



ECONOMIC RESEARCH FORUM RESEARCH REPORT SERIES

**LABOUR MARKET INSTITUTIONS, POLICIES,
AND PERFORMANCE:
FLEXIBILITY AND SECURITY IN TURKEY**





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Anıl Duman

Koç University - TÜSİAD
ECONOMIC RESEARCH FORUM
<http://eaf.ku.edu.tr>

February 2014

(Yayın No: ERF-RR/14-01)

Rumelifeneri Yolu 34450 Sarıyer / İstanbul
Tel: (0212) 338 18 34 o Faks: (0212) 338 18 37

February 2014

(Yayın No: TÜSİAD-T/2014-03/550)

Meşrutiyet Caddesi, No: 46 34420 Tepebaşı / İstanbul
Telefon: (0212) 249 19 29 o Faks: (0212) 249 13 50

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ISBN: 978-9944-405-99-7

Kapak Tasarımı: Kamber ERTEM

Grafik Tasarım:
SİS MATBAACILIK PROM. TANITIM HİZ. TİC. LTD. ŞTİ.
Eğitim Mah. Poyraz Sok. No:1/14 Kadıköy - İSTANBUL
Tel: (0216) 450 46 38 Basım CB Basımevi: (0212) 612 65 22

PREFACE

Koç University-TÜSİAD Economic Research Forum (ERF) is a research center formed jointly by Koç University and the Turkish Industrialists' and Businessmen's Association. Established in 2004 as a non-profit and non-partisan organization, the Economic Research Forum focuses on promoting independent and objective analysis on economic growth and discusses the implications of different economic policy options.

In today's rapidly changing economic environment, the global economic structure exhibits a rapid transformation. It is crucial to attune with this economic transformation and wisely fill in the gaps emerging from it. The promise of the new economic setting has transformed how agents view economic relations and unlocked a decision-making process to an innovative set of precedence. With the expanding complexity and interdependence and information-rich environment, policy-making for faster economic growth requires new approaches and fine-tuned calibrations based on longitudinal analyses, rather than rough designs. With these ideas in mind, the business and academic community have joined their forces to launch a new forum on economic research in Istanbul.

The report titled "LABOUR MARKET INSTITUTIONS, POLICIES, AND PERFORMANCE: FLEXIBILITY AND SECURITY IN TURKEY" is prepared by Anil Duman and published as a part of Economic Research Forum Research Report Series.

February 2014

ABOUT THE AUTHORS

ANIL DUMAN

Anil Duman is currently employed at Yaşar University and a research affiliate of Koç University-TÜSİAD Economic Research Forum (ERF). Her primary research interests are on labour market risks and their relation to individual policy preferences. She has been involved in several collaborative projects focusing on social policy across old and new members of European Union as well as a number of developing countries.

She is currently teaching at Yaşar University and has taught at CEU and Istanbul Bilgi University in previous years. Her recent publications include topics such as beliefs and redistributive preferences, insider-outsider cleavages, and skill formation. She obtained her MA and PhD in Economics from University of Massachusetts, Amherst, and her undergraduate degree from Middle East Technical University.

ABSTRACT

The report aims to delineate the impact of labour market institutions and policies on performance. When the widely-accepted view that rigid labour markets and generous social protection systems lead to worse labour market outcomes has been tested empirically, the findings are mixed. This has led to a debate over whether labour market institutions and policies can explain the cross-country variation in labour market performance and, if so, which institutions and policies matter. Although, there is a long standing literature on these issues, most of the developing countries, including Turkey, has been left out of empirical tests, partly due to data problems. Thus, the main goal of the report is to gather data on various aspects of labour markets and systematically analyze them to identify the institutions and policies that help to improve the labour market outcomes in Turkey. Whenever possible the experiences of other emerging economies will be presented to understand different approaches to flexibility and institutional rigidities.

To this end, the report examines the relevant indicators in each area under consideration; namely institutions, policies, and outcomes in Turkey. On the institutional front, wage coordination and collective bargaining, union density, and government regulations in wage setting are the taken as the core fields. For the policy indicators, strictness and implementation of employment protection legislation, generosity of unemployment benefits, passive and active labour market policies as well as tax wedge on labour are considered. The outcomes are measured by unemployment, employment, and inactivity rates among different labour market groups, labour costs and its components, and degree of informality. Finally, for comparative purposes, the flexibility and security measures in Turkey are situated against some of the other emerging market economies.

The analysis suggests that the labour markets in Turkey are characterized by low degree of institutionalization and weak social dialogue. As a result, coordination over important reforms is hard to achieve. Moreover, the employee voice is deteriorating over time, hence rendering the social dialogue systems as haphazard and ineffectual. Yet, the Turkish labour market also suffers from rigid regulations for insiders. Nevertheless, given the looming informal sector, imbalances across groups, and extremely limited safety nets and activation policies, the Turkish labour markets are faced with excessive deregulation on the one hand and inflexibility on the other hand. The relatively low level of improvement in unemployment and skill upgrading, and high degree of inactivity and

informality, particularly among women, are taken as reflections of flexibility without security in the report. Moreover, relatively high levels of severance pay, rigid work time arrangements and several entry barriers for younger cohorts restrain the labour market's adaptability to changing environment. Overall, when evaluated against a number of emerging market economies, Turkish labour markets are found to be inflexible and insecure, which is the least desirable combination as neither the employees nor the employers could benefit from such a setting.

A number of policy reforms including more comprehensive and generous social protection, coordination between education system and labour market needs, and making formal sector more attractive, are needed to correct for these shortcomings.

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S E C T I O N
1

INTRODUCTION

The relationship between labour market institutions, policies, and performance is traditionally approached from two angles. On the one hand, institutions and policies are viewed as impediments to growth and employment, and on the other hand, they are seen as necessary measures to provide insurance and protection for the most vulnerable groups. According to the first perspective, any form of regulation can distort the market and move the wages away from being equal to their marginal product. Besides, the responsiveness of the labour markets is curtailed as a result of institutions and policies, and hence the adjustments are much slower or incomplete. Lastly, institutions and policies transfer rents from employers to employees via unions and public employment schemes (Calderon et al., 2007). Therefore, reforms aiming deregulation are necessary to bring the labour demand and supply back to the equilibrium, and to boost the economic performance.

However, it has been recognized that labour market institutions and policies have significant distributional roles, and can be efficiency enhancing through insuring workers against numerous market risks. Additionally, for increasing aggregate demand and hence economic growth such regulations might prove to be useful. The employers could be pressured and encouraged to invest into productivity rising techniques when institutions and policies are in place (Freeman, 1993). This can be achieved by gaining competitiveness through improvements in human resources and innovations instead of simply cutting costs. Finally, social security and labour standards enhance effort levels, and help to match the skills better. Therefore, across the board deregulation is not advisable and the institutions that are beneficial for employment and growth should be maintained.

When these competing perspectives are tested empirically, mixed results have been found for each. While several authors show that rigid labour markets and generous social protection systems lead to worse labour market outcomes (i.e. higher unemployment, lower employment, higher inactivity rates), others argue that the institutions and social security systems well preceded the feeble employment records in the countries under consideration. Moreover, the mechanisms through which labour market institutions and policies affect individual incentives are found to work in opposing directions. Thus, delineating the impact of regulations on labour market performance remains to be an open empirical question. Also, most of the research in the current era focuses on the complementarities between flexibility and security, which can be attained via well designed institutions and policies. Known as flexicurity, this approach treats the institutions and policies having growth and employment enhancing functions given that they do not hinder the necessary flexibilities of employees and employers.

Another reason for recurring interest in labour market institutions and policies is the varied output and employment rates countries displayed during and after the last financial crisis. Contrary to the expectations that more flexible labour markets would be able to adjust rapidly and recover faster, the best labour market performers happened to be the countries where high internal flexibility was accompanied by social security. The lack of protective measures and weak labour market institutions with high external flexibility, on the other hand, generated high unemployment rates (Watt and Leschke, 2010; Aiginger et al., 2011). Hence, a good combination of security and flexibility appears to be positively contributing to the growth and employment not only during normal times but also acting as an adequate response to negative shocks.

Although, there is a long standing literature on these issues, most of the developing countries, including Turkey, has been mostly left out of the discussion. This is partly due to severe data problems, and partly due to the relative underdevelopment of regulations. A number of crucial labour market institutions and policies are less pronounced or lacking altogether in developing countries. Nevertheless, in most recent years, there are attempts by national and international agencies to analyze the flexibility and security in labour markets, and their link to performance. On average, developing countries have dual labour markets with limited social security coverage and dismal collective bargaining practices. Besides, employment rates tend to be low, and high unemployment rates are recorded especially for particular groups such as younger and female labour market participants.

Turkey is quite comparable with the rest of the developing countries in this regard given its relatively low level of unionization, large informal sector, high underemployment rates, and female inactivity rates. For instance, union density is estimated to be 5.9% in 2011 as opposed to 23% average in EU. Female labour force participation is around 30% and has shown almost a continuous decline since 1990s, only slightly recovering since 2008 (OECD, 2012). Nevertheless, several reforms have passed recently to encourage employment generation and to improve human capital investments. The Employment Package that was approved in 2008 takes the promotion of job opportunities for women and young people to its core. Moreover, several passive and active labour market policies are implemented including unemployment insurance and training opportunities for young employees. In terms of flexibility, 2003 Labour Law is crucial since it decreased the restrictions on temporary contracts, and provided a legal basis for atypical employment. Nevertheless, it has been also criticized for bringing excessive flexibility especially for the smaller firms without compelling them to set protective measures.

There are three main goals of the report, first is gathering comprehensive data on various aspects of labour market in Turkey, and assessing the recent developments in the institutional and policy areas. Second aim is to provide a systematic analysis of regulations in order to identify the appropriate tools that can help to improve the labour market outcomes. The emphasis is given to the impact on employer and employee incentives rather than the aggregate demand management. Since different segments and groups of the labour market do not need to be affected in a similar fashion, an overall assessment is also sought. Third goal of the report is to understand the feasibility of flexicurity approaches in Turkey, and to compare the experience of the country with numerous other developing economies.

The rest of the report is organized as follows. Second section briefly presents the debates about the relationship between labour market institutions, policies, and outcomes with an emphasis on the impact of flexibility and security. The viability of flexicurity in developing countries and recent reforms in this regard in Turkey are also reviewed here. In the third section, the institutional indicators are evaluated and compared to other developing countries. Wage coordination and collective bargaining, union density, and government regulations on wage setting are the taken as the core fields. Fourth section of the report considers the labour market policies, namely, strictness and implementation of employment protection legislation, generosity of unemployment benefits, passive and active labour market policies as well as tax wedge on labour. These policy areas are examined with regards to their role in providing flexibility and security along with the institutions. In section five, labour market performance as measured by unemployment, employment, and inactivity rates, wage distribution and degree of informality is presented, and links between the outcome indicators and the previously mentioned institutions and policies are established. Section six summarizes the findings for Turkey and provides a comparative perspective with a number of emerging market economies. In section seven, conclusions are drawn and few policy recommendations are highlighted.

S E C T I O N
2

OVERVIEW OF EFFECTS OF LABOUR
MARKET INSTITUTIONS AND
POLICIES ON PERFORMANCE

2.1 Do Labour Market Institutions and Policies Matter?

While there is an ongoing debate about the extent labour market institutions and policies play a role in determining labour market performance and direction, it is generally agreed that they have a sizable impact on labour demand and labour supply. The firms' decisions for hiring and firing as well as individuals' ability and willingness to find and accept jobs are shaped by the prevailing institutions and policies. Nevertheless, particular institutions can operate in distinct directions and finding the net impact on the equilibrium of employment or unemployment is rather difficult. For instance, unemployment insurance pulls the reservation wage up but also helps to attain a better skill match. Moreover, the interaction of various institutions and policies becomes crucial, and it is not sufficient to examine the relationship between them and the performance in isolation. It has been shown that several labour market regulations work differently in systems where centralisation and collective bargaining exist than in uncoordinated and decentralised settings.

In the literature there are three main strands that consider the influence of labour market institutions and policies on employment and unemployment. First, it has been suggested that the cross-country unemployment rates and the developments over time in a sample of OECD countries can be attributed directly to institutions and policies (Layard and Nickell, 1999; Elmeskov et al., 1998). While unemployment benefits, high tax wedge and extensive union coverage are found to be increasing unemployment, coordination and active labour market policies (ALMP) have the opposite impact. There are also several institutions and policies that are ambiguously related to labour market performance such as union density and employment regulation.

More recent studies dealing with the employment growth pointed out that certain countries displayed a structural break in the late 1990s and early 2000s in their employment patterns. This can be explained by the alterations in institutions and policies as the availability of part-time jobs and decreasing labour tax rates contribute to employment growth in the Eurozone (Mourre, 2006). Lower employment protection and subsidies to private sector are also loosely related to employment generation. The job flows, on the other hand, are found to be significantly and negatively affected by tight employment protection legislation (EPL). Like EPL, duration of unemployment benefits and more coordinated wage setting also decrease the job reallocation and job creation rates (Gomez-Salvador et al., 2004). The results hold after controlling for the firm characteristics, hence better capturing the importance of the institutions and policies in determining labour market performance.

The second strand evaluates labour market institutions and policies with regards to the macroeconomic shocks. While certain institutions and policies can amplify and prolong the impact of negative shocks, the others can help to overcome via providing wage and employment flexibility. According to these studies, the average unemployment can be explained by the macroeconomic shocks but the cross-country variation is related to the institutional and policy features (Blanchard and Wolfers, 2000). The economies with generous unemployment benefits, strict employment protection, and low levels of coordination suffer from longer periods of high unemployment rates. Since such institutions and policies prevent wages to be flexible, the transitory unemployment becomes permanent or long lasting (Fitoussi et al., 2000; Bertola et al., 2001).

A similar argument is developed for skill depreciation and how particular institutions and policies cause employees to refrain from reallocations in the job market. Macroeconomic shocks might lead to restructuring and destruction of jobs in traditional sectors. When the institutions and policies generate rigidities which decrease job creation or restrict movement of people between jobs, the unemployment spells would be longer and unemployment rates would be higher (Ljungqvist and Sargent, 1998). Long duration of unemployment insurance and lack of ALMPs are some of the examples where the negative effects of macroeconomic shocks on skills will be extended. Thus, in addition to the direct impact of institutions and policies on performance, it is important to account for the transmission mechanisms they produce.

Unlike the above mentioned studies, the third strand considers the interaction of labour market institutions and policies among themselves. The main idea is that there can be complementarities between several institutions and policies, and therefore, the performance should be evaluated by looking at the broader structure than a single area (Coe and Snower, 1997). Given that institutions and policies function in a systematic way, they need to be handled simultaneously, and partial interventions might be more detrimental than status quo. For instance, union density has a positive impact on unemployment only when the bargaining is decentralised and employment protection is insignificant if the wages are set at the national level (Belot and Van Ours, 2004). Similarly, strict EPL, generous unemployment benefits and low level of coordination might be harmful for the labour market performance but the same policies could be beneficial under high coordination. These results suggest that the institutions and policies can alter the labour market outcomes in different ways, and the ultimate response of employment and unemployment depend on the structural constraints and opportunities. Thus, reforming a certain institution or policy, such as labour taxes, might render ineffective if the bargaining conditions and welfare benefits are not altered at the same time.

Even though the literature is rapidly growing, the evidence on the relationship between labour market institutions, policies, and performance is still subject to intensive debates. There is a consensus about the significance of institutions and policies but identification of their exact effects and mechanisms is far from over. This is rather understandable given the different specifications and methodologies used in the studies, the difficulty of measuring institutions and policies, and the impossibility of accounting for all of the interactions between institutions, policies, and shocks (Baker et al., 2005; Freeman, 2005). Besides, the institutional and policy complementarities are not always easy to capture, and the coefficients and sign of the interaction variables are not robust (Bassanini and Duval, 2009).

Such inconclusive results also lead to opposing policy recommendations, while the proponents of flexibility claim that rigidities are at the core of numerous labour market ills (IMF, 2003; OECD, 2006), others suggest that security is efficiency enhancing (Baccaro and Rei, 2007; Howell et al., 2007). Additionally, the last crisis altered some of the views on the direction of necessary reforms as countries from distinct institutional and policy classifications exhibit similar outcomes in terms of employment and unemployment. Partly, in order to reconcile these views and partly learning from the successful cases, more recently the labour market researchers are interested in identifying the optimal combination of flexibility and security instead of advocating a wholesale deregulation or strict protection. The association between flexibility, security, and labour market performance is reviewed in more detail in the below sub-section.

2.2 Flexibility, Security, and Labour Market Performance

Flexibility and security were long seen as contradictory, and the existence of a trade-off between them has been the common understanding. When there are institutional and policy related barriers in the labour market, it is less likely that a desirable adjustment would take place at a rapid pace after an external shock. Thus, flexibility is required to allow labour demand and labour supply to move accordingly and meet at a new equilibrium. However, flexible employment can be quite detrimental for certain groups especially if they do not possess the adequate resources to cope with the transformations (DiPrete et al., 1997; Goldthorpe, 2002). One example is the skill biased technological change, where the low skilled workers are faced with major obstacles in the labour market because the rising sectors generate jobs that require high skills. Employers would slash low skilled jobs when the productivity increases are not sufficient to cover the labour costs, and full adjustment cannot be achieved if there is minimum wage legislation (Acemoglu, 2002; Wood, 1994). Thus, the low skilled employees might be protected against the competitive forces but only with a price of making the labour market more inflexible. The trade-off approach suggests that flexibility and security cannot be attained simultaneously, and labour market institutions and policies are designed to achieve one of these goals.

Nevertheless, there are more recent arguments which refute a trade-off between flexibility and security. In the literature this view is known as flexicurity, which proposes combining the two concepts in a manner to increase adaptability, employment and social cohesion (Wilthagen, 1998; Wilthagen and Tros, 2004). According to this approach, employment protection and social benefits can be restructured so that labour market security and flexibility are both supplied, and the economic performance is not forgone (Auer and Cazes, 2003; Auer et al., 2006). There are a number of reasons why such a shift among the researchers has occurred, and among them recognizing labour as a resource rather than a cost is crucial. In a knowledge economy, investments into human capital are the key for growth and better performance, and without adequate safety measures, such investments would not take place or maintained. If the labour market participants are made employable throughout their life course security and flexibility can be achieved at the same time. This is desirable both for the employees and employers given the specificity of labour contracts. There are many studies showing the positive association between fair wages, satisfaction, and work intensity (Akerlof and Yellen, 1990; Fehr and Gächter, 2001; Solow, 1990). Besides, employees can adjust more easily to changing labour market and macroeconomic conditions when they are given opportunities to accumulate skills and safety nets to rely on during unpredicted economic adversities.

Another major rationale for flexicurity emerged from the country experiences, and particularly the success of the Nordic states in Europe. US with its deregulated and flexible labour market has been discussed as an exemplary model, and for decades, the same policies have been advised to the European economies for solving their acute unemployment and other macroeconomic problems. However, it has been soon recognized that a number of European countries such as Sweden, Denmark, and Finland are able to perform outstandingly in job creation, innovation, and growth without compromises in security. Labour markets in these nations are characterized by generous income security combined with relative liberties for the firms in their employment decisions. For instance, the Danish flexicurity aims to prepare and shield employees for the transitions in the labour market rather than sheltering jobs by offering low levels of employment protection, high levels of income security, and ALMPs (Bredgaard et al., 2005).

Both flexibility and security are multidimensional concepts and thus different combinations of them are possible, and depending on the structural and institutional circumstances, countries can choose various forms of flexicurity. Among the most important types of labour market flexibility, four has been identified, namely external numerical, internal numerical, functional, and wage (Atkinson, 1984). External numerical flexibility indicates the ability of the employers to adjust their workforce, and can be

accomplished by temporary or fixed contracts. Deregulating the employee protection legislation also eases the hiring and firing decisions. Internal numerical flexibility, on the other hand, refers to the adjustments to the working times and schedules for the workers who are already employed. Functional flexibility can be done externally via outsourcing or internally via reorganizing the activities and functions. Finally, wage flexibility is related to the determination and changes in the earnings. Various performance or task based pay systems have been developed to make the firms more flexible in this sense. Additionally, individual bargaining rather than collective bargaining can boost wage flexibility.

Like flexibility, security also includes several dimensions ranging from job security to employment security to income security. While job security tries to maintain a particular job with the same employer, employment security is about remaining in work. Employment protection legislation generally aims the former and many labour market policies such as ALMPs try to attain the latter form of security by endowing the workers with necessary skills and training. Indeed, it has been argued that flexicurity is possible with a shift from job to employment protection as the former generates rigidities that render the labour markets inefficient (Auer, 2007). When there are social policies ensuring a certain level of earnings for workers, income security is provided. Unemployment insurance is the most widespread form of such protection but disability assistance, family allowances, and parental benefits are also relevant for income security.

Given the multiple types of flexibility and security, there are a number of paths countries can opt for. For instance, if we look at the European countries that explicitly implement flexicurity, we can notice the distinctions. In Netherlands, raising flexibility but also the security of workers is at the core of the policy discussions, and as a result the employment relations have been deregulated while measures for keeping a minimum standard for the part-time and temporary workers and dismissal protection were also endorsed (Wilthagen and Tros, 2004). Danish flexicurity, on the contrary, does not aim to provide job security and the hiring and firing regulations are relatively loose. However, there is high level of income security, and there are cases where unemployment insurance reaches 90% of the previously earned wages (Madsen, 2003). Thus, the system is more about enhancing mobility through external numerical flexibility and a combination of employment and income security. As can be seen from these examples, different combinations of institutions and policies are available, and successful labour market performance can be achieved under many forms. Nevertheless, there are stronger institutional and structural barriers in certain countries to find the optimal level of flexibility and security. With this regard, the applicability of flexicurity strategies in developing economies generally, and in Turkey particularly is examined in the following sub-section.

2.3 Towards Flexicurity Strategies in Developing Countries

Before assessing whether flexicurity can be a viable model for developing countries, it is useful to briefly review several components of the model that have been derived from the existing studies. First, labour laws and organizations should be suitable for arranging flexible and secure contracts that are both acceptable to employers and employees. Second, ALMPs should be in place to ensure that individuals are able to positively respond to labour market transitions. Third, life-long learning systems are needed for workers to keep their employability high and for firms to increase their productivity. Fourth, income and mobility should be supported through social security in order to provide a certain standard of living as well as reconciling work and family life (European Commission, 2007). It has been also stated that well established social dialogue practices and mutual trust among social partners are required to implement the referred measures (Viebrock and Clasen, 2009).

In many of the developing countries there is a large informal sector coexisting with a small and secure formal sector. Unlike the developed countries, high levels of flexibility in developing country labour markets are sustained with little or no security (De Gobbi, 2007). The labour markets are usually characterized by self-employment and micro enterprises where unpaid family work and atypical arrangements are common. Besides, the share of agricultural employment is still large although declining in most cases. Thus, the labour laws and regulations have limited coverage, and a significant portion of the labour force is left out of the formal protection regime. The productivity also tends to be much lower in the informal sector, and hence the employers are not keen on introducing any additional costs through security provision to their workers.

Moreover, ALMPs, life-long learning systems, and safety nets are extremely limited in majority of the developing countries. As mentioned above, these components are essential to guarantee the employability of labour market participants and to mitigate the negative effects of transitions. For instance, lack of unemployment insurance can lead to mismatches where people accept jobs that are not suitable for their skills or become self-employed. This might not only deteriorate human capital stock but also generate a group of working poor who are trapped in low productivity-low wage jobs. ALMPs and life-long learning are central to upgrading the skills of the labour force and without them it might be difficult for the unemployed to actively search for jobs. Both rates of underemployment and discouraged workers tend to be high in developing countries, and more importantly individuals exit from the formal markets, and enter into the informal sector.

When we look at the unionization and social partnership, developing countries once again score quite low. The existence of institutionalized relations between employee and employer organizations is seen as an important condition for carrying out the flexicurity instruments (ILO, 2008). While, in Scandinavian countries, union density on average reaches to 70% and collective bargaining coverage is even higher in most instances, in developing economies, the level of membership in unions is meagre and even declining over time. Moreover, the social dialogue practices are quite rare, and there are vital imbalances between the bargaining strength of actors. When they exist, generally they are on an ad hoc basis instead of regular and continual interactions among partners. It is quite unlikely that the employees and employers would be keen on internalizing the costs of labour market adjustments and help to attain mutually beneficial solutions without the proper social dialogue mechanisms.

In this sense, the proper conditions to reach a flexible and secure employment state are mostly missing in developing countries; hence the type of flexicurity that has been proposed for developed countries does not appear to be very easy to implement. Even though recent laws and regulations are passed to provide security along with flexibility in a number of countries, these usually apply solely to the formal sector. Moreover, both employees and employers switch to informal sectors to either cope with the insecurities or circumvent the protective measures. Nevertheless, still models of flexibility and security that are compatible with economic specialization, social values and political choices in these countries can be configured. And, indeed many developing nations are already implementing certain components of flexibility and security in their labour markets. Unsurprisingly there are significant country and regional variances, and these are not only determined by the underlying economic factors and institutional setting but also the governments' choices on different activation and protection policies.

S E C T I O N
3

INSTITUTIONAL PILLARS OF
LABOUR MARKETS IN TURKEY

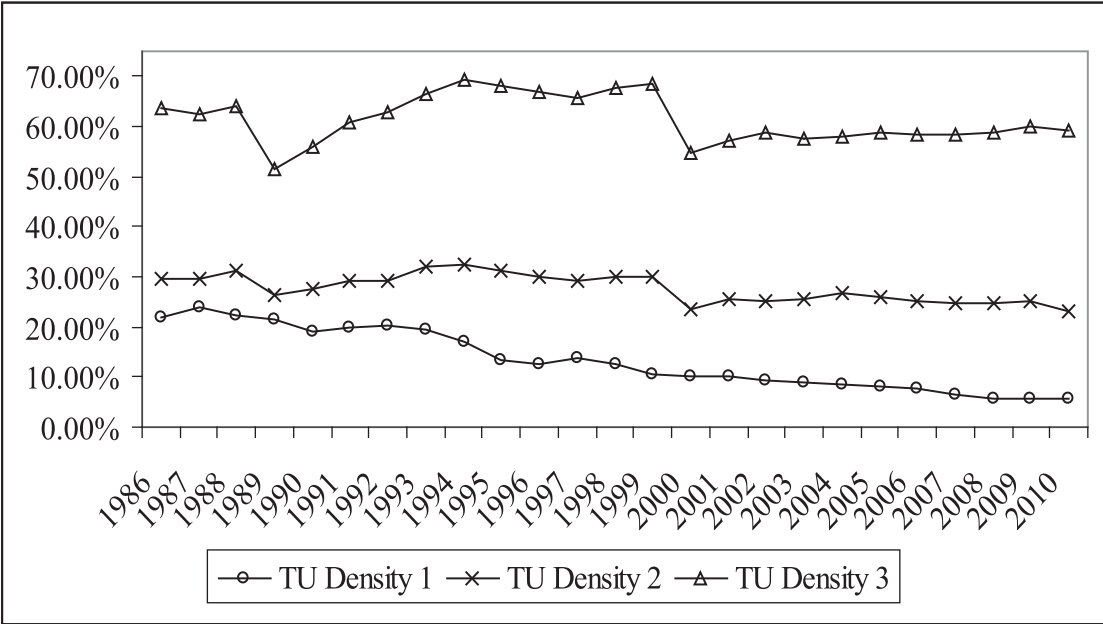
3.1 Trade Unions and Collective Bargaining

Trade unions have not attained an extremely high organizational power in most of the developing countries, and collective bargaining remained limited. Nevertheless, the presence, strength, and structure of trade unions matter vastly for the labour market outcomes and their variation across countries. Given that unions and collective agreements constitute an important pillar of the institutional set up, they significantly influence the effectiveness of labour market policies and performance. In the literature, the relationship between the industrial relations systems and growth as well as inflation has been widely studied. On the one hand, labour market institutions are argued to be reducing the rate of job creation and generating higher unemployment (Salvances, 1997). On the other hand, unions and collective bargaining are found to be positively contributing to growth and employment especially through improving the bargaining results under imperfect information, and advancing cooperative behaviour and coordination (Freeman and Lazear, 1995). Their role in providing security is less controversial since unions are the main organizational tools that employees can push for higher incomes and social protection policies. This part of the chapter first reviews the union density and bargaining coverage in Turkey over time. Also, a brief comparison with the institutional conditions in selected developing countries is presented. Then, their relationship to the selected labour market indicators such as unemployment and real earnings growth are examined in the next part of the chapter. The final part of the chapter looks into government regulations and minimum wage setting in Turkey.

Data on trade union membership in Turkey is highly contentious, and there is a large gap between the figures provided by international organizations such as OECD, ILO, and Ministry of Labour and Social Security (MoLSS). This is partly due to the differences in estimation techniques as the density can be calculated by considering the total number of wage and salary earners or total employment. As defined by ILO, the former looks at the ratio of union members to people in paid employment, and is known as narrow density rate. The latter is comprehensive density rate and includes all types of employment, regardless of formal or informal sector (Hayter and Stoevska, 2011). Since developing countries have sizable informal sectors, comprehensive density rates can be more appropriate in such contexts. MoLSS, on the other hand, uses the employees covered by social security as the denominator, and this is one of the reasons why unionization appears to be relatively high. In Turkey, unregistered economic activity is also persistent thus considering solely the workers covered by social security can lead to severe misrepresentation of unions. Another and more important difference emerges from the membership definition MoLSS uses in its calculations, which does not conform to the

international standards (Çelik and Lordoğlu, 2006). As a result, depending on the source, the density rates and number of union members vary greatly. For instance, in 2007, the density rate was around 6.63% by OECD, 26% by ILO, and 58.4% by MoLSS. Certainly, the inconsistency is too large and this generates significant limitations for any empirical analysis. MoLSS altered its calculation as of 2013 and according to the latest figures, the unionization rate appears to be 8.88%.

Figure 3.1.1 Trade Union Density in Turkey: 1986-2010



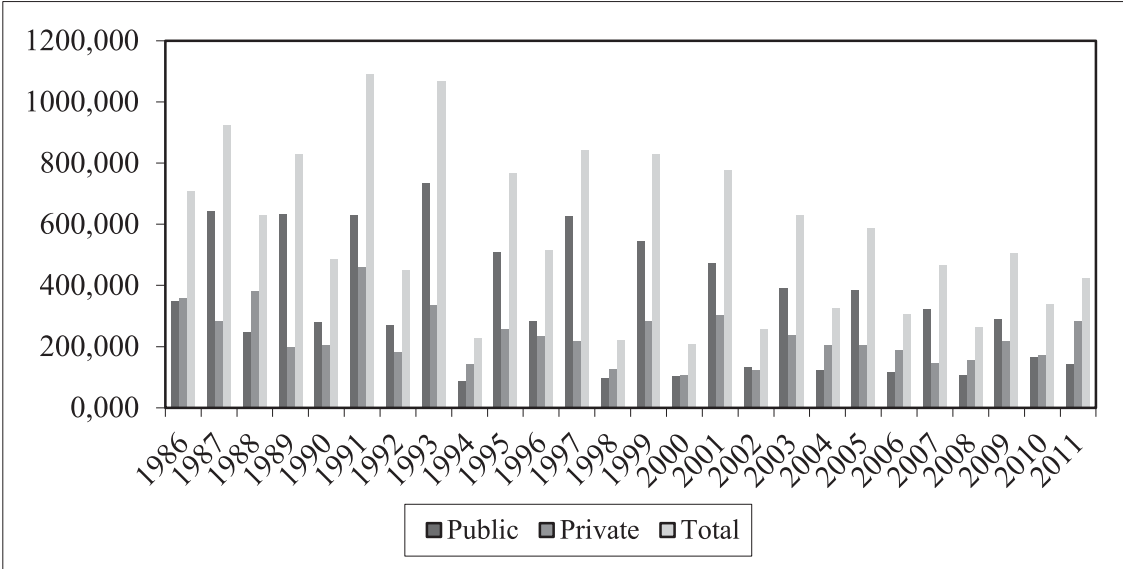
Source: Author's calculations based on OECD (2012), ILO (2012) and MoLSS (2012)
 TU Density 1: membership density according to OECD
 TU Density 2: membership density according to ILO
 TU Density 3: membership density according to MoLSS

Figure 3.1.1 above provides three different density rates (TU1, TU2 and TU3) over time, and even though the severity of decline varies across estimations, it is clear that unions are losing membership in relative terms. TU1, TU2 and TU3 are calculated by using OECD, MoLSS, ILO, and MoLSS density rates respectively. MoLSS uses the membership figures reported by unions and the employed people with social security to estimate density. ILO calculates the density by dividing the number of workers under collective bargaining coverage by total employment. And finally, OECD uses the same methodology but employs the total workforce in the denominator. While the membership numbers according to MoLSS are rising over time, they could not catch up with the increase in either employees covered by social security or total employment. The most severe reduction in union density occurred according to the OECD figures, which shows that between 1986 and 2010, the unionization in Turkey went down from almost 22% to 5.85%. Even the MoLSS data exhibit a decline albeit at a much slower pace, from 63.5% in 1986 to approximately 59% in 2010. Additionally, there are important sectoral differences, for instance unionization rates in health and education are above the average,

and these sectors remained to have better unionization rates over time. For instance, union density reached to 76% in education while the average in public sector was 57.9%. However, the more the sectors are exposed to competition such as leather processing and manufacturing or wood processing and manufacturing, they have lower density, 18.98% and 30.6% respectively according to the latest official figures. It should be noted that the mentioned sectoral rates are derived from MoLSS and are subject to the same criticisms raised earlier. Nevertheless, like in many other countries Turkey is also expected to display relatively greater unionization rates and organizational capacity in protected sectors than exposed sectors.

In addition to the union density, collective bargaining can be explanatory for labour market performance. Besides, given the confusion about trade union density in Turkey, coverage of collective agreements can provide a better understanding of the present institutional conditions. However, the overestimation of membership is partly related to the double threshold that is demanded from the unions (Bakır et al., 2009). Up until the most recent law, unions needed to represent over 50% of all employees in the company and 10% of all employees in the sector to become a bargaining agent. The collective bargaining takes place at the sectoral or industrial level but there is widespread local and company bargaining too. In the absence of accompanying policies, sector level bargaining is claimed to be less efficient since the internalization of costs is partial, and the search process is sub-optimal (Driffill, 2006; Lharidon and Malherbet, 2011). Coupled with lack of any legal provisions to extend the coverage to non-organised firms, Turkey can be said to have a non-centralized bargaining system. Figure 3.1.2 presents the number of workers covered by a collective agreement in total and across public and private sectors between 1986 and 2011.

Figure 3.1.2 Collective Agreement Coverage in Turkey: 1986-2011



Source: MoLSS (2012)

As can be seen from the above figure, there is high fluctuation in the number of employees that fall under a collective agreement and the coverage differs significantly from one year to another. While over the period, the total number of workers covered by a collective agreement decreased from 707,230 to 422,802, the largest amount of employees was reached in 1991. On average, 333,564 employees in public sector were within the realm of collective agreements between 1986 and 2011. In private sector, the average is around 230,348 workers for the same time period despite the fact that there are more people employed in this sector. The picture becomes even bleaker when the coverage rates are considered. While the coverage rate among the employees with social security was around 28.2% in 1987, it declined to 7.7% in 2011. For the same years, the coverage rates are merely 13.4 and 3.07% when the total number of employees is taken into account. Table 3.1.1 provides the details about the coverage rates and changes calculated by each method.

Table 3.1.1 Collective Agreement Coverage Rates and Changes in Turkey: 1987-2011

	Coverage 1 (Employees with social security)	Change 1	Coverage 2 (Total number of employees)	Change 2
1987	28.2%	5.2%	13.4%	2.7%
1988	18.1%	-10.2%	8.8%	-4.7%
1989	23.3%	5.2%	11.8%	3.0%
1990	13.6%	-9.7%	6.7%	-5.1%
1991	31.0%	17.4%	14.9%	8.2%
1992	12.5%	-18.5%	5.8%	-9.0%
1993	28.5%	16.0%	13.7%	7.9%
1994	6.0%	-22.6%	2.8%	-10.9%
1995	19.6%	13.6%	9.0%	6.2%
1996	12.7%	-6.9%	5.7%	-3.3%
1997	20.0%	7.2%	8.9%	3.2%
1998	5.1%	-14.9%	2.3%	-6.6%
1999	19.0%	14.0%	8.3%	6.1%
2000	4.6%	-14.4%	2.0%	-6.4%
2001	17.0%	12.4%	7.6%	5.6%
2002	5.6%	-11.4%	2.4%	-5.2%
2003	13.2%	7.6%	5.9%	3.5%
2004	6.6%	-6.5%	3.0%	-2.8%
2005	11.7%	5.1%	5.1%	2.1%
2006	5.9%	-5.8%	2.5%	-2.6%
2007	8.8%	2.9%	3.7%	1.2%
2008	4.9%	-4.0%	2.0%	-1.7%
2009	9.4%	4.5%	4.0%	1.9%
2010	6.2%	-3.1%	2.5%	-1.5%
2011	7.8%	1.6%	3.07%	0.61%

Source: Author's calculations based on OECD (2012) and MoLSS (2012)

Both the union density and collective bargaining coverage in Turkey lie below the European averages but they do not diverge much from the levels reached in some of the other developing countries. Table 3.1.2 summarizes labour market institutions of selected economies for the latest available year. The union density and bargaining coverage are estimated by using the total number of employees, and in many instances there are official rates are higher than the ILO figures but the difference is largest in Turkey. As can be seen from the table, India, Malaysia, and Mexico have lower density rates than Turkey while the rest of the countries exhibit greater membership ratios. South Africa with its 24.9% ranks the first, and the unionization in this country is comparable to some of the European countries. When it comes to coverage, Brazil is far above the rest of the sample but it should be noted that waged and salaried workers are considered for the estimation as opposed to total number of employees in other countries. South Africa, once again, has higher coverage rate which is around 17.1%. In Turkey collective coverage is 2.73%, which is broader than Malaysia only. Level of collective bargaining indicates at what stage the agreements are signed and whether there is coordination. Turkey, Brazil, and Hungary are recorded to have agreements at the sectoral or industrial level with additional firm level bargaining. Malaysia, Mexico, and Poland, on the other hand, have firm level bargaining as the predominant form. Finally, in India and South Africa, collective agreements are concluded at the national level hence can be viewed as more coordinated. Like the Turkish case, data on wage coordination and extension of agreements are missing for most of the developing countries.

Table 3.1.2 Union Density, Collective Bargaining Coverage, and Collective Bargaining Level

	Density	Coverage	Level
Brazil	17.8	60*	Sectoral or industrial
Hungary	14	-	Sectoral or industrial
India	2.4	-	National
Malaysia	7.6	1.8	Company
Mexico	11.2	6.9	Company
Poland	17.1	11	Company
South Africa	24.9	17.1	National
Turkey	14.6	2.73	Sectoral or industrial

Source: Compiled from ILO (2011) and ICTWSS (2011)

*Collective bargaining coverage is calculated only for waged and salaried workers

3.2 Impact on Labour Markets

In the conventional models, unionization and collective bargaining are argued to affect the flexibility of the labour markets directly both by distorting the competitive wages and employment levels. There are numerous empirical studies trying to identify the exact impact of such institutions on performance across countries. Unions are argued to be detrimental to employment growth as they can elevate the wages above their competitive levels. Additionally, the higher wages in unionized sector can have negative spillovers to the rest of the economy. For instance, if the leading sector is unionized, wages in other sectors would follow the developments in the former, and can also diverge from productivity. However, unionization rates are not high in majority of the developing countries, and the density is even lower among the tradable sectors due to the competitive pressure in the global economy. Additionally, unions can positively contribute to productivity through raising employee satisfaction and workplace motivation. Thus, whether unions increase overall wages and distort the wage-productivity link become empirical questions.

More recently, it has been suggested that unions seek protectionist policies for their members at the expense of the outsiders. There is no clear definition of these groups, incumbent employees with protected positions are considered as insiders and unemployed workers or people employed in non-protected jobs are seen as outsiders (Lindbeck and Snower, 2001). Although union members do not have to be always insiders, they are more likely to have stable occupations with permanent contracts and full time positions, hence can be more privileged. This holds especially for the developing countries where trade unions are organized in protected sectors and do not necessarily attempt to reach to people with precarious jobs. In addition to the large size of informal employment, many workers are excluded from membership and benefits that unions can provide both financially and socially.

Nevertheless, majority of the existing studies found that that union membership per se is not explanatory for macroeconomic variables and labour market outcomes. Once bargaining coverage and bargaining coordination are controlled for, the membership does not matter for unemployment or real earnings growth. Membership levels or rates are also not helpful in accounting for the cross country variation in other macroeconomic indicators such as inflation. At the same time, it has been shown that density is significantly related to wage inequality as unions tend to compress wages, especially for high income earners, hence decrease the overall dispersion (OECD, 1997; Freeman, 1988; Layard et al., 1991). Similar results are obtained for Turkey as well in which union membership increases the earnings more at the lower end of the distribution (Duman, 2012). Increasing wage inequality in some countries is partly attributed to the continual reduction in unionization as implicit and explicit wage floors as well as ceilings disappeared. This is especially the case in private sector where real wages and salaries of unskilled workers

went down while compensation of certain types of occupations such as CEOs, showed dramatic hikes.

Figure 3.2.1 displays the bivariate regression results between union density and unemployment over the 2000-2010 period in Turkey. Figure 3.2.2 repeats the same exercise with union density and real wage index for private sector employees for the same years. In the both figures, union density is used as the independent variable and while the unemployment rate is the dependent variable in the former, the real wage growth is the dependent variable in the latter. One year lagged values of union density are used in the estimations since the effects of membership are expected to occur with a lag. Real wage changes are calculated by deflating the nominal wages with consumer price index. The model turned out to be significant at 1% level with an R² of 0.56 for the unemployment. In the case of real wage growth, union density is not explanatory, and the R² is around 0.16.

Figure 3.2.1 Trade Union Density and Unemployment Rate

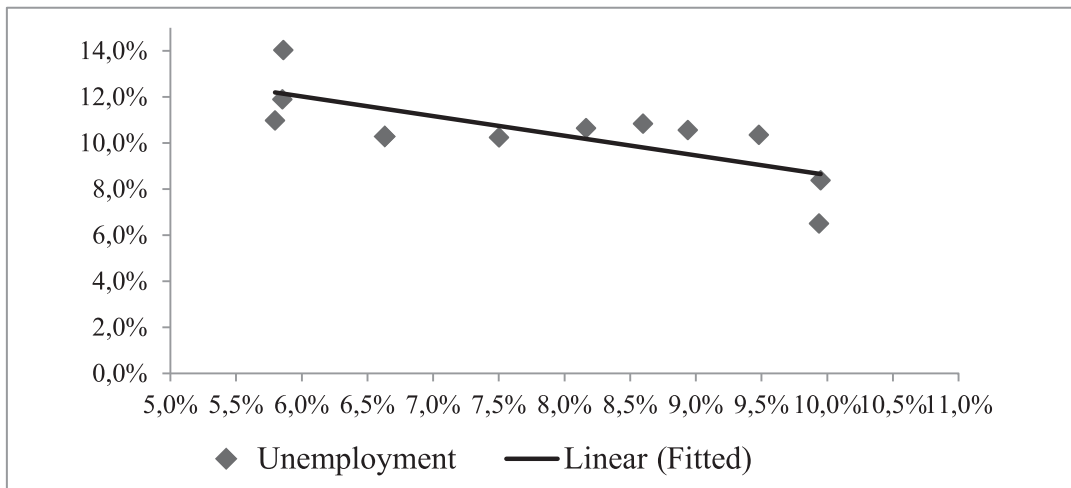
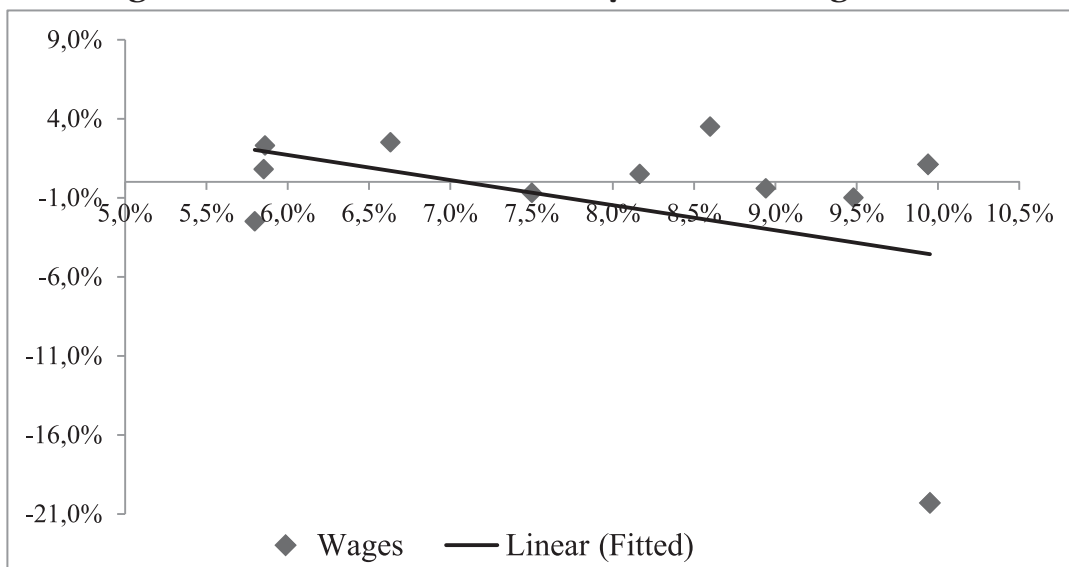


Figure 3.2.2 Trade Union Density and Real Wage Growth



As can be seen from the figure 3.2.1, membership rates and unemployment in Turkey are negatively correlated and the coefficient is around -0.77. When it comes to real wage growth, the union density loses its significance and there is no statistical relationship between the two variables. The correlation coefficient is -0.39 even though the negative sign is kept. It can be seen that the wages are much more volatile than the developments in membership. However, it should be noted that most of the existing studies that employ simple regression techniques suffer from endogeneity problems and small sample sizes; hence the causal relationship between labour market institutions and outcomes should be approached with caution. The data limitations are even more severe for Turkey as both the density and collective bargaining coverage rates are contentious. Additionally, consistent average wage data over time is only available for manufacturing sector. Therefore, empirically delineating the effect of labour market institutions on unemployment and wages in Turkey is not possible at this stage.

In the literature, coverage and coordination of collective bargaining are assessed as determining both employment and wage levels. It has been found that countries with extensive coverage are more likely to have higher unemployment rates and price instability. Since high bargaining coverage can provide substantial wage increases and accordingly growth in labour costs, in such settings underperformance is expected. Accordingly, many empirical studies showed that employment growth is negatively affected by high coverage while wages are positively influenced (OECD, 1997; Traxler, 2003). Besides, coverage raises the labour supply without altering the productivity levels, and thus does not contribute to economic growth (Nickell and Layard, 1999). This is especially the case when extensive coverage goes together with low levels of unionization. But in many developing countries, the collective agreements are not comprehensive, and the coverage is minimal, hence it is less likely to have economy wide effects of bargaining.

However, collective agreements can generate positive results especially when the bargaining is centralized and coordinated across industries and sectors. In many studies, it has been shown that semi-coordinated bargaining systems yield higher unemployment rates and there is a U-shaped relationship between the degree of centralization and employment (Calmfors and Driffill, 1988; Dowrick, 1993). Centralization and coordination becomes even more beneficial in a dynamic setting because shock absorbing capacity of labour markets is enhanced with those institutions. During the last crisis, coordinated economies in Northern Europe were affected less severely, and their labour markets outperformed the uncoordinated and semi-coordinated economies. The success is partly explained by the internalization of the costs and unions' ability to supply internal and wage flexibilities.

The situation is quite different in developing countries where the level of bargaining is at best at the sectoral and industrial level. There is also no explicit coordination across sectors and relatively low rates of spillovers between covered and uncovered segments of the economy. Thus, they can be seen as semi-coordinated economies and are more likely to suffer from the unemployment and inflation effects of collective bargaining. In Figure 3.2.3, the relationship between the collective bargaining coverage in the private sector and unemployment in Turkey is examined. Then, the same estimation is replicated for the relationship between collective bargaining coverage in the private sector and real wage growth in the private sector in Figure 3.2.4. For both of the estimations, collective bargaining coverage is used as the independent variable and unemployment rate is used as the dependent variable for the first and the real wage growth rate is used as the dependent variable for the second estimation. Once again the data is extremely restricted for the Turkish case, and the below figures only point out simple correlations between the outcome variables and collective agreement coverage. On average the collective agreements last two years in Turkey, and thus two year lagged values of the independent variable are utilized. The model is insignificant and has an R2 of 0.001 when the impact of collective agreement coverage on unemployment is considered. With the real wage growth as the dependent variable, the model becomes significant at 5% level with an R² of 0.51.

Figure 3.2.3 Collective Agreement Coverage and Unemployment Rate

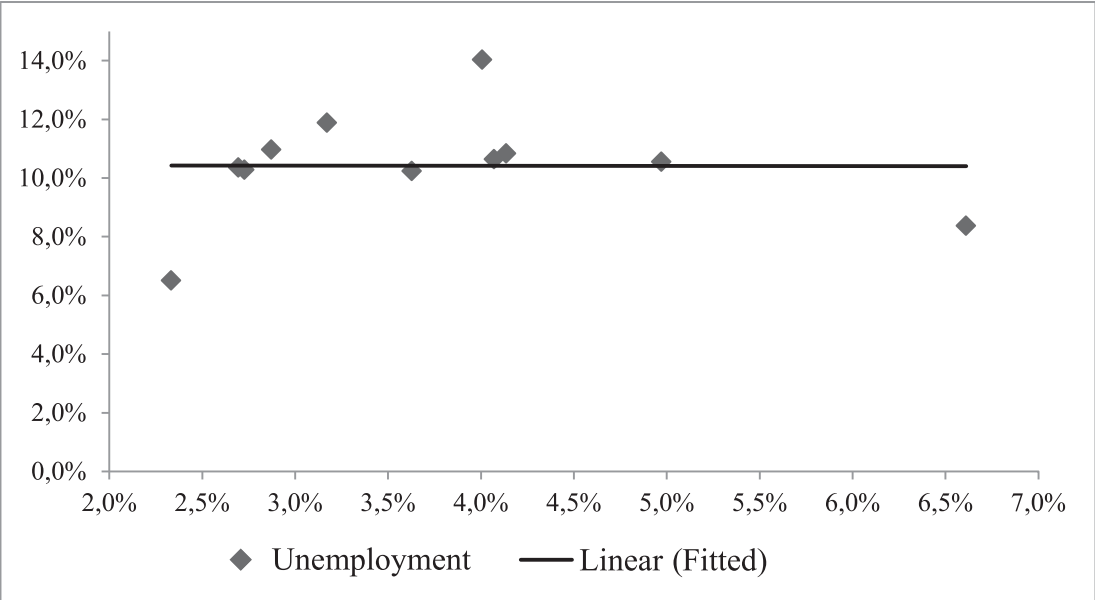
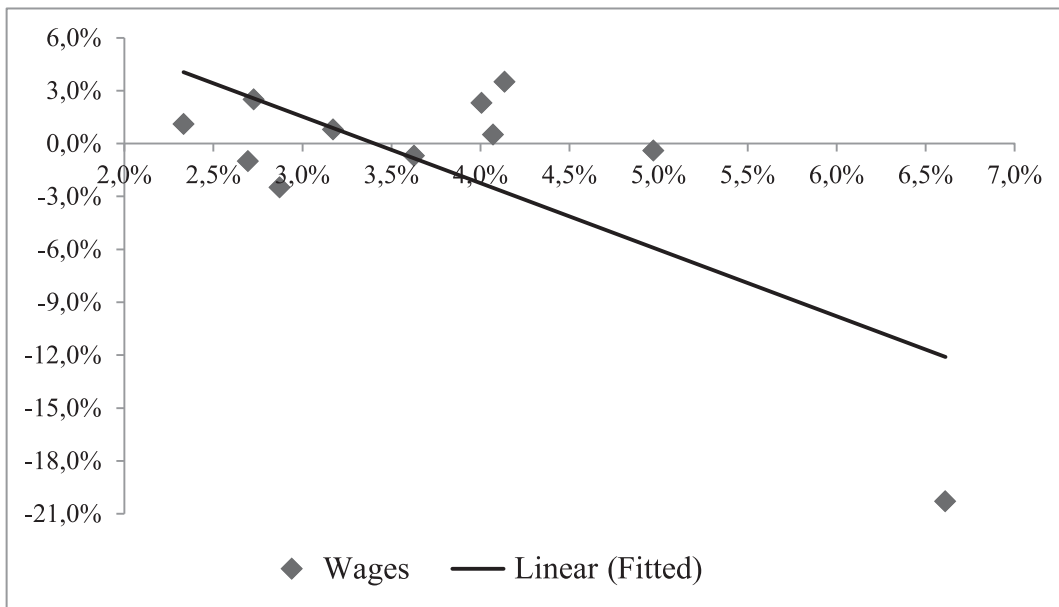


Figure 3.2.4 Collective Agreement Coverage and Real Wage Growth



The correlation between bargaining coverage and unemployment is negative but statistically insignificant. It has been estimated as -0.004 while the correlation coefficient for bargaining coefficient and real wage growth is around -0.71 . Unemployment displayed almost a secular increase over the period while wages had many ups and downs. Both in real wage growth and bargaining coverage, fluctuations over time can be observed, and there is overlap between increases in the real earnings and bargaining coverage extension with the exception of crisis year, 2001. There is no data about the bargaining coverage in Turkey at the individual level but it is known that most of the agreements are signed at the sectoral level. Additionally, the coverage is not very extensive as there is no legal requirement for asking the rest of the sector to follow the contracts once they are concluded. Besides, there is intensified inter-union rivalry and hence sectoral or industrial coordination is difficult to attain.

3.3 Government Regulations and Minimum Wage Setting

In addition to their role in determining labour market performance, unions are crucial for flexicurity model since they are the main social actors for the employee side. Without strong partners, it is unlikely that mutually beneficial pacts between employers and employees can be accomplished. To respond to the needs of the intensified competition in the world markets and changing business patterns in Turkey, several flexibility measures have been demanded by the employers. There were also discontents about the existing law from the unions and worker representatives since the regulations were not in line with the international standards and did not provide extensive security to their members. As a result in 2003 a new Labour Law was passed.

There are two main parts of the law covering the individual and collective labour relations. The individual law is concerned with the provisions between a private person or legal entity and a worker. Labour Act, No. 4857 regulates matters regarding the conclusion, form, types, content and termination of labour contracts, the reciprocal rights and duties of the worker and the employer in the course of the labour relationship, and individual labour disputes and their settlement (Dereli, 2012). The law covers both full and part-time employment contracts and wage stipulations. Collective labour law regulates the employment relations between a private person or legal entity and a trade union. Trade Unions Act, No. 2821 and Collective Labour Agreements, Strikes and Lockouts Act, No. 2822 regulate matters regarding the foundation, formation and functioning of unions, collective bargaining, conclusion, terms, effect and termination of collective labour agreements, collective labour disputes and disputes settlement procedures.

Further steps were taken in 2012 with the adoption of Trade Unions and Collective Bargaining Agreements Law No. 6356, which is claimed to be aiming at reducing the government intervention and allowing unions to take greater industrial action. One of the most important changes the new law brought is the reduction in the number of industrial sectors, which allows for higher density rates and mergers between unions. Nevertheless, the amendment is subject to controversy because around 25 unions lose their ability to bargain. The law also decreases the threshold for unions to become eligible for signing collective agreements from 10% to 3% (Resmi Gazete, 2012). Additionally, employees can register for more than one union if they work for different employers. The new regulation on compensation is highly criticized since only companies with 30 or more employees are subject to compensation claims. Given the large share of employment in micro and small enterprises in Turkey, the recent change can be deemed as exclusionary. Approximately, 6.5 million workers are deprived of their right to file compensation claims with the new law. Finally, the law does not extend the rights to strike with the exception of granting educational institutions and public notaries to call for industrial action. Nevertheless, most of the limitations remain to be in place.

As mentioned in the previous parts, the rights of trade unions and collective bargaining practices in Turkey have changed over time significantly. Table 3.3.1 presents the evolution of labour market institutions and social dialogue in Turkey between 1960 and 2010. Right to associate in private sector (RA_m) was free with minor restrictions during the beginning of 1960s but soon these were removed and Turkey had no legal obstacles to organize in either sector. 1980 military coup banned union activities and while private sector employees were granted its rights relatively soon, public sector employees (RA_g) were subject to severe restrictions. Only after the recent changes in the law public sector unions have had greater rights. A similar situation also holds for rights to collective bargaining (RCB_m and RCB_g). These were completely free for the private sector after

1965 until the coup, and then were reinstated with minor limitations. For the public sector, the collective bargaining rights are less comprehensive, and are heavily regulated. Right to strike (RS_m and RS_g) in Turkey was much larger before the 1980 military coup in parallel to the other indicators, and public sector even in the most current era cannot resort to strikes. In private sector, there are minimal restrictions against industrial action. Tripartite council (TC) was established as late as mid-1995 although there was an episode in 1970s where major unions, employer organizations and government reached to agreement over social and economic issues. Finally, the involvement of unions and employers in government decisions over social and economic policy (RI) in Turkey did not exist until mid-1990s, and has been infrequent and irregular since then.

Table 3.3.1 Labour Market Institutions and Social Dialogue in Turkey

	RA_m	RA_g	RCB_m	RCB_g	RS_m	RS_g	TC	RI
1960	2	0	2	0	2	0	0	0
1965	3	3	3	1	3	0	0	0
1970	3	3	3	1	3	0	0	0
1975	3	3	3	1	2	0	0	0
1980	1	1	1	0	0	0	0	0
1985	2	1	2	1	2	1	0	0
1990	2	1	2	1	2	1	0	0
1995	2	1	2	1	2	1	1	1
2000	2	1	2	1	2	1	1	1
2005	2	1	2	1	2	1	1	1
2010	3	2	2	1	2	1	1	1

Source: Compiled from ICTWSS (2011)

- 3 = yes
- 2 = yes, with minor restrictions
- 1 = yes, with major restrictions
- 0 = no

Turkey has ratified in total 56 ILO conventions, and after the accession process passed several laws to harmonize its legal framework with the EU. Aside from the arguments on what level the recent Labour Law is in line with international demands, there are still problems in the implementation and with the issues regarding union activities. As a result, there are constant pressures on government from EU and ILO to respect trade union rights and extend collective bargaining. For instance, the legislation about the collective bargaining, and strikes and lockouts waited a long time in the parliament to be passed, which received negative assessment in the progress reports. Additionally, the social partners continue to have strong disagreements over the new labour code. From the employers' perspective terms related to job security and severance payments are criticized on the basis of labour market rigidities. From the trade unions' perspective, new regulations are claimed to bring flexibility without the necessary security measures

hence leading to an unfair bargain between employees and employers. Additionally, informal sector in Turkey is quite sizable in which employees fall out of the supervisions brought by the legal clauses. Even though there are few plans to remedy for the lack of job security and benefits in the informal sector by the government, these tend to be insufficient for the time being.

In addition to the legal regulations, governments also intervene into the labour markets via setting minimum wages. It is the most direct way that governments can secure higher incomes for certain groups of workers, and to differing degrees a lot of countries implement such wage floors. Turkey has a statutory national minimum wage, which is set by the government after non-binding tripartite consultations. The last round of meetings were concluded in December 2012, and the new net minimum wage is fixed at 774 TL for the first half of 2013 and 804 TL for the second half of 2013. Table 3.3.2 presents the developments in real hourly minimum wages in Turkey between 1995 and 2011. The real hourly wages are calculated both by taking the purchasing power parity and dollar exchange into account. It can be seen that there was a significant decline in real minimum wages until 2002 and then a very slight recovery since then when the hourly rate is measured in terms of dollars. While in 1995, the rate was around \$56.6, in 2011 the rate was recorded as \$2.81. The over-time development is much more stable when the purchasing power parity is considered. Indeed there is an increase in the real minimum wages since 2001, which reached to \$4.7 in 2011 from \$2.61 in 1995.

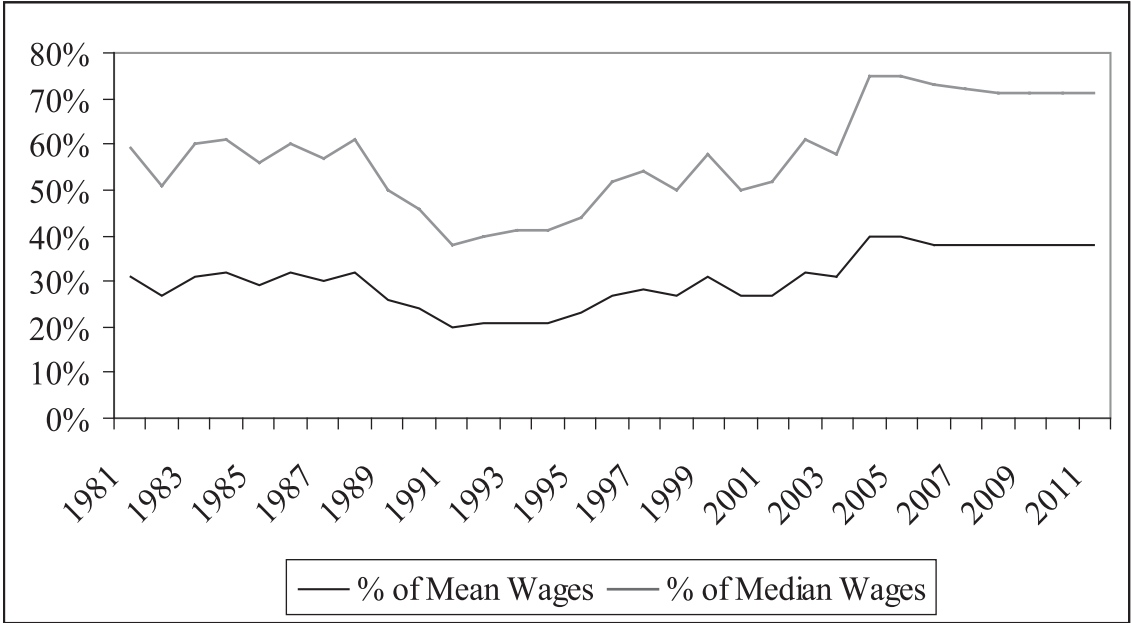
Table 3.3.2 Real Hourly Minimum Wages

	Measured by PPP (\$)	Measured by Exchange Rate (\$)
1995	2.61	56.65
1996	3.11	38.36
1997	3.48	22.89
1998	3.1	11.91
1999	3.95	9.44
2000	3.4	5.44
2001	2.93	2.39
2002	3.14	2.08
2003	3.35	2.23
2004	4.37	3.06
2005	4.55	3.39
2006	4.51	3.15
2007	4.48	3.44
2008	4.41	3.39
2009	4.52	2.92
2010	4.56	3.04
2011	4.7	2.81

Source: OECD (2012)

When we look at the minimum wages as a percentage of mean and median wages in Turkey over time, it is evident that the developments are parallel. The ratios decline until 1994 and at its lowest the minimum wage was around 21% of mean and 41% of median wages. Afterwards, a recovery occurred and minimum wage rose more proportionally in comparison to mean and median wages. For instance, in 2004, the highest ratios were attained, 40% and 75% for mean and median wages respectively. Since then there is stability and the minimum wages are documented to be around 38% of mean and 71% of median wages between 2008 and 2011. Turkey is quite similar to a number of emerging markets in terms of the ratio of minimum wages to the average wages. For instance, in Brazil, the ratio was 26% in 2011 while in Poland it was around 40% for the same year. Nevertheless, there are also countries like India where the minimum wages are relatively high enough to be 83% of the mean wages (ILO, 2012). Also, in several countries minimum wages experienced significant real improvements after 2000s, mainly because they were seen as anti-poverty tools. Brazil has a policy of raising minimum wages on a yearly basis taking both the inflation and economic growth into account with the goal of fighting against poverty and fuelling domestic demand.

Figure 3.3.1 Real Hourly Minimum Wages



Source: OECD (2012)

The impact of minimum wage on labour market performance is heavily debated in the literature but predicting the exact employment and wage effects in covered and uncovered sectors is hard. While legislation necessitates all firms to follow at least minimum wages, in developing countries large informal sectors exist, which cause a significant share of employees to be uncovered. Since switches between formal and

informal sectors are possible, identifying the employment and wage effects of minimum wages in developing countries become more relevant from a policy perspective. Typically, setting a wage minimum is expected to increase the overall wages and decrease the employment in the covered sector. If as a result the displaced workers seek employment in the uncovered sector, wages will go down and employment will rise. However, empirically these claims are not verified and it has been estimated that minimum wages have small employment effects in the formal sector while the informal sector is mostly unaffected. It should be noted the results are sensitive to the samples and vary greatly across countries. For instance, it has been estimated that the employment effects in Indonesia apply only to small firms whereas in Costa Rica the elasticity is around -0.1 and in Honduras it is approximately -1 (Rama, 2001; Gindglind and Terrell, 2007a; 2007b). The insignificance on employment can be explained by a number of factors ranging from the degree of competition in the markets to efficiency wages. More surprisingly, minimum wages in the formal sector are found to have a positive impact in the informal sector, which is also known as the lighthouse effect (Lemos, 2004; Kristensen and Cunningham, 2006). The positive spillover indicates that the informal sector wage determination follows the developments in the formal sector and employees use minimum wage as a basis for their reservation wage.

In Turkey, there are few studies examining the influence of minimum wage on employment in formal and informal sectors. The findings are in line with the rest of the literature and suggest that the minimum wages do not alter the employment significantly over time (Güven et al., 2009). Additionally, the displacements are small and employees with the least access to the informal sector experience even smaller chances of being unemployed as a result of minimum wage increases (Papps, 2011). A negative impact is observed among the female workers as their labour force participation declines with the presence of minimum wages but only when the work hours are inflexible (Öztürk, 2009). These results point out the difficulty of foreseeing the net impact of wage floors, particularly when they interact with different institutional settings. While minimum wage legislation can be an important step in providing income security when it is combined with the appropriate flexibility instruments, it can also alter the labour market performance in covered and uncovered sectors simultaneously causing switches and possibly an expansion of the latter.

S E C T I O N
4

FLEXIBILITY WITH OR WITHOUT
SECURITY

4.1 Employment Protection Legislation

A significant component of labour market regulation is employment protection legislation (EPL), which covers the hiring and firing arrangements and theoretically can have competing effects on performance. On the one hand, EPL decreases the inflows into unemployment by making dismissals more costly, and on the other hand, it limits the entrance of job seekers into employment since firms will consider the firing costs in their hiring decisions. Thus, the net effect on employment and unemployment is an unresolved issue and depends on the balance between outflows and inflows (Bertola, 1999). EPL is argued to have perverse effects on mobility and responsiveness to shocks, hence stringent protections could be particularly harming for the labour market performance during economic downturns (Lindbeck, 1993; Blanchard and Wolfers, 2000). Its impact on productivity is also indeterminate since job security can positively influence the effort levels and yet restrict the labour reallocation from less productive to more productive sectors (Koeniger, 2005; Mortensen and Pissarides, 1994). As a result, the empirical evidence is mixed and contradictory findings emerge from studies that use aggregate level data or investigate within country dynamics.

In the first part of this chapter, EPL and its components are examined, and their over-time developments are assessed. The relationship between EPL and part-time employment rate and long term unemployment is discussed in the second half of the chapter. Moreover, the divergence between regulation of permanent and temporary contracts, and whether this has differential impact across groups are analyzed. In the second part of the chapter, active and passive labour market policies in Turkey are reviewed and compared to several other developing countries. The final part of the chapter tries to evaluate the effect of taxes on labour in Turkey, and their impact on performance.

According to a number of indices produced by international organizations, Turkey appears to have rigid EPL, especially with regards to temporary employment (Taymaz and Özler, 2005). Table 4.1.1 presents the overall EPL and its three components for selected OECD countries and emerging markets in 2008, which is the latest year where comparative data is available. It can be immediately seen that Turkey scores the highest in terms of overall strictness but Indonesia, Mexico, and Portugal also are well above the sample average. The overall index is 3.72, which is highest among the selected countries and it even declines to 0.21 in United States. While the regular EPL index is in line with many other emerging markets and is around 2.56, the temporary EPL index is 4.88 marking a big gap with the rest of the countries except Brazil and Mexico. Also, the collective dismissal rules are more regulated in comparison to other emerging market economies, but the index is same, 2.88, with a number of countries such as Hungary, Slovenia, United Kingdom and United States.

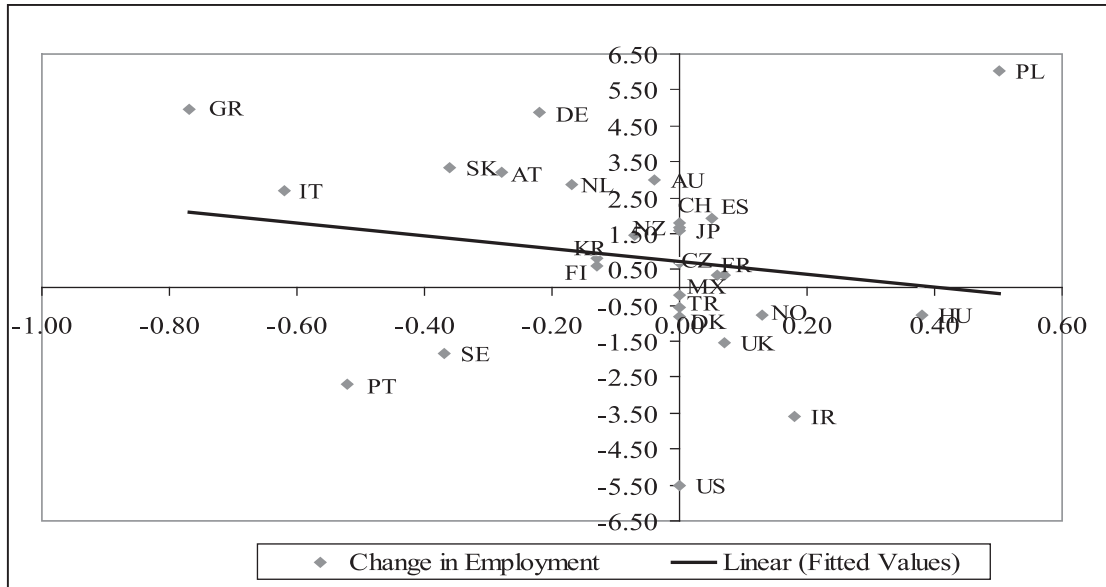
Table 4.1.1 Employment Protection Legislation and Sub-Components

	Overall EPL	Regular EPL	Temporary EPL	Collective Dismissals
Chile	2.65	2.67	2.63	0
Czech Republic	1.96	3.05	0.88	2.13
Denmark	1.5	1.63	1.38	3.13
Germany	2.12	3	1.25	3.75
Hungary	1.65	1.92	1.38	2.88
Mexico	3.13	2.25	4	3.75
Poland	1.9	2.06	1.75	3.63
Portugal	3.15	4.17	2.13	1.88
Slovak Republic	1.44	2.5	0.38	3.75
Slovenia	2.51	3.15	1.88	2.88
Spain	2.98	2.46	3.5	3.13
Turkey	3.72	2.56	4.88	2.38
United Kingdom	0.75	1.12	0.38	2.88
United States	0.21	0.17	0.25	2.88
Brazil	2.75	1.37	4.13	0
China	2.65	3.3	2	3
Estonia	2.1	2.46	1.75	3.25
India	2.77	3.54	2	0
Indonesia	3.68	4.24	3.13	0
Russian Federation	1.92	2.97	0.88	1.88
South Africa	1.25	1.99	0.5	1.88

Source: OECD (2012)

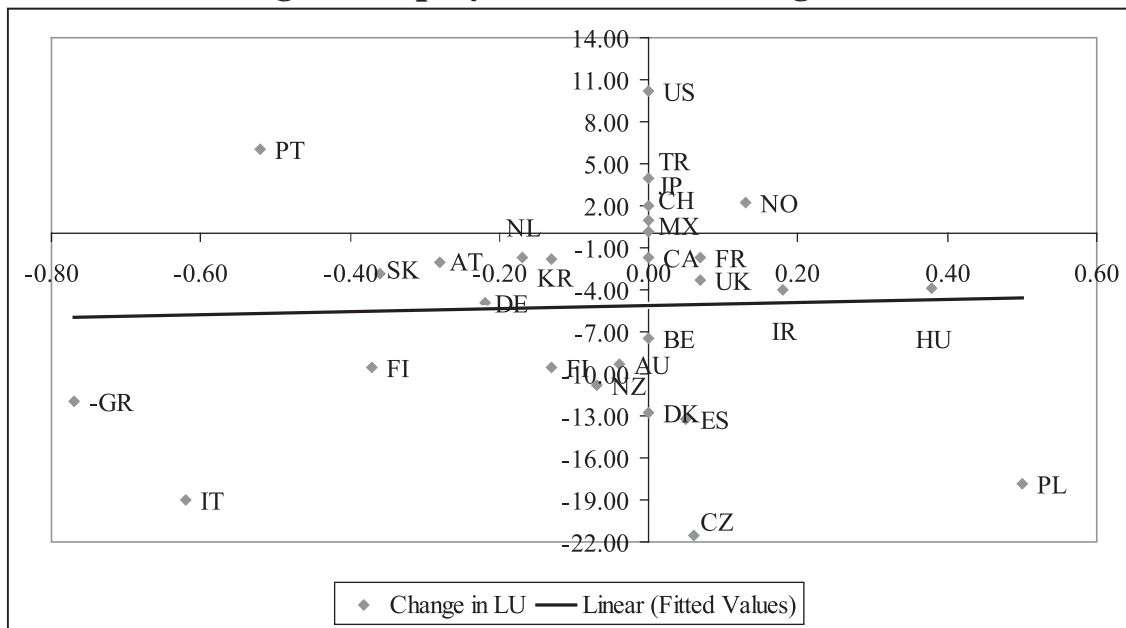
A new Labour Code was passed in 2003, which prepared the basis for atypical employment. There are no restrictions on the number of successive fixed term contracts and cumulated duration as long as essential reasons for renewal are provided. Thus, there is the possibility of employees to switch to fixed term contracts to cut down on their costs. The debate on severance payments is still on-going, and the government declared to respect the agreement between employer and employee representatives on establishing "a severance pay fund". Another step towards greater flexibility under the new Labour Code was the exclusion of small and medium sized firms from implementing the terms of the job protection clause of the Labour Code. With a law passed in 2002, companies having less than 10 workers were exempted whereas in 2003, this was widened to firms having less than 30 workers. Thus, EPL in practice in Turkey is much more limited than suggested by the official rankings. Figure 4.1.1 presents the correlation between the change in employment rate and change in EPL between 2000 and 2008, which are the earliest and latest years of available data for the OECD sample. Figure 4.1.2 repeats the same estimation for change in incidence of long-term unemployment and change in EPL for the same years. In both figures, change in EPL is the independent variable, and change in employment is the dependent one in the former while the incidence of long-term employment is the dependent one in the latter.

Figure 4.1.1 Change in Employment Rate and Change in Employment Protection Legislation



Source: Author's calculations based on OECD (2012)

Figure 4.1.2 Change in Incidence of Long-Term Unemployment Rate and Change in Employment Protection Legislation



Source: Author's calculations based on OECD (2012)

As can be seen from the above figures, the EPL has changed significantly only in few countries whereas the variation in employment rates and incidence of long-term unemployment are more visible. While there are countries like United States in which employment declined without any alteration in EPL, there are also economies such as Poland where an increase in protection is positively related to employment rate. In Turkey, EPL did not move very much over the period and the employment went down

by 0.57%. It should be noted that the correlation coefficient between the change in EPL and change in employment rate is around -0.184 and not statistically significant. When we look at the correlation between the change in incidence of long-term unemployment and change in EPL between 2000 and 2008, the coefficient turns out to be 0.04 and insignificant. In Czech Republic, higher protection is negatively associated with risk of being in long-term unemployment but in Portugal, the opposite relationship holds true. Turkey saw a rise in incidence of long-term unemployment over the considered period by 3.95% even though EPL decreased slightly as a result of the regulatory changes passed in 2003. Thus, it becomes difficult to establish an immediate link between EPL and aggregate labour market outcomes.

There are a number of reasons why EPL indices might not be accurately reflecting the extent of actual protection and additional costs they incur on employers. First, the occupational and tenure distributions as well as voluntary turnovers matter more for severance payments than the rules on paper for the companies (Addison and Teixeira, 2001). Additionally, in most of the developing countries, there is a very large informal sector, which is entirely left out EPL coverage. The size of informal sector in Turkey in 2012 was around 39%, indicating that a large number of workers were not falling under any type of legislation (TÜİK, 2012). Besides, as mentioned above, firms that have less than 30 workers are not subject to the same regulations, and 96% of all enterprises in Turkey are below that threshold (TÜİK, 2012). Certainly, the small enterprises still need to notify their employees and have to pay severance pay but do not have to have a valid reason for their dismissals. Finally, enforcement and implementation are at best incomplete even in developed countries (Bertola et al., 1999). And they are intensified by the existence of large informal sectors in developing economies such as Turkey. Table 4.1.2 displays the EPL and enforcement in several transition countries.

Table 4.1.2 Employment Protection Legislation and Enforcement

	Flexible EPL	Restrictive EPL	Rigid EPL
Weak Enforcement	Albania, Kazakhstan	Armenia, Georgia, Russia, Turkey	
Intermediate Enforcement		Bulgaria	Croatia, Macedonia, Romania
Strong Enforcement	Czech Republic, Estonia, Slovakia, Hungary	Latvia, Lithuania, Slovenia	

Source: Rutkowski and Scarpetta, 2005.

While Turkey appears to have restrictive EPL, the implementation is claimed to be weak both due to the protection only covering formal workers and the large difference between the legislative difficulty of hiring and firing and the low scores given to labour

inflexibilities as a problem by employers. For instance in Turkey, restrictive labour regulations is reported to be an issue for doing business only by 5.5% of the respondents, which is ranked as a greater obstacle for other countries. For instance, 10.1% of the respondents viewed restrictive labour market regulations as an issue in Brazil while the same ratio is around 13.6% in Poland (WEF, 2013). Thus, the official figures for EPL might not be accurately capturing the ease of hiring and firing, and employment flexibility.

In addition to the shortcomings that EPL scores can have in terms of measurement, there are also arguments suggesting that the effects are more visible for certain groups of labour. For instance, the younger employees, unskilled, and women are expected to be disproportionately affected by rigid protection since their entrance into the labour markets would be much more limited (Dolado et al., 2005). Moreover, the discrepancy between EPL for regular and temporary employment can be explanatory for the rise in atypical jobs for these groups. Indeed, most of the reforms over the years are found to be undertaken in the area of temporary employment, which enabled the firms to avoid the hefty regulations by resorting to atypical jobs. As a result, a dualized labour market structure would emerge with high turnover and frequent unemployment spells coexisting with long tenures and job security for different groups (Blanchard and Landier, 2002; Cahuc and Postel-Vinay, 2002). Table 4.1.3 presents the general EPL scores, the ratio of regular versus temporary employment protection, youth unemployment rate, and its ratio to total unemployment in selected OECD countries and emerging economies.

Table 4.1.3 Differences in Protection and Youth Unemployment

	EPL	Ratio of Reg./ Temp. EPL*	Youth UR (%)	Ratio of Youth UR/Total UR
Brazil	2.75	0.33	22.9	2.77
Turkey	3.72	0.52	23.6	1.68
Mexico	3.13	0.56	10.37	2
United States	0.21	0.68	24.29	2.62
Spain	2.98	0.7	55.31	3.07
Chile	2.65	1.02	29.32	3.03
Poland	1.9	1.18	27.37	3.35
Hungary	1.65	1.39	49.42	4.94
China	2.65	1.65	7.55	2.63
Korea	1.9	1.65	12.32	3.38
India	2.77	1.77	11.4	3.22
Portugal	3.15	1.96	27.2	2.87
Germany	2.12	2.4	11.22	1.45
Ireland	1.11	2.54	36.36	3.03
Russian Federation	1.92	3.38	31.12	3.69
Czech Republic	1.96	3.47	34.48	5.18
South Africa	1.25	3.98	58.47	2.47
Slovak Republic	1.44	6.58	53.37	4.43

Source: Author's calculations based on OECD (2012)

*The ratio is calculated by dividing the regular EPL index to temporary EPL index

It can be seen from the above table that the lower the protection for regular jobs in comparison to protection for atypical jobs, the lower the share of youth unemployment. For instance, in Turkey where the temporary EPL is rigid, the youth unemployment reaches to 23.6% and this is 1.68 times larger than the general unemployment rate. While in Czech Republic, the atypical jobs are quite flexible and youth unemployment is around 34.48% but more importantly, its ratio to total unemployment is 5.18. Thus, placing strict hiring and firing costs on regular jobs can be argued to be especially detrimental for younger cohorts. However, it should be noted that there are cases where such a relationship does not seem to exist. Germany is an example where low youth unemployment is achieved both absolutely and in relation to total unemployment with more rigid protection of regular employment. The youth unemployment rate is 11.22% and it is only 1.45 times larger than the general unemployment rate marking the lowest ratio for the entire sample. The difference between the protection levels on youth unemployment is more significant for countries with low EPL scores. Lastly, EPL is merely one policy tool that can provide security to employees and its interaction with other measures such as active and passive labour market policies would be crucial in determining the performance. To this end, the next part examines the development and impact of active and passive instruments in Turkey.

4.2 Passive and Active Labour Market Policies

Passive labour market policies can take multiple forms but ultimately they aim to provide income for people without work, and unemployment benefits form a large part of these measures. Due to risk pooling, unemployment insurance contributes to consumption smoothing and act as an automatic stabilizer (Browning and Crossley, 2001; Dolls et al., 2012). Additionally, by providing sufficient incomes, generous unemployment insurance allows workers to be selective and accept jobs that match their qualities better (Marimon and Zilibotti, 1999). But this has the consequence of higher unemployment risks and longer spells. Besides, it has been also argued that unemployment insurance leads to moral hazard problems through generating disincentives to work (Vodopivec et al., 2005). Since the reservation wages are higher in a system where unemployment benefits exist, the employees would be more reluctant to search for employment at least until the insurance period is exhausted. In order to minimize the negative effects, several design mechanisms were discussed in the literature ranging from attaching conditionality to benefits to limiting replacement rates and duration. It has been found that the lengthening of the duration brings more costs since people are more responsive to this component than replacement rates (Lalive et al., 2006). However, generosity of unemployment benefits in general is associated with longer unemployment despite different complementary institutions and labour market conditions.

In Turkey, passive labour market policies have four main components; unemployment insurance, severance payment, short time work measures, and wage guarantee fund. The consequences of severance payment has already been reviewed in the earlier part while wage guarantee fund and short time work measures have been adopted in early 2000s. The rights of employees in insolvent firms were addressed in 2004 with the bylaw that necessitates the enterprises to build a Wage Guarantee Fund. All the contractual employees are identified as privileged creditors and their wages up to 3 months should be paid of this fund (Togan and Hoekman, 2005). While both the amount paid and number of persons using the fund were low, with the crisis they peaked in 2009 where 12,371 employees benefited and in total 22,338,534 TL was spent (IŞKUR, 2012). Law No. 5838, which was passed in 2009, facilitated short term work arrangements giving the employees benefits in companies that suspend or shorten activities due to crisis or other compelling reasons (Erdoğan, 2011). In 2012, 2,309 people were eligible for short term work pay, and the total amount received was 2,480,000 TL (IŞKUR, 2012).

Among the passive labour market policies in Turkey, unemployment insurance is gaining importance over time. The system was established by the law No. 4447 where a fund has been set to pay for the benefits, health expenditure, and training and job placement expenses for the unemployed (Gençler, 2003). Table 4.2.1 summarizes the unemployment insurance system in Turkey. As can be seen from the table below, the duration is quite short and benefits are low but mainly due to the health and maternity insurance coverage, a high number of employees register. Since the beginning of the system in 2002 till the last quarter of 2012, 3,212,532 people applied for unemployment benefits and 2,543,803 of them received it. The total amount of payments reached to 4,858,371,127 TL for the same period (IŞKUR, 2012). There are also differences among the recipients across age and education, and it has been documented that majority of the beneficiaries have primary and secondary education and they are less than 35 years old. The higher share of recipients in these categories can be perhaps explained by the lower gap between the benefits and their base salary as the insurance lasts at most for 10 months and cannot exceed 80% of the gross minimum wage.

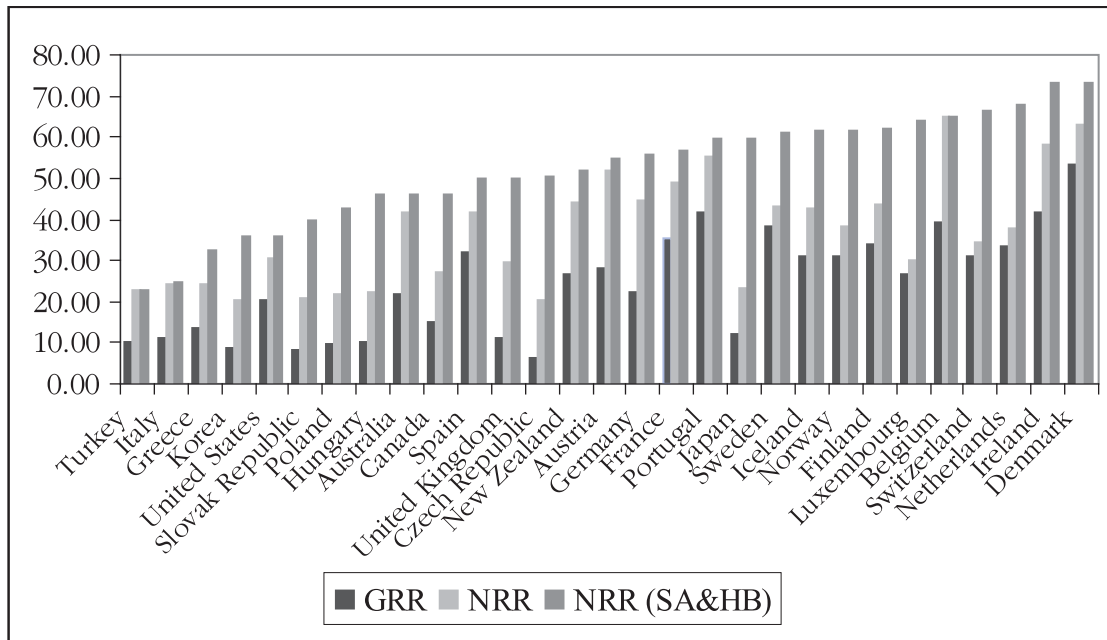
Table 4.2.1 Unemployment Insurance System in Turkey

Source of Funds	Employers contribute 2%, employees and state each also contributes 1% of the base salary
Requirements	Employees should be covered by social security and personally apply to ISKUR stating that they are ready for work. Self-employed and certain public servants cannot benefit from UI
Eligibility	Employees need to be working in a job covered by social security at least 600 days in the previous 3 years and must be paying contributions for at least 120 days prior to termination of the contract
Waiting Period	Between 3 and 7 days
Benefit Amount	The exact amounts of benefits are calculated according to the base salary and minimum wage in each year, and the maximum amount of benefits in 2012 was around 554 TL.
Benefit Duration	Payments are made for six months to the unemployed who contributed 600 days, eight months to the unemployed who contributed 900 days and ten months to the unemployed who contributed 1,080 days
Conditionality	The unemployed cannot receive UI if they reject an acceptable job offer, receiving payments from social security system, working while collecting unemployment benefits, and if they refuse to participate in training programs offered by ISKUR without reasonable cause
Other Considerations	Benefits are exempt from taxation

Source: *TISK (2000), Gençler (2003)*

Even though, the unemployment insurance scheme in Turkey is relatively immature, in terms of non-indexation of benefit to wages and short duration, it is similar to the models in Anglo-Saxon countries. In the Liberal welfare state model, all citizens should be guaranteed some insurance against the vagaries of market through a minimum income for a limited period (King, 1999). The aim of the state is to provide a safety net for those who could not survive under the existing circumstances, and typically, the benefits are attached to several conditions especially to strong obligations to search for work. Additionally, the Turkish unemployment insurance system has no unemployment assistance component where income protection is carried on after the insurance period is exhausted, hence pushing people to find employment immediately sometimes at the cost of skill mismatches. Figure 4.2.1 presents the gross (GRR) and net replacement rates (NRR) with and without social assistance (SA) and housing benefits (HB).

Figure 4.2.1 Gross and Net Replacement Rates in OECD



Source: OECD (2012)

GRR and NRR are defined as the average of the gross and net unemployment benefit replacement rates. Each of these rates are computed for various scenarios including single or two employees in a household, families with and without children, and short-term unemployment as well as unemployment that lasts more than 1 year. It becomes evident from the figure that both are low in Turkey, 10.11% and 22.74% respectively. While there are several countries such as Czech Republic and Poland that have lower rates, the benefits become much higher than Turkey when social assistance and housing allowances are included. For instance, in Czech Republic the NRR is 20.41% whereas it goes up to 50.18% with social assistance and housing benefits while they remain unchanged in Turkey. In countries like Denmark and Ireland, broader NRR exceeds 70% while Belgium has the highest NRR. Turkey is at the bottom of the list by 22.74% followed by Italy, Greece, and Korea where the NRR with social assistance and housing allowance are 24.73%, 32.63% and 35.83% respectively. However, it should be also noted that the total amount of social expenditures in Turkey has increased from 3.2% to 12.8% of the GDP over the last three decades. Yet they are still well below the OECD average, 22.1% (OECD, 2012). There is a shift towards active labour market programs (ALMP) from passive measures in many countries. The main goal of such programs is to effectively allocate public resources to generate enough employment opportunities and they can vary from training programs to unemployed to wage subsidies (Auer et al., 2005). In developing countries, the ALMPs are also becoming popular because passive labour market policies are expensive and these countries are fiscally constrained. Additionally, the effects of ALMPs are argued to be visible in shorter terms and more positive on employability (Van Ours, 2000). Besides, unemployment in developing countries hit the

younger cohorts disproportionately hence insurance schemes would be less suitable as such workers are less likely to be eligible. However, there can be shortcomings in implementing ALMPs in developing countries due to lack of administrative capacity and low service quality (Pages et al., 2009).

Like the passive measures, the ALMPs in Turkey are underdeveloped and limited in comparison to the other OECD countries and some of the emerging economies. The main provider of these programs is Turkish Employment Agency (İŞKUR), which offers courses for the labour force participants, occupational counselling, internships, and public works. Moreover, in accordance with the EU directives Turkey has launched major vocational education and training (VET) reforms including lifelong learning and adult training programs (Ercan, 2007). There are also very few initiatives where employer and employee organizations jointly invest into vocational education programs. Given that unemployment in Turkey is distributed across different educational levels, employability needs to address skills that are sought in the labour markets in addition to formal qualifications. Table 4.2.2 presents the number of beneficiaries and spending on ALMP in Turkey between 2003 and 2011.

Table 4.2.2 Active Labour Market Programs in Turkey

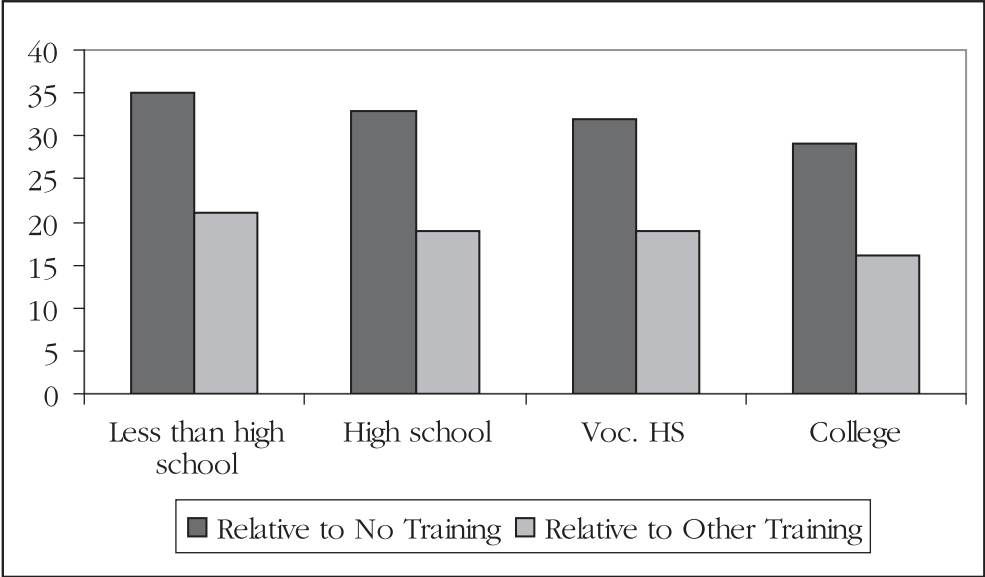
	Number of Beneficiaries				Costs (Thousand TL)			
	Courses	Public Works	Internships	Total	Courses	Public Works	Internships	Total
2003	3,251	281	-	3,532	11,796	699	-	12,496
2004	8,215	370	-	8,585	56,313	921	-	57,234
2005	11,473	-	-	11,473	9,515	-	-	9,515
2006	17,106	-	-	17,106	27,974	-	-	27,974
2007	22,834	-	-	22,834	29,672	-	-	29,672
2008	31,788	139	-	31,927	35,000	511	-	35,511
2009	166,713	45,467	1,285	213,852	192,907	111,359	2,100	306,366
2010	164,890	42,066	4,671	211,627	245,704	138,255	8,684	392,644
2011	169,538	64,085	16,393	250,016	263,917	134,129	10,551	408,597

Source: Keskin (2012)

The number of total beneficiaries went up from 3,532 in 2003 to 250,016 in 2011 whereas the majority of the participants were taking courses. There were also 64,085 people in public works in 2003, which is the second largest category in terms of number of beneficiaries. The internship programs started only in 2009 and rose more than 12 times as of 2011. In terms of spending, the total amount reached to 408,597 thousand TL in 2011 from 12,496 thousand TL in 2003. While the largest share goes to courses, public works appear to be more costly since the spending per beneficiary is higher. In 2011, per person expenditure was around 1.55 thousand TL for courses and 2.09 thousand TL for public works. Internships became the least expensive over the period going down to 0.64 thousand TL per person in 2011.

Nevertheless, the ALMPs are not substitutes for job creation and their positive effects are minimal when labour demand is neglected. Unless they are combined with other employment supporting policies, their contribution to skill matching and employability would be very limited. Also, it has been shown that different ALMPs have different impacts, and the effectiveness depends on the outcome chosen (Card et al, 2010). Job search assistance appears to have the most positive effects and turn out to be more cost effective (Kluve, 2007). Training programs are also recognized to be beneficial but the public works' link to employment is mixed at best and they are financially more burdensome (Card et al., 2010). This is also observable from the previous table where courses and internships that help in job seeking appear to be more valuable in terms of the number of people benefiting from them and relative affordability for the state. Figure 4.1.2 presents the expected impact of İŞKUR training programs compared to no training and other types of training that include private certificate programs and any other public courses.

Figure 4.2.2 Expected Impact of İŞKUR Training



Source: Almeida et al. (2011)

On average, İŞKUR training is anticipated to increase the chances of getting a job by 32.25% as opposed to no training, and 18.75% as opposed to training given by other institutions. The impact is largest for people with less than high school even though this group is the least populous among the trainees. Additionally, 94% of the participants think that programs are useful for job-readiness skills and only 34% of them believe that they will have a positive impact on earnings (Almeida et al., 2011). The İŞKUR schemes are also preferred by respondents since they believe that the schemes are valued by employers. Even though, these findings are based on subjective evaluations, they still can be crucial in understanding the effectiveness of ALMPs in Turkey. For instance, the lower expected effect of courses on wages might be considered as a signal to revise

the programs for skill upgrading and ability to find high quality jobs. Moreover, the comparatively lower value of public works might suggest a reallocation of resources to other types of policies. Lastly, it needs to be remembered that the completion rates of these courses are low, and informal networks are still the most prevalent way to get a job in Turkish labour markets. Thus, the usefulness of vocational and other types of training schemes need to be assessed on the basis of beneficiaries and the increase in their likelihood of getting employment.

4.3 Tax Burden on Labour

The tax burden on labour is widely accepted to be detrimental both for labour demand and labour supply. On the one hand, the higher tax rates on labour mean higher costs for the employers, hence less demand. On the other hand, the taxes decrease the disposable income hence put a downward pressure on labour supply decision as well. Therefore, it has been argued by many researchers that there is a negative relationship between employment rates and taxes on labour (Vodopivec, 2005). However, the magnitude of the effect depends on institutional features of the labour markets. It has been found that minimum wage regulations and unemployment benefits, wage coordination, share of tax incidence between employees and employers, and skill levels are among the intermediary institutions (Kugler and Kugler, 2003; Goerke, 1999; Bassanini and Duval, 2006; Gora et al., 2006). Moreover, how the taxes are used makes a difference, for instance, if they are channelled towards financing public services and ALMPs, they can indeed increase the demand and supply.

Developing countries constitute an interesting sample since they have higher tax burdens on labour compared to some of the developed countries but also greater informal sector size suggesting the possibility of tax evasion. Table 4.3.1 presents the total tax rate and labour tax rate for selected developing countries in 2012. Both measures are reflected in percentage terms of commercial profits. Income, sales, and value added taxes are not included hence the rates can be understood as the net amount that business has to pay in total and on labour. It can be seen that Chile has the lowest ratio of contributions on labour with 3.8% and in Turkey, this figure goes up to 18.8% but still is lower than most of the other countries in the sample. Even though the tax wedge in Turkey is argued to be high in comparison to OECD average, which were recorded to be 38.2% and 35.6% in 2012, respectively, the real cost that business has to pay out of its profits is below 20%, which is well below the majority of the new EU member states (OECD, 2013). Tax wedge is defined as the difference between how much net income the employee receives and how much s/he costs to the employer. Besides, there is a downward trend in taxes on labor in Turkey since the 2000s. A similar development occurred in new EU member states but more moderately for the same time period.

Table 4.3.1 Taxes out of Commercial Profits (2012)

	Labour Tax Rate	Total Tax Rate
Chile	3.8	28.1
South Africa	4.1	33.3
Indonesia	10.6	34.5
Korea, Rep.	13.2	29.8
Malaysia	15.6	24.5
India	18.2	61.8
Turkey	18.8	41.2
Bulgaria	20.2	28.7
Poland	23.8	43.8
Mexico	26.5	52.5
Latvia	27.3	36.6
Argentina	29.4	108.3
Romania	31.5	44.2
Hungary	34.5	50.3
Lithuania	35.1	43.7
Czech Republic	38.4	49.2
Estonia	39.4	67.3
Slovak Republic	39.6	47.9
Brazil	40.8	69.3
Russian Federation	41.2	54.1
Ukraine	43.1	55.4
China	49.6	63.7

Source: World Bank (2013)

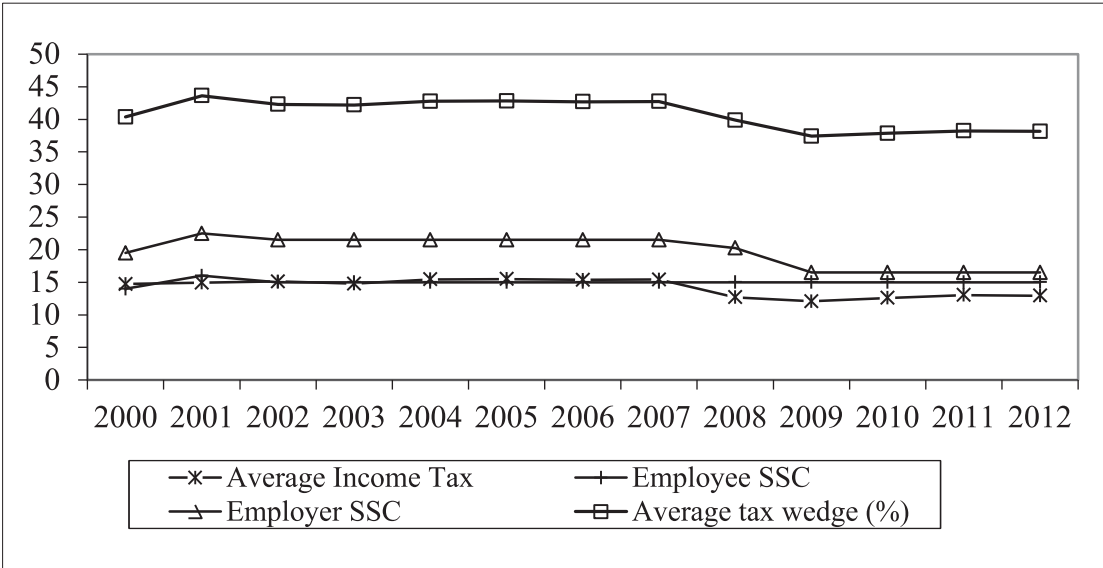
When we look at the total tax ratio to commercial profits, Turkey is placed in the 8th lowest cell. However, the difference between the labour contributions and total contributions might suggest that there are other types of taxes that employers need to pay out of their profits. Also, it should be noted that there has been a steady decline in total tax rate in Turkey since 2005, which is the earliest year of available data, from 53% to 41.2% in 2011. Argentina stands out to be an outlier where the payments exceed profits and reach to 108%, which is followed by Brazil with 69.3%. In Brazil's case, this is mainly due to relatively high labour taxes and expenses. The same can be said for Ukraine and Russia as well where the labour contributions out of profits amount to 43.1% and 41.2%, respectively.

In addition to the levels of taxation, the distribution of the burden between employees and employers is also important for labour market outcomes. When the job opportunities are few and unemployment is high, employers can pass the cost of taxation on workers via lower wages. The decrease in earnings can have a negative effect on labour force participation. An opposite situation arises when the unemployment is low and labour is organized. In such a setting, the cost of taxes has to be shouldered by employers even when they are levied on workers by higher wages. This might cause labour demand

to shrink and as a result employment to fall (Rutkowski, 2007). The composition and rate of taxation also affect the transitions to informal employment since raising the cost of registered labour makes informal arrangements to have a higher payoff. Figure 4.3.1 shows the evolution of tax rates in Turkey between 2000 and 2012 for a single person earning 100% of average national wages.

As can be observed from the figure below, the average tax wedge decreased within the period under consideration, going from 39% in 2000 to 38.15% in 2012. This is mainly achieved by the reductions in average income tax and employers' social security payments rather than changes in employee social security contributions. In fact, the social security expenses by workers remain to be quite stagnant over the whole time period, around 15% while the average income tax was cut from 13.2% to 9.8%, and employers' social security contributions went from 19.5% to 16.5% between 2000 and 2012. Like the average tax wedge, the employee social security contribution is also higher than the OECD average where the Turkish average is 12.9% but the OECD average is 8.2%. On the contrary, the employer contribution in Turkey is quite in line with the OECD average, which is around 14.2% in 2012.

Figure 4.3.1 Development of Taxes over Time



Source: OECD (2012)

There are few studies that quantify the impact of tax changes on employment in Turkey, and the findings reveal that a decrease in employer contributions lead to more jobs than cutting down the employee social security payments or income tax because the pass-through effect is smaller under the first case (Taymaz, 2007; Betcherman and Pages, 2007). The pass through, or in other words, translation of higher taxes into higher wages is more evident at the upper end of the earnings distribution. When the employees are in well paying jobs, the taxes that government collect tend to raise the wages more in comparison to low paying jobs that take the minimum wages as an anchor.

S E C T I O N
5

POSITIVE TRENDS, PERSISTENT
PROBLEMS, AND NEW CHALLENGES

5.1 Labour Force Participation, Employment, and Unemployment

From a theoretical point of view, labour markets can be in disequilibrium either due to insufficient demand or supply. In a stock approach, the labour market status of an individual is a function of the employers' price setting and employees' wage setting curves (Layard and Nickell, 1999). The policies and institutions need to strike a balance between employment and wages. In the flow approach, the transitions between different labour market states are examined where the search and matching processes determine the aggregate performance (Nickell et al., 2003). Since there can be a lot of frictions due to firm and worker heterogeneity, the labour markets can continue to display positive unemployment rates, particularly when the institutions and policies are not designed to attain high volumes of job creation and adequate skill upgrading.

The chapter inspects the labour market performance in Turkey over time and in comparison to other emerging market economies. Labour force participation, employment, and different types of unemployment across age, education, and gender groups are considered in the first part. Given that Turkish labour market is characterized by low female participation, unsatisfactory employment growth, and high youth unemployment, these areas are further reviewed. Then, the components of earnings and labour cost are investigated in the second part of the chapter. The recovery after the global crisis is assessed with respect to the changes in the real wages and employment. In the third part of the chapter, the developments in the informal sector in Turkey and its interactions with the formal sector employment and wages are evaluated.

Table 5.1.1 presents the key labour market indicators for selected emerging market economies in 2012. In terms of labour force participation, Turkey has a similar rate with the sample average for men but is well below it for women. While Turkish female labour force participation was around 30% in 2012, it attained 68% in China. India, on the other hand, has the highest labour force participation for men, 79.7%. A similar picture arises from the employment rates across gender. Female employment rate in Turkey is 27.2% whereas the sample average is 44.1%. The largest employment for men is in Indonesia by 77.4% and in China for women by 62.5%. Indeed, Turkish female employment is the lowest along with India in comparison to the other emerging markets under consideration. When it comes to unemployment, Turkey, Argentina, Brazil, Chile, India, Indonesia, Malaysia, Poland, and South Africa have higher rates for women, and it has been recorded as 11.6% in Turkey, which is greater than the average for the group of countries. Bulgaria,

Hungary, Latvia, and Lithuania display unemployment rates more than 10% for each gender while South African total unemployment reaches to 25.15%. The table confirms one of the shortcomings of the Turkish labour market, namely low female labour force participation and employment.

Table 5.1.1 Labour Market Performance in Emerging Economies (%)

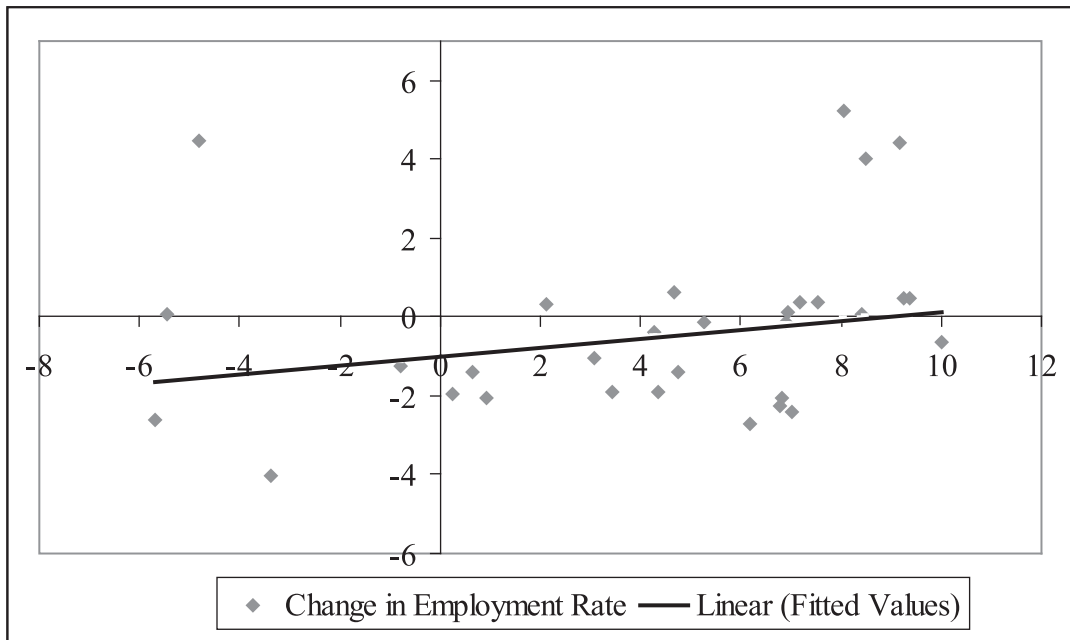
	Labour Force Participation		Employment		Unemployment	
	Male	Female	Male	Female	Male	Female
Turkey	71.9	30.7	66.2	27.2	7.9	11.6
Argentina	73.6	48.7	68.6	44.9	6.7	7.9
Brazil	81	59	63.9	47.6	3.9	5.4
Bulgaria	59.9	48.9	52.3	43.9	12.7	10.1
Chile	71.8	47.7	68.1	44.2	5.2	7.3
China	80	68	74.8	62.5	3.7	2.4
Hungary	60.4	45.5	54	40.9	10.6	10.2
India	79.7	29	77.1	27.7	3.3	4.3
Indonesia	84	51	77.4	46.7	6	6.9
Latvia	67	54.7	57.7	47.5	13.9	13.2
Lithuania	64.2	53.4	55	47.9	14.2	10.4
Malaysia	77	44	76.1	44.6	3.6	3.8
Mexico	78.3	43.7	74.4	41.6	4.9	4.9
Poland	64.7	48.4	58.9	43.1	9	10.9
Romania	64.4	48.1	59.8	45.1	7.2	6.3
Russia	73.9	63.1	70.7	60.2	5.5	4.9
South Africa	60	44	47.7	34.6	22.4	27.9

Source: ILOSTAT (2013), World Bank (2012)

Certainly, the outcome in labour markets is related to the actual economic performance yet the responsiveness of employment to growth depends also on the policies and institutions. For instance, the last crisis showed that the adjustments to output declines have been varied across countries. While in most of the European economies and Japan, the total hours worked were reduced to a small degree through productivity falls, in North America and Spain, the opposite happened with sharp cuts in labour input and productivity gains as a response to GDP contraction (OECD, 2010) . Moreover, during economic expansions job creation might not be large enough to meet labour supply or the quality of jobs might be questionable. In the new EU member states, GDP recovery was not followed by employment generation after the transition and as a result high levels of unemployment were reached (Boeri and Garibaldi, 2006). Figure 5.1.1 presents the relationship between the change in real GDP and the change in employment rate for Turkey over the period. The dependent variable is the change in employment rate and the independent variable is the real GDP growth. Lagged values of real GDP growth

is utilized for the estimation, and the correlation coefficient is found to be approximately 0.2. Significant increases in employment have only been achieved in the last couple of years while the change in employment rates was negative for the most of the period.

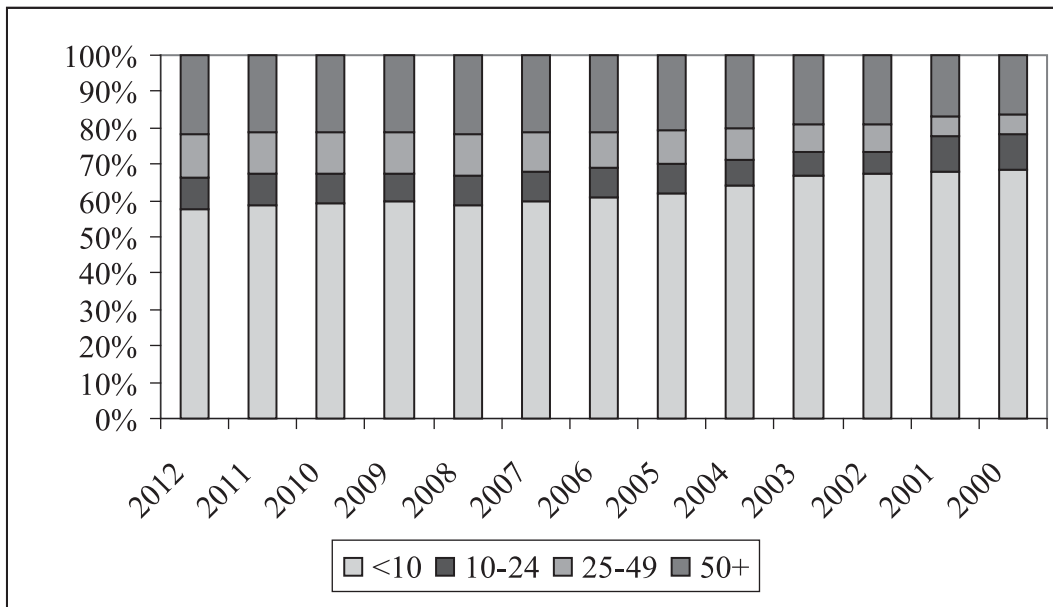
Figure 5.1.1 Real GDP and Employment Rate



Source: Author's calculations based on ILO (2013) and TÜİK (2013)

This is in line with other studies that examined the association between growth and employment in Turkey. After the 2001 crisis, the official unemployment remained to be high and there were declines in participation rates, which aggravated the segmentation in Turkish labour markets where a small number of dynamic and high technology jobs co-existed with a large stagnant and informal traditional economy (Yeldan, 2011). Additionally, it has been found that the elasticity of employment is rather low in Turkey and even decreased after 2000s. For instance, the overall responsiveness of job creation to output expansion was around 39% in 2002 while went down to 14% in 2008 (ibid). This was also visible in the sectoral analysis where the elasticity of employment was cut in both agricultural and non-agricultural parts of the economy. Unlike the labour hoarding experience of some of the European countries during the last crisis, recessions in Turkey are mostly dealt with labour shedding with the exception of short term employment schemes. In addition to deficient job creation, the firms that provide most of the employment are also small in size. Figure 5.1.2 exhibits the employment by firm size in Turkey between 2000 and 2012.

Figure 5.1.2 Employment by Firm Size



Source: Author's calculations based on TÜİK (2013)

It can be observed that even though the share of larger companies has increased throughout the period, it is still around 21.7% in 2012. In the same year, 56.57% of all employment was in firms that have less than 10 employees. Between 2000 and 2012, the employment in firms with 50 and more workers increased by 5.14% while the employment in firms with less than 10 workers went down by 10.64%. The biggest growth in employment share was seen in companies that have 25-49 employees by 7%. Thus, over time, the number of jobs in small and micro enterprises declined but their proportion to total employment continues to be greater than that of OECD countries. The size is particularly important for Turkish labour market since the companies with less than 30 workers are not subject to the job protection clause of the Labour Code. Moreover, the informal sector in Turkey consists of predominantly micro enterprises, hence such firms can be said to have more flexibility without adequate security provisions.

Youth unemployment and unemployment among the university graduates is another structural problem Turkish labour market faces. Table 5.1.2 shows the youth unemployment rates for different education levels in Turkey between 1990 and 2012. The overall unemployment rate is approximately 9.2% and the youth unemployment is 17.5% in 2012. While 10.1% of individuals with a university degree are unemployed, the ratio goes up to 28.5% for young university graduates between the ages of 15-24 in 2012. For the working age population, individuals who are older than 15 years, the primary and secondary schooling do not have a significant impact on employability. The effect is mostly discernible for women as the chances of illiterate female persons getting a job is near zero while it is 50% for men (Taymaz, 2010). Over time, the unemployment among the more educated individuals remain to be high in Turkey and increased

significantly since 2005 after an initial decline at the second half of 1990s. From the table, it can be noticed that immediately during the crisis years young university graduates suffer most from unemployment. For instance, the rate attained 35.2% in 1994 and the highest point 39.8% in 2004, which are both marked by economic contractions. There are significant decreases in unemployment for high school and vocational high school graduates. In 1990, these were 35.6% and 28.8% respectively and went down to 19.8% and 19.1 in 2012, however, they continue to be higher than the lower education categories.

**Table 5.1.2 Youth Unemployment Rates across Educational Categories
(ages 15-24)**

	Illiterate	Literate but No Diploma	Primary School	Secondary School	High School	Vocational High School	College and University
2012	9.00%	14.80%	2.50%	14.10%	19.80%	19.10%	28.50%
2011	11.20%	15.10%	11.20%	14.50%	22.40%	21.20%	30.00%
2010	16.40%	18.40%	14.60%	18.40%	27.20%	23.10%	32.50%
2009	19.50%	23.00%	17.90%	21.60%	30.60%	27.60%	33.20%
2008	11.00%	19.80%	14.30%	18.70%	25.00%	20.80%	29.80%
2007	16.70%	17.30%	14.70%	19.30%	23.50%	22.60%	28.50%
2006	12.50%	15.30%	14.70%	17.90%	25.20%	21.10%	27.20%
2005	11.30%	16.30%	14.10%	19.20%	25.30%	25.60%	30.50%
2004	9.60%	13.00%	13.40%	19.60%	26.60%	29.30%	39.80%
2003	18.10%	30.20%	15.30%	19.70%	25.90%	23.80%	38.80%
2002	11.50%	15.70%	12.40%	20.70%	26.80%	28.00%	38.30%
2001	8.70%	14.40%	10.60%	17.70%	24.00%	25.50%	30.70%
2000	5.00%	11.00%	8.30%	13.70%	20.60%	20.80%	28.30%
1999	6.70%	9.30%	10.00%	13.90%	26.30%	24.10%	30.00%
1998	6.60%	8.50%	7.40%	15.70%	26.90%	26.00%	31.60%
1997	5.60%	8.70%	7.90%	15.30%	29.30%	27.50%	29.40%
1996	7.70%	7.20%	8.50%	13.90%	26.40%	27.40%	28.30%
1995	7.20%	13.50%	11.00%	18.20%	26.40%	30.20%	29.80%
1994	7.20%	14.80%	10.90%	21.10%	31.90%	31.00%	35.20%
1993	9.50%	16.70%	13.30%	22.50%	34.00%	27.80%	29.60%
1992	5.00%	13.80%	11.80%	21.60%	34.30%	30.80%	34.10%
1991	5.90%	12.40%	11.40%	21.90%	34.20%	30.70%	32.70%
1990	11.30%	14.70%	11.80%	21.20%	35.60%	28.80%	30.90%

Source: TÜİK (2013)

As the educational attainment increases, the unemployment probability appears to be rising in Turkey, indicating a structural weakness of the labour market. Not only the jobs created are not sufficient to meet the labour supply but they are also disproportionately low productivity jobs where high levels of human capital are not required. There is also a gender difference in recent years among youth unemployment rate with respect to

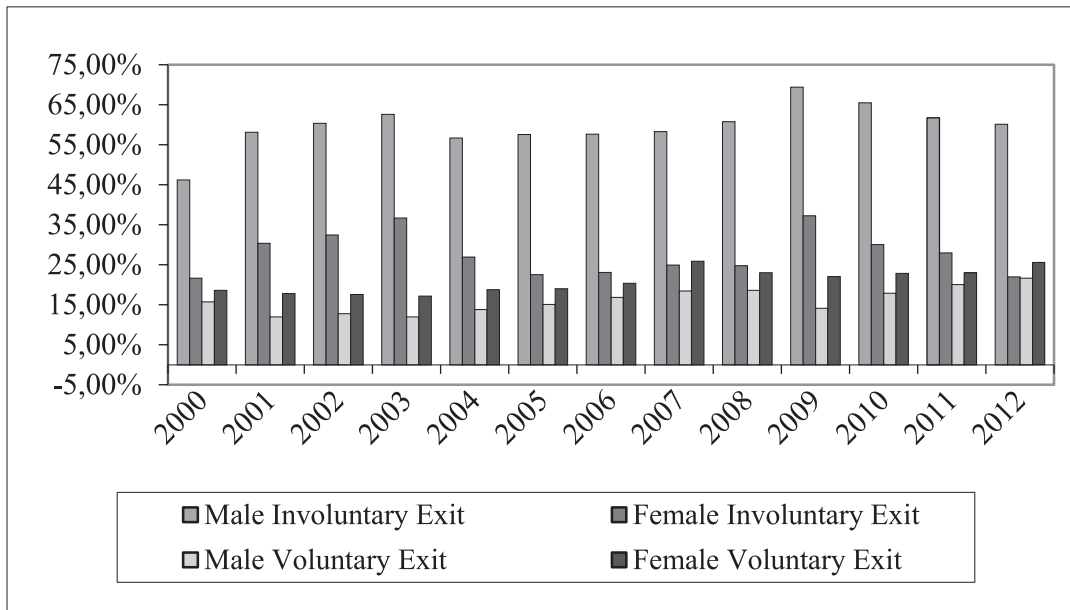
educational categories. While in 2000, both male and female university graduates faced unemployment rates around 28%, in 2012, this figure rose to 33.7% for women and declined to 23% for men. Younger women that have only primary schooling, on the other hand, had unemployment rate of 4.6% in the same year, which could be due to the lower rates of labour force participation among the uneducated women. The gender variation carries on for employment rates among the younger cohorts thus suggesting that the younger female labour market participants are experiencing negative conditions both due to their gender and age. In 2012, illiterate women had an employment rate of 12.7% whereas this was 25.7% for illiterate men, again showing that the quality of available jobs for women is lower than their male counterparts. For university graduates, employment rate was recorded as 46.6% for female and 59.5% for male employees in 2012.

However, the unemployment rate among the educated is higher than less educated, especially for women. Women with university degree had an unemployment rate of 14.7% and illiterate women had an unemployment rate of 1.4% in 2012. This is partly due to the low level of labour force participation of uneducated women but also due to skill mismatches. Thus, the labour market programs and employment strategies have to address youth unemployment specifically, yet most of the measures implemented to boost employment were general and as a result did not have positive consequences on youth labour market performance (Ercan, 2010). Labour market policies such as unemployment insurance and other contributory schemes including work related sickness and maternity benefits do not cover the first time entrants because a certain level of premiums should have been paid by the employees and employers. Thus these type of programs do not necessarily help the younger cohorts in their job search. Finally, coordination between the higher education institutions and labour markets need to be established to identify the skill needs of the employers in order to avoid mismatches (Şenses, 2007). Even though there are several recent investments into vocational training by the Turkish state and joint initiatives with industrial organizations, there is plenty of room for skill upgrading and specific human capital accumulation.

In Figure 5.1.3 the causes of unemployment across genders are examined for the 2000-2012 period. Involuntary exit refers to the situations where the employees lost their jobs due to termination of contract in a temporary position, getting laid off, and bankruptcy. Voluntary exit is estimated by adding up the retirement and voluntarily leaving the job options. It can be seen that involuntary exit was much higher among men exceeding 60% in 2012 whereas the voluntary exit was slightly above 21% for the same year. At the beginning of the period, 2000, the involuntary and voluntary exit rates were 46.2% and 15.8% for male workers. The same figures were recorded as 27.5% and 25.5% for women in 2012, which increased from 21.9% and 18.6% in 2000 for involuntary

and voluntary. Hence, for both genders, the share of non-personal reasons for being unemployed have risen over time but at a much higher pace for men. The voluntary female exists typically differ between married and single women, and depending on motherhood. In Turkey, having children and being married negatively affect the employment status of women both in rural and urban regions (Dayıoğlu and Kırdar, 2009; Eyüboğlu et al., 2000). This is mainly due to the gendered division of labour where the household services are expected from women.

Figure 5.1.3 Voluntary and Involuntary Unemployment across Genders



Source: Author's calculations based on TÜİK (2013)

The above analysis suggests that unemployment is associated more with labour demand than supply in Turkey particularly for male employees. Nevertheless, the unemployment benefit system in Turkey is very limited and the duration is short without any additional compensatory scheme afterwards. Thus, it does not have the capacity to generate adequate income buffer against unemployment risk, and since majority of the job losses occur despite workers' willingness to be employed, it could be beneficial to extend the coverage and generosity. Additionally, the lack of public facilities for child rearing and elderly care make it harder for women to be in employment. Hence, such welfare measures are needed to restrain voluntary exits in Turkey.

The last table looks into the reasons for not being active in the labour markets from 2000 to 2012 in Turkey. Overall, household duties appear to have the largest share for the entire period although declining significantly over time. In 2012, 43.79% of people responded that household responsibilities are the factor behind not being in the labour force, and it should be noted that these are only women as they shoulder childcare,

elderly care, and household services in Turkey. There has been a decrease from almost 61% in 1990. Share of discouraged individuals, continuing education, and retirement also experienced increases since 1990s but ratio of disability, sickness, and old age remain to be steady. The rise in discouraged rates is interesting and its growth does not correspond with the economic downturns in Turkey, which is typically given as an explanation of not looking for a job. In 2012, the share of discouraged individuals was around 2.52% and it showed a continuous increase since 2003 from 0.33%. But it should be noted that the number of discouraged individuals go up during times when total unemployment is high (Tansel, 2002; Gürbüz et al., 2013). Moreover, poor qualifications are also positively related to withdrawals from labour markets as expected.

Table 5.1.3 Reasons for Not Being Active

	Discouraged	Household Duties	In Education	Retired	Disability, Sickness, and Old Age
2012	2.52%	43.79%	16.10%	13.86%	12.63%
2011	2.52%	44.19%	15.70%	13.46%	12.68%
2010	2.66%	44.29%	15.32%	13.30%	12.62%
2009	2.81%	44.92%	14.73%	13.45%	12.61%
2008	2.27%	45.19%	13.93%	12.93%	12.66%
2007	2.28%	45.11%	13.69%	13.10%	12.00%
2006	2.36%	46.96%	13.58%	12.25%	12.48%
2005	1.88%	49.04%	13.33%	12.01%	11.96%
2004	1.22%	51.09%	13.39%	12.24%	11.30%
2003	0.33%	49.77%	13.68%	11.80%	9.78%
2002	0.30%	50.41%	13.17%	11.20%	10.11%
2001	0.46%	52.24%	12.78%	10.37%	9.53%
2000	0.57%	53.34%	12.54%	9.84%	9.41%

Source: Author's calculations based on TÜİK (2013)

5.2 Wages and Labour Cost

At a theoretical level, wage curve establishes a direct relationship between real wages and unemployment rate, and the higher the wages the lower the employment is expected to be. However, empirically it has been found that wages and employment are positively associated across countries (Blanchflower and Oswald, 1994). The theoretically unanticipated results can be due to efficiency wages and implicit profit sharing arrangements within the firms, and the lack of negative impact of wages on unemployment is confirmed both for developed and developing countries (Freeman, 2009). Additionally, during the last crisis it has been seen that other forms of flexibilities are also compatible for fast adjustments, and wage flexibility was not sufficient to avoid sharp downturns. Table 5.2.1 presents the real gross mean wage growth in selected emerging markets between 2006 and 2011.

Table 5.2.1 Real Wage Growth in Emerging Markets

	2006	2007	2008	2009	2010	2011
Brazil	4.0	3.2	3.4	3.2	3.8	2.7
Bulgaria	3.6	11.1	13.0	9.1	3.3	5.6
Chile	2.0	2.8	-0.3	4.8	2.2	2.5
China	12.9	13.4	10.7	12.6	9.8	-
Hungary	4.1	0.0	1.3	-3.5	-3.4	1.3
India	-2.1	-2.3	-1.6	-2.5	2.1	-4.0
Indonesia	-6.0	-1.5	-2.7	0.8	6.4	-
Latvia	15.2	19.7	4.4	-6.8	-2.3	0.0
Lithuania	16.1	18.2	13.8	1.4	-0.2	-0.1
Malaysia	0.0	3.2	-3.2	0.0	4.0	3.9
Mexico	1.6	1.5	0.2	-1.0	-0.9	0.8
Poland	3.8	5.3	5.6	1.9	1.4	1.1
Romania	11.1	16.2	17.0	-0.8	-2.8	-
Russia	13.3	17.3	11.5	-3.5	5.2	4.3
South Africa	-	1.0	-0.2	4.0	9.7	2.7
Turkey	3.3	5.5	0.1	-7.7	6.7	8.0

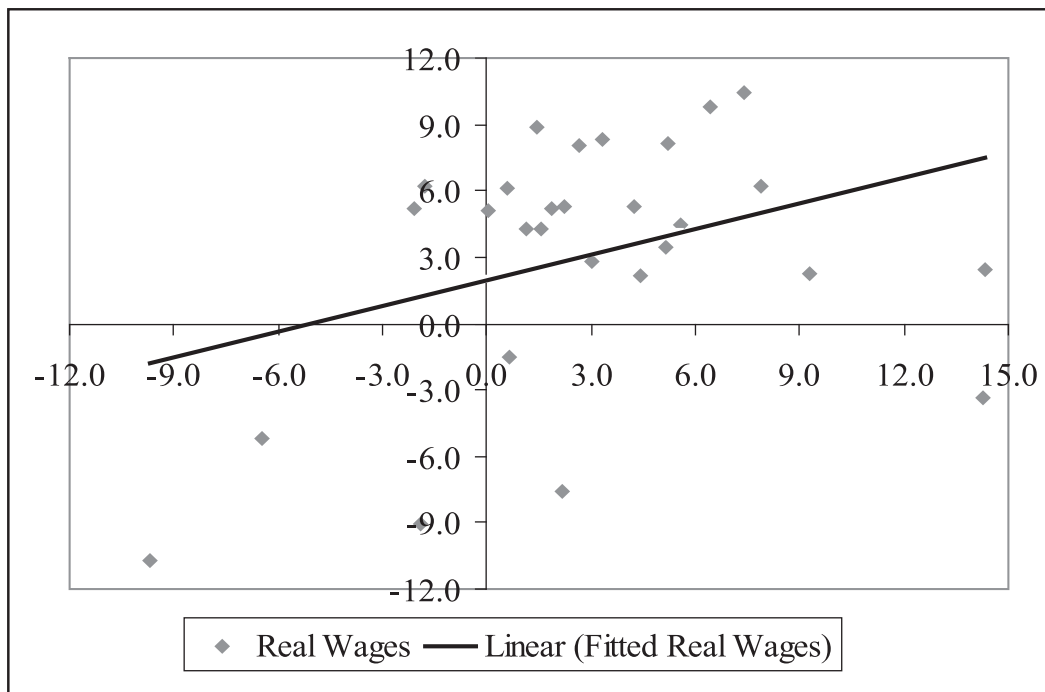
Source: ILO Global Wage Database (2012)

The years of economic contraction are consistent with decreases in real wages in majority of the countries. And it should be also noted that the employment performance had deteriorated in the same years for these selected economies together with wages. From the above table, it can be seen that most of the countries experienced a real wage growth over the period with the exception of India and Indonesia where real wages have declined on average 1.7% and 0.6%, respectively. In Turkey, the wages have increased by 2.6% on average in real terms between 2006 and 2011 but a sharp reduction, approximately 7.7% in 2009 was observed. The real GDP growth rate in Turkey has been 4.2% on average with the sharpest decline of 4.8% in 2009 and biggest expansion of 9.2% in 2010. The negative impact of global recession on wages is also evident in many other countries but particularly in the Central and Eastern European economies where the real wages have not recovered or saw relatively small increases in 2010 and 2011. China, Romania, and Russia appear to have the highest increases over the period, which can be attributed to the low levels of initial wages and greater economic growth rates.

In a recent study, unemployment elasticity is found to be -0.05 for private sector male and -0.042 for private sector female workers, and the broader unemployment rates are even more negatively associated with wages for female workers in Turkey. Additionally, it has been suggested that unemployment elasticity of wages is higher around the middle of the wage distribution, going beyond 0.1 for women employees. But the unemployment is less elastic at the lower and upper deciles due to the downward and upward wage

rigidities in Turkey (İlkkaracan et al., 2012). The reason for having unemployment inelasticity for the low paid workers is that their earnings are already set at rather lowest acceptable levels. For the higher earning groups, the competition is less severe for highly and specifically skilled workers, hence the unemployment elasticity is less pronounced. Definitely, the positive developments in wages might be due to productivity gains rather than inflexibilities. In a typical economic model the earnings should be determined by the marginal productivity of labour. Figure 5.2.1 displays the correlation between the changes in productivity and real wages in Turkey on a quarterly basis for the period of 2006-2012. The real wage growth is used as the dependent and the productivity change is used as the independent variable for the estimation.

Figure 5.2.1 Productivity and Real Wage Growth in Turkey



Source: Author's calculations based on TÜİK (2013)

The correlation coefficient between real wage growth and productivity in manufacturing sector is around 0.36 and is significant at 10% level. While the real wage growth was below productivity increases up until mid-2010, from there on the wage recovery has been stronger. Moreover, there is a widening gap between the two variables particularly in private sector manufacturing. Similar findings are also present in other studies, for instance, it has been shown that the real wages lack behind the rises in marginal product of labour between 1950-2009 in Turkey mainly due to declining bargaining power of the workers (Elgin and Kuzubaş, 2012). Indeed, the relationship between labour productivity and real wages in public sector is unidirectional, and the developments in the latter follow the developments in the former closely in Turkey (Aslan et al., 2009). This also can be attributed to the differences of wage setting mechanisms in each sector.

However, the labour costs are also divergent for public and private sector employees. Table 5.2.2 shows the changes in the labour cost index over 1999 and 2010 by taking 1994 as the base year for calculations prior to 2005 and by taking 2003 as the base year from there on.

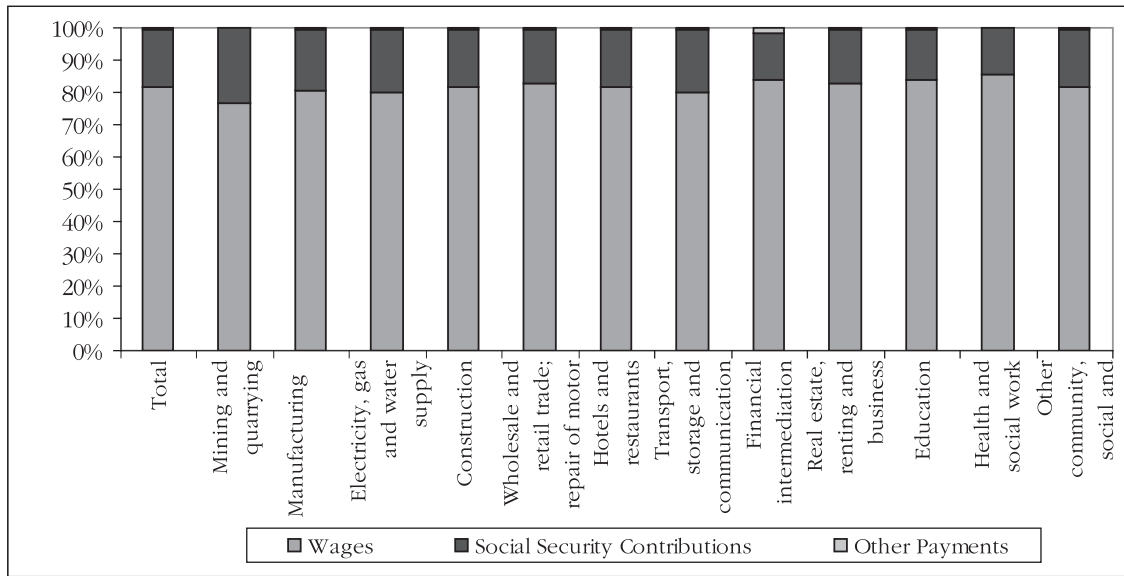
Table 5.2.2 Change in Labour Costs in Public and Private Sectors (%)

	Public	Private
1999	36.1	15.2
2000	20.8	13.4
2001	-11.1	-17.7
2002	-14	-6.1
2003	2.7	-2.3
2004	3.1	4.5
2005	1.9	3.4
2006	-2.8	-0.8
2007	7.2	3.8
2008	-6	-4.4
2009	6.4	6.8
2010	-1.5	0.8

Source: Ministry of Development (2013)

The private sector labour cost index is higher than the public sector index for the entire period. At the end of 1990s and beginning of 2000s, the cost has risen in both sectors but at a much faster pace in the private sector. Nevertheless, with the crisis the index went down sharply and recovered in private sector only in 2004. And since then the labour costs are fluctuating, for instance increasing by 7.2% in 2007 for the public sector and 3.8% in the private sector, and declining by 6% and 4.4% respectively in the next year. When the labour cost is disaggregated to its components, it can be seen that wages constitute the biggest chunk, on average nearly 82%. The social security contributions are around 17.6%, and only 0.6% is spent on other payments in total. There are some differences between the economic activities as wages reach to 85% of all costs in health and social work category while make up 76.6% in mining and quarrying. The same economic activities also have the lowest and highest share of social security contributions respectively. Financial intermediation is the only category where other payments exceed 1%, and is approximately 1.4% of all labour costs. In manufacturing, the wages are 80.5%, the social security contributions are another 18.8%, and finally the all the other type of costs are 0.6% of the total labour costs.

Figure 5.2.2 Components of Labour Cost



Source: Author's calculations based on TÜİK (2013)

Wage flexibility is an indispensable part of flexicurity model since the labour market performance depends largely on the responsiveness of real wages to economic cycles, and this is argued to be affected by the institutions and policies as limitations on downward wage flexibility can lead to low levels of employment generation (Bertola et al., 2001). While there are contradicting findings in the literature about the magnitude and sign of the effects of labour market institutions and policies, generally it has been pointed out that union density and employment protection legislation decrease the responsiveness of real wages to alterations in unemployment. Coordination, on the other hand, has a positive impact on wage adjustments whereas active labour market policies and unemployment benefit replacement rates are usually insignificant in explaining the real wage responsiveness to unemployment (Clar et al., 2007). Table 5.2.3 tries to compare the average monthly labour costs and its components in firms covered and not-covered by collective agreements by enterprise size. It is interesting to see that the gross earnings are significantly lower in every establishment type when it is not covered by collective agreement, and the disparity grows as the firms get larger. This illustrates the importance of company size as well as labour organizations for wage determination.

Table 5.2.3 Average Monthly Labour Costs in Firms Covered and Not-Covered by Collective Bargaining by Firm Size

	Gross earnings (TRY)	Gross earnings (the wage ratio to total labour cost) (%)	Social security payments (%)	Other labour cost payments (%)
Establishments covered by collective agreement				
Total	3.394	80.1	19.1	0.8
10-49	1.754	81.5	18.0	0.5
50-249	2.808	82.3	17.3	0.4
250-499	2.913	81.2	18.0	0.8
500-999	3.041	81.0	18.4	0.6
1000+	3.848	79.3	19.8	0.9
Establishments not covered by collective agreement				
Total	1.587	82.3	17.1	0.6
10-49	1.205	82.4	17.1	0.4
50-249	1.621	82.1	17.4	0.5
250-499	1.970	82.1	17.2	0.6
500-999	2.062	82.8	16.7	0.5
1000+	2.670	82.2	16.8	1.0

Source: TÜİK (2013)

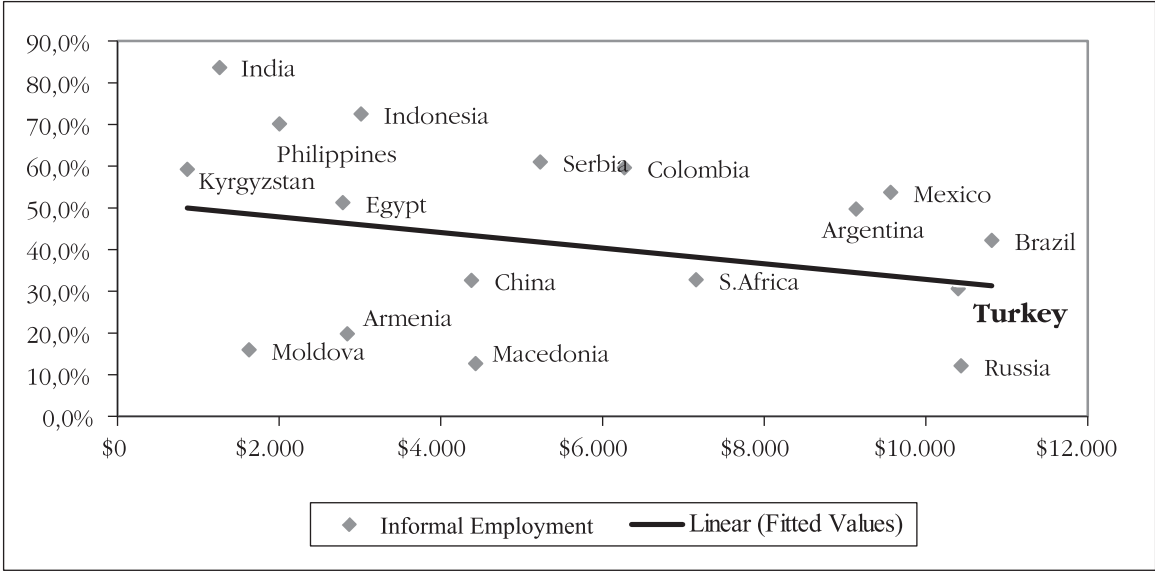
In the table above, the average gross monthly wage for an employee under collective bargaining amounts to 3,394 TRY and the earnings go up as expected in larger enterprises reaching to 3,848 TRY in firms with more than 1,000 workers. However, the same figures are 1,587 TRY for the average and 2,670 TRY for employees in the largest companies when the enterprise does not fall under a collective bargaining agreement. The wage share in total labour costs is around 82% and does not differ significantly across size without collective bargaining. Nevertheless, for largest firms under collective bargaining, the wage ratio to total labour cost goes down to 79.3%. When it comes to social security contributions, their ratio slightly decreases in larger firms from 17.1% to 16.8% under no coverage but increases from 18% to 19.8% with the size under coverage. The share of other payments is in general positively related to size, and goes from 0.4% in enterprises with 10-49 workers to 1% in enterprises with more than 1,000 workers when there is no collective agreement and from 0.5% to 0.9% when there is collective agreement.

5.3 Informal Sector

Traditionally, informal sector is understood as a form of dualism where insufficient growth and employment opportunities push workers to seek jobs in a sector with no social protection and lower wages. According to this view, a negative relationship between economic development and informality is expected since the labour force will get more skilled over time and the more productive sector will grow at the expense of

lower productivity sectors (Fields, 1975). Nevertheless, a number of developing countries have seen increases or at least did not experience any substantial reductions in the size of their informal sector even after periods of steady economic growth. Figure 5.3.1 shows the correlation between the share of informal employment and GDP per capita in several developing and post-communist countries in late-2000s. The GDP per capita is the dependent variable and the informal employment is the independent variable in the following figure.

Figure 5.3.1 Informal Employment and GDP per capita



Source: Author's calculations based on ILO (2012)

As can be seen, the fitted values indicate a negative association between the two variables but there are many economies which have relatively high or low informal sector employment with regards to their level of development. For instance, Philippines has more than 70% while Armenia has less than 20% of employment in unregistered economy even though their GDP per capita are quite similarly low, \$2,007 for the former and \$2,846 for the latter. Russia, Turkey, and Brazil are also exemplary with low, medium, and high share of informal jobs, 12.1%, 30.6% and 42.2%, respectively. Their GDP per capita ranges from \$10,399 in Turkey to \$10,816 in Brazil. Moreover, in fast growing countries such as China and India, the informal sector size got bigger over time. In India, 83.6% of all jobs are informal while the ratio is 32.6% in China, and there is no visible fall in the extent of unregistered economic activity despite the rapid economic development.

The existence of a large informal sector is claimed to alter the way labour market institutions and policies function. Generally, job security provisions and entry regulations are given as the prime causes of switches to informal sector as these make the formal sector employment more costly both for workers and firms. Employers favour to be smaller in size in order to circumvent minimum wage or severance pay regulations and hence distort the efficient resource allocation (Rauch, 1991). Additionally, excessive

taxation can be the basis for employees and employers to opt for informal sector while tax evasion has detrimental impacts on economic and employment performance in the long run (Tanzi, 1999). The extent and quality of social protection, on the other hand, can reduce the incentives to move to informal sector particularly for employees (Johnson et al., 1998). However, the larger the unregistered economic activities get the smaller the tax base becomes, and the states have fewer resources to spend on safety nets and social insurance. Additionally, corruption can be another obstacle for formalization since side payments to authorities increase the relative costs.

Table 5.3.1 considers the perceived and actual tax evasion in several developed countries and emerging markets between the years of 1999 and 2005. Perceptions are estimated based on the respondents opinion on the share of firms in their sector of activity that do not report 100% annual sales to tax authorities. Actual tax evasion depends on the average percentage of sales that are not reported to tax authorities. It is evident that there is an association between the two variables and Turkey has the highest perceived and tax evasion rates, 63.05% and 27.74%, respectively. Germany, Korea and Poland are exceptional since the high levels of subjective tax assessment are matched with low levels of unreported sales (44.68% and 5.69% for Germany, 43.86% and 10% for Poland, and 43.65% and 9.98% for South Korea). There are also economies such as Russia and Hungary where the actual underreporting is high in comparison to the perceptions. Spain, on the other hand, is at the bottom of the evasion ranking in the sample with 18.33% of firms thought to be reporting their sales incompletely and 3.67% of firms actually not reporting to tax authorities.

Table 5.3.1 Tax Evasion across Countries

	Perceived Evasion (%)	Actual Evasion (%)
Turkey	63.05	27.74
Greece	53.19	11.05
Czech Republic	51.05	13.09
Germany	44.68	5.69
Poland	43.86	10.00
South Korea	43.65	9.98
Russia	40.25	15.55
Hungary	40.03	11.28
Portugal	37.25	8.17
Slovenia	35.61	7.23
Ireland	28.78	3.84
Estonia	24.71	3.07
Slovak Republic	21.99	4.45
Spain	18.33	3.67

Source: EBRD-World Bank (several years).

More recent explanations of informality focus on the voluntary participation in unregistered economic activities by workers and firms. This can be done to avoid high taxes and regulations but it has been also recognized that informal sector can be rather dynamic hence lead to ample job creation and capital accumulation (Porters and Schaufler, 1993). In many countries of Latin America, the self-employment in informal sector is found to be voluntary for most of the workers and very few of them have any inclination to change their occupations. For instance in Argentina, 80% of self-employed in the informal sector did not see their jobs as temporary, and 62% of males in Brazil were happy in their current informal positions (Maloney, 2004). Thus, informal sector can be preferred both by firms and employees instead of formal sector, and furthermore there can be high levels of mobility and complementarity within and between the two sectors. Indeed, many companies and workers are recognized to have transitory positions and the borders between registered and unregistered activities are sometimes blurred. Table 5.3.2 summarizes the distribution of informal employment by status, education, and age across genders in Turkey for 2012.

Table 5.3.2 Features of Informal Employees

	Male	Female
Status		
Waged and Salaried	43.97%	23.16%
Employer	3.72%	0.45%
Self-Employed	40.46%	17.83%
Unpaid Family Worker	11.86%	58.55%
Education		
Illiterate	4.33%	19.68%
Literate but no diploma	8.28%	10.91%
Primary School	46.41%	47.26%
Secondary School	8.14%	3.33%
High School	7.28%	4.02%
Vocational High School	5.81%	2.65%
University	3.72%	1.92%
Age		
15-24	21.83%	15.31%
25-49	46.67%	57.92%
50-64	24.92%	22.15%
65+	6.57%	4.62%

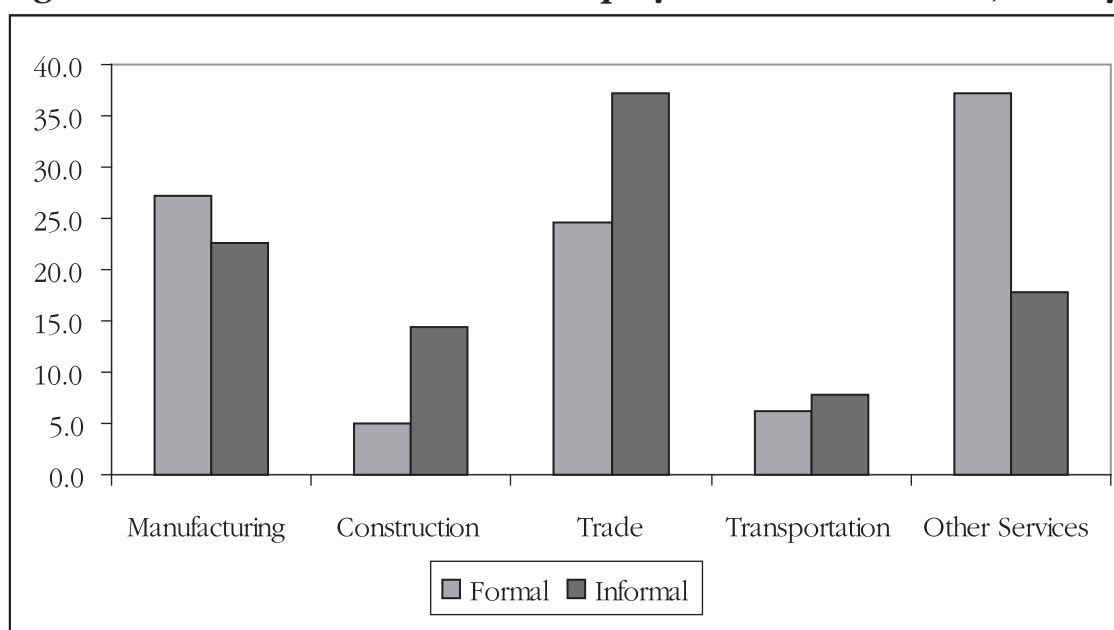
Source: Author's calculations based on TÜİK (2013)

There is a clear distinction between the employment status among male and female workers in informal sector. While nearly 44% of men are in waged and salaried category, another 40% of them are self-employed. However, more than 58% of women working in the informal sector are in unpaid family labour, and only 17.83% of them are self-employed, which lies well below their male counterparts. The share of being an employer

is low for each gender, 3.72% for men and 0.45% for women. In terms of educational distribution, primary school graduates constitute the majority for both genders, around 46.4% and 47.2% for women. But the education level is in general lower among female informal sector employees as almost 30% of them have less than primary degree. The same figure is approximately 12.5% for male informal employees. Also, 3.72% of men in informal jobs are university graduates and it is less than 2% for women. The age cohorts that are more present in the informal sector for each gender are prime age workers, and slightly older ones. Among the age groups, 21.83% of men and 15.31% of women between the ages of 15-24 are in informal sector.

Turkish labour market is found to be quite stagnant and the transitions between states are quite limited across different time spans with the exception of unemployment. For instance, the degree of inflows to formal-salaried positions is very low suggesting the dualistic characteristics of labour market in Turkey. Besides, the informal self-employment is concentrated in agriculture and among female workers in Turkey, which is different than the Latin American examples as mentioned above (Tansel and Kan, 2012). The sectoral composition of formal and informal employment also differs, and Figure 5.3.2 exhibits the allocations across sectors in Turkey. It can be easily observed that trade has the largest informal share with 37.3%. In transportation sector, this ratio declines to 7.8% followed by construction’s employment share of 14.3%. It is also interesting to note that among the informal jobs, 22.7% comes from manufacturing, which is quite similar to its level in the registered segment of the economy. While construction sector has a greater share in informal employment compared to its share in formal employment, the opposite holds for other services where in the registered economy it constitutes more than 37%, and in the unregistered economy less than 18%.

Figure 5.3.2 Formal and Informal Employment across Sectors, Turkey



Source: Author's calculations based on ILO (2012)

S E C T I O N
6

SECURITY AND FLEXIBILITY IN
TURKEY COMPARED TO OTHER
EMERGING MARKET ECONOMIES

6.1 Flexicurity in Emerging Markets

The theoretical and empirical findings on how labour market institutions and policies affect performance are still inconclusive. However, recently, the flexicurity concept has been offered as a way to optimally combine labour market security and flexibility. While the flexicurity idea dates back to 1970s, it gained prominence in the literature and among the policy makers after the success of the Danish model, which brings together low levels of dismissal protection and high unemployment benefits. However, any system that is based on a combination of labour flexibility and security can be identified as flexicurity, and there can be distinctive configurations of optimal social protection and labour market policies (Sarfati and Bonoli, 2002). The feasibility of institutions and policies ultimately depend on the structural conditions of an economy, hence the design of the mechanisms should reflect the underlying circumstances.

Danish model should be thought as one of the many alternatives that countries can implement, and even across developed nations the Danish model is found to be hard to apply. For instance, the generous unemployment insurance can generate perverse intentions in places where public spiritedness is low (Algan and Cahuc, 2006). Moreover, the policy makers can resort to different degrees of flexibility and security for different groups of people such as greater security for permanent workers and greater flexibility for temporary workers (Tangien, 2004). Certainly, this can lead to labour market segmentation, and given that in developing countries, a vast informal sector co-exists with a well-protected but undersized formal sector, the social costs of dualism could be even higher.

When it comes to transferring the Western type flexicurity systems to developing countries and emerging markets, there are greater difficulties since a number of prerequisites such as institutionalization of social dialogue, extensive safety nets, and enforcement of laws are largely missing. Income protection for the unemployed, which is a crucial part of the flexicurity model, is present only in few developing economies, and the unemployment benefit systems are relatively limited and has been put in place quite recently. When unemployment insurance or assistance is inadequate, people are more likely to accept any job they can get to minimize the transition period and avoid excessive income losses. This can result in self-employment and underemployment and both can be sub-optimal ways of overcoming labour market deficiencies. Moreover, policies are interdependent and without establishing the system as a whole, each part might not work effectively. For instance, people would have lower incentives to participate in active labour market policies (ALMPs) when they are not linked to unemployment benefits (Pierre, 1999). Additionally, many of these countries are dominated by the

presence of sizeable informal sectors in which labour market regulations are circumvented. Informal firms are on average very small or are engaged in self-employment, unpaid family work, and other atypical contractual arrangements.

Nevertheless, emerging markets can still have various forms of social protection and labour market mobility to ensure the best possible performance. In fact, a number of countries have seen transitions over time towards employment security from job security and as the former is one of the main pillars of flexicurity, these countries can be argued to move towards adopting a flexicurity model. As mentioned above income security is partial but increasingly emerging markets try to compensate the incomes of people in periods of work termination via other social policies such as poor relief, financial assistance, and family allowances. It should be remembered that the level of the expenditures is not yet comparable to the developed countries but rising over time both in proportion to national income and total government spending.

Like flexibility, security is a multidimensional notion, and can be understood by looking at several aspects of working life. Labour market security is mostly concerned with the transitions between different states, and the policies and programs like training or unemployment benefits to smooth the transitions (Auer, 2007). Employment or job security, on the other hand, can be offered by the employers and does not have to be extended beyond assurances to stay in the same position. The mobility and fast adjustments that an integrated economic system compels cannot be adequately met by the latter form of security. Also, the pace of adjustments to economic shocks is mostly determined by the form of security, and the heavy job regulations are found to be growth inhibiting (Kucera, 1998; Nicoletti et al., 2000). Hence, many emerging markets adopted employment strategies emphasizing the transitions and went to reductions in their employment or job protection. This has been done through different policy tools ranging from extension of public employment services to provision of subsidies to private employers.

In the existing studies, some regional patterns are observed but there are important dissimilarities within the regions when it comes to security and flexibility combinations. While most of the Latin American countries are identified as having relatively lower employment security, they also have elements of social protection and organizational labour rights. But, Mexico and Brazil can be distinguished as exhibiting low and high institutional rigidities and relatively restricted and broader passive labour market policies (Weller, 2009). In Asia, China and Korea are found to be emphasizing unemployment insurance and ALMPs more as opposed to India and Sri Lanka where security principally emanates from job protection. Also, in countries such as India and China where informal

and rural economies are considerable, public works, self-employment programs and skills training are used by governments (Vandenberg, 2008). Central and Eastern European countries, on the other hand, score higher in terms of activation and safety nets but have limited EPL, especially for temporary workers, although the Baltic nations have higher external flexibility (Casez and Nesporova, 2007). Thus, it can be seen that there is a fair amount of diversity in flexicurity strategies among the emerging markets, and the rest of the chapter aims to situate Turkey given the previously discussed flexibility and security dimensions.

Turkish flexicurity is generally evaluated as similar to other transition and developing countries where internal flexibility is low, and rigid legislation covers the formal sector (Gündoğan, 2009). Also, the existence of large informal sector and insufficient human capital make both the employees and employers to move towards unregistered economic activities, which increase the de facto flexibility. In the previous three chapters, the details of the institutional, policy, and performance indicators for Turkey are investigated in detail to understand the extent of labour market rigidity and the flexibility, and its impact on outcomes. The following parts systematically examine the flexicurity models along flexibility, security, and institutional rigidity in a number of emerging markets to offer a comparative perspective. The factor analysis and the measures used in the analysis are explained in more detail in the following part of the chapter. Then, in the final part of the chapter, Turkish flexicurity system is summarized and a number of policy measures are evaluated.

6.2 Flexibility, Security, Rigidity

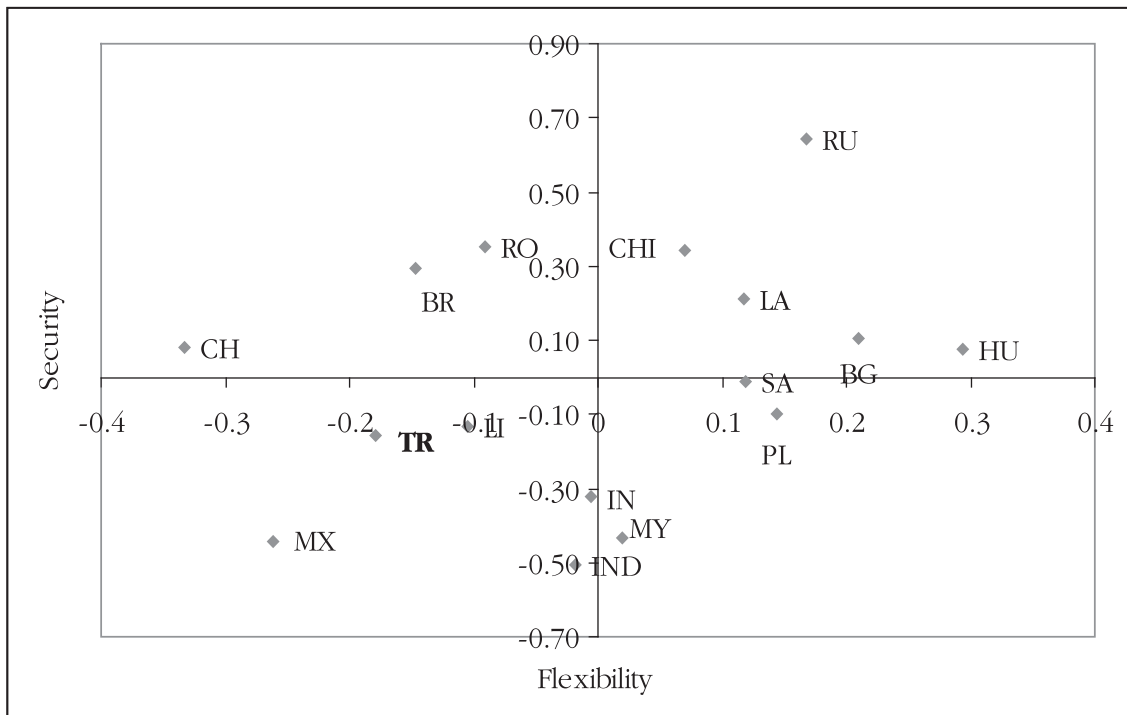
As mentioned above, there is variety over the flexicurity models emerging markets tend to adopt. In order to categorize them according to the flexibility and security indicators, first factor analysis is utilized. Since a large set of variables have been identified as crucial for flexicurity, factor analysis is helpful for summarizing the relevant information, and combining them. The criteria for selection and elimination of the variables are numerous, and our goal was explaining at least 75% of the common variance. We used the Kaiser-Meyer-Olkin scores to decide about the variables that need to be dropped from the analysis (Child, 2006). Also, the orderings are rotated since flexicurity measures are related to each other and several indicators are simultaneously explanatory for flexibility and security. However, it should be noted that flexicurity models can contain alternative measures, and factor analysis is highly contingent on the variable choice. Thus, the examination below needs to be supported by qualitative information and detailed case studies.

The flexibility factor is constructed by first looking at the overall EPL and its three sub-components; protection for permanent workers, protection for temporary workers, and collective dismissals. Then, the maximum severance pay and notice period, as well as the values of each for 9 months, 4 years, and 20 years are included in the estimations. The enforcement is an issue in many emerging market economies; hence the strong laws on paper do not automatically mean strict protection for employees in practice. In fact, it has been found that EPL does not have a statistically significant effect on job flows in countries with poor enforcement measured by the rule of law, and its impact is augmented in countries where the rules are strictly enforced (Micco and Pages, 2006). The rule of law tries to capture the perceptions of incidence of crime, effectiveness and predictability of judiciary and the enforceability of contracts. To control for the gaps between the de jure and de facto flexibility, we also add subjective evaluation of the easiness of hiring and firing as well as the flexibility of wage determination to the factor analysis.

For security, spending on passive labour market policies such as early retirement, social assistance, and family allowances are taken into account. Each one of these measures can assist workers in income smoothing throughout the transition periods. While, early retirement allows them to have financial means prior to normal retirement, family benefits can be particularly supportive for women who are the main care takers of children and elderly. The expenditures on unemployment insurance as well as the coverage and replacement rates under different scenarios are considered because the countries are generous to differing degrees in their unemployment benefit systems. Unemployment insurance should be viewed not only as a protective tool but also an effective instrument for decreasing the skill mismatches especially when accompanied by employment subsidies (Coles and Masters, 2006). Many of the emerging markets in our sample introduced unemployment benefit system very recently or do not have it all together. For instance, Malaysia, Indonesia, and Mexico have not established a nationwide unemployment insurance program yet while Turkey started to be in force only in 2000.

ALMPs are an important component of flexicurity model but unfortunately no comparative data exists for the selected countries. But it is well known that the extent of such programs is quite limited. To account for the overall social protection we included the social spending as percentage of GDP for each economy in the factor analysis. Finally, since several of the emerging markets have a high share of unregistered economic activity and as a result large number of unprotected employees, we adjusted the social protection by the size of the informal sector jobs. This ranges from more than 80% in India to less than 7% in Lithuania, and the average is around 32%, which is significantly higher than the developed countries. Figure 6.2.1 presents the relationship between flexibility and security across emerging markets. The negative values suggest inflexibility and insecurity.

Figure 6.2.1 Flexibility versus Security



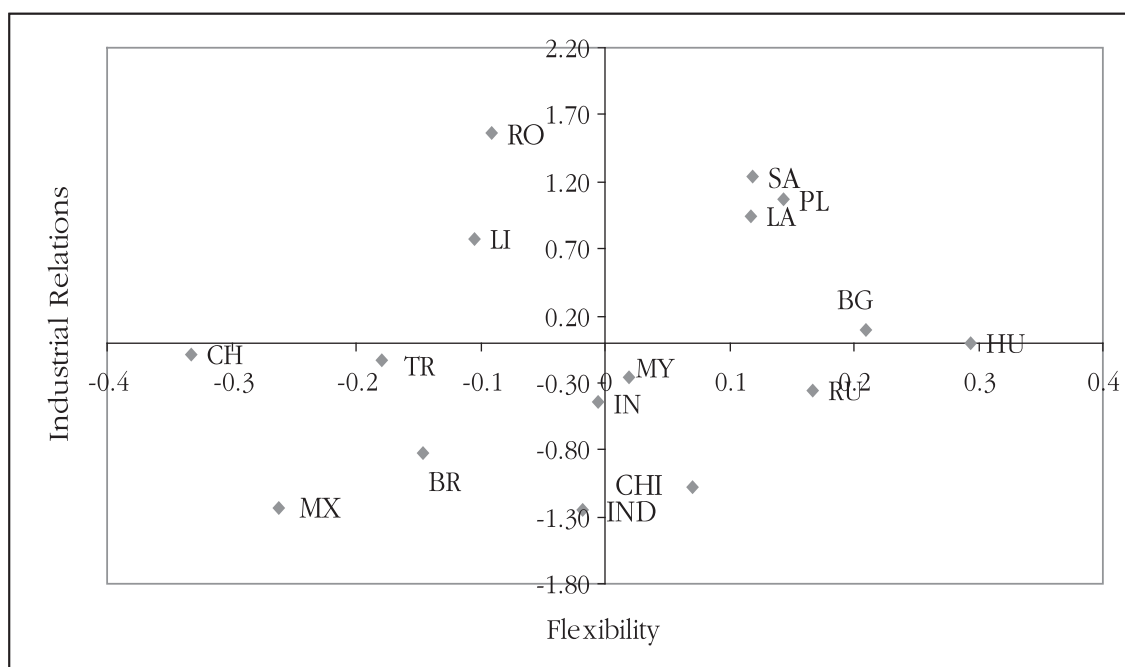
Source: Author's calculations based on ICTWSS (2011), WEF (2013), ILOSTAT (2013)

As can be observed from the above figure, there are significant differences among the selected economies. While countries such as India, Indonesia, and Malaysia are insecure, they are not necessarily more flexible. South Africa, Bulgaria, Poland, and Hungary appear to be quite flexible but do not rank high on the security front. Russia, China, and to a lesser extent Latvia display flexibility and security at the same time whereas Brazil and Romania are securer yet inflexible. Chile is the only country where high level of inflexibility and almost no security for employees are observed. Lastly, Mexico, Turkey, and Lithuania are inflexible and insecure, possibly the worst combination for labour market performance.

Thus, it can be concluded that the emerging market economies are dissimilar over the two dimensions; flexibility and security. The countries such as India and Indonesia need to focus on making the transitions securer for their employees but also enhance flexibility. This can be achieved via activation policies, and making the contractual arrangements easier to adjust to business cycles. On the other hand, South Africa, Bulgaria, Poland, and Hungary need to protect their employees through income support and employment protection legislation. Russia, China, and Latvia can be labelled as the only economies having the right combination of flexibility and security. Even though Brazil and Romania also manage to be secure, their employees are not mobile enough. Chile has the highest degree of inflexibility within the sample, which is not matched with security. Countries like Mexico, Turkey, and to a lesser extent Lithuania are the most problematic, and they have to deliver policies that target flexibility and security at the same time.

The industrial relations system is measured by union density, the level wage bargaining takes place, collective agreement coverage and possibility of extensions, existence of tripartite and bipartite organizations, and the degree of government involvement in wage negotiations. Industrial relations are crucial for the flexicurity model not only through the impact on wage and employment determination but also in coordinating the interests of the social partners. It has been widely recognized that stronger social dialogue and cooperative industrial relations are more conducive to find the optimal mix of flexibility and security, and without the agreement of all social partners, flexicurity policies could not be implemented (Wilthagen and Tros, 2004). Nevertheless, most of the emerging market economies in the sample do not have high organizational power on behalf of workers, and none of them have bipartite agencies where the employer and employee representatives regularly discuss labour market related issues. Trade union density and collective bargaining coverage is relatively greater in countries like Romania and South Africa while government intervention is extensive in Russia and China. Additionally, the typical unionized workers in these countries are employed in large enterprises of the formal sector, which are not necessarily representative. This can aggravate the dualism and cause insider-outsider gaps where the former groups' protection come at the expense of the latter's flexibility (Boeri and Garibaldi, 2007). As discussed previously, there is a sizable informal sector across a number of the selected countries, and the employees of this sector are not organized. In Figure 6.2.2, the association between flexibility in labour markets and industrial relations is shown.

Figure 6.2.2 Flexibility versus Industrial Relations



Source: Author's calculations based on ICTWSS (2011), WEF (2013), ILOSTAT (2013)

Once again the countries are highly scattered across the two dimensions under consideration. On the one hand, we have economies such as Bulgaria, Hungary, and perhaps also Russia where flexibility in labour markets does not come with strong industrial relations. After the collapse of the socialist regime, these countries have experienced very dramatic decreases in unionization and political power of workers. On the other hand, Chile and Turkey exhibit lack of institutionalization in their industrial relations, but this does not add to the mobility or adjustment capacity of their workforce. Romania and Lithuania display greater power for employers and employees but at the same time inflexibility, which suggest that these countries need to alter their industrial relations systems in a way that support schemes for easier transitions in the labour market. Malaysia, Indonesia, India, and China are the cases where labour is institutionally weak; however there doesn't seem to be significant flexibility gains. South Africa, Poland, and Latvia have more institutionalized industrial relations system and yet their employees are more flexible. Thus, there does not need to be a trade-off between the strength of social partners and the mobility and adjustment capacity of labour markets. Finally, Brazil and Mexico have inflexibility and low levels of institutional representation at the same time, and the main source of weak industrial relations is the lack of employee voice in policy making and appropriate consultative bodies. However, the findings from the factor analysis are only suggestive, and the specificities of the mixture of flexibility and security in Turkey, and the associated shortcomings are discussed at more length in the next part of the chapter.

6.3 Features of Turkish Combination of Flexibility and Security

Turkish labour market is characterized by a number of endemic problems such as low levels of female participation in economic activity, large share of informal sector employment, insufficient human capital, and not very cooperative industrial relations. Table 6.3.1 presents the summary of policies for different flexibility types and their implementation level in Turkey.

Table 6.3.1 Types of Flexibility, Policies, and Level in Turkey

	Components	Flexibility Level
External numerical	Low enforcement and coverage of employment protection legislation Social security coverage	High
Internal numerical	Working time	High
Internal functional	Internal qualification Work organization	Low
External functional	Active Labour Market Programs Education and training Subcontracting and outsourcing	Medium

Source: Author's evaluation based on the previous chapters

The external numerical flexibility in Turkey is high since employers can easily hire and fire workers in the unregistered parts of the economy. There is also a large reserve of people actively or potentially searching for jobs when unemployment, underemployment, and discouraged workers are jointly considered. Thus, the supply of labour is ample intensifying the competition and putting pressure on wages. Also, under the meagre enforcement of regulations companies may extend working hours without paying overtime. Functional flexibility internally is low mainly due to the hierarchical structure of the Turkish companies, lack of employee autonomy, and inadequate skills and qualifications for multitasking and rotation. For instance, it has been pointed out that by far Turkey has the highest work intensity among the European countries and the lowest participation in workplace innovation. Also, the incidence of working in a team is slightly over 45% (Eurofound, 2012). On the external functional flexibility front, the outsourcing and subcontracting are widespread among the large and medium sized enterprises (Özar, 2005). But, external functional flexibility is also concerned with the ability of the labour force to adjust to external conditions through skill upgrading, which is mostly missing in the Turkish context since the vocational training initiatives are limited. Thus, overall external functional flexibility is at a medium level.

Table 6.3.2 shows the security in different areas of working life and the relevant policies in Turkey. As can be seen security is mostly provided in the form of job security, which is not central to flexicurity. Indeed, this type of security is argued to be mobility inhibiting and costly for employers. However, it should be noted that share of people who benefit from strict employment protection in Turkey is quite small. In terms of income and combined security, several reforms were adopted in the last years to increase the generosity and coverage. The new system, which is amended in 2008, permits on-call workers and part-time employed to be registered under social security, and receive full benefits if they pay an additional premium. There are also initiatives for raising the

family and child allowances yet their current levels are far from being sufficient. The most comprehensive reform in combined security was passed in healthcare services. In 2012, general healthcare security is provided for all citizens and no payments are required from individuals living in households where per person income is less than one third of the minimum wage (Yentürk, 2012).

Employment security emphasizes the conditions under which the employability of the labour force can be increased so that they do not have to stay in transitory phases too long. Thus, active labour market policies such as education and training, wage subsidies, and public employment services are essential. Even though, the educational outcomes are getting better in Turkey and there have been recent reforms lengthening the compulsory schooling, still the enrolment rates are low, except primary education, compared to other emerging economies. Also, the quality of the education system is debatable since Turkey ranks 43rd in math and science and 41st in reading ability among 65 countries participating in PISA evaluations (Özenci and Arslanhan, 2010). Moreover, there is a big gender gap and residents of rural and eastern regions have poor access to education. Certainly, the deficiencies cannot be solely attributed to the policy design because there are important social and cultural factors behind the undervaluation of schooling.

Table 6.3.2 Types of Security, Policies, and Level in Turkey

	Components	Flexibility Level
Job Security	Employment protection legislation	High
Employment Security	Education and Training Wage subsidies Public employment services	Low
Income Security	Unemployment benefits Short term work payments	Low
Other Related Policies	Family benefits Social assistance Healthcare services	Medium

Source: Author's evaluation based on the previous chapters

There are also recent attempts for broadening the vocational training programs by public and private entities. In line with the EU accession preparations, Strengthening Vocational Education and Training (SVET) project was launched in 2002, which was jointly financed by the Turkish state and European Union. The key goal of SVET was to advance the coordination between the skill needs of the labour markets and content of vocational training. Specialized Vocational Training Centres (UMEM Beceri'10) was

developed through public, private, and university partnership although the results of the program are so far limited. In 2012, 1,987 courses were offered for 29,247 trainees but only 17,842 people finished the courses and in total 35,001 unemployed individuals have applied to the program (Sayan, 2012).

Our findings are in line with the other studies that analyze the state of flexicurity in Turkey. For instance, it has been shown that the divide between the formal and informal sectors also makes the flexibility and security measures to function in a vicious manner where the former is generally associated with security through strict legislation and the latter leads to precarious status with low wages and low productivity (Majcher-Teleon and Bardak, 2011). Also, the external numerical flexibility in Turkey based on subjective assessment of employees is estimated as high as 71% and 67% of the workers have no contract or in other words no protection (Tangian, 2009). Thus, from our analysis and existing research, it is possible to infer high degrees of numerical flexibility in Turkish labour markets. Internal and external functional flexibility as well as employment and income security are among the most vital components of flexicurity model but Turkey is short on these accounts, and hence reveals a pattern of flexibility without security.

The shortcomings in the labour market are worsened by the weak industrial relations system in Turkey. As can be seen from the earlier chapters, there are severe restrictions on unionization as well as coverage of collective bargaining. Social dialogue in Turkey needs to be improved. Indeed, this is one of the main areas where the country has been criticized in the annual progress reports by EU. The external functional flexibility achieved through outsourcing and subcontracting leads to mistrust among the employees, and they become adamantly opposed to further measures in this direction. But trade unions differ in their perceptions about the necessity of flexibility as a solution to labour market ills (van der Valk and Süral, 2005). This was also visible in the fierce struggles over the arrangements on temporary work and the proposal to build a severance pay fund. The industrial relations system in Turkey is not conducive to social dialogue and only grants institutional protection to a small segment of the labour force.

S E C T I O N
7

CONCLUSION AND POLICY
RECOMMENDATIONS

Flexibility and security in labour markets have been viewed as contradictory for a long time but recently it has been recognized that optimal combination of these measures are possible and can help to improve the outcomes. Widely known as flexicurity, such an approach is advocated by international institutions in targeting key labour market challenges both for developed and developing economies. Nevertheless, many of the necessary conditions for implementing flexibility and security in tandem are missing in developing countries, which tend to have large informal sectors together with infrequent and irregular social dialogue practices, financially restrained safety nets, and inadequate active labour market programs as well as life-long learning facilities. Moreover, the effectiveness of each tool relies on not only the impact on employability but also the financial resources spent since developing countries have strict constraints on their public budgets. Therefore, the policy makers of the emerging markets face higher obstacles in terms of the flexicurity both due to the limited public resources and existence of dual labour markets.

Turkey also fits into this sample since despite the progress in a number of areas over-time, there are still structural and institutional obstacles for implementation of well-developed flexicurity strategies. Additionally, majority of the employment in Turkish labour markets is in small and micro enterprises, which have lower levels of regulation on average. All in all, Turkey turns out to have insecurity, inflexibility, and weak representation of social partners, which put the combination of flexibility and security in the country at a sub-optimal position. The main reason of insecurity is the very limited unemployment insurance system whereas the primary factor behind inflexibility is the high redundancy costs for tenured workers, and lack of temporary work arrangements. Industrial relations system in Turkey is not very cooperative, and the union density as well as the collective agreement coverage rate is quite restricted leading to weak social dialogue mechanisms. These, coupled with relatively low levels of skills, high share of unregistered activities, and demographic pressures, pull the country's labour market performance down.

Even though a European style flexicurity is hard to be diffused to developing countries, the multidimensionality of the concept allows them to formulate models that are in line with their economic and structural circumstances, and to articulate activation and protection policies that cater to the local needs. In fact, several attempts in Turkey towards enhancing flexibility and protecting workers at the same time have been observed. This is partly due to the country's efforts to harmonize its policies with the European Union and partly due to the developments in the economic and social structures. In the report, reforms in core institutional and policy areas, and their relation to labour market outcomes are looked in more detail. Then, the Turkish experience

with flexicurity is compared to few other emerging market economies. Main findings and conclusions that appear from the examination carried out in this report can be summarized as follows.

First, the trade union density and collective bargaining coverage in Turkey are well below the European averages but quite similar to the levels in developing countries. The official unionization appears to be high, yet these figures are quite controversial, and do not match with international institutions' accounts for most of the years. Both union density and collective bargaining coverage in Turkey are found to be loosely related to unemployment rate and wage growth, nevertheless, the data limitations are severe, and hence these correlations have to be taken with caution. More importantly, the industrial relations system in Turkey is not very cooperative and the social partners rarely reach to joint solutions over dialogue. This is partly due to lack of trust between the actors yet there have been several attempts particularly in developing education and training programs between employer and employee associations. Also, government assumes a major role in Turkey when it comes to negotiating with employees and employers, and hence directly affects the labour market outcomes, sometimes at the expense of both of the social partners. Thus, in addition to the expansion of unions' organizational rights, the utilization of the existing tripartite institutions such as Economic and Social Council could enhance the cooperation between employers and employees.

Second, it can be seen that most of protection in Turkey comes in the form of job protection, and the official rankings imply that Turkish legislation is quite rigid. Nevertheless, there is a wide gap between the objective and subjective evaluations, and Turkey appears to be more flexible when enforcement issues are taken into consideration. Also, there have been several amendments under the New Labour Code, which raised the flexibility of contracts on paper. While the new law enforces larger firms to have a certain degree of job protection, it allows firms less than 30 employees to be exempt from the legislation related to job protection. And given that majority of employment in Turkey is realized in small and medium sized enterprises, a big number of workers might be falling out of the legislative coverage. Nevertheless, there are some concerns about the implementation of the new law since the terms for temporary work and subcontracting remain to be strict. There are also recent discussions about altering the severance payment system into a fund in order to promote flexicurity. From the employer perspective the payments are needed to be made financially less cumbersome and from the employee perspective the eligibility should be extended to all workers even with short term contacts. Overall, the severance pay is one of the components of employment protection legislation and it should not substitute for other forms of security that employees would need in their transition between unemployment to employment.

Third, in addition to the low levels of protection, the passive and active labour market policies in Turkey are very limited in spite of the recent programs such as unemployment insurance and employment incentive packages. While insurance allows for partial income security, its duration is short and the replacement rates are minimal. Since unemployment benefits are an important part of flexicurity model, the coverage and generosity need to be expanded in order to provide sufficient buffers against labour market risks and assist workers to preserve a decent living standard in the meantime. Income protection policies such as unemployment insurance are also crucial for skill matches, and given that unemployment among university graduates is high in Turkey, such benefits can avoid highly educated people to accept unskilled jobs. The active labour market policies are harder to assess since there is no systematic monitoring but their effectiveness and financial sustainability are frequently questioned. One of the important tools of active labour market policy is education and training, which is increasing in Turkey over the years but is still limited and there is ample room for vocational training and cooperation between industry and schools. These would not only help to decrease the skill mismatches but also raise the employability of individuals.

Fourth, there is duality in the Turkish labour market and the informal sector has cost advantages over the former sector. While the informal sector enjoys lower labour costs due to wages less than minimum wages and lack of regulation, the formal sector has to bear higher labour costs. Overall it has been affirmed that restrictive institutions and policies prevent formal sector's absorption capacity to rise, and lead to segmented labour markets where insiders enjoy protected jobs with high wages while outsiders are left to unemployment or informal employment. The types of flexibility and security are affected by the segmentation in the labour markets in Turkey. The switches between the formal and informal sectors put additional restraints on protection and heighten excessive employee substitution. Changes in the tax system and social policy can help to decrease the size of the informal sector, which adds to the insecurity and flexibility of the Turkish labour market. While the income tax rates have been declining, the taxes paid out of profits are still considerable and reducing the non-wage labour costs could make the formal sector more attractive. Besides, the taxes are disproportionately allocated in Turkey, and the tax reforms that target low wage workers, unskilled, youth, and women who have greater difficulties in participating and getting a job in Turkish labour markets could be more effective and egalitarian. Also, the social benefits can be tied to the formal labour market status in order to generate incentives for employees to become registered.

Fifth, there seems to be a drop in unemployment rates over time but the developments are quite cyclical, and during the crisis sudden increases are common in Turkey as

observed in the last major recession. Yet, several programs were also utilized such as short-term work pay during and after 2009 crisis in order to reduce the layoffs. While there are improvements in terms of the general unemployment rates and length of average years of schooling throughout the recent decade, there are still large disparities across genders and regions. Moreover, the unemployment rate among highly educated workers is quite high both suggesting that there are skill mismatches and insufficient labour demand. Lifelong learning, vocational training and work subsidies could be used to decrease the unemployment of skilled employees in the short run. In the long run, establishing close linkages between the skill needs of the employers and the curricula of the educational institutions can be done.

Sixth, the female labour force participation has been on an almost continual decline over the last decade with a slow upward trend since 2008, and the degree of informality is greater among the female employees. It should be noted that one of the major reasons for not actively participating is related to household chores and hence improving labour supply requires well designed social and family policies. Flexible arrangements are more necessary for women who are also mostly responsible for child and elderly care in Turkey. Access to affordable child care services should be considered as a national policy. Another important factor behind low level of female labour force participation is the existence of informal economy. There are only minor gains in unregistered economy and still a considerable portion of employment is provided through such activities. Like in other developing countries, gender, education, and sector also significantly affect the mobility patterns in Turkey where being unskilled, woman, and in agriculture increases transitions to informal states. A big portion of working women in Turkey is not covered by social security hence tax and social protection policies aiming to diminish the duality in the Turkish labour market would also be beneficial for women.

Overall, when evaluated against a number of emerging market economies, Turkish labour markets are found to be inflexible and insecure, which is the least desirable combination as neither the employees nor the employers could benefit from such a setting. The rigidities mainly emanate from the little usage of temporary contracts and high severance pay for tenured workers. The reasons for insecurity have been mentioned already ranging from deficiencies in social protection to sizable informal sector employment. Therefore, Turkey needs to address these weaknesses and design policies that directly target flexibility and security in labour markets. Certainly, the financial costs of flexicurity approach have to be taken into account, and should be weighed against the potential benefits that would be created by the increased mobility, competitiveness, and productivity.

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