

AN OVERVIEW OF SEVERANCE PAY SCHEMES IN SOUTH-EASTERN EUROPE

Primož Dolenc¹, Suzana Laporšek²

¹University of Primorska, Faculty of Management Koper, Slovenia

²University of Primorska, Science and Research Centre of Koper, Slovenia

Summary: *The paper provides an overview of severance pay regulation in the South-Eastern Europe (SEE) countries, thereby complementing empirical analysis of severance pay programs with findings on the SEE countries. We found that in general severance pay schemes are very similar among the SEE countries, but vary significantly in their modalities. The results of the empirical analysis show that generous severance pay is negatively associated with GDP per capita, labor productivity and employment. These results reinforce previous findings on this topic and lead to the conclusion that traditional severance pay schemes need to be reformed. However, the inventory among the SEE countries shows that until now no serious debate on the issue took place.*

Keywords: *severance pays, SEE countries, overview*

1. INTRODUCTION

Severance pay is one of the most common but also most controversial social programs. Introduced by legislation or collective agreement, it requires that employers pay lump-sum compensation to qualifying laid-off workers, with the amount usually depending on years of service and the person's recent earnings. Holzmann and Vodopivec (2012) argue that these programs can have several, sometimes quite sophisticated, objectives, ranging from providing compensation for job loss to stabilizing employment and preventing unemployment by discouraging layoffs. Further, they encourage long-term relationships that retain valuable workers and reduce transaction costs resulting from labor turnover. But while mandated severance pay is the most prevalent income support system in developing (but not developed) countries (Vodopivec 2004, 2009), these programs are often considered to be one of the least appropriate options for income protection. They not only provide deficient and incomplete protection but are often responsible for distorting the behavior of firms and workers, and thus imposing other efficiency costs (see Holzmann and Vodopivec (2012) for a comprehensive evaluation of the program and a review of reform options).¹

Generous severance payments increase costs of dismissal for firms and may therefore induce employers to search for more flexible solutions to dismissal, such as improvement of the functional flexibility of employees and increase in workers' motivation (Kuddo, 2009), or to use more flexible temporary or part-time employment arrangements. According to Nesporova (2011), most of the countries in the South-Eastern Europe (SEE) have over the past years considerably increased the flexibility of employment relations, which is reflected in the growth

¹ See also Holzmann et al. (2011) for a survey of the incidence of the severance pay around the world and a review of the origin, economic rationale, and current attempts to reform severance pay programs

of self-employment and fixed-term employment. The increase in temporary employment regulations is especially evident among young and lower-skilled people.²

The main objective of the paper is to provide a detailed insight in severance pay schemes in the SEE countries.³ Besides norms and practices we were interested also in the eventual projected reforms and some other relevant details. However, the task was not an easy one. As already noticed by Holzmann, Pouget, Vodopivec and Weber (2011), one of the difficulties of examining the topic of severance pay is that different types of cash payments can be considered as forms of severance payments and many terms exist in English and other languages. For some countries official or at least unofficial translations of the relevant legislation was not available and we relied heavily on the domestic texts of the legislation. We benefited a lot from consultations with local experts,⁴ where they were willing to provide the relevant information. Even though this support was of extreme help, the eventual errors in the interpretation and understanding of the severance pay schemes are of course our own.

We find that SEE countries have very similar severance pay schemes. Most of the reviewed countries have a mandatory severance pay scheme, where the payment is usually based on the work tenure with the (former) employer. Redundancy is always defined as a legitimate ground for dismissal in the SEE countries. Thus, redundancy payment is mandatory in all the observed countries, whereas the legislation on severance payments for other causes of contract termination varies among countries. Other modalities, such as minimal required tenure, eligibility for severance pay other than redundancy, severance pay generosity index etc., differ considerably from country to country.

The paper is organized as follows. Next section provides an overview of severance pay schemes in the SEE countries. Section 3 presents the rationale for and results of empirical analysis. Section 4 concludes.

2. OVERVIEW OF SEVERANCE PAY SCHEMES IN THE SEE

The SEE countries, observed in this inventory, have on one hand very similar severance pay schemes. Figure 1 in Appendix shows that most of them (all except one, i.e. Romania, where severance pay scheme is regulated in collective agreement) have severance pay mandated in legislation, usually Labor Law/Code. Most of these countries further develop severance pay schemes also in collective bargaining agreements.

Two other similarities are evident. First, in all the observed countries, the severance pay is mandated for redundancy termination, and in none of the observed countries the end-of-service

² For example, the share of temporary employment in total employment for young people (15–24 years) in 2009 amounted 37.1 % in Macedonia, 35.0 % in Croatia and 66.6 % in Slovenia. For comparison, in Central and Eastern New EU Member States (without Estonia) the share of young temporary employed, on average, amounted 21.6 %, which is 18.3 percentage points below the EU-15 average (see Laporšek and Dolenc, 2011).

³ The countries in the inventory were Albania, Bosnia and Herzegovina, Bulgaria, Croatia, Kosovo, Macedonia, Moldova, Montenegro, Romania, Serbia, Slovenia and Turkey.

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severance pay is mandated (see Figure 2). Second, in most of the observed countries the severance pay is tied to worker's tenure with employer.

All other aspects of severance pay schemes are very country-specific. Seventy percent of observed countries have mandated severance pay for dismissal, bankruptcy and incapacity. Old-age severance pay is legally enforced in half of the countries (see Figure 2).

One of the rare numeric parameters, according to which severance pay schemes can be compared, is its generosity. The generosity of severance pay varies strongly among SEE countries. As can be seen from Table 1 and Figure 3 in Appendix, the severance payments are the most generous in Montenegro and Turkey. In comparison to countries in the region, Montenegro provides substantially generous severance payments for one year of tenure (i.e., 13 weeks of wage), whereas in Turkey severance payments are especially high for five and ten years of tenure. The median value of the severance pay generosity index⁵ in the region amounts 1.7, which is particularly high when comparing to OECD countries (i.e., 0.7), however lower than in Middle East and North African (i.e., 2.5), Latin American (i.e., 2.5), Asian (i.e., 2.1) and African countries (i.e., 2.2) (for details see Holzmann and Vodopivec, 2012).

Further, Figure 4 shows minimum tenure with the employer, required for severance pay eligibility. The median minimum tenure equals six months, but this requirement varies strongly among SEE countries. On one hand, half of the observed countries have no minimum tenure in place, but on the other hand the minimum tenure ranges up to 36 months in Albania.

Next sub-sections explain severance pay schemes in the SEE countries in more detail.

3. ALBANIA

Information on severance pay in Albania is very limited. The Code on Labor⁶ was adopted in 1995 and its Art. 145 stipulates that in case of termination of permanent employment contract due to unreasonable causes the worker is entitled to so called seniority-related reward – at least 15-days wage for each year of service with the employer. The seniority-related reward (i.e., severance pay) must be paid to workers with at least three years of service with the employer. The same regulation is used for workers with temporary employment contract (Art. 152) if the work tenure with the employer is at least three straight years. No severance pay (or seniority related award) is mandated for end-of-service separation or retirement.

The severance payment is mandated in case of unjustified dismissal or redundancy termination. Namely, the unreasonable causes for contract termination are explicitly given as: i) the worker has claims that result from the employment contract; ii) the worker has fulfilled all legal obligations; iii) the termination is due motives related to the personality of the worker, having no legitimate ties with labor relations (race, color, sex, age, civil status, family obligations, pregnancy, religious and political beliefs, nationality, and social status); iv) the termination is due to motives related to the worker's exercise of a constitutional right, which however does not lead to the violation of the obligations resulting from the contract of employment; and v) the termination is due to motives related to the worker's membership in labor unions created as defined by law, or because of his/her participation in labor union's activities on the basis of law.

⁵ We use the standard definition of severance pay generosity index: average severance payment per year of service for workers with 1, 5, and 10 years of service (in weeks of wage).

⁶ The unofficial translation to English is available on <http://www.ilo.org/dyn/natlex/docs/SERIAL/41344/63433/F1167646799/ALB41344.PDF>.

According to the code, collective agreements could provide more generous severance payments. However, no clear evidence has been found that collective agreements in practice regulate severance payments differently than the mandatory provisions of the code.

4. BOSNIA AND HERZEGOVINA

Bosnia and Herzegovina, being decentralized sovereign country of two entities (Federacija Bosna i Hercegovina and Republika Srpska), has two labor market regulations. In Federacija Bosna i Hercegovina severance pay is regulated by the Labor Law,⁷ adopted in 1999. In Art. 100, the law stipulates that a worker is entitled to severance pay in the amount to be determined depending on work tenure of the worker. Eligible are workers with permanent employment contract and minimum of two years of service with the employer. Upon termination of the employment contract, the severance pay applies regardless the cause of the termination, except if the reason for termination is misconduct on the worker's side.

According to the law, the severance pay needs to be determined by collective agreement, the company's rulebook or the employment contract, however the mandated minimum severance pay is one average monthly wage of the employee as paid in the last three months before the termination of employment contract. In addition, as stipulated in the law, employer and worker may agree on other form of compensation, not only cash payment, but such an agreement must be in the form of written contract.

End-of-service and retirement severance pay are not mandatory by the law. However, according to the national collective agreement,⁸ the end-of-service severance pay is determined at the level of at least three average monthly wages in Federacija Bosna i Hercegovina.

Very similar regulation is in place in Republika Srpska, where the Law on Labor⁹ was adopted in 2007 and regulates main provisions of severance pay in Art. 141. In fact, the only real difference is in the level of severance pay: in Republika Srpska the mandated minimum severance pay is 1/3 of average monthly wage in three months preceding the termination for each year of service with the employer.

As the taxation is concerned, the severance payment is tax exempt up to the level of 70 % of average wage in three months before the contract's termination for each year of service with the employer. Beyond that level the severance payment is taxed under the personal income tax legislation.

5. BULGARIA

In Bulgaria, labor market relations are regulated by the Labor Code,¹⁰ adopted in 1986 and amended in 2004, and Employment Promotion Act,¹¹ adopted in 2001 and amended in 2006.

⁷ The official text is available in Croatian language on <http://www.fuzip.gov.ba/uploaded/zakoni/zakon%20o%20radu%20federacija.pdf>.

⁸ The official text is available in Croatian language on http://www.sobih.ba/siteoo/images/stories/galerije/Zakonska_akta/opci_kolektivni.pdf.

⁹ The official text is available in Serbian language on http://www.uspon.ba/down/zakon_o_rad_rs.pdf.

¹⁰ The official text is available in English on <http://www.mlsp.government.bg/en/docs/labour/Labour%20code%20consolidated%20en.pdf>.

¹¹ The official text is available in English on <http://www.az.government.bg/eng/Legislation/EmplPromAct.htm>.

Regulation regarding severance pay is modest. There is no statutory severance pay scheme, with three exceptions:

- mandated severance pay in case of termination of employment due to illness for worker with at least five years of service (severance pay amounts two monthly gross wages);
- mandated severance pay in case of termination after the worker has acquired the right to a pension (severance pay amounts two monthly gross wages or six monthly gross wages for a job tenure of ten years);
- redundancy payment of not more than one monthly wage following any individual or collective dismissal on economic grounds.

Beyond this regulatory framework, workers and employers can arrange severance pay in collective bargaining agreements. Except for some individual cases, no detailed information is available on this issue, though. For example, in December 2011 collective agreement has been signed between Bulgarian State Railways and labor unions.¹² The unions went on strike over draconian restructuring plans for the troubled railway firm, which included 2,000 job cuts, the suspension of 150 train services and pay cuts. The strike caused an estimated BGN 2.5 million (about EUR 1.25 million) in losses. Between the start of the strike and its end, some 1,050 Bulgarian State Railways employees have taken up an offer to leave for a severance pay of six monthly wages.

6. CROATIA

In Croatia, the severance pay is regulated by the Labor Law,¹³ which was changed recently (in 2009 and 2011). Under current legislation, the worker is entitled to severance payment in case of dismissal¹⁴ or redundancy under condition that work tenure with the employer is at least two years. Art. 119 stipulates that severance payment is tied to work tenure and needs to be agreed with the employer. It cannot be, however, lower than 1/3 of average wage in the three-month period before termination of contract for every completed year of service with the employer. Further, the law mandates that the maximum severance payment cannot be higher than six monthly wages, except if other laws, collective bargaining agreements, internal regulations of the companies or employment contracts define otherwise.

The Labor Law itself does not mention any other type of severance payments, for example, for old-age, end-of-service etc. However, it regulates the exception in case of incapacity due to work injury or professional disease, caused in the service for the employer. In this case the severance pay should be double the amount that would be received by worker in case of dismissal or redundancy. As regards the old-age severance payments, they are usually regulated in collective bargaining agreements.

As in many other countries, the law regulates only the minimum standards. According to collective bargaining agreements, however, severance payments are usually more generous. Systematic overview is not available, though, but one example is shown in the Box 1 below.

According to tax regulation, the eventual old-age severance payment is tax exempt up to HRK 8,000 (equals approx. EUR 1,050) or slightly more than average wage in Croatia. Severance payments, paid for dismissal or redundancy according to the Labor Law, are tax exempt up to

¹² The information is available on http://3e-news.net/show/18861_collective%20agreement%20signed%20at%20bulgarian%20state%20railways%20strike%20finally%20over_en/.

¹³ The official text is available in Croatian language on <http://www.zakon.hr/z/307/Zakon-o-radu>.

¹⁴ Worker's incompetence or lack of discipline does not apply here.

HRK 6,400 for every year in service. For severance pay due to incapacity the tax exemption is higher – up to HRK 8,000 per year of service.

Note that in Croatia the severance pay regulation is isolated from other form of unemployment insurance, for example unemployment benefits. So, the severance payment due to termination of the contract and eventual unemployment benefits are paid separately. According to the unofficial information, the government in Croatia is not considering of reforming the severance pay regulation in the near future.

Box 1: An example of severance payment under collective bargaining agreement – the case of INA d.d.

In the bargaining agreement of INA d.d., the largest Croatian oil and gas company, the severance pay is agreed for retirement and dismissal/ redundancy under the provisions of the Labor Law.

In case of retirement, the worker is entitled to severance payment of HRK 8,000 and HRK 16,000 net of taxes, in case of full or incomplete retirement conditions, respectfully. Note that average wage in Croatia is about HRK 7,600 gross.

In case of dismissal/redundancy under the provisions of the Labor Law, the worker is entitled to severance payment of 60% of average gross wage in three preceding months before termination of the contract for every year of service. Note that according to tax regulation and wage distribution in INA d.d., there is a high probability that no taxes would apply for received severance payment.

7. MACEDONIA, FYR

Macedonia adopted the Labor Relations Act¹⁵ after several years of negotiations with social partners. Other than regulatory minimums, not much information is available regarding the severance pay. According to Art. 97, the employer is obliged to pay the worker redundancy payments in the case of termination of the employment contract for business reasons (severance payments for other types of dismissals are not covered by law). The mandated severance pay is as follows:

- one net wage for up to five years of work tenure;
- two net wages for five to ten years of work tenure;
- three net wages for 10 to 15 years of work tenure;
- four net wages for 15 to 20 years of work tenure;
- five net wages for 20 to 25 years of work tenure;
- six net wages for over 25 years of work tenure.

The basis for calculation of severance pay is worker's average net wage in six months prior to the termination of the contract, but it may not be lower than 50 % of the average wage in Macedonia within the last month before the dismissal.

¹⁵ Official text is available in Macedonian language on http://www.mtsp.gov.mk/WBStorage/Files/PT_Zakon_za_Rabotnite_odnosi_158_09122010.pdf.

According to tax regulations, severance payments are tax exempt if they are paid according to provisions of the Labor Relations Act or if retirement severance payment does not exceed two average monthly wages calculated from six months' average before retirement.

8. MOLDOVA

In Moldova, the severance pay is mandated by the Labor Law,¹⁶ adopted in 2003. In case of redundancy termination (i.e., in case of liquidation of the company, termination of the activity of the employer as physical person or reduction of number of workers in the company) the worker is entitled to:

- one average weekly wage for each year of service, but no less than one monthly wage;
- preservation of the average monthly wages for the period of looking for another job, but no more than three months, including the severance pay. For the third month the average wages are kept provided that the employee has in a fortnight term after the dismissal applied to the employment agency, has been enlisted as unemployed and has not been employed, confirmed by the corresponding certificate.

In case of termination of the employment contract due to incapacity (health reasons or insufficient qualification confirmed by the decision of the attestation commission), the worker is entitled to lump-sum severance pay of two weekly wages, regardless the work tenure. The same severance pay is mandated for terminations of employment contract due to call up for the military service, reduced military service or civil service, or in case of workers resignation due to infringement by the employer of the individual employment contract or collective bargaining agreement.

No minimum work tenure is specified by law. Also no severance pay is mandated for termination of contract due to retirement. The law, on the other hand, explicitly stipulates that severance payments can be agreed in the individual employment contract or by collective bargaining agreements in more generous manner. Unfortunately, no formal or informal information is available on the functioning of the collective bargaining agreements in Moldova and related severance pay (other than mandated one).

9. MONTENEGRO

Montenegro introduced a reformed Labor Code¹⁷ in 2011; in the reform some changes were introduced also for severance pay.¹⁸ The regulated severance pay denotes minimum requirement for severance in case of dismissal, whereby in Montenegro some collective agreements post a more generous conditions for laid-off workers. It is worthwhile to note that severance pay benefits in Montenegro are in no way connected to other social protection programs (for example, unemployment insurance).

The Labor Code sets the following conditions for severance pay (Art. 94):

¹⁶ The unofficial translation to English is available on

<http://www.lexadin.nl/wlg/legis/nofr/oeur/arch/mol/labour.doc>.

¹⁷ The official text is available on <http://www.slistcg.me/PANapRezultati.aspx?no=&it=&la=-1&ldt=-1&ai=28&eu=-1&src=-1&dt=-1&fts=&frm=&to=&kw=&nvg=6,12,1>.

¹⁸ The 2003 Labor Code was very generous: it requested that laid-off workers received a severance pay of 24 monthly wages, regardless the work tenure (by the employer). The amendment in 2008 lowered this to six monthly wages. The reformed Labor Code from 2011 binds the severance payment to working tenure.

- Laid-off workers are entitled to severance payment in the amount of 1/3 of average wage in six months preceding the dismissal for each year by the employer or, if more favorable for worker, 1/3 of average national wage. Minimum payment is set to three monthly wages in six months preceding the dismissal for each year by the employer or, if more favorable for worker, three average national wages.

- There is an exception introduced for disabled workers. If a disabled worker is laid-off due to economic reasons, it is entitled to his/her 24 or 36 wages, if the invalidity was not caused in the company or if the invalidity was caused in the company, respectively. If more favorable for worker, average wage in the company applies also here.

The base for calculation is net wage. The severance payment is subject to personal income tax, yet only those amounts of severance that exceed legally binding minimum are taxed (PIT is 9 % flat rate).

The above rules apply for dismissal due to redundancy. In case of dismissal, some causes lead to severance payment¹⁹ and some do not. No severance pay is mandated for dismissal in case of incapacity or for old-age/end-of-service separation. For the latter case, the collective agreements usually include some provisions (see Table 2).

There is, however, a special rule set for old-age severance pay provisions for companies in bankruptcy, which is specified in Art. 98 of the Labor Code. Workers in company in bankruptcy, which fulfilled the retirement conditions prior to company's bankruptcy, are legally entitled to severance pay at the level of three average wages in manufacturing sector.

Companies in Montenegro usually do pay the required severance pay. In case of non-performance, workers are entitled to file the company to the Agency for Peaceful Dissolution of Labor Disputes or to the court. Workers whose companies went bankrupt can claim their severance payments to the Labor Fund, which was introduced in April 2010. According to the Ministry of Finance of Montenegro, total number of 21,279 claims was submitted to the Labor Fund since its establishment until November 2011. During that period 2,218 claims has been taken into decision, out of which 1,959 claims was accepted and 1,613 paid. In total 256 claims was rejected. Among them, the majority came from non-performed severance pay claims from state-owned companies, which bankrupted in the past.

As noted above, the Labor Code sets the minimum standards for severance pay. The collective agreements, however, can be more generous. Table 2 in Appendix shows the severance payments for retirement and for redundancy in different branches. The banking and insurance sector and energy sector step out significantly in severance pay generosity. Just recently, also the government negotiated with labor unions of public sector an agreement that is more favorable for workers than existing Labor Code – see Box 2 below.²⁰

Box 2: Agreement between Montenegrin government and labor unions on employment and wage policy in public sector

In 2011 the Government of Montenegro signed an agreement with labor unions about the employment and wage policy in public sector for the period 2012–2015. Both parties agreed on conditions for adjustments of wages and number of employees in sectors, financed from the

¹⁹Only three cases apply (Art. 143 of the Labor Code): i) if the worker is dismissed because he/she would not agree to sign an annex to work contract intended to change the wage, ii) in case of economic reasons (other than those leading to redundancy), and iii) in case of technological and structural changes. Note that at least the last reason is similar to redundancy lay-off.

²⁰ Full text of the agreement is available on <http://www.gov.me/ResourceManager/FileDownload.aspx?rId=91538&rType=2>.

budget. The agreement was signed under the pressure of current economic crisis. Among others, the agreement set special provisions for termination of employment in the relevant sectors. Those who voluntarily terminate employment/resign are entitled to severance pay of:

- 8, 12 and 10 gross wages for those with up to 10, from 10 to 30, and from 30 to 35 years or work tenure, respectively;
- 6 gross wages for those with at least 35 years of work tenure, under condition that they do not meet conditions for pension; and
- 3 gross wages for those with at least 35 years of job tenure, under condition that they do meet conditions for pension.

These workers cannot apply to new employment in public sector for at least five years after the termination of employment.

Those whose employment contract was terminated involuntarily (due to economic reasons) are entitled to severance pay of:

- 8, 12, 15 and 10 gross wages (or, if more favorable for worker, average wage in Montenegro) for those with up to 10, from 10 to 20, from 20 to 30, and from 30 to 35 years or work tenure, respectively;
- 6 gross wages (or, if more favorable for worker, average wage in Montenegro) for those with at least 35 years of work tenure, under condition that they do not meet conditions for pension; and
- 3 gross wages (or, if more favorable for worker, average wage in Montenegro) for those with at least 35 years of job tenure, under condition that they do meet conditions for pension.

These workers cannot apply to new employment in public sector for at least one year after the termination of employment.

10. ROMANIA

The Labor Law in Romania does not regulate severance pay in any way. As many other provisions of employer-worker relation, also severance pay is determined by national collective agreement. As regards provisions on severance pay, the national collective agreement changed in 2007. The severance pay for individual terminations and collective dismissals was increased from two weeks average wage for each year of service to at least one monthly wage for each year of service. All reasons other than worker's misconduct apply here. No additional information on the functioning of severance pay was found for Romania.

11. SERBIA

Regulation regarding severance pay in Serbia is very similar to severance pay scheme in Montenegro. This makes sense, as Serbia and Montenegro shared the same sovereignty until mid-2006. In Serbia the current Labor Law²¹ was introduced in 2005.

As regards the severance pay scheme, the Labor Law in Serbia, similarly to legislation in Montenegro, also distinguishes two major types of contract termination from employer's side. First, a special rule is applied for old-age severance pay provisions for companies against whom bankruptcy procedure has been raised, which is stipulated in Art. 125 and 126 of the Labor

²¹ The official text is available in Serbian language on: <http://www.zakoni.rs/zakon-o-radu/zakon-o-radu.pdf>.

Law. In these companies, workers, which fulfilled the retirement conditions prior to company's bankruptcy, are legally entitled to severance pay at the level of three average wages in manufacturing sector (same as in Montenegro).

For "regular terminations" apply the provisions from Art. 158. Workers, who are redundant due to technological, economical and organizational reasons, are entitled to severance payment. The level of severance payment is agreed in employment contract or collective bargaining agreements, but it cannot be lower than 1/3 of average monthly wage in three months preceding the termination for each year with the employer.

Besides severance pay for lay-offs, the law also mandates old-age severance pay of three average wages, calculated from monthly wages in three months prior to the retirement.

According to tax legislation, all severance payments are tax exempt up to the level of three average wages in Serbia. Amounts beyond that level are taxed at 20 % rate, where the tax basis is lowered for 20 % (normative costs).

Similarly to Montenegro, also in Serbia the Labor Law introduced a special fund (in Serbia it is called the Solidarity Fund). Its purpose is to provide assistance and to secure worker's rights in case of company's bankruptcy. Among these rights is, as mentioned above, also the right to severance payment if the worker qualifies for retirement.

As in many other countries, the law in Serbia mandates only minimum standards for severance payments. Collective agreements and managerial employment contracts can be more generous or can define some modalities in more detail. In collective agreement for teachers (in public schools), for example, the severance pay is set at the level of mandatory requirement, however, the basis for calculation severance payment can be either average wage of worker, average wage of all workers by the employer or, if even more favorable to worker, average wage in Serbia.

In reality, severance payments in different companies and sectors are very volatile. Tomčić (2010) reports that actually paid severance payments ranged from 0 EUR to near 1,000 EUR per year of service. The author claims that the highest severance payments were paid in (state-owned) Telekom and Lukoil. Managerial severance payments amounted to as much as one quarter of million EUR.

12. SLOVENIA²²

In Slovenia, severance pay is regulated by the Labor Code,²³ the Law on the Public Guarantee Fund,²⁴ and the Law on Bankruptcy and Liquidation,²⁵ and is further guided by collective bargaining agreements, as well as individual contracts (on the managerial level). Mandated severance pay is paid to laid-off workers and workers who retire, with the level of pay proportional to the work tenure with his or her former employer. To address the severance pay non-performance problem, the Guarantee Fund was introduced in 1997, to at least partially reimburse the unpaid severance pay claims of workers.

²² The explanation of the severance pay regulation is summarized from Vodopivec, Madjar and Dolenc (2009).

²³ The official text is available in Slovenian language on http://www.mddsz.gov.si/si/zakonodaja_in_dokumenti/veljavni_predpisi/zakon_o_delovnih_razmerjih/.

²⁴ The official text is available in Slovenian language on <http://www.uradni-list.si/1/objava.jsp?urlid=200678&stevilka=3404>.

²⁵ The official text is available in Slovenian language on <http://www.uradni-list.si/1/objava.jsp?urlid=2007126&stevilka=6413>.

Slovenia introduced a Labor Code in 1990 and a new one in 2003. The 1990 Labor Code mandated severance for early retirees as well as for redundant workers. While for early retirees the law did not mandate the amount of severance pay, it did so for redundant workers. Workers with at least two years of service were entitled to half of their monthly average wage for every year of service, with the wage determined on the basis of the wage paid in the last three months of employment. Other cases for severance pay were not legally binding.

The 2003 Labor Code significantly differs from the previous one, as it more precisely defines the obligations on the part of employers and the rights of workers. Workers are entitled to severance pay if they retire or they are dismissed (either because of business reasons or bankruptcy or even in the case of incompetence). Retired workers are entitled to the severance pay of two average gross wages, calculated from three-month average gross wage in Slovenia, or (if more favorable to the employee) two average gross wages, calculated from his/her three-month average gross wage before retirement. In contrast, the basis for the calculation of the severance pay for dismissed workers is the average monthly gross wage which was received by the employee, or which would have been received by the worker if working, in the last three months before the termination. The employee is entitled to severance pay amounting to:

- 1/5 of the basis for each year of employment with the employer, if the employee has been employed with the employer for more than one and up to five years;
- 1/4 of the basis for each year of employment with the employer, if the employee has been employed with the employer for the period from five to fifteen years;
- 1/3 of the basis for each year of employment with the employer, if the employee has been employed with the employer for the period exceeding fifteen years.

Unless with collective bargaining agreements defined otherwise, the severance pay is limited to ten average monthly gross wages which was received by the employee, or which would have been received by the worker if working, in the last three months before the termination.

Severance pay at retirement is tax exempt up to the amount set by the government. This amount is approximately four average gross wages in Slovenia. Other severance payments are tax exempt up to the level of ten average gross wages in Slovenia.

It may be noted that legislation provisions for severance payments are usually simply copied to collective bargaining agreements, so these usually do not include more generous provisions for severance pay as the Labor Code. Some collective bargaining agreements are more generous, though. Collective bargaining agreement for banking sector, for example, for a dismissal due to economic reasons and even due to incompetence (!) mandates 1/3 of average monthly gross wage which was received by the employee, or which would have been received by the worker if working, in the last three months before the termination, regardless the work tenure. The maximum is set to 14 monthly wages. At retirement the worker is entitled to three average monthly wages (not two as mandated by Labor code). Severance payments can and in fact are significantly higher for workers with individual contracts – see example in the box 3.

Box 3: An example of severance payment under individual employment contract

One of the most notorious examples of severance payments in Slovenia was an end-of-service severance to former CEO of NLB bank (the biggest Slovenian bank, mostly state-owned). At the end of his mandate he received approx. EUR 1 million gross, which was about 700 average gross wages in Slovenia. The severance pay was “unusual” (as stated by Prime Minister at that time), as the amount was significantly higher than he would receive under the collective agreement for banking sector (max. 14 average wages). The NLB case resulted in a *lex specialis*, which retro actively applied a tax rate of 95 % (!) to managerial severance payment above a specific threshold. The law was sent to the Constitutional Review, however, the

Constitutional Court has not ruled yet.

It is worthwhile stressing that also under the 2003 law, the severance pay program remains unrelated to the unemployment insurance program. That is, qualifying workers receive severance pay and, in addition, they also qualify for unemployment insurance benefits (which can be received for up to two years, see van Ours and Vodopivec, 2006).

To protect worker's rights in the case of a firm's insolvency, in 1997 Slovenia – following the 1980 EU directive 80/987 – introduced the Public Guarantee Fund. Workers, legally entitled to severance pay but unsuccessful in its exaction, can claim partial reimbursement of their severance pay claims from the Fund, with the ceiling on such reimbursements being a monthly minimum wage.²⁶ Moreover, under the 1993 Law on Bankruptcy and Liquidation, workers can sue their former employers that undergo a liquidation or bankruptcy process, with workers' severance pay claims having a priority before other claims (up to a limit – for details, see Kresal Šoltes, 1997).

Vodopivec, Madjar and Dolenc (2009) addressed the non-performance problem of severance pay in Slovenia. Their findings, which are among the very few of such results in existence, suggest that severance pay non-performance has been a significant problem in Slovenia. In 2000, only two-thirds of total severance pay obligations were actually honored, a small portion of non-paid severance pay claims was reimbursed by the Guarantee Fund, and the rest – one-third of total obligations – was not paid at all. Moreover, authors showed that while both men and women were equally affected, workers older than 40 years were more likely than younger ones to be confronted by severance pay non-performance. And, finally, they also found that among firms that incurred severance pay liabilities, larger and more productive firms were more likely to pay them out. The authors conclude that severance pay seems to be an inefficient income protection program for the unemployed in Slovenia. First, the program fails to protect a significant share of those who are legally entitled to such protection – even after the introduction of the Guarantee Fund. Second, the program is prone to creating inequities, as it disproportionately affected older workers. At the same time, their findings also provide some clues about how to make the program more effective. The fact that less productive – and hence less profitable – firms are less likely to honor their obligations suggests that non-performance is strongly related to the non-funded nature and limited risk-pooling of severance pay, which leads to the recommendation for severance pay to be converted to a funded program.

13. TURKEY

Turkey has mandatory severance pay scheme, where the legislation mandates only the minimum requirements and collective bargaining agreements add modalities to the practice. Even though Turkey has reformed and modernized the Labor Law,²⁷ which was put in place in 2003, the severance pay regulation has not been changed for decades (Erçan, 2006). The regulation on severance pay in force is the one from the former Labor Law; it remained the same also in the new labor market regulation as labor unions opposed any changes in adoption of 2003 law.

²⁶ Under the 1993 Law on Bankruptcy and Liquidation, workers can sue their former employers that undergo a liquidation or bankruptcy process, with workers' severance pay claims having a priority before other claims (up to a limit – for details, see Kresal Šoltes, 1997).

²⁷ The unofficial translation to English is available on <http://www.ilo.org/dyn/natlex/docs/SERIAL/64083/63017/F1027431766/TUR64083.PDF>.

Severance pay is mandated for all workers in formal (private and public) sector, regardless the size and type of the employer. As reported by the World Bank (2006), Turkish severance pay legislation is generous one judged by international standards. Workers qualify after one year of service and the legislation mandated a payment of one month wage (most recent monthly gross wage is applicable)²⁸ per year of service for qualifying separations (including separations for economic reasons, just cause discharge cases and retirements, death, compulsory military service, disability, “female getting married” etc., thus in fact all terminations other than resignation or misconduct), with no ceiling on number of years but with a ceiling on amount paid per year. Old-age severance pay applies under the same rules as any other qualifying reason. There is a ceiling on severance pay compensation, which is the retirement bonus of the highest-ranking civil servant (the undersecretary to the prime minister).

With the collective agreements, the amount of the severance pay can be changed in workers’ favor. Besides this, workers (labor unions) and employers can determine additional in kind and cash assistances in collective bargaining agreements. If there is not any additional in kind and cash assistances in collective agreements and the amount of severance pay is not determined with collective agreements, the amount of the severance pay equals to the employee’s recent wage. If employees entitle any assistance with the collective agreements, the amount of the severance pay increases. As a result, collective agreements are in general even more generous than regulatory framework.

When it comes to implementation, public sector and formal large unionized private blue-collar employees are covered by severance pay legislation, where informal sector of small establishments will not abide by the law (Ercan, 2006). Because severance payment is a generous lump-sum payment, it presents a significant burden for employers and most of the employers try to avoid it. Ad hoc evidence suggests that compliance is limited outside the public sector, and that employers use various practices to avoid payments (including forcing workers to sign undated “voluntary” resignations when starting a job, termination of employment at the last day of annual contract with rehiring the next day, etc.). Due of this reason, entitlement rate to severance pay is quite low. According to the government’s estimate, more than 40 % of workers whose employment contract is terminated in fact resign and do not entitle to severance pay. In addition, those employed on the basis of temporary contracts are usually not eligible to severance payments due to minimum tenure requirement.

In Turkey, severance payment is mandated also for firms in bankruptcy. In the case of bankruptcy, government’s claims are the first priority claims, followed by the claims of employees including severance and notice pay. In case of non-performance, the worker can follow two alternative paths. First, the employee can make a complaint to the Regional Work and Employment Directorate. Second, if the employee’s complaint remains inconclusive, the employee must directly go to the labor court. As a result, the employer has to pay the severance pay in accordance with the court decision.

Severance pay regulation in Turkey is one of the most generous in the world, however being decades old. Although there is a political will/attempt to change the regulation, oppositions from both labor unions and employer unions prevent such changes. Employer associations oppose the regulation because most of the employers do not pay severance pay. Moreover, they argue that there’s no further need for severance pay, as now there is unemployment insurance in place.²⁹ Also, labor unions oppose the regulation because they do not want any reduction in the amount of severance pay and argue that severance pay is simply a component of gross wage and

²⁸ For those who work part-time, the amount of severance pay is calculated as the monthly average of payments in the year before the termination.

²⁹ Turkey introduced the unemployment insurance only in 2002

needs to stay. It could be shown that such strict regulation hinders labor market flexicurity and severance pay may be blamed for the employer reluctance in expanding employment.³⁰

14. CONCLUSION

In this paper we tried to identify similarities and differences in severance pay schemes in the SEE countries. We found that severance pay is mandated by law in all SEE countries except one. The only exception is Romania, where the severance pay is mandated by the national collective agreement. Redundancy is a legitimate ground for dismissal in all studied SEE countries, but always leads to worker's claim to severance pay. Other grounds for contract's termination, for example dismissal, incapacity, old-age etc., are justified reasons for severance pay claim only in some of the observed countries. In case of justified reason for contract's termination, a common basis for severance pay is work tenure with the employer.

Even though the basic framework of severance pay scheme is similar in the SEE countries, the modalities are very different. Countries vary significantly in minimal required tenure, eligibility for severance pay other than redundancy, severance pay generosity index and in other characteristics.

Severance pay schemes have several weaknesses. One of the important weaknesses is that severance pay increases rigidity of labor markets, which has negative effects on GDP growth, labor productivity and finally on labor market outcomes. The other evident fact is that severance pay, being separated from unemployment insurance, induces inefficiency – it is paid regardless the unemployment spell. On top of that, evidence from Slovenia and Turkey suggest that non-performance of severance pay is not negligible. These considerations call for reforms of classic severance pay schemes; some evidence does exist in other countries (i.e. Austria, Chile etc.). However, it seems that no reforms or upgrades of the existing schemes are expected really soon among the SEE countries. One of the reasons can be that current regulation has been put in place at latest in last decade, whereas the other reason could be the opposition from workers' and employers' side. Here again, experiences from Slovenia and Turkey evidently show that the lack of strong political inevitably result is failure of reforms.

³⁰ Note that employment rate in Turkey is extremely low by international standards.