This short ‘statements and comments’ paper comments on the reform of severance pay law in Austria as presented in the host country discussion paper by Helmut Hofer. The paper is structured as follows.

In Part 1, there is a brief assessment of the severance pay policy, surrounding economic circumstances, and institutional/legal background in Turkey. In Part 2, there is a brief assessment of the potential transferability to Turkey of the new transition in Austria from ‘severance pay’ to ‘separation accounts’ system. The discussion takes into account the likely conditions for the new policy’s application and labour market problems it could potentially solve. The measure does not fit well with the institutional setup and legislative system in Turkey now. An argument must start, however. Current debate on the severance pay issue is given in Part 3. Important issues relevant to severance pay that are currently being raised and debated in Turkey are presented in this section.

Note that Turkey does not have a National Reform Programme yet. This is not necessarily a handicap for the analysis in here. Such a programme’s basic features will obviously be in line with the European Employment Strategy, taking as given the known Turkish labour market features.

1. Severance pay and job security in Turkey

The objective of this section is to provide a compact institutional background on severance pay and job security in Turkey. In light of the recent labour market reforms, which have mostly been prompted by the EU accession process, this background may then set the stage for long-term labour policy and transferability recommendations on the issue.

The importance of the topic is self-evident in the sense that, labour flexibility is typically implicitly or explicitly associated with economic growth performance. This association has been enforced in the volatile global economic environment of the 1990s. Regional crises are now more contagious and spread across continents among the emerging market economies. Under these economic conditions, what then is the optimal balance between the economic need of flexibility and the individual worker’s need for job security, of which severance pay is a major component? The concept has been important for some years in Europe now that it is called flexicurity.

Severance pay institution is worldwide and Turkey has one of the more generous and rigid implementations of this inflexibility and job security institution on paper. When it comes to implementation, public sector and formal large unionised private sector blue-collar employees are covered by severance pay legislation. Informal sector small establishments will not abide by the law. Unregistered employment is common and registered low-skilled workers are likely to be fired at the last day of their annual contract and rehired the next day. They do not become eligible for coverage this way.
Note that, recent years’ economic growth in Turkey came after years of hardship and it came without jobs until recently. Flexibility in terms of falling real wages and employment losses inclusive of informal labour market arrangements emerged as the clear political winner, despite the protective laws that have not been or could not have been applied.

**New Labour Act (2003) introduced labour flexibility**

The new Labour Act no. 4857 was put into effect on June 10, 2003. It replaced Law no. 1475 that had prevailed for decades. Job Security Act was act no. 4773 and it was passed before the general elections in November 2002 to become effective on March 13, 2003. Later it was absorbed into the New Labour Act. Job security act was of course part of the new labour law, but it was deemed expedient at the time by the government to be separated and passed as a law unto itself just before the elections (the government coalition parties disappeared in the election nevertheless). ILO convention on the termination of employment was the model for the Job Security Act. It increased protection against dismissal by improving on the previous Labour Act and still existing Unions Act. Job security act was severely criticised by the Turkish Employer Unions Confederation (TISK) for having gone too far in guarding the workers against dismissal and placing the burden of proof on the employers.

Employers are generally content with the law except for the job security regulations and the continued existence of severance pay (in spite of the recently institutionalized unemployment insurance scheme). Worker unions regard these two issues as their gains in the process.

The new law’s innovative feature is its formal introduction (or, in some cases, official acceptance of existing practices) of new modes of employment like part-time work regulations and flexible hours arrangements.

There was intense lobbying by both the labour unions and the employer’s associations during the legislation process. Since economic growth came after years of hardship and it came without jobs, there were newly introduced firing restrictions for larger establishments (previously enjoyed by union members only) and severance pay remained as a labour market institution. In addition, labour unions’ lobbying had the satisfactory outcome on their part, as suggested regulations for temporary employment agencies were revised in their favour. Employers’ lobbying had the satisfactory outcome on their part, as increased job security was limited to establishments employing thirty or more workers. Note that, over 90% of manufacturing sector establishments, not to mention enterprises in the trade and services sector, operates below this level. Flexibility argument has won over job security, it may be argued.

**Severance pay regulations remain unchanged**

Severance compensation was very important in the Turkish labour relations system because there was no unemployment insurance system before 1999. The fact that there were no amendments to the existing system in the new Labour Act is due to labour union opposition.

Severance compensation in Turkey is the lump-sum payment made to a worker if he/she worked for at least one year and if his/her labour contract is terminated according to certain specifications. These specifications are death, compulsory military service, retirement, disability
benefits, female worker getting married, quitting with ‘just’ cause, and employer’s termination of employment except for reasons of serious misconduct and immoral behaviour.

Severance compensation is thirty days' pay (last daily gross wage) for each year of service at that workplace. This may be increased by individual or collective agreements. There is a ceiling on severance compensation, which is the retirement bonus of the highest-ranking civil servant (the undersecretary to the prime minister). This is a popular benchmark public position in Turkish labour practice. This cap notwithstanding, the stipulated provision is the most generous in the world (and possibly the most circumvented as well).

2. **Transferability of the Austrian reform to Turkey**

The process of EU accession has provided strong incentives for various institutional changes in Turkey. Labour market regulations and employment policies have been one of the most important areas for Turkey in the adoption of the EU acquis. These recent changes in the Turkish labour code will alter the functioning of the labour market significantly with critical outcomes pertaining to workers, firms, and long-term economic performance.

This atmosphere coupled with Turkish macroeconomic crises and ensuing unemployment problem allowed policy makers to consider in depth new possibilities in working time and modalities of employment. Prior to the new Labour Act, Turkey had rigid employment protection schemes and no legally regulated flexible work arrangements. Employers demanded flexible employment regulations. Labour unions were hostile to the proposition as they claimed that it would deteriorate working conditions and reduce unionisation rates. Therefore, a balance had to be struck between the aims of making enterprises more competitive and productive through flexible forms of employment and satisfying workers’ demands for job security. That is, the very same Austrian (and European) dilemma was the agenda.

The fact that such an important institutional change was made through active participation of social partners is a good sign for future labour market debates and changes. However, the fact that severance pay regulation to have remained the same in the new code is a bad sign for future reform in this specific area. Union resistance is strong and it is likely to remain strong. The reason is understandable. Unions are more interested in protecting the (unionised) job than protecting the worker (through unemployment insurance and skills training). The new job may not necessarily be a union job after all. Any measure that increase labour mobility will be opposed by the unions. Current pre-election climate will not allow a debate on the necessity of severance pay reform any time soon. That is a pity. This author would definitely like to see a similarly funded (albeit at a higher rate than 1.53% contribution), transferable severance pay scheme implemented in Turkey.

3. **Current debate on severance pay in Turkey**

The incidence of economic recovery since 2002 and jobless growth prompted a heated public debate, which continues to date. Employer organisations were quick to criticise the new Labour Act (2003) that has replaced a decades-old one. The job security clauses (which amount to a firing tax on the employers) and severance pay were blamed for the employer reluctance in expanding employment (never mind that the applicability of job security clauses being rather
limited). The question was (unfairly in this author’s opinion) posed as why would one still need severance pay, now that Turkey has finally institutionalised unemployment insurance.

On the other hand, the new Labour Act specified, for the first time in Turkey, flexitime and flexible work regulations. These were strongly opposed by the workers unions. Workers unions countered the employer’s job security argument with a forceful “Now, you have all the flexibility you had wanted for decades, and you still failed to create jobs.”

As it is, one is not in a position now to assess the new labour law’s impact on the labour market. Because of the productivity increase factor, one may not yet debate whether the new labour law had the ‘right’ mix of flexibility and job security, ‘flexicurity’, for Turkey.

Nevertheless, one may talk about an interim grade report. In the second half of 2004, employment started to grow and 644 thousand new jobs were created in that year. TURKSTAT reported that non-registrants increased from 51.7% to 53% of the total workforce from 2003 to 2004. Most of these were unpaid family workers in agriculture. In urban areas, 37% of all workers did not belong to a social security organisation. These numbers imply that only 30 thousand out of 644 thousand new jobs were those that had social security registration! The new labour law introduced flexitime regulations and flexible modes of employment, citing a need for formal employment creation against high informal employment. If one had to judge the Labour Act’s performance in its second year with 2004 data only, the picture did not look nice at the time.

As a result, the severance pay debate rages on. Academically speaking, severance pay is a compensation mechanism for unforeseen permanent income loss (because of job termination) or unforeseen permanent income loss (because of retirement). The mechanism for unforeseen temporary income loss component of job termination is unemployment insurance.

In the debate, employers association TISK (Turkish Employer Unions Confederation) posits that there is no further need for severance pay, now that there is unemployment insurance. This argument ignores permanent income loss compensation. Labour unions counter with the argument that, severance pay is simply a component of gross wage. This argument conveniently ignores (especially for smaller establishments) a cash management crisis that will ensue in case of a (by definition) unforeseen economic crisis. (The problem of the firm here is the well-known design problem of an insurance ‘pool’ against such an eventuality. The new ‘mandatory’ Austrian system removes this uncertainty component from the firm’s point of view; a desirable outcome that requires universal coverage, which is only possible by legal regulation.) Moreover, recent empirical findings, on the impact of severance pay on the labour market, find that firing tax view that dominated the academic literature since Lazear (1990) is not necessarily the one that is

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27 From a speech by Salim Uslu in April 2005, the president of one of the three major workers union confederations, Hak-Is (the other two are Türk-Is and DISK).

28 The specific reason for the lacklustre employment performance in 2002-2004, however, was partial labour productivity increase (Ercan, 2005). Productivity has been improving in private Turkish manufacturing sector while real wages have been going down. Almost two years into the macroeconomic recovery, employers started hiring again after having invested in equipment and machinery. This observation has also been borne by increasing capital goods imports, which is an indicator of future production and productivity increases.

29 The employment picture did not improve later by much, either. By June 2006, the non-institutional civilian population of Turkey has risen to 72.6 million, with an annual population growth rate of 1.4%. The working-age population has risen by 870,000 from June 2005, reaching 51.6 million; its annual growth rate is 1.7%. Employment growth rate was only 0.6%!
observed. Given the institutional setup of many EU countries, severance pay is much more like a transfer payment than a tax from the firm’s point of view (Garibaldi and Violante, 2005).

One should only hope that, the results of this peer review would contribute to the Turkish debate by both academic rigour and the pioneering example of Austria. This author wishes for the success of the system.

**References**

