, that is, it analyses the size of restructuring and the role of labour market institutions, using the Iberian experience as a benchmark. Section 5 presents the concluding remarks.

2. Main Changes in Labour Regulations and Institutions in Portugal and Spain

During the dictatorial regimes of Salazar (in Portugal) and Franco (in Spain), trade unions were never recognised as independent bargaining partners, neither at sector nor firm level negotiations. Although minor changes during the sixties allowed workers to choose their representatives directly, industrial relations in both countries were dominated by single employer-employee organisations at industry level – official organisations to which employers and employees were forced to accept compulsory membership. No right to strike or lock-out was recognised, and direct intervention by the state, either by sanctioning or refusing to sanction free-established agreements, was the rule.

Firing and hiring practices were highly regulated in Spain, with dismissals being mostly driven by political considerations and mobility strongly discouraged by strict regulations on hiring, while fixed-term contracts were restricted to strictly temporary and seasonal jobs. In Portugal, the government used to be able to refuse the publication of any collective agreement, but between 1969 and 1974 there was a system of collective bargaining in place that included independent conflict arbitration. This practice was important because it sowed the seeds of labour organisation in the post-dictatorship period. Workers with a permanent contract were also dominant in Portugal, but firing and hiring were, by law, at-will, subject to severance payments and advance notice. Fixed-term contracts were allowed in a wide range of circumstances as well, but covering only a tiny portion of workers.

In Portugal, workers' rights to organise and participate in collective bargaining and the right to strike were introduced in 1975-1976. The law regulating works councils came in 1979, but since 1974 workers have been actively participating in the day-to-day management of numerous firms, especially in the expanding public sector. Wage bargaining and the negotiation of employment conditions at work were mostly conducted at the sector-level, with only a small fraction of firms covered by firm-level agreements. Centralised, tripartite agreements (including the government, trade unions, and employers' organisations), came into effect just before Portugal's accession to the EEC in 1986, when its democracy became better established.

The second phase of the transition in Portugal began in 1986, with new challenges arising from increased economic integration, which, in a first wave, launched a further reduction in agricultural employment, followed by the privatisation of key state-owned firms and the transformation of a manufacturing- (and agriculture-) based economy into a service-based economy.

Unlike Portugal in its early stages of transition to democracy, Spain did not undergo massive nationalisation of its key sectors nor was it under the threat of becoming a "people's democracy" (i.e. a European version of Cuba). With a much smoother start, the Spanish transition process really seemed to shadow that of Portugal, except for possibly one important point: the centralised tripartite bargaining, which in Spain started in 1978 with the Moncloa Agreements. Portugal did not have its first social pact signed until 1986 (Acordos de Concertação). Stable political majorities also occurred first in Spain, with three victories from the PSOE (the socialist party) in 1982, 1986, and 1989. The first single-party majority in Portugal came in 1987. Since then both countries have been ruled by single-party majorities.

Not surprisingly, the first part of the transition process (that is, before accession to the EEC) was characterised in both countries by strong government activism in all areas including the labour market. During dictatorship rule, labour contracts had, in principle, an indefinite duration (open-ended contracts), but none of the countries

Table 2.1. Introduction and revision of major labour legislative packages

	Portugal		Spain	
	Introduction	Major revision	Introduction	Major revision
Individual dismissals (a)	1975	1989	1980	1997
Collective dismissals	1976	1989	1980	1994
Fixed-Term contracts	1976	1989	1984	1992 and 1993
Unemployment insurance	1975	1985	Late 1970s	1992

Note: (a) Until 1989 (1997), individual dismissals based upon economic reasons were not allowed in Portugal (Spain).

ever made the principle of job security explicit. As a matter of fact, in Portugal, despite dominant, paternalistic (and corporatist) principles, the law did allow firms to shed labour at will. This regime could not of course survive the revolutionary turmoil and was removed in 1975, triggering a huge transformation process in which the system of industrial relations literally changed its face in a period of less than three years.

Table 2.1 indicates the timing of the introduction of major labour legislative packages in both countries i.e. individual dismissals, collective dismissals, fixed-term contracts, and unemployment insurance benefits. In all cases, it is clear that the legislative changes in Portugal were introduced earlier than in Spain. In particular, the timing of the first three items must be underscored. As mentioned earlier, in Portugal, the laws regarding firing-at-will were abolished in 1975, but the timing of the new legislation regarding collective dismissals and fixed-term contracts does show some relation with the process of labour adjustment in a period of intense industrial restructuring, which included nationalisation of the key sectors of the economy (in 1975) and the loss of protected export markets in the former African colonies (in 1974, 1975 and 1976). Thus, in accordance with the new regime of fixed-term contracts, firms were free to shed labour with no risk of being challenged in court on the grounds of unfair dismissal, while the new system of collective dismissals imposed a low threshold of 2 (5) workers in firms with less (more) than 50 workers and legal severance payments clearly below international standards. (It should also be pointed out that, contrary to Spain, there is no evidence of any systematic gap between agreed and legal severance payments in Portugal).

The major revision of Portuguese labour legislation came in 1989. The new regime eased individual dismissals by allowing firing for economic reasons, but new restrictions were introduced on fixed-term contracts, making very clear the purpose of combining lower restrictions on individual dismissals with tougher regulations on fixed-term contracts. Specifically, the new law on fixed-term contracts established eight statutory reasons for concluding a fixed-term contract. In most general cases, the maximum duration was limited to three years and the number of renewals to two.

Legislation on collective dismissals was also eased, namely by lifting administrative authorisation (only the consultation requirement was maintained).

In Spain, single unions, incorporating both workers and employers in each industry, were the key feature of the labour relations system, as Franco's Workers' Statutes removed all workers rights to representation and collective bargaining. However, as in Portugal, very small moves toward free negotiation in the late sixties were decisive in future developments because they allowed emerging and independent union activity.

The first major revision of Franco's Workers' Statutes was made in 1980, five years after Franco's death. Meanwhile, the principle of job security (just-cause dismissals) was established in the law by the Industrial Relations Act of 1976, while genuine unions, the freedom of negotiation, and the right to strike and lock-out obtained constitutional recognition in 1978.

Between 1976 and 1980, there were also some changes to the Francoist regulations on fixed-term contracts, but the law remained highly restrictive, with the major restrictions were only lifted in 1984. According to the new law, fixed-term contracts could be used in any activity (temporary or not) and signed for periods of at least 6 months (one year in 1992), and the total duration could not exceed 3 years (4 years in 1993). Upon expiration of the last renewal, the contract becomes of indefinite duration or the worker is fired. In the case of firing, the worker cannot appeal to labour courts, but firms must wait one year before hiring another person for the same position on a fixed-term contract basis. Following the introduction of this regime, there was a massive increase in the proportion of non-permanent workers: 11.3 % in 1985 and 32.2% in 1991.

Until 1994, collective redundancies in Spain required a minimum threshold of 2 workers within a month for firms with less than 50 employees. They were subject, however, to prior administrative authorisation and consultation with employee representatives, with labour authorities requiring in general prior agreement from workers representatives. Approval of a redeployment plan for displaced workers was also required, especially in the case of large corporations. Severance entitlements were set to 20 days per year of service, but firms usually agreed to pay well-above the legal minimum to avoid lengthy procedures and unfavourable court decisions.

Spain started its program of labour reforms in 1994. Firstly, by changing the law on collective dismissals, adding to the previous economic and technological reasons the organisational and production causes (consultation and authorisation requirements were retained), and secondly, in 1997, by introducing a new system of individual dismissals in which economic, technological, and organisational reasons (including changes in cyclical demand) constitute justifiable grounds for dismissal.

Finally, we present the main legislative initiatives with respect to the unemployment insurance system. Unemployment benefits were first introduced in Portugal in 1975.

Maximum entitlement was a fixed value prior to 1985, but in that year it became a function of the years of service worked, inter al. From their inception in 1975 until 1984 unemployment benefits in Portugal were unrelated to past earnings and were fixed in terms of the minimum wage (introduced in May 1974). From 1985, however, benefits have been partly earnings related. Between 1985 and 1988 inclusive, the unemployed worker received 65% of previous earnings for six months plus a further month's benefit set at the same rate for each year of service. From 1989, benefits became payable at 65% of past earnings for 16.5 months (for a worker with 10 years of service), and at a certain proportion of the minimum wage thereafter. Eligibility requirements for insurance benefits were fixed at 18 months of work in the previous 2 years. Combining insurance and assistance benefits, the maximum duration of unemployment benefits for a worker with 10 years of service was 6, 12, 15, 31, and 25 months in 1975, 1977, 1983, 1985, and 1989, respectively.

The unemployment benefit system in Spain is also divided into insurance and assistance benefits. The first is earnings related and the employee must have worked for at least 6 months in the previous 4 years (in 1992, it was changed to 12 months in the previous 6 years). The eligibility time scale for a worker with 10 years of service, for example, is 2 years, receiving 80% of the gross wage during the first 6 months, 70% from month 7 to month 12, and 60% thereafter. (70% in the first 6 months and 60% thereafter in 1992). The assistance benefit requirement is 3 months of work prior to unemployment and then the worker receives 75% of the minimum wage for up to 18 months (for a worker of less than 45 years of age with no dependents).

This description is an oversimplification of the Portuguese and Spanish unemployment benefit systems. Indeed much more would be required to fully describe a complex system of benefits that vary widely across individual types. On the whole, however, it seems that the Portuguese system is not as generous as the Spanish one as: a) it has, in general, stricter eligibility rules; b) it has lower replacement ratios; and c) it imposes a lower maximum period of time for both insurance and assistance benefits. It should however be pointed out that the impact of legal provisions on unemployment benefits must be tempered by actual (effective) coverage rates, which, in both countries, are clearly below the OECD average. *The OECD Jobs Study* (OECD, 1994), for example, reports that for Portugal and Spain, in 1991, the percentage of unemployed people reporting receipt of benefit in the EC Labour Force Survey (LFS) was 17% and 29%, respectively (the ratio of the number of registered unemployment beneficiaries to the total number of unemployed (LFS) is 41% and 59%, respectively). (Annex Tables 1 and 2 in the appendix show the main aspects regarding individual and collective dismissal laws, fixed-term contracts, temporary agency work and unemployment benefits).

Table 3.1. Employment by sector and labour market outcomes in Portugal and Spain: 1975-93

	Portugal			Spain		
	1975	1985	1993	1975	1985	1993
AGR	0.34	0.24	0.11	0.22	0.18	0.10
IND	0.34	0.34	0.33	0.38	0.32	0.31
SER	0.32	0.42	0.56	0.40	0.50	0.59
	1975-77	1978-85	1986-93	1975-77	1978-85	1986-93
EMPPOP	0.400	0.403	0.442	0.346	0.299	0.307
UNRATE	0.062	0.080	0.056	0.048	0.146	0.187
LFPR	0.427	0.438	0.468	0.363	0.351	0.379

Source: Addison, Teixeira, and Grosso (2000), OECD Main Economic Indicators, and OECD (1999). AGR, IND, and SER denote agriculture, industry, and services, respectively. EMPPOP is the employment-population ratio and is obtained dividing total employment by total population; UNRATE is the OECD standardised unemployment ratio; and LFPR is the labour force participation ratio (the ratio of total labour force to total population).

3. Employment protection and labour market outcomes during transition

In this section we discuss how the changes described above, in labour market institutions and legislation have made an impact on the development of labour markets in Portugal and Spain. We begin by looking at the size of economic restructuring and major labour market outcomes during the period 1975-93: post-dictatorship (1975-77), pre-EEC accession (1978-85), and post-EEC accession (1986-93). Then we assess the role of fixed-term contracts with respect to employment and wage flexibility and finally discuss the connection between job security provisions and labour market reallocation.

3.1. The size of restructuring

As shown in Table 3.1., restructuring (that is, the shift from agriculture to services) was very intensive in both countries, with employment in agriculture being more than halved in Spain and reduced by 2/3 in Portugal (it is still twice the OECD average). On the other hand, employment and labour force participation ratios have been increasing in Portugal and are clearly higher than in Spain by more than a margin of 10%. The developments in the unemployment front are also in sharp contrast, with the unemployment rate in Spain being two to three times higher than in Portugal.

Table 3.2. Output and employment growth rates and labour productivity: 1978-96

	1978-85		1986-96	
	Portugal	Spain	Portugal	Spain
Output	2.3	1.0	3.3	2.8
Employment	0.9	-1.8	0.4	0.9
Labour productivity	1.4	2.8	2.9	1.9

Source: Bentolila and Blanchard (1990), and OECD (1999).

What then are the reasons for such differences in the impact of restructuring? After all, and despite differences in economic openness at the beginning of the transition process (Portugal has been a member of the EFTA since 1960), the oil crisis had apparently the same effect on both countries, causing excess capacity in highly protected domestic industries (in basic industries, for example) and the wage dispersion, a pre-requisite to faster labour reallocation, was similar to that in the early 1970s.

A very popular explanation for labour market failure in Spain, especially with respect to unemployment and labour force participation rates, is that firms were forced to accommodate the oil shock and the increased competition from abroad, without being allowed to adjust their labour input. As a result, when major labour market restrictions were lifted, in the mid-1980s, firms just got rid of unneeded workers very quickly, while less efficient firms had no option other than to close down. According to this view, what happened then was a huge process of labour shedding (Bentolila and Blanchard, 1990).

A rough measure of labour shedding can be shown by looking at the evolution of employment and output per employee (labour productivity) at both the aggregate and sector levels. We begin by presenting aggregate data for the two sub-periods 1978-85 and 1986-96, in Table 3.2.

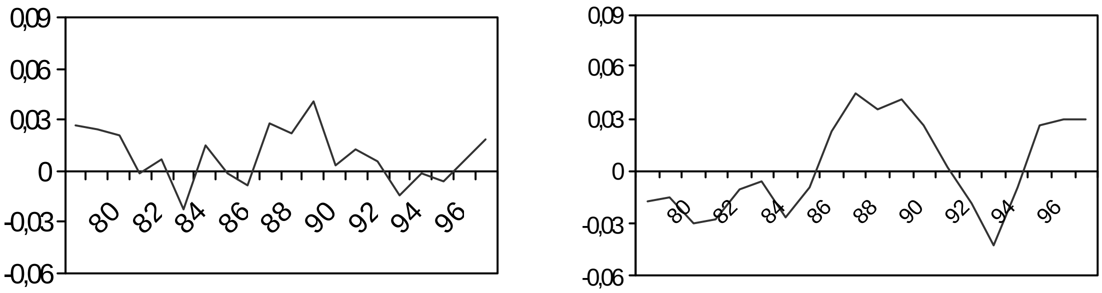
In both sub-periods, the average output growth was higher in Portugal. The most striking difference between the two economies is, however, the sizeable reduction of employment levels in Spain in the period before EEC accession (-1.8%, annual average).

Figure 3.1. uses common scale plots to show the behaviour of output and employment over the 1975-97 period (OECD quarterly data). This indicates that both output and employment show greater volatility in Portugal. In turn, Figure 3.2. shows the growth rates of employment and output. If employment and output mirror each other, the data points will lie close to a 45º line. Panel (a) of Figure 3.2., represents the entire period, while panels (b) and (c) present sub-periods 1978-85 and 1986-97.

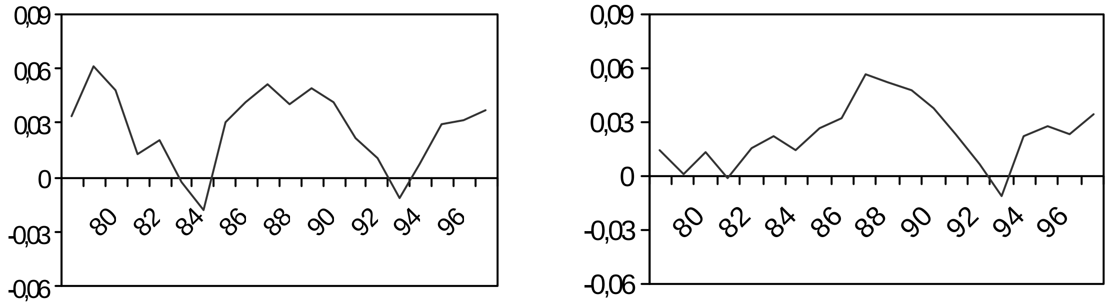
Figure 3.1. Employment and output growth in Portugal (1977-97)

(a) Employment growth

Portugal Spain



(b) Output growth



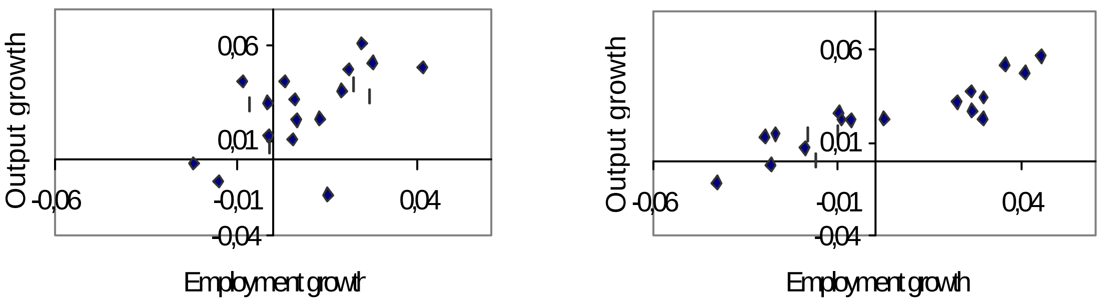
In all cases, the slope seems to be steeper in Portugal, that is, changes in output are larger than changes in employment. In other words, the same output growth seems to imply lower employment growth in Portugal.

A different indicator of the importance of restructuring, suggested by Bentolila and Blanchard (1990) is presented in Figure 3.3., where labour productivity growth is plotted against employment growth in two sub-periods: 1977-85 and 1986-93. The exercise allows us to establish whether there is any visible correlation between the two variables, and, although simple, it gives a rough indication whether supply or demand shocks have prevailed. If supply shocks (taken as proxy for restructuring) are dominated by demand shocks, then a positive correlation should be expected; otherwise the correlation will be negative.

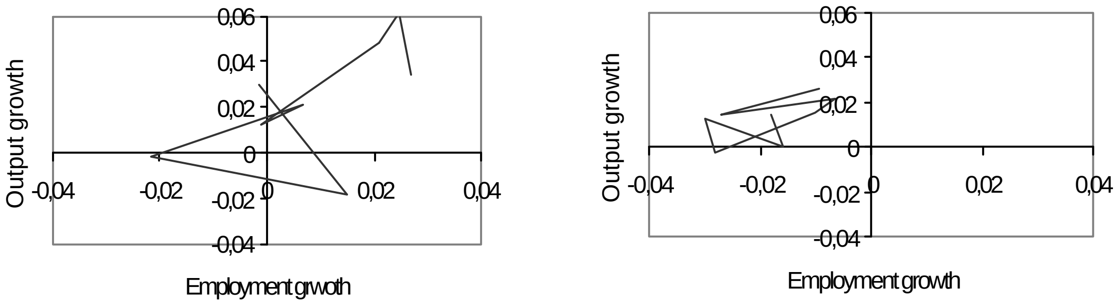
To carry out this exercise, we used nine two-digit manufacturing sectors. As Figure 3.3. shows, the correlation between labour productivity and employment growth rates is negative in both sub-samples, particularly in the period prior to EEC accession (in this period, the regression coefficient is -0.76, with a standard error of 0.60). Juxtaposing with Bentolila and Blanchard’s findings for Spain, obtained from a sub-set of 14 manufacturing industries in the period 1979-85, it is clear that the size of restructuring, at least during the period before accession to the EEC, was higher in Portugal. (The regression coefficient in the case of Spain is -0.14).

Figure 3.2. Employment and output growth rates in Portugal and Spain

(a) 1978-97



(b) 1978-85



(c) 1986-97

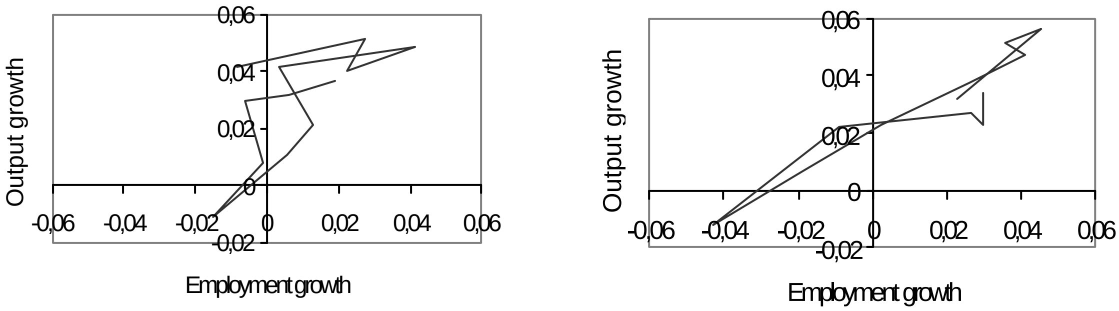
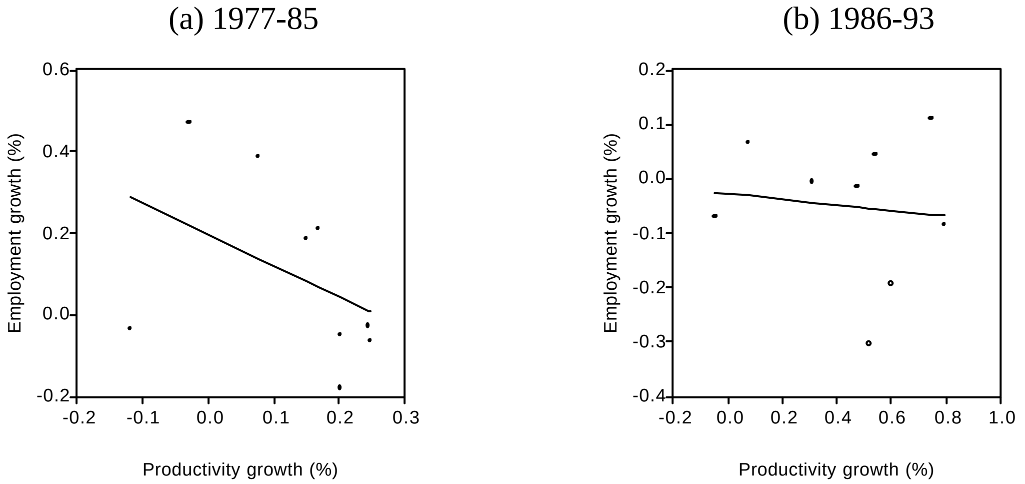


Figure 3.3. Employment and labour productivity growth rates in Portugal – two-digit manufacturing sectors (scatter diagrams with regression lines)



3.2 The role of fixed-term contracts

As mentioned above, in 1984 there were substantial reductions in firing costs in Spain, with the new law lifting important restrictions on fixed-term contracts. Introduced explicitly to improve employment flexibility, liberalisation of fixed-term contracts was expected to induce greater employment fluctuations over the cycle, but there was also the concern that it might imply less wage flexibility and higher wage compression.

Indeed, the introduction of a flexible system of fixed-term contracts into a system of labour relations dominated by core permanent workers (dominant in terms of wage bargaining, for example) could have risked creating a segmented market of insiders (workers with open-ended contracts, highly protected against dismissal) and outsiders (*atypical* workers with fixed-term contracts but with low firing costs), without any discernible reduction in labour costs or improvement in wage flexibility. Although Francoist restrictions on hiring and firing practices were very pronounced, the combination of high wage dispersion and flexible wages was believed to have resulted in low unemployment. The concern was therefore that, by imposing lower wage dispersion and tighter labour regulations, powerful trade unions, created in the wake of Franco’s death, would produce an explosive combination of labour regulations, with an extremely negative impact on labour market performance.

Using manufacturing data at firm level, Bentolila and Saint-Paul (1992) provide a substantive test on the hypothesis that fixed-term contracts imply greater cyclical variability of labour demand. The evidence is not conclusive, but there seems to be some indication that firms in expansion tend to adjust more quickly to unexpected changes in demand, that is, that employment inertia is slightly lower during periods of expansion.

The impact on wages is a little more difficult to estimate, mainly because of composition effects arising from the absence of accurate information on wages of both types (*permanent* and *non-permanent* workers). If, as Bentolila and Dolado (1994) argue, fixed-term contract workers are easy to hire, we would expect an increase in the proportion of non-permanent workers, making labour costs lower. Once this proportion stabilises and firms are happy with the mix of non-permanent and permanent workers, the latter may become more concerned with wages, implying an increase in labour costs. (The probability of being fired decreases and, as a consequence, they become less concerned with their level of employment). Permanent workers may also become less co-operative with non-permanent workers, which implies additional wage increases. If, however, non-permanent workers threaten not to co-operate in wage bargaining or in labour disputes, for example, labour costs will tend to decrease. In short, the net effect is not known (and there are serious econometric obstacles to a correct identification of these different components).

These caveats aside, Bentolila and Dolado concluded that the liberalisation of fixed-term contracts without any changes in regular contracts has resulted in higher labour costs and increased wage rigidity. As predicted, it seems that, following the liberalisation of fixed-term contracts, firms decided to increase the proportion of non-permanent workers in total employment, implying lower labour costs. However, as the proportion of non-permanent workers stabilised, trade unions, dominated by permanent workers, have tended to ask for higher wages. Although uncooperative behaviour from non-permanent workers in labour disputes might work in the opposite direction, the threat to be uncooperative with non-permanent workers, who are higher-skill/higher-productivity workers, and the lower weight given to employment seems to have been the dominant effect, resulting in a bigger share of the economic rents going to permanent workers and higher labour costs overall. More importantly, perhaps, in this scenario if any negative shock in demand arises, non-permanent workers will be forced to bear all the adjustment costs.

In section 2 we mentioned that in Portugal the fixed-term contract legislation was introduced in 1976, following the defeat of hard-line trade unionism. The introduction of fixed-term contracts in Portugal coincided with a system of collective dismissals, which was relatively favourable to firms (by international standards). This means that the flexible component brought in by the new regime was thus of much less importance than in Spain, which is corroborated by the greater cyclical variability of non-permanent workers in Portugal. Not surprisingly, wages have also shown greater flexibility and increasing dispersion, which is an additional sign that transition to a more flexible regime of labour relations was accomplished to a greater degree (in the sense that mobility costs born by workers were matched by higher wage differentials). As Table 3.3. shows, in 1993 only the U.S.A. presented a larger D9/D5 ratio than Portugal. Portugal has also shown the biggest increase in wage dispersion measured by the D9/D5 and D5/D1 ratios.

Table 3.3. Earnings inequality in selected countries

	1985	1989	1991	1992	1993	Late 1980s D9/D5	Late 1980s D5/D1
Portugal							
D9/D5	2.14	2.24	2.24	2.48	2.47		
D5/D1	1.69	1.56	1.56	1.61	1.64		
Italy						1.56	1.33
Germany						1.65	1.39
France						2.11	1.52
U.K.						1.96	1.64
Canada						1.75	2.27
U.S.A.						2.14	2.63

Source: OECD (1993) and OECD (1996). D9/D5 is the ratio of the upper limit of the ninth decile to the upper limit of the fifth decile; similarly for D5/D1. Larger figures indicate more inequality.

3.3. The role of job security provisions

We offer in this section some brief remarks on the relationship between reported measures of (overall) employment protection and labour market developments. We also focus on labour reallocation issues. Due to data limitations, cross-country comparisons of job turnover flows will be established using all seven OECD countries included in Table 3.3.

Striking differences between European and North-American labour markets have inspired many attempts to find a solid relationship between the stringency of labour regulations and major labour markets outcomes. In this literature, spurred on by the work of Lazear (1990), job security provisions typically have a negative impact on employment creation, unemployment, and labour force participation. Methodological and data problems have nevertheless been so important in these studies that the findings should be taken very cautiously, and while replication can be one answer (e.g. Addison, Teixeira, and Grosso, 2000), the clear trade-off between the length of the time-series and the comprehensiveness of labour protection indices has warned researchers that progress in this area will be slower that expected.

In any case, and everything else being constant, higher employment protection is expected to lead to lower gross job turnover as firms are more reluctant to fire and hire over the cycle. The cross-country evidence seems, however, to be at odds with this prediction, because, as we will see below, inspection of gross flows does not reveal any clear pattern distinguishing high-protection from low-protection countries – at least using OCDE 'reputation' indices, which incidentally are not immune to criticism (see Addison, Teixeira, and Grosso, 2000, and Addison and Teixeira, 2001).

While it is true that cross-country comparisons of job and worker flows are hard to make (poorly measured data is the most common source of error), the absence of any significant differences between countries with very distinct score levels of job protection raises two critical issues. The first is related to the enforcement of labour regulations: one cannot exclude in particular the possibility of rigid regulations being circumvented in practice by workers and firms (Bertola et al., 1999). Secondly, and perhaps more importantly, labour reallocation is a function of industrial labour relations as a whole, which means that focusing on firing restrictions and not directly taking into account wage setting behaviour, inter al., might be misleading.

A useful perspective is given by Bertola and Rogerson (1997). According to these authors, the apparent paradox of distinct labour systems generating similar job turnover flows can be explained by taking firing restrictions together with the wage determination process. Indeed, countries with higher firing restrictions are the most likely to have lower wage differentials and higher wage rigidity (lower wage variations), with the latter inducing higher job turnover throughout the cycle (especially employer-initiated job turnover). However, if wage uniformity leads to higher job turnover, and workers are concerned with the volatility of labour income, then they will lobby for restrictions on firing practices. Conversely, if firing costs are high, firms will tend to reduce wages, making them more variable. Workers who are averse to taking risks will then lobby for wage compressing legislation. Higher job protection and wage uniformity will then be the expected outcome and hence a larger job turnover will be observed even when job protection rules are very strict.

A distinct issue is whether restrictions on firing affect unemployment flow values. As high firing costs affect labour market allocations, there is in principle an impact on unemployment flows, lowering both unemployment inflows and unemployment outflows. The obvious result is an increased proportion of long term unemployment.

What evidence do we have for this? According to Table 3.4. there is no clear relationship between the stringency of employment protection legislation (EPL) and job turnover flows. In particular, higher job protection does not seem to imply (or be correlated with) lower job turnover, irrespective of whether one uses single-dimension measures (e.g. regulations on regular contracts or severance entitlements) or overall indices of job protection (e.g. IOE, 1985, and Bertola, 1990). As a matter of fact, the rank correlations between EPL measures and job turnover show the expected sign, but it is not statistically significant except in one case.

Evidence on the impact of job turnover on unemployment is not conclusive either, but, as Table 3.5. shows, there seems to be some indication that higher job turnover implies more inflows into unemployment and a lower incidence of long-term unemployment. The correlation between job turnover on the one hand and unemployment rate, outflows from unemployment, and net employment changes on the other is again not statistically significant, although with the expected sign.

Table 3.4. Rank correlation between various cross-country rankings of measures of employment protection legislation and job turnover

	All establishments (private sector)	All establishments (manufacturing)
Regulations governing permanent workers (a)	-0.44	-0.23
Regulations on temporary workers (a)	-0.79*	-0.41
Maximum severance pay and notice for dismissal of permanent worker (b)	0.54	-0.38
IOE (c)	-0.65	-0.52
Bertola (d)	-0.58	-0.26

Sources: (a) Grubb and Wells (1993); (b) OECD (1993); (c) IOE (1985); and (d) Bertola (1990). * denotes significance at the 5% level.

Table 3.5. Rank correlation between job turnover (private sector) and unemployment

	All establishments	Continuing establishments
Unemployment rate	-0.32	0.00
Inflows into unemployment	0.22	0.61*
Outflows from unemployment	0.30	0.47
Incidence of long term unemployment	-0.62*	-0.56
Net employment change	-0.40	-

Source: OECD (1996). * denotes significance at the 5% level.

Table 3.6. Job turnover flows

	Portugal (1983-94)		Italy (1984-92)	Germany (1983-90)	France (1984-92)	U.K. (1985-91)	Canada (1983-91)	U.S.A. (1984-91)
	Manufacturing	Economy						
JC	11.4	14.9	12.3	9.0	13.9	8.7	14.5	13.0
JD	11.8	13.7	11.1	7.5	13.2	6.6	11.9	10.4
JT	23.2	28.6	23.4	16.5	27.1	15.3	26.4	23.4

Sources: OECD (1994a) and Portugal (1999). JC, JD, and JT denote job creation, job destruction, and gross job turnover, respectively. The values are in percentage of total employment (annual averages).

Much more evidence is therefore required in order to establish more robust relationships between labour reallocation, unemployment flows, and employment protection. In any event, since labour institutions frame both wage determination and employment, what matters is the entire system of labour relations. By looking exclusively at any single dimension, there is the risk of missing crucial aspects connecting wage determination and employment protection; this linkage being at the core of observed cross-country patterns of labour adjustment. To illustrate this point we compare job turnover statistics in Portugal and core OECD countries, in Table 3.6. Although we should bear in mind the usual qualifications on data sources and comparability, one major point seems to stand out. There are no visible differences in gross job turnover between these countries. (This point has recently been challenged by Blanchard and Portugal, 2001), who claim that employment protection has impact in labour reallocation if one looks at more disaggregate (quarterly) data, but more evidence in a broader set of countries is required before generalisations can be made.)

4. Putting Poland in perspective

The economic problems Poland had to face at the beginning of the transition program (in 1989) were in many aspects similar to the ones Portugal and Spain had to meet in the 1970s, in particular those related to the reallocation of labour from agriculture and manufacturing to the service sector. As Table 4.1. shows, the employment figures in Poland (in 1989) were approximately the same as the (non-weighted) average of Portugal and Spain in 1975 (roughly the beginning of the transition period in these two countries). Despite this parallelism, the differences in GDP figures were substantial, with industry output in Poland being twice that of the OECD average. More noticeably, in all three countries the agriculture sector was, in comparison with the 1988 OECD average, clearly over-represented, both in terms of output and employment.

In Poland, the transition from an agriculture-and-industry-based economy to a service oriented one, was accompanied by a program of privatisation aimed at transforming very rapidly from a centrally-planned economy to a market-oriented economy. Although on a different scale, the two Iberian countries have also been through an intensive program of liberalisation during transition, especially in the case of Portugal where, in a period of two decades the size of the public enterprise sector was reduced from a 23% share in GDP in 1975 to 8% in 1997 (from 19 % to 3% in terms of total employment). As shown in Table 4.2., in one decade, the size of the public enterprise sector in Poland was reduced from 53% to 29% in terms of employment share (a reduction from 72% to 45% in GDP share between 1995 and 1999).

Table 4.1. Sectoral GDP and employment for Portugal, Spain, and Poland

		GDP			Employment		
		Agr	Ind	Ser	Agr	Ind	Ser
Portugal	1975	14	39	47	34	34	32
Spain	1975	9	37	54	22	38	40
Poland	1989	15	61	24	28	35	37
OECD	1988	6	33	61	3	33	64

Source: OECD Main Economic Indicators. Values given as percentages.

Table 4.2. The size of the public enterprise sector in Portugal and Poland

		Share in GDP	Share in employment
Portugal	Before 1975	8	12
	After 1975	23	19
	1988	20	6
	1997	8	3
Poland	1989	-	53
	1995	72	-
	1999	45	29

Source: Ministério das Finanças (1998) and OECD Country Surveys – Poland.

4.1. The transition process

The early stages of the transition process in Poland were marked by a severe reduction in output growth (-11.5% in 1990 and -7.0% in 1991), caused by the collapse of the socialist economy and by the shock therapy approach inflicted on an emerging market economy.

Not surprisingly, adjusting the size of the industrial sector was the most painful task. In five years (from 1988 to 1992) the share in GDP of industrial output dropped from more than 60% to 34%. Neither the labour nor the product markets were ready for such an enormous transformation, and the result was a massive process of job destruction, especially in heavy industries. From being an unknown phenomenon, unemployment, which was actually forbidden during the communist era, rapidly reached the two-figure level (14.4% in 1994, Labour Force Survey).

In Portugal, as we have shown in section 2, industrial restructuring was followed from the beginning (1975-77) by changes in the labour relations system which enabled firms to adapt to new market conditions. As a result of an early settlement of major labour regulations, all major labour market outcomes were remarkably stable throughout an entire period of more than two decades, in which the country had to face, we recall, (i) a political revolution, a decolonisation process, and a massive program of nationalisation of major firms in key sectors of the economy in 1974 and 1975; (ii) the preparations required to join the EEC in 1986; and (iii) the adjustment to an economic community of more industrialised countries following EEC membership.

In Spain, the early successes enjoyed in the period 1975-77 proved illusory if not counterproductive. With no serious social unrest to cope with, there was no massive pressure towards any major change in labour relations until the 1980s. Moreover, the changes in labour regulations introduced in the 1980s, seem to have fallen short of those required to respond to increased competition from abroad and to the industrial restructuring necessary for successful EEC membership on the employment /unemployment front.

In Poland, all major labour market reforms were introduced in 1990 and 1991: legislation on collective and individual dismissals, the right to strike, works councils, and collective bargaining. However, without any real experience of the functioning of price adjustment mechanisms, the reforms sounded, in many cases, like a western extravaganza. If, in Spain, the introduction of fixed-term contracts was an escape route to ease the pressure on firms anxious to have more labour flexibility, in Poland massive unemployment created by the complete disruption of the economy forced authorities to implement generous unemployment safety nets and an arsenal of Active Labour Market Policies (ALMPs) to which only the more advanced western economies were familiar with.

4.2. The role of labour market institutions

In the mid-1990s, Poland started the second phase of the transition period, which included an intensive program of privatisation and preparation for E.U. accession. Table 4.3. summarises information on major labour outcomes during this period. For comparison, information on Portugal and Spain has also been included. We note that, due to the use of different definitions, figures on EMPPOP and LFPR variables are not strictly comparable with those given in Table 3.1. The data source is the Labour Force Survey.

The first relevant point is that employment-population and labour force-population ratios in Poland are much closer to Portugal than to Spain (Portugal is slightly over the OECD average in both categories). Unemployment in Poland is much higher than in Portugal but clearly below the Spanish rate by a factor of (almost) two. In Poland, the unemployment rate is also slightly lower than the corresponding value in the first part of the Spanish transition (i.e. the period 1975-77).

The period 1993-97 is also characterised by very strong output growth (the average growth rate in the 1994-98 period is 6%). Given that employment has increased at a much slower pace (1.1% per year), the result is very strong growth in labour

Table 4.3. Labour market outcomes in Poland, Portugal, and Spain: 1993-97

	Poland	Portugal	Spain
EMPPOP	58.4	62.8	47.9
UNRATE	12.8	7.1	22.5
LFPR	67.3	67.7	61.8

Source: OECD (1999). The employment-population ratio is computed using people from 15 to 64 years old (16 to 64 in the case of Spain).

Table 4.4. Relative position on strictness of labour regulations (late 1990s)

	Portugal	Spain	Poland
Regular contracts (individual dismissals)	27	18	12
Temporary employment	21	22	11
Collective dismissals	20	13	22
Overall index	26	22	10

Source: OECD (1999). The total number of countries in the sample is 27 (26 in the temporary employment category).

productivity. On the other hand, and because output has shown greater variability than employment, the very steep pattern of the relationship between output growth and employment growth may indicate lack of labour market flexibility.

To assess the role of labour market institutions and regulations in Poland more directly, Table 4.4. presents the OECD rankings on strictness of employment protection regulations. A summary of the main features of the Polish job protection system is also included in the appendix (Annex Tables 1 and 2). As mentioned above, the computation and interpretation of these ‘reputation’ indices has been subject to intense debate, but looking at the position of Poland there seems to be no apparent reason for concern. Having said that, when considering the favourable overall index – tenth out of 27 countries – it should not be ignored that the scoring exercises in general involve ad hoc weighting procedures. The collective dismissals score is just an example. It may well be the case that the actual combination of strict firing restrictions on mass layoffs with restrictive practices on wage setting has a much larger impact on labour market outcomes than the reported overall index suggests and this should be a matter of some concern.

5. Policy Issues

The performance of the labour market is the key factor that distinguishes success from failure in economic transition as labour markets are required a) to be flexible, to allow new allocations of factors; b) to be stable, to prevent workers from income losses; and c) to have low unemployment spells to guarantee that workers do not bear all the costs of mobility. Wage flexibility and wage differentials are also required, to induce sufficient labour mobility, and reforms must keep incentives to work at a high level to avoid unsustainable reductions in labour force participation. The challenges to labour policy made during transition (and in general) are thus very far from trivial since they imply difficult choices among obviously conflicting goals.

“The OECD Jobs Study” and the follow-up report “Implementing the OECD Jobs Strategy” has offered a comprehensive recipe for labour recommendations which have been applied to a wide variety of countries. Very broadly, they include recommendations in favour of (i) decentralised wage setting, to stimulate wage growth in correspondence with gains in productivity; (ii) non-indexation of minimum wages to average wages, to avoid damage to the employability of lower-skilled workers; (iii) low unemployment benefits (insurance and assistance benefits) and strict eligibility rules (including means-tested benefits) “to make work pay” as much as possible; and (iv) strict monitoring of ALMP measures.
In this study we have assessed how changes in job protection rules were implemented in Portugal and Spain during transition from dictatorship to E.E.C. (and E.U.) membership. Although employment protection must not be taken in isolation, we believe the differences in labour market performance in Portugal and Spain make it clear that firing restrictions had a decisive role in the observed labour market developments. In particular, they show that firing restrictions on regular contracts need to be co-ordinated with regulations on temporary work in order to improve labour market outcomes. Given the difficulties in implementing (and “refreshing”) structural changes, it is of key importance to avoid misguided legislative interventions, since the very first steps of any reform package very often become the founding policies, with a decisive and permanent impact in framing future developments.

How useful can be the Iberian experience to Poland? In the first instance, there is a clear indication that policy choices must be well defined, with long-term objectives clearly stated to avoid being “stuck in the middle of the river” (Bertola, and Ichino, 1995). In particular, it seems that if a given country’s objective is greater flexibility in labour shedding, firing restrictions and regulations regarding regular contracts should be combined with those governing fixed-term contracts. For, as the Spanish case clearly illustrates, simply using the latter as an escape route to ease the pressure arising from stringent employment regulations on typical, open-ended contracts has proven to be a mistake, largely because it involves the risk of introducing higher wage rigidity and separate (dual) labour markets with lower mobility between them.

The combination of a flexible regime of fixed-term contracts with adequate regulations regarding mass layoffs, which provides firms with sufficient room for the necessary labour adjustment required by large scale restructuring, has proven successful during the Portuguese transition period in that it has enabled the country to maintain an above average performance in terms of unemployment, labour force participation, and output growth. There is no “Portuguese Miracle” to call. Output growth rate although higher than average is not spectacular. The country has been able however to make steady progress in many fronts without major disruptions. If Poland is to consider a similar route, it needs to improve its position in relation to collective dismissals and maintain its current regulations on fixed-term contracts, avoiding the recent easing of the latter as suggested in the 1999-2000 OECD survey on Poland.

The direction which Poland should take in terms of unemployment benefits seems quite obvious. When both the unemployment insurance benefits and assistance benefits were initially introduced in Portugal (in 1975), there were related to minimum wages as opposed to average wages (only in 1985, unemployment insurance benefits became related to past-earnings). This is still the way the Portuguese unemployment benefit system works. As minimum wages have never been indexed to average wages, Portugal has been able to keep the principle of “make work pay” very alive.

The Spanish approach has however been very different, not only in terms of minimum wages, but also in terms of wage setting and unemployment benefits, and this has resulted in a considerably more compressed wage structure. In this context, the OECD recommendation for Poland on the need to improve its decentralised bargaining must be kept in mind.

The demographic trends in Poland point to a significant increase in the labour force, while restructuring is largely unfinished business in a wide variety of sectors. Agriculture still holds 25% of total employment and helps sustain substantial levels of unemployment in rural areas. It is therefore required even more attention to current labour market policies to assure that the country can indeed maintain its current leading status among the transition countries in the years to come.

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Annex Table 1: Individual dismissals – Spain

	Definition (a)	**Notice** (b)	**Severance pay** (b)	**Exemptions**
Law 10/3/1980 (Workers' Statute)	Requires the dismissal to be fair, i.e. based on disciplinary reasons and objective grounds.	0 months	For disciplinary reasons: no severance payment is required. For objective grounds: 20 days of wages for each year of service.	The dismissal for objective grounds can be used only by firms with less than 50 workers.
Law 19/5/1994		3 months		The dimissal for objective grounds must affect less than 10% of the total workforce (otherwise the firm will have to follow the administrative procedure for collective dismissals)
Decree 17/5/97	Economic, technological, organisational and productive reasons, including changes in cyclical demand, constitute now "justifiable" grounds for dismissal.	30 days	2/3 of a month's pay per year of service.	

Source: Bertola, Boeri, and Cazes (1999) and OECD (1999). (a) Objective grounds cannot be attributed to the worker and they include economic, technological, organizational and productive reasons ("objective dismissal"). In practice, however, and because "justifiable" grounds were vague in the law prior to 1997, individual dismissals based on economic grounds were precluded or resulted in prohibitive severance pay settlements; (b) notice and severance pay for a typical worker with 10 years of service.

Annex Table 1 (cont.): Individual dismissals – Poland and Portugal

	Definition	**Notice (a)**	**Severance pay (a)**
Poland	Fair dismissals include reasons attributed to the worker and to economic redundancy.	90 days	Usually none.
Portugal	Prior to 1989, individual dismissals were only allowed on disciplinary grounds. Economic grounds and lack of professional or technical capability are now valid reasons for individual dismissals.	60 days	1 month per year of service.

Source: OECD (1999). (a) Notice and severance pay for a typical worker with 10 years of service.

Annex Table 1 (cont.): Collective dismissals – Spain

	Definition	Severance pay	Procedural obligations	Social plan
Law 10/3/1980 (Workers' Statute)	A collective dismissal is grounded on economic and technological reasons. There is a threshold of two or more employees (for firms with less than 50 employees.	No regulations. Firms with less than 25 workers pay only 60% of the severance payment agreed. The remaining is paid by the "Wage Guarantee Fund".	Information and consultation with the trade union and the labour authority. If an agreement with the legal representatives is reached, it is notified to the labour authority who certifies. Otherwise, the case is left to the labour authority, who has to decide whether the procedure is accepted or rejected. Because, labour authorities oppose in general the dismissals, employers always seek an agreement. Length: 30 days bargaining period with workers' representatives; 30 days for the labour authority to reach a decision. (a)	Not required.
Law 2/8/1984		For firms with less than 25 workers, the "Wage Guarantee Fund" pays 40 per cent of the legal severance payment.		There is often an agreement with the trade union to provide a plan for professional qualification and benefits.
Law 19/5/1994	Organisational and production causes were added to the previous economic and technological reasons. There is a threshold (within a period of 90 days) of 10 workers for firms with less than 100 employees, 30 workers for firms with more than 300 workers, and 10 per cent of the workers for firms with employees between 100 and 300.		30 days for the bargaining period and 15 for the labour authority decision.	A social plan is required for firms with more than 50 employees.

Source: Bertola, Boeri, and Cazes (1999) and OECD (1999). (a) There has been a sustained trend in the jurisprudence according to which the lack of administrative authorisation makes the dismissals null and void (workers are reinstalled and paid the outstanding wages)

Annex Table 1 (cont.): Collective dismissals – Poland and Portugal

	Definition	Severance pay (a)	Procedural obligations	Social plan
Poland	The threshold is defined as follows: 10 percent of workers in firms with less than 1000 employees; 100 workers in firms with at least 1000 employees.	2 months per year of service.	Obligation to inform and consult with the trade union and the local employment office. Length: 45 days.	An agreement has to be reached with the trade union on alternatives to redundancy and ways to mitigate the effects.
Portugal	There is a threshold of 2 (5) workers in firms with less (more) than 50 employees, within a period of 90 days.	1 month of average basic earnings per year of service.	Obligation to inform and consult with works council or trade union delegations and labour authorities. Since 1989, authorisation by the labour authority is not required before implementation of dismissals, nor a written agreement has to be reached. Length: 75 days if an agreement with workers' representatives is reached; 90 days otherwise.	There is consultation with trade unions on alternatives to redundancy, selection standards and ways to mitigate the effects.

Source: OECD (1999). (a) Severance pay for a typical worker with 10 years of service.

Annex Table 1 (cont.): Regulation on fixed-term contracts

	Valid cases	**Maximum number of successive renewals**	**Maximum cumulated duration**
Portugal	Permitted under a specific set of circumstances.	3	3 years (2 for new activities and business startups).
Spain	Permitted under a specific set of circumstances.	3	3 years.
Poland	There are no restrictions to the use of fixed-term contracts.	2	No limit.

Source: OECD (1999). Fixed-term contracts are allowed in all countries in objective situations, such as specific projects, seasonal work, temporary replacement of permanent workers and exceptional workload. A distinctive cross-country feature is whether or not the law permits other cases and under which circumstances. The most flexible regimes have no restrictions at all.

Annex Table 1 (cont.): Regulation on temporary work agency employment

	Definition
Portugal	It is restricted to “objective situations” (business startups, lunching of new activities of uncertain duration, recruitment of workers in search for their first job and long-term unemployed, inter al.).
Spain	Legal since 1994. It is limited to “objective situations.”
Poland	No restrictions.

Source: OECD (1999).

Annex Table 2: Unemployment insurance benefits in Portugal and Spain: main changes (1975-92)

	1975	1977	1983	1984	1985	1989	1992
Spain							
Eligibility (a)				6 (in the previous 4 years)			12 (in the preceding 6 years)
Maximum length (b)				24 months			
Replacement ratio				0.675 of the gross wage Lower bound: 100% of the statutory minimum wage (SMW). Upper bound: 2.2xSMW			0.625 of the gross wage Lower bound: 100% of SMW Upper bound: 2.2xSMW
Effective coverage (c)						Around 60%, including beneficiaries from unemployment assistance.	Around 40%, including assistance benefits.
Portugal							
Eligibility (a)						18 (in the previous 2 years)	
Maximum length (b)	6	12	15		31	25	
Replacement ratio (d)	2/3xSMW	0.75xSMW	0.9xSMW		0.94xSMW	65% of basic earnings or 0.98xSMW	
Effective coverage (c)						Around 60% , including assistance benefits (introduced in 1989).	

Sources: Addison and Teixeira (1997), Bentolila and Blanchard (1990), and Bover et al. (2000). (a) Minimum number of months of work; (b) values for a typical worker, defined as a worker employed in manufacturing, with 10 years of service and in a family unit of 3 to 5 persons. We also assume that the unemployed worker exhausts the 24- month period of eligibility; (c) values on effective coverage of unemployment benefits should be taken very carefully. The OECD Jobs Study, for example, reports two indicators that differ substantially for a given country. For Portugal and Spain, in 1991, the percentage of unemployed people reporting receipt of benefit in the EC Labour Force Survey is 17% an 29%, respectively, while the ratio of the number of unemployment beneficiaries (registered) to the total number of unemployed (LFS) is 41% and 59%, respectively. Prior to 1989 reform, only a very tiny portion of the unemployed received unemployment benefits in Portugal; (d) the scale controls for the ratio of the minimum wage to the average wage. SMW is the statutory minimum wage.

Annex Table 2 (cont.): Unemployment insurance benefits in Poland: main changes (1989-97)

	1989	1990	1991	1992	1993	1994	1995	1996	1997
Eligibility	Registered, non-old-age, no farm.	Employed for at least 6 months in last year but admits many exceptions.							Employed for 365 days in the previous 18 months.
Duration	No limit.		12 months			12 months; 18 months in special cases.			6, 12 or 18 dependent on the local rate of unemployment and duration of unemployment.
Replacement ratio	70% of previous monthly wage in the first 3 months; 50% for the next 6 months; and 40% thereafter.			36% of the average wage of previous quarter.		52% of average wage in special cases.		Flat Zl 340 per month (indexed to CPI and defined as a given percentage (about 30%) of average wages).	
Effective coverage				73%			60%		30%

Source: OECD Country Surveys – Poland, and IMF Staff Country Report – Poland (several issues).