EPL and labor market dynamics in the Netherlands

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(Preliminary version, please do not quote)

ABSTRACT: In the Netherlands, an employer has two choices to terminate permanent employment contracts. The first option is to go to civil court to dissolve the contract. The second option is to request permission from the labor inspectorate. The civil court and the labor inspectorate are two different worlds. Both apply a different set of laws and have different objectives. The civil court acts independently from the government, the labor inspectorate is a governmental institution for which the Minister of Social Services and Employment is responsible. The Dutch system has received much criticism because two routes of dismissal are believed to lead to firing rigidities. Modifications to adapt the existing legislation have been introduced continuously. However, legislation is only one component that determines if and under which terms an employment contract is terminated. The interpretation of law by the two institutes enforcing labor law is a second component. This paper shows that modifications that are introduced to decrease firing rigidities are more likely to be introduced during times that are more favorable to employees. Moreover it shows that the labor inspectorate is more likely to decide in favor of employers when labor market conditions are more favorable to employees. Data for the civil court is still being collected.

I Introduction

The Dutch dismissal system has a rather unique dual character. This duality implies that the employer has two options to terminate an employment contract. The first option is to request the labor inspectorate for dismissal permission, the second option is to go to civil court to dissolve the employment contract. These two routes of dismissal are two completely different worlds, captured in one system. Both institutes act independently of each other, interpret a different set of laws and have different responsibilities. The civil court is part of the Dutch judicial system and acts as an independent institute enforcing labor law. Judges do not have to report to the Minister of Justice. When deciding to dissolve an employment contract, civil court interprets regulations recorded in article 7:685 Civil Code of Law. The labor inspectorate is a governmental institution for which the Minister of Social Services and Employment is responsible. It reports to the minister, who is allowed to interfere. It strives to prevent unreasonable dismissal taking into consideration both the employee, the employer and the society as a whole. Rules regarding the dismissal permission are recorded in article 6 BBA.

The Dutch EPL system has received much criticism since its introduction in 1945. Opponents of the two routes of dismissal argue that the system leads to high firing costs. In other words, the Dutch labor market is characterized as rigid.[1] It is believed that employers in a rigid labor market are restrained from adapting their workforce to changing economic conditions because they are supposed to be reluctant to hire new workers and unable to fire the ones that are employed. In the past 20 years, modifications were introduced to decrease labor market rigidity. These modifications merely focused on changing legislation. However, the law is only one component that determines under which conditions an employment contract is terminated and at what costs. From Ichino et al (2003) we know that judges in Italy are biased by local labor market conditions. In periods of higher unemployment, when a firing litigation is taken to court, it is more likely to be decided in favor of the worker. For the United States, Siegelman and Donohue (1995) find that the number of employment discrimination cases settled and won in federal district courts increases with the unemployment rate. The results of both studies indicate that the interpretation of law by the institute enforcing labor law is a second component determining the degree of labor market rigidity. The institute examined by Ichino et al (2003) and Siegelman and Donohue (1995) is the civil court. However as mentioned before, in the Netherlands we have a second institute responsible for the enforcement of labor law, namely the labor inspectorate. How do both the civil court and the labor inspectorate react upon changing economic conditions? When are they most likely to grant dismissal permission? Being two totally different institutions, with different objectives and interpreting a different set of laws, do these institutes react in the same manner upon changing economic conditions? Another difference between the studies conducted by Ichino et al (2003) and Siegelman and Donohue (1995) and ours is that Italy and the U.S.A apply a repressive check on dismissal. In a repressive check the reasonableness of dismissal is checked after the employee is fired. An employee can file a lawsuit against his or her employer. In the Netherlands, a preventative check is applied. In a preventative check the reasonableness of dismissal is checked before the employee is notified of dismissal. If dismissal is judged to be unreasonable, an employer does not receive the permission to fire an employee.

We have some evidence to believe that the institutes enforing labor law are influenced by labor market conditions. However, what we do not know is whether the political system that is responsible for adjustments in EPL is influenced by changing labor market conditions. Under what conditions are EPL modifications more likely to find support? Saint-Paul's (2002) theoretical study of the political support for employment protection shows that when workers vote in favor of employment protection they trade off lower wages against longer job duration. Political support for employment protection depends on the value of longer job duration (rents) relative to the costs of firing. Support in favor of EPL (less labor market flexibility) then turns out to be anti-cyclical. However, Saint-Paul's study is theoretical. This paper addresses this issue empirically.

[1] When we refer to a rigid labor market we refer to a labor market in which firing costs are high.

The structure of this paper is as follows. Section II describes the most important EPL developments since the 19th century. In section III, the current Dutch dismissal system is discussed and compared to the systems of other OECD countries. Section IV investigates how adjustments in EPL are related to changes in labor market conditions. Section V analyzes to what extent the labor inspectorate is affected by employment conditions. Section VI concludes.

II History of Dutch EPL

This section describes the most important modifications introduced since the introduction of the Dutch Civil Code of law. After understanding the nature of these modifications and the context in which they were introduced, section IV of this paper analyzes when these modifications are more likely to find support.

The introduction of the old Civil Code of Law in *1838* can be regarded as a milestone in the history of Dutch EPL. Inspired by the French Code Civil of 1804, the Dutch Civil Code introduced a new national civil law. Even though the Civil Code did not encompass labor law in its strictest sense, it did contain three articles regarding the employment relationship. It must be noted that these articles were all written to protect the employer, not the employee. The first legal measures that aimed for the protection of the employee were not introduced until *1909* when the Law on employment contracts was enacted. One of the most crucial elements of this law was the introduction of the notice period.[2] Protection was also provided in regulations that imposed the form and the terms in which the loan should be paid. Article *1639w* entitled the civil court to dissolve a contract.

The core of the Dutch EPL remained unaltered until the Dutch government introduced the Special Resolution on Labor Contracts (BBA 1945) in *1945*. The resolution introduced a preventative check on dismissal for which the labor inspectorate was made responsible. For dismissal a reasonable cause was required. If the labor inspectorate judged dismissal to be unreasonable, permission to terminate the employment contract was not given. Before the introduction of the BBA 1945, Dutch EPL was very liberal. An employer could dismiss at will, he or she only needed to take into account the notice period. When the employer had met the notification duty, the termination of the employment contract was declared legitimate. In other words, before the introduction of the BBA 1945 no valid reason for dismissal was required. Additionally, before 1945 the civil court was the only institution enforcing employment protection. The BBA 1945 introduced a second public administrative body responsible for this task. As such, the widely debated duality in Dutch EPL became a fact.

[2] The notice period had to be taken into account when a permanent contract was terminated. This period was equal to the time in between two loan payments. Because most workers received a weekly pay, the notice period was often equal to a week (Naber, 1981).

In December *1953* Dutch EPL was drastically revised. Due to this revision the civil court became entitled to perform a check on the reasonableness of dismissal (*article 1639s*). Unlike the check of the labor inspectorate, this check was performed after dismissal had taken place. Another consequence of the revision was the extension of article *1639w*. As a result of this extension, the power of the civil court to dissolve an employment contract was widened. Furthermore, in 1953 two prohibitions of dismissal came into being: one during the first two years of sickness and one during military service. More prohibitions of dismissal were introduced in *1976* and *1980*.[3] Since the introduction of the Law "Verbetering Poortwachter" in *2002*, prohibitions of dismissal during sickness may be broken in special occasions.

In *1976* the Law Notification Collective Dismissal was enacted. The law states that employers who intend to dismiss at least twenty employees, within one working district of the labor inspectorate within three months, should notify the labor inspectorate about this intention. Originally, the lifo (last in first out) criterion was applied as a selection criterion for dismissal. Since the 1st of March *2006*, the employer is obliged to apply the reflection principle as a main selection rule.[4] The reflection principle stipulates that the age structure of the group of dismissed employees is in proportion with the age structure of all employees. Approximately twenty years later, in *1999*, the Law Flexibility and Security is introduced to decrease labor market rigidity. The law has led to a broadening of the possibilities to close temporary contracts, allowing employers to work with a more flexible workforce. At the same time, security for temporary workers has increased.

Since 1953, the Dutch dual system has survived repeated attempts of modification. One of those attempts was made in *1999* when the Commission Dual Employment Protection was installed. The commission's purpose was to investigate the transparency and efficiency of the dual system. In a final report, presented in November 2000, the commission argued for the abolishment of the preventative dismissal procedure and for the introduction of a civil repressive dismissal system. As such, the dual dismissal system would disappear. However, the recommendations of the commission were never put into practice.

A modification of the Unemployment Law in October *2006* simplified the application procedure for unemployment benefits. Before October 2006, a dismissed employee could not receive unemployment benefits if objection to the dismissal was not made. In many dismissal cases the employer and the employee reach an agreement about the dismissal and the amount of severance pay due. However, in order to register a notice of objection these cases were brought to court or the labor inspectorate. After

[3] 1976: prohibitions of dismissal during pregnancy and parental leave. 1980: prohibitions of dismissal in connection to discrimination between men and women.

[4] The new selection rule is to be applied in all dismissals due to economic reasons, regardless of the number of employees involved. The lifo-criterium is applied after all employees have been subdivided into age categories.

October 2006, objection to dismissal is no longer necessary to receive unemployment benefits. This modification was introduced to unburden the civil court and the labor inspectorate and to decrease labor market rigidity.

In June *2007* the Dutch cabinet organized the Labor Force Participation Meeting. One of the most important subjects of this meeting was the rigidity of the Dutch EPL. According to the cabinet, dismissal procedures have become complex, long and expensive. This rigid EPL inhibits employers from employing new employees. Furthermore, the cabinet believes that the relatively high costs and burdens of Dutch EPL do not positively affect the functioning of the labor market (AV/IR/2007/23064, p2). The cabinet is in favor of a simplification of the Dutch system and proposes to introduce a singular regulation in the Civil Code of Law. Employers agree to great extent with these intentions, employees are strictly against. Political parties are divided. Despite of the criticism received, the Minister for Social Services and Employment indicates not to abandon his intentions to modify Dutch EPL.

The political impasse led to the establishment of the Commission Labor Force Participation in December *2007*. The Commission is requested to investigate what measures are needed to structurally increase labor force participation in the Netherlands to a level of 80% in 2016. The report, which is delivered in June 2008, does not give a concrete advice about the modification of EPL. The commission mainly focuses on what (work related) measures have to be taken in order to bear the costs of the aging population. The modification of the dismissal system is hardly touched upon. After the delivery of the report the discussion on EPL seems to have come to an end.

Or not? At the 30th of October *2008* the civil court formula, which determines the amount of severance pay a dismissed worker receives, is adapted.[5] Due to this adaptation years worked at a younger age are weighted less heavily. As a result dismissal costs decrease. The reason for the new formula is the decreasing unemployment rate and the improvement of the labor market position of young people in the years before. In that same month October, the cabinet, employers and employees reached an agreement about the maximum dismissal compensation. Employees earning more than €75.000 gross per year are given at maximum one yearly salary when dismissed. In exchange for this modification, the current cabinet has promised to leave employment protection untouched until the end of its period of governance. Is this the end of a long debate?

[5] The civil court formula is as follows: A (weighted years of service) x B (gross monthly salary plus additional structural rewards) x C (correction factor).

III Dutch EPL in an international perspective

In this section we first describe the current Dutch dismissal system and explain that this system is unique in the world. Moreover, by presenting an overview of OECD countries and their Employment Protection Legislation Index we discuss the degree of Dutch labor market rigidity from a macro-economic perspective.

A. The current Dutch dismissal system

The dual employment protection system in the Netherlands is most relevant for employees with a permanent contract.[6] Duality implies that there are two options for the employer to end the employment relationship:

I. The first option is to request the labor inspectorate for permission according to art. 6 BBA.
II. The second option is to request the civil court to dissolve the employment contract according to art. 7:685 Civil Code of Law. [7]

If the employer selects route I and the labor inspectorate does not grant the permission to terminate the contract, the employer can still select route II and file a request at the civil court, and vice versa.[8] In both routes a preventative check is applied. This check is performed before the employee is notified of the dismissal. The latest proposed modification of Dutch duality, as discussed during the Labor Force Participation Meeting in 2007, intents to abolish route II. The point of departure for the proposed regulation is that the employer can terminate the employment relationship:

- without the permission of the labor inspectorate or the civil court. Severance payment is obliged.
- if dismissal is due to economic reasons, with the permission of the labor inspectorate. Severance payment is not obliged.

The employer must always have a valid reason for the termination of the employment contract. Termination without a valid reason is not possible or leads to a penalty (AV/IR/2007/23064, p7). According to the cabinet the average costs of dismissal will decrease.

The existence of two different preventative routes of dismissal is unique in the OECD region. In most countries only the repressive check is applied. This repressive check implies that after having received a notification of dismissal, an employee can file a lawsuit against his employer.[9] There are a few countries that do apply a preventative check. In Germany for instance, the preventative check is executed by the works council (*Betriebsrat*) and not by a governmental institution such as the labor

[6] In some circumstances employers file a request for dismissal for employees with a temporary contract.
[7] Since April 1997 regulations regarding dismissal are recorded in the New Civil Code of Law. Most articles received a new number. Article 7:685 Civil Code of Law used to be article 1639w (Old) Civil Code of Law.
[8] Next to the both routes of dismissal described above there are other possibilities to terminate an employment contract: termination of a temporary contract, summary dismissal, dismissal with the approval of both parties and legal termination of a contract (e.g. retirement).
[9] In the Netherlands, the repressive check also exists.

inspectorate. This works council is supposed to object to the dismissal within seven days after the intention of dismissal is made known. The deadline is three days when dismissal due to urgent reasons is intended. If the deadline is not met, it is automatically assumed that the council agrees with the termination of the employment contract. Accompanied with a valid objection, the employee can request for (re)employment. Companies that employ less than five workers are not requested to have a works council at one's disposal. In Belgium the request for dismissal is not checked in advance. However, for some 'special employees' [10] exceptional regulation exist and the preventative check is applied. In France, the preventive check of dismissal was performed until two decades ago. As from the Second World War dismissal was possible with the permission of the *Directeur départemental du travail.* If permission was not given, the employer could appeal to the Labor Inspectorate. A final appeal could be made to the federal government. The preventative check is abolished in 1986. Ever since, France is only applying the repressive check. As most countries do.

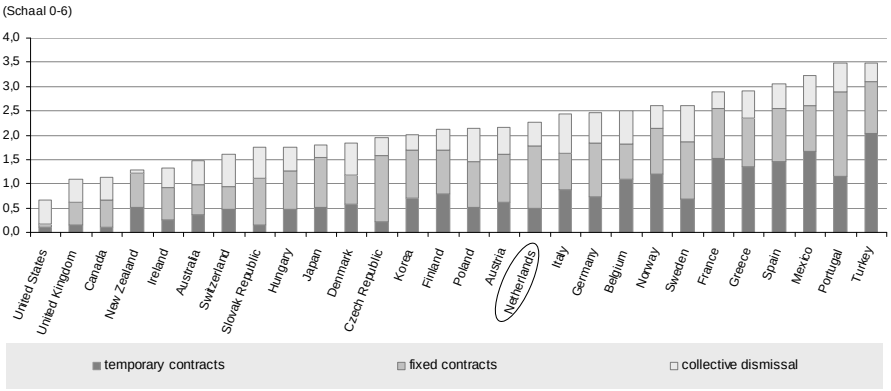
B. A measurement for the strictness of EPL in OECD countries

After publication of the studies "*Regulation or deregulation of the labour market. Policy regimes for the recruitment and dismissal of employees in industrialized countries"* of Michael Emerson (1988), "*Job security provisions and employment"* of Ed Lazear (1990), and "*Job security, employment and wages*" of Guiseppe Bertola (1990) policymakers became widely interested to quantify the degree of rigidness of employment protection. Since 1990 the OECD calculates the Employment Protection Legislation (EPL) Index for a large number of its member states. The EPL index is available for the years 1990, 1983 and 2003. Summarized, the index is composed out of three components: one component related to the protection of employees with a permanent contract against (individual) dismissal, one component related to specific regulations regarding collective dismissals. The third component captures the regulations dealing with temporary forms of work.[11] The constructed index intends to describe the costs of dismissal from an employer's perspective. Higher costs are interpreted as less flexible EPL. Figure 1 below presents an overview of OECD countries and their EPL-index. The higher a country's EPL score, the stricter is its EPL in terms of firing costs. It should be noted however, that the EPL index is not informative when we are concerned about the functioning of a specific country's labor market. Figure 1 below solely presents a comparison of composed costs of dismissal. The total EPL scores range from 0.65 for the United States– completely on the left hand

[10] Members of the works council or of a safety commission (Heerma Van Voss, 2006).

[11] See for example "*Employment regulation and patterns of work in EC countries*" of David Grubb and William Wells (1993) and (OECD, 2004). Measurements of the component collective dismissals are only available since 1998. Therefore two versions of the EPL index are available: version 1, without the component collective dismissal (available for all years) and version 2: with the component collective dismissal (only available for the years 1998 and 2003).

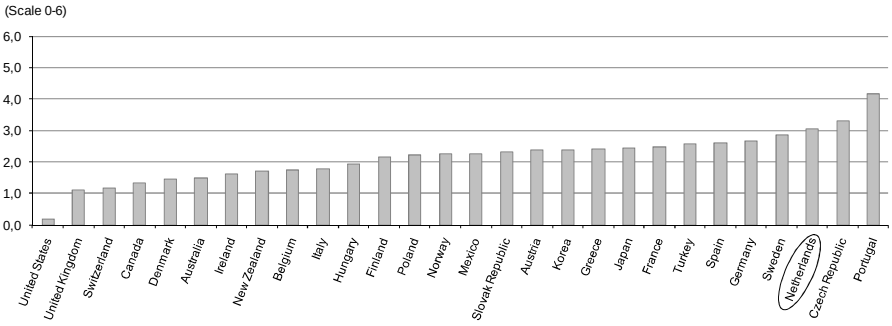
Figure 1 Total EPL scores (version 2, 2003)



Source: OECD data from Online OECD Employment Database (www.oecd.org)

side of the axis –to 3.49 for Turkey, which is situated on the right hand side extreme. The Netherlands has a score of 2.27 and finds itself just right from the middle. If we look at the separate components of

Figure 2 EPL component for permanent contracts (version 2, 2003).



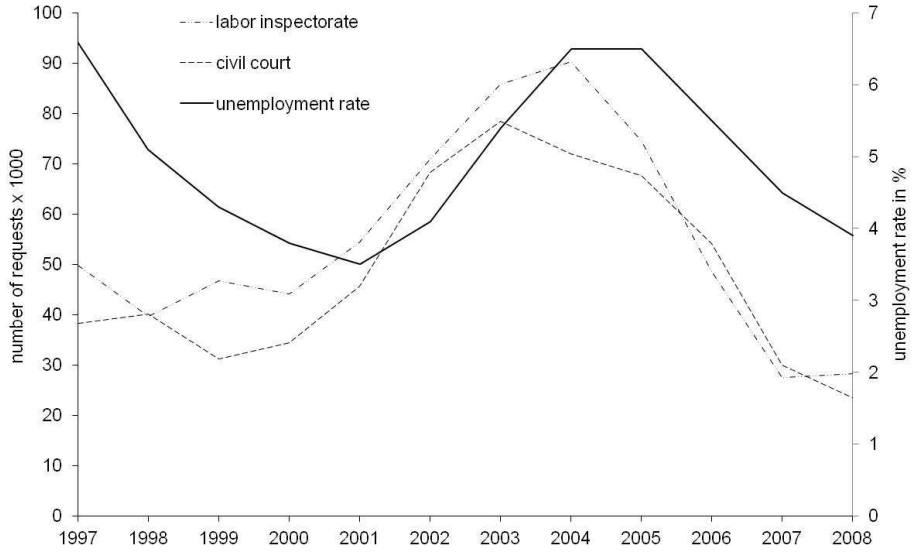
Source: OECD data from Online OECD Employment Database (www.oecd.org)

the EPL index in Figure 1 it is seen that the Netherlands scores relatively high on the component for permanent contracts. By looking at Figure 2 this becomes even better visible. The only countries in which firing costs for permanent workers are higher are Portugal and the Czech Republic. The position the Netherlands holds on the EPL ranking is determined by both the civil court route and the labor inspectorate route. These two systems together determine the extent of firing costs. Would the abolishment of the civil court route lead to shift to the left on the horizontal axis? We doubt this. The Dutch EPL system gives employers the freedom of choice to select either the one or the other route. On itself, this freedom of choice is a form of flexibility. Abandoning this freedom by eliminating the civil court route will automatically lead to more rigidity because decisions will then have to be made under stricter requirements.

C. The Dutch EPL system in equilibrium

Figure 3 shows that the number of requests filed at the labor inspectorate is approximately equal to the number of requests filed at the civil court. A balance between the routes exists. This implies that both routes are of equal importance in the termination of employment contracts. Figure 3 moreover shows a relation between the number of dismissal requests and the economic situation, expressed by the unemployment rate. An increase in dismissal requests foreruns an increase in the unemployment rate.

Figure 3 Use of different routes for dismissal in the Netherlands [a)]



a) Requests for permission directed at the labor inspectorate are expressed in number of employees. Requests directed at the civil court are expressed in dismissal cases.
(Sources: CPB 135 – Employment Protection Legislation – november 2006, Ontslagstatistieken, 2006-2008)

If we look at the correlations in table 1 we see that the correlation between the number of dismissal requests filed at the labor inspectorate in year *t* and the unemployment rate at year *t+1* equals 0.8648. It is significant at a 1 percent level. The correlation between the number of requests filed at civil court at time *t* and the unemployment rate at time *t+1* is insignificant. Apparently, the number of dismissal request filed at the labor inspectorate is a better predictor for the unemployment rate than the number of requests filed at the civil court. A possible explanation for this is that the labor inspectorate route is a common used route for dismissals due to economical reasons (Ontslagstatistiek, 2008). However, data on the reason of dismissal for civil court cases is still being collected. As such, we must be careful drawing too sharp conclusions.

Table 1 Correlations

	Unemployment rate at time *t+1*	Number of dismissal requests filed at UWV Werkbedrijf at time *t*	Number of dismissal requests filed at civil court at time *t*
Unemployment rate at time *t+1*	1	0.8648*	0.2626
Number of dismissal requests filed at UWV Werkbedrijf at time *t*		1	0.5541**
Number of dismissal requests filed at civil court at time *t*			1

* Correlation is significant ($p < 0.01$), ** Correlation is significant ($p < 0.05$)

IV Political support for EPL adjustments

This section analyzes when the political system is most likely to alter EPL. It shows us how the political system reacts upon changes in employment conditions.

A. Data

The data used in this section is drawn from the online CBS Statline database. The vacancy rate, which is defined as the number of vacancies per one thousand jobs, is available on a quarterly basis for the years 1997 to 2009 and is used as a proxy for the condition of the labor market. The data holds 49

Table 2 Descriptive statistics

	Vacancy rate	**Vacancy rate adjusted for seasonality**
Mean	22.33	22.33
Standard deviation	6.05	5.90
Min	31.83	11
Max	12.83	32
N	49	49

Table 3 Summary overview of most important modification 1997-2009

Modification/events	**Law coming into force**	**Bill became a law**	**Date Bill**	**Proposed Effect**
Law Flexibility and Security	January 1, 1999	May 14, 1998	March, 7 1997	More flexible
Commission "Dual Employment Protection" installed			February 25, 1999*	More flexible
Law "Verbetering Poortwachter":	April 1, 2002	November 29, 2001	April 17, 2001	More flexible
"Reflection principle" as main selection rule	March 1, 2006	December 6, 2005	November 17, 2005**	More flexible
Modification "Unemployment Law"	October 1, 2006	June, 29, 2006		
"Labor Force Participation Meeting"			June, 2007***	More flexible
Commission "Labor Force Participation " installed			December, 2007*	More flexible
Agreement to modify CCF	January 1, 2009		October 30, 2008****	More flexible
Maximum dismissal compensation		Bill is not passed yet	Feb 16, 2009	More flexible

* Date at which the decision to install the commission is made.
** Both modifications were proposed in the bill of November 17th, 2001.
*** The "Participation Top" took place June 2007.
**** Agreement is made October 30 2008.

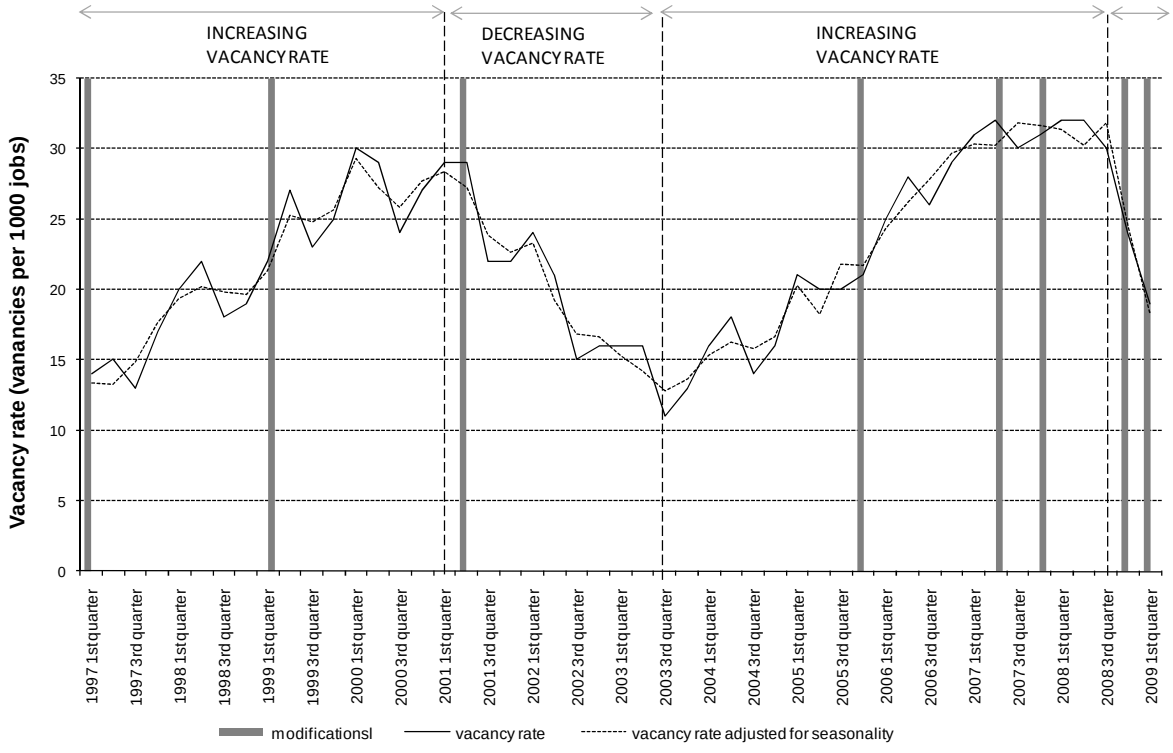
quarterly observations. The vacancy rate is adjusted for seasonality.[12] Furthermore, the most important EPL modifications and events[13] are quantified as dummy variables. An observation receives the value 1 if a modification is introduced in that particular quarter, zero otherwise. Table 2 shows that both the mean of the unadjusted vacancy rate and of the adjusted vacancy rate are equal to 22.33. Standard deviations are 6.05 and 5.90, respectively. Table 3 shows all modifications together with their date of introduction. In case of the introduction of a new law or a modification of an existing law three dates are recorded: 1) the date at which the bill is made publicly available, 2) the date at which the bill became a law and 3) the date at which the law came into force. The bottom row shows that the bill for

[12] In order to correct for seasonality we regressed the unadjusted vacancy rate on four seasonal dummies, one dummy for each quarter. The constant is dropped. The error terms are saved and added to the mean of all observed (unadjusted) vacancy rates.
[13] These modifications and events are further referred to as modifications.

the maximum dismissal compensation was made publicly available at February 16th 2009. However, this bill is not passed yet. For the establishment of both commissions in 1999 and 2007 and the Labor Force Participation Meeting in 2007, table 3 records the actual date of the event (see also footnotes table 3). All modifications in the period 1997-2009 were introduced with the intention to increase labor market flexibility. This is shown in the last column of table 3.

Figure 4 gives a graphical presentation of the vacancy rate and the modifications. In case of a law, the date of the bill is taken as the modification date. Bills are regularly designed in connection with new

Figure 4 Modifications in EPL 1997-2009



developments in society. As our purpose is to explore whether certain modification are introduced as a reaction to changes in employment conditions, it is necessary to know when these modifications were proposed, not when they were enacted. As table 3 shows it may take over a year before a bill is passed. Figure 4 additionally shows which periods are characterized by an overall increase in the vacancy rate and which periods are characterized by an overall decrease in the vacancy rate. A high vacancy rate implies that labor demand is relatively high. As such, labor market conditions are more favorable for workers during periods in which vacancy rates are high than in periods in which vacancy rates are low. As all modifications are introduced to increase flexibility - that is, in favor of employers - it is likely that these modifications find more support, and are thus more often proposed, in times of increasing vacancy rates than in times of decreasing vacancy rates.

To explore when EPL modifications are most likely to be introduced, the following basic probit model is estimated:

$$W_t = \alpha + \beta V_{t-n} + \varepsilon_t \qquad for\ n=0,..,3 \qquad (1)$$

,where W_t stands for the dummy modification variable at time *t*. V_{t-n} is the vacancy rate at time *t-n* and ε_i is the random error. Table 4 presents the results.

Table 4 PROBIT estimates: lagged values of the vacancy rate

n	**0**	**1**	**2**	**3**
Dependent variable: modifation date of bill (0,1)				
Vacancy rate [t-n]	.0314 (.036)	.0741* (.042)	.0875** (.043)	.0983** (.047)
Vacancy rate [t-n] adjusted for seasonality	.0241 (.037)	.0989** (.047)	.0916** (.045)	.0995** (.048)
Log likelihood Vacancy rate [t-n] Adjusted vacancy rate [t-n]	 -21.430 -21.595	 -18.233 -17.290	 -17.409 -17.322	 -16.909 -16.994
Number of observations	49	48	47	46

(standard errors in parentheses)
* p < 0.10, ** p < 0.05, *** p < 0.01

For the estimator of the vacancy rate corresponding to *n=0,* no significant results are found. This indicates that the vacancy rate at time *t* does not have an effect on the likelihood that a modification is introduced at time *t.* This finding is highly plausible as it takes some time for policy makers to react upon changes in employment. All lagged vacancy rate estimates, except one, are positive and significant at a 5 percent level. The effects of the adjusted and the unadjusted vacancy rates are fairly similar. Although being merely descriptive, these preliminary results indicate that past vacancy rates have an effect on the likelihood that a modification is introduced. This likelihood increases with increasing vacancy rates. These findings are consistent with our expectations.[14] They are furthermore consistent with the model of Saint-Paul (2002).

[14] We have just found some preliminary evidence that the direction of causation runs from labor market conditions to modifications in EPL. However, the correlations that are found might also reflect the effect of changes in EPL on changes in the vacancy rate. In order to provide more information on the direction of causality we have estimated the following model: $W_{2t} = \alpha + \beta V_{2t-n} + \varepsilon_2$ *for n=-3 and* where W_{2t} stands for the dummy modification variable at time *t*. W_{2t} only includes new laws or modifications of existing laws and instead

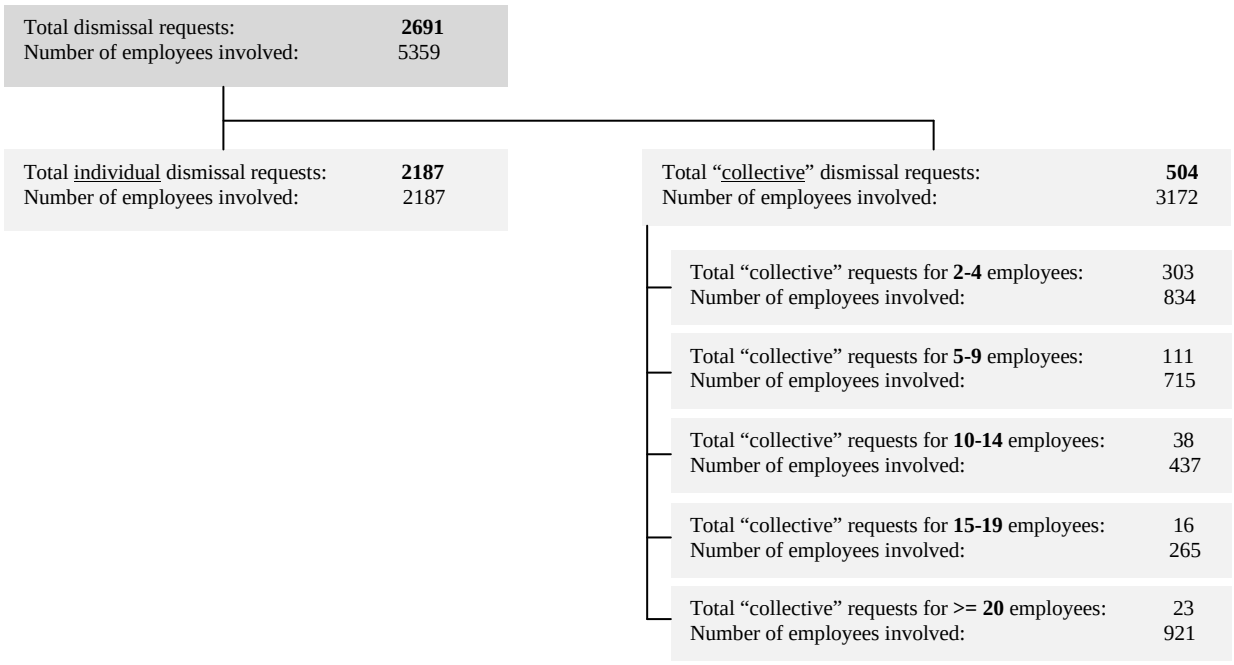
V Is the labor inspectorate affected by labor market conditions?

Using micro-data on individual dismissal cases filed at the labor inspectorate this section explores when and under what conditions the labor inspectorate is most likely to grant dismissal permission.

A. Data and descriptive statistics

The data used in this section contains information on 2691 dismissal requests filed at the labor inspectorate in Maastricht in the years 2007-2009. 2187 of these requests are individual requests. The remaining 504 cases are cases in which at least two employees are involved. That is, 504 requests were filed by the employer to dismiss more than one employee. The majority of these requests involved 2 to 4 employees, 23 requests concerned at least 20 employees. In total 5359 employees were involved. Figure 5 gives a graphical presentation of these numbers.

Figure 5 Dismissal requests filed at the labor inspectorate in Maastricht 2007-2008



of taking the date at which the bill was made publically available, the date of the enforcement of the law is taken as the modification date. For example, the bill for the Law Flexibility and Security is introduced March 7, 1997. The law came into force January 1, 1999. Hence, January 1th 1999 is taken as the modification date. Because the establishment of the "Commission Dual Employment Protection" in 1999 and the establishment of the "Commission Labor Force Participation" in 2007 did not lead to the introduction of new laws these events are excluded from this analysis. The same holds for the "Labor Force Participation Meeting" held in 2007. V_{2t-n} is the vacancy rate at time *t-n* and ε_{2t} is the random error. None of the estimators for the lead vacancy rates are significant. This is a first indication that the direction of causation flows from employment conditions to EPL and not the reverse.

The data contains information about the gender, age and tenure of the employee. Furthermore, whether or not the employer is given a dismissal permission, the reason of dismissal and the sector in which the employer operates are known. The reason of dismissal is classified into six categories: *1) economical, 2) malfunctioning, 3) sickness absenteeism, longer than two years, 4) disturbed employment relation, 5) reproachable behavior* and *6) other*. Combinations of categories 1 to 5 belong to category "other". Additionally, refusing to cooperate with reintegration measures during sickness and serious scruple are classified as category "other". The sector in which an employer operates is divided into eight categories: *1) industry, 2) building industry, 3) wholesale trade, resale trade and repairs, 4) hotel and catering industry, 5) transport, storage and communication, 6) commercial services, 7) health and wellness* and *8) other*. Table 5 presents individual level descriptive statistics. It distinguishes between employees involved in individual dismissal requests and employees involved in collective dismissal requests. The percentage of dismissal permissions granted is 70% and is equal for both groups.[15] The percentage of requests that is withdrawn is 23% for individual requests and 27% for collective requests. Requests may be withdrawn because the employer is unable to provide the labor inspectorate with the necessary documentation or because the employer no longer intends to dismiss the employee. Additionally, in some occasions the employer and the employee reach an agreement about the termination of the employment contract and the labor inspectorate no longer needs to interfere. The percentage of males involved in individual dismissals equals 45%, for collective dismissals this percentage is 67%. Collective dismissals only occur due to economic reasons; the reasons of dismissal most common in individual dismissal cases are economic circumstances or sickness absenteeism that has lasted longer than two year. Regarding the sector in which the employer operates it is seen that 21% of employees involved in individual cases is working in the health and wellness sector, 11% is working in the industry sector. For employees involved in collective dismissal cases these percentages are 5% and 33%, respectively.

[15] If an employer files a request for e.g. 20 employees, the UWV reviews each individual case. As such, it is possible that permission is not granted for one or more employees.

Table 5 Descriptive statistics

	Employees involved in individual dismissal requests (N=2187)				Employees involved in collective dismissal requests (N=3172)			
	Sum	% of total (2187)*	Mean	Standard deviation	Sum	% of total (3172)*	Mean	Standard deviation
Number of dismissal permissions granted	1540	70%			2217	70%		
Number of requests refused	121	6%			71	2%		
Number of requests withdrawn	512	23%			883	27%		
Male	988	45%			2003	67%		
Female	1199	55%			1169	33%		
Age			41.60	97.88			43.28	10.68
Tenure in months			114.28	99.82			117.30	107.02
Size of employer								
Less than 10 employees	516	24%			508	16%		
Between 10 and 100 employees	1216	56%			2068	65%		
More than 100 employees	429	20%			539	17%		
Dismissal reason (dummies)								
economical	727	33%			3166	100%		
malfunctioning	103	5%			0	0%		
sickness absenteeism, longer than two years	1119	51%			0	0%		
disturbed employment relation	58	3%			0	0%		
reproachable behavior	111	5%			0	0%		
other	69	3%			6	0%		
Sector employer								
industry	245	11%			1058	33%		
building industry	150	7%			213	7%		
wholesale trade, resale trade and repairs	507	23%			739	23%		
hotel and catering industry	69	3%			101	3%		
transport, storage and communication	96	4%			216	7%		
commercial services	471	22%			541	17%		
health and wellness	450	21%			147	5%		
other	199	9%			157	5%		

* Due to missing cases, percentages do not always add up to 100%.

B. Model

In order to determine when the labor inspectorate is most likely to grant dismissal permission all withdrawn requests are excluded from the data. Furthermore, for 18 dismissal cases the labor inspectorate had not passed judgment at the time of data gathering. These cases are also excluded. The following probit model is estimated:

$$P_i = \alpha + \beta V_i + \delta S_i + \eta C_i + \upsilon X_i + \theta R_i + \psi I_i + \varepsilon_{i,} \qquad (2)$$

,where P_i is a dichotomous variable that receives the value 1 if a dismissal permission is granted and 0 otherwise. V_i stands for the adjusted vacancy rate, S_i is a categorical variable indicating the size of the employer. It receives the value 1 if the employer employs less than 10 employees, the value 2 if this number is between 10 and 100 and 3 if the number of employees is above 100. The unit of analysis of the model is the individual employee. As mentioned earlier, in a collective request due to economical reasons the labor inspectorate reviews the request for each individual employee involved. Although the labor inspectorate may decide that the employer is indeed in financial distress, for some employees dismissal permission may not be given. Often, these individual employees are not the first in line to be fired according to the reflection - and the lifo principle. C_i indicates whether the request is part of a collective request. It is a dichotomous variable receiving the value 1 if at least two employees are involved, 0 otherwise. X_i stands for a set of employee-specific variables such as tenure, age and gender. R_i is a set of dichotomous variables that indicate the reason of dismissal, I_i is a set of industry dummies. The reasons of dismissal and the different industries are given in table 5 above. Table 6 displays the results. It shows that the likelihood permission is granted increases with increasing vacancy rates. This implies that during times that are more favorable to workers, the labor inspectorate is more likely to decide in favor of the employer. These results seem plausible and are consistent with the results of Ichino et al (2003). Moreover, these results imply that the rigidity of the labor market is not alone dependent on a set of laws that determine under which conditions an employee may be dismissed, but rigidity also depends on the judgment of the labor inspectorate.

Table 6 Probit estimates, dependent dichotomous variable: permission granted (1=yes, 0=no).

Independent variables	**Probit**
Adjusted vacancy rate	.0176*** (.0035)
Size of employer (1=<10, 2=10-100, 3=>100)	-.2019*** (.0328)
At least two employees involved (dichotomous)	.1280** (.0603)
Tenure in months	.0010*** (.0002)
Male (1=male, 0=female)	.0664 (.0444)
Age	.0039* (.0021)
Dismissal reason (dichotomous)	
economical	.4392** (.1764)
malfunctioning	-.2325 (.2223)
sickness absenteeism, longer than two years	1.1000*** (.1762)
disturbed employment relation	.1726 (.2552)
reproachable behavior	.2221 (.2133)
Line of business employer (dichotomous)	
Industry	.1576* (.0904)
building industry	.1870 (.0904)
wholesale trade, resale trade and repairs	.2008** (.1327)
hotel and catering industry	-.2698** (.1327)
transport, storage and communication	.2006* (.1160)
commercial services	-.1080 (.0898)
health and wellness	.0479 (.1024)
Log likelihood	-2648.7152
N	4962

The size of the employer also matters. The larger the employer, the smaller the likelihood permission is granted. Additionally, a request for an employee involved in a dismissal case in which at least one other employee is involved has a larger likelihood of being granted. Other estimators that are positive

and significant are the estimators for tenure, dismissal due to economical reasons and dismissal due to sickness absenteeism that has lasted longer than two years. The reference category for the reason of dismissal is “other”. Regarding the sector in which the employer operates table 6 shows that the likelihood permission is granted is the largest in the “wholesale trade, resale trade and repairs” industry and the lowest in the “hotel and catering” industry.

VI Conclusion

The duality of the Dutch dual employment protection system has its origins in the 1950’s. Ever since, attempts have been made to modify the dual system. The abolishment of one of the two routes was never accomplished. However, different EPL modifications were introduced throughout history. This study examined those modifications introduced in the period 1997-2009. Alle examined modifications intended to decrease labor market rigidity. We find that the likelihood a modification is introduced increases with increasing vacancy rates. These results are consistent with Saint-Paul’s (2002) model. We moreover find that the direction of causality runs from changes in labour market conditions to changes in EPL, and not the reverse.

Often, the laws concerning employment protection are used as a proxy for labor market rigidity. The more regulations and procedural inconveniences, the stricter the classification of EPL. However, procedures and regulations need to be interpreted by the institutions enforcing the law. In the end, these institutions decide whether dismissal permission is given or not. We examined the labor inspectorate route. Although the labor inspectorate has a checklist with criteria a dismissal request should fulfil, the decision to grant permission is never fully objective. Our analysis shows that the labor inspectorate is more likely to grant permission in times of increasing vacancy rates. That is, the likelihood that the labor inspectorate decides in favour of the employer increases during times that are more favourable to employees. These results indicate that labour market rigidity is dependent upon employment conditions.

Our analysis would have been more complete if we could have conducted an equal study for the civil court. However, data on individual civil court dismissal cases is still being collected. We hope to have collected this data at the end of June 2010.

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