The objective of the paper is to examine the relationship between employment protection regulations and profits in the European economies. Using regression analysis on the panel of 18 European countries over the period 1998-2008, we study the effect of EPL index on net operating surplus of mixed income (a measure of profits). Our findings confirm a statistically significant negative relation between EPL index and profits at the level of economies, implying that more rigid employment legislation, and by that higher hiring and firing costs, hinder an efficient allocation of resources, resulting in lower efficiency of companies and in decline of profits. Although the effect is small, we believe that further flexibilization of employment protection regulation presents an important determinant not only for labor market performance and productivity, but also for companies’ profits and therefore for the competitiveness of the European countries.

**Keywords:** employment protection, EPL index, profits, capital investments, economic policy, Europe.
1. Introduction

The issue of employment protection legislation (EPL) has over the last two decades gained a considerable importance among labor market economists and policy makers. This is among others reflected in an extensive literature on the effects of employment restrictions. Nevertheless, most of the empirical and theoretical studies on the EPL focus on its relation with labor market outcomes and productivity (for overview of studies see, for example, OECD, 1999, 2007; Bassanini and Duval, 2006; Bassanini, Nunziata and Venn, 2009; Bassanini et al., 2010). In contrast, little attention has been devoted to the effect of EPL on profits, i.e. on one of the most important determinants of companies’ operation. The factor that without doubt influences the level of companies’ profits is labor legislation. Namely, strict EPL can affect the effectiveness of resource reallocation and thereby decisions of companies to invest, which is reflected also in their profits. However, the empirical studies in this field are rather scarce.

As mentioned above, profits are without doubt important for the economic activity of companies. However, the level of profits is dependent on several factors. As Keynesian economists put it, profit expectations are, beside demand and institutional factors, based upon “animal spirits” (Stockhammer, 2006). One of the primary factors affecting the level of profits is the investments. The issue of relation and the question on causality between profits and investments is already for decades a subject of intense debate among economists. Namely, profits present an internal capital source for financing the investments of companies. By investing in physical capital, companies try to achieve their primary goal – to increase the value for the owners. In order to attain this, they must invest in activities with positive present value. The present value of the expected net cash flows discounted with a proper discount rate, which takes into consideration also the risk of investment, must exceed the present value of invested capital. In this case investment adds value. However, financial market imperfections increase the difference between internal and external financial resources. Limited financial resources and the disparity between the external and internal sources of capital affect the level of investment and increase the importance of profits for investments. This reasoning opens a further question of causality between profits and investments and of its direction. The existence of causality running from profits to investments was confirmed by Little (1962), Baumol et al. (1970), Lintner and Glauber (1972), Bar-Yosef, Callen and Livnat (1987) and Inci, Lee and Suh (2009). On the other hand, McFetridge (1978) and Mahdavi, Sohrabian and Kholdy (1994) found that causality is running from investments to profits, whereas Lee and Nohel (1997) reported on a two-way causality. As can be seen, studies do not give an ultimate verdict about the direction of causality. However, they confirm that investments and profits are strongly related.

The main objective of this paper is to examine, whether employment protection regulations affect profits in Europe. To be more precise, we study the relation between EPL index and net operating surplus and mixed income (i.e., an aggregate measure of profits, later referred as NOSMI) in 18 European countries over the period 1998-2008. Since the financial theory suggests that profits are strongly related with investments,
we also perform an empirical overview of the level of investments among studied countries. As a measure of investments we use gross fixed capital formation (i.e., a measure of gross net investment in fixed capital assets in the economy, later referred as GFCF). We believe that employment restrictions present costs for the employer and affect companies’ decisions on hiring and firing, therefore, their investment activities, and, by that, the level of profits in the economy. The empirical findings will provide an important added value in the field, as the understanding of the relation between EPL and profits is essential for effective policy making.

The paper continues with a brief overview of theoretical background and empirical findings on the studied issue, followed by the presentation of methodology and data. In addition to that we present our empirical findings, i.e. descriptive statistics and panel regression estimates on the relation between EPL index and NOSMI. In the last section we offer our conclusions.

2. Brief overview of the theoretical background and empirical findings

2.1. Theoretical background

As already mentioned in the introduction, profits are strongly related to investments. Therefore, before we focus on the theoretical view of the effects of EPL on profits, we briefly present the theoretical background on the relation and causality between profits and investments. The latter can be defined as a synthesis of the theoretical concepts in economics, finance and entrepreneurship. According to Keynes (1936), profits and interest rates represent the main determinants of investments. On the contrary, Kalecki (1971) emphasized that changes in investment cause changes in profits. Furthermore, Robinson (1962) established the two-way causality between investments and profits by showing that investments are dependent on profits and profits are dependent on investments. Galbraith (2007) and Eichner (1976) found that modern corporations set market prices in a way to make enough profits to finance the planned investment.

Financial theory acknowledges that profits are strongly linked to investments. Namely, financing of investments depends on the financial resources of the company. When companies operate in the perfect capital market, their investment decisions are independent of the financial position of companies. However, the real prospective is different – internal and external sources of finance are not substitutes, but rather, according to Davidson (1994), complementarities. Namely, if a company does not have enough internal sources (i.e., retained profits, free cash flows etc.) to finance the planned investment, it must acquire them on the financial market, implying that it is subjected to specific requirements of the financial markets. This can lead to problems such as high costs of external sources, high risk, and information asymmetry between the management and potential investors, moral hazard and adverse selection. For these reasons, companies rather chose to finance their investments from internal sources; it suggests that there is a strong link between profits and investments. On the significant investment dependency on profits reported, for example, Young (1994),
Carruth et al. (2000) and Driver, Temple and Urga (2001). From the entrepreneurship point of view, profits represent one of the motivations for the entrepreneur to invest (Hisrich, Peters and Shepherd (2005, p. 67) and Burns (2008)).

The level of profits in the economy is, beside investments, dependent on other factors, out of which several relate to institutional framework and the environment in which companies operate (for example, ownership structure (see Dolenc, 2010), structure of companies assets (Jerman, Kavčič and Kavčič, 2010), the scope of innovation (Fatur and Likar, 2010), institutional framework, investment climate etc.). One of the important factors, however less researched, is definitely employment protection regulation. EPL refers to a set of provisions and procedures to be followed at hiring and/or firing of workers. The most commonly used measure of the strictness of employment protection regulation is the EPL index, developed by the Organization for Economic Co-operation and Development (OECD). EPL index covers three different aspects of employment protection: (i) EPL for regular workers, which comprises a set of instruments related to the termination of employment contracts for regular workers on individual or collective basis (for example, notification procedures, advance notice of dismissal and severance payments, provisions regarding unfair dismissal and compensation for it); (ii) additional provisions for collective dismissal; and (iii) regulations on hiring on the basis of fixed-term contracts or employed by the temporary work agencies (OECD, 2011). EPL therefore imposes costs on employers for adjustments of employment levels and may consequently influence the level of profits (Boeri and van Ours, 2008).

From a theoretical point of view, the effects of EPL on profits are ambiguous. In the competitive model, stricter dismissal protection regulations would increase the companies’ costs of employing workers, causing an inward shift in labor demand, and reduce the effectiveness of resource allocation. The reduction of allocation effectiveness results in the loss of companies’ efficiency and the level of profits (Boeri and van Ours, 2008; Bird and Knopf, 2009; Bernard, Fanning and Yüksel, 2011)\(^1\). Namely, in order to avoid costs of dismissal protection, companies will be reluctant about firing unproductive workers and hire new ones, which will result in lower labor productivity, \textit{ceteris paribus}, and could reduce profits (Autor, Kerr and Kugler, 2007; Boeri and van Ours, 2008). Nevertheless, in these circumstances employers could compensate the loss of productivity and profits by reducing workers’ wages – in this way, the workers pay the costs of being insured from dismissal (Boeri and van Ours, 2008; Bird and Knopf, 2009). Similarly, in the context of efficiency of wages, the existence of strict EPL may induce companies to pay workers lower wages. By assuring workers stable and secure employment and incomes, strict EPL would therefore not result in the reduction of workers’ effort and would have favorable effects on profits (Barone, 2001).

\(^1\) Boeri and van Ours (2008) show that under rigid regime with fixed wages companies that are operating without EPL are more efficient than companies constrained with EPL.
Furthermore, strict dismissal regulations could stimulate employers to substitute labor with capital, to adopt new capital-intensive technologies and production processes, or to hire more productive workers (although such hiring measures could be costly). This may increase companies’ productivity, however their profitability could still decline, because they are operating under a constrained environment compared to companies operating in the environment with flexible employment protection regulations (Autor, Kerr and Kugler, 2007; Bird and Knopf, 2009; Cingano et al., 2010).

2.2. Overview of empirical findings

Most studies on EPL focus on its effects on labor market outcomes and productivity (for overview of studies see, for example, OECD (1999; 2007) and Bassanini et al. (2010), respectively). As for the effects of EPL on profits, the empirical literature is rather limited, also due to the fact that theoretical models offer little guidance on these effects (see Cingano et al., 2010).

Using a dynamic model of labor demand, Boeri and Garibaldi (2007) showed that economies with flexible labor market are, on average, able to make higher profits and are more efficient than economies with rigid labor markets. Namely, flexible labor markets and, therefore, less strict employment protection allow companies to allocate more efficiently their resources, resulting in positive effect on profits. Some authors confirmed these findings using company-level data on Italy in the period 1995-2000. Similar conclusions were reported by Boeri and Jimeno (2005).

Bernard, Fanning and Yüksel (2011) conducted a labor market experiment to study how efficiency and distribution of production surplus change with changes in EPL strictness and substitutability of labor. The authors showed that companies’ efficiency and profits are the highest when companies have the ability of replacing workers and lower when they are constrained by strict employment protection. The authors further established that the ability to replace workers is crucial for efficient production, as the employer is able to screen out uncooperative and unproductive workers and restart efficient production after relationship breakdowns.

Bird and Knopf (2009) investigated the economic impact of employment protection, i.e., wrongful discharge laws, on company-level costs and profitability by examining 18,000 U.S. banks over the 1977-1999 period. The authors confirmed that the constraints of wrongful discharge laws might decrease profitability of companies, even though the productivity increased. Namely, if wrongful discharge laws induce higher wages and greater investment in capital without a commensurate increase in income, the ratio of expenses to income would increase, resulting in lower profitability.

Some of the empirical studies followed the theoretical prediction that stricter EPL through increase in labor costs leads to substitution of labor for capital. For example, Risager and Sørensen (1997) studied how job security policies affect employment using a model which recognizes that these policies affect also profitability and investments. The authors found that an increase in firing costs could dampen the level of investments, both in monopolistic and perfectly competitive markets. However, the effect was rather modest, as by increasing firing costs from 0 to 50% in monopolistic market, investment
declined by slightly more than 1%. Moreover, the authors showed that the negative effect of firing costs on investment is higher when the price elasticity in goods demand is high. Namely, increases in firing costs lead to relatively big quantity adjustments and small increases in price of goods, what is undesirable both for employment and investment. The decline in investment is therefore a consequence of a fall in profitability. On the other hand, authors showed that in case of high capital-labor substitution elasticity, a rise in firing costs leads to a small increase in investments, as companies start to invest more in capital than in working force.

3. Methodology and data

The empirical analysis is divided in two parts. Firstly, we used descriptive statistics to present the labor market situation in terms of employment protection regulations and dynamics in investments and profits over the period 1998-2008. The analysis was performed for 18 European countries.

In the second part of our empirical analysis, we studied the relationship between EPL index and profits at the level of economy. As a measure of profits we used NOSMI, defined as the return to capital, or the effect of time passing on the net present value (Eurostat, 2011). The effect of EPL index on NOSMI was estimated using panel regression GLS analysis with random effects, performed on the sample of 18 European countries between 1998 and 2008. We based our decision to use panel regression analysis with random effects on the estimations of Hausman test and Breusch and Pagan Langrangian multiplier test for random effects. A regression function with the following specifications was estimated:

\[ \text{NOSMI}_{it} = \alpha_0 + \beta \cdot \text{EPL}_{it} + \Pi \cdot \left[ \begin{array}{c} \text{EG}_{it} \\ \text{GDPg}_{it} \\ \text{INF}_{it} \end{array} \right] + \varepsilon_{it}, \]

where NOSMI refers to profits in country \( i \) at time \( t \). The main explanatory variable is EPL and refers to overall EPL index.

2 Although the main focus of the analysis is profits, we also present data on investments among studied countries. By this we follow theoretical prediction presented in Section 2, which claims that profits are strongly related with investments. As a measure of investments we use gross fixed capital formation (GFCF), which by definition of Eurostat (2011) consists of resident producers’ acquisitions, less disposals, of fixed assets during a given period plus certain additions to the value of non-produced assets realized by the productive activity of producer or institutional units.

3 The decision on the number of countries included in the panel and on the length of studied period was based on the availability of the data. We studied the following countries: Austria, Belgium, Czech Republic, Denmark, Finland, France, Germany, Hungary, Ireland, Italy, Netherlands, Norway, Poland, Portugal, Slovakia, Slovenia, Spain and Sweden.

4 Until today OECD presented three versions of EPL index calculations. In accordance with data availability, we used the second version of the EPL index in the panel regression analysis (OECD, 2011).
As a control for labor market and macroeconomic situation in studied countries we also included variables employment growth (EG), growth of gross domestic product (GDPg) and inflation rate (INF).

In order to check for robustness and sensitivity of obtained results we repeated the above panel regression analysis by adding two additional control variables, i.e., total factor productivity growth (TFP) to control for efficiency and labor costs growth (LC) to measure dynamics of labor costs. We therefore also estimated the following panel regression function with random effects:

\[
NOSMI_{i,t} = \alpha_0 + \beta \cdot EPL_{i,t} + \Pi \cdot \begin{bmatrix} EG_{i,t} \\ GDPg_{i,t} \\ INF_{i,t} \\ TFP_{i,t} \\ LC_{i,t} \end{bmatrix} + \varepsilon_{i,t},
\]

Each of the panel regression functions was tested for the presence of the first-order autocorrelation with the Wooldridge test for autocorrelation in panel data (for further details see Wooldridge (2002) and Greene (2003)) and, accordingly, controlled for possible violations of assumptions.

Data needed for empirical analyses were collected from the OECD.Stat (2011) and Eurostat (2011) databases. Missing estimations of EPL index for Slovenia in the period 1998-2004 were obtained from Vodopivec et al. (2007), who calculated them according to the OECD methodology.

4. Empirical results

4.1. Descriptive statistics

As can be seen from Table 1, EPL strictness varies greatly among studied countries. The regulation is, according to the data for 2008, the most rigid among Southern or Mediterranean European countries (for example, in Spain, Portugal and France) and becomes more liberal when moving to Scandinavian countries. With the highest level of flexibility in employment protection are characterized Anglo-Saxon countries, i.e., UK and Ireland. Compared to the year 1998, a majority of studied countries either kept similar EPL index values or adopted employment legislation that increased the rigidity of employment protection. An increase in EPL index was the most substantial (i.e., exceeding 0.5 point) in Czech Republic, Poland and Hungary. On the other hand, in only six countries the employment protection regulations were made more flexible, by which the flexibilization was the most evident in the Netherlands and Italy (the EPL index decreased with 0.6 point and 0.5 point, respectively).
Table 1: EPL index in the studied European countries and comparison to the EU-15 and New Member States (NMS), 1998, 2008

<table>
<thead>
<tr>
<th>Country</th>
<th>Regulation on regular employment</th>
<th>Regulation on temporary employment</th>
<th>Collective dismissal</th>
<th>EPL index, overall, 2008</th>
<th>EPL index, overall, 1998</th>
</tr>
</thead>
<tbody>
<tr>
<td>Austria</td>
<td>2.2</td>
<td>2.3</td>
<td>3.3</td>
<td>2.4</td>
<td>2.4</td>
</tr>
<tr>
<td>Belgium</td>
<td>1.9</td>
<td>2.7</td>
<td>4.1</td>
<td>2.6</td>
<td>2.5</td>
</tr>
<tr>
<td>Czech Republic</td>
<td>3.0</td>
<td>1.7</td>
<td>2.1</td>
<td>2.3</td>
<td>1.8</td>
</tr>
<tr>
<td>Denmark</td>
<td>1.5</td>
<td>1.8</td>
<td>3.1</td>
<td>1.9</td>
<td>1.9</td>
</tr>
<tr>
<td>Finland</td>
<td>2.4</td>
<td>2.2</td>
<td>2.4</td>
<td>2.3</td>
<td>2.2</td>
</tr>
<tr>
<td>France</td>
<td>2.6</td>
<td>3.8</td>
<td>2.1</td>
<td>3.0</td>
<td>2.8</td>
</tr>
<tr>
<td>Germany</td>
<td>2.9</td>
<td>2.0</td>
<td>3.8</td>
<td>2.6</td>
<td>2.6</td>
</tr>
<tr>
<td>Hungary</td>
<td>1.8</td>
<td>2.1</td>
<td>2.9</td>
<td>2.1</td>
<td>1.5</td>
</tr>
<tr>
<td>Ireland</td>
<td>1.7</td>
<td>0.7</td>
<td>2.4</td>
<td>1.4</td>
<td>1.2</td>
</tr>
<tr>
<td>Italy</td>
<td>1.7</td>
<td>2.5</td>
<td>4.9</td>
<td>2.6</td>
<td>3.1</td>
</tr>
<tr>
<td>the Netherlands</td>
<td>2.7</td>
<td>1.4</td>
<td>3.0</td>
<td>2.2</td>
<td>2.8</td>
</tr>
<tr>
<td>Norway</td>
<td>2.2</td>
<td>3.0</td>
<td>2.7</td>
<td>2.7</td>
<td>2.7</td>
</tr>
<tr>
<td>Poland</td>
<td>2.0</td>
<td>2.3</td>
<td>3.6</td>
<td>2.4</td>
<td>1.9</td>
</tr>
<tr>
<td>Portugal</td>
<td>4.0</td>
<td>2.5</td>
<td>1.9</td>
<td>3.1</td>
<td>3.5</td>
</tr>
<tr>
<td>Slovak Republic</td>
<td>2.5</td>
<td>1.2</td>
<td>3.8</td>
<td>2.1</td>
<td>2.2</td>
</tr>
<tr>
<td>Spain</td>
<td>2.4</td>
<td>3.8</td>
<td>3.1</td>
<td>3.1</td>
<td>3.0</td>
</tr>
<tr>
<td>Sweden</td>
<td>2.7</td>
<td>0.7</td>
<td>3.8</td>
<td>2.1</td>
<td>2.5</td>
</tr>
<tr>
<td>Slovenia</td>
<td>3.0</td>
<td>2.5</td>
<td>2.9</td>
<td>2.8</td>
<td>3.1</td>
</tr>
<tr>
<td>Mean ± st. dev.</td>
<td>2.4 ± 0.6</td>
<td>2.2 ± 0.9</td>
<td>3.1 ± 0.8</td>
<td>2.4 ± 0.4</td>
<td>2.4 ± 0.6</td>
</tr>
<tr>
<td>EU-15 mean ± st. dev.</td>
<td>2.3 ± 0.7</td>
<td>2.3 ± 1.2</td>
<td>3.2 ± 0.8</td>
<td>2.5 ± 0.6</td>
<td>2.5 ± 0.7</td>
</tr>
<tr>
<td>NMS mean ± st. dev.</td>
<td>2.4 ± 0.4</td>
<td>2.0 ± 0.6</td>
<td>3.4 ± 0.7</td>
<td>2.4 ± 0.3</td>
<td>:</td>
</tr>
</tbody>
</table>

Note: Countries are arranged in alphabetical order.

Sources: Authors’ calculations (OECD Stat, 2011; Vodopivec et al., 2007)

Figure 1 presents dynamic properties and relative flows of the NOSMI and GFCF relative to GDP. In most countries both profits and investment, relative to GDP, are very volatile over the observed period. At the first glance, the flow pattern of the variables contradicts the theory, which presumes that investments and profits are linked. On the other hand, this could imply that the relation between investment and profits is country specific and depends on different investment policies, institutional environments, and (especially in NMS) on stages of economic development, which differ in investment needs (Žižmond and Novak, 2007). Why variables exhibit different dynamic patterns could be also explained by the loss of a part of the long-term dynamic information of variables due to their normalization with GDP and due to the inclusion of the lag effects in the linkage.

5 The EPL index for 2008 is calculated according to OECD methodology Version 3, whereas for 1998 according to Version 2 (for further information see OECD, 2011).
Figure 1: Dynamics of NOSMI and GFCF, 1998-2008


Source: Authors’ calculations
Table 2 presents descriptive statistics for NOSMI and GFCF. On average, the highest investment to GDP ratio was recorded in Czech Republic, Slovakia and Spain, whereas Sweden, Germany and Finland reported the lowest values. As regards NOSMI, the highest average ratio was recorded in Slovakia, Poland and Ireland and the lowest in Denmark, Sweden and Slovenia. As we can see from the standard deviation and the minimum and maximum values, the level of profits to GDP and the level of investment to GDP in some countries, especially NMS, changed substantially during the observed period.

**Table 2**: Descriptive statistics for NOSMI and GFCF, 1998-2008

<table>
<thead>
<tr>
<th>Country</th>
<th>NOSMI</th>
<th>GFCF</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Mean</td>
<td>St. dev.</td>
</tr>
<tr>
<td>Austria</td>
<td>23.3</td>
<td>1.9</td>
</tr>
<tr>
<td>Belgium</td>
<td>21.6</td>
<td>0.7</td>
</tr>
<tr>
<td>Czech Republic</td>
<td>29.2</td>
<td>0.8</td>
</tr>
<tr>
<td>Denmark</td>
<td>15.1</td>
<td>1.3</td>
</tr>
<tr>
<td>Finland</td>
<td>24.4</td>
<td>0.9</td>
</tr>
<tr>
<td>France</td>
<td>21.6</td>
<td>0.3</td>
</tr>
<tr>
<td>Germany</td>
<td>23.0</td>
<td>1.4</td>
</tr>
<tr>
<td>Hungary</td>
<td>25.0</td>
<td>0.7</td>
</tr>
<tr>
<td>Ireland</td>
<td>38.1</td>
<td>1.6</td>
</tr>
<tr>
<td>Italy</td>
<td>31.3</td>
<td>1.3</td>
</tr>
<tr>
<td>Netherlands</td>
<td>23.8</td>
<td>0.9</td>
</tr>
<tr>
<td>Norway</td>
<td>30.7</td>
<td>4.6</td>
</tr>
<tr>
<td>Poland</td>
<td>35.8</td>
<td>2.8</td>
</tr>
<tr>
<td>Portugal</td>
<td>22.5</td>
<td>4.6</td>
</tr>
<tr>
<td>Slovakia</td>
<td>32.0</td>
<td>3.7</td>
</tr>
<tr>
<td>Slovenia</td>
<td>19.5</td>
<td>2.0</td>
</tr>
<tr>
<td>Spain</td>
<td>27.0</td>
<td>0.6</td>
</tr>
<tr>
<td>Sweden</td>
<td>17.7</td>
<td>1.4</td>
</tr>
</tbody>
</table>

**Notes**: Descriptive statistics are averaged for the 1998–2008 period.

**Source**: Authors' calculations

### 4.2. Relation between employment protection and profits

In this section we are expanding the obtained findings by estimating the relationship between EPL index and NOSMI (i.e., a measure of profits). We firstly examined this relation using scatter plots. As can be seen from Figure 2, the analysis confirms the theoretical predictions on a negative relation between EPL strictness and profits in the economy.

In order to study this relation in more detail, we applied panel regression analysis on the panel of 18 European countries during the period 1998-2008. Both estimated

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6 The methodological scope of the panel regression analysis is explained in Section 3.
models confirm a statistically significant negative relation between EPL index and profits, measured with NOSMI. This implies that stricter employment protection regulation increases the firing and hiring costs and hinders efficient allocation of resources, which lowers profits. As can be seen from Table 3, one point increase in EPL index decreases NOSMI for approximately 2.6 percentage points (regression estimates are rather similar in both models, confirming robustness of our results). The negative effect on profits is observed also at the control variable labor costs growth, but is statistically insignificant. The empirical results give evidence that strict employment protection is associated with lower profits. Our findings therefore are in accordance with the theoretical views and related empirical studies presented in Section 2. Namely, stricter EPL negatively affects the effectiveness of reallocation of workers – companies are unable to replace unproductive workers without costs – and results in the companies' efficiency loss. The latter is reflected in the decline of profitability.\footnote{As we assume that profits are linked to investments, we also conducted panel regression analysis on the relation between EPL index and GFCF (leaving other variables the same). The estimates showed that stricter EPL increases GFCF, indicating the substitution of labor for capital. However the effect was not statistically significant.}

5. Conclusions

The paper assesses the characteristics of employment protection legislation and dynamics of GFCF and NOSMI and examines the effect of employment protection regulations on profits in 18 European countries over the 1999-2008 period.
The findings of the paper confirm that EPL presents a cost to the employer and influences companies’ decisions on hiring and firing, consequently affecting the level of profits in the economy. Namely, the panel regression estimates show that strict EPL has a negative impact on NOSMI, probably due to decrease in labor flows and allocation efficiency. Although the effect is small, we believe that flexibilization of employment protection regulation presents an important determinant not only for labor market performance and productivity (Bassanini and Duval, 2006; Bassanini, Nunziata and Venn, 2009; Bassanini et al., 2010), but also for companies’ profits and therefore for the competitiveness of European countries.

To conclude, there is a lack of theoretical and empirical research on the relation between employment regulations and profits in the economy. Our paper therefore presents an important added value in the area and should be considered as an introduction to a more comprehensive study on the issue. Nevertheless, the analysis is subjected to several limitations. Firstly, some countries experienced only small change in EPL index during the studied period, indicating that additional measures on the situation regarding the employment protection and other labor legislation should be considered in further research. Moreover, there is a need for longer time series of information on employment protection and labor legislation and the level of profits. Limitations also arise from a small number of variables used and therefore possible formation of omitted variables problem, insufficient sources of variation and low value of R-squared. Further studies should also take into consideration the relation between employment protection and investments and possible causality with profits. Especially valuable will be studies performed on the micro level, i.e., taking into account specific employment protection regulation and observing how their changes affect the level of companies’ profits and other financial results.
References:


