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Working Paper

Job creation, job destruction and labour demand in Slovenia

LICOS Discussion Paper, No. 74

Provided in Cooperation with:

LICOS Centre for Institutions and Economic Performance, KU Leuven

Suggested Citation: Bojnec, Stefan; Konings, Jozef (1998) : Job creation, job destruction and labour demand in Slovenia, LICOS Discussion Paper, No. 74, Katholieke Universiteit Leuven, LICOS Centre for Transition Economics, Leuven

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LICOS

Centre for Transition Economics

LICOS Discussion Paper

Discussion Paper 74/1998

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Job Creation , Job Destruction and Labour Demand in Slovenia

by

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August 1998

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Abstract

This paper uses a unique firm level data base of traditional and newly established private enterprises to investigate gross job flows and labour demand in the transition period in Slovenia. We find that job destruction dominates job creation in the early years of transition, but later in the transition job destruction diminishes. The excess job reallocation rate, a measure for restructuring, is found to be rather low.

We find that newly established private firms or de novo firms are fundamentally the most dynamic ones in terms of job creation. We estimate a reduced labour demand equation controlling for ownership and competitive pressure and find that the estimated employment elasticity with respect to sales is rather low, 12%. We do not find any difference in this elasticity if we split the sample in expanding versus contracting firms. Furthermore we cannot find evidence that competitive pressure has any impact on the demand for labour. We do find that de novo firms have a higher employment growth than traditional firms.

JEL classification: J63

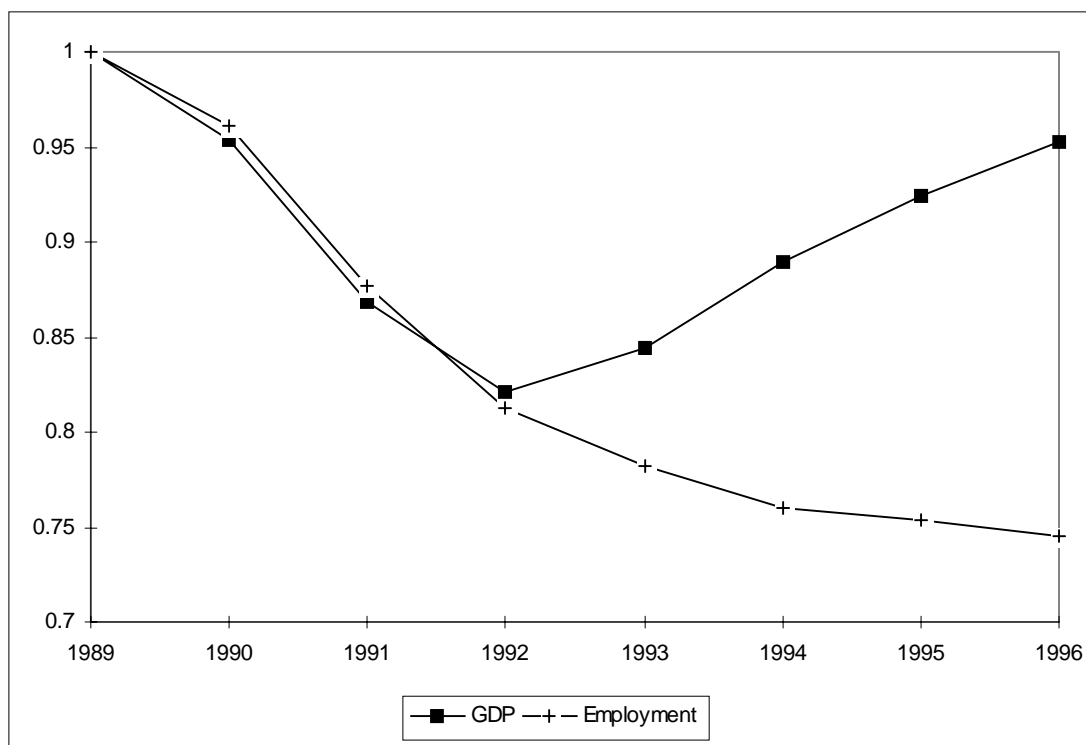
Keywords: Job creation; Job destruction; Slovenia; Transition; Private firms

Acknowledgement : This paper is part of a Phare ACE funded project number P96-6203-R

Introduction

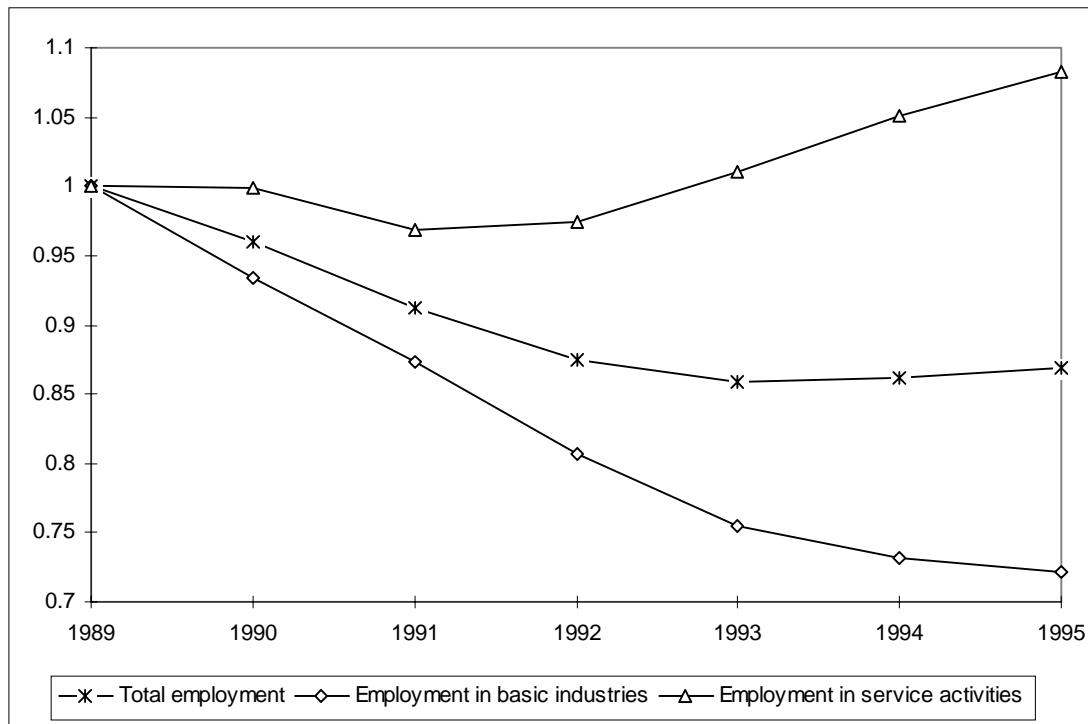
The evolution of output (gross domestic product) and employment for Slovenia is shown in Figure 1. We normalised all series on 1 at the start of transition. The collapse in employment has lagged behind the collapse in output. While output is picking up again by 1993, total employment further collapsed. However, the latter is due to a steep collapse in industrial employment, while employment in the service sector is in fact growing as illustrated in figure 2. The U-shaped pattern in output and employment is observed in most transition countries and by now most East European countries are emerging from their deep recessions.

Figure 1: The Evolution of Gross Domestic Product (GDP) and Employment in Slovenia



(*) Own calculations on the basis of data from the Statistical Yearbook of Slovenia (1977).

Figure 2. The Evolution of Employment in Slovenia



(*) Own calculations on the basis of data from the Statistical Yearbook of Slovenia (1997).

Under central planning and self management the Slovenian manufacturing sector was too large compared to the standards of market economies, so with transition a part of the reallocation takes the form of reallocating activities from manufacturing to services and from large to small firms. The macroeconomic evolution of employment might hide important gross employment flows reflecting an active reallocation process. An example can illustrate this. A net aggregate employment growth of -5% might be the result of a gross job creation rate of 1% and a gross job destruction rate of 6%, or alternatively, a gross job creation rate of 10% and a gross job destruction rate of 15%. Obviously, the latter suggests a much more active reallocation process than the former. As suggested by Blanchard (1997) there are two key components of transition; one is *reallocation* the other is *restructuring*. While the removal of state subsidies and the emergence of a private sector implies a reallocation of resources from the “social” sector to the private sector as well as causes unemployment; restructuring refers to reducing overmanning levels and to improving the efficiency in production, which can be done by replacing unproductive workers with productive ones or by other measures of “deep restructuring”.

This paper is the first to illustrate this reallocation and restructuring process for Slovenia. To this end we use a data set of 97 firms out of 100 firms that were collected by personal interviews with the key manager of “socially” owned, privatised and newly established private firms. Thus, this paper allows us to study industrial restructuring from the firm’s perspective. This paper makes various contributions to the literature. First, there is an increased interest from both labour and industrial organisation economists in the empirical aspects of gross flows of jobs and turbulence (e.g. Davis and Haltiwanger, 1992). There exists very little work to date that studies job reallocation for transition countries. Yet, reallocation presumably matters a lot in reforming economies. Konings, Lehmann and Schaffer (1996) study gross job reallocation in the Polish industrial sector at the start of transition (1988-91), while Faggio and Konings (1998) study gross job flows for Romania, Bulgaria and Estonia in the 90’s. This paper uses data between 1990 and 1996 to study gross job flows as indicators of reallocation and industrial restructuring in Slovenia. We expect to gain some insights into the timing of transition and the magnitude of reallocation during transition.

A second motivation for this study lies in assessing the relative dynamism of various ownership forms in terms of job creation. Evidence from Poland, Bulgaria and Romania suggests that - especially at the start of transition - *de novo* private firms are fundamentally the most dynamic ones in the job generation process, while privatised and state owned enterprises do not perform significantly different and are predominantly shedding labour (Konings, 1997; Konings et al. 1996). Industrial restructuring implies the disappearance of traditional firms and the emergence of a new private sector. Understanding the growth of the private sector is therefore essential if one wants to understand the details behind industrial restructuring. This paper should provide insights into the growth and performance of the *de novo* sector relative to the traditional one.

Finally, little is known about the adjustment of labour to demand shocks. Most centrally planned economies were characterised by overmanning levels. Obtaining an idea about the elasticity of employment with respect to output could provide insights in the responsiveness of firms to demand shocks as in Estrin and Svejnar (1997). The gross flows of jobs that we study in this paper are linked to the micro economic adjustment of firms in response to output shocks.

In the following section we describe the data set and in section III we report job flows for Slovene sample of firms. In section IV we estimate firm level labour demand equations. In section V we summarise and conclude the paper.

II. Data

We use micro-economic data that are based on firm-level surveys of 100 enterprises in Slovenia, which were collected by personal interviews with the owner of the *de novo* firm and general and/or financial manager or some other leading managers in “socially” owned and privatised enterprises. Often it was necessary to obtain the decision of the director general that the enterprise could participate in the survey. The interviews were carried out in different regions to reflect the geographical and economic concentration. 50% of the firms in the sample were *de novo* or newly established private firms, and the other 50% were “socially” owned and privatised enterprises. The *de novo* firms were selected in manufacturing, trade and services, while “socially” owned and privatised enterprises were selected from the manufacturing branches. Within each region the enterprises were selected by local interviewers who visited each enterprise at least once. Most interviews were performed during the period of October 1996 to November 1996. The questionnaire covered basic information about the enterprise and various aspects of firm behaviour related to sales, employment and competitive pressure, among other things.

We constructed three ownership categories, *de novo* private firms, “socially” owned and privatised enterprises. The *de novo* firm was defined as a firm that was private since it was established. Unlike for many other ex-socialist countries (except for the rest of former Yugoslavia, Poland and Hungary), a private sector (especially in agriculture, services and small-scale craft firms) was allowed in Slovenia during the socialist period. However, the private firms were limited in size, especially on employment outside the family household. During the 1970s and 1980s some limitations on private sector activity were relaxed, but they were still in place. After the abolishment of most limitations on size, job flows and enterprise performance in the 1990s one could expect more dynamic job flows to emerge. In our sample, the *de novo* firms do not include spin-offs from previously “socially” owned enterprises.

This was controlled for using information from the questionnaire on the ownership history of the firm and on the business start-up. Enterprises that indicated that they had previously been a part of the “socially” owned enterprise or that the enterprise was set-up by the state programme were not included in the *de novo* category.

The second category of enterprises contains traditional, non-privatised yet, “socially” owned enterprises. Their important characteristic was that they were in “social” ownership and operation (i.e. self-management). Many of them were established during the socialist period via the state programme. Some of them originated from the period before World War II or even from the previous century, but after the World War II were confiscated/nationalised and turned into state/”social” property and operation. If they were not privatised yet, we treated them as the “socially” owned enterprises. However, if they were at least partially privatised, we included them in the third category of privatised enterprises.

The third category contains privatised enterprises. Privatised enterprises are defined as those enterprises that were privatised during transition, but they were operating before transition with majority up to 100% “social” (state) ownership. The idea in the sample selection was to include in the survey most known ex-“socially” owned enterprises by regions as they were being the most important in employment and development of a certain region. The interview experiences showed, that such “composite organisation of associate labour” often does not exist anymore in the former form as they were usually split or transformed in more independent units. Due to delays in a mass privatisation process of enterprises, restructuring of enterprises was often prior to their privatisation. Furthermore, according to the enterprise business and accountancy data, majority of employed still work in the “socially” owned enterprises, while privatised enterprises are majority insider management-employee owned (Bojnec, 1998). In our sample we pool the privatised and “socially” owned firms together in one category, the traditional firms. Note that 3 traditional firms out of the sample of 100 firms are omitted from the empirical analysis and hence we are using 47 traditional firms. Most traditional firms are privatised in our sample, only 9 traditional firms were still fully state owned. The reason why we pool privatised firms and state owned enterprises in one category is based on recent evidence showing no difference in performance between these two categories of firms (Konings, 1997; Richter and Schaffer, 1997). Table 1 presents the sample structure and summary statistics on size and employment growth for *de novo* firms and traditional ones for 1996. We can see that *de novo* firms typically are smaller

than traditional ones and their growth rate is positive, while traditional firms are still declining in 1996.

Table 1. Summary Statistics of the Slovene Sample According to Employment and Employment Growth in 1996

	number of firms	average employment '96	average employment growth '96
de novo	50	32 (85)	0.11 (0.26)
Traditional firms	47	586 (1064)	-0.02 (0.13)
Total	97	300 (790)	0.04 (0.21)

Note: standard errors in brackets

III. Job creation and job destruction

We follow the literature¹ on gross job flows and define gross job creation as the sum of all employment gains at expanding firms, and gross job destruction as the sum of all employment losses at contracting firms. The latter is expressed as a positive number. Gross job reallocation is defined as a sum of gross job creation and gross job destruction, while net employment growth rate is defined as a difference between gross job creation and gross job destruction. We also report an alternative measure of job reallocation, excess job reallocation. This is defined as the difference between the gross job reallocation rate and the absolute value of the net employment growth rate. This measure reflects real turning of jobs, after taking into account aggregate movements in employment growth. The excess job reallocation rate can also be interpreted as an indicator of “deep” restructuring because a high excess job reallocation rate would be the result of simultaneous high job creation and destruction, which would be the case if firms are replacing unproductive jobs with productive ones. This is typically a condition for deep restructuring implying an increase in production efficiency. Since we asked retrospective questions on employment we were able to compute gross job flows for several years.

Table 2 indicates rather low job creation rates. Except for 1994 and 1995, it was below one percent. Job destruction rates were much higher ranking from 3.2 percent in 1994 to 7.8 percent

¹ See Davis and Haltiwanger (1992); Boeri and Cramer, 1992; Konings, 1995; Konings et al. (1996).

in 1991. Gross job reallocation rates varied between 5.2 percent in 1996 and 8.5 percent in 1991. This indicates larger stability in job flows compared to findings for some other CEECs (Bilsen and Konings, 1998). The net employment growth rate was positive in 1994 indicating that temporarily job creation rate offsets job destruction rate. This survey evidence is largely consistent with the macroeconomic evolution observed in aggregate statistics. In 1994 the rate of unemployment was stabilised and employment growth in service activities was picking up. Although, the current data is not representative for the entire economy, we do pick up this evolution in the data. For other years, the net employment growth rate was negative ranging from -7 percent in 1991 to -2.7 percent in 1995. The excess job reallocation rate was the largest in 1994 (6.3 percent), which suggests that firms behaved in a very heterogeneous way regarding their employment decisions. It could also reflect that some deep restructuring was going on by 1994, reflected in simultaneous creation and destruction of jobs. However, by 1996 the excess job reallocation rate is only 2%, suggesting that “deep” restructuring is rather low.

Table 2. Job Flows by Available Years

Year	jcr	jdr	Gross	Net	excess
1991	0.007	0.078	0.085	-0.070	0.015
1992	0.002	0.071	0.073	-0.069	0.004
1993	0.007	0.057	0.064	-0.050	0.014
1994	0.043	0.032	0.075	0.012	0.063
1995	0.013	0.040	0.054	-0.027	0.027
1996	0.008	0.044	0.052	-0.035	0.017

Note: jcr = job creation rate, jdr = job destruction rate, gross = gross job reallocation rate (jcr+jdr), net = net employment growth rate (jcr-jdr), excess = excess job reallocation rate (gross-!net!).

Table 3 presents job flows according to firm ownership and indicates that most job creation has occurred by *de novo*, private enterprises. In the period 1991-1996, the job creation rate was 7.0 percent for *de novo* and 1.0 percent for traditional privatised and non-privatised “social”

enterprises. The variability in job creation rates for *de novo* private enterprises was much larger than for traditional former “socially” owned enterprises. Many new private enterprises were established during the 1990s, and they were mostly set-up as *de novo* private firms. Also note that the excess job reallocation rate is much higher for *de novo* firms than for traditional ones.

Table 3. Job Flows According to Firm Ownership, Average 1991-1996

	jcr (Min, Max)	jdr (Min, Max)	gross (Min, Max)	net (Min, Max)	excess
de novo	0.070 (0.030, 0.138)	0.115 (0.049, 0.224)	0.185 (0.104, 0.269)	-0.045 (-0.179, 0.084)	0.140
Traditional*	0.010 (0.001, 0.039)	0.050 (0.030, 0.078)	0.060 (0.036, 0.085)	-0.039 (-0.072, 0.008)	0.021
Total	0.014 (0.002, 0.043)	0.053 (0.032, 0.078)	0.067 (0.052, 0.085)	-0.040 (-0.070, 0.012)	0.037

* Privatised and “socially” owned firms.

Job destruction rates were also larger for *de novo* than for traditional “social” enterprises. In the period 1991-1996, it was 11.5 percent for *de novo* and 5.0 percent for traditional “social” enterprises. Consequently, the gross job reallocation rate for *de novo* enterprises was three times (18.5 percent) as high as for traditional “social” enterprises (6.0 percent). The average net employment growth rate was negative for both *de novo* (-4.5 percent) and for traditional “social” enterprises (-3.9 percent). This is largely consistent with a macroeconomic evidence showing that the overall economy employment has declined since 1991 (see figure 1). The excess job reallocation rate was 14 percent for *de novo* and 2.1 percent for traditional “social” enterprises. As shown in table 4, the most dynamic in job creation were small enterprises with the job creation rate 22.8 percent in the period 1991-1996 compared to 2.4 percent for medium and 1.0 percent for large enterprises. The job destruction rate was the largest for large enterprises (5.5

percent) compared to 4.1 percent for small and 3.4 percent for medium enterprises. Thus, the gross job reallocation rate was 26.9 percent for small, 6.5 percent for large and 5.8 percent for medium enterprises. While the net employment growth rate was largely positive for small enterprises (18.7 percent), it was negative for medium (-1.0 percent) and large enterprises (-4.5 percent). The excess job reallocation rate confirmed that the job flows were the most dynamic by small enterprises (8.2 percent). It was 4.8 percent for medium and 2.0 percent for large enterprises.

Table 4. Job Flows According to Firm Size, Average 1991-1996 (*)

	jcr (Min, Max)	jdr (Min, Max)	gross (Min, Max)	net (Min, Max)	excess
Small	0.228 (0.171, 0.420)	0.041 (0.018, 0.096)	0.269 (0.202, 0.438)	0.187 (0.137, 0.402)	0.082
Medium	0.024 (0.001, 0.068)	0.034 (0.022, 0.066)	0.058 (0.030, 0.095)	-0.010 (-0.053, 0.041)	0.048
Large	0.010 (0.001, 0.040)	0.055 (0.032, 0.082)	0.065 (0.046, 0.088)	-0.045 (-0.076, 0.008)	0.020

* Small = less than 50 employees, Medium = between 50 and 250 employees, Large = exceeded 250 employees.

Bilsen and Konings (1998) use similar survey data and report results on job creation and destruction for Bulgaria, Romania and Hungary. They found a high job destruction rate and a low job creation rate in the early phase of transition (in 1991). In the second phase (in 1994), the job destruction rate decreased, while the job creation rate remained very low.

The pattern of a declining job destruction rate with ongoing transition is largely consistent with our results for Slovenia in table 2, irrespective of the slight increase in the job destruction rate in Slovenia after 1994. Furthermore, our results indicate an increase in the job creation rate in 1994, but a decrease and a stabilisation of the job creation rate afterwards. Comparing the results

here with Bilsen and Konings (1998) the Slovene results are more similar to those for Hungarian enterprises, with a lower gross job reallocation rate than in Bulgaria and Romania. Furthermore, the transition in Slovenia started before and hence rather high job destruction rates presumably already occurred in the second half of 1980s. Unlike the findings in Bilsen and Konings (1998) for Bulgaria and Romania that *de novo* enterprises had the highest job creation rate and the lowest job destruction rate, we find that the *de novo* enterprises in Slovenia had a higher job creation rate, but also a much higher job destruction rate. The latter is roughly similar to the situation in Hungary. This suggests that *de novo* firms are in a steady state situation in which job creation is roughly equal to job destruction. It also suggests that *de novo* firms engage in a process of creative destruction or deep restructuring. The employment dynamics of small enterprise is less likely only a catching-up effect aimed at filling market niches as suggested by Bilsen and Konings (1998) for Bulgaria and Romania, but it seems to be a process of a deep restructuring towards a more viable size of enterprises.

IV. Adjustment of employment

Previous section nicely illustrated that job reallocation is substantial and that especially *de novo* small firms are fundamentally the most dynamic ones. In this section we move to the level of the firm and investigate the response of employment to demand shocks, taking into account a number of control factors. We follow Estrin and Svejnar (1997) and specify a reduced form labour demand equation as a function of sales, ownership, union recognition and competitive pressure. We are particularly interested in the elasticity of employment with respect to sales. We estimate the model in first differences to control for unobservable fixed effects.

We control for ownership in two ways. First, we use a dummy equal to 1 if the firm is a ‘*de novo*’ firm. Second, we use the ownership share of employees and of the state, with the benchmark the ownership share of the outside private owners. We expect that *de novo* firms have a higher demand for labour.

We also include a dummy equal to 1 if the firm is unionised. This is an indirect way of controlling for wages. Under central planning and self-management unions were important in bargaining over work conditions. So, if unions are still important for bargaining over wages in the transition, we should find an effect of unionisation on the demand for labour. If wages are

set competitively, which is not unrealistic given that unemployment is so high, unions would not play a role in the demand for labour. Finally, we also include controls for competitive pressure. Transition economies were endowed with relatively rigid product markets, so with transition to a market economy it can be expected that competitive pressure will increase, which should result in a higher demand for labour. We include a traditional measure, proxying the number of competitors and we use a marginal measure capturing the response of prices to new entrants. In particular, the following questions were asked:

“How many competitors does your company face in its output market?”

1. dominant firm
2. between 2-4 competitors
3. more than 5 competitors

and

“Suppose a new firm would enter in your market, how would this affect your price?”

1. stay the same
2. go down moderately
3. go down a lot

Table 5 shows the results. We report 5 different specifications. Irrespective of the specification used, we find that the employment elasticity with respect to sales is around 12%. This is quite low. Estrin and Svejnar (1997) find for a number of transition countries much higher employment elasticities with respect to sales, in addition they find differences between firms with expanding and firms with contracting sales.

We find that *de novo* private firms outperform traditional ones in terms of employment growth. This confirms earlier results on gross job flows (Bilsen and Konings, 1998). In other words, when we control for other firm specific factors, we still find that *de novo* private firms have a higher demand for labour. Surprisingly, as can be seen in column (3) whether the firm is unionised or not does not seem to matter. This suggests that unions do not have an impact

on wages and hence not on employment. Presumably, wages are determined exogenously and do not play a role in the demand for labour. Rather, product market demand (as measured by sales) seems to matter more. Finally, when we look at the effects of competitive pressure, we cannot find strong effects of competition on the demand for labour (column 4). In column (5) we experimented with an alternative definition of ownership, based on the shares owned by employees and the state, the benchmark case reflecting the shares owned by the outsiders. We find strong negative effects of employee ownership and state ownership on the demand for labour. Thus, inside ownership leads to lower demand for labour than outside ownership. This is important for understanding rather low job creation rates in the Slovene economy during transition.

Table 5. Labour Demand (*)

	(1)	(2)	(3)	(4)	(5)
Sale	0.146 (4.390)	0.114 (3.573)	0.115 (3.598)	0.111 (3.429)	0.126 (3.763)
de novo	-	0.231 (5.619)	0.231 (5.616)	0.224 (5.262)	-
Employee ownership	-	-	-	-	-0.182 (2.664)
“social” ownership	-	-	-	-	-0.216 (2.404)
Union recognition	-	-	-0.027 (0.802)	-0.005 (0.130)	0.011 (0.291)
few competitors	-	-	-	0.054 (0.733)	0.040 (0.506)
Many competitors	-	-	-	0.019 (0.272)	0.015 (0.211)
Price goes down	-	-	-	-0.044 (1.140)	-0.069 (1.707)
Price goes down a lot	-	-	-	-0.079 (1.133)	-0.086 (1.197)
Constant	-0.165 (2.560)	-0.145 (2.376)	-0.134 (2.117)	-0.135 (1.385)	-0.044 (0.395)
F test	4.28	6.68	6.27	5.09	3.80
Number of observations	287	287	287	287	284

(*) t-statistics in brackets. Sector and year dummies are included. Equations are estimated in first differences. In equation (5) benchmark is ‘outside private ownership’.

We next address the issue of labour hoarding. We follow Estrin and Svejnar (1997) and report split regressions, based on whether firms experienced an increase in sales or not. If there is labour hoarding we would expect that increased production can be achieved with the existing workers, so that the labour demand elasticity with respect to sales should be close to zero, compared to the case in which sales are declining. Table 6 shows the results of the split regressions. Comparing column (1) and (2) we cannot find much difference in the employment elasticity with respect to sales, in both cases it is estimated at 13%. We do, however, find a substantial difference in the effect of de novo enterprises. The effect of de novo enterprises is only statistically significant in the sub-sample of firms that expanded sales. The other parameters are estimated, as before, insignificantly.

Table 6. Labour Demand (*)

	Sales up (1)	Sales down (2)
Sale	0.135 (2.988)	0.133 (1.789)
de novo	0.253 (5.161)	0.028 (0.127)
Union recognition	-0.008 (0.209)	0.151 (1.199)
few competitors	0.091 (1.109)	-0.225 (0.804)
Many competitors	0.042 (0.529)	-0.131 (0.661)
Price goes down	-0.017 (0.386)	-0.140 (1.188)
Price goes down a lot	-0.098 (1.254)	-0.001 (0.007)
Constant	-0.168 (1.561)	-0.164 (0.466)
F test	4.36	0.94
Number of observations	253	26

(*) t-statistics in brackets. Sector and year dummies are included. Equations are estimated in first differences.

V. Conclusions

This paper uses a unique data set based on a survey of 100 firms in Slovenia to gain some insights into the employment adjustment process in de novo and traditional firms. We find that job destruction increases in the early stages of transition, but decreases later on. Also, job creation increases, albeit at a slower pace. The excess job reallocation rate is quite low, which is a consequence of a low excess job reallocation rate in the traditional sector. Thus, deep restructuring seems to be limited in the traditional sector. This contrasts with the de novo firms and small firms where both job creation and destruction is high. We report evidence that the de novo firms have the highest job creation rates, but also the highest job destruction rates, while traditional firms have low job creation and high job destruction. This indicates that the de novo firms are fundamentally the most dynamic ones.

In a reduced labour demand equation we find that, after controlling for ownership and competitive pressure, the employment elasticity with respect to sales is rather low, estimated at around 12%. This suggests that shocks in the output market only have a limited impact on the demand for labour. We do not find any evidence of asymmetric responses, i.e. firms with expanding sales have the same employment elasticity with respect to sales as firms with contracting sales. This suggests that there is no labour hoarding going on. We also find that de novo firms have a higher demand for labour. We cannot find evidence that competitive pressure matters in explaining the demand for labour in Slovenian firms.

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