

Who's afraid of labour market flexibility?

Executive summary

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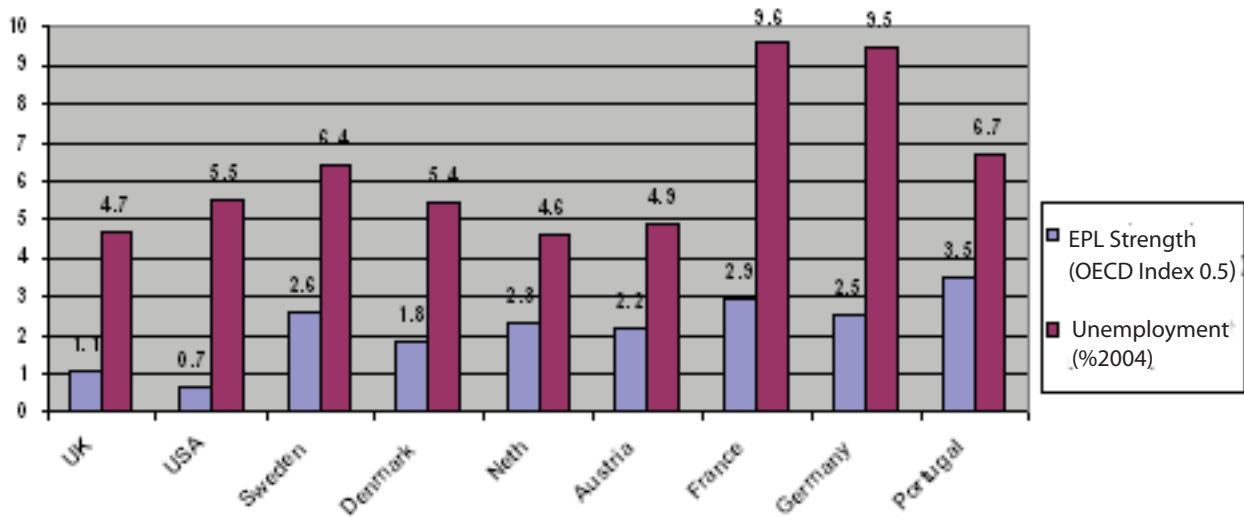
- Labour market flexibility is said to be essential for economic success. Yet precisely what is meant by “flexibility” is not always clear. Some commentators talk about limited regulation, low unemployment benefits with tight conditions, weak trade unions and low coverage of collective bargaining, but the reality is that countries with very different labour markets have performed equally well suggesting that there is no single route to full employment.
- The OECD's 1994 Jobs Study has set the frame of reference for the debate about economic policy over the last decade. Indeed, with some notable differences, New Labour's programme is broadly consistent with these prescriptions. The Jobs Study is a rather curious hybrid that draws on elements of orthodox Keynesianism (deficit spending in recessions, fiscal consolidation in booms), endogenous growth theory (particularly the emphasis on investment in skills, R&D and innovation) and a rather conventional analysis of the role of trade unions. Twelve years on the OECD are about to publish a comprehensive review and their preparatory work suggests that they now accept that very different labour market models can deliver equally good results. In one sense this is unsurprising, simply because the standard account of what makes for good labour market performance cannot explain the relatively good records of some small countries in Europe – Denmark, Sweden, Austria and the Netherlands.
- It is particularly important to understand that bundles of policies are responsible for good outcomes. Simply put, the following seem to be particularly important in explaining why some European countries have done well:
 - A high degree of wage flexibility, often in the context of strong trade unions and high coverage of collective bargaining, where the co-ordination and centralisation of negotiations ensure that wages respond to changes at the macro level and sustain non-inflationary growth.
 - Open markets with a relatively low level of product market regulation
 - “Moderately strict” employment protection legislation that legitimises change but does not act as an impediment to necessary restructuring.
 - Significant investment in Active Labour Market programmes (ALMPs) to improve the skills of the unemployed to help them back into work.
 - An “activation” approach to the benefits system so that high benefits are married with tight conditions, limited durations and job search obligations.
 - A high level of “functional flexibility” at enterprise level where workers have a wide range of generic skills so that they can be redeployed from one activity to another.

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- It is wrong to believe that “flexibility” is a necessary response to the “threat of India and China” or that there is an inevitable “race to the bottom” with an attack on strong welfare states with progressive systems of taxation. The experience of the “low unemployment” countries in the EU 15 (excluding the UK and the Republic of Ireland) show that it is possible to combine social justice and economic dynamism. Similarly, while it is clear that some of the big European economies (France and Germany in particular) face major employment challenges, it would be wrong to believe that the only response is a hefty dose of labour market deregulation.
- Countries need to consider the appropriate policy mix given their specific circumstances. This must include an appropriate monetary and fiscal policy stance alongside, where necessary, the reform of labour market institutions. The objective must be to secure the balance of flexibility and security that has been successfully achieved elsewhere. The OECD make clear that the inter-dependencies between different areas of policy are not always well understood. Policy makers should therefore take care not to rush to judgment and identify either a single reform (like the first employment contract in France) or a package focused on one area of policy (like the Hartz reforms to the unemployment benefits system in Germany) in the belief that such initiatives can carry the full weight of expectations. A more comprehensive and sophisticated approach is needed which explains where change is necessary but also makes clear that some fundamental principles – strong welfare states and progressive taxation – are not under threat.
- The UK is often said to have a “flexible” labour market as conventionally defined, which explains our good employment performance. Yet experience elsewhere suggests that a rather different balance between flexibility and workplace justice can be achieved without any adverse impact on employment. It would therefore be possible to have somewhat tighter regulation than the UK and retain our highly prized flexibility. Amongst the measures that might be considered are:
 - a higher level of compensation for redundancy;
 - reducing the qualifying period for a redundancy payment;
 - a review of the penalties and sanctions imposed on employers who fail to properly inform and consult about threats to employment and redundancies;
 - the development of “sector forums” in low pay, low skill, low productivity industries to improve productivity and increase pay;
 - an improvement in the level of out-of-work benefits so that the unemployed are not the victims of a catastrophic collapse in income following job loss;
 - increased investment in active labour market programmes to get the socially excluded back to work

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Employment Protection Law Strength and Unemployment



Source: OECD Factbook 2006 (unemployment, 2004)