

# **DISMISSAL RULES AND COSTS: BALANCING EFFICIENCY AND EMPLOYEE PROTECTION**

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# Contents

## INTRODUCTION / 4

### 1. EXCESSIVELY RIGID EMPLOYMENT PROTECTION LEGISLATION HAS UNDESIRABLE EFFECTS ON THE LABOUR MARKET / 4

- 1.1. Flexible dismissal rules incentivize job creation, turnover and overall efficiency and productivity / 4
- 1.2. Strict EPL rules may increase the duration of unemployment / 4
- 1.3. Rigid dismissal rules may lead to increased labor market segmentation / 5
- 1.4. High dismissal costs and rigid dismissal rules may force employees into the informal sector / 5

### 2. GENERAL OVERVIEW OF THE SELECTED CEE COUNTRIES' REGULATIONS / 5

### 3. ANALYSIS OF THE NATIONAL LAWS OF THE SELECTED CEE COUNTRIES AND THEIR IMPLICATIONS / 6

- 3.1. High dismissal costs discourage job creation and reduce job turnover and may force out less well-off companies out of the market / 6
- 3.2. Derogations from general dismissal rules unjustly discriminate other employees on other grounds than their competence / 7
- 3.3. Bringing dismissal rules closer to practice may ensure greater benefits to both employees and employers / 8
- 3.4. Allowing dismissal on other than economic reasons reduces indirect costs and would help solving human resources issues as to increase the efficiency and productivity of remaining employees and the company / 8
- 3.5. Collective dismissal procedures restrict the ability to promptly respond to change, which is crucial in the light of the quarantine induced crisis / 10

## CONCLUSIONS AND RECOMMENDATIONS / 11

## BIBLIOGRAPHY / 13

# INTRODUCTION

Changing labor market trends such as greater employee mobility and the growth of the gig economy create the need for greater flexibility in labor relations. In the light of the COVID-19 situation governments around the globe are juggling the aims of ensuring business liquidity and preserving workplaces. Scientific literature and empirical studies demonstrate that more leeway in dismissal cases may provide means for the economy to recover more efficiently that would benefit both employers and employees in the long-term.

Long-run benefits of liberalizing dismissal practices can be expected in the form of higher productivity and economic growth, as increased separations and hiring should foster a more efficient allocation of resources (OECD, 2018). It has often been suggested that the elevated severance pay and job security requirements in Europe are in part responsible for the high unemployment levels in this continent (Kugler and Pica, 2004). Dismissal rules that would be in line with the actual circumstances in the market, e.g. letting go of toxic employees, dismissal costs which are length of notice period and severance pay that would not force the companies into bankruptcy, may reduce uncertainty for workers and employers with possible benefits in terms of attractiveness for foreign direct investment (OECD, 2018).

In addition, many legal systems neglect the importance of the overall work environment as a factor determining the efficiency of the employees, the company as a whole and the economy at large. Generally dismissals are allowed

only on economic and objective grounds (which are defined rather narrowly) thus making it impossible to let go of a toxic hire or an employee who's capacity no longer fits the position. This in turn harms the overall work climate and incentivizes employers to seek legal gaps when considering dismissals.

During the current economic crisis caused by the COVID-19 more relaxed dismissal rules and costs would benefit companies that have directly suffered from the lock-down. More flexible regulations would allow making efficient and timely decisions, saving as many workplaces as possible, adjusting better to economic fluctuations and in turn would ensure more efficient business recovery. Lastly, dismissal procedures and dismissal costs have a significant impact on the overall assessment of state employment flexibility and competitiveness, which in turn may attract more local and foreign investment.

The **aim** of the research is to assess the employment regulations of Bulgaria, the Czech Republic, Estonia, Lithuania, Poland and Slovakia in the light of economic implications of dismissal rules and costs and to accordingly design proposals on how to improve said regulations. Recommendations are aimed at enhancing labor market efficiency and competitiveness. The research employs literature review and analysis, systematization of data, comparative data analysis and empirical research by carrying out an expert interview.

## 1. EXCESSIVELY RIGID EMPLOYMENT PROTECTION LEGISLATION HAS UNDESIRABLE EFFECTS ON THE LABOUR MARKET

### 1.1. Flexible dismissal rules incentivize job creation, turnover and overall efficiency and productivity

Research on the labour market impact of employment protection legislation (EPL) has found that overly strict regulations can reduce job flows, have a negative impact on employment of outsiders, encourage labour market duality and hinder productivity and economic growth (Martin and Scarpetta, 2012; OECD, 2004; OECD, 2007; OECD, 2010). It also reduces job creation (Kugler and Pica, 2004; Millard, 1996). Fewer vacancies implies that fewer job matches take place (Fanizza and Koranchelian, 2005). In European labour markets with more stringent EPL, a larger percentage of the unemployed experiences long-term spells of joblessness; many of the unemployed are young labour market entrants (Cazes, Boeri and Bertola, 1999). Since EPL prevents reallocation of employed workers from less to more productive

jobs, it reduces the overall efficiency of production (Bertola, 2009). Reduced labor market flows may hinder labor force adjustment and the reallocation of jobs, and may thereby slow down aggregate productivity growth (Davis and Haltiwanger, 1999).

### 1.2. Strict EPL rules may increase the duration of unemployment

Since tighter EPL does reduce the propensity to hire in response to labour demand shocks, it makes it more difficult for unemployed workers to re-enter employment: thus, it lengthens unemployment spells (stagnant unemployment pool) (Bertola, 2009). Scientific literature confirms that employment protection reduces inflows to and outflows from unemployment (Kugler and Saint-Paul, 2004; Kugler, 1999, 2004). It is somewhat a paradox that EPL also decreases employers' incentives to fire redundant workers since in-

creasing employment in response to possibly temporary increases in labour demand increases the chance of encountering dismissal restrictions in the future (Bertola, 2009).

Such a situation protects current employees at the account of potential employees, and, most importantly, locks the ability of efficient use of resources. While the inefficient allocation of resources is not always visible and measurable, what the society will see on the surface is an increased duration of unemployment.

### 1.3. Rigid dismissal rules may lead to increased labor market segmentation

Strict protection against dismissal for employees on open-ended contracts is likely to induce labour market segmentation (European Commission, 2017). This is because these factors may create incentives for employers to hire

workers under temporary contracts in order to avoid high firing costs. Moreover, strict regulation against dismissals is usually associated with low hiring and firing rates. These may contribute to higher unemployment rates and longer periods out of work for weaker groups such as young and/or low-skilled workers (European Commission, 2017).

### 1.4. High dismissal costs and rigid dismissal rules may force employees into the informal sector

Liberalization of employment protection is associated with reducing incentives for informal employment and uncertainty for firms and workers (OECD, 2018). Lower dismissal costs encourage legal employment and reduce undeclared work (Loayza, Oviedo and Servén, 2005) in turn ensuring greater employee protection and foreseeability of the labor market.

## 2. GENERAL OVERVIEW OF THE SELECTED CEE COUNTRIES' REGULATIONS

According to the World Bank, the regulation of dismissal varies significantly: the law of the Czech Republic imposed the most rigid regulations, whereas the most flexible regulation is in Bulgaria. The Global Competitiveness Report 2018 suggests similar results; in the global context the selected CEE countries score relatively low.

**Table 1. Scores on hiring and firing practices of the selected CEE countries and highest scoring EU/OECD countries, position by indicator value.**

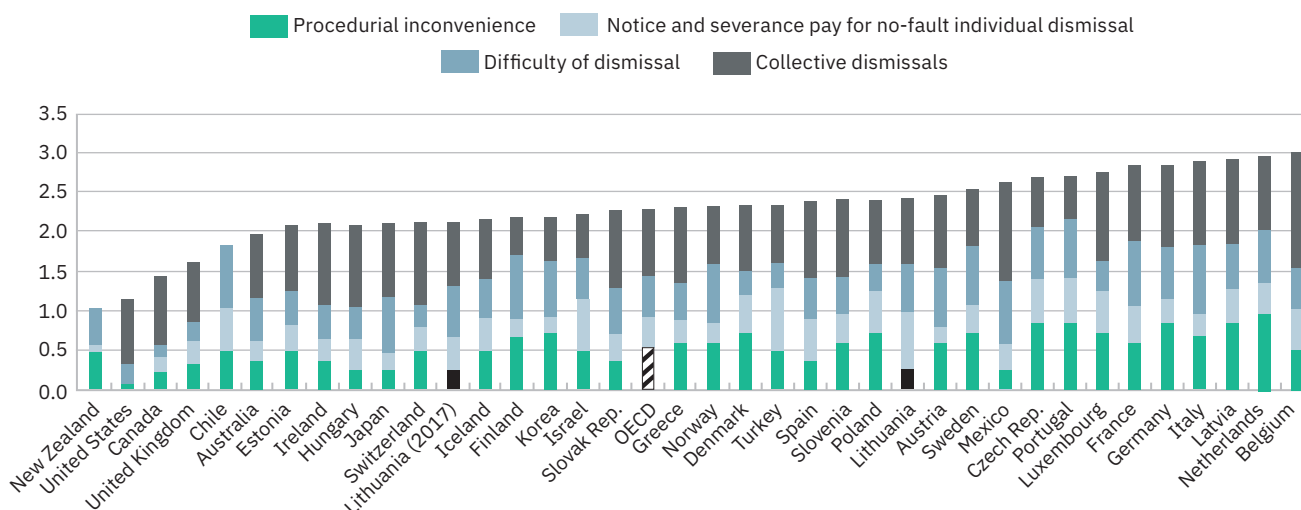
Hiring and firing practices	Score	GCI position (total of 140 countries)
Switzerland	5,7	2
Denmark	5	8
Estonia	4,5	24
Bulgaria	3,8	69
Lithuania	3,6	92
The Czech Republic	3,4	107
Poland	3,3	113
Slovak Republic	3,2	116

*Source:* author's elaboration on the available data of the Global Competitiveness Index (2018). Note: the higher the score – the more flexible regulations are

**Fig. 1. Strictness of individual and collective dismissal regulations**

### B. Strictness of employment protection legislation: individual and collective dismissals

Scale from 0 (least restrictions) to 6 (most restrictions), latest year available\*



*Source:* OECD (2018), *OECD Reviews of Labour Market and Social Policies: Lithuania*

Fig. 1. shows that out of the analyzed countries (and all of the EU) Estonia has the lowest ranking of strictness of EPL in terms of dismissals and is below the OECD average. The regulations of Slovak Republic, Poland and

the Czech Republic may be considered having the most rigid EPL regulations in terms of dismissals that are equal or above the OECD average among the selected CEE countries.

### 3. ANALYSIS OF THE NATIONAL LAWS OF THE SELECTED CEE COUNTRIES AND THEIR IMPLICATIONS

Cumbersome redundancy procedures pose challenges to firms. Requirements may cover notification and approval requirements, retraining obligations, and priority rules for dismissal and reemployment. Hopenhayn and Rogerson (1993) show how the distortion induced by dismissal restrictions pushes firms to use resources less efficiently. As a result, employment levels adjust at a lower speed and productivity is reduced.

#### 3.1. High dismissal costs discourage job creation and reduce job turnover and may force out less well-off companies out of the market

Rigid dismissal rules and severance pay reduce employment: Lazear (1990) finds that severance pay increases unemployment and reduces both employment and labor force participation (confirmed later by Addison and Teixeira (2005). Jobs that are not expected to have a long life are not created when there are high job destruction costs (Pissarides, 1999). In addition, Bartelsman et al. (2004) suggest that stringent layoff regulations might discourage firms from experimenting with new technologies, characterized by higher mean returns but also higher variance, in order to avoid the risk of paying high firing costs.

**Table 2. Comparison of mandatory shortest and longest notice periods**

	Bulgaria	Czech Republic	Estonia	Lithuania	Poland	Slovakia
Minimal (months)	1	2	1/2	1/2	1/2	1/2
Longest (months)	3	Upon agreement between parties	3	1 (tenure) or 3 (based on social group)	3	3

In some instances when there is a necessity of prompt decisions regarding workforce adjustments to keep the company afloat, notice periods may be detrimental. Having that said the regulatory framework should aim to strike a balance between the interests of employees and employers. The labor laws should ensure the possibility for the employers to function in an unfavourable economic climate. In addition, if it is necessary, the employer must be able to reduce his work force at a reasonable cost. In the long-term this would benefit current and potential employees if the company survives the fluctuation and expands.

The minimal notice period is the longest in the Czech Republic as the laws impose at least 2 months of notice period. However Czech laws allow the parties to negotiate particular terms of dismissal, including the minimization of the notice period or even not applying it. Bulgaria comes in second – the laws impose a 1 month (30 day) notice period if tenure is less than 1 year. In Estonia, Poland and Lithuania the minimal notice periods are two weeks. When terminating contracts by agreement Slovakia allows a 2 week notice period, but generally a minimal 1 month notice period is mandatory. However most of the researched countries impose different notice periods based on tenure, except for the Czech Republic. In Lithuania the differentiation is the most leeway – a two week notice period is requested if the tenure is less than 1 year, for a longer tenure the notice period is 1 month (yet, other conditions may apply). Estonia, Slovakia, Bulgaria and Poland request longer notice periods based on duration of tenure. The strictest rules apply in Estonia and Slovakia, where the notice period can go up to 3 months if tenure is more than 10 years and 5 years accordingly. Bulgarian laws also provide a maximum of 3 month notice period, but that may be negotiated by the parties and is not rigidly based on duration of employment. In this sense Lithuania imposes the shortest notice period of 1 month if tenure is over 1 year. However, none of the other countries apart from Lithuania differentiate the notice period on the specific social status of the employee. For example, the general notice period is doubled for employees that have 5 years left until retirement age, and tripled for employees who have children younger than 14 years. Based on the data, Slovak and Estonian laws impose the highest dismissal costs making it more difficult and expensive for companies to change their workforce. Bulgarian laws provide a unique regulation allowing the parties to negotiate the particular duration of the notice period, however it has to be at least 1 month.

Bulgarian laws impose the highest general severance pay of 4 average monthly salaries (not differentiated by tenure). Even though the Slovak Republic and the Czech Republic impose one the lowest minimum severance pay amounts (1 average monthly salary), the final amount is differentiated by tenure and can go up to 3 average monthly salaries in Czech Republic and 5 monthly salaries in Slovakia (for tenure of more than 20 years). Lithuania and Estonia base the required severance pay amount not on the duration of tenure, but on the type of contract or its termination. The minimal severance pay for a tenure of less than 1 year is half of an average monthly salary in Lithuania, and 1 monthly sal-

**Table 3. Comparison of minimal and highest mandatory severance pay**

	Bulgaria	Czech Republic	Estonia	Lithuania	Poland	Slovakia
Minimal (average monthly salary)	2 (unfit to work due to illness)	1	1	½ (for < 1 year)	1 (only for collective redundancies)	1
Highest (average monthly salary, based on tenure)	4	3 (for 3+ years)	Not applicable	2 (for 1+ year)	3 (for 8+ years, only for collective redundancies)	5 (for 20+ years)
Highest (average monthly salary, based on grounds other than tenure)	6 (when the employee reaches retirement age and has 10+ years of tenure)	Not applicable	3 (based on the ground of dismissal)	6 (for termination at the will of the employer)	Not applicable	Not applicable

ary in Estonia. Depending on the grounds of termination of contract, the general severance pay in Lithuania is 2 average monthly salaries, however, dismissing a worker at the will of employers for other than economic reasons would cost 6 average monthly salaries. The latter amount is not possible to compare, because none of the countries allow dismissal at the will of the employer for other than economic reasons.

It is noteworthy, that in all of the research countries except for Poland severance pay is mandatory for all dismissals (except for the fault of the employee). Poland's labor laws require mandatory severance pay only in cases of group redundancies. The amount of pay-out is differentiated in these cases based on tenure, ranging from 1 average monthly salary to 3 average monthly salaries.

Taking into account both notice periods and severance pay, the dismissal costs of, take for example, an employee of a 4 year tenure are the highest in Bulgaria (1 month notice period and 4 average monthly salaries of severance pay). Among the research countries that impose the least rigid regulations on dismissal costs is Poland, which insist on paying severance pay only in cases of collective redundancies, and Lithuania that has the least grounds of differentiating severance pay (general 2 average monthly salaries is required for tenure of over 1 year) and the general 1 month notice period (however it must be kept in mind that the notice period may be doubled or tripled if the employee belongs to a certain social group).

Prolonged notice periods pose indirect costs in a few additional aspects. An expert interview showed that the most severe impact on the company during the notice period is caused by the decrease of employee motivation and quality of work. This affects not only the employee's personal results, but may also harm the overall morale and productivity of the workplace (particularly in cases where the dismissed employee engages in group assignments). In other cases the employee may be inclined to engage in activity to harm the employer's reputation and even cause material damages. To solve this issue some countries allow payment in lieu of notice, however it involves a cost to the employer for which there is no corresponding production or benefit (*Bohemier v. Storwal International Inc.*, 1982). In essence this means that dismissed employees would be entitled to additional severance pay. In other instances

employers may prefer removing the employee from work during the notice period. Some legal systems offer intermediary solutions. During the notice period the Lithuanian Labor Code allows giving the employee a minimum of 10 percent of the former standard working hours to look for a new job with full pay, during which the employee shall retain his or her remuneration. If the parties agree on more than 10 percent of the former standard working hours, payment for this part of the working time shall be decided by mutual agreement. In theory the application of this measure could prevent possible damages to the company, however it's application is restricted and difficult to employ given that it requires the employee's consent.

On average the dismissal costs are the highest in Bulgaria, thus its employers run the highest risk of being forced into inefficiently using resources. This results in being less prone to both hiring new employees and creating workplaces given the possible risk of expensive dismissals. The negative implications of high and rigid dismissal rules further accumulate and may discourage firms from experimenting with new fields and (or) technologies since high dismissal costs may be expected if the experiments do not succeed. This results in less innovation and accordingly may harm the overall competitiveness of the state. An expert interview confirmed that during times of economic downturn mandatory high severance pay may have detrimental effects on the livelihood of the company, and consequently, the economy at large.

In terms of dismissal costs and rules Poland offers an environment that fosters workplace creation and innovation through experimenting with new business forms and technologies. This is due to the fact that generally employees and employers themselves agree on the severance pay, thus on part of the employer dismissal costs are more foreseeable allowing them to better plan their operations.

### **3.2. Derogations from general dismissal rules unjustly discriminate other employees on other grounds than their competence**

Strict notice period regulations, which are differentiated according to duration of tenure, provide greater protection



for employees with longer tenures and encourage the dismissal of workers with shorter tenure despite their qualification (Montenegro and Pagés 2010; Heckman and Pagés 2003). This is typical to the selected CEE countries. Poland, the Czech Republic, Estonia, Slovakia, except for Lithuania and Bulgaria, differentiate their notice periods based on tenure. This has adverse effects on employees working for a shorter period as employers are more inclined to dismiss them in order to save costs when workforce adjustments are needed. On a more general level, it leads to inefficient use of resources and degenerates companies and economy at large.

Lithuania is the only of the research countries that imposes primacy criteria based on specific characteristics. Specific protection when dismissing more than one redundant employee is granted to, e.g., those who were injured at work, parents of children under 14 years, persons with a tenure of over 10 years, and even employee representatives. An expert interview of Lithuanian employers confirmed that due to such primacy rules for certain employees, the employers often are forced to dismiss an employee with a higher qualification but with a shorter duration of tenure or not complying to certain subjective characteristics, because the law prescribes higher costs for dismissing an employee with a lower or improper qualification but with a longer tenure or if the employee belongs to a certain social group. In times where innovation and experimenting with new technologies is a key, such rigid regulations are redundant, since they disincentivize job creation fearing the possible and unforeseeable dismissal costs. It is noteworthy that if the employee no longer fits the position or the particular duty does not correspond with the capacities of the employee, or there is any other mismatch between the needs of the company and the abilities/competence of the employee, the employers of the research countries have no legal means to dismiss such an employee. In times of rapid changes this becomes an intolerable burden and a hindrance to advancement and competitiveness.

### **3.3. Bringing dismissal rules closer to practice may ensure greater benefits to both employees and employers**

The fact that employment rules may not be formally followed (European Commission, 2015; OECD, 2016) may be due to the mismatch with the needs of the market, which gradually form the actual practice. OECD (2018) confirms that bringing firing rules closer to actual practice could reduce uncertainty for workers and employers by making employment relations more foreseeable (OECD, 2018). This means providing more leeway for the parties to determine the particular terms and conditions of the dismissal, also by not establishing such legal restrictions that make it impossible to use certain grounds of dismissal or pose a high risk for doing so.

Another means to bring law closer to practice is to allow the parties to negotiate the outcomes of dismissals - severance pay amounts rather than establishing concrete

amounts in a centralized manner. According to the data of World Bank (2019) countries such as Austria, Belgium, Finland, Iceland, Italy, Japan, New Zealand, Sweden, Switzerland, the United States of America do not regulate severance pay in redundancy cases by law. Said countries are among the top 30 economies according to the Global Competitiveness Index 2019 (GCI) which measures national competitiveness as defined by the set of institutions, policies and factors, determining the level of productivity in the country. GCI covers not only institutional and policy framework, but also takes into account the hiring and firing practices demonstrating that more leeway in dismissal cases contributes to the overall competitiveness and productivity of the country.

In contrast to the aforesaid practice, in all of the research countries redundancy costs are established by law, only in the Czech Republic the parties may override mandatory requirements in their contract. When the law does not regulate the particular cost amounts, parties may decide on the appropriate severance pay and notice period individually, or dismissal costs may be fixed in collective agreements. Fixing said rules in collective agreements would mirror the will of the employees better than having them in generally applicable laws. Also such practice would correspond to the essence of severance pay as a compensation. Such a compensation would reflect the possibilities of finding another job in the specific sector, would also adequately correspond to the value created by labor. In addition, allowing to set dismissal rules and costs in collective agreements would promote social dialogue and cooperation between the employers and employees, could possibly reduce litigation incentives, and increase clarity and transparency in legal relationships.

### **3.4. Allowing dismissal on other than economic reasons reduces indirect costs and would help solving human resources issues as to increase the efficiency and productivity of remaining employees and the company**

Porath and Pearson (2013) found that incivility in the workplace demoralizes people, decreases work effort. The study found that dismissing a toxic hire quickly delivers \$12,500 in cost savings (Housman and Minor, 2015). Such costs are both direct and indirect, generally covering the increase in productivity of other employees. The latter was confirmed in an expert interview carried out in Lithuania.

Dismissal at the employers' initiative is only permissible for objective and (or) economic grounds in all of the research countries; Lithuania allows dismissing an employee at the will of the employer for other than economic reasons. In this context objective grounds are understood as such that prevent the employee from carrying out one's duties, e.g. changes of the health condition, loss of required specialisation or licence, a court sentencing, *etc.*

When terminating employment relations under the law becomes overburdensome, both employers and employees seek legal gaps to reduce their costs and potential tensions



both at the interpersonal and company level. In addition, an expert interview showed that employers tend to select the most convenient dismissal ground based on the length of the notice period and other costs rather than the actual ground of dismissal. The laws of the research countries neglect the significance of the overall work climate in the enterprise as a key factor determining the economic performance both of the enterprise as a singular body and the separate input of the employees. A good working climate is crucial for fostering creativity, productivity and innovation. Therefore every human resources problem, if timely unsolved, acquires definite economic nature, impacts the company's economic efficiency and results. This relates not only to toxic hires, but also to employees that in time become unfit to carry out their duties or the duties no longer match the employees capacity. It accordingly affects the overall efficiency of the company. Therefore these conditions may be determined as objective reasons. The only legitimate option for the employer then is to reallocate the employee within the company as it is prohibited to dismiss such an employee for other than economic grounds. Such a situation in turn incentivizes the employers to seek legal gaps as there is no legitimate ground to dismiss. In practice a redundant employee may only be dismissed for objective reasons, for example, the reorganization of the enterprise that results in abolishing the particular employee's workplace. Even then the employer has to prove that the reorganization was necessary and that there is no other way to keep the employee.

In the aforementioned circumstances allowing the employers to dismiss employees on other than objective grounds or broadening the legal concept of what is considered objective grounds for dismissal would be beneficial. Regardless of being designed to facilitate the efficient reallocation of the employers' resources and improving the work climate, which is of key importance in labour-intensive sectors, the measure is underutilized due to the risks and costs involved. The low level of dismissing employees for other than economic reasons is due to the high risk of litigation after termination or because of the requirement to pay a severance pay of at least 6 average monthly salaries, which is 3 times more than the general severance pay amount in Lithuania.

The key risk that deters employers from employing dismissal at will is the possibility of judicial appeal. There is a prevailing legal presumption common to European countries that the employee must be regarded as the weaker party of the employment relation.<sup>1</sup> Under the jurisprudence of the Court of the European Union this notion means that it is necessary to prevent the employer being in a position to disregard the intentions of the other party to the contract or to impose on that party a restriction of his rights. National regulations may go even further. For example, under Lithuanian laws and court practice the "weaker party" approach implies that any ambiguity must be interpreted to the benefit

of the employee, his (her) protection is a priority and the burden of proof lies on the part of the employer. Therefore when dismissing an employee the employers always face the risk that the decision may be appealed and later decided upon by a judicial body, which *per se* is not impartial as it follows the presumption that the employee is the weaker party and primacy is given to the employee's interests.

In cases where fired employees judicially appeal their dismissal, national courts have discretion on interpreting what constitutes a "just cause" for a dismissal. Therefore it becomes more difficult to precisely foresee the outcomes and costs. Empirically, court decisions are influenced by local labour market conditions, as judges are more likely to decide in favour of worker reinstatement when and where unemployment is high (analysis of Italy's data; Ichino, Polo and Rettore, 2003; Germany analysed by Berger and Neugart, 2006). This might lead to long, costly and uncertain judicial battles, results of which often depend on the subjective appraisal of the randomly assigned judge (Fischman, 2011a, 2011b; Ichino and Pinotti, 2012).

The risks regarding *ex post* review of the dismissal manifest not only in litigation costs. Typically the injured party is rewarded financial compensation (for forced absenteeism) calculated by the average monthly income of the employee. The injured party may also be rewarded non-pecuniary damages, the amount of which lies completely at the court's discretion. In addition the court may order to reinstate the party, which could potentially cause limitless tensions in the workplace. All of these risks are taken into consideration and lead to finding other ways of dismissing an employee, which does not necessarily mean a higher degree of employee protection, rather it leads to even more uncertainty and insecurity. The expert interview for this research confirmed that the majority of employers are reluctant to dismiss employees at their initiative due to the high risk of facing subsequent litigation thus being more inclined to seek legal gaps when dismissing employees.

Allowing to dismiss employees for other than economic and objective reasons would ensure more legal certainty in the labor market and a more efficient use of human resources. In addition, when a toxic employee is dismissed it would result in higher employee satisfaction and better work climate which is crucial in labour-based sectors. The enterprise must function as a unity, and if this unity is somewhat broken, it has a detrimental effect on the overall results. Stringent rules on resolving human resources issues retracts the employer from the company's economic priorities and instead firing procedures and litigation concerns become a key focus. This may have detrimental economic effects on the company. Yet, instead of facilitating these situations rigid labor laws only aggravate them. Allowing to swiftly reallocate human resources would benefit the remaining and potential employees as employers would be less reluctant to hire, knowing that they would not incur inadequate costs for dismissal. Accordingly it is recommended that countries allow dismissal for other than economic and (or) objective reasons and ensure that the regulations would not make it impossible

<sup>1</sup> See, *inter alia*, Joined Cases C-397/01 to C-403/01 *Pfeiffer and others v Deutsches Rotes Kreuz*, ECLI:EU:C:2004:584, para. 82; Case C-429/09 *Günter Fuß v Stadt Halle*, ECLI:EU:C:2010:717, para. 80.

to apply. This implies reducing legal uncertainty and litigation risks by not requesting a “just cause” for termination and reducing the severance amount. An expert interview carried out in Lithuania showed that the litigation risks and amount of severance are the key factors and that such rigid rules force looking for legal gaps.

The “weaker party” approach serves as a preemptive measure to protect workers, which is particularly relevant if the workplace and management culture are poor. Cases of unjust treatment of employees decrease over time, however unfair practices such as undeclared overtime, unofficial remuneration, employee mobbing, forced resignations, *etc.* have not been and possibly will not be completely abolished. Poor work culture may also be a relic of the Soviet era. Even though Post-Soviet countries have shown significant improvements when transitioning to a different economic and legal system, some flaws of the past era still may be characteristics to those economies. Regardless, erroneous work practices cannot be expected to be solved overnight and with severe legal instruments since the whole mentality in the market needed change. On the contrary, practice shows that forceful rigid laws do not always solve said problems, and at times they may even aggravate the maltreatment of employees. In this sense not only rigid labor laws, but also the overall tax environment and social security policy become determinant factors. Therefore the overall labor policy should be aimed at striking a proper balance between the interests of employees and employers, and relaxing those restrictions, which force employers to engage in unfair practice.

### **3.5. Collective dismissal procedures restrict the ability to promptly respond to change, which is crucial in the light of the quarantine induced crisis**

The quarantine forced many employers to significantly rethink their business strategies. Some were able to reorganize their work and respond to the new demand for services and products. Yet others may have had no other option but to reduce their costs and operational scope. This manifested in a growth of individual dismissal and branches closing down. It is unlikely that the need to cut costs will come to a stop in the near future. Even if some countries may avoid drastic depression, the economic and legal uncertainty still remain relatively high. The changes that were necessary in order to survive have led and may potentially continue to lead to more reorganization which can be achieved by closing certain branches, types of production and thus dismissing groups of employees.

Having in mind that collective redundancies are a measure of last resort, rigid rules and high costs of these dismissals may be detrimental to the company. This is due to the fact that even though the procedures of collective redundancies are regulated in detail under the EU law, the outcomes and costs are still difficult to foresee making it accordingly difficult for the employer to plan its actions.

Under relevant EU legal acts, the employers are obliged to inform and consult employee representatives and govern-

mental institutions well in advance. Firstly, EU law requires to inform employee representatives “in good time” about the projected collective dismissals. In addition EU law requires to consult the workers’ representatives with a view to reaching an agreement on at least the ways and means of avoiding collective redundancies or reducing the number of workers affected, and of mitigating the consequences by recourse to accompanying social measures aimed, *inter alia*, at aid for redeploying or retraining workers made redundant. The consultations must also take place and last “in good time”. However the EU law and national laws provide no detail if an amicable agreement is not reached thus enhancing the uncertainty regarding these dismissals. Lastly EU law provides that the collective dismissals shall take effect not earlier than 30 days after their notification to respective governmental institutions.

Member States have discretion to determine what is considered “good time” regarding the advance notice and consultations with workers’ representatives. Some EU Member States use this particular formulation yet other prescribe concrete minimal notice periods. For example, in Lithuania the employee representatives must be informed about plans of collective dismissals at least before 7 work days before consultations, which must be held for at least 10 work days. In addition the respective governmental body must be informed at least 30 days before the planned dismissals. Therefore in Lithuania collective redundancies may take effect not earlier than in 47 days after the need of the dismissals arises. Such a duration significantly restricts the enterprises’ ability to promptly adapt to economic change. Moreover it results in even more costs which possibly are covered at the expense of the remaining workers or may lead to the risk of bankruptcy. In addition the enterprise incurs indirect costs that manifest in the form of redundant workers being less motivated and productive that affects the company’s overall efficiency.

In contrast, Estonia requires that the notification and negotiations occur “in good time” which is a more preferable option because it allows leeway for the respective parties to act in accordance with the particularities of the situation and it allows for more timely decisions to be made.

The COVID-19 induced economic crisis puts collective redundancy and dismissal procedures in general into question as the value of the additional costs (such as information and consultation) become significantly higher compared to ordinary economic circumstances. This is particularly evident in cases where businesses were forced to significantly reduce their operations or even completely close down, meaning that not only there was no income, but that the mere existence of the company caused damages each day. Such a situation calls for balancing flexibility in human capital reallocation and the protection of workers. Attempting to protect employees’ interests through various barriers leads to even greater financial challenges for companies and may even result in bankruptcies, and is therefore more detrimental to employees’ interests than flexible human capital planning and decision making.

# CONCLUSIONS AND RECOMMENDATIONS

**1. Efficient human capital allocation ensures the company's viability and preconditions its development which in turn benefits current and potential employees.** To the extent that the dismissal restrictions reduce the enterprise's ability to respond to structural and demand changes, to use the workforce efficiently (which implies employing the maximal potential of each employee as to bring most mutual benefits) it inevitably reduces the firm's efficiency and viability. This applies to the whole economy on a larger scale. Inefficient use of resources means that there will be a threat of unemployment in the future. Therefore "artificial" restrictions that do not ensure a proper balance between economic interests and employee protection, and which do not reflect the actual market processes ultimately harm the interests of employees as their incomes may decrease and their unemployment risk becomes higher.

**2. Relaxed labor regulations that balance the interests of both employees and employers ensure a more foreseeable market and foster development that offers more employment options.** Rigid rules and prolonged procedures restrict the enterprises' abilities to promptly respond to fluctuations which are crucial in the light of the current economic state. More relaxed dismissal rules would accommodate efficient reallocation of resources, by allowing efficient and timely decisions. In turn this would incentivize new job creation and innovation. More relaxed rules would also allow to save as many workplaces as possible and to better adjust to economic fluctuations and would ensure more efficient economic recovery.

**3. Ensuring a proper work climate benefits both the employees and the company as a whole.** Expanding legitimate grounds for dismissal at the will of the employer for other than economic and (or) objective grounds would be particularly relevant in cases of toxic hires and promptly responding to economic fluctuations. This is due to the fact that every human resources problem may become an economic problem as the overall working atmosphere is crucial for fostering creativity, productivity and innovation, especially in labour-intensive production economies, which currently prevail. A poor working climate may be caused not only by toxic hires, but also by employees who no longer fit their position or the particular duty no longer fits the employee's competences. However the laws do not provide for legitimate solutions apart from reallocating the employee. Out of the researched countries only Lithuania allows such type of dismissals, thus other research countries are recommended to add grounds of dismissal at the employer's will for other than economic and (or) objective reasons. The understanding of what constitutes objective economic reasons for dismissal should be broadened as well. Practice shows that dismissal at will is rarely applied

due to the high actual costs and potential risks. Therefore it is recommended to set rules, which would be possible and efficient to apply practically. The potential risks and costs refer to the possible legal costs if the employee appeals the dismissal since judicial bodies, and not the employer, determine whether the dismissal ground was just.

**4. Regulations that do not correspond with the actual needs of the labor market decrease the level of employee protection.** Regulations typically do not correspond to the actual needs and processes of the labor market forcing both employers and employees to seek legal gaps. Thus it would be feasible to allow determining dismissal rules and costs under sector-specific collective agreements that would best reflect the actual state in the labor market and would voice out the opinions of employees and employers. Such changes may result in incentivizing job creation, and increase efficient job turnover. In this sense EPL should not be given the absolute priority, rather measures to ensure and foster the balance between sound economic processes and employment protection should be established.

**5. Mandatory derogations from general employment rules incentivize unjust discrimination among employees and aggravate the problems of a particular employee groups face.** Derogations from general dismissal rules based on tenure or belonging to a specific group unjustly discriminates against other employees. Higher severance pay and longer notice periods based on tenure make the dismissal of this employee more expensive, therefore the employers are more inclined to dismiss employees with a shorter tenure (or not belonging to the protected group) to save costs. In practice this leads to a situation where primacy is not given to professional competences and the added value. In turn, more restrictions to dismiss persons belonging to a certain group, e.g. those close to retirement age, parents with minors, may not necessarily protect them. Employees may be reluctant to hire said persons knowing that their dismissal would be difficult and expensive.

Unreasonably long notice periods coupled with severance pay that is differentiated by length of tenure lead to unjust discrimination of more recent employees, since they would be cheaper to dismiss comparing to employees with a tenure of over 1 year. Thus the research countries are recommended to abolish differentiation of notice periods based on tenure. Even though the Czech Republic requires one of the longest minimal notice periods (2 months), the laws allow to disregard the notice period if the parties agree. Other research countries only allow compensating the employee in lieu of notice. This unjustly increases the costs of dismissal and forces the employers to seek legal gaps, therefore allowing the parties to revoke the notice period is recommended.

**6. Rigid labor laws rarely protect those whom they aim to protect, instead disproportionate regulations, such as high dismissal costs discourage the employer from creating new workplaces and employing new personnel.** The estimation of costs plays a significant role when planning further operations and possible development of the enterprise. When enterprises face the risk of high dismissal costs they are less inclined to create new workplaces or employ new personnel. High dismissal costs also discourage from experimenting with new operations or technologies resulting in less innovation, which is directly linked with the overall competitiveness of the country. In addition, indirect costs also restrain decision making. **High risk of litigation** incentivize seeking legal gaps, this is particularly relevant when judicial bodies intervene in determining whether the ground for dismissal is “just”. Moreover prolonged notice periods pose additional costs as during this period employees may be less motivated and productive. Overall such regulations restrict the efficient use of human capital. This could be solved by establishing measures that better balance economic interests and employee protection.

**7. Mandatory dismissal requirements that exceed the financial capacity of companies force less well-off companies into economic decline and disrupt their functioning.** As economic fluctuations occur companies are forced to take out loans not only to maintain a certain level of operations and to cover the salaries of their employees. As costs of operations accumulate, high dismissal costs lead to greater debts, the company’s liquidity decreases. This in turn hinders the possibility for the company to swiftly get back to its regular economic conditions. Ultimately rigid rules and high costs may force the struggling companies to go bankrupt, which means that all of the employees lose their source of income. Thus it is recommended to allow the employers and employees to negotiate the particular costs of dismissals each time individually or in collective agreements rather than having mandatory amounts established by law.

Another option to facilitate the company’s economic recovery when the employer does not have the resources to provide employees with work or remuneration, would be the minimization of the notice period. Unreasonably long notice periods coupled with severance pay that is differentiated by length of tenure lead to unjust discrimination of more recent employees, since they would be cheaper to dismiss comparing to employees with a tenure of over 1 year. Thus

the research countries are recommended to abolish differentiation of notice periods based on tenure. Even though the Czech Republic requires one of the longest minimal notice periods (2 months), the laws allow to disregard the notice period if the parties agree. Other research countries only allow compensating the employee in lieu of notice. This unjustly increases the costs of dismissal and forces the employers to seek legal gaps, therefore allowing the parties to revoke the notice period is recommended.

**8. Rules on collective redundancy rules restrict the possibilities of companies to reorganize and reinvent their operations.** To cope with the challenges associated with the quarantine many companies had to significantly cut their costs and scope of operations. So far this has led to an increase of individual dismissals, yet further adaptation to the current economic climate may precondition a need for collective dismissals. Current regulations restrict the possibilities of businesses to promptly respond to economic fluctuations forcing them to find alternatives, which result in a decrease of employee protection. In addition both the company and remaining employees may suffer from the lack of motivation and productivity of the dismissed employees. It is noteworthy that at time of crisis the value of dismissal costs is much more significant compared to an ordinary economic climate. In this context it is recommended to balance the economic sustainability and employee protection by ensuring such a framework that would allow efficient and timely decision making. Since the rules fall under the EU regulation, certain revisions should be made at the EU level for reducing the mandatory prior notice period. Reduced notice periods would ensure more possibilities to respond to economic shocks and keep the company viable in the short-term, it would also allow to save as much of existing workplaces as the company can financially retain. In the long-run such efficient allocation of human capital would facilitate the company getting back to its regular economic state. Accordingly more workplaces would be created. In contrast, rigid rules and prolonged notice periods increase the company’s costs which are covered at the account of the remaining employees. To retain the workplaces and a certain level of operations, companies are forced to take out loans. If the losses are too high and the operations are no longer profitable, companies are forced to go bankrupt and dismiss all of its employees. On a larger scale, this affects the whole economy as unemployment rises and competitiveness within the market decreases.

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