

Economic and Employment Policies and Performances in Four European Countries

France, Germany, Sweden, the United Kingdom

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INTRODUCTION AND MAIN FINDINGS

This report stems from research carried out as part of the SALTSA Project coordinated by The National Institute for Working Life and The Swedish Trade Unions. The aim of this study was to evaluate employment performance based on an international comparison of four countries: France, Germany, Sweden and the United Kingdom.

The method

The objective was to attribute employment performance to two sets of factors: the macroeconomic environment on the one hand, and the workings of labour markets, on the other. In other words, the aim was to discuss a widespread theory that labour market characteristics in each country are the only factors taken into account when evaluating employment performance.

In order to better examine this question, the first decision was to select a limited number of countries, rather than use the entire European Union. It is therefore possible not to stick to overall statistical indicators and instead to continue analysing each of the national models, so as to better take into account their specific characteristics.

The four countries were selected using several criteria. The first criterion was size: France, Germany and the United Kingdom represent over half of the European GDP and cannot be considered as small size free riders benefiting from exceptional circumstances. The second criterion was to have a wide range of situations: whether from the perspective of employment performance or labour market functioning, the four countries display relatively contrasting configurations. The third criterion was membership of the Eurozone, with Sweden and the United Kingdom not being members.

The choice of a restricted number of countries also enabled the opinions of different social partners to be collected: employers, trade unions, governments and parties. Several research visits were carried out in the four countries, with a researcher from the country under review working with a researcher from another country. In each of the countries, these pairs of researchers interviewed the chosen targets in order to cover all the social partners, as well as interviewing researchers specialising in this field. The report therefore includes a transversal chapter and then a chapter on each of the countries.

Main Findings

In this section, we will give an overall picture of the general results from the entire project, referring to each chapter for details on specific results.

- 1 Unemployment rate is not an overall indicator of labour market performance and needs to be combined with other indicators, such as job creation. Depending on the selected indicator, the ranking of the countries changes.
- 2 Relative employment performance reproduces quite precisely the relative rhythms of growth. Therefore, macroeconomic factors greatly over-determine the workings of labour markets.
- 3 There is no univocal link between wage moderation, which is supposed to measure labour market flexibility, and employment performance. The salary freeze in Germany was accompanied by a rise in the unemployment rate, while the United Kingdom combines the best results in terms of employment and the quickest progression of wages.
- 4 Productivity gains are the key element of growth dynamism and therefore of employment. While the general trends can be seen in the countries under review, developments differ largely from one country to the next, particularly as regards the relative growth of GDP and productivity.
- 5 The labour force participation rate is a key variable that alters the effect of job creation on the unemployment rate. It appears to clearly correlate with working time: in the countries where working time has dropped the most, the participation rate has risen the most.
- 6 Links between productivity and wages follow different profiles from one country to the next, if we introduce a sectoral dimension enabling exposed and sheltered sectors to be distinguished. The extent to which labour market workings enable these major sectors to disconnect from each other influences overall employment performance.
- 7 Public services employment makes a major and different contribution in the four countries to the progression of total employment.
- 8 The institutional indicators used to describe the workings of the labour markets do not enable a solid link with employment performance to be established. They tend to

become virtually meaningless when macroeconomic indicators are introduced amongst the explanatory variables.

- 9 In particular, there is no transversal link between the degree of flexibility and employment performance of each of the countries.
- 10 The specific nature of the national models is clear to see when we go beyond a transversal statistical comparison methodology. The type of insertion in the global market and the type of relations between the social partners play an equally if not more important role than labour market reforms.
- 11 Each of the countries exhibits specific characteristics, which can be briefly summarised by running through the salient facts developed in each of the chapters. Germany is experiencing a debate on the compatibility of insertion in the global market and the long-term future of the social model. France is marked by a strong opposition between contradictory diagnostics, making any form of consensus difficult to obtain. The United Kingdom is an example of a specific mix between a good international insertion and a policy of accompaniment of flexibility. Finally, Sweden follows a different path, basing the quality of the social model on industrial performance.
- 12 One of the main conclusions of this study is that we cannot deal with the European countries by referring to a universal target standard. It is therefore impossible to set out “one size fits all” recommendations that do not take into account the economic environment and the reality of employment relations in each country.
- 13 This diversity calls into question the coherence of European decisions. The countries occupy different positions in the global market: the specialization of France is of worse quality than that of Germany, which combines its supremacy in capital goods with the use of international sub-contracting. The United Kingdom benefits from its considerable financial sector and its own energy resources, while Sweden relies on its industrial “champions”. In these conditions, it is difficult to implement cooperative policies, as demonstrated by the recourse to VAT in Germany and soon in France.
- 14 Rather than seeking to conform to a single model, labour market reforms should take this diversity into account, and target forms of harmonisation, which are not based on a single rule. They should enable each country to consolidate its social model rather than setting off a race to the bottom. However, this is a more difficult path to follow than a general downgrading of the social models.

CHAPTER 1

Employment performance, macroeconomy and labour markets

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This transversal chapter aims to examine the relative role of macroeconomic and institutional factors on the employment performance of each country. It contains four sections.

The first section contains a comparative overview of these performances using a range of indicators, instead of just using the unemployment rate, in order to study the relative importance of economic and demographic factors.

The second section focuses on the links between productivity and wage formation. Indeed productivity is the key factor behind economic dynamism, while salary progression is supposed to define the employment content of growth.

The third section introduces a sectoral dimension and seeks to distinguish between sectors, which are exposed to international competition, and sectors, which are relatively protected. The links between these two major sectors play a key role in the general employment dynamic.

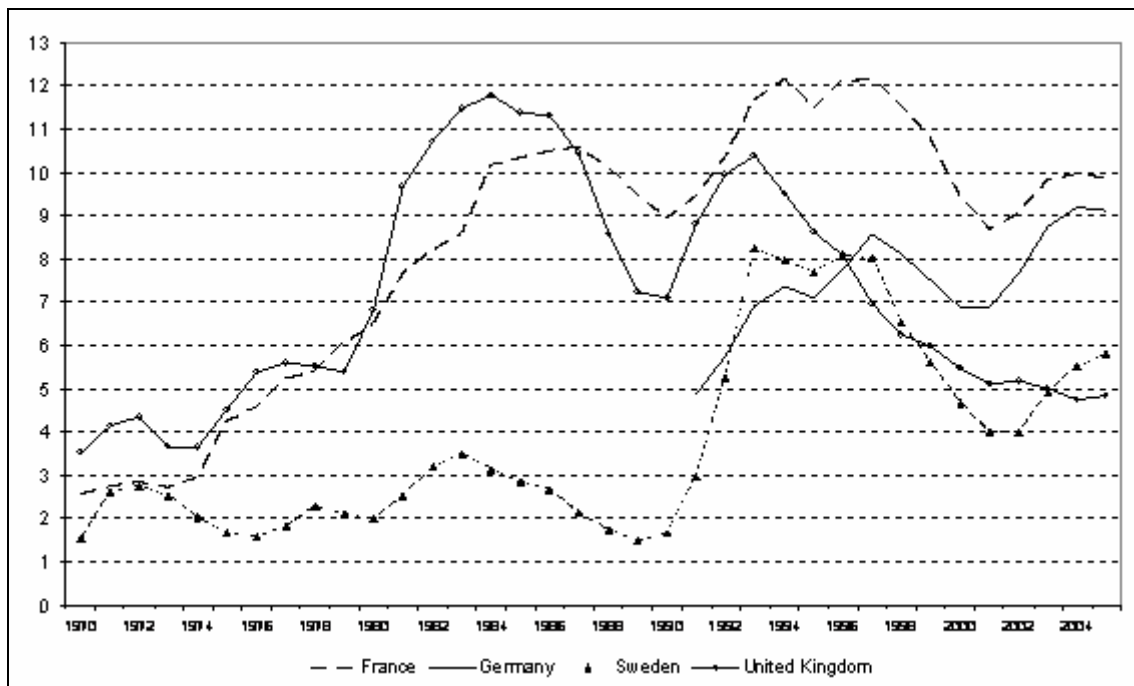
The fourth section examines links between employment performance and institutional variables, which describe the workings of the labour market.

1 Employment performance

Employment performance indicators

The indicator most frequently used to measure employment performance is the unemployment rate. From this angle, the United Kingdom is well ahead of the other three countries, recording a four-point unemployment rate drop between 1991 and 2005. Over the same period, the unemployment rate increased significantly in Germany (over four points), fluctuated considerably in Sweden, and remained at more or less the same level in France (see Figure 1).

Figure 1. Unemployment Rate



Source: OECD

The example of Sweden shows that this comparison poses methodological problems as regards the choice of period. However, this is also the case for the selected indicators. The unemployment rate is not the only way of measuring labour market dynamism, the function of which is, after all, to create jobs. It is therefore legitimate to examine job creation potential over a given period. Using this criterion, the rankings of the four countries change considerably (see Table 1). Over the period in question, employment remained virtually stable in Germany and Sweden (with the countries having different profiles), which fits with the unemployment rate rise recorded in the two countries. On the

other hand, the comparison between France and the United Kingdom shows a paradox, as both these countries experienced a very different unemployment rate progression, while they created the same proportion of jobs.

Table 1. Indicators of employment performances

	France	Germany	Sweden	United Kingdom
Employment 1991-2005	109.6	100.3	96.1	109.9
Unemployment rate				
1991	9.5	4.9	3.1	8.8
2005	9.9	9.1	5.8	4.8
variation	0.4	4.2	2.9	- 4.0
Employment rate				
1991	60.2	69.3	81.5	70.0
2005	62.0	68.0	73.4	72.3
variation	1.8	- 1.3	- 8.1	2.3
Annual rate of growth 1991-2005	1.9	1.4	2.3	2.7
Total working hours	0.0	- 7.1	- 1.4	4.2

Source: OECD

The GDP growth rate may explain these differences. The United Kingdom benefited from quicker growth (2.7% per year) but did not create any more jobs than France, whose growth rate only reached 1.9% per year. Sweden, with a growth rate of 2.3%, did not create any new jobs and saw its unemployment rate rise. The slight growth observed in Germany fits with its performance as regards job creation and unemployment rate.

Employment rate is another useful indicator, which measures the proportion of the working age population in employment. Level and progression must be distinguished. In terms of level, both Sweden and the United Kingdom exceeded the 70% objective set by the Lisbon Strategy, but the employment rate dropped considerably in Sweden while it rose in the United Kingdom. It logically dropped in Germany, while it rose in France despite the unemployment rate remaining the same.

A last possible indicator is working time. Once again, the comparison between France and the United Kingdom is illuminating: for equivalent levels of job creation, the volume of work remained constant in France, while it increased by 4% over the 1991-2005 period in the United Kingdom. The impact of working hours on employment progression

can be seen here, which also explains some of the differential progression in Sweden and Germany.

Overall, performance assessment leads to a ranking, which can vary depending on the selected criterion (see Table 2).

Table 2. Employment performance assessment

Unemployment rate	Employment growth
1. United Kingdom	1. United Kingdom
2. Sweden	2. France
3. France	3. Germany
4. Germany	4. Sweden
Employment rate	Total working hours
1. United Kingdom	1. United Kingdom
2. France	2. France
3. Germany	3. Sweden
4. Sweden	4. Germany

In order to obtain a better understanding of how each country achieves its performances, an accounting breakdown will be used, enabling the different factors for consideration to appear, in order to explain employment and unemployment progression. The economic variables are the growth of GDP, hourly productivity and working time, to which a demographic variable, the working age population, will be added. The following overall breakdown is obtained (see Box 1) which will be used in greater detail further on:

Box 1**Unemployment rate breakdown**

This breakdown will focus on the complement to unemployment rate (1-U), which will be called *active employment rate*. It relates employment to labour force and therefore differs from the employment rate, which links it to the working age population. This breakdown will firstly bring into play employment determinants: GDP, hourly productivity and working time. So we therefore have:

$$N = Q / (PR \times WT)$$

N	employment
PR	hourly productivity
Q	GDP
WT	working time

Labour force determinants are then introduced. They can be expressed in the following way:

$$LF = ACTI \times POPAGE$$

ACTI	participation rate
LF	labour force
POPAGE	working age population

By combining these two relationships, the following overall breakdown is obtained:

$$1-U = \frac{Q}{PR \cdot WT \cdot ACTI \cdot POPAGE}$$

ACTI	participation rate
LF	labour force
N	employment
POPAGE	working age population
PR	hourly productivity
Q	GDP
U	employment rate
WT	working time

Growth and productivity: the employment content of growth

Growth is a key determinant of job creation, but it must be linked to hourly productivity. A given level of growth will not create jobs unless it is accompanied by lower productivity progression. The difference between the two will be called *net growth*. The four countries under analysis have very different configurations as regards this aspect (see Table 3).

Table 3. Productivity and growth

	GDP	productivity	net growth	working time	employment
France	1.9	1.9	0.0	-0.7	0.7
Germany	1.4	1.9	-0.5	-0.5	0.0
Sweden	2.3	2.4	-0.1	0.2	-0.3
United Kingdom	2.7	2.4	0.3	-0.4	0.7

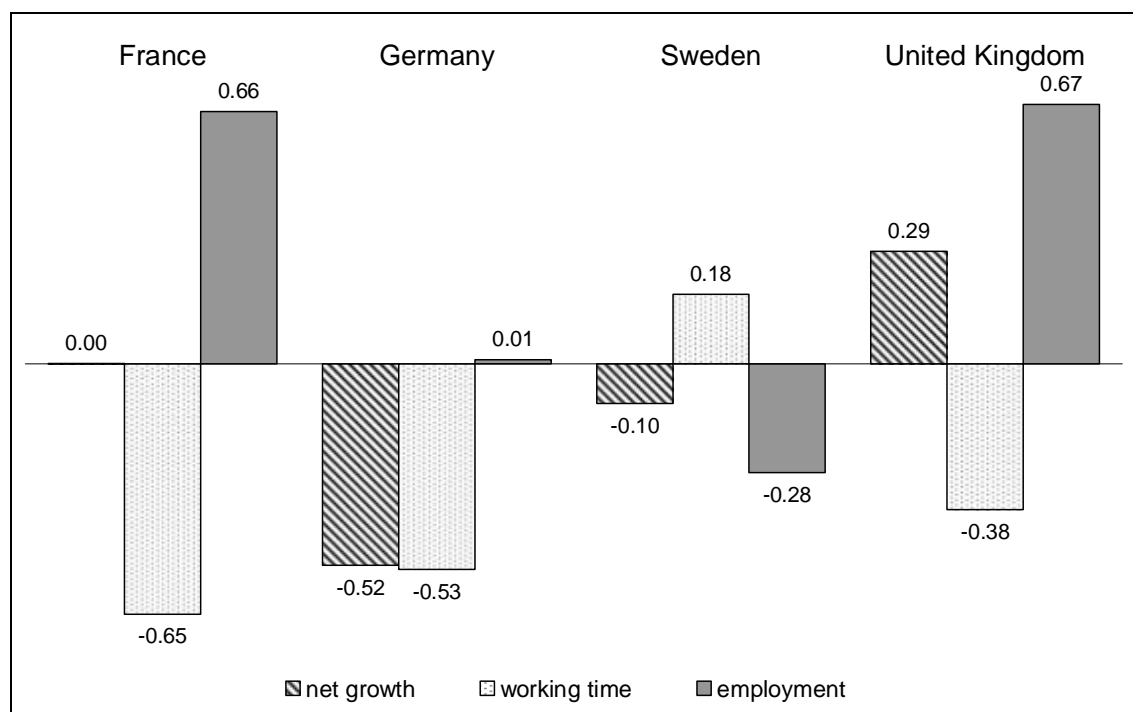
Source: OECD

France provides a particularly illustrative example, as GDP and hourly productivity progressed at exactly the same annual rate of 1.9% between 1991 and 2005. The associated employment potential over this period is therefore zero. This is more or less the case for Sweden. On the other hand, the United Kingdom has benefited from the quickest rate of GDP growth, and quicker productivity progression than the other countries, although productivity has progressed less than GDP: this growth therefore has a higher employment content. Germany has experienced the exact opposite, as productivity has increased more quickly than GDP, having a very negative effect on employment (-0.5% per year, making for a 7% job loss over the period).

Employment potential (growth – hourly productivity) is therefore zero or negative in all the countries apart from the United Kingdom. At a constant working time rate, only the United Kingdom would have been able to create jobs. Workforce progression therefore depends on working time. New differences between the countries can be observed. Sweden is a special case as working time increased and worsened the effect of net growth on employment. In the other countries, the reduction in working time has had a positive impact on employment. In Germany, this reduction compensates for the employment shortfall

linked to net growth and enables the level of employment to be maintained. In France, all the jobs created correspond to the reduction in working time.

Figure 2. Employment, growth and working time



Source: OECD

Figure 2 summarises these very different employment configurations in the four countries, where the reduction of working time has played a major role. In France, the reduction of working time accounts for all jobs created, for zero net growth. In Germany, it compensates for zero net growth so as to stabilise the number of jobs. In Sweden, it increases the effect of slightly negative net growth on employment. Finally, in the United Kingdom it combines with positive net growth, leading to job creation levels equivalent to that of France. In the light of the key role played by this variable, it is necessary to study the details of its progression in greater depth.

Working time

The reduction in working time can be obtained in two ways. It can result from a generalised reduction in full-time working time or from an increase in part-time working. The overall progression can be attributed to these two effects, using two additional pieces of data: the proportion of employees working part-time, and the average part-time working time in relation to the average full-time working time (Box 2).

Box 2**Working time breakdown**

The total working time is broken down into hours carried out by full-time employees and hours carried out by part-time employees:

$$N \times WT = N_f \times WFT + N_p \times WPT$$

N	employment
N _f	full-time employees
N _p	part-time employees
WFT	full-time working time
WPT	part-time working time
WT	working time

To successfully carry out this breakdown, two additional pieces of information are required. The first piece of information is the share of part-time working in total employment and the second part-time working time in relation to full-time working time. The previous formula is therefore expressed as:

$$WT = (1 - N_p\%) WFT + N_p\% \cdot \theta \cdot WFT$$

Hence:

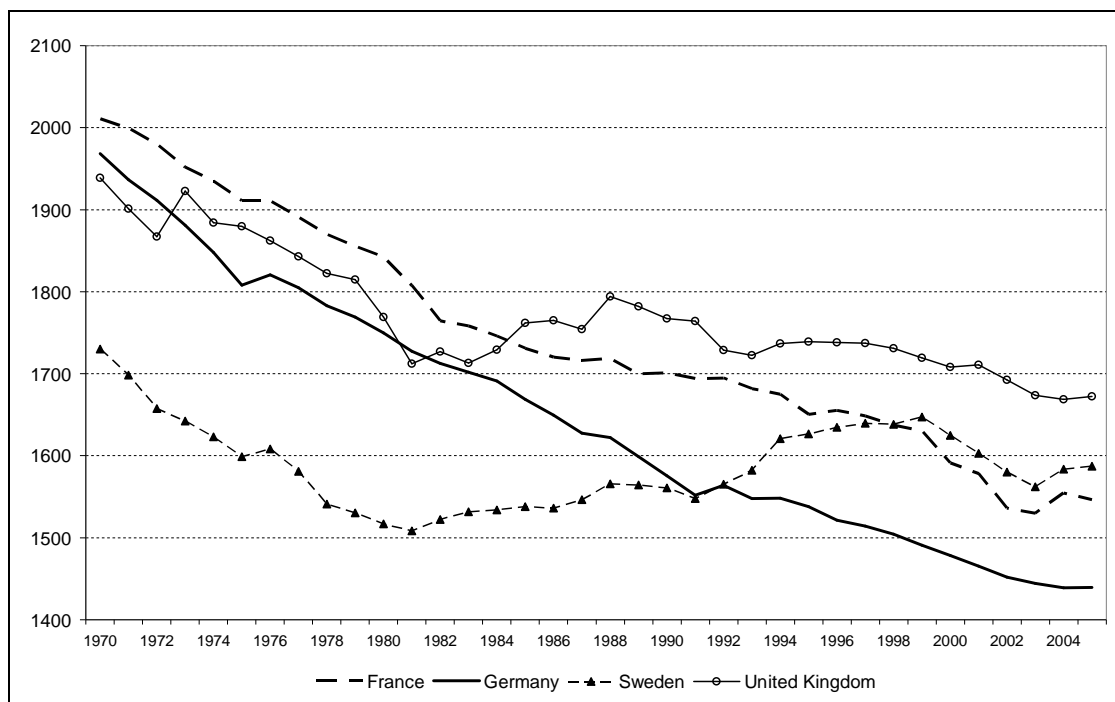
$$WT = [1 - (1 - \theta) N_p\%] WFT$$

and finally:

$$WT = WFT \times RPT$$

N _p %	share of part-time working
RPT	recourse to part-time working index = [1 - (1 - θ) N _p %]
WFT	full-time working time
WPT	part-time working time
WT	working time
θ	share of part-time working time in relation to full-time working time

Figure 3. Working time

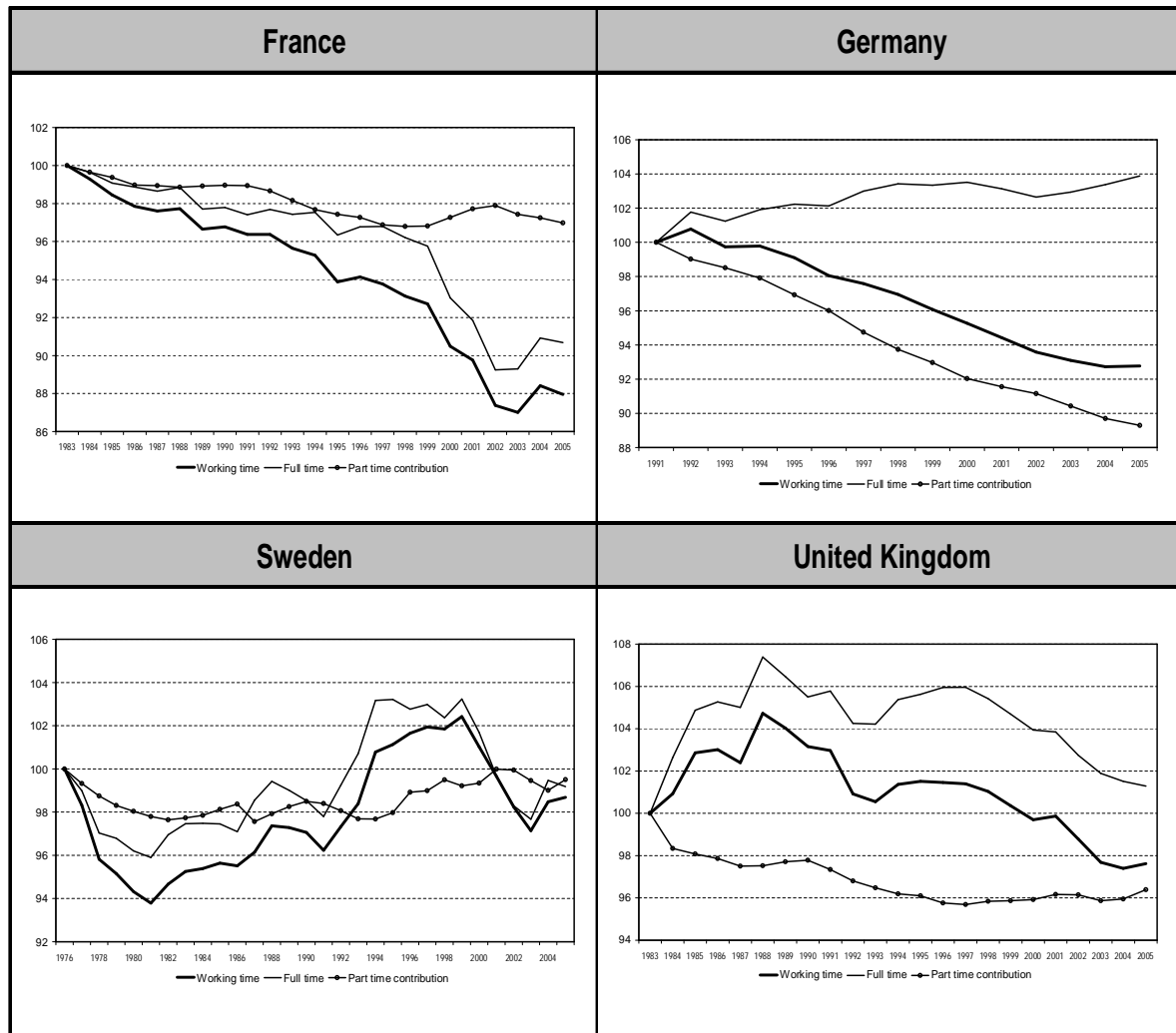


Source: OECD

Working time dropped in the four countries until the beginning of the 1980s. This continued in Germany and France, with a steep drop linked to the 35-hour working week. In the United Kingdom and Sweden, the rhythm stabilised and even increased during the 1980s. The relative position of the two countries changed: working time in Sweden was significantly lower than in France, but the two countries are now at the same level.

These different progressions have not all been obtained in the same way (see Figure 4). Germany has a specific configuration: full-time working time is slightly increasing and it is the progression of part-time working which alone explains the drop in average working time. Part-time working also plays an important role in the United Kingdom, but plays a more minor role in France and Sweden (see Table 4).

Figure 4. Working Time Progression



Source: OECD

Table 4. Full-time and part-time working time

	France			Germany			Sweden			United Kingdom		
	1992	2005	change	1992	2005	change	1992	2005	change	1992	2005	change
Working time	1695	1546	-148	1564	1439	-124	1565	1587	22	1729	1672	-56
Full-time working time	1799	1670	-129	1733	1769	36	1763	1762	-1	2001	1944	-57
Part-time working time	963	945	-18	633	630	-3	979	1034	55	773	848	75
Share of part-time work	12.5	17.1	4.6	15.4	28.9	13.5	25.2	24	-1.2	22.1	24.8	2.6
Part-time working time as a % of full-time working	53.5	56.6	3.0	36.5	35.6	-1.0	55.6	58.7	3.1	38.7	43.7	5.0

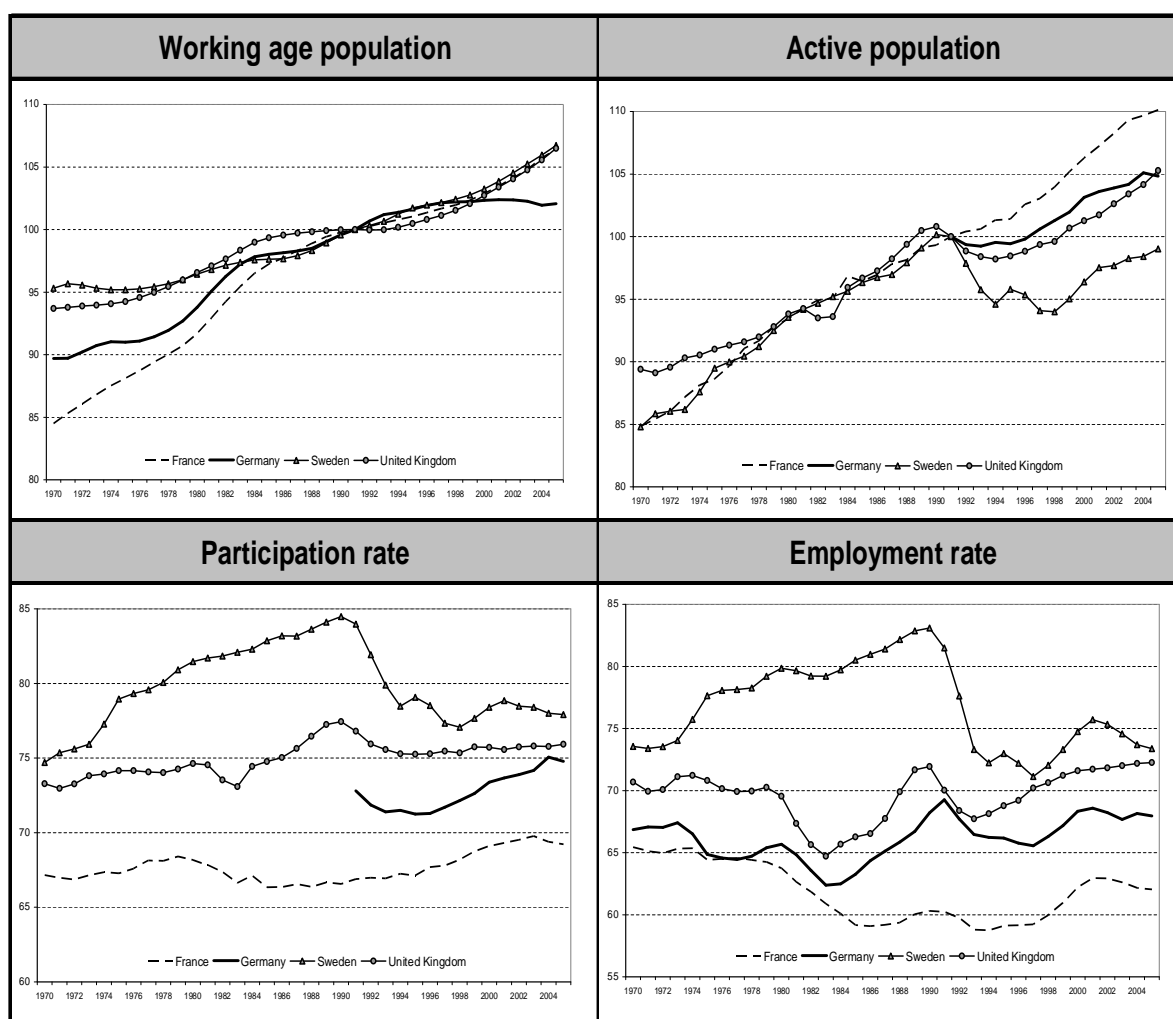
Sources: Eurostat, OECD

Labour force

From the start of the 1990s, the working age population progressed at roughly the same speed in France, Sweden and the United Kingdom, at a rate of around 6% between 1991 and 2005. Progression was lower in Germany (+2%) where the working age population stabilised over the course of a few years.

On the other hand, labour force progression is a lot more differentiated. In the United Kingdom, and even more in Sweden, it is increasing a lot less than the working age population, and even dropped during the 1990s. The labour force participation rate dropped sharply in Sweden (-7.2% between 1991 and 2005) and stayed at more or less the same level in the United Kingdom. On the other hand, Germany and France are characterised by a quicker progression in labour force than in working age population, the effect of which is an increase in labour force participation rate. The differences observed as regards labour force therefore mainly stem from the labour force participation rate (see Figure 5).

Figure 5. Progression of activity in the four countries



An overall view of performance

The breakdown formula will firstly be applied to the 1991-2005 period in a simplified version (see Table 5). The progression of the unemployment rate U (Column 1) is explained using the variation of the active employment rate 1-U (2), which itself is broken down using the information described in Boxes 1 and 2.

For each of the countries, the relative weight of these different components on overall performance can be seen. We will focus here on the first line of the table, which provides information on France between 1991 and 2005. The unemployment rate increased by 0.4 points over that period (Column 1), which corresponds to a drop of 0.5 points in the active employment rate (Column 2).

Table 5. A breakdown of performances 1991-2005

1991-2005	(1) ΔU	(2) 1 - U	(3) Q	(4) 1/PR	(5) 1/WT	(6) 1/ACTI	(7) 1/POPAGE	(8) 1/WFT	(9) 1/RPT
France	0.4	-0.5	29.8	-23.0	9.6	-3.4	-6.0	7.4	2.0
Germany	4.2	-4.5	20.9	-23.2	7.8	-2.6	-2.0	-3.7	12.0
Sweden	2.9	-2.9	36.7	-27.9	-2.5	7.8	-6.3	-1.4	-1.1
United Kingdom	-4.0	4.4	45.2	-28.3	5.5	1.1	-6.1	4.4	1.0

ACTI: participation rate; POPAGE: working age population; PR: hourly productivity; Q: GDP; RPT: recourse to part-time working index; U: employment rate; WFT: full-time working time; WT: working time

- The contributions to the evolution of employment are given in the following columns. Over the whole period, GDP (Column 3) increased by 29.8 points; so employment potential linked to growth will be modulated by two factors: hourly productivity and working time:
- The progression of productivity (Column 4) had a negative 23-point effect on this potential.
- The reduction in working time (Column 5) had a positive effect on employment (reduced by 9.6 points).
- The progression of the labour force appears in Columns 6 and 7:
- The labour force participation rate (Column 6) increased, with a negative 3.4-point effect on the active employment rate.
- The working age population (Column 7) also had a negative effect of 6.0 points on the active employment rate.

- Finally, columns 8 and 9 enable a breakdown of the progression of working time to be made. The drop in full-time working time made a positive contribution of 7.4 points to the active employment rate, to which a positive contribution of 2 points due to part-time working is added.

This breakdown can obviously not be used as a causal relationship due to the relationships, which may exist between each of its components, but it does have the merit of highlighting how employment performance is achieved in each country. It then enables an overall typology to be created, using the previous observations, from which two main trends emerge. These trends concern relations between productivity and the growth of GDP on the one hand, and working time and the labour force participation rate, on the other (see Figure 6A).

The first relationship between productivity and growth has already been pinpointed and had led to a notion of net growth being put forward. This means that the faster the growth in GNP, the greater the productivity gains. In other words, any advantages gained as regards employment due to increased growth are automatically reduced by the higher productivity gains, which accompany them. The direction of this relation is difficult to define: a quicker growth is the opportunity to reorganise production and to obtain productivity gains and, on the other hand, a more sustained productivity growth improves competitiveness and enables a higher GDP growth rate to be achieved.

The second relationship concerns relative progressions in the labour force participation rate and working time. This relation is very clear cut for the countries under review (see Figure 6B). The reduction in working time was more marked in the countries, which experienced a quicker progression in the labour force participation rate. This increases when a higher proportion of the working age population joins the labour market. Everything seems to indicate that this additional influx was absorbed by a reduction in average working time. This mechanism exists in all the European countries, apart from the Southern European countries (Italy, Greece and above all Spain) where working time is a lot less affected by an increase in the active population (see Figure 7).

Figure 6. Two main relationships

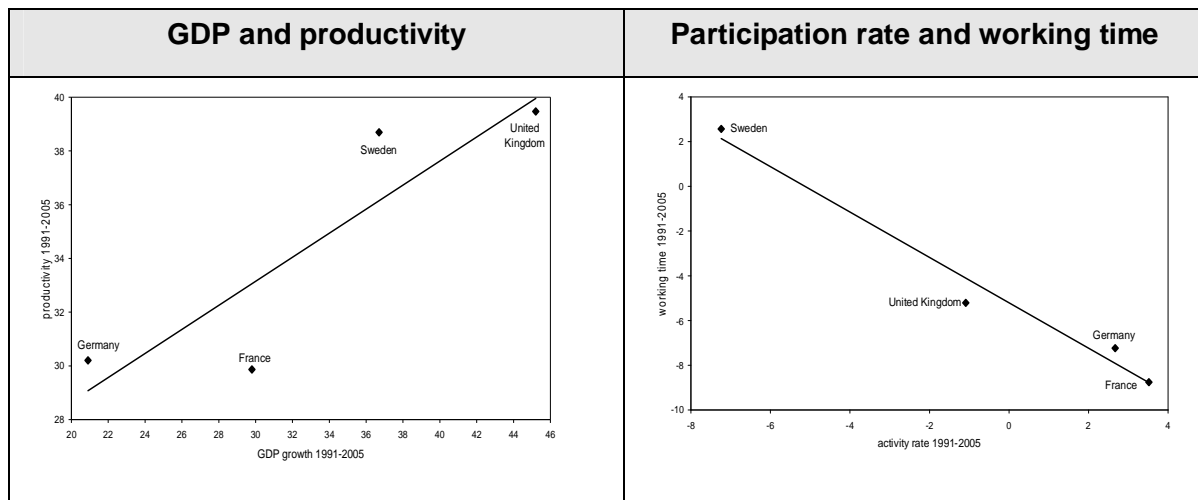
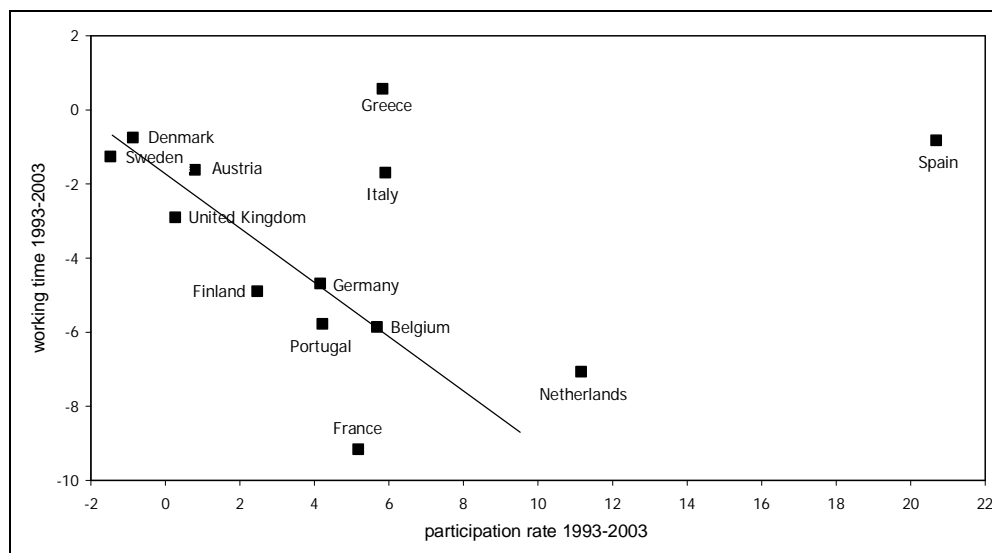


Figure 7. Working time and participation rate



Overall, the employment performances of the four countries, measured using the unemployment rate, can be summarised based on three variables:

- Net growth, in other words the effect of GDP growth minus productivity growth.
- The net pressure of activity, in other words the cumulative effect of the progression of the labour force participation rate and the reduction of working time.
- Demographics, namely the increase in the working age population.

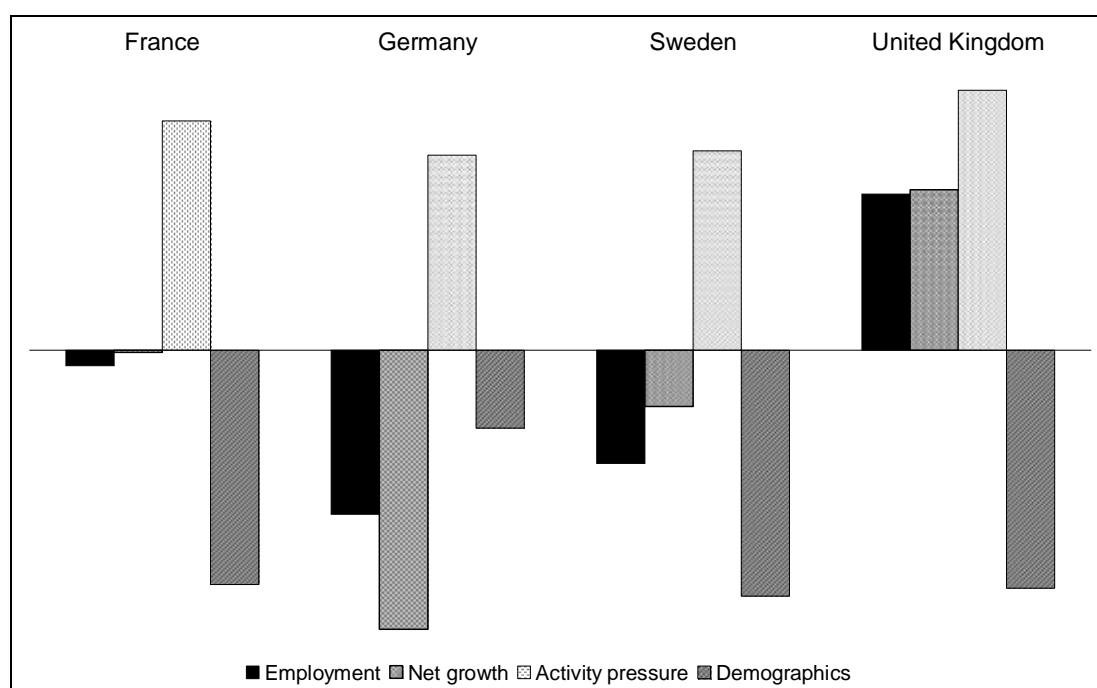
Table 6, in which the most marked features are shaded, enables the comparative assessment to be summarised (see also Figure 8).

Table 6. A breakdown of the unemployment rate 1991-2005

	France	Germany	Sweden	United Kingdom
change in unemployment rate	0.4	4.2	2.9	-4.0
net growth	-0.1	-7.1	-1.4	4.1
net pressure of activity	5.9	5.0	5.1	6.7
démographics	-6.0	-2.0	-6.3	-6.1

- Net growth was highly unfavourable to Germany, where productivity rose more quickly than GDP, and favourable to the United Kingdom due to the country having the opposite configuration.
- The net pressure of activity was favourable to France, thanks mainly to a reduction in working time, as well as to the United Kingdom, due to the moderate progression of the labour force participation rate.
- Demographics were favourable to Germany, where the working age population increased less quickly than in the other three countries.

Figure 8. A breakdown of performances 1991-2005



2 Wage dynamics and productivity

The dominant theory states that labour market workings influence employment performance via wage formation. Labour market rigidity, which structural reforms attempt to reduce, has a negative effect on employment in the sense that it prevents wages from adjusting employment supply and demand in the specific market. The aim of this section is to examine links between wage progression – which can be related to productivity progression – and employment performance in the four countries under review.

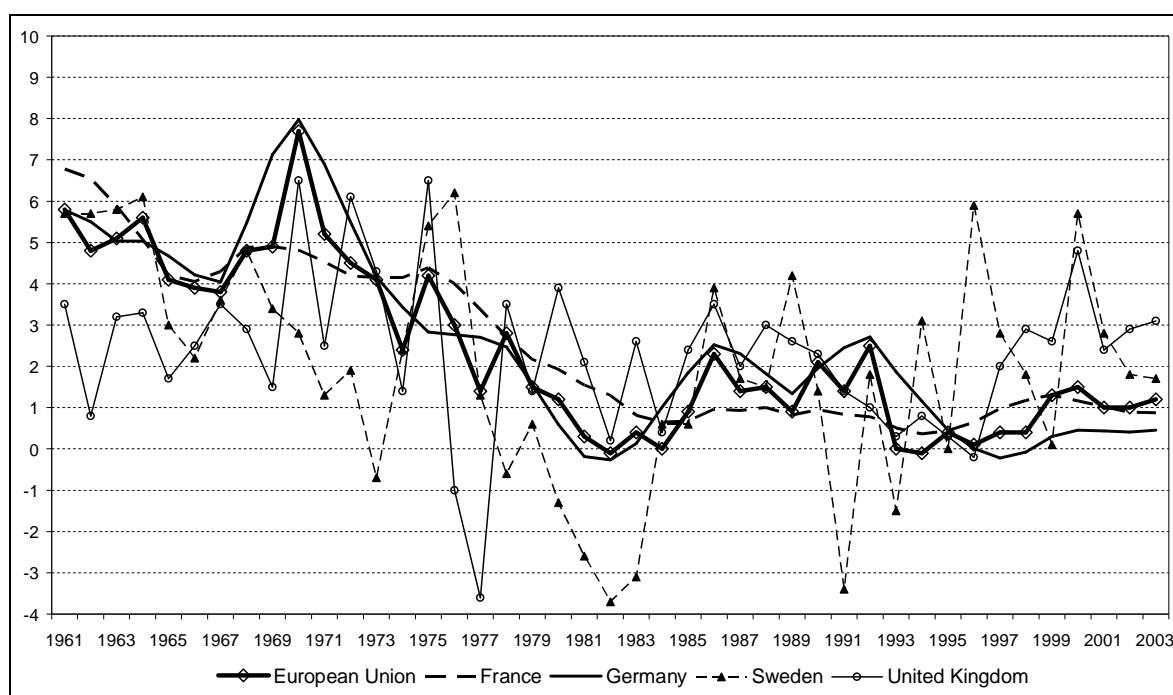
Progression of real wages

European wage dynamics help us to distinguish three major phases:

- A sustained *period of growth* of real wages (1960-73)
- A *period of transition* marked by a slowing down of this progression (1973-1985)
- A *period of stabilisation* based around a moderate growth rate (1985-2003)

While France and Germany follow this profile of average progression relatively closely (see Figure 9), the two other countries under review deviate from it considerably. In the case of the United Kingdom, periodization is a lot less marked and wage progression is steadier in the long-term, so that wage progression is lower than the European average during the years of expansion, and tends to be higher over the recent period. In Sweden, the progression of real wages has fluctuated significantly, but tends, just like the United Kingdom, to be higher than the European average at the end of the period (see Table 7).

Figure 9. Real wages growth rate



Real wages = average wages deflated by producer price.

Source: OECD, *Economic Outlook*

Table 7. Real wage growth

	1960-1973	1973-1985	1985-2003
France	5.0	2.2	0.9
Germany	5.5	1.4	1.2
Sweden	3.5	0.4	1.9
United Kingdom	3.2	1.6	2.1
EU15	4.9	1.5	1.1

Real wages = average wages deflated by producer price.

Source: OECD, *Economic Outlook*

The progression of wage share

Employment productivity enables real wages to progress in the medium and long-term. However, links between these two variables are nevertheless not stable and help to determine the progression of wage share, at approximately relative prices, which changes in line with the relative development of wages and productivity. Wage share is a good

indicator of income distribution, but also fits with the notion of real unit labour cost, which is considered to be a key component of competitiveness.

At European Union level, wage share has undergone progression marked by the three major phases, which roughly coincide with those characterising real wages (see Figure 10):

- *A period of wage share stability (1960-73)*
- *A period during which the high level was maintained (1973-1982)*
- *A period of underlying decreases affected by the cyclical position (1983-2003)*

During the 1960-1973 period, wages and productivity progressed at the same rate and wage share remained at roughly the same level (see Figure 11). The breakdown, which occurred during the first half of the 1970s, did not affect the two variables in the same way: wage progression continued, and only started going down several years after productivity. This transition phase therefore began with a quick wage share increase, followed by a progressive reversal at the start of the 1980s. It helped to install a new model, in which wages increased at a slower rate than productivity, which itself was slowed down compared to the growth years. The differential between wages and productivity tended to come down, and wage share tended to stabilise at a historically low level.

Figure 10. Wage share

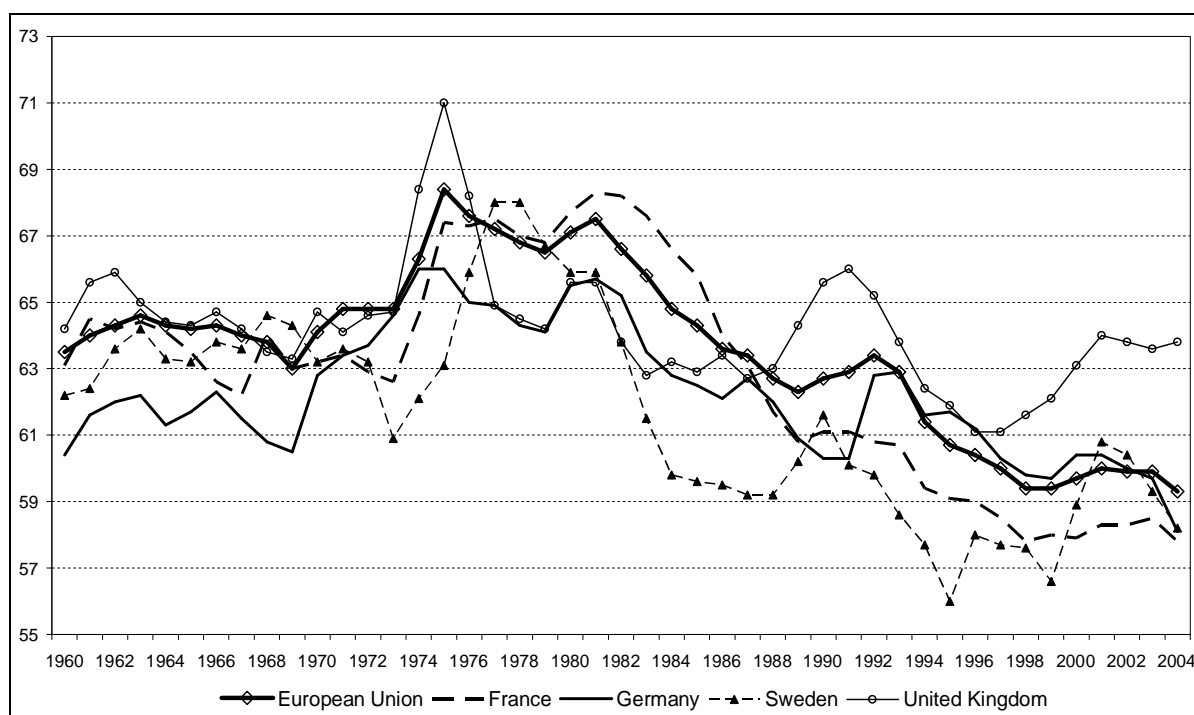
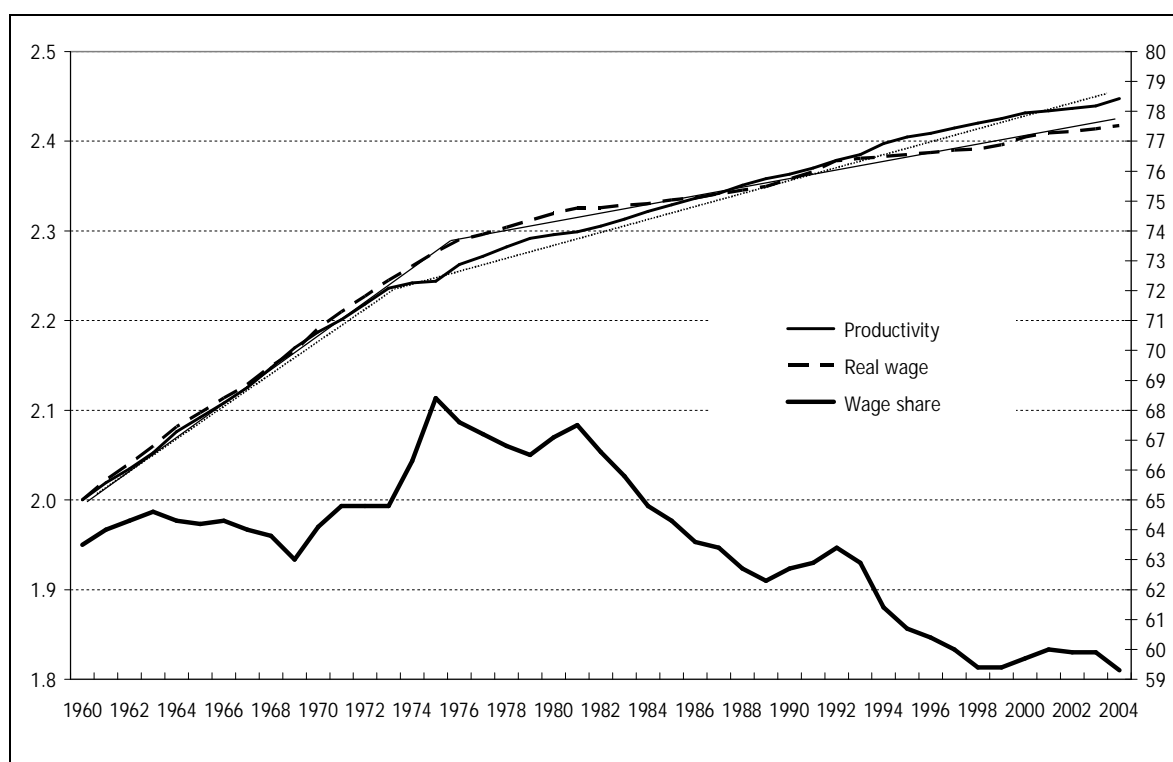


Figure 11. Wage and productivity in the European Union



Productivity: logarithm of GDP per person employed (left-hand scale)

Wages: logarithm of wages per employee, deflated by the price of GDP (left-hand scale)

Adjusted wage share (right-hand scale)

Source: AMECO (2004)

The countries under review do not all fit this general framework. Once again, France and Germany follow it quite closely, but this is not the case for the other two countries. In the United Kingdom, wage share fluctuates around a steady level in the medium-long term. In Sweden, it increases over the recent period (see Table 8).

Table 8. Evolution of the wage share 1962-2002

	wage share					change	
	1962	1972	1982	1992	2002	1962-1982	1982-2002
France	75.7	73.2	79.3	70.2	68.9	3.5	-10.3
Germany	72.4	73.0	73.8	69.1	67.0	1.4	-6.3
Sweden	70.1	71.6	70.6	68.5	72.1	0.5	1.6
United Kingdom	72.4	72.0	73.0	74.6	73.4	0.6	0.3
EU15	73.0	73.2	74.8	71.0	68.5	1.8	-6.3

Adjusted wage share: average wage expressed as a % of GDP per person employed.

Source: AMECO (2004)

Two possible frameworks for the European Union countries can be pinpointed. These can be summarised by comparing, in a stylised manner, the 1970s and the 1980s / 1990s (see Table 9).

Table 9. Continental and Anglo-Saxon models

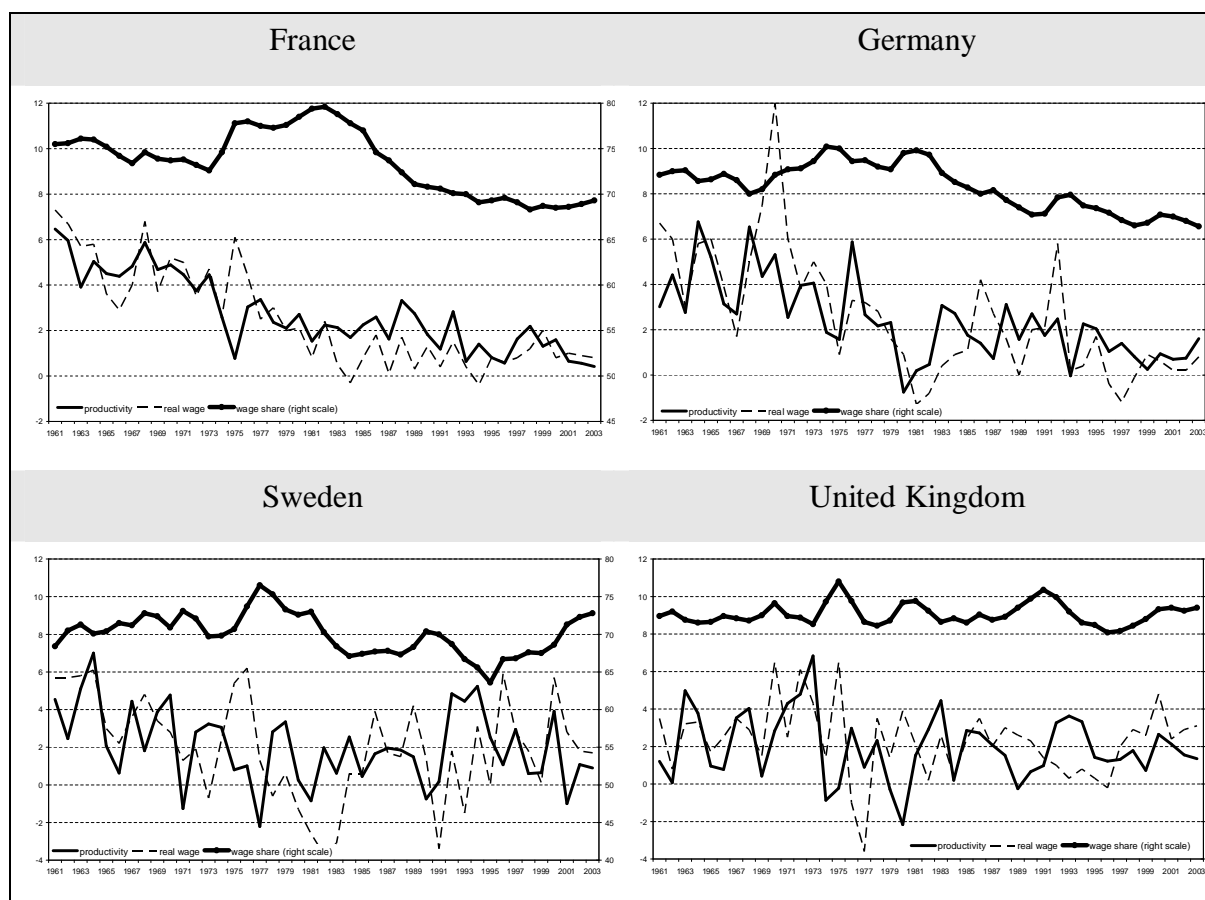
<i>Model</i>	Decade	Productivity	Wages	Wage share
Continental model	1970	Strong growth followed by a drop	Delayed drop	Moderate rise
	1980 & 1990	Slow growth	Marked slowdown	Drop
Anglo-Saxon model	1970	Moderate growth	Moderate growth	Level is maintained
	1980 & 1990	Moderate growth	Moderate growth	Level is maintained

In the *continental* model, events take place as follows. During the 1970s, productivity started to slow down from a high speed of progression (from 5% to 2%). Initially, net wages also slowed down, but to a lesser extent, so that wage share tended to progress a little. The 1980s breakdown set up another model, with employment productivity growing at under 2% and real wages held back even more, so that wage share tended to drop once again (see Figure 12).

In the *Anglo-Saxon* model, there is virtually no difference between the two periods. Over the three decades in question, productivity and wages rose at a steady and approximately equivalent rate, so that wage share did not present any marked trends.

Germany, and especially France, followed the continental model very closely, while the United Kingdom is a textbook example of the Anglo-Saxon model (see Figure 12). Sweden, meanwhile, has a specific configuration. Wage share tended to increase at the end of the 1980s, but this progression was hindered and gave way to a significant drop in wage share in the first half of the 1990s, due to productivity gains not affecting real wages. Then, from 1995 onwards, the situation reversed: real wages increased more quickly than productivity, and wage share went up by close to nine points between 1995 and 2003.

Figure 12. Wage share



Wages and the employment rate

In the continental model, over-shooting of wage slowdown takes place, in the sense that wages are curbed at a level beyond that of productivity. The immediate hypothesis is that this over-reaction was made possible by increased pressure on the labour market, in other words by the rise in the unemployment rate. This idea was tested econometrically using the following simple model:

$$w = (a + bU) pr + c$$

w Real wages growth rate

pr Growth rate of productivity

U Unemployment rate

In this simple model, the coefficient indexing wages to productivity depends upon the unemployment rate, instead of being considered to be stable. This sensitivity enables the relationship of forces in the labour market to be indirectly measured.

The results show that this model is generally valid (see Table 10). However, it is very inadequate for Sweden, where the unemployment rate has very little significance. In the United Kingdom, sensitivity to the unemployment rate does appear, contrary to standard results, but is in fact a conjectural adjustment rather than a change in wage regime.

Table 10. Estimations of the real wages growth rate (1961-2003)

country	pr	t	pr*U	t	R2
France	1.047	10.2	-0.108	-4.3	0.74
Germany	1.169	1.7	-0.155	-3,5	0.65
Sweden	0.635	2.4	-0.059	-1.2	0.09
United Kingdom	0.491	2.4	-0.064	-2.1	0.10
European Union	1.193	12.9	-0.146	-5.4	0.80

This first analysis must nevertheless be clarified by carefully distinguishing between the two major sub-periods. In order to do this, the same equation was used over the 1981-2003 period. The overall result is very clear cut: over this shorter period, the equations weaken considerably: the link with productivity disappears or becomes weaker, and this is also the case for the unemployment rate.

In conclusion, the rise in the unemployment rate was the main factor leading to the “desindexing” of wages in relation to productivity. However, rather than being a case of conjectural regulation, it constitutes a transition between two wage regimes:

- Pre-1980: wages progressed in parallel to productivity.

- Post-1980: real wages progressed slowly and steadily in the medium term, relatively independently of the standard determining factors.

Productivity as a basis for growth

Productivity plays a central role in the general growth and employment dynamic. The productivity gains redistribution mode helps to develop the social models, according to which these gains are kept by the companies or redistributed to employees in the form of purchasing power or free time. The comparison between the countries studied for hourly productivity progression must be further developed.

Firstly, we can see that the progression of productivity gains has slowed down (see Table 11). Until the end of the 1970s, Germany and France benefited from much more sustained progression than the two other countries. The 1980s were marked by a clear slowdown in productivity: this was a generalised and well documented phenomenon. From 1990 onwards, the situation reversed: productivity continued to slow down in Germany and France, while it grew again in the United Kingdom and even more so in Sweden. Over the past fifteen years, Sweden and the United Kingdom have regained the productivity progression rate that they had enjoyed before the slowdown, while France and Germany saw productivity gains increase at a slower rate.

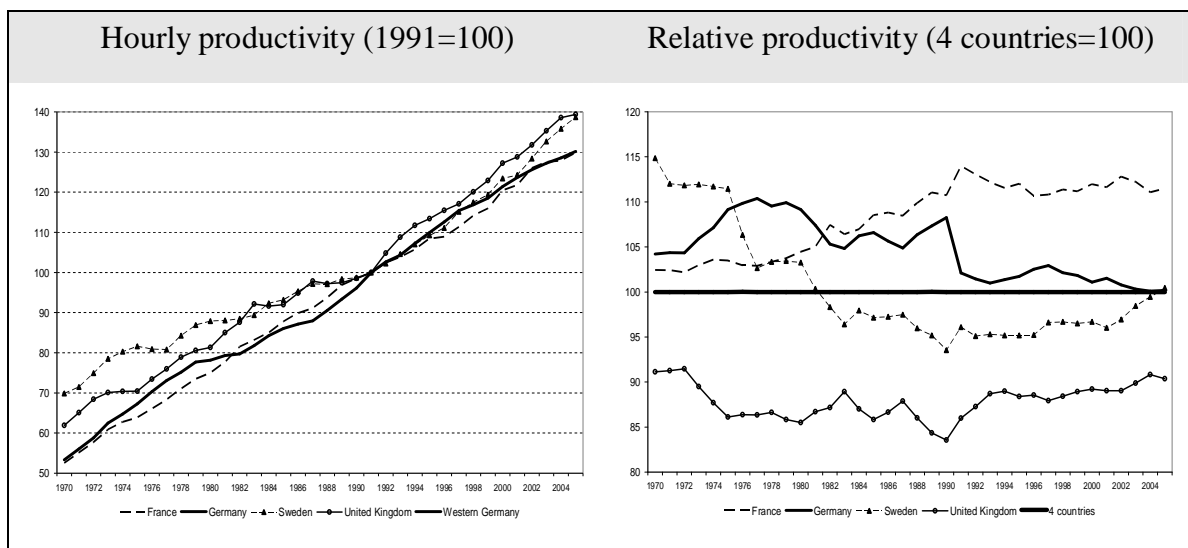
Table 11. Hourly productivity

	1970-1980	1980-1991	1991-2005
France	3.6	2.7	1.9
Germany	3.9	2.3	1.9
Sweden	2.3	1.2	2.4
United Kingdom	2.8	1.9	2.4

Source: OECD

The hierarchy of hourly productivity levels shows that the United Kingdom and Sweden have caught up and Germany has dropped back, while France is ahead by around 12% in relation to the average for the four countries (see Figure 13).

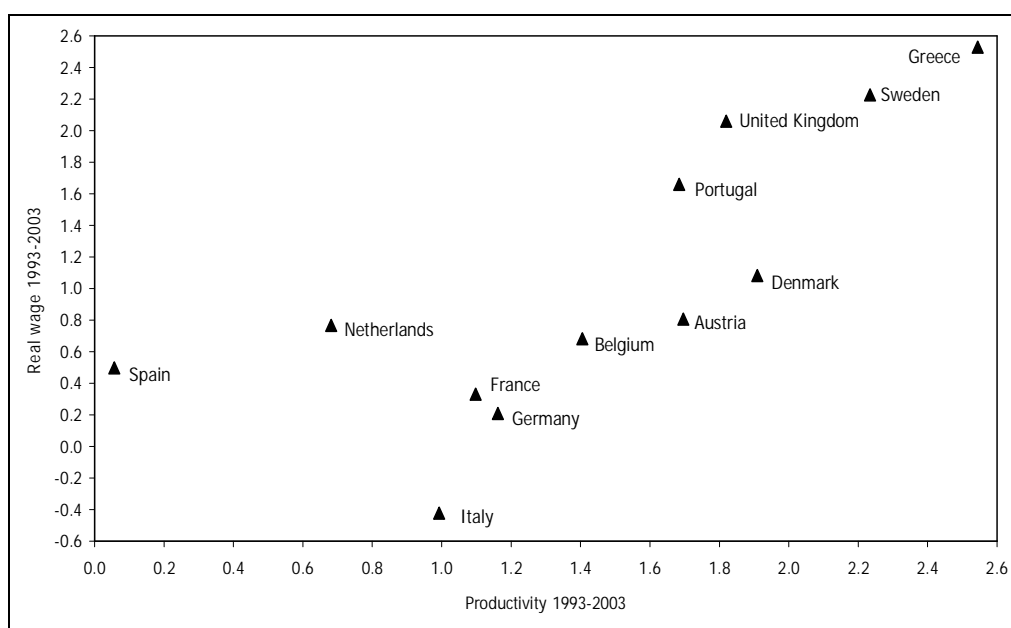
Figure 13. Hourly productivity



Dynamics compared

The fact that wage progression is partially disconnected from productivity progression over time does not imply that there is a complete breakdown. The international comparison shows that the countries where productivity progresses the most quickly are those where wage progression is the most dynamic (see Figure 14). The advantage in terms of productivity seems vital, and causes a virtuous circle in which growth feeds on productivity gains and, conversely, enables them to progress (see Figure 15). This growth is favourable to employment, and enables wage share to be maintained or even to be increased. These complex determinations show that in any case there is no direct link between wage moderation and employment. On the contrary, the countries with the most dynamic wage share create the most jobs (see Figure 16).

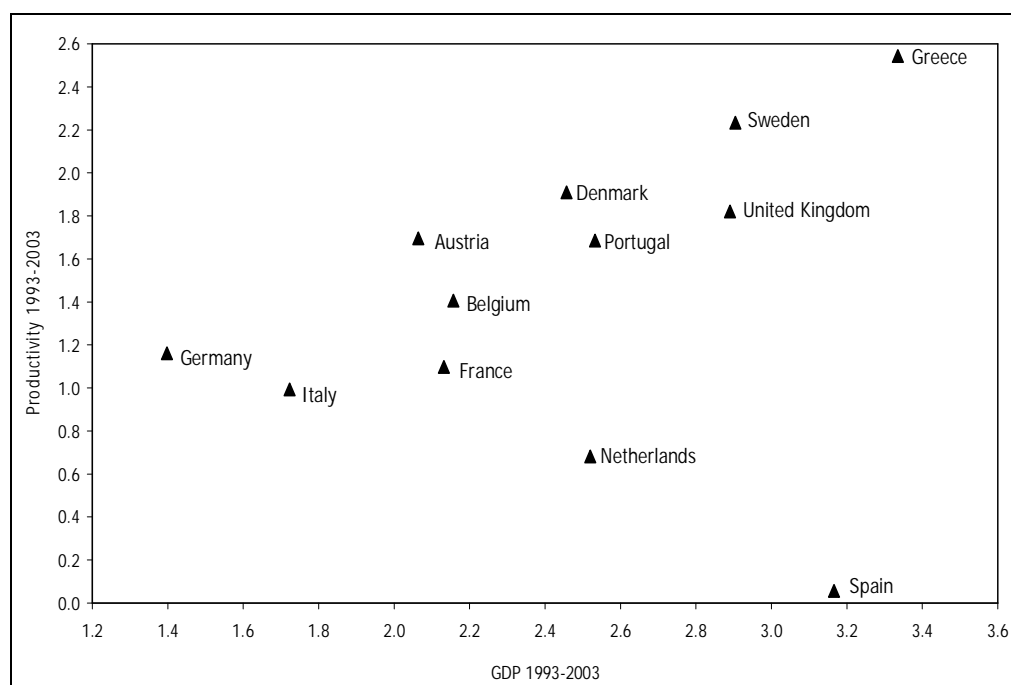
Figure 14. Wage and productivity



Average annual growth rate 1993-2003.

Source: OECD

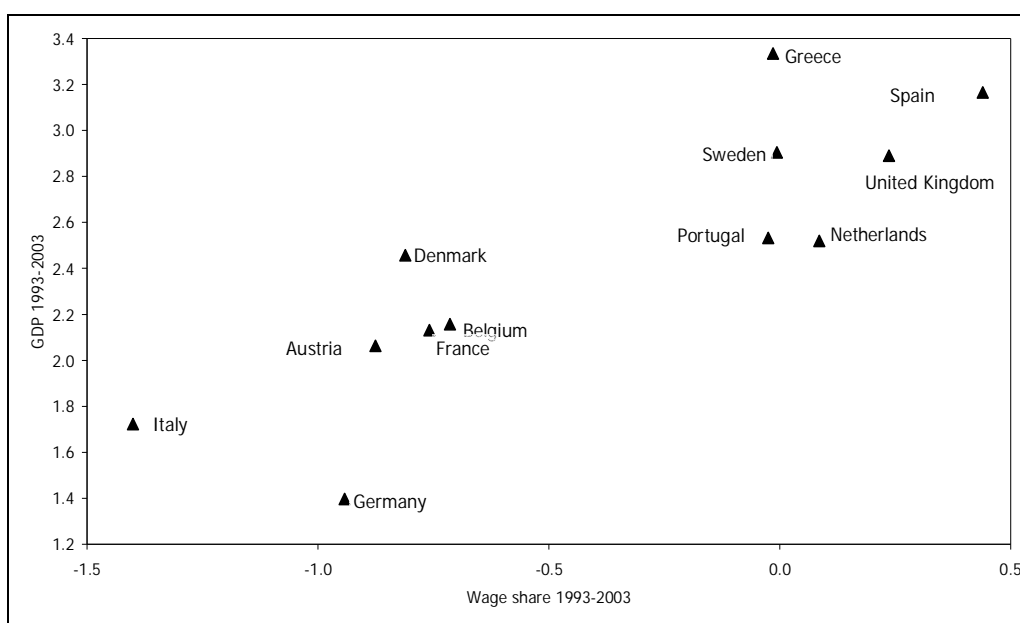
Figure 15. Productivity and growth



Average annual growth rate 1993-2003.

Source: OECD

Figure 16. Employment and wage share



Average annual growth rate 1993-2003.

Source: OECD

These various criteria establish a clear link between Germany and France on the one hand, and Sweden and the United Kingdom on the other, as summarised in the box 3 below.

Box 3	
Wages and growth	
United Kingdom, Sweden	
Real wage	+
Productivity	+
GDP growth	+
Wage share	= +
France, Germany	
Real wage	-
Productivity	-
GDP growth	-
Wage share	-

3 National Configurations

The different sectors of the economy are not exposed to competition on the global market in the same way. As regards competitiveness, it is mainly the progression of productivity in the exposed sectors that matters. An approach enabling the different national configurations to be distinguished from this angle must be adopted. To move forward in this analysis, economies were divided into three major sectors:

- Manufacturing
- Business services
- Community, social and personal services: civil services, education, healthcare, and social work.

This classification only partially covers the exposed / sheltered dichotomy: some industrial sectors may be relatively sheltered, and a growing segment of business services are exposed to competition via international trade. In addition, the division can differ from one country to the next. Finally, statistical measurements of the added value and the productivity are all the more conventional as one passes from industry to the services.

However, from a practical point of view, this division has two main advantages: it is easier to use than a very detailed classification and it enables international comparisons to be made on a relatively homogeneous basis. It is therefore possible to examine national employment configurations using such a division, which enables a certain number of stylised facts to be defined.

Sectoral development of employment

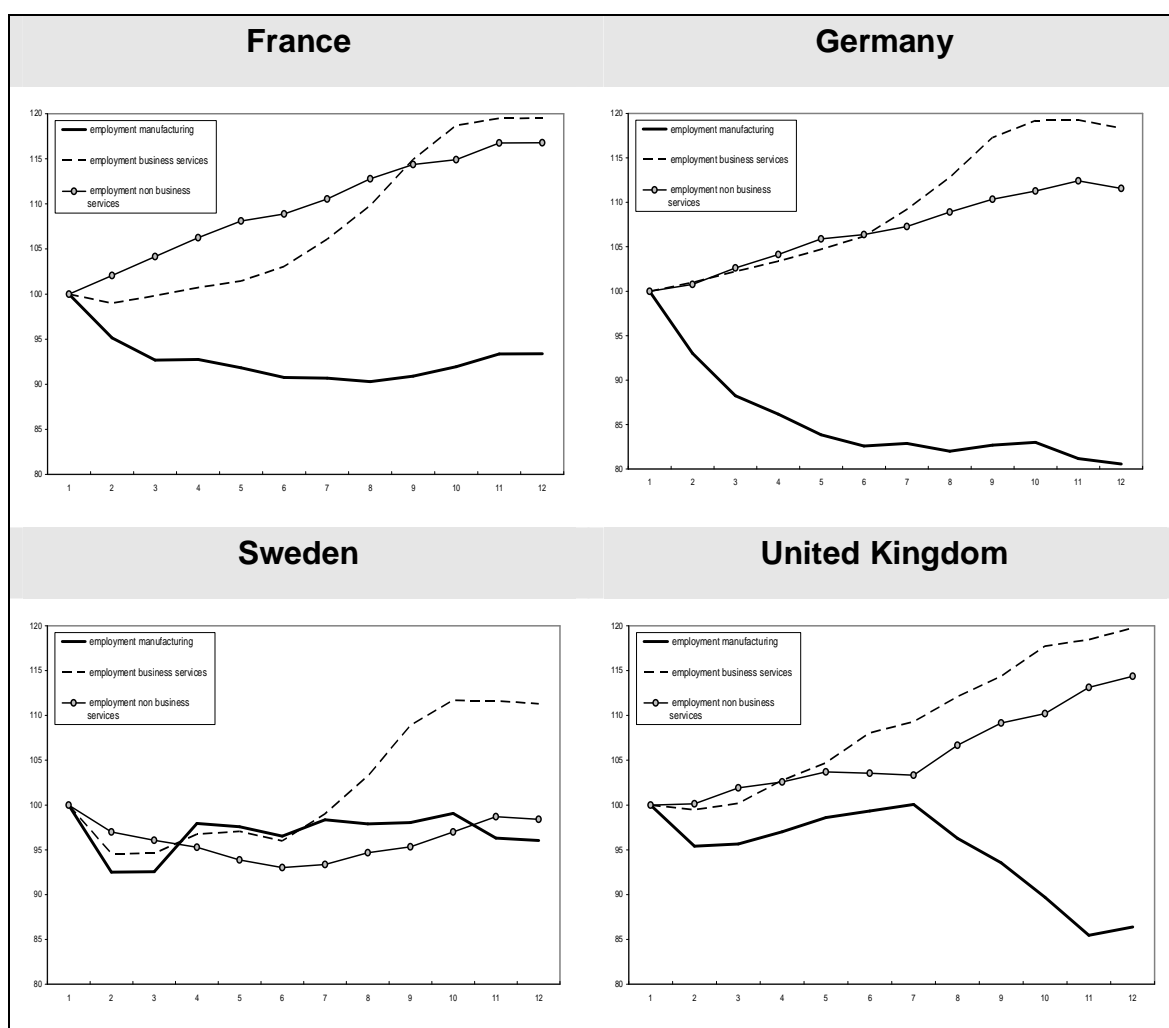
The specialisation of each country can be seen when we divide employment into major sectors. In 2003, manufacturing made up, at the lowest end of the scale, 14.2% of the UK economy and 22.8% of the German economy, at the highest end of the scale. As regards services, the United Kingdom is characterised by a high percentage of business services in its economy (53.2%) whereas Sweden is the country with the highest levels of employment in non-business services (42.1%). The drop in industrial employment is particularly marked in Germany and the United Kingdom, while the increase in business services is relatively homogenous from one country to the next. Taking into account the structure of employment, this change will have an impact to a greater or lesser extent on the overall employment situation (see Table 12).

Table 12. Evolution of employment 1992-2003

		Total	Manufacturing	Business services	Non business services
France	structure 2003	100.0	17.5	44.8	37.7
	evolution 1992-2003	9.6	- 9.4	17.8	11.6
	contribution	9.6	-1.4	8.3	6.1
Germany	structure 2003	100.0	22.8	45.3	31.9
	evolution 1992-2003	1.3	- 19.0	17.8	11.6
	contribution	1.3	- 5.8	7.4	3.5
Sweden	structure 2003	100.0	18.5	39.5	42.1
	evolution 1992-2003	1.1	- 4.3	11.6	- 1.1
	contribution	1.1	- 0.8	4.1	- 0.7
United Kingdom	structure 2003	100.0	14.2	53.2	32.6
	evolution 1992-2003	9.4	- 13.4	20.4	14.0
	contribution	9.4	- 2.5	9.8	4.6

Employment in the manufacturing sector is decreasing at the expense of employment in the service sectors, apart from in Sweden where it remains at the same level. However, the extent of this development varies from one country to the next and its impact depends upon the basic structure of employment in a given country. The contribution of each sector to overall employment (excluding agriculture and energy) is quite different from one country to the next. The impact of the destruction of manufacturing jobs in Germany and of the creation of jobs in the service sector in the United Kingdom can be seen here (see Figure 17).

Figure 17. Employment by sectors



Source: OECD, Stan database

This approach highlights the specific role of productive structures in employment dynamics. However, this role becomes even clearer cut if we examine the determining employment factors in each major sector – namely added value and productivity. All things being equal, the higher the rate of net growth – in other words the difference between added value and productivity – the higher the increase in employment. The four countries under analysis have very different configurations as regards this aspect.

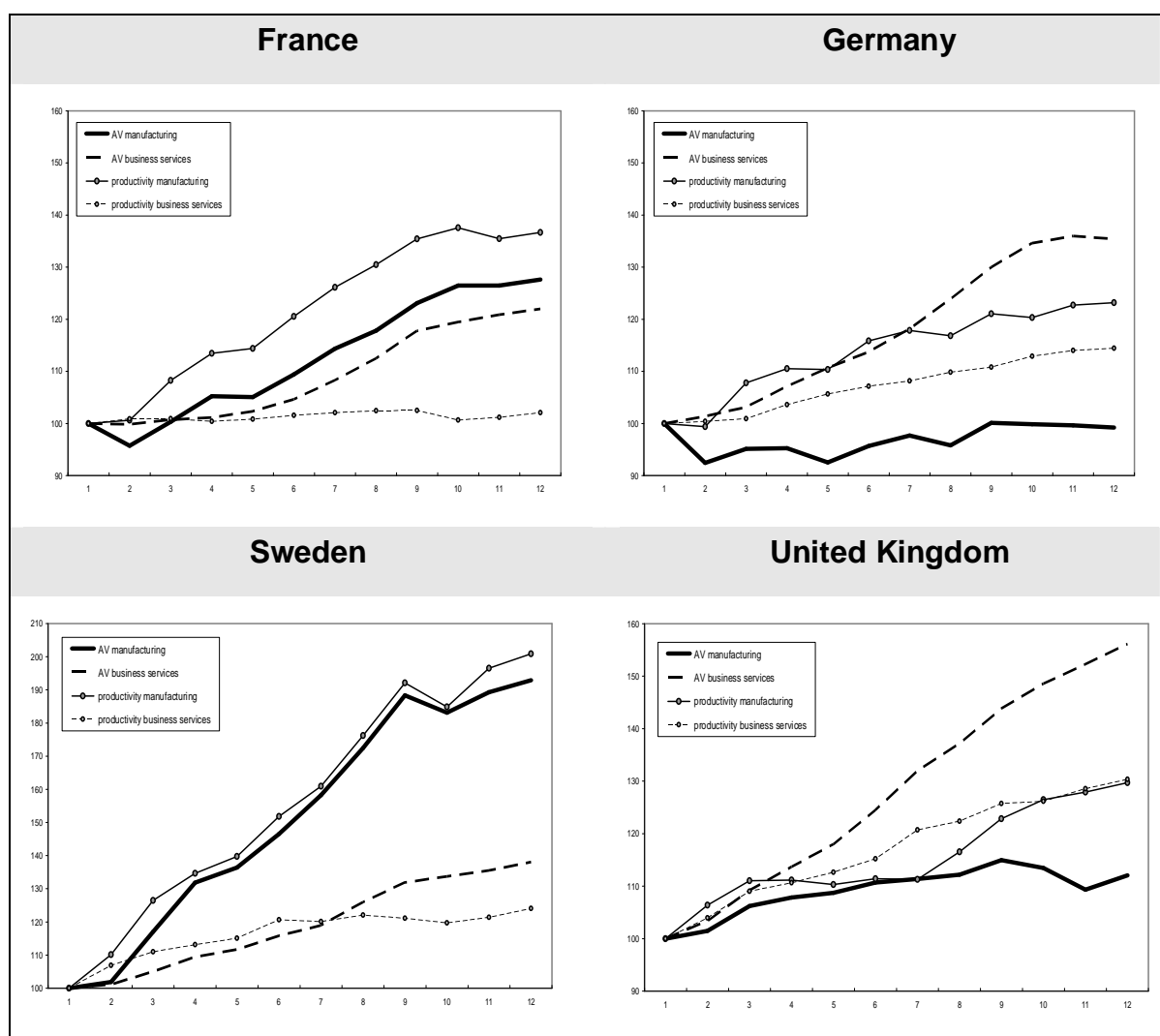
Sweden is marked by very quick growth of added value in manufacturing. However, productivity is developing at a comparable rate in this sector, meaning that practically no new jobs are created. This is also the case in the service sector where added value and productivity progress at roughly the same rates.

France has an extreme productivity configuration, which remains at virtually the same level in the services sector and is increasing in manufacturing. However, the increase

in added value differs little from one sector to another and is in an intermediate position as regards the productivity range. These results in the systematic destruction of manufacturing jobs, and the creation of jobs in the service industry, are based on virtually zero-level productivity.

Germany and the United Kingdom present a third configuration with the increase in productivity being relatively similar in the two major sectors, while added value is increasing much more quickly in the services sector than in manufacturing (see Figure 18).

Figure 18. Growth and productivity by sectors



Source: OECD, Stan database

Employment performance is largely explained by the productive specificities of the various countries, which are strongly marked. The differences in evolution of the productivity compared to that of the value added between great sectors strongly modulate

the general link between the growth of GDP and employment. They should therefore be analysed at the level of the two major sectors.

Sectoral development of productivity

The progression of productivity in manufacturing shows a wide range of situations (see Table 13). Over the 1991-2003 period, France and the United Kingdom progressed at roughly the same speed (respectively 3% and 2.6%). Germany was a long way behind (1.2%) while Sweden achieved a much higher percentage (6.4%). These relative performances are part of differing scenarios in the long-term: an upturn in Sweden, the same level being maintained in France, decline in Germany, and even more so in the United Kingdom. The weight of national history and particularly the effects of productive system restructuring periods can be seen here. This took place during the 1980s in the United Kingdom and during the 1990s in Sweden, and does not seem to have occurred with the same impact in the other two countries. Everything seems to indicate that the effects of restructuring periods boosted the progression of industrial productivity, yet these gains did not necessarily go beyond the end of an industrial cycle, as suggested by the British example. If productivity in manufacturing is a key competitiveness parameter, we can see that it is less contingent upon labour market reforms than industrial restructuring, which is based on a different rationale.

Table 13. Growth rate of productivity by sector

		France	Germany	Sweden	United Kingdom
manufacturing	1980-1992	2.7	1.7	2.7	4.6
	1992-2003	3.0	1.2	6.4	2.6
business services	1980-1992	1.9	1.9	0.9	1.8
	1992-2003	0.3	-1.0	2.0	2.2
difference	1980-1992	0.8	-0.2	2.2	2.8
	1992-2003	2.7	2.2	4.4	0.4

Source: OECD, STAN database

It is striking to note that changes observed in manufacturing productivity in Sweden and the United Kingdom are in fact going in the opposite direction: manufacturing productivity increased considerably in Sweden (up from 2.7% to 6.9%) in the two decades

in question, while it slightly dropped in the United Kingdom (from 4.6% to 2.9%). Everything seems to indicate that the effects of restructuring periods (at the start of the 1980s in the United Kingdom and at the beginning of the 1990s in Sweden) boosted the progression of industrial productivity, yet these gains did not necessarily go beyond the end of an industrial cycle, as suggested by the British example. While these two countries stand out due to a rate of progression, which is amongst the best in Europe, the performances of Germany and France appear mediocre in terms of manufacturing productivity.

However, it is the difference between manufacturing and services, which enables us to separate more clearly the countries under review. This productivity differential enables two polar opposite cases to be distinguished, which go back to what we could call the “productivity paradox”. Indeed, there are two main methods of creating jobs. The first method is based on competitiveness using major gains in productivity. The second method is based on “enriching the employment content” of growth which, on the contrary, amounts to low productivity gains. The productivity differential is an indicator, which enables the mix between these two methods to be measured.

From this standpoint, the dominant movement is the growing weight of the competitive rationale, which is demonstrated by an increase in the productivity differential. Over the 1980-1992 and 1992-2003 periods, it increased by 1.9 points in France, 2.4 points in Germany and 2.2 points in Sweden. The United Kingdom was the exception, with a productivity differential drop of 2.4 points.

We can therefore distinguish two main configurations, depending on whether the progression of productivity is quicker in manufacturing than in the overall economy, or whether it is comparable. Sweden can be classified amongst the “dualistic” countries where this differential is considerable. France joined this group during the second decade and the structure of its productivity performances has undergone a major change. Germany also joined this group but against a backdrop of a major decline in productivity performances. The United Kingdom joined the group of “homogeneous” countries during the second decade, when its manufacturing productivity began to grow at a rhythm similar to that of the rest of the economy.

Wages and productivity

As productivity is progressing very differently in the various countries, the issue is to find out just how independently labour markets work in relation to productive structures. In other words, do the productivity differences observed have an impact on real wages? A link could be made if it was possible to demonstrate that the progression of labour costs at least partially explained the changes observed in productive structures. In the sector exposed to global competition, labour costs are a key element in competitiveness. In the sheltered sector, wage moderation could facilitate an increase in the number of jobs created. Employment performance would therefore depend upon the capacity to disassociate wage progression in each of the major sectors, so as it increases as little as possible in the service sector. At sectoral level, this hypothesis adds to the general idea, discussed above, of the positive effect of wage moderation on employment. In order to test the hypothesis, the relative development of productivity and real wages in each of the major sectors should be compared (see Table 14 and Figure 19).

Table 14. Productivity and wages by sector

	Productivity			Real wage			Unit wage cost		
	Manuf. (1)	Services (2)	difference (1) – (2)	Manuf. (1)	Services (2)	difference (1) – (2)	Manuf. (1)	Services (2)	difference (1) – (2)
France	3.0	0.3	2.7	1.0	0.5	0.5	-2.0	0.2	-2.2
Germany	1.2	-1.0	2.2	0.3	-0.8	1.1	-0.9	0.2	-1.1
Sweden	2.6	2.0	0.6	3.0	2.5	0.5	0.4	0.5	-0.1
United Kingdom	6.4	2.2	4.2	2.2	1.9	0.3	-4.2	-0.3	-3.9

*Productivity per head. Wage deflated by consumer price.
Average annual growth rate 1992-2003*

Sources: OECD, STAN database

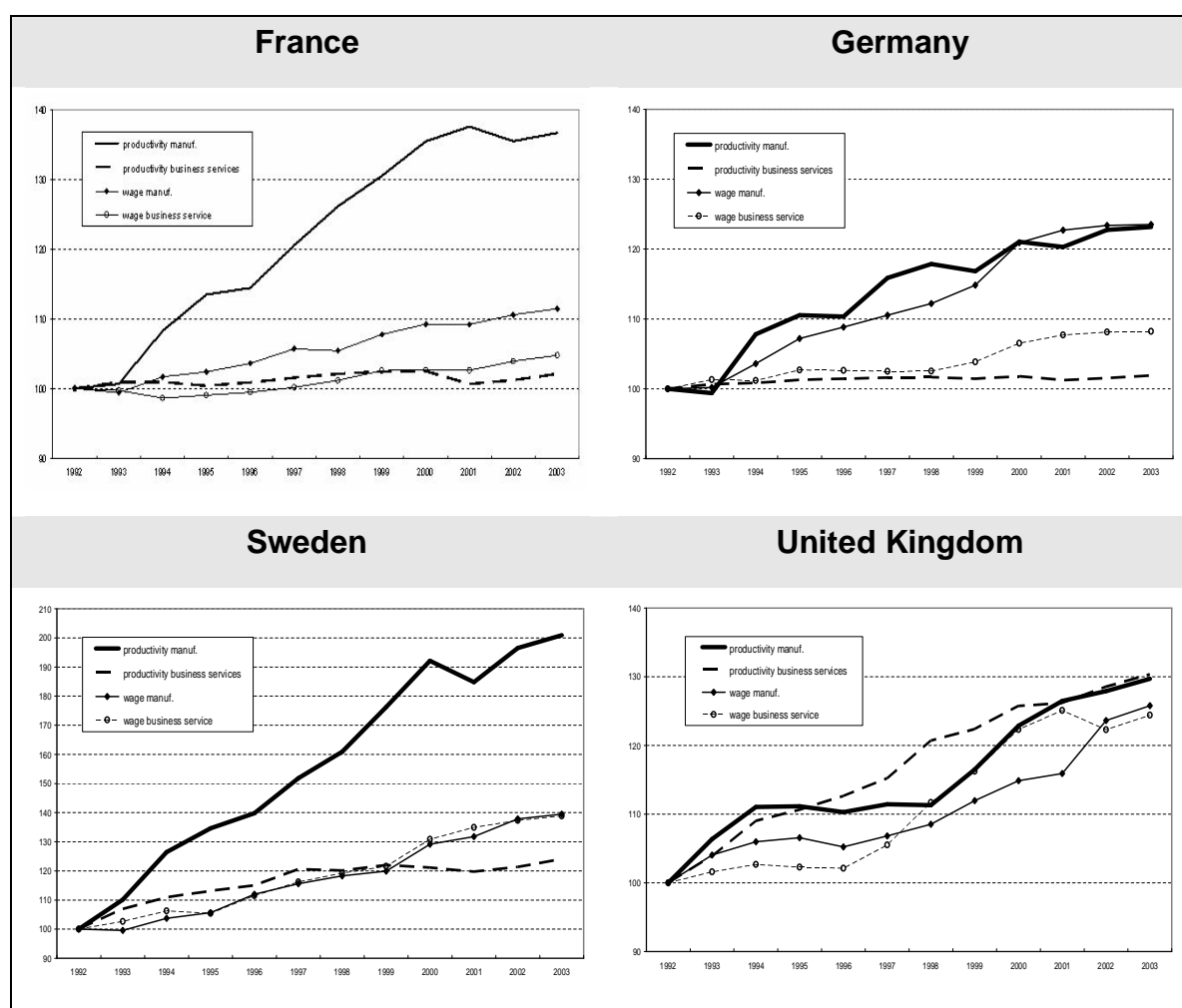
There is little difference between wages in the different sectors in Sweden and the United Kingdom. In both these countries, whose labour markets nevertheless work very differently, wages in the manufacturing and service sectors are very similar.

Germany has a relatively straightforward configuration, with wages in each of the major sectors tending to closely follow changes in productivity. The United Kingdom is the complete opposite with the progression of real wages hardly differing from sector to sector, with this also being the case for productivity. The other two countries occupy the middle ground between these two extreme cases. France is the country, which gets closest to this

form of disconnection, but the phenomenon has a limited scope: real wages are increasing more quickly in manufacturing, but at a much lower rate than productivity. In Sweden, the progression of real wages is very similar in various sectors, but is dragged down by the slower progression of productivity in the service sector.

However, the real wages examined here are obtained by deflating the nominal salary, using the price of added value in each major sector. This goes back to adopting a notion of real costs. This must be supplemented by examining employees' purchasing power, by deflating nominal wages using the index of retail prices. The results do not differ greatly, apart from in the case of Germany, where the relative price movements (between the price of GDP and retail prices) play an important role, which will be discussed in the chapter devoted to Germany.

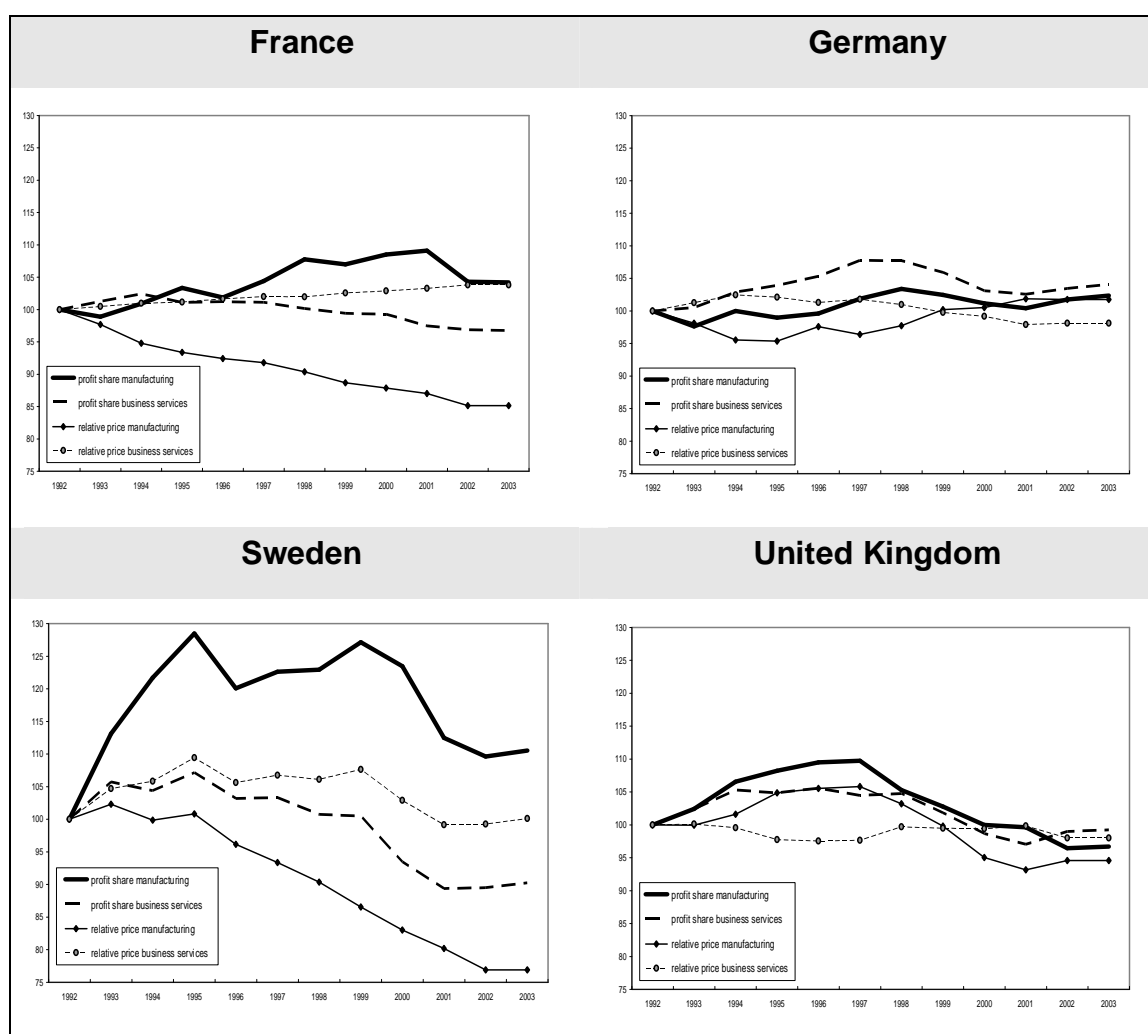
Figure 19. Productivity and wage by sectors



The inter-sectoral dynamic of relative prices and unit labour costs does however lead to a differing progression of margins in the various countries (see Figure 20). In

Germany and the United Kingdom, margins more or less follow the same progression in manufacturing and services. This is not the case in France, however, where a drift has been observed since the mid 1990s in favour of margins in the manufacturing industry. In Sweden, the situation is different once again: margins in manufacturing increased significantly during the first half of the 1990s, since then they have progressed in line with margins in the services.

Figure 20. Profit share and relative prices by sectors



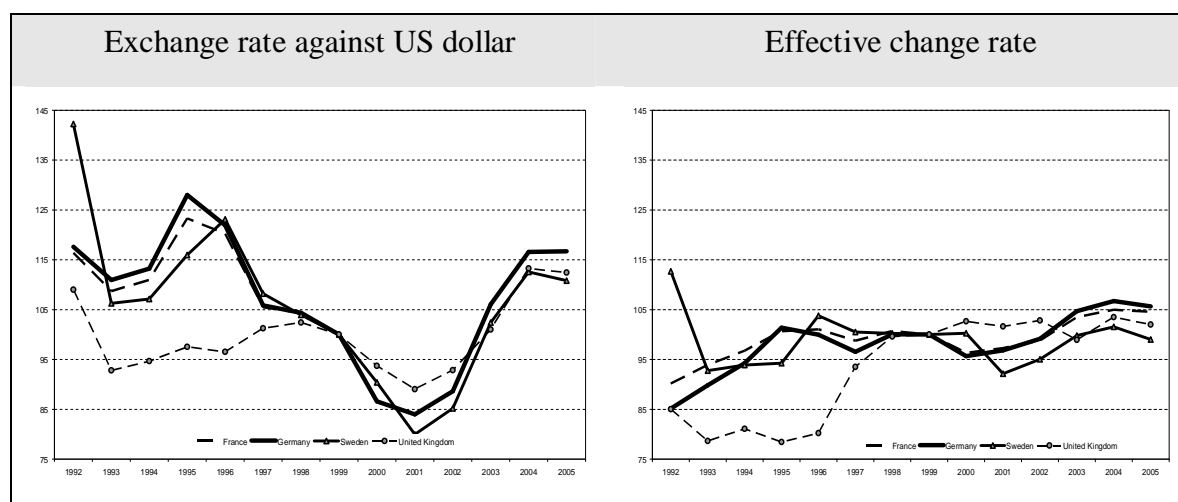
The exchange rate

Two of the countries under review are members of the Eurozone (Germany and France) while the two others (Sweden and the United Kingdom) remained outside the zone. The issue here is to find out whether the decision to stay out of the Eurozone enabled them

to implement more independent exchange policies. The response is not clear cut (see Figure 21). The exchange rate against dollar does not show significant differences, apart from for the pound sterling before the creation of the Euro. Progression of the effective exchange rate, which takes into account the export structure of each country, has experienced fewer fluctuations due to intra-European trade. Sweden and the United Kingdom's effective exchange rates differ from the two countries in the Eurozone, but this is down to other reasons than the actual exchange policy.

It is therefore difficult to highlight a differentiated effect of competitive pressure on the different economies, which would be caused by the exchange rate and would lead to more stringent workforce management.

Figure 21. Exchange rates



Public sector job and the self-employed sector

Public sector jobs and the self-employed sector make a significant contribution to employment performance, while being exempt from macroeconomic or institutional assessments. They occupy a different place depending on the country under review (see Figure 22 and Table 15). In 2005, the percentage of public sector employment in total employment ranged from 31.2% in Sweden to 10.8% in Germany. However, both these countries have experienced a major reduction in the workforce between 1992 and 2005: down 18% in Germany and 8% in Sweden. In both these countries, public sector employment makes a negative contribution to the growth of total employment. In France, public sector employment makes a positive contribution, and this is also the case in the

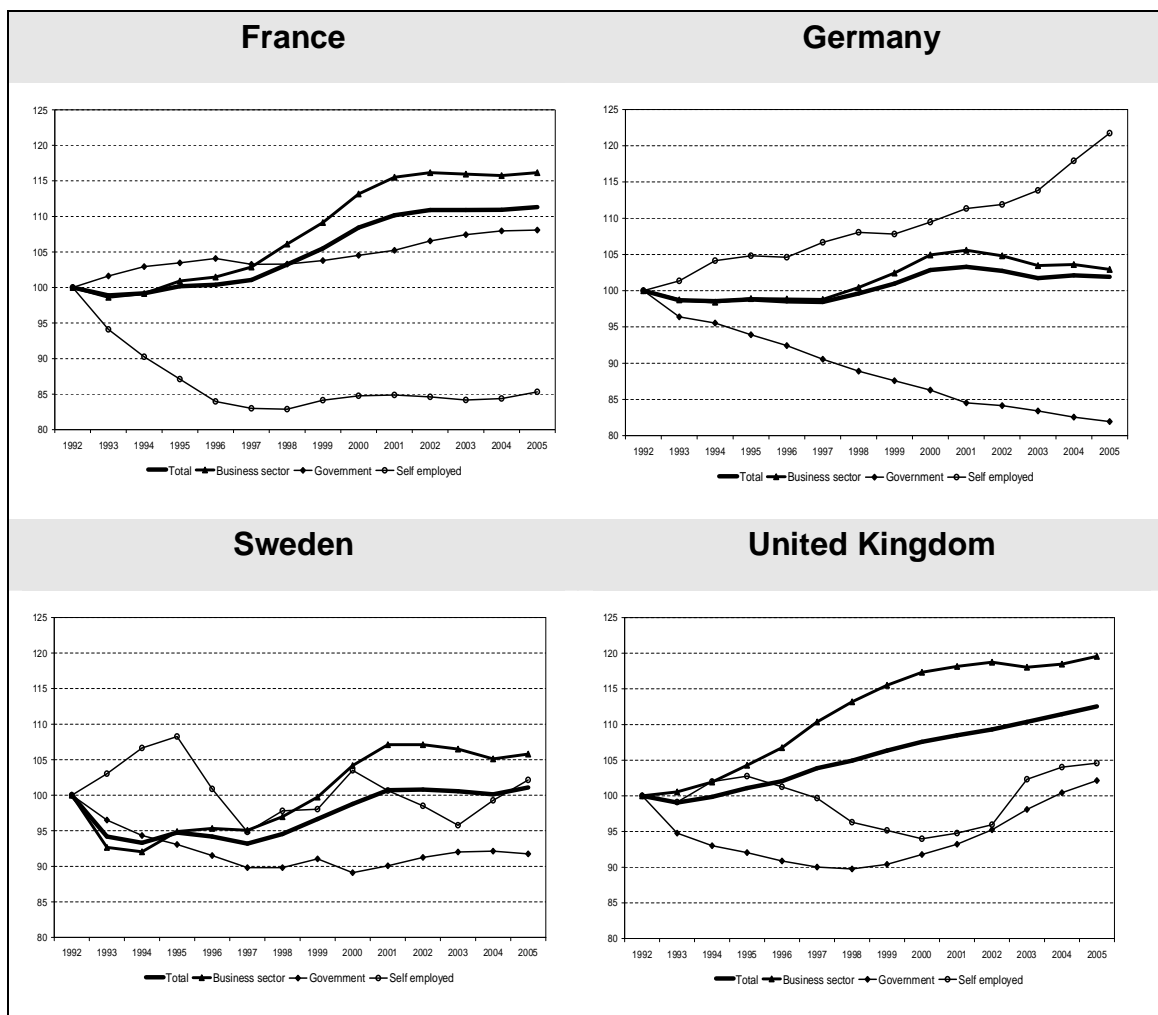
United Kingdom, where public sector employment started to increase once again as of 2000.

Self-employed workers represent between 7-13% of total employment. This sector makes little contribution to total employment, and even makes a negative contribution in France. On the other hand, this sector makes a major contribution in Germany, where the progression of casual work is tending to replace the drop in public sector employment.

Table 15. Evolution of employment 1992-2005

		Total	Dependent business sector	Government	Self-employed
France	structure 2005	100.0	70.0	22.7	7.3
	evolution 1992-2005	11.3	16.2	8.1	- 14.7
	contribution	11.3	10.8	1.9	- 1.4
Germany	structure 2005	100.0	78.0	10.8	11.2
	evolution 1992-2005	1.9	3.0	- 18.1	21.8
	contribution	1.9	2.3	- 2.4	2.0
Sweden	structure 2005	100.0	62.4	31.2	8.1
	evolution 1992-2005	1.1	5.8	- 8.3	2.2
	contribution	1.1	3.4	-2.8	0.2
United Kingdom	structure 2005	100.0	67.5	19.1	13.0
	evolution 1992-2005	12.6	19.6	2.2	4.6
	contribution	12.6	12.4	0.5	0.6

Figure 22. Public employment



4 The role of the institutions

Can a link be pinpointed at macroeconomic level between structural reforms of the labour markets and employment performance? This question has given rise to numerous studies, which are far from being conclusive. Rather than go over all the results, comparing these four countries constitutes an opportunity to focus on specific national situations by using previous results and in particular the decomposition equation. This equation uses economic data (GDP, productivity, working hours) and socio-demographic data (working age population, labour force participation rate).

Each of these variables is a “way in” for the variables describing the workings of the labour market: wage dynamic on the one hand, and institutional variables on the other. Wage moderation can, for example, affect the growth of GDP by boosting competitiveness,

or can alter the productive capital-labour combination and therefore influence the progression of productivity. Greater labour market flexibility can modify the balance between working hours and productivity, can change the progression of the labour force participation rate and can even help to better match production to demand. It can also lead to increased wage moderation.

This rational approach is not used in the majority of cases and it makes two methodological errors. The first error is to not distinguish the direct effect of labour market reforms and their indirect effect by wage dynamic. In reality, two types of model are available, which have followed one another over time. The first model seeks to establish a tidy relation between wage moderation and employment. However, the model has largely failed to establish this direct link. Research, notably by the OECD, has moved towards another form of modelling directly linking employment performance and institutional variables, describing the degree of labour market rigidity. Apart from the fact that the results of this approach are hardly convincing, it represents a “black box” which does not question which paths have been taken.

However, the second error is more serious: namely seeking to establish a direct link between an employment performance variable (generally the unemployment rate) and a range of institutional variables. This approach can be criticised on several fronts. The first criticism is that the unemployment rate is not the only possible indicator and it can differ appreciably in relation to other indicators. We saw earlier that the unemployment rate can drop steeply in countries where levels of job creation are nevertheless lower than those observed in other countries. The second weak point relates to the absence of any macroeconomic variables, particularly the growth of GDP. It is however obvious that a country which benefits from stronger growth will, as a rule, create more jobs. The absence of macroeconomic variables sidelines this relative advantage and consequently gives institutional variables a disproportionately important role. These two criticisms combine: it is all the more inappropriate to sideline GDP growth, with which job progression closely correlates, as the selected indicator (unemployment rate), can progress very differently.

These methodological remarks lead to a two-phase comparison of the countries under review, with wage moderation and then the impact of institutional variables being successively examined.

Can employment performance be related to labour market reforms? In order to shed light on this issue, we began by creating an overall employment performance indicator.

This overall indicator is based on the average performance achieved by each of the countries, which is measured using four indicators: employment growth, variation of unemployment rate, variation of employment rate, and the progression of the number of hours worked. All the variables are standardised to make them comparable (see Table 16).

Table 16. Indicators of employment performance

1991 - 2005	France	Germany	Sweden	United Kingdom
Change in employment	109.6	100.3	96.1	109.9
Change in unemployment rate	0.4	4.2	2.9	- 4.0
Change in employment rate	1.8	- 1.3	- 8.1	2.3
Change in total working hours	0.0	- 7.1	- 1.4	4.2
Employment Global performance	100.3	99.4	99.2	101.1

A certain number of institutional indicators were gathered together which can be seen in the following table.

Table 17. Institutional indicators

	France	Germany	Sweden	United Kingdom
Average EPL	2.9	2.5	2.4	0.8
Global Competitiveness Index (2006)	5.31	5.58	3.00	5.54
Workplace relations (1999)	3.3	5.3	5.9	5.1
Unemployment Insurance Generosity (2002)	6.9	7.5	10.6	6.6
Wage inequality (1995)	1.59	1.59	1.39	1.84
Job insecurity 1994-2005	101.9	116.8	99.1	99.4

Sources: OECD, Global Competitiveness Report, World Value Survey, Scruggs (2006), Philippon (2007), Comparative Welfare States Data Set.

We added an aggregated job insecurity indicator based on three series describing the percentage of total employment made up by self-employed workers, fixed term contracts and part-time working. This indicator is relatively stable in the medium term in Sweden and

the United Kingdom, is increasing in France and is rising significantly in Germany (see Table 18) where the three components of job insecurity are increasing significantly.

Table 18. Job insecurity indicators

		1994	2005	change	Global indicator of precariousness
France	fixed term contracts	11.5	13.3	1.8	
	self employed	11.2	8.9	-2.3	
	part time	14.7	17.1	2.4	
	precariousness	31.8	34.8	3.0	
Germany	fixed term contracts	10.4	14.2	3.8	
	self employed	9.9	11.2	1.3	
	part time	17.2	28.9	11.7	
	precariousness	32.6	48.7	16.2	
Sweden	fixed term contracts	14.1	16.0	1.9	
	self employed	5.6	4.8	-0.8	
	part time	26.0	24.0	-2.0	
	precariousness	42.9	42.4	-0.5	
United Kingdom	fixed term contracts	6.9	5.7	-1.2	
	self employed	13.8	12.7	-1.1	
	part time	23.0	24.8	1.7	
	precariousness	36.8	36.8	0.0	

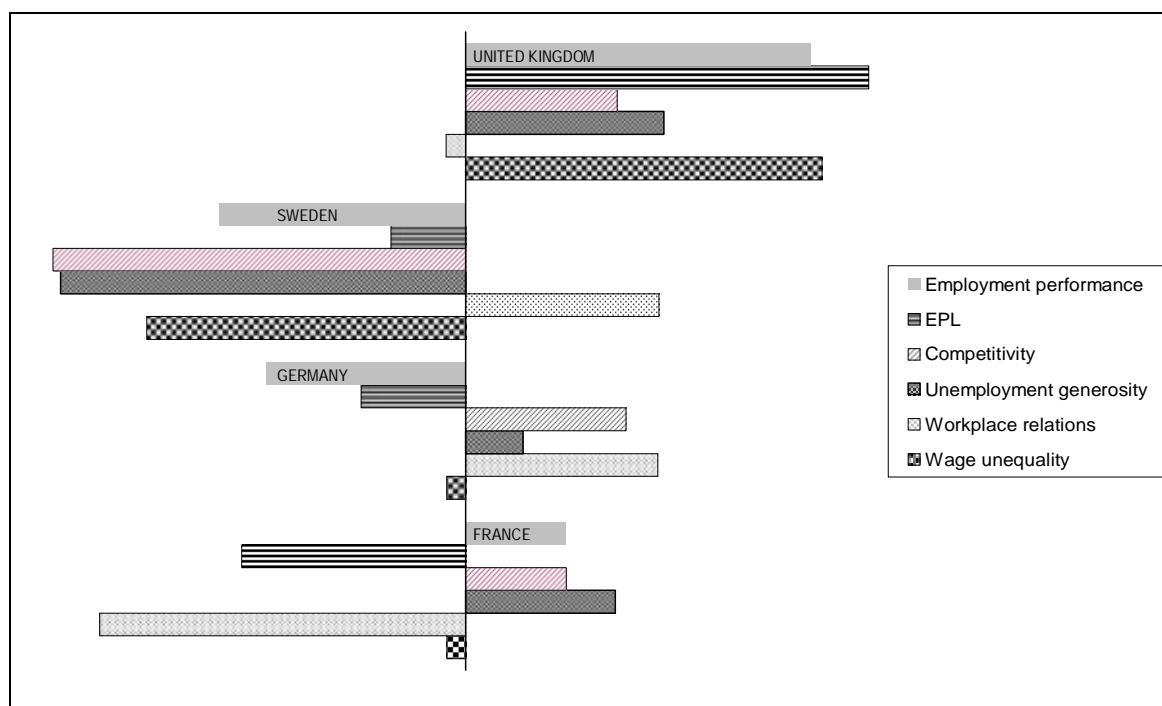
This job insecurity indicator shows a negative link with employment performance. This result goes against the notion that greater labour market flexibility enables more jobs to be created for a given level of growth. Indeed, it shows quite the opposite, namely that an improvement in the labour market situation enables non-standard forms of employment to be reduced or at least to be curbed. On the other hand, non-standard forms of employment increase more quickly when the labour market situation worsens.

Can a link be established between the various institutional indicators and employment performance? Figure 23 below shows that there is no overall coherent connection. The United Kingdom is a textbook case, in the sense that all the institutional variables (standardised over the four countries) go towards explaining its better performance, apart from workplace relations, which are slightly below the average for the countries under review.

None of the other three countries show the same degree of “coherence”. For Sweden, lower employment performance tallies with lower indicator scores, apart from the overall competitiveness indicator, giving the country a good ranking. France achieves

relatively good employment performance, despite a poor score for Employment Protection Legislation (EPL) and the quality of workplace relations. Germany does not achieve good employment performance, despite obtaining a good ranking for competitiveness, incentive to work (low unemployment benefit) and the quality of workplace relations.

Figure 23. Employment performance and institutional indicators



The conclusion to be drawn from this analysis is that, apart from the United Kingdom, there is no solid link between employment performance and the variables describing the labour market institutions. Everything seems to show that each country is an individual case, which cannot be analysed using a general rule.

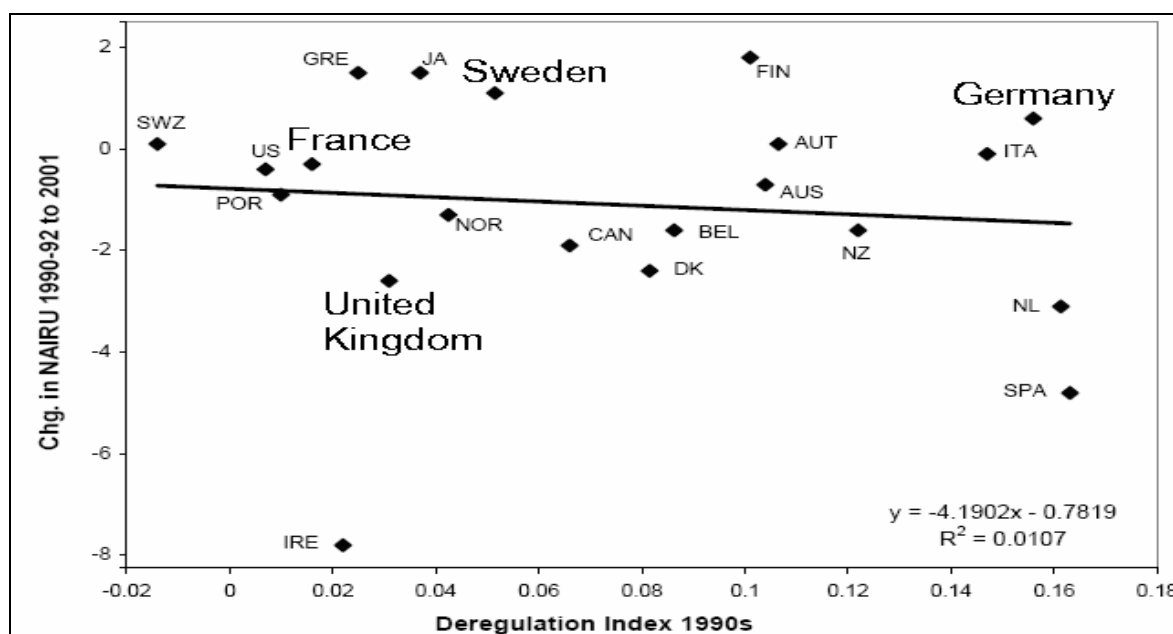
This result differs from the literature published by the international organisations such as the IMF and the OECD, which seeks to establish systematic links between these two groups of variables. As a result of this, there is a now dominant interpretation stating that mass unemployment in Europe is down to labour market sclerosis and rigidity. This concept, called the Labour Market Flexibility Hypothesis, attributes wage rigidity, which prevents changes to the labour market, to institutional factors (union density, centralised wage bargaining, employment protection laws, taxes, unemployment benefit, and benefit duration). Unemployment in Europe is to some extent the flip side of the Welfare State. In order to restore full employment, labour market reforms must be instituted aiming to

reduce trade union influence, relax employment protection legislation and reduce unemployment benefit and the minimum wage.

For the four countries under analysis, we have seen that this interpretation cannot be automatically applied. This observation confirms the results, which could have been achieved using two different methods. The first method is based on reproducing the tests and demonstrating their flimsiness. This is the method followed by David Howell, Dean Baker, Andrew Glyn and John Schmitt (2006). Figure 24 from this study illustrates the absence of a general link between the NAIRU and the deregulation index, with the countries under review not bucking this trend. During the 1990s, Germany, France and Sweden recorded relatively similar NAIRU variations, while having very different deregulation indexes.

Figure 24

Labour Market Deregulation and Changes in the NAIRU for 21 OECD Countries



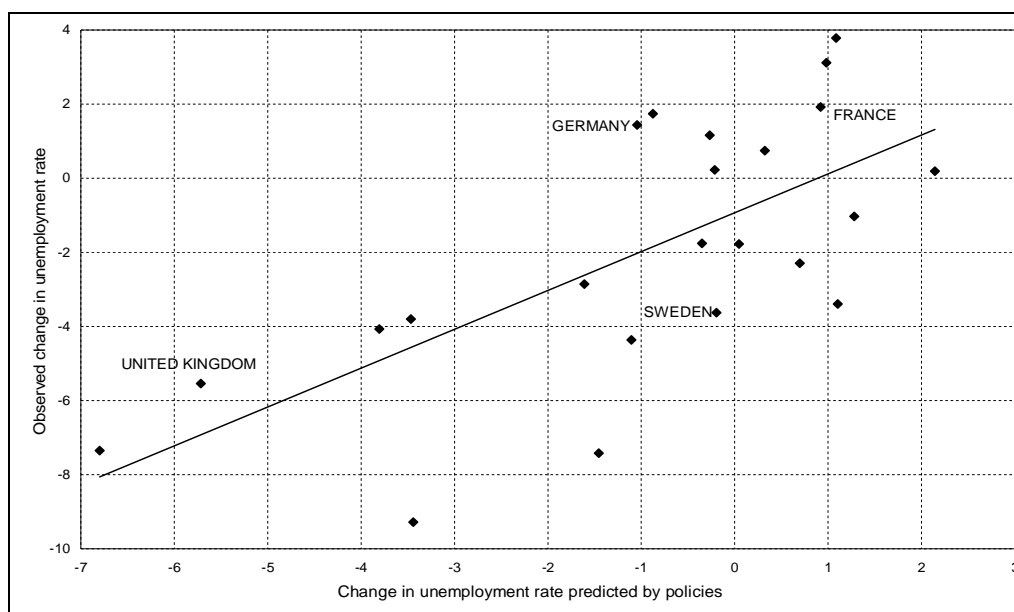
Source: David R. Howell, Dean Baker, Andrew Glyn and John Schmitt (2006)

The only statistically significant link remaining is that between the employment generosity indicator and the unemployment rate. However, the authors discuss the scope of this effect and put forward “a second reason to remain sceptical about the direct applicability of the regression results concerns timing and causality. To the extent that policy makers increase and decrease the generosity of benefits in response to the perceived need for a safety net, the statistical fit should not be interpreted as a measure of the

disincentive effects of the benefits system.” They reach the opposite conclusion based on Granger causality tests focusing on the success stories (Denmark, Ireland, Netherlands and United Kingdom), which “indicate that it is the unemployment rate that drives the benefits level in each case – just the reverse of the orthodox prediction.”

More recently, the OECD took up this question again in its 2006 Employment Outlook, based on a working paper (Bassanini Duval 2006), which highlights the major effect of reforms on employment performance. However, this has not been exempt from criticism (see Howell 2006). Furthermore, Figure 25 shows that the four countries under review are located relatively faraway from the correlation line. There is a major variation in the unemployment rate not explained by institutional variables in Sweden (3.4 points), Germany (2.4 points) and France (1 point). The introduction of an output gap as an explanatory variable does not improve and even worsens the estimation, apart from the case of Sweden, where it fully explains the variation observed in the unemployment rate (see Table 19).

Figure 25. The evolution of unemployment is well explained by policy reforms



Source: OECD (2006)

Table 19. Explanations of changes in the unemployment rate

	Change in unemployment rate	Change explained by policy reforms only	Change explained by policy reforms and the output gap
France	1.9	0.9	1.1
Germany	1.4	-1.0	-1.0
Sweden	-3.6	-0.2	-3.3
United Kingdom	-5.5	-5.7	-8.7

Source: Bassanini Duval (2006)

The Macroeconomic Policy Hypothesis

These results lead us to go back over the Macroeconomic Policy Hypothesis, an alternative to the Labour Market Flexibility Hypothesis (Galbraith, Roy and Chowdhury 2007). This hypothesis is based on macroeconomic policies being the main determining factors in changes in the unemployment rate. This hypothesis was developed by Thomas Palley (2001 and 2004). This original contribution is significant as it combines macroeconomic variables with institutional variables describing the labour market in order to explain changes in the unemployment rate. Palley (2001) firstly verifies the important and sound role of macroeconomic variables such as the growth of GDP and the real interest rate. Regarding variables describing the labour market, "the evidence is more problematic: unemployment benefit duration and union density are both consistently insignificant. The level of wage bargaining coordination and the extent of union coverage matter consistently, but they need not raise unemployment if they are appropriately paired with other policies. Finally, the significance of other microeconomic variables (employment protection, unemployment insurance wage replacement rate, tax burden) is unstable and not robust to changes in specification". Palley's overall conclusion is that European unemployment is "principally the result of self-inflicted dysfunctional macroeconomic policy. European policy makers adopted a course of disinflation, high real interest rates, and slower growth that raised unemployment. Moreover, they all adopted this course at the same time, thereby generating a wave of trade based cross-country spill-overs that generated a continent wide macroeconomic funk and further raised unemployment".

The study even suggests an institutional variables feedback effect on economic policy. Palley states "real interest rates have tended to be systematically higher in countries

with high union density despite the lack of any evidence that high union density raises inflation. This suggests that central banks have systematically raised interest rates in countries with high union density". If restrictive macroeconomic policies are designed as a way of disciplining the trade unions via rising unemployment, we have an additional example of the mistakes made when establishing a direct link between unemployment and institutional variables, which ends up bypassing macroeconomic policy.

In order to extend Palley's results to the four countries under review and over a more recent period, we will use the following simple model: The unemployment rate U of each country depends on the unemployment rate for the previous period in accordance with a coefficient which itself depends on EPL the Employment Protection Legislation index (EPL):

$$U_{i,t} = (a + b \cdot EPL_i) U_{i,t-1}$$

The model is estimated by bringing together the four countries over the 1982-2005 period (1991-2005 for Germany). The idea here is that labour market rigidity increases the persistence of unemployment. The result obtained seems to confirm the Labour Market Flexibility Hypothesis even if the EPL coefficient is barely significant and very low:

$$U_{i,t} = (0.904 + 0.0186 EPL_i) U_{i,t-1} + 0.497$$

(22.1) (1.6) (0.1)

$$R^2=0.924$$

However, if an element ΔQ reflecting the GDP growth rate is introduced, a relation in which the significance of the EPL variable disappears completely is obtained.

$$U_{i,t} = (0.998 - 0.0026 EPL_i) U_{i,t-1} - 1.058 \Delta Q_{i,t} + 1.097$$

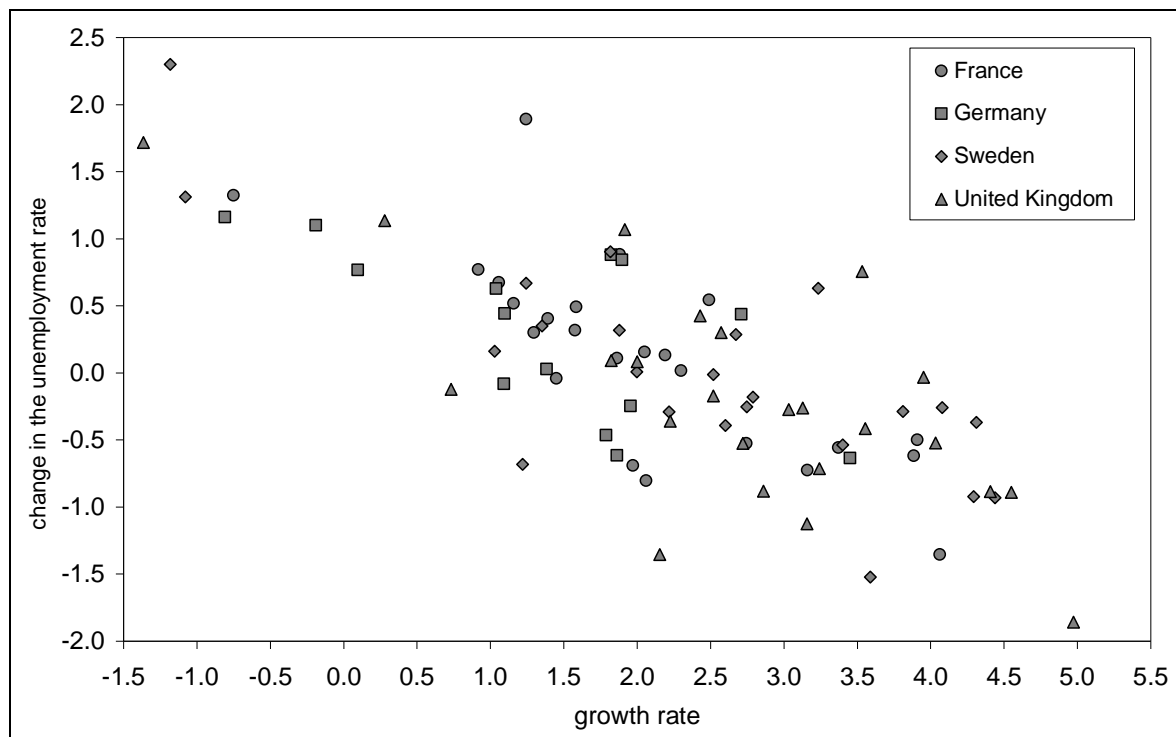
(35.6) (0.3) (10.6) (6.4)

$$R^2=0.968$$

In this case, we have a result, which fits with Palley's analysis. The link between employment performance and growth is so strong (Figure 26) that it tends to make the explanatory role of institutional variables disappear. In other words, the importance

attributed to these variables, which are supposed to quantify labour market reforms, stems from the omission of macroeconomic variables.

Figure 26. Unemployment and growth rate



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CHAPTER 2

Labour market reforms and macroeconomy in Germany

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This chapter is devoted to Germany from a “Franco-German” view of the situation. The report uses issues as a means of analysing the situation and is based on a series of interviews carried out during two research visits to Germany in March and April 2006 (see Appendix 1). It is also based on other research work which was started before this project and which the project is now extending.

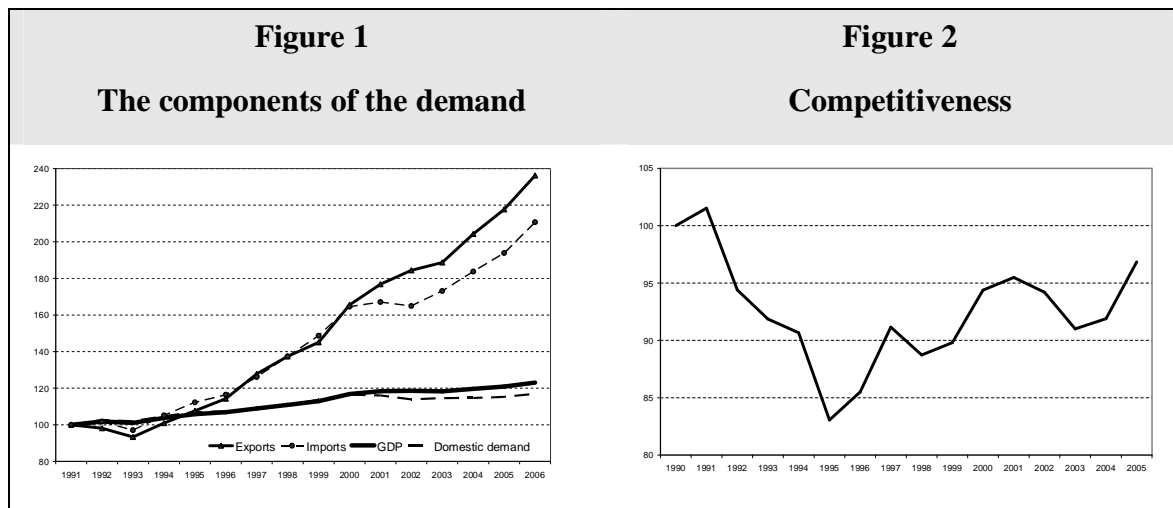
The objective of the two research visits was to question contacts (unions, parties, ministries and research bodies) about the relationship between macro-economic policy and labour market reforms in Germany. We therefore focused our interviews on this general question, using an interview grid which was initially highly detailed (Appendix 2) and which was then adapted to the specific skills of each contact, as well as a qualitative questionnaire (Appendix 3).

1 The macroeconomic framework

Considerable internal transfers bear witness to the effect of reunification on the macroeconomic framework of the country. The beginning of the 1990s was characterized by economic activity being reoriented towards the enlarged domestic market and by a loss of competitiveness. The biggest impact was on the current account: pre-reunification it had a large surplus (4% of GDP at the end of the 1980s) but was close to 0% post-reunification (Figure 4). The contribution of external trade to growth was wiped out and GDP grew at the same pace as domestic demand (Figure 1). Between 1995 and 2005, the growth of German GDP was therefore one point lower than that of the rest of the Euro zone: 1.3% per year, compared with 2.4%. This pattern continued throughout the 1990s but then changed at the start of the 21st century when, from that moment on, exports progressed extremely quickly, the current account re-established itself and domestic demand dropped.

Germany’s current situation is characterized by a “competitiveness paradox” which can be briefly summarized. Competitiveness has significantly improved in comparison with

the Euro zone since the mid-1990s, especially if it is measured based on real unit labour costs (Figure 2). Thanks to this upturn, exports have picked up, even if other factors may have had an effect, in particular the successful specialisation of the German economy.



Competitiveness in terms of real unit labour costs in the manufacturing sector. 1990 = 100.

Source: OECD, *Economic Outlook*, 2006

On the other hand, this export dynamism has produced extremely slow growth of domestic demand, which in turn has held back the progression of GDP (Figure 1 and Table 1).

Table 1. Annual rate of growth (%) 1998-4 - 2005-4

Real Total Compensation per Employee	- 0.4
Exports of goods and services	6.9
Gross Domestic Product	1.2
Final Domestic Demand	0.4
Private Consumption	0.8

German performance therefore appears rather mediocre compared with the performance of the Euro zone (Table 2). Job creation has also been slowed down and the rate of unemployment has increased, overtaking the Euro Zone average to reach the same level as France.

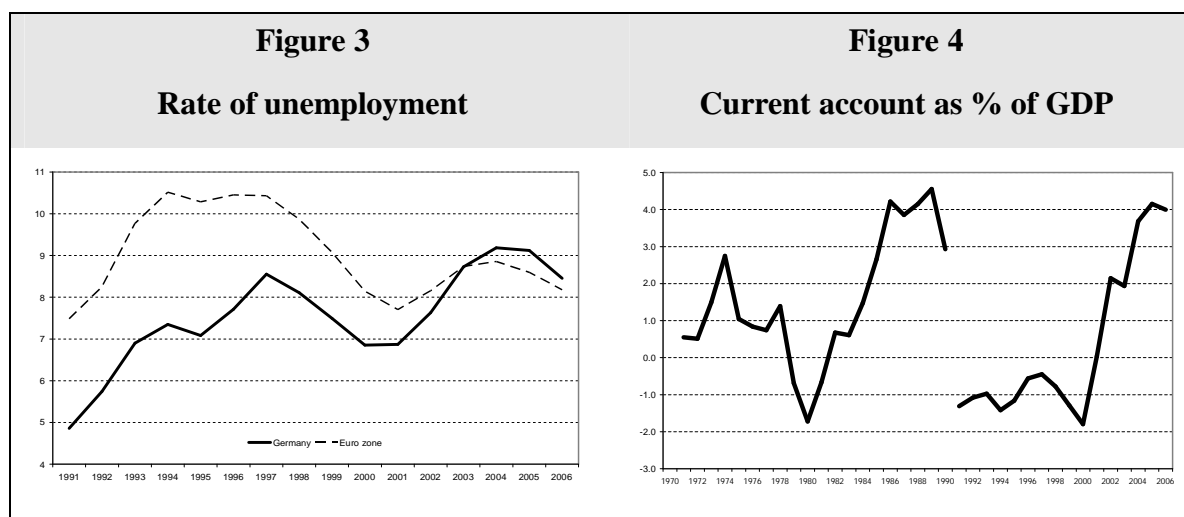
Table 2. Macro-economic performances Germany/Euro Zone

Average growth rates	1990-1995	1995-2000	2000-2005
GDP Germany	1.4	2.0	0.7
Euro area except Germany	1.4	3.1	1.7
Final domestic demand ¹ Germany	1.9	1.7	-0.2
Euro area except Germany	0.5	3.3	2.0

Average growth rates.

¹: Domestic demand except change in stocks.

Sources: Statistisches Bundesamt, Eurostat, own calculations.



Source: OECD, *Economic Outlook*, 2006

This observation is obviously not challenged by the different players but is however put into perspective by two major issues: retrospective analysis of reunification and the prognostics on the development of such a pattern.

The impact of reunification leads to two opposing interpretations of the situation. The first interpretation focuses on method: the low growth rates of the 1990s were the price that had to be paid in order to absorb the different levels of productivity of the two Germanys. This is the point of view put forward in particular by the CDU.

A different interpretation focuses on the macroeconomic policy errors made during the last decade; a policy, which did not manage to implement, measures, which would have absorbed the impact of reunification. This is the standpoint of economists who follow the Keynesian theory, but few go as far as highlighting or challenging the persistent choice of a monetary policy aiming to support the value of the mark. At a time when Germany was

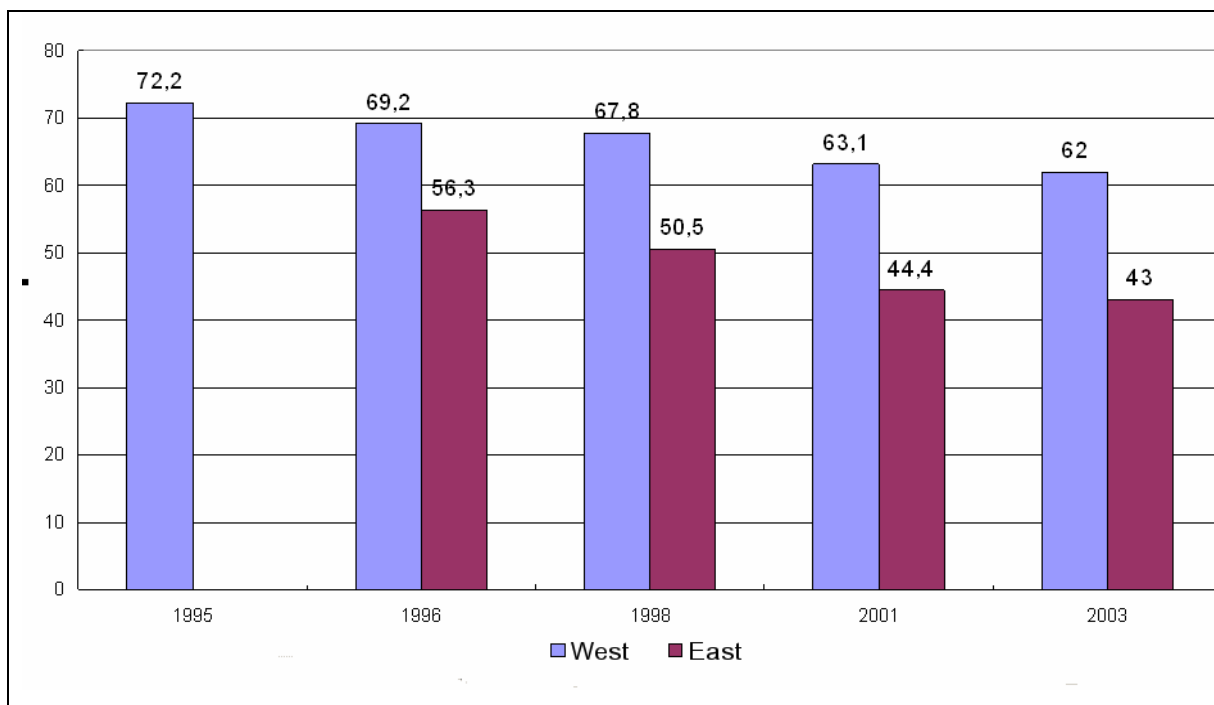
facing up to reunification, the country was promoting orientations aiming to generalise its policy of a having a strong currency at European level. It would not be ridiculous to think that the mark joined the Euro with an overvalued exchange rate in the light of the impact of reunification. However, this monetary margin for manoeuvre could not be envisaged due to a strong consensus ruling it out. Monetary unification then made it disappear once and for all. Economic policy therefore had to find room for manoeuvre in the budgetary policy but this caused Germany to experience major problems when attempting to comply with the constraints of the Stability and Growth Pact. In terms of competitiveness, labour costs became the only adjustment variable.

Competitiveness and wage negotiation

The mid 1990s were also characterised by the start of an effort to rectify the cost competitiveness of companies, which had been negatively affected by the impact of reunification as well as the successive realignments of the Deutsche Mark.

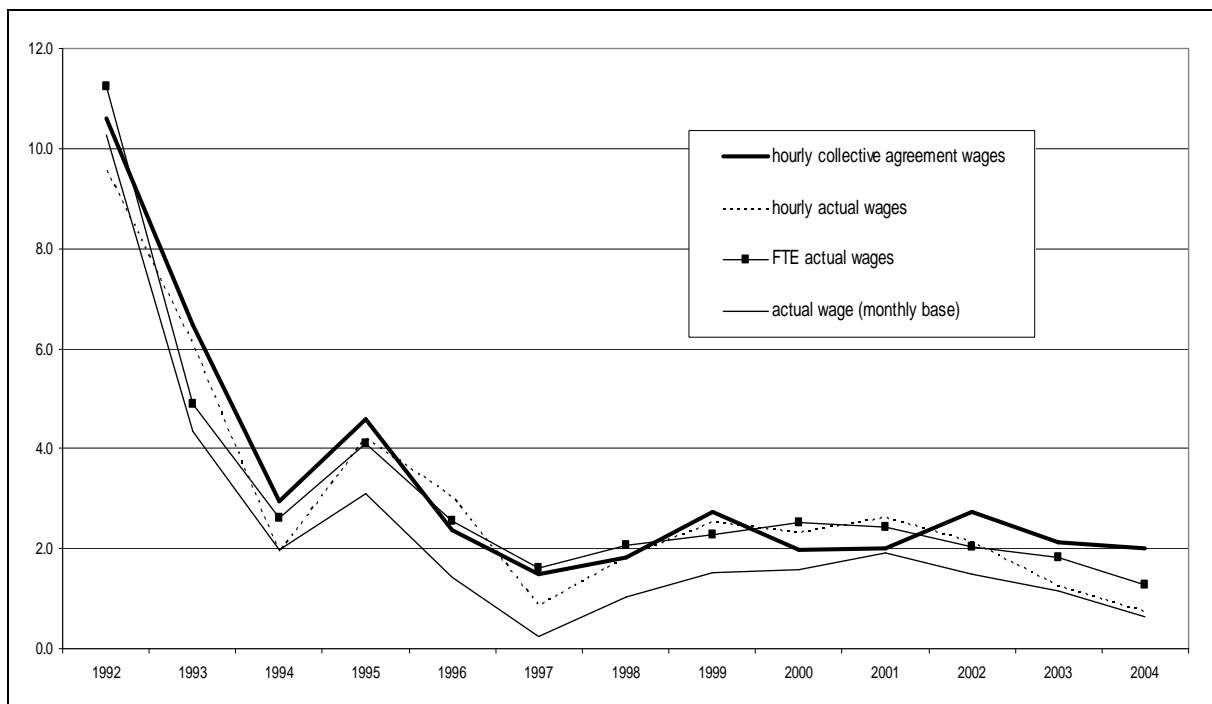
It was set in motion in 1996, in a context of weakening union power, which can be explained by an increase in unemployment, the weak union presence in the East and by the growing weight of the argument for competitiveness. The drop in union membership and the reduction in the collective agreement coverage rate (see Figure 5) had a major impact in a country where contract law prevails over regulatory law and where there is no legal minimum wage. That is the reason why wage purchasing power has, over the past few years, experienced systematically lower development (*lohndrift* – wage drift) than negotiated salaries (see Figure 6). The return to pay restraint coincided with an upturn in industrial productivity. These developments started to affect domestic demand and therefore growth, but up until the end of the 1990s only led to a moderate recovery of company cost competitiveness and profits.

Figure 5. Collective agreement coverage rate



Source: IAB Betriebspanel.

Figure 6. Wages and “lohdrift”



Changes in the labour market

The second half of the 1990s was also characterized by changes in the labour market: the deterioration of the situation of some categories of workers, particularly non-qualified workers, and a drop in worker mobility in the labour market¹. However the German employment rate, as calculated by the Federal Statistics Office, was still five points above the European Union average in 2000 (68.5% compared with 63.2%²). The drop compared with other European countries has therefore occurred mainly during the past few years.

If we apply a flexicurity (flexibility and security) type approach, Germany is characterised by internal numerical flexibility (adjustment of working hours) which holds sway over external flexibility (workforce adjustments). Regulatory protection for workers, as measured by the OECD's own indicator, was still relatively high at the end of the 1990s, for both permanent and temporary jobs. As in many other countries, changes that took place from the mid 1980s onwards have taken the form of temporary employment deregulation³. Therefore, since 1985, there has been a simplified fixed term contract with a maximum duration of two years. This is reserved for new employees with employers not being required to provide any form of justification when terminating the contract. Temping has been authorized since 1972, with a maximum assignment length of twelve months since 1997.

This relatively strict job protection goes hand in hand with relatively high levels of employment stability. Average length of service was 10.6 years in 2000, as opposed to 8.3 years in Denmark⁴. The relaxation of regulations on temporary employment could be seen in a slight increase in the number of temporary employment contracts (see Table 3) but temping's overall share is still very small, and permanent contracts remain the predominant form of employment. As in many other countries, fixed-term contracts are, on the other hand, playing an increasing role in mobility, with 43% of recruitment being on a fixed-term basis.

¹ Thomas Rhein, Hermann Gartner and Gerhard Krug, "Aufstiegchancen für Geringverdiener verschlechtert", *IAB Kurzbericht* number 3, March 2005; European Commission, *L'emploi en Europe 2004*

² In a survey of the German workforce, professional status was not dealt with by an ILO type question on professional activity, but instead respondents declared their own status. As a result, the number of marginal jobs was underestimated. The Office's programmes corrected this bias.

³ Helmut Rudolph, "Beschäftigungsformen : ein Maßstab für Flexibilität und Sicherheit ?" in Martin Kronauer and Gudrun Linne (dir.), *Flexicurity, Die Suche nach Sicherheit in der Flexibilität*, Hans Böckler Stiftung, Berlin, 2005; Adelheid Hege, "Les salarié(e)s précaires, l'emploi normal et la représentation syndicale", *Chronique internationale de l'IRES* n°97, 2005.

⁴ Peter Auer and Sandrine Cazes (eds), *Employment stability in an age of flexibility*, ILO, Geneva, 2002.

Internal numerical flexibility, through changes in working time or through part-time working, has, on the other hand, clearly increased in importance: in 2003, 41% of employees had a working hours "account" (37% in 1999). Germany should be ranked as one of the leading European countries for flexible working hours⁵. The level of part-time working increased by nearly ten points between 1991 and 2000 (see Table 3) and in 2005 was three points higher than the UK level. Very low-wage jobs (known as mini jobs in Germany) were reformed by the Hartz laws and underwent rapid expansion during the 1990s. They are exempt from employee contributions and only give workers limited rights to disability benefits and no right to unemployment benefit and sick pay. However, for a long time, these jobs were not perceived as insecure, as they were mainly carried out by married women, students and retired people

Table 3. Structure of employment

	1991	1995	2000	2005	variation 1995-2000 (thousands)	variation 2000-2005 (thousands)
Total employment (thousands)	38,623	37,599	39,144	38,778	1,545	-366
Independent workers (%)	9.1	10.0	10.0	11.2	163	439
Part-time (%)	15.7	18.8	24.5	28.9	2,500	1,606
Mini jobs – (Low-wage jobs) (%)	- (1)	- (1)	10.4	12.2		660
Fixed-term contracts (%) ⁽²⁾	10.1	10.4	12.7	12.6	954	-137
Temping (%) ⁽²⁾		0.5	0.9	1.2	162	90

(1) Separate records of the figures for the workforce with mini jobs (low-wage jobs) were introduced in 1999.

The total 2000 employment figures from the National Accounts were retropolated to include low-wage jobs.

(2) As a percentage of paid employment.

Sources: *Arbeitsagentur, Eurostat, Statistisches Bundesamt*, author's own calculations.

Before the reforms, unemployment benefit offered a relatively high⁶ level of social assistance and its coverage rate was high (80% of the unemployed received benefits from social insurance or social assistance schemes in 2002). The length of time benefits were claimed was low (12 months) but it rose to 32 months for elderly unemployed people and included no limit within the assistance system. The NRR was in the average bracket for OECD countries for short-term unemployment, but was quite high for long-term

⁵ Steffen Lehndorff, "Arbeitszeitregulierung unter Druck", in Kronauer et Linne, op.cit.

⁶ Odile Chagny, "Les réformes du marché du travail en Allemagne", *La Revue de l'IRES* n°48, 2005; Cerc, Aider au retour à l'emploi, Report number 6, 2005.

unemployment⁷. This system therefore provided “a certain guarantee of professional skills”⁸ as benefits payment was still proportional to the previous net salary (60-70% for the unemployment insurance scheme, 53-57

With slightly more than one GDP point in 1998, the spending effort on active labour market policies was, according to *Eurostat*, slightly higher than the European average. Significant weight was given to long-term professional training measures, as well as direct job creation in the non-commercial market. Available evaluations show a relatively major effect on retention and the relative lack of effectiveness of non-commercial schemes aiming to reintegrate people into the primary (non-assisted) labour market⁹.

2 Reforms

Interviews dealt with labour market reforms: the Hartz reforms, Agenda 2010, and reforms proposed by the "Grand Coalition", and examined them from the standpoint of their internal logic and how they combine with other structural policies (pensions, taxation, and company governance) and macroeconomic policy. Four main periods can be observed.

First period: December 1998-March 2002

The first years of the left-wing coalition, which came to power in September 1998, coincided with the start of the EES (European Employment Strategy) and were a key period. On the initiative of Chancellor Schröder, the three-way consultation was relaunched in December 1998 in the form of an “Alliance for Work, Training and Competitiveness”. Its main objectives were to reduce social security contributions on low wages in a targeted and long-term way, thus mainly aiming to facilitate the development of service-industry jobs requiring few qualifications, to continue with the policy of making working hours more flexible and to increase professional training.

A benchmarking group, led by four experts, had the role of carrying out comparative international analyses. The group produced two reports, one on employment perspectives for workers with few qualifications and the other on the Public Employment

⁷ Ocde, *Prestations et salaires*, 2004.

⁸ Mechtild Veil, “Les lois Hartz, plus qu’une réforme du marché du travail ?”, *Chronique internationale de l’IRES* n°92, 2005.

⁹ Bundesregierung, *Die Wirksamkeit moderner Dienstleistungen am Arbeitsmarkt*, 2006 ; Lena Jacobi et Jochen Kluge, “Before and After the Hartz Reforms: The performance of Active Labour Market Policy”, *IZA Discussion Paper* n°2100, 2006.

Service¹. The key points from both these reports are summarized in Table 4. However, the group's recommendations (Box 1) were strongly opposed by the unions and their application was therefore limited to measures contained in the *Job-Aktiv* law (job seeker profiling, *activation* plans).

Table 4. The Benchmarking Group Consensus

Diagnosis	Consequences
Too high labour costs mainly, but not only, due to high social contributions rates inherited from the German reunification	Structural unemployment (NAIRU)
Lack of development of the low productivity jobs, specifically in the domestic services sector	Unemployment rate of workers with lower levels of qualifications.
Wrong incentives in the benefit system	Financial sustainability of the benefit system, development of the low wage sector.
Sub-optimal Public Employment Service	Mismatch problems, long-term unemployment rate, and financial sustainability of the benefit system.
Lack of efficiency in the ALMP programs	Labour market mobility, social assistance culture, financial sustainability of the benefit system.
Less emphasis put on external flexibility than on internal flexibility	

Box 1**The Benchmarking Group recommendations****1. Non-linear decreases in the social contribution rates (low wages) preferred to the development of the low wage sector:**

- Less pressures on gross wage levels, adverse redistributive effects if low wages counterbalanced by EITC, preservation of the collective bargaining grids.
- An open question: employers' or employees' social contribution rates? :
 - no differentiated effects in the German econometric literature: uncertain effect.
 - If demand size > supply side effects: wage moderation would be necessary (ZEW)
 - If supply side > demand size effects: trade union may call for the introduction of a minimum wage (Kaltenborn).

2. Social protection financing reform (social contributions taxes, Danish example)

- Avoiding implementation of specific ALMP programs (dead weight and displacement effects).
- Abolition of the Mini jobs regulation (reduced social rights).
- Concentrating on general measures in favour of employment ("first market").

3. Complementary measures

- Qualification measures within ALMP (in order to avoid traps).
- Benefit system reform (rights and duties, activation)
- PES reform (new public management).

Second period: March 2002-March 2003

It was only in spring 2002 that the reform process was really launched. In the meantime, the government had shown its inability to bring down unemployment and three-way negotiations had failed in the face of union refusal, particularly by IG Metall, to renew pay restraint commitments made in 2000. A scandal had also revealed serious irregularities in the Federal Employment Office's job placement statistics. All these factors supported the idea that a radical modernisation of employment policy was needed, and this was entrusted to a commission of experts led by Peter Hartz, Head of HR at Volkswagen. His proposals, published in August 2002, were mainly drafted "with union approval" due to the fear of even more radical reforms if a centre-right coalition won the elections. The proposals led to the reform of the Public Employment Service (Hartz I) and the creation of mini-jobs (low

income jobs under 18 hours per week) and midi-jobs (between 19 and 25 hours per week) (Hartz II).

Third period: March 2003 - autumn 2005

Three-way negotiations on the proposed employment alliance failed and there was no longer a consensus on the new Agenda 2010 measures announced in March 2003. They led to a reform of the law on dismissal (Hartz III), to the reduction of the period during which unemployment insurance benefits can be received (Hartz IV) and to new labour market reforms.

Fourth period: beginning autumn 2005

In many aspects, the “grand coalition” (CDU-CSU and SPD) which resulted from the September 2005 general elections is carrying on the work of the previous government. The main objective is still to reduce social security contribution rates to below 40%. The two-point reduction of the unemployment contribution (to 4.5%) should partly be compensated for by an increase in the VAT rate (from 16% to 19%) in 2007. Several measures aim to toughen up means-testing for the new social assistance benefit in order to curb the costs associated with the increase in the number of benefit claimants. The SPD is proposing that a minimum wage should be established and the CDU, meanwhile, is proposing a combined salary (Kombilohn): this is a set of measures aiming to reduce social security contributions for those on incomes below the contract minima. The CDU has obtained a change to the length of the trial period for new recruitment on permanent contracts (from six to twenty-four months) and *quid pro quo* has ended the system of simplified fixed-term contracts. However, this measure was criticized within the coalition itself on the grounds that it would not make labour law more flexible, and due to this has been postponed. However, the measure did not provoke an outcry from the unions, as they were relieved that CDU plans to review existing protection rights for workers (ending of the principle of favourability to the employee, possibility of overriding agreements being negotiated with the board) had been abandoned. Finally, this period witnessed the start of a debate on the minimum wage.

Reform content

The reforms mainly dealt with unemployment benefit, “activating” the unemployed and making employment protection legislation more flexible¹. They also aim to increase labour market flexibility (see Box 2).

The reform of the unemployment benefits system reduces the maximum period during which benefits can be claimed from thirty-two to eighteen months and reduces from three to two years of employment the period used to calculate whether someone is eligible to receive benefits. The most important changes concern the long-term unemployed. The so-called “Hartz IV” law merged social assistance benefits with unemployment assistance benefits into a new fixed minimum income, called Unemployment Benefit II. Claims for this benefit are based on need and in the majority of cases, the amount received is lower than the old unemployment assistance benefit; another requirement is that the claimant is actively seeking work.

Box 2

The Benchmarking Group recommendations

The reforms: main orientations

1. Increase the effectiveness and efficiency of PES and ALMP programs
2. Activating the unemployed, with emphasis on long term unemployment
3. Deregulation of non-standard forms of employment (periphery)
 - of all restrictions for temporary work,
 - increased number of exemptions for fixed-term contracts,
 - increase in the firms' size threshold for exemption from the dismissal protection.
4. More (supply side) incentives: mini jobs, introduction of midi jobs.
5. Wage bargaining system autonomy preserved (in principle).
6. No compensation in form of expansionary fiscal policy: in contrast to the Benchmarking group conclusions

Reforms of the Public Employment Service aim to increase the efficiency and the effectiveness of its job seeker support policy. Employment agencies have become Job Centres with the idea being to set up one-stop shops at a local level, which would manage the new means tested benefits. They implement objective-based management and give more responsibilities to local agencies, which are becoming customer reception centres with increased staff – customer ratios. The reforms facilitate the use of external operators with the introduction of an agency credit voucher and agency training voucher and the implementation throughout Germany of Job Placement Agencies (*Personal Service Agenturen*) close to job centres. Active policy measures have been reformed in favour of increased targeting of disadvantaged groups and must now undergo an evaluation.

Activation plans have been implemented but are only compulsory for the long-term unemployed, resulting from the new unemployment benefit system II. Eligibility conditions for receiving unemployment benefit have been toughened up. Job seekers have to register earlier with the employment agency and unless they have a compelling reason not to, have to accept a job anywhere in Germany. Burden of proof has been reversed, as it is now down to the unemployed person to demonstrate that the job offer is unacceptable if s/he does not wish to be subject to sanctions, which are now scaled. For the long-term unemployed, job acceptability conditions have been considerably toughened up compared with the former unemployment benefits system. All job offers are now considered as suitable, including those, which are paid at a level below collective standards, such as the “1 Euro jobs” (community-service work paid at an extremely low hourly rate). The only lower wage limit is that of a salary contrary “to morality”. In order to make going back to work more attractive, there are more multiple job-holding opportunities.

The reforms implement new back-to-work incentives while focusing on integration into the primary labour market. They make the *mini jobs* system more flexible and created a midway point (*midi jobs*) for salaries between 400 and 800 Euro per month. The aim is to encourage the unemployed and those who are not working to get back to work, via more flexible worker social security contributions. Those with mini jobs are totally exempt from paying social security contributions and those with midi jobs have partial exemption with a progressive increase in rates, aiming to limit the threshold effect. The reforms also include a new set of assistance measures for those wishing to set up individual micro-enterprises (*Ich AG*).

Finally, all restrictions on temporary work have been removed. The threshold from which protection against dismissal is applied - which determines the conditions of fair or unfair dismissal - has been increased from five to ten employees and the age limit at which no objective reason has to be given for renewing the simplified fixed-term contract for a limitless period is reduced from 58 to 52.

Clearly, the objective is to absorb long-term unemployment, reduce the demands of the unemployed (including the minimum salary people are willing to work for) and to facilitate reintegration into the labour market, even if this is not on a standard full-time employment contract. The reforms are therefore consistent with the objectives set out in the expert group report, apart from three exceptions, which also deviate from the proposals made by the 1999, and 2001 Benchmarking group. The reduction in social security contribution rates for low-waged jobs is not incorporated into the general contributions system but is specific to certain forms of non-standard contracts (mini and midi jobs). The budget only partially compensates for the exemptions, meaning that workers have reduced benefit rights, especially for mini jobs. The general aim is to reintegrate people into the labour market at wage levels below those of collective agreements via targeted sets of employment policy measures.

The minimum wage debate

The major changes to the negotiation system and in particular the drop in the collective agreement coverage rate, as well as the appearance of the phenomenon of *the poor employed* has led several unions (Ver.di and NGG) to put forward the idea of a standardised minimum wage. In January 2006, they led a campaign in favour a minimum hourly wage of €7.50, which should be raised, to €9.00.

However, this was not universally supported. Other unions, particularly IG Metall and IG BCE, see it as a threat to collective bargaining in the sense that a standardized minimum wage would be lower than the contract minimum in several sectors. During its conference, the DGB adopted a compromise position in favour of a legal minimum wage of €7.50 per hour, while reaffirming the need to boost collective bargaining.

The employers' confederation (BDA) sees the minimum wage as a form of social assistance and is proposing that it should be set at a much lower level: €4.90 per hour for a full-time job, €9.30 for a couple. The Grand Coalition government is also divided on the issue. Michael Glos, the Minister of the Economy (CSU), is against the very principle of a

minimum wage. Franz Müntefering, meanwhile, opposes a standard minimum wage and favours a combined model (Kombilohn).

Evaluating the reforms

It is still too early to make an overall assessment of these reforms, which are subject to a long evaluation process that is not yet fully completed. The available empirical and theoretical evidence does however show that in the short term the negative effects of the structural reforms of the labour market are generally winning out over the positive effects¹. Based on information available mid-2006 and the first public evaluation report on the Hartz laws¹, it is however possible to make some comments.

The effort to rationalise government spending is clear. While remaining relatively stable between 1998 and 2002, the share of GDP allocated to spending dropped by 0.16 points between 2002 and 2004, mainly due to the drop in professional training expenditure. The reorientation of employment policy in favour of reintegrating people into the labour market is also clear to see. Assisted non-commercial jobs represented 53% of the total number of assisted jobs in 2000; that share fell to 36% in 2005.

The employment policy has made a major contribution to increasing the share of non-standard jobs (including mini jobs). Between 2000 and 2005, net job losses increased throughout the economy to 366,000 (see Table 1). Over the same period, net creation of mini jobs (not including multi-activity employment) rose to 660,000, creation of non-waged jobs to 439,000 (of which almost two thirds benefited from business set up funding). In 2005, out of the entire workforce in assisted waged jobs, 87% were being paid wages below standard contract levels. Micro-economic evaluations show that the reforms have had quite a positive effect on the effectiveness of employment policy measures, particularly in terms of the likelihood of reintegrating the labour market. However, the majority of studies also agree that there will be major windfall gains and substitution effects.

Conclusion

In summary, we can draw some conclusions from the German reforms. The main objectives were and remain 1) to reduce labour costs and 2) to absorb long-term unemployment. The reluctance shown by both the unions and a large section of the political class to go about this by reforming funding of social protection has meant that employment policy has had to be the main arena for reforms. The reforms have therefore mainly taken

place on the edge of the labour market: the long-term unemployed and those receiving non-contributory benefits rather than the short-term unemployed; low-wage jobs rather than the standard employment contract. Yet, in the absence of a legal minimum wage, replacing commercial posts (with levels of pay, which fall short of contract minima) with standard jobs contributes to pushing overall wages down. By accentuating the deflationist pressure, which has been present for around ten years in Germany, the reforms have indirectly weakened the very heart of the labour market, and now threaten positions held by insiders. By breaking with the negotiated strategies, Germany has introduced two forms of insecurity: a first form being objective, on the edge of the labour market, and the second being economic, on the path towards reforms.

Box 3

Provisional assessment and further steps of the reforms

The Bundesregierung Report (January 2006) shows very mixed results for the PES and Hartz I to III reforms and indicates a posteriori relevance of the Benchmarking group conclusions:

- evidence of dead weight effects,
- dominating supply side effects,
- inefficiency of midi and mini jobs as labour market instrument.

The evaluation for Hartz IV is yet to come.

Further steps (great coalition program):

- Decreases in social contribution rate remains main objective with a decrease in unemployment social contribution rate (6.5 % to 4.5 %) compensated by a VAT rate increase in 2007 (16 % to 19 %),

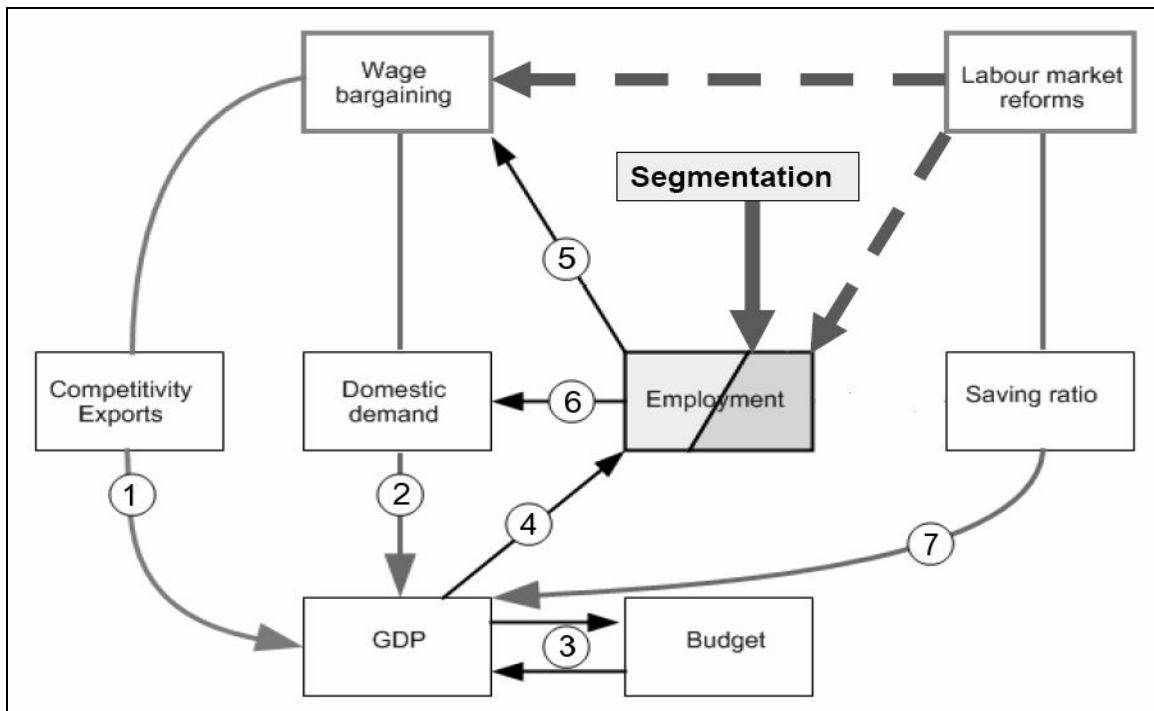
Further restrictions in the benefit system (insurance + assistance).

- Forthcoming reforms of welfare state unavoidable.
Kombilohn model to be developed (CDU) and/or Minimum wage to be discussed (SPD)

In compensation of re affirmation of untouched bargaining system (favour principle, derogatory agreements): deregulation of open-ended contracts.

- Further consolidation of public finances, partly balanced by an investment program (25 billions € over 4 years = 1.1% of 2005 GDP).

Diagram 1: Macro – micro relationship



The relationship between the reforms and the macroeconomic framework can be summarized by Diagram 1, which is based on three factors:

- Wage bargaining
- Budget
- Wage bargaining

The results of wage bargaining determine the GDP through two channels:

- (1) The effect of wages on competitiveness
- (2) Its effect on domestic demand

Budget policy also influences the development of the GDP (3).

The level of GDP determines that of employment (4) which itself influences wage bargaining (5) and domestic demand (6).

Labour market reforms will transform this overall diagram in the following two ways (—→):

- by changing the conditions for wage bargaining.

-by changing the structure of employment which in turn influences the development of the savings ratio (7).

The effect of these transformations will largely be contingent upon the degree of employment segmentation, which influences household and employer behaviour. In that situation there are two possible scenarios.

The optimistic scenario is that of a "U-curve". After a phase of adjustment during which negative effects will prevail on overall employment, positive effects on competitiveness (already achieved) and on the dynamics of the domestic market (to come?) will win out. The structure of the model – in particular the degree of segmentation - will stabilize.

The negative scenario, however, would be if an overall positive effect on employment does not occur and long-term increased segmentation of both the labour market and the whole of society takes place. In both scenarios, the question of the relationship between the effects of reforms and the macroeconomic framework occupies a central place.

Conclusions from the qualitative questionnaire

In this specific case, we are working with a reduced sample of responses to the questionnaire. However, the sample is sufficiently diverse (DGB, BMAS, Research Institutes) to enable us to summarize the views, which were expressed in the interviews.

Generally, respondents had an unfavourable opinion of macroeconomic performance, with a score of 0.6 on a scale ranging from 0 to 4. The contribution of wage share development to this macroeconomic performance receives a lower than average score for the short term (1.6) but is around the average (2.4) for the long term. We can therefore state that there is a relative amount of confidence regarding the existence of a "U-curve" for the effects of labour market reforms on macroeconomic performance.

In terms of flexibility, pre-reform opinions are relatively uniform, with a more positive opinion of internal flexibility (2.5) as opposed to scores ranging from 1.8 to 2 for other forms of flexibility. For internal and functional flexibility, respondents anticipate that reforms will have little effect and the score hardly changes. On the other hand, external flexibility and wage flexibility have clearly progressed. In other words, our respondents forecast that the labour market will be in a better position compared with the rest of the European Union in terms of those two types of flexibility.

Regarding job and income security, pre-reform opinions were clearer cut: high levels of security in terms of income (3.2), average for employment (2) and poor for combined security (1.5). Employment security should not be changed by the reforms, but revenue security is perceived to clearly deteriorate (from 3.2 to 1.4) as does combined security, albeit to a lesser extent (from 1.5 to 1.0).

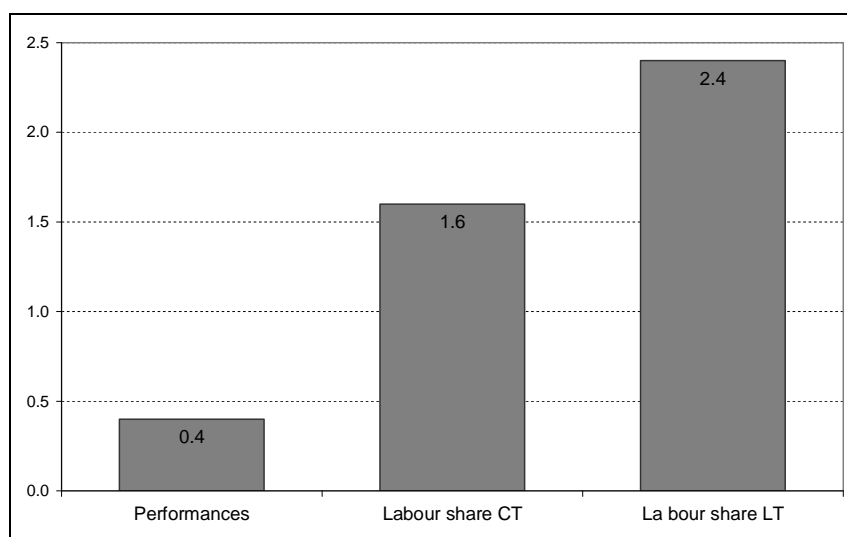
The big picture confirms relatively convergent opinions on the effect of the reforms: the reforms should accentuate the more “standard” forms of flexibility (external and wage) and worsen security indicators, particularly in terms of income.

A - Macroeconomic performances

A1. How do you assess the overall national macroeconomic performances of your country over the last decade?

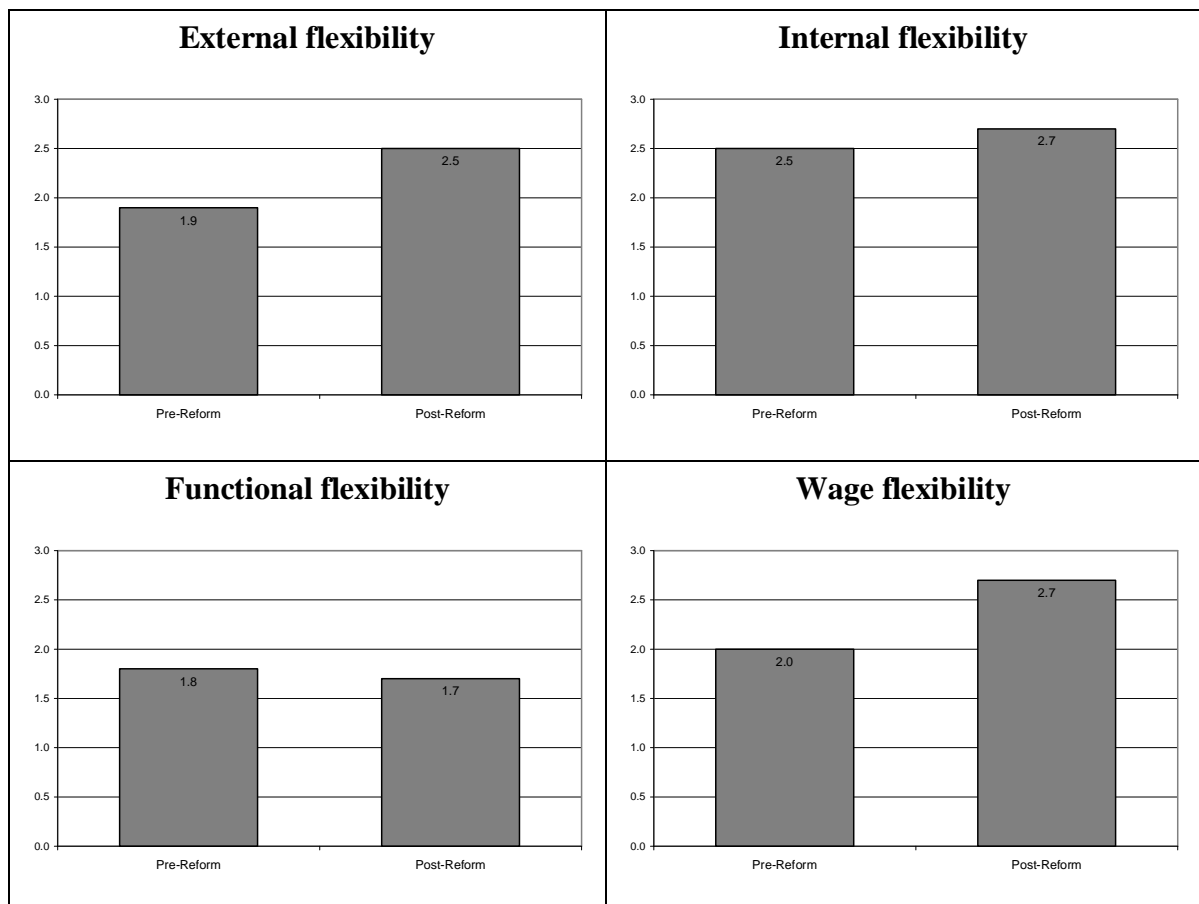
A2. Do you consider that the labour share evolution over the last decade in your country has given impetus to short-term macro-economic performances in your country?

A3. Do you consider that the labour share evolution over the last decade in your country will give impetus to **long-term** macro-economic performances in your country?



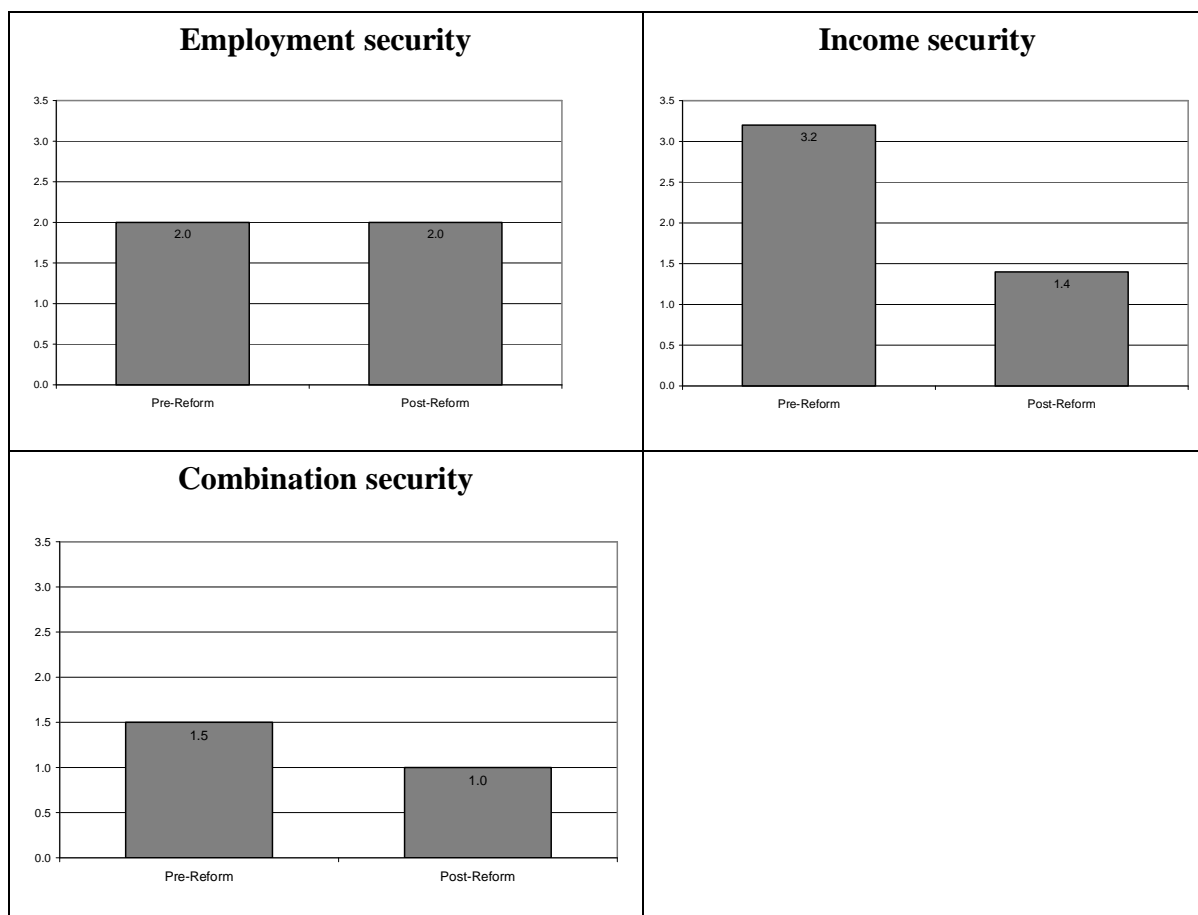
B1. Flexibility

B1. How do you assess the position of your country (in comparison with the EU15) in the pre-reform/post reform situation with regard to flexibility?



B2. Security

How do you assess the relative position of your country (in comparison with the EU15) in the pre-reform situation with regard to security?



Box 4

Main conclusions from the interviews

Poor macroeconomic policies leading to an unbalanced mix.

Pessimistic view for the short run: economic recovery would be threatened by the effects of increases in VAT (2007).

A long-term adjustment, which "mops" the effects of unification.

The forecast is more optimistic: the cleaning up once accomplished, conditions of a more balanced growth will be met.

The European dimension

- General agreement on **the effect of the European unification** which has abolished or restricted two instrument of macroeconomic policy: monetary policy and, to a certain extent, budgetary policy.
- In relation with the **Stability Pact**, the German position consists in invoking the specific burden of unification, and asking for a staggering in the time of return to 3 % criterion.
But this one is not called into question.
- European orientations are **not perceived as an essential determiner** of policies led in Germany, notably the structural reforms.

Appendixes

1. Interviews
2. General framework for interviews
3. Simplified framework for interviews
4. Questionnaire
5. Main reforms in Germany
6. Main findings of the evaluation literature on the specific ALMP programmes
7. Main targeted Almp programmes in Germany

Appendix 1: Interviews

BMAS Bundesministerium für Arbeit und Soziales	Katja LACK Friederike HESSE Roland LANG-NEYJAHR	Berlin, March 29, 2006
BDA Bundesvereinigung der Deutscher Arbeitgeberverbände	Hans-Jürgen VÖLZ Alexander WILHELM Ms BARLAGE-MELEBER	Berlin, March 28, 2006
CDU	Ralf BRAUKSIEPE (MP)	Berlin, March 28, 2006
DGB Deutscher Gewerkschaftsbund Bundesvorstand	Andreas BOTSCH Ingo KOLF	Berlin, March 27, 2006
Die Grünen Bundestagsfraktion	Brigitte POTHMER (MP) Arne BAUMANN	Berlin, March 29, 2006
IAB Institut für Arbeitsmarkt und Berufsforschung	Knut EMMERICH Michael FEIL Johann FUCHS Elke JAHN Susanne KOHAUT Thomas RHEIN Gesine STEPHAN Ulrich WENZEL	Nürnberg, April 25, 2006
IMK Institut für Makroökonomie und Konjunkturforschung	Gustav HORN Rudolf ZWIENER	Berlin, March 27, 2006 Düsseldorf, April 24, 2006
SPD	Gerhard FISCH	Berlin, March 28, 2006
VER.DI Vereinte Dienstleistungs-gewerkschaft	Ralf KRÄMER	Berlin, March 27, 2006
WSI Wirtschafts- und Sozialwissenschaftliches Institut	Hartmut SEIFERT Thorsten SCHULTEN	Düsseldorf, April 24, 2006
WZB Wissenschaftszentrum Berlin für Sozialforschung Gemeinnützige Gesellschaft	Michael NEUGART	Berlin, March 29, 2006

Appendix 2: General framework for interviews

A. MACROECONOMIC PERFORMANCES

1. Assessment: what is your personal assessment of the national growth and employment performances during the last decade?

1.1. Relatively to the potential performances of the country

1.2. Relatively to foreign references: USA and EU average

2. Diagnosis: what are the obstacles to best and / or more stable performances (or the factors explaining high and stable performances) you consider as major?

2.1. Structural specific-country factors?

2.1.1. Demographic growth (natural and migration)

2.1.2. Technical progress and productivity gains

2.1.3. Productive specialisation and employment structure

2.2. Functioning of national labour market and / or goods and services markets?

2.2.1. Wages bargaining system and wages dynamics

2.2.2. Employment and labour regulation, quality of jobs and transitions

2.2.3. Competition on goods and services market

2.2.4. Tax wedges and social protection

2.3. Specific obstacles to productive investment?

2.3.1. Internal demand or / and profitability

2.3.2. Financial and fiscal incentives

2.3.3. Restructuring, foreign investment, relocation

2.4. Macroeconomic and public policies?

2.4.1. Exchange rate

2.4.2. Policy mix and public debt

2.4.3. Efficiency of public sector

2.5. Interaction with EU or / and euro area?

2.5.1. Maastricht criteria and stability pact

2.5.2. Specific inside euro area competition

B. REFORMS

3. Policies and reforms

3.1. During the last decade, what policy changes or reforms do you consider as having developed systemic or persistent effects for growth and employment performances?

3.1.1. General policy changes / reforms

3.1.2. Employment and labour market policy changes / reforms

3.1.3. Social protection policy changes / reforms

3.2. Do you consider the relation between national policies / reforms and European processes effective?

3.2.1. In the case of the Broad Economic Policy Guidelines

3.2.2. In the case of the European Employment Strategy and the Lisboa Strategy

3.3. What is your assessment of the present reforms in your country for future performances?

3.3.1. Employment and labour market reforms

3.3.2. Social protection reforms

3.4. What is your assessment of the "national reform program" incorporated to the new European "integrated guidelines»?

3.4.1. Assessment of the procedure

3.4.2. Assessment of the content

3.5. What are your main recommendations concerning necessary reforms? What technical and socio-political obstacles do you perceive if front of these recommendations?

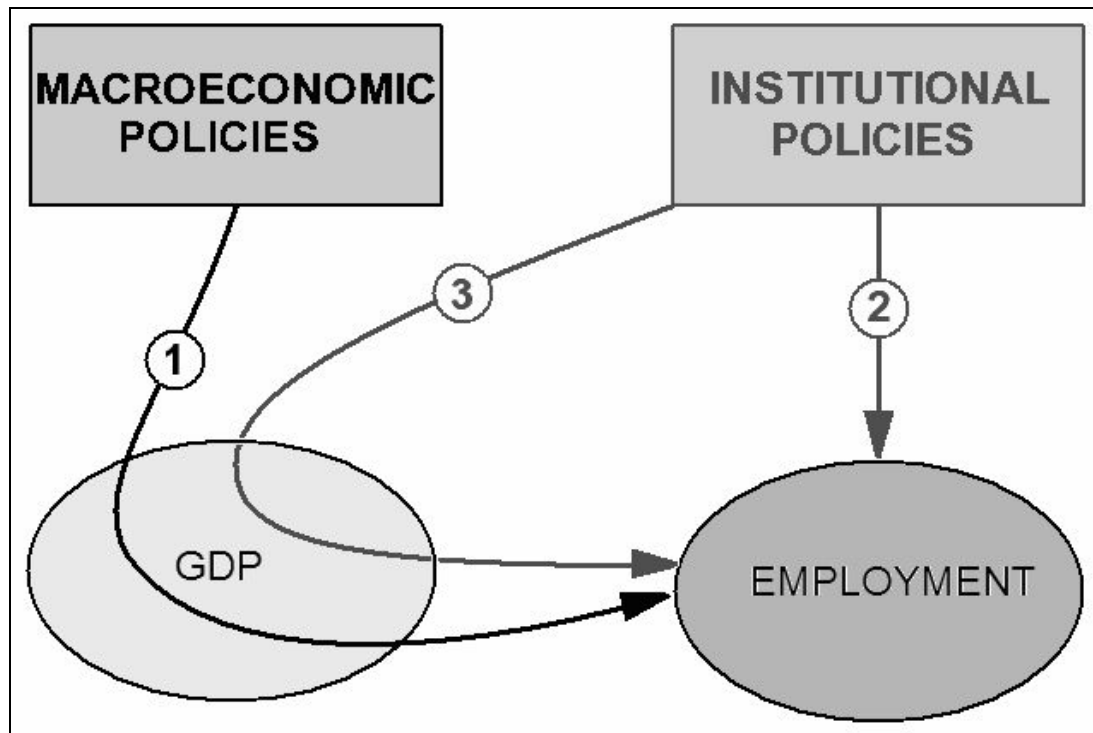
Appendix 3: General presentation of the interview framework

IRES (The Institute for Economic and Social Research) is participating in a research programme which is part of the SALTSA programme (*The National Institute for Working Life and The Swedish Trade Unions in Cooperation*) and which is jointly managed by Swedish academic staff and union members. The aim of the project is to evaluate economic and employment policy performance in Europe using a comparative approach based on four countries: Germany, France, Sweden and the United Kingdom. Researchers from different countries are taking part in the programme.

Within this framework, we plan to interview different actors including Government, political parties, unions, employers and research institutes. The general framework for our interviews is set out below. In order to facilitate reading, we would really like to insist upon the fact that our objective is not to obtain an extremely general analysis of German performance – a topic that we already know about as Germany specialists, but to obtain, thanks to these interviews, a greater understanding of how these problems are ranked in Germany by the different actors.

These interviews will therefore be focused on two issues.

- 1) Out of all the transformations which have taken place over the last ten years, which has had the greatest impact (positive or negative) on the performance of the German economy?
- 2) The performance can be analysed as a mix of macroeconomic orientations and institutional reforms, which mainly affect the labour market: how do you assess and rank these different measures and how would you describe the way they combine?



Appendix 4 : Questionnaire

A. NATIONAL MACRO-ECONOMIC PERFORMANCES

A1. How do you assess the overall national macro-economic performances of your country over the last decade?

Items	Codification	Notation
Negative	- -	
	-	
	0	
	+	
Positive	+ +	

A2. Do you consider that the labour share evolution over the last decade in your country has given impetus to short-term macro-economic performances in your country?

Items	Codification	Notation
Low impetus	- -	
	-	
	0	
	+	
High impetus	+ +	

A3. Do you consider that the labour share evolution over the last decade in your country will give impetus to **long-term** macro-economic performances in your country?

Items	Codification	Notation
Low impetus	- -	
	-	
	0	
	+	
High impetus	+ +	

B. REFORMS

We propose you, concerning labour market and social protection reforms, the following “flexicurity matrix” (taken from Wilthagen/Tros/Van Velzen)

Flexibility/security trade offs

<div>SECURITY</div> <div>FLEXIBILITY</div>	Employment security	Income Security	Combination security
	(employability, ALMP, placement services)	(benefits)	(work-family balance, leave facilities)
External numerical flexibility (easy hiring, easy firing, external turnover)			
Internal numerical flexibility (shift work, hours)			
Functional flexibility (internal turnover, mobility)			
Wage flexibility			

B1. How do you assess the position of your country (in comparison with the EU15) in the pre-reform/post reform situation with regard to flexibility?

External flexibility

Items	Code	Pre-reform	Post-reform
Low	--		
	-		
	0		
	+		
High	++		

Internal flexibility

Items	Code	Pre-reform	Post-reform
Low	--		
	-		
	0		
	+		
High	++		

Functional flexibility

Items	Code	Pre-reform	Post-reform
Low	--		
	-		
	0		
	+		
High	++		

Wage flexibility

Items	Code	Pre-reform	Post-reform
Low	--		
	-		
	0		
	+		
High	++		

B2. How do you assess the relative position of your country (in comparison with the EU15) in the pre-reform situation with regard to security?

Employment security

Items	Code	Pre-reform	Post-reform
Low	--		
	-		
	0		
	+		
High	++		

Income security

Items	Code	Pre-reform	Post-reform
Low	--		
	-		
	0		
	+		
High	++		

Combination security

Items	Code	Pre-reform	Post-reform
Low	--		
	-		
	0		
	+		
High	++		

Appendix 5: Main reforms in Germany

5.1. Benefits

2001	Insurance benefits	Activation (December 10, Job Aktiv Law) Introduction of an activation plan.
2002	Insurance	Availability criteria and sanctions (December 30, Hartz I Law) <i>Availability</i> : Early registration of jobseekers. <i>Definition of suitable jobs</i> : stricter criteria for geographical mobility. <i>Sanctions</i> : Introduction of gradual sanctions, burden of proof on the jobseeker.
2002		Work incentives (December 23, 2002 Hartz II Law) Reform of the mini jobs, introduction of midi jobs.
2003	Insurance	Entitlement (December 27, Hartz III Law) Reduction in the number of years for calculating the contribution period. Participation in ALMP ceases to renew benefit entitlement.
2003	Insurance	Availability criteria and sanctions (December 27, Hartz III Law) Introduction of sanctions in the case of improper job search efforts.
2003	Insurance	Benefit duration (December 24, 2003 Law reforming the labour market) Reduction in the benefit duration for older jobseekers (18 months, instead of 32 months, from February 2006 on).
2004	Insurance	Benefit level (December 29, Hartz IV Law) Reform of the reference wage calculation.
2004	Insurance	Activation (December 29, Hartz IV Law) Reform of income imputation from reduced activities.
2004	Unempl. assistance and social assistance	Entitlement, availability criteria, sanctions, benefit level, activation (December 29, Hartz IV Law) Merger of the former unemployment assistance benefit and social aid benefit into a single unemployment benefit (<i>Arbeitslosengeld II</i>) for assistance needy persons capable to work.
2005	Assistance	Activation (August 14, Law reforming imputation of income for recipients of Unemployment benefit II) Reform of the imputation of income for reduced activities for recipients of the unemployment benefit II.
2005	Assistance	Benefit level (December 2, Law Project on harmonisation of the Unemployment benefit in Western and Easter Länder) Harmonisation in the benefit levels for Easter and Western Länder recipients.

5.2. Employment services

2002	<p>Activation (Job Aqktiv Law, in force 1.1.2002).</p> <p>Beginning of the re-assignment of PES staff from administrative tasks to job placement including : - intensification of job search monitoring ; - qualitative profiling of newly registered job seekers' strengths and perspective ; - written agreement between the jobseeker and the local employment agency ("integration agreement", "Eingliederungsvereinbarung").</p>
2002	<p>Outsourcing (Job Aqktiv Law, in force 1.1.2002 and 1.3.2002 for the vouchers)</p> <p><i>Placement can be outsourced to private agencies.</i> Introduction of placement vouchers. Reformed in 2005: tighter conditions for the payment of bonus to private operators.</p>
2003	<p>Outsourcing (Hartz I Law, in force : 1.3.2003)</p> <p>Establishment of for-profit subsidised temporary work agencies at every public employment agencies (Personal Service Agenturen, PSA) designed at bring unemployed into work and organizing additional training</p>
2003	<p>Activation (Hartz I Law, in force 1.7.2003)</p> <p>Early registration to the employment agency.</p>
2004	<p>Organisational reform of the PES (Hartz III, in force 1.1.2004)</p> <p>Reform of the Federal Employment Agency. Transformation of the local employment agencies into "customer service centres of the future" ("Kundenzentrum"). Introduction of a management by objectives approach. Definition of performance targets for local offices and introduction of control of their placement performance</p>
2005	<p>Activation (Hartz IV Law, in force 01.01.2005)</p> <p>Integration agreements become mandatory for recipients of the new unemployment benefit II.</p>
2005	<p>Organisational reform of the PES (Hartz II (in force 1.1.2005)</p> <p>One-stop shops responsible for the benefits and job placement of the long term unemployed become operational (Job-Centres).</p>

5.3. Employability (Active labour market programs, vocational training)

1998	<p>ALMP</p> <p>With the abolition of the Labour promotion Act ("<i>Arbeitsförderungsgesetz</i>", AGF) and the introduction of the Labour Code III ("<i>Sozial Gesetz Buch III</i>"), evaluation of ALMP programmes becomes compulsory.</p>
1998	<p>Vocational training (and unemployment benefits)</p> <p>Participants in further vocational training cease to regain unemployment benefit entitlement.</p>
1999	<p>ALMP</p> <p>Specific programme for young (up to 25 years old) "JUMP", reformed in 2003 (JUMP +). Objective: 100 000 training/job opportunities in the non-business sector (cities).</p>
2002	<p>ALMP (Job-Aktiv Law, in force since 1.1.2002)</p> <p>Turn of the ALMP towards activation and more pre-emptive measures: activation of the young after 6 months at latest, of older unemployed after 12 months.</p>
2002	<p>Vocational training (December 30, 2002 Hartz I Law, in force : 1.3.2003))</p> <p>Introduction of training vouchers ("<i>Bildungsgutscheine</i>"): increased role of external operators in the further vocational training.</p>
2002	<p>ALMP (and placement) (December 30, Hartz I Law, in force : 1.3.2003)</p> <p>Establishment of for-profit subsidised temporary work agencies at every public employment agencies ("<i>Personal Service Agenturen</i>", PSA) designed at bring unemployed into work and organizing additional training.</p>
2002	<p>ALMP ((December 23, 2002 Hartz II Law, in force : 1.1.2003 and 1.4.2003)</p> <p>Introduction of a new program designed to help the creation of small enterprises by unemployed (so called "<i>Ich AG</i>"). Objective: to enhance the production of personal household services, to reduce the production of these services by the shadow economy.</p>
2003	<p>ALMP (December 27, 2003 Hartz III Law, in force 1.1.2004)</p> <p>Merger of two direct job creation schemes (ABM and SAM) into a single new ABM programme. Vocational training no more compulsory, participants cease to regain unemployment benefit entitlement.</p>
2003	<p>ALMP (December 27, 2003 Hartz III Law, in force 1.1.2004)</p> <p>Tighter targeting of one of the subsidised employment scheme in the profit-making sector (integration subsidies, "<i>Eingliederungszuschuss</i>").</p>
2003	<p>ALMP (December 29, 2003 Hartz IV Law, in force 1.1.2005)</p> <p>Creation of a new ALMP programme (so called "1 € jobs"), aimed at providing working opportunities of public interest to recipients of the new unemployment benefit II.</p>
2004	<p>Vocational training (June 16, 2004 bipartite (government and representatives of employers) pact on apprenticeships)</p> <p>Commitment of employers to create new opportunities over the next three years.</p>

Appendix 6: Main findings of the evaluation literature on the specific ALMP programmes

Programmes	Effects
Labour training measures	<p>Lock in effects in the short run.</p> <p>Low, but positive effects in the long run for long run training programmes.</p> <p>More positive effects for work-training related schemes than for full-time school/academic programs.</p> <p>Need for tight targeting of the programmes.</p> <p>Important costs.</p>
Direct job creations	<p>Low or negative long run effects.</p> <p>Adequate for fulfilling social politics integration aims, or as a work test for unemployment benefit claimants.</p>
Subsidised employment in private sector (employer)	<p>Important dead weight and displacement effects (90% in some cases, reduced to 70-80% in case of tight targeting to special groups and intense monitoring of employer behaviour.</p>
Subsidised employment (employees incentives)and in work benefits	<p>Low or non-significant effect.</p> <p>Difficulties to reach the target of low qualified and long term unemployed.</p> <p>Impact of in work benefits depending on their interaction with other benefits (important heterogeneity effects) (EC 2004, p 357)</p>
Support for start-up	<p>Positive effects in case of targeting on relatively well educated unemployed.</p> <p>Consequently, important dead weight effects.</p>
Participation in ALMP interaction with unemployment benefits	<p>Impact increased in case of combination of compulsory participation, sanctions and incentives.</p>
PES: Jobseekers' counselling and placement in combination with tighter unemployment benefit receipt conditions	<p>Reduces lock-in effects.</p> <p>Relatively high incidence of counselling and placement services on the probability of exit from unemployment, particularly in conjunction with compulsory activation plans and generous benefits.</p> <p>Counselling and placement services effects increased in case of strict monitoring of the job search and application of negative sanctions on the receipt of unemployment benefits.</p> <p>Impact on re-employment earnings: potential high paid workers are relatively well able to respond to re-enter work, but at the cost of accepting lower pay.</p> <p>Relatively low implementation costs.</p>

Sources: Konle-Seidl Regina: "Lessons learned. Internationale Evaluierungsergebnisse zu Wirkungen aktiver und aktivierender Arbeitsmarktpolitik", IAB Forschungsbericht N°9/2005, Grubb and Martin 2001, OECD 2005 (Benefits and Employment, Friends or Foe? Interactions Between Passive and Active Social Programmes", OECD Employment Outlook, 2005), Caliendo and Steiner 2005.

Appendix 7: Main targeted ALMP programmes in Germany

Programme	Year	Duration/Type of measure	Target group
Training			
Measures to improve prospects of integration - training measures ((Eignungsfeststellung + Trainingmassnahmen)	1997 – (1992-1997, existed as a form of further vocational training)	Duration: Short training (max. 12 weeks). - Counselling of job search possibilities. - Assessment of the job seeker's skills, interest, employment prospect and aptitude - provide skills necessary for completing vocational training.	Unemployed (recipients of benefits or not).
Further vocational training (berufliche Weiterbildung)	Reformed in 1998, 2003, 2005 (Hartz III)	Duration: Up to one year in the absence of professional degree, up to two in the case of professional degree. Most of the programmes are full-time. Adjusting the skills of jobseeker's to changing requirement in their fields of profession. Subsidy: Payment of a maintenance allowance (Unterhaltsgeld), bearing of the cost of the programme, and of part of the additional expenses. Since 1998: no unemployment benefit entitlement. Since 2003 (Hartz I): partial imputation (50%) of the training period with regard to unemployment benefit duration, tighter targeting of the subsidy recipients. 2005- : merge of Unterhaltsgeld and UI Benefit.	Unemployed, employed with unemployment risk, low skilled.
Retraining (berufliche Wiedereingliederung)	Reformed in 1998, 2003	Duration: almost two years. In most cases full-time. Enabling jobseekers to structural changes by awarding a new professional degree. Subsidy: Payment of a maintenance allowance (Unterhaltsgeld), bearing of the cost of the programme, and of part of the additional expenses. Since 1998: no unemployment benefit entitlement. Since 2003 (Hartz I): partial imputation (50%) of the training period with regard to unemployment benefit duration.	Unemployed
Language courses (Deutsch-Sprachlehrgänge)	End of the scheme: Dec. 2004	Duration: up to six months (full-time), 12 (part-time). Specific language courses for immigrants. Income support, bearing the cost of the courses and part of the additional expenses. Since January 2005 and the enforcement of the new Immigration Law, formal language courses are no more subsidised within the framework of the employment policy (SGB III).	Unemployed, immigrants.

Vocational training allowance (Berufsausbildungsbeihilfe)	1940 -	Duration: 2-3 years. Income support for the participants in the regular vocational training system. Subsidy: means tested allowance (subsistence 443 €/month, 80 €/month for housing).	Trainees in companies.
Training voucher (Bildungsgutschein)	2003-(Hartz I)	Duration: 3 months. To give the possibility to the jobseeker to choose freely among further vocational training providers admitted by the PES	Unemployed (recipient of Unemployment benefit with 3 months of unemployment, employed in ABM),
Direct job creation (non business sector)			
Support for job-creation measures (Arbeitsbeschaffungsmaßnahmen) (old)	1969 -2003	Duration: one year, up to three in exceptional cases. Integration of long-term unemployed by mean of contracts of social interest. Subsidy: 30-100% of the remuneration (depending on the situation in the local labour market and the of the jobseeker). Vocational training: min. 20% of the duration period.	Until 2001: unemployment record of at least six months within the year preceding the ABM. 2002- : (Job Aqtv gesetz) abolition this criteria.
Support for structural adjustment measures (Strukturanpassungsmaßnahmen)	1998 (replacing previous programmes introduced in 1993 and 1994) -2003	Duration: up to three years, can be extended to four. Creation of jobs in economically weak regions. Flat rate wage-cost subsidy Integrated within new ABM since 2004.	Unemployed with bad employment prospects.
New Support for job-creation measures (Arbeitsbeschaffungsmaßnahmen)	2004-(Hartz III)	Duration: one years for persons below age 55, two years for older workers. Improving employability of persons in region with high unemployment. Objective of integration within the first labour market and creation of working opportunities for unemployed. Improving integration chances is no more compulsory. Subsidy: fixed monthly subsidy, differentiated by education level of the participant. (900, 1100, 1200 or 1300 €). Remuneration : obligation for the employer to provide an adequate remuneration Exclusion from UB entitlement. Vocational training: not compulsory.	Unemployed
Employment generating promotion of the infrastructure (Beschäftigung schaffende Infrastrukturförderung)	2002 –End 2008	Support project improving local infrastructure. Maximum wage-cost subsidy: 25%.	Unemployed.

Working opportunities Arbeitsgelegenheit nach §16 abs 3 SGB II (1 € jobs)	2005 – (September 2004 : beginning of a temporary programme in anticipation of the implementation of the Hartz IV law)	Duration: 6 to 12 months. Working opportunities of public interest, which have to be offered to Unemployment benefit II recipients who cannot find a job. Transfer of 1-2 € per hour, in addition to Unemployment benefit II ("Mehraufwandsvariante"). These activities have to be "additional", and not in substitution to other activities.	Unemployed, recipients of UB II.
Start-up incentives			
Bridging allowance (Überbrückungsgeld)	1985- Reformed 2004	Duration : six months Financial incentive to self-employment Allowance : level of Unemployment benefit + fixed payment for social security contribution. No public pension insurance Participation is subject to the success probability of the project.	Unemployed. Not available for recipients of UB II.
Business start-up subsidy (Existenzgründungszuschuss, so called Ich AG)	2003-(Hartz II)- end 2005 (initially planed for 2003- 2005, extended up to end 2007 in April 2005, back to end 2005 in September 2005) Reformed Nov. 2004	Duration : up to three years. Financial incentive to self-employment To help creation of small enterprises (up to 25 000 € yearly earning). Fixed monthly subsidy : 600 € first year, 360 € second year, 240 third year (corresponding to approximately 50%, 30% and 20% of the average UB benefit of 2002 (Caliendo and Steiner 2004) Payment to public pension insurance. Target people had a legal claim for the allowance until November 2004. Participation conditional to the success probability since November 2004.	Recipients of unemployment benefit, participants in ABM/SAM. Not available for recipients of UB II.
Employment incentives			
Integration subsidies (Eingliederungszuschüsse, EGZ)	1998 (for the new program), reformed 2004 (Hartz III)	Duration : six months , up to 12 months for difficult to place unemployed, 24 for older workers. Employer-based subsidy to low wage work. 2004- : tighter targeting of the program (people with integration difficulties and disabled). 2004- Subsidy : 50% of the wage cost (max. 12 months, up to 36 months for older workers), 70% (24 months) for disabled.	Long-term unemployed, older unemployed (aged 50 and over), disabled.

Recruitment subsidy for new businesses (Einstellungszuschuss für Arbeitslose bei Neugründungen, EZ)	1997 -	Duration : up to 12 months. Employer-based subsidy to low wage work. To help owners of new enterprises (no more than 5 employees) to hire unemployed. Subsidy : 50% of the wage cost.	Unemployed or in ALMP for at least three months.
Employment assistance scheme for long-term unemployed (Beschäftigungshilfen für Langzeitarbeitslose)	1989-2002	Employer-based subsidy to low wage work. To help reintegration of long-term unemployment in the regular market. Subsidy : 40 to 80% of the wage-cost, depending on the previous duration of unemployment.	Long term unemployed.
Personnel Service Agencies (Personal Service Agenturen, PSA)	2003- (Hartz I)	Duration : min. 9 months, up to one year. To bring the unemployed into work through TAW and to organize additional training and advice. Choice of the unemployed is responsibility of the PES. Subsidy to the PSA : lump sum fee per case (degressive over time) and placement bonus. Training compulsory during periods of inactivity. Remuneration :	Unemployed.
(Arbeitsentgelt zuschuss bei beruflicher Weiterbildung)			
Taking up money (Einstiegsgeld)	2005-	Duration : up to two years. Employee based subsidy. Transfer paid in addition to Unemployment benefit II for unemployed taking up insured employment (also when becoming self-employed). Amount depends on the duration of unemployment and the size of the households.	Unemployed, recipients of UB II.
Specific programmes			
Specific programmes against youth unemployment	1999-2003 : JUMP 2003-2004 : JUMP Plus 2005 : Grundsicherung für Arbeitsuchende" (Basic Security for Job Seekers)	Reintegration of young unemployed (under 25 years) into the regular labour market. Priority access of the target group to training and direct job creation schemes of cities.	Young unemployed (under 25 years of age) recipients of unemployment assistance benefit or of minimum social benefit or long term unemployed or in risk of long term unemployment.
Special programme: 'Work for the long-term unemployed' ('AfL') (Arbeit für langzeitarbeitslosen)	2003-2005	Reintegration of unemployed (over 25 years) into the regular labour market. Priority access of the target group to training and direct job creation schemes of cities.	Unemployed aged 25 and over, recipients of unemployment assistance benefit or of minimum

Source: ONS

CHAPTER 3

France: the difficulty of building consensus

Jacky FAYOLLE (Ires)

The mediocre nature of French performance regarding growth and employment is broadly considered by the interviewed personalities (see Appendix 1) to be an accepted fact. It is not dramatized as an absolute weakness: French performance is in line with that of the Euro zone and is partly related to the zone's difficulties concerning collective regulation. The mediocre nature of French growth is rather seen as a worrying trend towards weakening and stalling, compared with the most dynamic industrialised countries and the intensity of global growth. Inability to meet employment needs - which is illustrated by persistent unemployment – and unequal exposure to the risks of unemployment and job insecurity are perceived with gravity.

Four major kinds of explanation for this situation can be identified amongst the personalities who were interviewed.

1 Upstream from the labour market: insufficient quality of productive specialisation

The insufficient quality of productive specialisation in France is considered to be an intrinsic difficulty, which cannot simply be seen as being the result of labour market failure or economic policy errors. Compared with the United Kingdom, which marries state-of-the-art finance and commonplace services, and with Germany, which proves its ability to regenerate its industrial and export model, France suffers from an insufficiently asserted productive identity, even though it does have some strong points both in the service sector and in industry. France's competitive costs and prices benefited for a relatively long period - from the mid-eighties until the end of the nineties – from gains made by a policy of competitive disinflation, of which it was one of the best pupils. However, by their very nature, the gains were transitory, even if their effect could be lasting. Within a global economy and a Euro zone, where low inflation has become a shared norm, the real determining factors of competitiveness,

associated with the quality of specialisation and products, take precedence. Moreover, competitive disinflation has been able to conceal forms of adaptation, which count notably on the reduction of the pay bill and are now showing their limits, because they have not acted as a great incentive to proactive renewal of French specialisation.

The French economy has continued to live on the momentum of the major programmes that were inherited from the 1960s and 70s, but the combination of competitive disinflation and the new influence of the financial markets has not compensated for the exhaustion of industrial policies. Several soundly argued studies¹⁰ corroborate the view that French industrial potential is intrinsically waning and that the services sector is unable to take over as an autonomous driving force for growth. Artus and Fontagné (2006) indicate that it is difficult to understand the reappearance, over the last decade, of the French economy's competitive difficulties, compared with Germany, on the basis of the criterion of competitiveness of industrial costs alone. Competition hangs more on the ability to innovate and marry industry and services in the organisation of productive activity. The decline in France's market shares, especially in emerging markets, reveals the inadequate adaptation of the fine structures of its foreign trade to the trade flows, which drive global growth. French technology is too highly concentrated in a small number of sectors, such as aeronautics – a phenomenon that had already been identified in the Beffa report, *Pour une nouvelle politique industrielle* (2005). It is too weak in many high-tech activities (such as biotechnology). France is insufficiently specialised in high added value segments of value chains that are buoyant at international level.

The French economy does not lack big firms that are well established in global markets, from which they draw their prosperity. Nevertheless, these firms tend to operate as “closed worlds”, whose functioning depends mainly on their multinational location and is based on their own human resources management practices (careers, mobility and training within real internal markets). Their expansion and prosperity do not guarantee those of the national economy that is composed of a huge number of SMEs, which are facing more difficult obstacles when they are on the path to growth

¹⁰ The report of the Economic Analysis Council (Conseil d'Analyse Economique), *Désindustrialisation, délocalisation* by Fontagné et Lorenzi (2005) refers to the serious risk of a loss of industrial substance that surpasses the tendency towards distortion of productive structures; the report of the same institution *Evolution récente du commerce extérieur français* by Artus and Fontagné (2006) emphasises SMEs' difficulties in accessing international markets and thereby promoting a large variety of exported products.

and seeking to assert their market power internationally. These SMEs are vulnerable when their financial security depends primarily on the situation of the national market and local competitiveness – they do not have the ability to diversify risks, which big internationalised companies have. Entrepreneurial activities are shackled by a series of financial and regulatory constraints. The result is that French exports lack variety and imports are highly elastic, responding to each increase in domestic demand, given the constraints weighing on available supply within the country.

Shortcomings of the private sector and the extinction of industrial policy have led to an implicit absence of asserted choices regarding specialisation, which would be able to place the country in a good position as far as international competition is concerned. Financial incentives to create low-skilled jobs have not encouraged the promotion of high-quality specialisation. Promotion of personal services to individuals as an area of job creation meets certain needs, but cannot be considered as a contribution to the development of service activities that are factors of growth. Public policies that have been implemented over the past ten to twenty years are thus strongly called into question by the productive weaknesses of the French economy: they are suspected of not having developed the right incentives or - when they can be credited with commendable intentions (promoting the employment of the low-skilled) - of having transformed measures meant for managing transitional situations into permanent measures. It is true that this permanence has also been said to be necessary in order to encourage companies to recruit the unskilled on a long-term basis... The French economy is thus thought to have been locked in a rationale, whereby efforts to respond immediately to employment needs distance it from productive specialisation, which would promote the creation of high-quality jobs in high added value activities with great growth potential.

A recent report of the Montaigne Institute (2006), *Mondialisation: réconcilier la France avec la compétitivité*, systematizes this approach and makes recommendations¹¹. The current problem of competitiveness results from the fact that national productive organisation is not adapted to trade dynamics, which are driven by the increasing role of emerging powers within globalisation. French SMEs are insufficiently incorporated in the networks, which tend to structure “the new order of

¹¹ This report is quoted here, because it summarises many of the ideas expressed by the interviewees, especially on the employers' side.

productive activities” at global level. It is as much a societal, as an economic, problem. There is no intrinsic economic inevitability, as the major internationalised companies have in practice shown their ability to adapt. Nevertheless, the obstacles, which SMEs come up against, mean that they solicit the mechanisms of French organisation of industrial relations, because they are not able to create their own industrial relations world. To what extent is labour market failure – *a fortiori*, if the big firms cream off the highly skilled – likely to handicap SMEs more directly? Without exclusively blaming labour market failure – because it makes, for example, the shortage of capital contributions for growing SMEs and their access to public markets play an important role – the Montaigne Institute’s report does attribute specific responsibility to such failure: the labour market lacks diversity regarding the range of contractual relations, which are able to marry employees’ need for security and companies’ need for flexibility. The report puts forward the idea of “finalised employment contracts”, which have great legal flexibility and are complementary to (or competitors of) existing forms of contracts. It suggests “creating a set of public and private employment services, which are able to guarantee employee mobility”. The ability of the education system to promote the employability of pupils and students also seems to be a major challenge in the report.

The specific indecision hanging over the productive engine of French growth is felt by various interviewees: heads of companies, trade union officers and experts. Even if it is not a point of firmly established consensus, based on a shared diagnosis of its causes, it is, at least, a generally shared - though not unanimous - feeling. A country, which shows such weakness within the Euro zone, no longer has the lever of devaluation for re-establishing its competitiveness; nor does it receive direct financial incentives to rectify its situation. The way the zone functions allows for polarisation within it between countries with current surpluses or deficits, which are associated with different forms of growth. However, in the end, cohabitation of such systems and the limits of national tolerance towards chronic mediocre growth can be a problem for the zone’s viability.

Industrial policy is not the most contentious area between employers’ organisations and trade unions. Unions were able to get something out of major proactive industrial restructuring in the era of industrial imperatives and, recently, the Beffa report was rather positively received by the unions, as was the creation of the Industrial

Innovation Agency, which it originally proposed. However, on subjects that are related to industrial policy, such as restructuring today, social dialogue is difficult and inter-sector bargaining has repeatedly failed over many years. The difficulty of inter-relating anticipation of productive changes and human resources planning within preventive decentralised social dialogue in a relevant area (sector, group and its subcontractors or employment zone, etc.) is part of the complexity of this issue. It is, however, an area where the effort of carrying out social dialogue between the social partners sufficiently upstream could contribute to rendering public action more intelligent, by internalising what is at stake in industrial policy choices in dialogue on restructuring. Some European countries are clearly more successful in this than France, while “redundancy programmes” (*plans sociaux*) - which were originally intended to avoid redundancies rather than organise them - have undergone procedural degeneration. The latter does not satisfy any of the stakeholders and excludes in-depth discussion of alternative economic options.

Indeed, what is successful restructuring? Is it a matter of a form of restructuring that management manages to get accepted smoothly, by skilfully using its privileged access to available information, legal tools and financial incentives to convince employees at the right moment of inevitable departure and agreeing to help them in a way that is considered to be of suitable quality? Or is successful restructuring, which – without being painless – is a matter of explicit controlled conflict, which forces the birth of a real project, by associating effective industrial change and real occupational redeployment? Several of the personalities, who were interviewed, said that they are following closely the impact of “method agreements” (*accords de méthode*) that set out a framework for managing industrial restructuring and have recently been incorporated into law. If these agreements foster preventive negotiated processes, they could constitute the framework for the emergence of projects concerning the future of companies and local areas, by managing individuals’ careers, without banking on their future silent disqualification. These agreements could not then simply be agreements on timing that are reassuring for employers, but would open up discussion on the various possible economic options and would bring with them increased rights to redeployment for employees. They would constitute support for public action without it being systematically called upon to make up for the weaknesses of negotiations, so that its role is seen as mobilising institutional and financial

mechanisms that facilitate joint action by social players. In this way, recovery of industrial competitiveness and promoting proactive productive specialisation are not separate from action for “guaranteed social protection throughout working life” (*sécurité sociale professionnelle*) that fosters fluidity in reallocating productive capital.

2 Exclusive anti-economic productivism?

The foregoing thesis, which emphasises the inadequate quality of productive specialisation, is not incompatible with the thesis, which insists more on the limits – and, above all, contradictions – of French productive performance. Comparison of the levels and development of wealth and productivity between France (and more generally Europe) and the United States reveals two stages in Franco-European stalling: since a quarter of a century, the interruption – and even reversal – of the process of European per capita GDP catching up with its American counterpart can be explained primarily by lesser mobilisation of the working age population in terms of employment rates and hours worked. This is the result of different economic and social arbitration between economic inactivity, unemployment and work. Since a decade, the reversal of the process of catching up also concerns labour productivity and overall productivity of factors of production, whereas catching up on productivity had continued until the beginning of the 1990s.

This new increase in the productivity gap compared with the United States has especially affected countries with a relatively high level of productivity, such as France; it does not concern those with relatively lower productivity, which seem to have benefited from their reforms to pursue catching up on productivity (United Kingdom, Canada, Australia and New Zealand). According to the above thesis, the stalling is notably the result of less investment in – and too slow dissemination of – new information and communication technology. The insufficiently competitive nature of the goods and services markets, inadequate adaptation and qualifications of the working age population (including young people who have just left the educational system) and organisational rigidity are all factors that curb incentives to invest in new technology and also reduce the speed with which they are disseminated. Reforms, which remove these obstacles, promote improved performance regarding productivity. Sufficiently intensive competitive exposure of companies to competition

in the goods and services markets seems to be a particularly decisive factor regarding their productive performance. Continental European countries are struggling to cross the threshold of capitalistic intensity, which is associated with new technology and do not benefit fully from the latter's features, because the drop in prices of corresponding equipment improves total factor productivity, as measured by value.

However, it is not a matter of intrinsic technological incompetence. In serious international comparisons, the level of hourly productivity of workers employed in the French economy – or at least by French industry – is amongst the highest. But this high productivity of occupied workers goes along with the exclusion from productive activity of less efficient individuals. When productivity is measured with comparable employment rates between France and the United States, the productivity gap to the detriment of France is pronounced and on the increase¹². The performance of hourly productivity is therefore only apparent, as it masks much lower implicit productivity of full employment, because of decreasing performance affecting the mobilisation of additional labour beyond the low employment rate that is a feature of the French economy. Certain institutional features accompany this selective productivism and both explain and perpetuate the low employment rate: in particular, the relatively high level of hourly national minimum pay (*SMIC*) and the extent of its recent increases, following on from the laws on the 35-hour week, are factors that exclude the least skilled from employment. Major reductions in employers' social security contributions for the low-paid contribute to compensating for this, but the result is excessive concentration of the pay structure close to minimum pay, thus creating problems regarding incentives for the workers concerned.

In dynamic terms, the ambivalence of French performance regarding productivity raises a strategic issue: how can raising the employment rate to meet the targets of the European Employment Strategy be reconciled with absorbing the productivity gap in relation to the American leader, as raising the employment rate involves mobilising less productive people? Should priority be given to returning to full employment before making new progress on the productivity front (which is one way of understanding the American path in recent decades)? But, in this case, it is difficult to

¹² See the report by Patrick Artus and Gilbert Cette to the Economic Analysis Council *Productivité et croissance*, 2004, and later work by Renaud Bourlès and Gilbert Cette, "A comparison of structural Productivity Levels in the major industrialised countries", *OECD Economic Studies*, N°41, 2005/2.

disown policies aimed at increasing employment that are based on reduced employers' social security contributions during the 1990s.

This interpretation of the widening productivity gap between the United States and France is presented by its authors as being factual. This is, indeed, the case, if the hypothesis of declining performance applied to the population of working age, beyond those who are employed, is acceptable and if the proposed parameters of this decrease are plausible¹³. But the natural character of this hypothesis can be challenged:

- On the one hand, the high hourly productivity of occupied workers can, no doubt, not be reduced to a simple artifice: it can reflect both the technical efficiency of productive processes that are used and the labour intensity applied to them; it does not confirm the idea of the insufficient capitalistic intensity of these processes in France compared with the United States. Such an assessment would rather apply to the British economy, whose performance regarding hourly productivity appears to be much lower, even if it is catching up. But this does not prevent the United Kingdom from showing honourable performance regarding growth and employment.

- On the other hand, the low French employment rate is mainly concentrated amongst young and older people, whereas the employment rate of the 25-54 age group hardly shows any specific weakness (despite the heterogeneous nature of this age group in terms of qualifications). Can one so easily consider that young people's lack of experience does more than compensate negatively for their recent training, thus making them less productive (except if one is specifically interested in young people without qualifications, but, in that case, it is no longer simply a question of age)? Making an implicit hypothesis of generalised inadequate productivity of the category, "young people", was one of the deadlocks of the defunct First Job Contract (*Contrat première embauche, CPE*). As for older people, they do not seem to be characterised by lower productivity when they stay in employment. Obviously, if their jobs disappear without redeployment in the same quality of job, their productivity can be considered to drop suddenly to zero, but this is not quite the same thing as natural reduction in labour performance because of being intrinsically less efficient individuals – it is a matter of combined annihilation of the productivity of all the factors of production of an activity that has, in one way or another, become obsolete.

¹³ The scale that is chosen is that one additional point of employment rate reduces productivity by 0.5%. Applying this scale to a country that is characterised by a low employment rate is legitimate if one considers that workers, who are excluded from employment, are those who are marginally inefficient.

If they were correctly redeployed, these workers could continue to have a perfectly honourable level of productivity.

The thesis is, thus, not as clear as it is sometime presented: is the French productive system characterised by reduced capitalistic intensity, reflecting mediocre investment in ICT, or by a capitalistic bias that excessively eliminates workers from production without it being possible for all of them to be immediately considered marginally inefficient? The reasons for lesser dissemination of ICT are not clearly established and the specific nature of the American and European cycles in the last decade affects the comparison of productivity performance during the same period - it is difficult to identify the share of performance that is endogenous to cyclical trends. If the endogenous share is small, the productivity performance gap can, indeed, have lasting consequences for comparative growth prospects.

This thesis, which primarily highlights French mediocre productive performance, does not appear to be self-sufficient. It would gain from being added to in two respects:

- Sectoral breakdown provides additional clarification: low productivity and the employment deficit of the French economy appear to be concentrated in service activities. How can this combination be understood? Institutional obstacles (hindrances to competition and restrictive regulations, etc.) impede the expansion of these activities; competition and economies of scale are not sufficiently influential to lead to an increase in productivity and a decrease in prices in these activities - the expansion of markets is thus impeded, as is job creation. The competitive expansion of services, which drives the American economy, is hindered in France by the weight of oligopolistic structures, which curb these activities (in distribution, for example). The resulting loss of jobs affects young people, in particular, who are often employed abroad in services, and also the low-skilled, whom a range of services (hotels, catering and commerce, etc.) potentially make use of.
- The fact that young and older workers are primarily excluded from economic activity can be because of strictly institutional factors (the ever-present deadline of retirement at 60, for example). It can also be the result of a more individualised comparison between productivity and labour costs, which rejects implicit subsidies between employees of different generations that were previously permitted by domestic markets. If national minimum pay for young people and high end-of-career

pay for older people seem excessive, when they are related to the individual productivity - which is considered to be measurable - of these employees, then the overall rationality of the pay structure is brought into question, rather than the intrinsic productive performance of such and such a component of the workforce. Pay structures (in terms of solidarity between generations within companies via career profiles that involve implicit subsidies) are no longer in line with supposed profiles of productivity, in a context of individualisation of measuring and remunerating performance. What is at stake is related to the ability to collectively bargain a pay structure, which promotes the employment of young and older people in a context, where domestic markets – without actually disappearing – have lost their influence or become more closed: access to employment of young people entering the labour market and older people, who have been made redundant, can become more difficult if access has to happen at pay levels, which are associated with domestic markets that have lost their strength as practical reference points. The drop in starting pay – including for graduates – has effectively become a major feature of developments in the pay structure.

3 Job creation is handicapped by recurrent ineffective policy measures and negative supply shocks

France is considered to be persistently affected by negative supply shocks, which are caused in particular by ineffective and inappropriate economic policies. For those who support this thesis, the list is long: since the abortive recovery in 1981-2, there have been excessive increases in the national minimum pay, as well as employment policies, which are certainly inventive and whose measures transitorily absorb unemployment, but do not fundamentally change its long-term path, because of a lack of suitable incentives for creating skilled jobs (and even run the risk of discouraging job creation). But two sets of public-inspired measures and actions are especially targeted:

- The reduction of working time and the legislation on the 35 hour week are the culmination of a process of rationing the quantity of effectively available work (early-retirement was another manifestation of this, which peaked in the 1980s and 90s).
- Combined excessive public expenditure and regulations, result - in different ways - in both capturing resources and discouraging productive supply.

In fact, according to this thesis – besides the series of recurrent shocks – it is a matter of a real systemic drift of a “Bismarckian State”, which claims to base its welfare-state action on a tax resource base that is increasingly restricted by the rationing of the quantity of effective work.

This is, of course, not a thesis that is unanimously adopted – far from it! Significant differences in formulation are to be found among the personalities, who were interviewed:

- For some of them, the reduction in working time is the “error of the century”. They consider that the transition to the 35-hour week leads to the paradox of work-sharing, which in turns results in collectively rationing work even more, by reducing competitiveness of productive supply and encouraging companies to relocate, in order to avoid the constraints involved. For others, the reduction in working time is not worthy of such excessive indignity and positively contributed to major job creation between 1997 and 2001, but its long-term effect, which is theoretically neutral, has been diminished by unfavourable methods of implementation: “disastrous” implementation in the public sector; management of repercussions on pay, which – via guaranteed pay and the upward reunification of the SMIC – increased the cost of unskilled labour to the detriment of its employment and contributed to narrowing the pay range yet again; in order to compensate for these effects, the introduction of further reductions in employers’ social security contributions, which were added to existing measures, thus reducing the overall visibility of all of these measures and providing new opportunities to recruit people on low pay. Finally, for a third group of interviewees - especially on the union side - the reduction in working time made it possible to embark on a process of bargaining regarding work organisation in companies and thus contribute to mobilising productivity reserves, so that it was not an obstacle to growth. This positive assessment does not exclude a circumspect judgement of the static conception of the exchange between the reduction in working time and increased flexibility, which governed the transition to the 35-hour week. One point that is fairly common to all of the interviewees is that the implementation of the reduction of working time raised many more questions in relation to the services sector, where the specific nature of the service relationship plays a role that makes it more difficult to manage the implications of reducing working time via collective bargaining – compared with the situation in industry. What outcome can be imagined

for these residual controversies of the 35-hour week that are difficult to settle via objectified arguments based on consensus, including regarding their *a posteriori* assessment? Perhaps by taking into account the issue of working time more in terms of a dynamic conception of the economically active life cycle and work-life balance throughout this cycle – following the example of other countries.

- The idea of predatory excess of public expenditure and regulations has been systemised by the recent Pébereau Report on public debt¹⁴. Such plundering occurs not only via the impact of potentially unsustainable debt, but also directly by the misappropriation or absorption of monetary, material and time resources resulting from inefficient expenditure and regulations. The free play of market mechanisms is thus hindered. This classic theme is renewed via the idea that efforts made by companies to adapt to globalisation have not been matched by public authorities. This approach is clearly challenged by those who think that the strategies of big companies, which respond to adventurous financial standards, show evidence of uncertainty, restless wandering and failure, whose heavy costs fall on the community. State intervention is then useful as a last resort. This leads economists with liberal leanings to suggest that companies should bear the social costs of their redundancies in line with various modalities¹⁵. The trade-off proposed is thus one of drastic simplification of regulations that apply to labour market flows, reduction of the role of judicial procedures and rendering redundancies commonplace – as a counterpart to their taxation, so that companies take, at least partly, into account the social costs of their decisions. Regarding the *CPE* affair, De Villepin's government is reproached for having begun to reform regulations by starting with the recruitment of young people, whereas companies – especially SMEs – have most problems with the lack of existing employees' mobility and constraints preventing negotiated departures. Some of the interviewees suggested, in this respect, different regulations for big companies (which have fewer constraints, as they have efficient selection procedures for recruitment and also efficient procedures for managing internal mobility and departures) and SMEs (which have much less internal freedom and come directly up against the constraints

¹⁴ *Des finances publiques au service de notre avenir, Rompre avec la facilité de la dette publique pour renforcer notre croissance économique et notre cohésion sociale*, Report of the Commission chaired by Michel Pébereau, December 2005.

¹⁵ See in particular the report by Olivier Blanchard and Jean Tirole to the Economic Analysis Council, *Protection de l'emploi et procédures de licenciement*, 2003, and also the report by Pierre Cahuc and Francis Kramarz, *De la précarité à la mobilité: vers une Sécurité Sociale professionnelle*, Documentation française, 2004

of regulations). The State is considered to legislate too much and the social partners ought to initiate more and also take more responsibility for promoting contractual labour law, rather than one based on regulations, thus making it possible to adapt to local situations.

Emphasis on inefficient economic policy measures as a factor explaining France's mediocre performance in fact goes beyond reference to recurrent negative supply shocks. It leads to more or less radically challenging the "Bismarckian State" model of the welfare state, which is broadly common to many continental European countries, especially France and Germany. These so-called "Bismarckian" systems¹⁶ are based on the highly structured rationale of relative equivalence between contributions and services, in order to cover for risk within closed risk communities. This is both a strength and weakness: when employees are subjected to new fragmentary forces, these systems can accept such fragmentation, rather than combat it – and accompany the scattering of employees between compartmentalised and homogeneous communities, between big companies and sub-contractors and between different categories of the workforce. By tolerating low employment rates, Bismarckian systems create problems for themselves and their claim to universality shrinks to nothing, apart from agreeing to massive public expenditure on solidarity measures. Resulting major tax costs are put to the test by the competitive nature of economic integration. This type of system guarantees social stability as long as the differentiation, on which it is based, goes along with spreading the advantages and gains of the groups of employees in the best position to those who are less advantaged. When this process of spreading advantages no longer functions, because of the mass unemployment and local corporatism that it can lead to, employee differentiation then becomes fragmentation and contributes to deconstructing the workforce. There is no endogenous incentive for full employment, because risk communities can be limited to the groups of workers, who are considered to be the biggest contributors because of their productivity.

¹⁶ This term is considered to be historically incorrect by Lechevalier and Palier, who suggest renaming it "pay insurance systems" (*Essai d'analyse des caractéristiques économiques, sociales et politiques du régime d'assurance du revenu salarial*, Communication to MATISSE's symposium "Etat et régulation sociale", 11-13 September 2006).

4 Labour market failure

The reality of labour market failure is widely accepted, but interpreted in many different ways. Two interpretations can be identified amongst the interviewees:

- The deficit in the creation of skilled jobs and persisting unemployment have nourished an economy based on “skills picking” (*cueillette des qualifications*), which makes it possible – especially for big companies – to have, at little cost, young employees, whose qualifications are often much higher than the skills required by the positions they are offered. This results in a general trend of downgrading and inefficient use of young people entering the labour market. This is a factor that reduces productivity, *a fortiori*, when discrimination on entry into the labour market and the latter’s hyper-segmentation lead to some young people being kept in sectors and types of jobs, which make only very partial use of their skills. Such distortion contributes to the erosion of a pay system, in which pay is poorly related to qualifications. During the 1990s, the increased frequency of low pay occurred via the expansion of atypical, low-paid forms of employment and also via recruitment procedures and the way companies manage pay: the frequency of low pay is increasing significantly amongst new full-time recruits (both those with and without qualifications), whilst pay mobility within companies - which is measured by the exit rate from an initial low-paid situation - is structurally reduced. Starting pay in companies is less related to anticipated careers in terms of pay within it and more related to constraints exercised by the queue waiting to access the labour market, in a situation of high and persisting unemployment. Absorption of these distortions involves creating sufficient qualified jobs and reducing labour market tensions, thus encouraging companies to return to healthier recruitment practices.

- The second interpretation of labour market failure emphasises all the factors, especially of an institutional nature, that curb reallocation of jobs and people’s mobility and thus inhibit the “creative destruction” of jobs, which is a source of growth¹⁷. Today, workforce turnover is twofold and concentrated on the most vulnerable components, especially young people who are low-skilled and locked in insecure jobs: access to permanent contracts is segregated. The obstacle of labour law

¹⁷ This idea was popularised by the work of Pierre Cahuc and André Zylberberg, *Le chômage, fatalité ou nécessité ?*, Flammarion, 2004.

regulations, especially regarding dismissal, is of course to be found here as well. Legal uncertainties and administrative complications curb employers' propensity to create jobs. The combined effects of several mechanisms can be prohibitive: the relatively high level of the national minimum wage becomes dissuasive for recruiting new people, if it goes along with employment protection that makes it difficult and costly to dismiss them later on. Other factors of a sociological or institutional nature also intervene: excessive attachment to diplomas for judging the suitability of a person for a particular position is an out-dated conception of occupational hierarchies and curbs individuals' mobility; the lack of efficient support from institutions related to the public employment service for those who have lost their job. The system of redeploying and monitoring those made redundant and the unemployed is inadequate and inefficient. It is desirable to experiment a system, which is both more protective and restrictive and opens up possibilities of positive mobility after redundancy, thus rendering it less dramatic.

For those who support the second interpretation of labour market failure, the normative intention is to re-establish fair play in market mechanisms concerning turnover and pay, by using more decentralised institutions to manage the labour market (local job centres (*maisons de l'emploi*) and private redeployment operators), thereby reducing centralised State intervention, which is a source of rigidity. National minimum pay could be subjected to more direct arbitration by the social players, in order for it to take on board more effectively sectoral and local situations and be more in line with the creation of operational pay scales. The reestablishment of more open pay scales - which avoid an accumulation of employees whose pay is close to the national minimum and which provide real prospects in terms of pay - implies also moving away from a policy that concentrates reduced employers' social security contributions on the low-paid, thus fostering "crushed" pay scales, as contributions on higher pay are too onerous. Is it possible to call such a policy, which combines greater confidence in the market to determine and remunerate jobs with more decentralised social dialogue, "market social democracy"? If one looks at the United Kingdom, the viability of this kind of functioning leaves the way open to the powerful play of inequality, depending on the balance of forces between local players; in a country like France, where there is little and uneven union membership within the private sector, this is a real risk and is one of the reasons why the unions are attached to the national

minimum pay being fixed centrally. On the other hand, “social market economy”, as in Scandinavia and Germany, gives precedence to a certain degree of pay egalitarianism via national coordination of pay bargaining or the leading role of leading sectors, even if such egalitarianism now compromises much more with negotiated and accepted principles of pay differentiation. Compared with both of these points of references, the French system seems uncertain and hesitant: sectoral solidarity no longer has the strategic importance it could have in an administered and protected economy. The priority given to companies weakens solidarity between employees of the same sector and reduces the effects of spreading pay gains from trade union bastions. The to-and-fro between poorly managed decentralisation of pay bargaining and correction of its drift via public intervention or inter-sector bargaining has become a recurrent feature.

Conclusion: the difficulty of diagnosis based on consensus, in spite of points in common

The interviews of personalities reveal some points that are partially shared – and they are far from being insignificant. In particular, handicaps affecting productive specialisation in France are a widely shared concern. This is a source of a certain degree of consensus on the need for new public policies in this area. This consensus is also partially extended:

- The difficulty that the French educational system has in training young professionals in skills, which are adapted to the complexity and mobility of the contemporary economy, is very widely referred to. Obstacles to people’s mobility and to the fluidity of jobs are not – as we have seen - the subject of analysis based on consensus, but the idea that mobility can be based on skills, which can be mobilised within different activities and not be reduced to a narrow qualification, is making progress. It obviously raises huge questions about the recognition of skills and making career paths secure.

- There is general awareness of specific obstacles to the growth of promising SMEs and to their ability to create jobs. However, there is much less consensus about the balance between these different obstacles (access to capital and credit, administrative inertia and constraints of labour law) – and about the idea of specific labour law that is adapted to SMEs.

- There is fairly general scepticism about the replacement of the various existing types of labour contract by a “single contract” that incorporates a principle of length of service (with gradual accumulation of rights related to length of service). The solution provided by such a contract to insufficient mobility and the excessive role of judicial proceedings is very strongly challenged. In line with international standards, individual dismissals must be justified and, therefore, be potentially subject to judicial proceedings. Apart from shared scepticism, divergences reappear regarding alternatives: for some interviewees, it is a matter of rationalising the far too large range of contractual formulae that are available today, monitoring the validity of their use and confirming the permanent contract as the point of reference; for others, the priority is to make redundancy legislation more flexible and introduce forms of taxation and pooling of the cost of resulting redeployment. It is to be noted that the Montaigne Institute’s report, which was referred to above, is quite cleverly situated at a certain intersection of these points of view.

- There is a shared perception of the French difficulty in building a confident and dynamic relationship with the European Employment Strategy, in spite of the fact that France is not as bad a pupil as it might seem¹⁸. French players find it difficult to translate the problems of the French labour market into the language (conceptual framework and indicators) of EU strategy. The ability of these players – especially trade unions – to use the European lever for influencing the national agenda is limited. These points, which are partially shared, do not suffice to draw up joint diagnosis. The difficulty of forging such a diagnosis seems to be a feature that is more marked in France than in other countries. The above interpretations of mediocre French performance form a puzzle, whose pieces are not always incompatible, but are far from fitting together easily. Some interpretations go together: the idea of a “skills picking economy” is based on a lack of creation of skilled jobs, which is partly related to the handicaps of French productive specialisation; if inefficient employment policies have contributed to the trend of a decline in productivity gains, then they can have made lasting access to employment more segregative, by reserving it only for

¹⁸ C.f. the report that was recently published by DARES, “Stratégie européenne pour l’emploi: évaluation des politiques de l’emploi et du marché du travail en France (2000-2004)”, coordinated by Christine Charpail and Frédéric Lerais, *Document de travail n°114*, Avril 2006. On the basis of a precise examination, area by area, this report defends the idea that “the European Employment Strategy has exercised discreet, but important, influence on policies, priorities and conduct of employment policy... it has contributed to promoting reforms along the lines of this shared perspective, in a way that was certainly different and more rapid than would have been the case without it”.

employees, who are able to work near the frontier of productivity. But not all interpretations are compatible: the idea of a “skills picking economy” suggests that the productivity of the whole of the occupied population is under-used, thus excluding the thesis of exclusive productivism, which is based on a clear separation between workers, who are occupied because they are sufficiently productive, and the unemployed, who are less efficient and therefore insufficiently profitable given current pay levels.

Without doubt, one could wish that the attention of analyses and debates - especially within competent bodies - concentrated on the various points that lack consensus, so they could be overcome by efforts of demonstration that do not consider, from the outset, that each person’s truth is an established fact.

Appendix 1

List of personalities interviewed

Jean-Louis Beffa, Chairman of Saint-Gobain, 11 April 2006

Pierre Cahuc, Professor of Economics at Paris I University, 31 May 2006

Gilbert Cette, Director of Macroeconomic Analyses and Forecasting at the Bank of France, 10 April 2006

Michel Didier, Director of Rexecode, 12 April 2006

Yves Chassard, **Head** of the Department of Social Affairs of the Centre for Strategic Analysis, 10 April 2006

Jean-Christophe Le Duigou, National Officer of the CGT, 12 April 2006

Pierre Nanterme, Chairman of Accenture and Chairman of MEDEF's Economic Commission, 29 May 2006

Michel Pébereau, Chairman of PNB-Paribas, 29 May 2006

Raymond Soubie, Chairman of the Employment Policy Council, 31 May 2006

CHAPTER 4 - The United Kingdom:

More nuanced than its (distorted) Anglo-Saxon image

Iain BEGG, European Institute, LSE

Florence LEFRESNE, IRES

1 Introduction

During the 1980s, a series of legislative and other measures transformed the labour market in the UK. The broad directions of these changes are well-known: reduced employment protection, curbs on trade union activity (notably the effective abolition of secondary picketing) and a range of other measures designed to increase flexibility. Tax and other supply-side reforms – many of which brought market principles to bear widely on policy - were also implemented during the 1980s and, like much of the labour market reform, have remained largely intact since the change of government in 1997.

However, in the decade after ‘New’ Labour came to power in 1997, further extensive changes in many aspects of UK economic governance were implemented. First, a new macroeconomic policy framework was established in which monetary policy was delegated to an effectively independent Bank of England, complemented by fiscal policy rules that included a ‘golden rule’ approach to public investment. Second, a far-reaching programme of ‘welfare to work’ was introduced with the express aim of activating and rewarding unemployed and inactive people. Third, the government, especially in its second term, substantially increased public expenditure. In addition, many further measures of labour market reform were introduced, some of which restored, though in a different form, rights that had been taken away by the previous government.

As is also well-known, the UK economy has enjoyed an improved performance, especially since the early 1990s, notably by comparison with the other major EU countries, but also compared to its own history. The improved performance is seen in all the main indicators: higher growth, a low rate of unemployment, stable prices and successful management of public finances. Annual average growth was

below 2% in the 1970s, and there were major recessions at the beginning and end of the 1980s. Since 1992, when the last full-blown recession ended, the UK has had continuous, albeit variable, economic growth and its GDP per head relative to the EU average (measured in PPS) has moved up from 93.6 of the EU-15 average in 1992 to an estimated 108.1 in 2006. According to the latest European Commission forecasts, the UK economy will have grown by an annual average rate of 2.5% from 2001-8, comfortably above the rate of 1.7% registered by the euro area. The improved macroeconomic performance has been accompanied by relatively favourable labour market trends, but does not seem to have fuelled inflation as in previous upturns.

This report starts with an overview of data relating to the labour market performance. It then describes the main reforms that have taken place and assesses how they have affected the labour market. Section 4 looks in detail at one of the main changes, the introduction of a national minimum wage, then section 5 summarises the findings from interviews with a range of key actors. In section 6 the strengths and weaknesses of the UK 'model are assessed and the outlook for future policy development is appraised. Conclusions complete the report.

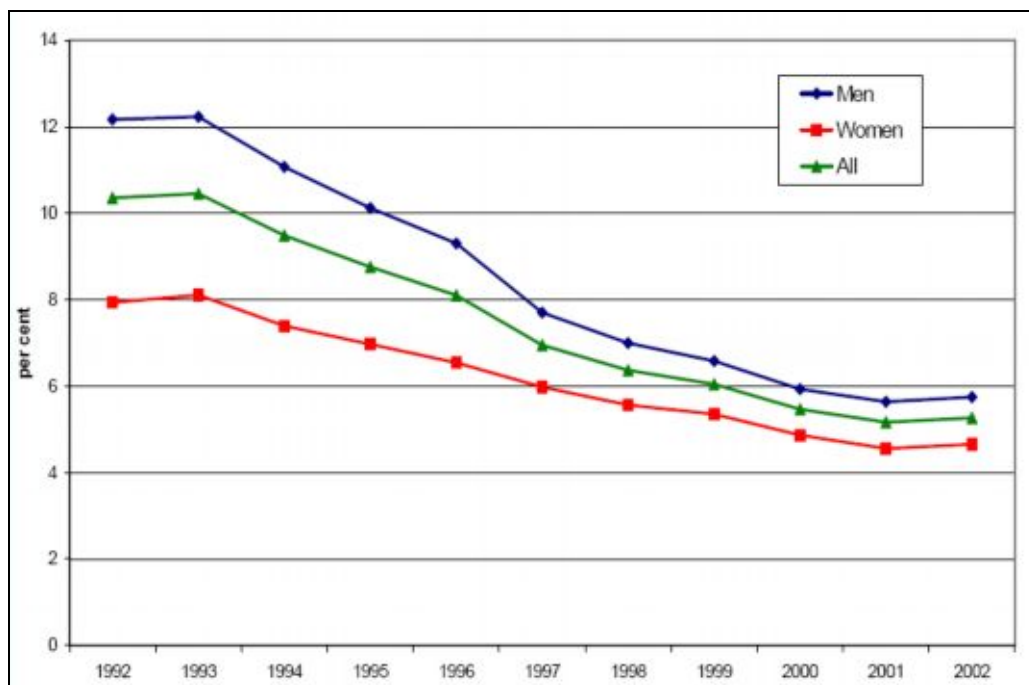
2 Statistical and institutional snapshot of labour market

Unemployment has remained comparatively low since its last peak of just over 10% during the 1990-92 recession. The rate fell quite rapidly in the mid-1990s and has hovered around the 5% mark since the end of 1999 (figure 1). One of the main features of the UK labour market that became apparent in the recovery from the recession of the early 1990s is that unemployment responded more rapidly than in the past to the recovery in demand, emphasising the increased flexibility that has become a defining feature of the economy. In explaining relative levels of unemployment, 1992-1997 was a key period, as the rapid growth over those five years meant that the rate of unemployment dropped quickly. In 1992, the rate of unemployment in the United Kingdom was the same as that of France (9.8%), compared with 8.2% in the Euro Zone. In 1997, the rate of unemployment had fallen to 6.9% in the United Kingdom. The drop then slowed down, reaching 4.7% in 2005 and turning up slightly in 2006.

The employment rate is one of the highest in the EU according to Eurostat data based on the LFS, at 71.8% in the 1st quarter of 2005, compared with an EU average

of 63.2%. [note: UK national statistics put the rate higher at 74.2] The UK labour market is one of the most female friendly ones, with an employment rate of 66%. Unlike most other Member States of the EU, the UK has tended to have lower unemployment rates for females than males and has also had a consistently high employment rate for females. As in the Netherlands, there is a relatively high level of part-time female employment, which manifestly raises the employment rate. About a quarter of the labour force is in part-time employment and some 80% of part-time employees are female. Temporary employment is a relatively small proportion of the total at 5.5% in 2002 and is higher for females at 6.7% (4.7% for men).

Figure 1. Unemployment rates 1992-2002



Source: Office of National Statistics

A common explanation for the favourable employment and unemployment rates (figure 2) is the flexibility of the UK labour market, albeit with the caveat that these results have been obtained at the expense of the security of workers. It is true that in the UK employment contracts are subject to few regulations and that there is no formal labour code, as in France. However, contrary to the cliché about it being easy to dismiss workers in the United Kingdom, individual dismissal is actually more costly in terms of notice periods and compensation in the United Kingdom than in

France¹⁹. Nevertheless, in spite of the administrative procedures implemented in 2004, there seems to be few restrictions placed on employers wishing to terminate a permanent contract. Moreover, this is why there is very little recourse to temporary work (both fixed term contracts and temping) (6% of paid work compared with a European Union average of 17%). However, do these good results really stem from labour market flexibility?

The record of the last decade (unless otherwise stated, the data quoted relate to the period 1995-2005) has been generally positive for employees as can be seen from the data summarised in box 1, based on a recent overview compiled in a report by Fitzner (2006), with additional material derived from other sources.

¹⁹ See the World Bank's study published in May 2004 on 85 countries:
<http://www.doingbusiness.org/ExploreTopics/HiringFiringWorkers> .

Box 1

Trends in UK employment (mid-90's to 2000's)

- Pay in the private sector has grown at an annual rate, in real terms, of about 2.7%, compared to 2.4% in the public sector. Although some sectors, notably manufacturing, have enjoyed more rapid rates of pay, all major industries have recorded significant real increases
- There is no evidence of poorly paying jobs – typically in retail services – replacing higher quality jobs (manufacturing).
- Female pay, at an annualised rate of 3.2% in real terms, has risen faster than male pay (2.3%).
- The pay distribution has seen a shift in which the proportion of workers on low pay has fallen, more are on high pay and the number clustered around the middle has been stable, contradicting what Fitzner calls ‘the thesis of a “disappearing middle”’.
- Despite the opposition of the UK government to the mandatory application of the 48 hour limit in the Working Time Directive, average hours worked have fallen to 32 hours per week., down from 33.5. Male full-time hours average 39, and females, 33.6.
- In addition, the proportion of full-time male employees working more 48 hours has decreased by about 20% between the Working Time Directive coming into effect (in 1998) and 2005.
- Most part-time workers do not want longer hours and the number who work part-time because they could not find a full-time job has fallen from 13% to 8%
- Job turnover has been stable and, in 2006, the number of job losses due to redundancy fell to 6% of employees, down by three percentage points since the mid-1990s
- Temporary employment has fallen from a peak of 7.5% in 1997 to 5.5% in 2005, below the proportion in most other EU Member States
- The employment rate of target groups – the disabled, lone parents, ethnic minorities and immigrants - has increased more rapidly than that of the employed population as a whole

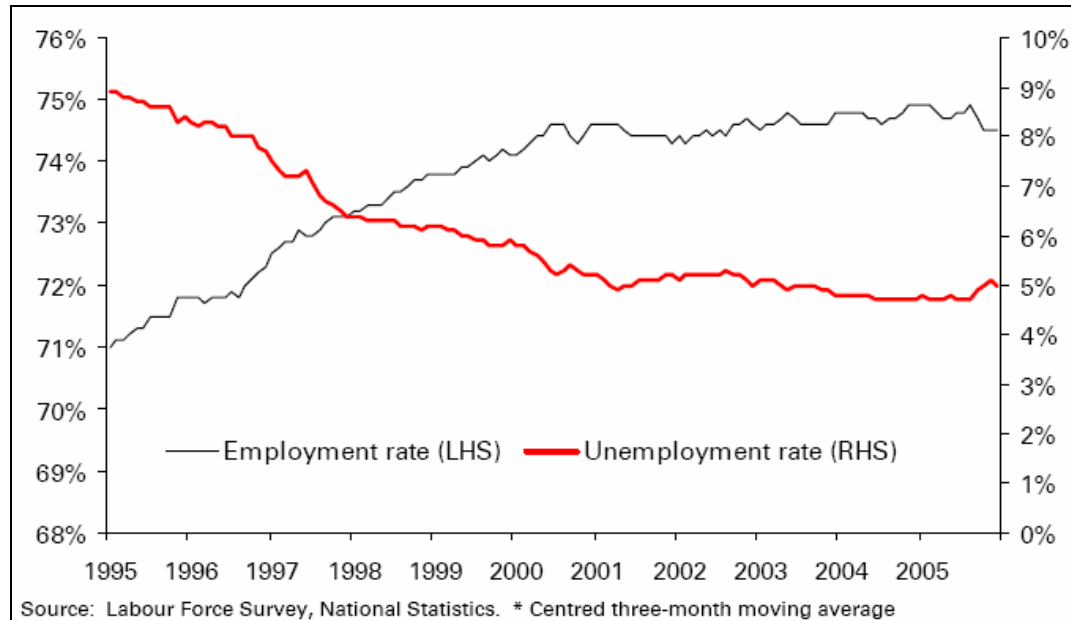
There are, though, continuing problems in the UK labour market, which has, notably, long been characterised by poorly developed skills and other structural weaknesses. These include:

- Low productivity, certainly compared with the larger continental European countries, although this observation has to be tempered by the fact that the higher employment rate implies that more low-productivity workers are counted in the data.

- Wage inequalities:
 - The gender pay gap has narrowed, but still persists, especially for women employed part-time
 - There is also still evidence that, after controlling for other relevant variables, men from ethnic minority backgrounds and immigrant women from ethnic minorities are paid less well
- The number of working age people on incapacity benefit continued to rise up to 2004, but has now started to decline and is seen as the next key focus of policy action.

The UK labour market has quite a high annual rate of both inflows and outflows from jobs, with some 6 million moves each year, roughly one in five workers. The number of workers recruited tends to be fairly stable, while the number leaving is more affected by the economic cycle. The evidence shows that the proportion of outflows that is involuntary has been on a falling trend, declining from 37% in 1995 to 28% in 2005²⁰.

Figure 2. UK employment and unemployment rates, 1995-2006



Source: Fitzner (2006)

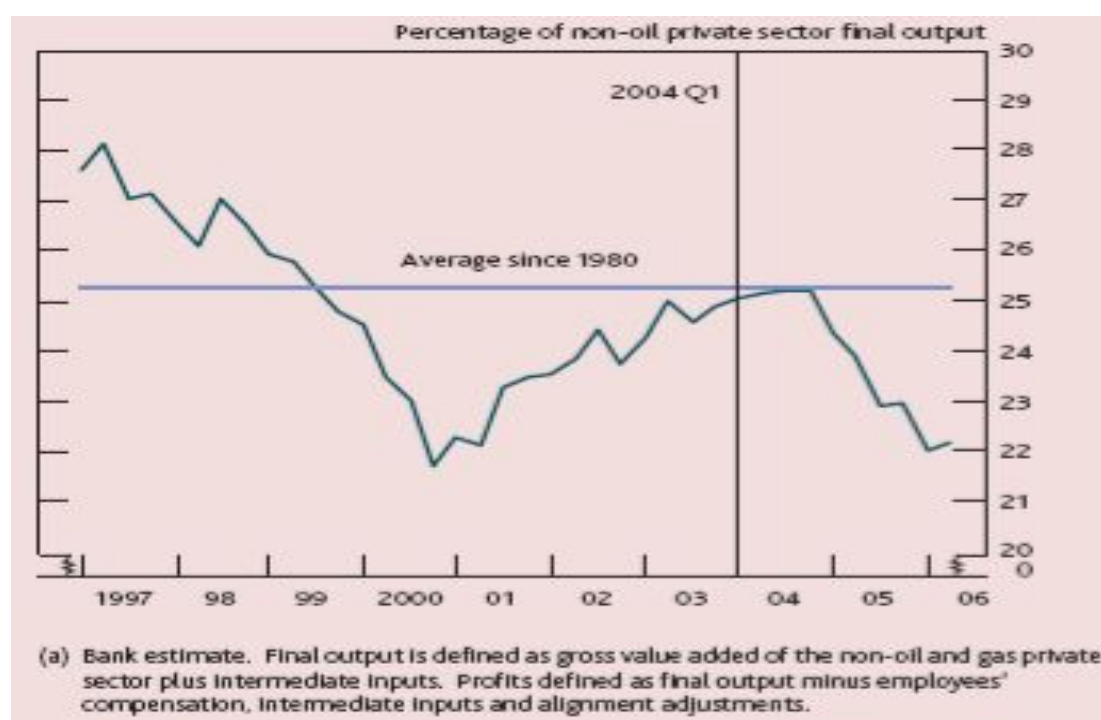
²⁰ Involuntary includes the end of temporary contracts and 'voluntary' redundancy and may therefore overstate the true proportion (Fitzner, 2006)

On the whole, the changes in the unemployment position appear to be durable, despite the slight increase in unemployment in 2006. Estimates suggest that the short-run NAIRU in the UK peaked in the mid-1980s and have fallen since (Batini and Greenslade, 2006). Favourable international conditions that have diminished inflationary pressures are part of the explanation, but structural labour market reforms have also been influential. The minimum wage is set nationally and thus does not reflect differences in cost of living in different regions. As a result, it is more likely to have an impact on the sustainable rate of unemployment outside the high-cost areas of South East England. Blanchflower *et al.* (2007) find, though that this and other structural factors do not offer a convincing explanation for the small increase in unemployment that occurred in 2006, and attribute the rise instead to ‘greater slack in the labour market now compared to a year ago’.

The share of labour

The UK has differed from most other OECD countries in the trend in the respective shares of labour and profits in national income, with the apparent paradox of having a rising labour share in a country in which unions had been enfeebled. There are awkward measurement issues surrounding how best to measure these shares, especially when the public sector comprises a large share of the economy and where it is difficult to distinguish between the labour input and the return on capital of the self-employed (for a discussion, see Batini *et al.*, 2000). However, using one measure computed by Bank of England (2006), it is clear that in the last decade the UK has seen a profit share tending to fall below the long-run trend of profitability for the non-oil private sector (figure 3). Previously, the UK labour share had fluctuated from year to year, but been stable over the medium (see, also, Bentolila and Saint Paul, 2003). The recent decline in the profit share can be explained by a range of factors, including the high exchange rate and the more competitive environment domestically, reinforced by the single market and global competition. In addition, Metcalf (2007) argues that the need for companies to make good a shortfall in pension funds may have contributed to this turnaround, but his analysis suggests that the introduction of the NMW is likely to have been part of the explanation. While there are elements of coincidence, it is certainly striking that the profits share has been below the long-run average since the NMW was introduced in 1999.

Figure 3. The non-oil, private sector profit share



Source: Bank of England Inflation Report, November 2006

The influence of the macroeconomic framework on the labour market

Labour market performance on the two sides of the Channel exhibit interesting differences. The comparison is made easy by the fact that the size of the working age population (15-64 years old) has for a long time been almost identical in the two countries (slightly more than 38 million in 2004). Over the past decade, there has undeniably been a higher rate of net job creation in the UK: 3.1 million additional jobs in the UK compared with 2.4 million in France between 1993 and 2004 (*Eurostat*). The employment rate for the working age population has grown almost three times more on a yearly average basis than in France. However, an accounting breakdown of this indicator shows that this relative advantage stems from, on the one hand, the GDP growth differential between the two countries and, on the other, from the quasi-stagnation of the labour force in the UK (see Appendix), although the surge in immigration since 2004 is now altering the picture.

A first factor is macroeconomic policy. The economy had started to recover in the second quarter of 1992 and growth was helped, in the first instance, by the

devaluation of sterling later that year²¹, against a backdrop of various economic problems (a record trade deficit, doubts about the record of recent privatisations, a peak in unemployment and high interest rates). The devaluation and lower interest rates helped to boost economic activity at a time when interest rates remained high in the EMS and other EU countries were pursuing restrictive budgetary policies designed to comply with the Maastricht criteria. It is, however, important to stress that tough decisions were also taken about reforming the macroeconomic framework, cutting the budgetary deficit and pursuing a stability-orientated policy.

These initial macroeconomic reforms under Chancellors Lamont and Clarke were taken further when Gordon Brown took over in 1997. An early decision was to delegate monetary policy to an effectively independent Bank of England, though with an inflation target set by the Chancellor. Unlike the approach adopted by the European Central Bank, the target was a symmetrical one obliging the Bank to aim for 2.5% inflation and to ensure that the actual rate did not diverge from the target by more than one percentage point – up or down.

In the early years of the New Labour government, public spending was held down and the result was a healthy budgetary position, with surpluses in each fiscal year from 1998-2001, a huge turnaround from the record deficit of 7.8% recorded in 1993. As a result, public debt (on the Maastricht definition) fell below 40% of GDP by 2001, having been over 50% as recently as 1996. This reduction meant a significantly lower burden of interest payment on public debt than in France and Germany where the debt has been well over 60% in recent years. From 1997 to 2000, public expenditure fell slightly as a proportion of GDP²², but following a political decision to invest more heavily in public services, the share of public expenditure in GDP has grown significantly. At 44.6% in 2006, it was only two and a half percentage points below the EU-25 average and, on certain definitions, is now higher than in Germany as a proportion of GDP, although still well below that in France. The main increased in expenditure have been for education, transport and, especially, health for which the government has undertaken to raise the amount spent to the EU average as a proportion of GDP.

²¹ On 17th September 1992, the government withdrew the pound from the European Monetary System that it had joined in October 1990. The Bank of England had lowered its official market rates and the pound exchange rate had fallen sharply.

²² The government also gained from the sale of third generation mobile phone licences, recorded in official statistics as negative public expenditure.

It is true that the country had a lot of catching up to do after years of under-spending, especially on infrastructure. But the catch up was spectacular: two thirds of jobs created between 1998 and 2005 were in the public sector with 224,000 in education and 300,000 in health and social services²³. There are now more jobs in the latter sector in the UK than in France, although many more are part-time and there are far fewer established posts in the UK. This spending has been financed partly by tax increases and partly by allowing the deficit to expand, although it should be noted that, in EU terms, the UK only just moved into a position of excessive deficit in the period 2002-04 (reaching 3.3%) and brought the deficit back below the 3% threshold in 2005. In this respect the budgetary position of the UK has consistently been better than those of France and Germany.

The current fiscal framework relies on two principles: the first is the ‘golden rule’ that the State only borrows over the economic cycle to fund public investment. In other words, public investment is not sacrificed on the altar of budgetary rigour. Second, the sustainable investment rule requires public debt to be kept below 40%. There has been some concern in the last year or two about these rules being breached and a degree of political sophistry from the Chancellor about the definition of the economic cycle. In response, the budget plans for the coming years announced in March 2007 foresee a renewed clamp-down on public expenditure. Nevertheless, the combination of monetary and budgetary instruments has meant that growth and inflation have been maintained at satisfactory levels, ironically without the UK diverging much from the parameters of the euro area rules. Many commentators in France and Germany complain about ‘having their hands tied’ by the Stability and Growth Pact and an overly restrictive European Central Bank, and look with envy at the more flexible UK framework, but as the outcome data show, the difference has not been that great.

Unlike most other Member States of the EU, the UK has tended to have lower unemployment rates for females than males and has also had a consistently high employment rate for females. As in the Netherlands, there is a relatively high level of part-time female employment, which manifestly raises the employment rate. About a quarter of the labour force is in part-time employment and some 80% of part-time

²³ *Labour Market Review*, 2006, Office for National Statistics.

employees are female. Temporary employment is a relatively small proportion of the total at 5.5% in 2002 and is higher for females at 6.7% (4.7% for men).

Vacancies notified to Jobcentre plus, the public employment service, capture only a proportion of total vacancies, and are currently around half a million, about 60% of the number of job-seekers. Estimates of the Beveridge curve linking vacancies and unemployment are relatively flattering for the UK, although if some allowance is made for the disguised unemployment implicit in the high level of incapacity claimants, the picture is less rosy. Work by Alcock et al. (2003) and Ardy and Umbach (2004) suggests that, especially in some of the less dynamic parts of the country, unemployment is much more persistent. Nevertheless, the aggregate data on the employment rate do still signal a labour market that is tolerably successful in providing employment.

An explanation sometimes offered for the low recorded level of unemployment in the UK is that is the result of a statistical manipulation in which working-age people without work are classified as inactive instead of unemployed. Among the European countries where the rate of unemployment has dropped steeply since the mid-1990s, the UK case has a distinctive hallmark: while the working age population increased over the past decade, the labour force almost stagnated. The male labour force even decreased. The drop in unemployment for this group was more acute than the growth in employment, a section of the unemployed having been reported as not part of the labour force, particularly older people (Table 1).

Table 1. Unemployment, employment and inactivity in the UK

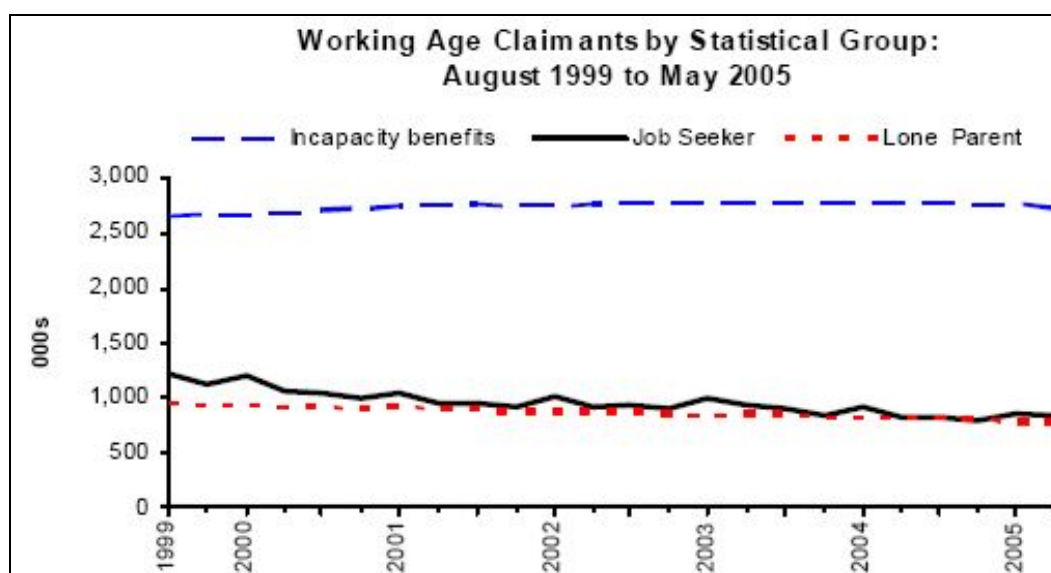
	Men		Women	
	Variation 1993-2004	Relative variation*	Variation 1993-2004	Relative variation*
Unemployment	-1,092	- 5.9	-376	- 2.1
Employed	907	+ 3.9	1,478	+ 4.8
Not part of the labour force	408	+ 2.0	-211	- 2.7
15- 64 population	223	0	891	0

Thousands; * variation of the share in the overall population of 15-64 year olds.

Source: European Commission, *Employment in Europe 2005*.

Is this disguised unemployment in the form of high levels of invalidity or incapacity? Over the last six years, the number of working-age claimants of incapacity benefit has grown by around 100,000 to exceed 2.7 million, while claimants of 'job-seeker' benefit have dropped from 1.21 million to 845,000 (see figure 4). The result is that the ratio of incapacity to job-seeker claimants has risen from 2.2 to 3.2. The government has recently made clear that it intends to review the terms on which incapacity benefit is granted with the aim of re-activating those who are, in practice, employable.

Figure 4



Source: Office of National Statistics

An element in the low official unemployment figures for the UK is that the terms on which claimants could obtain benefits were tightened in 1996 to require more job search. In a recent study Manning (2005) finds little evidence that these changes resulted in an increase in the number of claimants taking jobs. Instead, the effect has been to reduce the count of unemployed by about eight percentage points, with the implication that previous claimants became non-claimant inactive. Manning's analysis suggests that most of the change can be accounted for by outflows from claimant to non-claimant status, rather than any reduction of in-flows into claimant status.

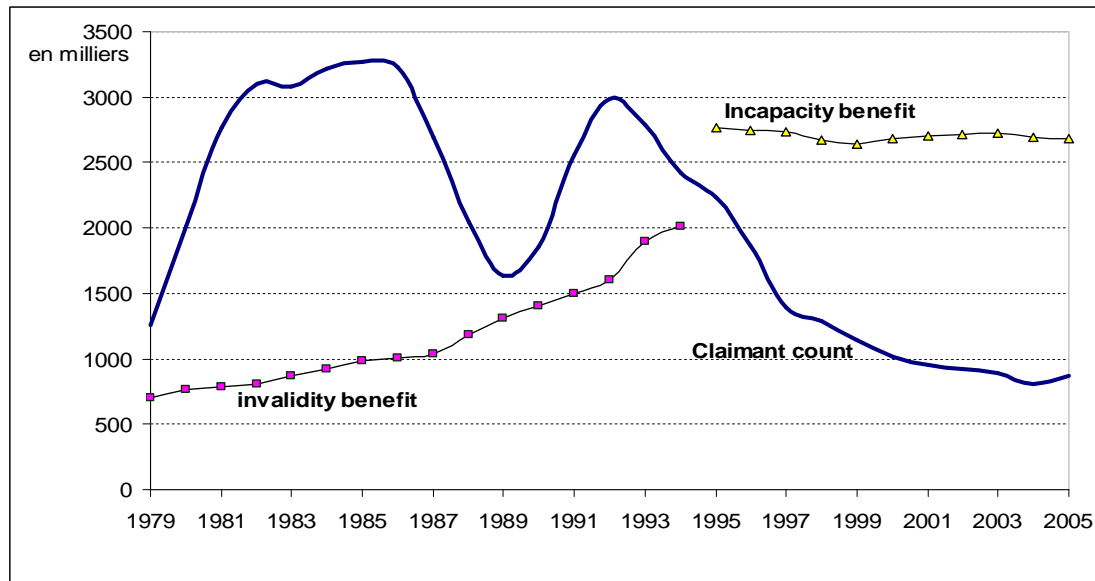
An explanation for this phenomenon can be found in the sheer number of people claiming Incapacity Benefit – a figure of 2.7 million according to official sources. There are two and half times more incapacity benefit claimants than job seekers as the job seeker benefit system has been made increasingly more restrictive by successive reforms²⁴ (see figure 5).

This shifting of the unemployed towards social assistance has, as in the Netherlands, been identified as a policy problem and has led to a tightening of eligibility checks (medicals during which claimants must prove that they are unable to work). It is also at the heart of the government's latest push to raise the employment rate through new initiatives. The New Deal for Disabled People Programme aims to get people back to work through low-wage jobs in the commercial or charity sector, accompanied by training in the best case scenario. The recent Pathways to Work scheme involves a six month period of interviews which focus on the job search before the individual can claim Incapacity Benefit. Checks may lead to sanctions which can include benefit being withheld, but there is still little reintegration of individuals on Incapacity Benefit into the world of work. According to official statistics, one million Incapacity Benefit claimants are very long-term unemployed people (a typical case being that of the former miners).

²⁴ Since 1996, Jobseeker's Allowance has been paid out without means-testing for six months for jobseekers who have made National Insurance contributions for at least one full year. For over-25s, the weekly allowance is fixed at £57.45 per week. For all other cases (85% of the total), it is means-tested based on the same conditions as Income Support. In that case, the amount paid out takes into account the partner's income (s/he must not be working more than twenty-four hours per week) and family size.

Figure 5

People of a working age claiming incapacity benefit and unemployment benefit



* In thousands

NB: Incapacity Benefit replaced Invalidity Benefit in 1995, introducing some changes in eligibility.

Source: Department for Work and Pensions

Taxes on income and on labour

The UK tax system taxes incomes most, followed by expenditures and is relatively light on taxes on labour. High marginal rates of personal income tax were progressively diminished during the 1980s, culminating in the introduction in 1988 of a top rate of 40 %, which has remained in place since.

Financing of social protection is predominantly from general taxation as the proceeds of explicit social charges ('National Insurance') are not directly hypothecated to social expenditure and not sufficient to finance that expenditure.

The welfare system

The UK system of welfare has fluctuated over the years since the original Beveridge system was introduced in 1948, but has long had a safety net and means testing at its heart. The broader social policy context is critical to understanding the labour market performance of the UK in the last decade. New Labour made a number of commitments to change social policy, the core of which is the combination of flexibility with better social protection (Taylor-Gooby *et al.*, 2004). The new government's approach represented a change from its predecessor's focus purely on

restricting benefits as the means of pushing the unemployed into work, to one of complementing restrictions on benefits by much greater efforts to support individuals in becoming active in the labour market. This approach – initially focused on youths, but subsequently extended to other workers – placed a premium on making work pay and has a more elaborate targeting of groups at risk of unemployment. In this approach, the value of unemployment benefit has fallen relative to the median wage, but the incentives for finding work have been increased through a tax credit system for low paid workers. In addition, there have been reforms of the administration of the which, according to Taylor-Gooby *et al.* (2004: 581) make up a package of measures, which act together ‘to combine support and compulsion to shift people into paid work, to enhance market competitiveness and reduce poverty’.

It is also noteworthy that the broad thrust of policy continues to enjoy broad support from the social partners, though with concern emerging about the extent of ‘red tape’ and the concomitant burden on employers. From a political economy perspective, what is significant is that these complaints tend not to be about the direction of policy, so much as its implementation. A key element in this approach is that liberal, market orientated economic and labour market policies are linked to left-of centre social objectives (Taylor-Gooby *et al.*, 2004).

The working families’ tax credit does seem to have an effect on employment by increasing the incentives for lone mothers to work and by inducing adults in couples with dependent children to work longer hours (Brewer and Browne, 2006). The latter finding is readily explicable by the fact that the tax credit increases for those who work more than thirty hours per week. The new system is more generous, has a less steep taper than the system it replaced (meaning a less abrupt ‘poverty trap’) and gives more allowance for child-care costs. Brewer and Browne also find that there is no evidence that the tax credit has had a negative effect, as theory might predict, on the employment rate of second earners in families.

The UK employment service has also evolved over the years and in its current structure (known as Jobcentre Plus) is responsible simultaneously for placement of the individual in a job and payment of the unemployment benefit. There are no restrictions on private employment agencies, which are a thriving service provider in the UK. Key indicators on recipients of benefits are:

- Over the 8 years to May '05, the caseload for working age incapacity benefits has risen by 3.7% to 2.74 million. The working age incapacity benefits caseload has fallen by 41 thousand in the year to May '05 (see section 1.3)
- The number of Job Seekers has decreased steadily. Between May '00 and May '04 the caseload fell by 251 thousand from 1.07 million to 820 thousand. This figure rose very slightly to 845 thousand at May '05
- Lone parent caseloads fell by 97 thousand between May '00 and May '04, falling from 918 thousand to 821 thousand. This decrease continued in the year to May '05, to stand at 787 thousand
- A total of 2.38 million people have started on a New Deal programme up to August '05. Of the 2.31 million people who had started New Deal up to May '05, some 1.47 million of these people had gained a job up to May '05

UK unemployment benefits are not linked to previous pay and are means-tested, although the fact that there are complementary housing benefits means that for low income families, replacement rates can be reasonably high²⁵. Clearly, though, the corollary is wealthier individuals who lose higher-paying jobs face a much greater income loss.

Making work pay has been a central direction in UK policy.

Regional wage differentiation has occurred

²⁵ De Koning *et al.* (2004) state that in the UK the replacement ratio is high for people with large families and that 5% of the employed population would receive aggregate benefits amounting to 70% of their net income if they became unemployed.

Box 2

Government programmes for the most disadvantaged

The Government's main programmes for the most disadvantaged have been the New Deals and Pathways to Work.

These are:

New Deal for Young People. Mandatory programme for people aged 18-24 who have been on JSA for six months. It is composed of a "Gateway" period of intensive Personal Adviser support, which lasts up to four months. This is followed by mandatory activity on one of four "Options" – subsidised employment, further education/ training, voluntary work or the environment task force.

New Deal 25 Plus. Mandatory programme for those on JSA who are aged over 25 and have been on the benefit for 18 months. It follows the same structure as New Deal for Young People – with a Gateway of up to four months followed by one of four "Options".

New Deal 50 Plus. Voluntary programme for people aged over 50 and who have been on a main benefit for more than six months. Based on Personal Adviser support with looking for and preparing for work, including employability measures (training and voluntary work). In-work financial support can be provided through a top-up to Working Tax Credit and access to a Training Grant.

New Deal for Lone Parents. Voluntary programme of intensive Personal Adviser support, aimed at lone parents on Income Support. The adviser interventions can include confidence building, help with looking for and applying for jobs, help with understanding the financial returns from work, help with finding childcare, and some limited financial support.

New Deal for Disabled People. Voluntary programme of intensive Job Broker support. Job Brokers are located outside the Jobcentre Plus network and can be in the public, private or voluntary sector. Intensive support covering all aspects of moving towards and taking up work, including in-work support for up to six months.

Pathways to Work. Mandatory programme for new claimants to incapacity benefits and voluntary for existing claimants. Core of work-focused interviews delivered by Jobcentre Plus or the private and voluntary sector, supported by financial support in work and the New Deal for Disabled People.

Progress2work/ linkup. A "benefit blind" programme for recovering drug addicts, the homeless and ex-prisoners.

Source: Freud (2007)

3 Employment relations: the reform battleground

As Davies and Freedland (2004) show, Great Britain²⁶ has traditionally had a relatively uncoded system of industrial relations in which constitutional rights (for example to strike or to organise) are much less rooted in law than in other mature economies. The voluntarist nature of collective bargaining means that agreements are not enforceable by law so much as by the threat of industrial action. This system has led to single employer agreements increasingly becoming the norm in recent decades, rather than sector wide agreements, although the latter do still exist. A key characteristic of the British environment is that the 'possibility to extend collective agreements by means of official order or ministerial decree does not currently exist in the UK. This, again, has a complex history but is basically attributable to successive versions of a voluntarist approach to industrial relations (Davies and Freedland, 2004: 12).

The voluntarist approach to industrial relations has a number of implications. It means that the social partners have a much more limited role in economic governance than in other Member States, and that the social dialogue does not have the same resonance. Indeed, the two expressions are largely unknown in the lexicon of UK policy discourse. Corporatist institutions akin to the Economic and Social Councils in other Member States were established in the 1960s, but they were never very powerful and they were emasculated during the Thatcher era and closed down in the early 1990s. Sectoral Wages Councils charged with setting minimum wages and conditions, established by statute, were a feature of earlier decades, but they too were closed down in 1993 as part of the deregulation of the labour market.

British collective agreements cannot specify terms and conditions (for example, in relation to health and safety) below those stipulated in labour law (Davies and Freedland, 2004), but there are significant derogations, such as the exemptions to the Working Time Directive as transposed into British law. These two authors also stress that a key difference between British labour law and its continental counterpart is that unions do not have rights (for example to call strikes) but immunities from the

²⁶ The industrial relations system concerns Great Britain rather than the United Kingdom. As such, it excludes Northern Ireland, which has long had a separate industrial relations structure in which employees are more likely to belong to unions based in Ireland than in Britain. Similarly, British political parties have no real presence in Northern Ireland.

consequences of doing so. This contrasts with the position in most other countries where there is a right to strike, often written into the constitution.

During the eighteen years of the Thatcher/Major governments, there was a succession of major legislative Acts affecting the labour market, starting early in the Thatcher era (Davies and Freedland, 2004). These were:

- **1980 Employment Act** which restricted picketing and repealed union recognition rules
- **1982 Employment Act** which further restricted action by unions and established that unions could be held liable for damages.
- **1984 Trade Union Act** which instituted secret ballots
- **1988 Employment Act** further restricting industrial action and introducing ballots for separate workplaces
- **1990 Employment Act** banning secondary action and providing for dismissal of strikers engaging in unofficial strikes
- **1993 Trade Union Reform and Employment Act** establishing rules for ballots on industrial action

The cumulative effect of these Acts was considerable in eroding union power and in altering the character of industrial relations. The labour movement had also lost in a number of major disputes, the most politically important of which was the miners' strike of 1984-5, which marked a strategic turning-point in the ability of the unions to dictate terms either to employers or the government. By the mid-1990s, union membership was down sharply (table 2) and the industrial unions which had once had a powerful role in the governance of the British economy had been largely eclipsed.

Reforms since 1997

The election of 'new' Labour in 1997 was expected to result in a government more attuned to worker interests. While not being willing to do much to reverse the 'Thatcher' reforms, the new Labour government has made a number of significant changes, notably by introducing a statutory minimum wage (enacted in 1998 and coming into force in April 1999) and by placing considerable emphasis on a welfare-to-work programme that gives priority to making work pay for the least well-off and

diminishing the poverty trap that deters seeking work. The so-called New Deal has been one of the flagship policies, initially aimed at youths, but subsequently extended to other segments of the labour market (see box 2). Recently published data reveal that 2.38 million people have started on a New Deal programme up to August '05. In the period from its inception up to mid-2005, 63% of participants in New Deal went on to obtain jobs. Tax credits for the low paid are another important element in the strategy, though there has been growing criticism of the implementation of these credits

Although New Labour has not brought union interests back into a central role in economic governance in the UK, it has nevertheless introduced legislation that has restored certain union rights and defined a framework for industrial relations that is some way from that bequeathed by the Conservative governments. The extent of this reversal and redefinition is not well understood outside the UK and can be portrayed as a particular model of flexicurity. A full understanding of the model can only be obtained by considering the changes wrought in macroeconomic and social policy, as well as in industrial relations. But even the changes directly affecting the labour market are substantial. Three Acts altering the Labour market were passed:

- **1998 Minimum Wage Act** introducing a universal minimum wage and setting up a Low Pay Commission
- **1998 Working Time Regulations** transposing the EU directive
- **1999 Employment Relations Act** which defined procedures for union recognition and restored protections against dismissal for union activity, while revising the rules on balloting
- **2002 Employment Act** with various provisions on workers rights in the workplace, and provisions relating to family commitments that are intended to flesh out the government's objective of giving working parents more time with children
- **2004 Employment Relations Act** which reinforces the protections enjoyed by workers in relation to union activities, including calling industrial action, and clarifies various procedures. It also envisages better enforcement of the minimum wage.
- **2006 Work and Families Act** setting a framework for the rights and responsibilities of employees and employers, including new conditions for parental leave and entitlements to flexible working.

EU directives bearing on employment are transposed into UK law either through regulations or as part of Acts of Parliament. Some are resisted if they are considered to be contrary to UK interests (for example, the long-running opposition to full implementation of the Working Time Directive), with either a search for derogations or procrastination in transposition being used to avoid full compliance.

The post-1997 changes have had the following main effects on the framework for labour law (Davies and Freedland, 2004):

- They have created a new framework for collective bargaining, notably through the support for voluntary agreements backed by the threat of a legally binding procedure for recognition
- There is a new institutional support mechanism for collective bargaining

Other reforms

The extensive privatisations during the eighteen years of the four Conservative governments in power between 1979 and 1997 also had a marked effect on union power by breaking up major public utilities that enjoyed positions of monopoly or dominance that enabled the unions to extract rents. Even where state control was not ceded, out-sourcing and other mechanisms were used systematically to introduce market pressures in areas such as education and health.

Assessment of the reforms

The post-1997 legislative programme has, according to Dickens and Hall (2005), been shaped both by a mix of domestic policy priorities and compliance with EU directives and other legislation. It has also, unsurprisingly, been shaped by pressures from employers to avoid undue additions to the regulatory burden and from unions to restore worker protections that had been taken away during the previous fifteen years. New Labour manifestly has not undone, nor even sought to undo, some of the key transformations of the previous government, especially concerning the regulation of industrial action.

Nevertheless, the Employment Relations Acts of 1999 and 2004 restored some of the union rights that had been removed in the previous two decades, with the main focus on union recognition, enforcement of minimum wage legislation and the terms on which industrial action can be taken, with other provisions dealing with topics such

as flexible working hours. Some improvements are made to the protection afforded to striking workers and to workers seeking to advance union recognition, but overall the Acts do not go that far in bolstering the position of the workers, although the 2004 Act was regarded as a significant advance by the union side. It may contribute to a more effective social dialogue by paving the way for greater consultation. That said, change in collective bargaining has occurred largely because actors themselves have altered their negotiating behaviour than because of changes in labour law. Indeed, there is not a formal legal framework for collective bargaining imposed by statute.

Bargaining takes place at sector level, company level and at plant level, although the public sector as an employer has a key leading role. National bargaining has declined markedly in favour of company level bargaining, with some erosion as well of plant-level bargaining. Nor is there much evidence of formal co-ordinated bargaining even though there are few significant ideological or other divisions between unions. However, informal comparisons and exchanges of information do result in some co-ordination and market pressures clearly also exert an influence. Pay is set unilaterally by management in a majority of private workplaces, but this practice is less prevalent in the public sector.

The social partners

Employers are represented principally by the Confederation of British Industry - CBI (composed predominantly of large industrial companies), the Institute of Directors (with a membership that is more individual than corporate and is generally regarded as more to the right, politically) and various bodies representing different sectoral interests (for example, banks and insurance companies have specialist trade associations) and smaller business. Unlike many other Member States, there is no umbrella organisation for employers associations, because the CBI membership is individual entities, not associations.

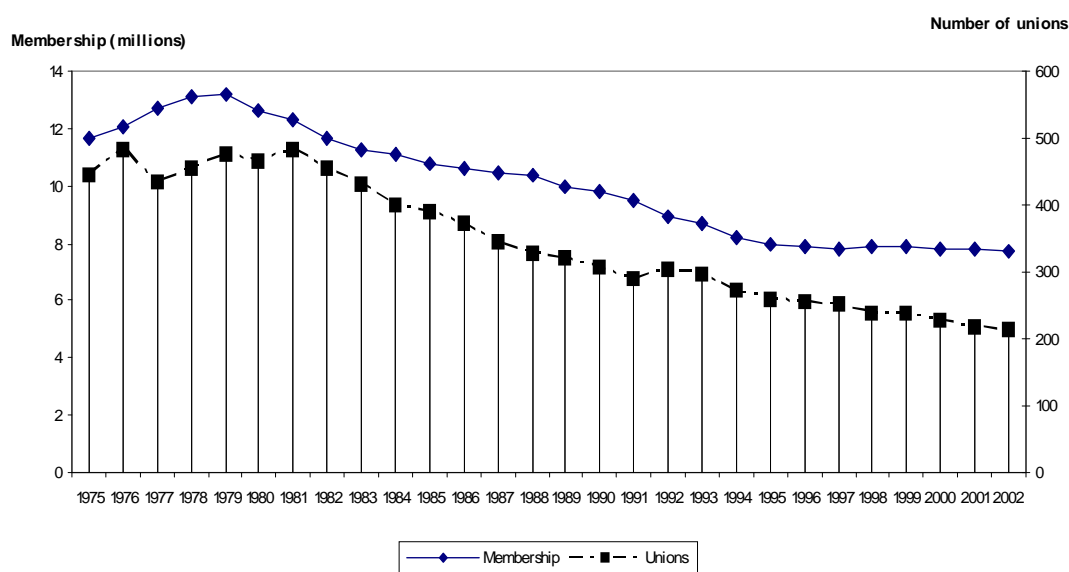
The main umbrella body for unions is the Trade Union Congress (TUC). A key political economy consideration is that bodies such as the TUC and the CBI, which might have fulfilled the role of social partner, have struggled to, as Davies and Freedland (2004: 13) put it ‘to control their constituents, which is necessary for the efficient functioning of a tripartite institution’.

As a result, there is no real tradition in the UK of the exercise of power (or even of much influence) by the social partners, and the one period in which it was tried – the 1970s, when an attempt was made to control inflation through incomes policies that engaged the social partners – is remembered as a period of decline and near anarchy in industrial relations. In fact, the events of the late 1970s, which saw union power at its peak, created a platform for the reforms implemented by the Thatcher government over the following decade. Already, in 1972, an earlier Conservative administration had to concede to demands from the miners and was forced into various ‘u-turns’ on industrial policy. The same government, led by Edward Heath, then suffered a further challenge from the miners in 1974, as a result of which it narrowly lost two elections that year, with a Labour government returning to power. By 1978, the tripartite incomes policy was in disarray and the now notorious *Winter of Discontent* led to the election in 1979 of the untried and relatively little known Mrs Thatcher. The failings of the late 1970s have become etched in the collective consciousness of the British electorate and still surface in contemporary political discourse. They are therefore central to comprehension of the political economy of the subsequent evolution of British labour market policy and, indeed, the approach to industrial policy.

Union membership and activities

Union membership and union recognition declined substantially from the late 1970s onwards, with male membership falling most (figure 6). Although membership has stabilised, it is against a background of increasing total employment, so that union density slipped under 30% at the turn of the millennium and has fallen a little more since then according to official figures. In 2004, for the first time, female union density exceeded male density. Blanden et al. (2005) suggest that the election of the Labour government in 1997 may have arrested the fall in recognition and that the 1999 Employment Relations Act may have served to underpin union activity. However, though there is evidence of new recognitions picking up in number, they also point out that they tend to be in traditionally unionised activities and that unions are not making much progress in achieving recognition in more dynamic sectors and companies.

Figure 6: Union membership and number of unions, 1975 - 2002

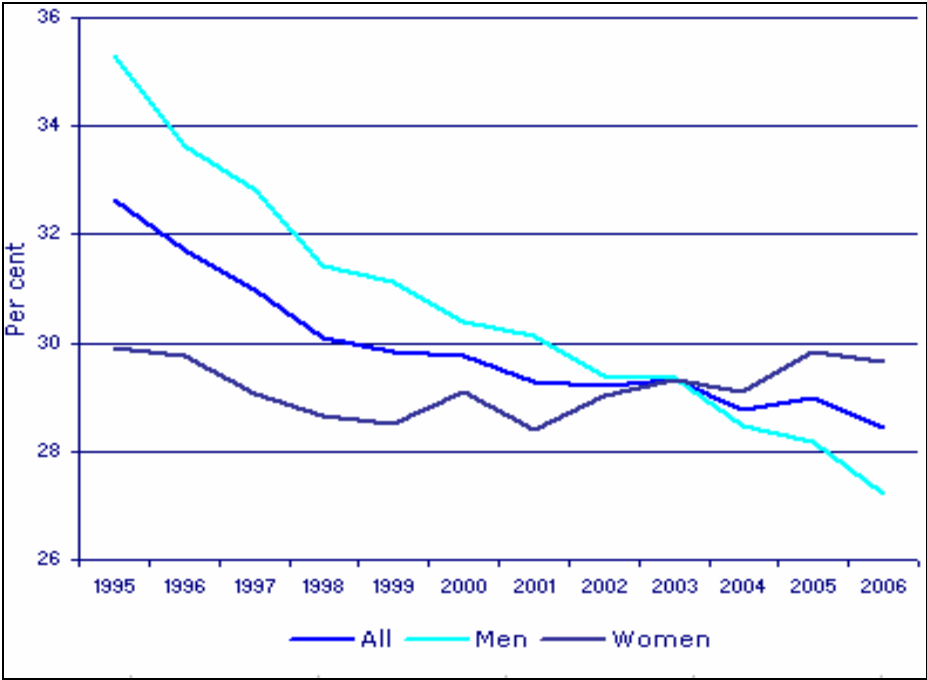


Source: Department of Trade and Industry

Decline in union membership overall has been associated with a halving of the number of unions since the mid-1970s and a relative concentration of membership in a small number of large unions. A trend has been for a relative decline of sector unions in favour of generalist ones, though with a distinct difference between those that organise largely in the private and public sectors: the public sector has much higher union density.

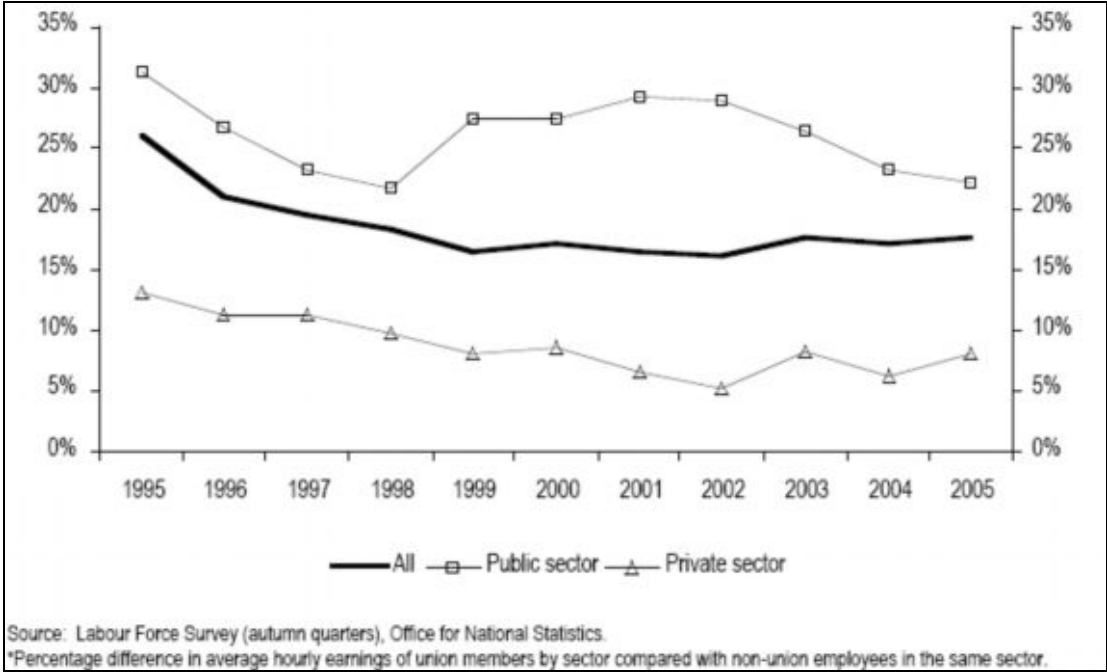
Arguably, an inevitable consequence of the marginalisation of the unions has been to make them less attractive to members and this is very evident from the decline in membership. From 1992 to 2005, trade union density declined by over six percentage points, with the fall in male density especially pronounced (see figure 7). By contrast, female union density has not only increased since 2001, but has also overtaken the male rate, and 2005 saw the first overall increase for decades. Directly comparable data for the 1970s and 1980s are not available, but at the high point in the late 1970s, UK union density was comfortably over 50%.

Figure 7. Union density in the UK



Source: Office of National Statistics

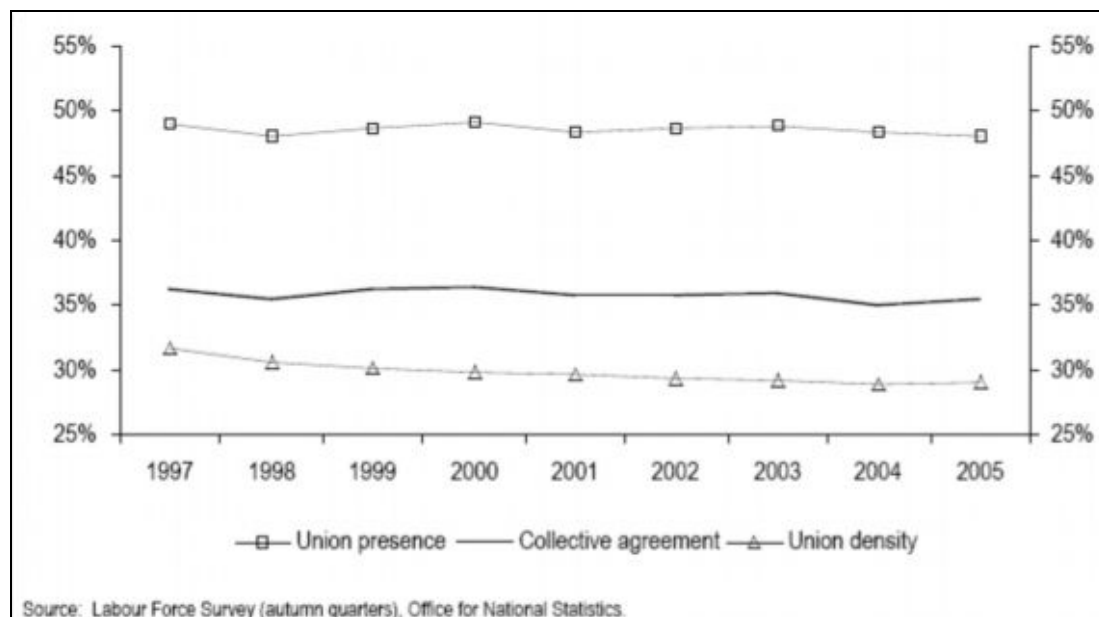
Figure 8. The wage premium of union members



Source: Grainger (2006)

Full-time workers are some 50% more likely to be union workers than part-time workers and there is a big difference between regions, with low density in the prosperous South East region and the highest densities in Northern Ireland, Wales and North East England – areas traditional industry used to be dominant. The public sector is much more heavily unionised than the private sector, even for comparable occupations according to the European Industrial Relations Observatory.

Figure 9 Union density and coverage



The nature of the employment policy

Employment policy aims to counter ‘inactivity or unemployment traps’ following a two-pronged approach: checks combined with sanctions and incentives (make work pay). The detail of the approach is important. First, the rationalisation of the employment service has allowed for an effective relationship between the payment of Jobseeker’s allowance and support and checking of the unemployed by Job Centre Plus. A key part of placement activity is devoted to matching work where the aim is to help the unemployed move into occupations where jobs are available. Training is not such an important part of this process. Evaluations carried out by the Department of Work and Pensions on this subject highlight the lack of effectiveness

of training in redeployment²⁷. Second, the actual effect of the Back to Work programmes (The New Deal – the main assisted employment programme for the unemployed on the one hand and the Working Tax Credit, a scheme which gives tax support to those going back to work, on the other) is slight: it is estimated that the labour force increased due to these two programmes by less than 1% between 1997 and 2001²⁸. Out of 520,000 young people who took part in the New Deal for Young People between 1998 and 2002, only 30 – 40,000 of them are thought to have found a job thanks to the programme²⁹.

The conditionality central to the ‘New Deal’ approach introduced since 1997 has, according to de Koning *et al.* (2004) has been effective in reducing long-term unemployment, virtually eliminating it for youths – the main initial target group. Moreover, it has not increased short-term unemployment, which might have been expected if it encouraged ‘churning’ with individuals subject to more frequent episodes of unemployment. A significant problem still confronting employment policy in the UK is, however, the high level of innumeracy and illiteracy among the unemployed.

The New Deal has, however, been subject to substantial *deadweight* effects and the majority of young people did not stay in their job for more than thirteen weeks. For the least qualified and older workers, periods of unemployment are actually slightly longer. Back to Work policies come up against a clear problem: in the former industrial urban areas or certain hard hit areas in the Midlands and North, for example, obtaining employment for workers who have been unemployed for many years is far from easy. Therefore, unemployment and the phenomenon of people not being involved in the labour force tend to be locally and socially concentrated: in 17% of households of a working age, not one member of the household has a job. When these policies do manage to make an impact on people not working or on unemployment, it is by facilitating employment in poor quality part-time roles: half of all Working Tax Credit recipients work between sixteen and twenty hours per week.

²⁷ It must be highlighted that this is short-term training.

²⁸ Andrew GLYN and Stewart WOOD, 2001, ‘Economic Policy under New Labour’, *The Political Quarterly*, Volume 72 January.

²⁹ National audit office, 2000, *The New Deal for Young People*, Report by the Comptroller and auditor general, London, February.

Employers' reactions

The CBI, in its latest *Employment Trends* survey, published in September 2006, reveals the growing disquiet among its members about the burden of regulation of employment, with three quarters of respondents objecting to the time and takes and over 60% concerned about the amount of senior management time it absorbs. The survey also shows the extent to which employers are reducing their commitment to defined benefit pension schemes, with the proportion having fallen from 54% in 2002 to just one third in 2006. This represents a significant change in the non-wage element of remuneration. Employers continue to voice considerable dissatisfaction with the educational standard of school-leavers, with over 40% of employers critical of basic numeracy and literacy.

More employers are, nevertheless, setting up formal procedures for consulting employees, a process that has been given impetus by new regulations³⁰ that came into force in 2005.

Far-reaching changes to the UK pension system are in prospect. The retirement ages for men and women are to be increased by stages with a target of 68 by 2047. Some time after 2012, a link to average earnings as the benchmark for pensions will be restored. Although union and employer representative have broadly welcomed the changes, there have been some criticisms from both sides.

Industrial unrest

The decline in industrial action, already seen since the mid-1980s, has been maintained in the last decade. In the early 1980s, the average number of stoppages per year was around 1,300 per year and days lost to industrial action (even excluding the very exceptional year of 1984 in which the miners strike occurred) was in excess of 4 million. Days lost fell sharply after 1989, and in the decade after 1991, the number of stoppages shrank to one around one sixth of the rate of the early 1980s. As table 2 and figure 10 show, the decline in industrial action has continued up to 2006, albeit with occasional jumps as in 2002 when disputes in public administration and education caused a jump in days lost (Monger, 2003). The data also show that disputes and days lost in the private sector have generally continued to decline,

³⁰ A legal instrument, but of lesser standing than an Act of Parliament

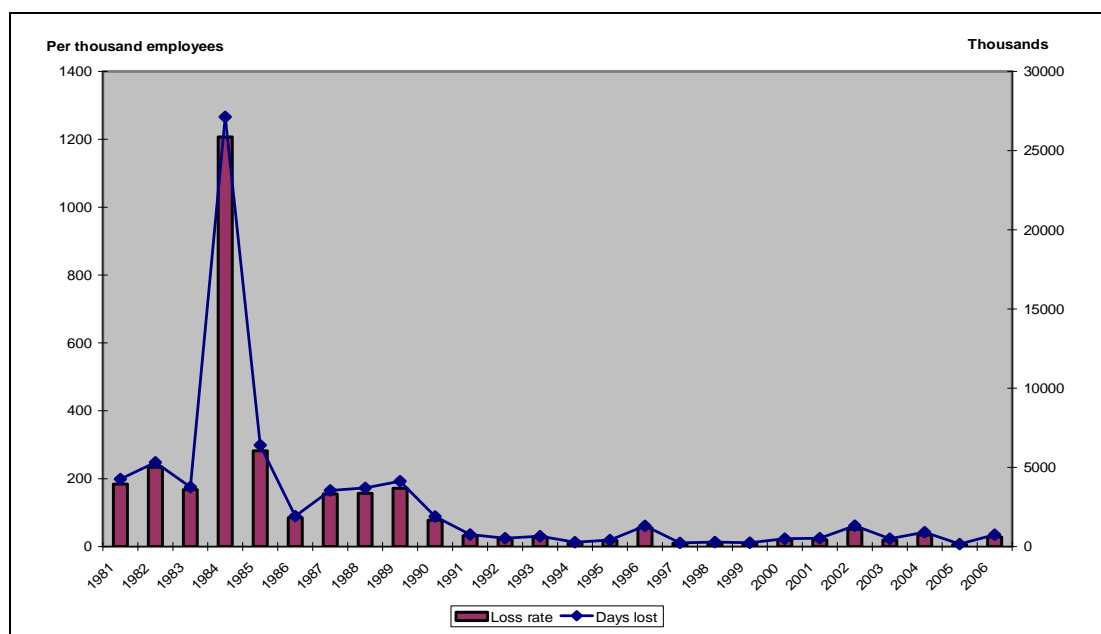
whereas in the public sector figures are more volatile. In fact, Beardsmore (2006) notes that the figures for 2005 were the lowest on record and in a government statement on employment relations policy³¹ it was stated that this is the lowest figure since records began in 1891, although the table shows that there was some increase in 2006.

Table 2 Industrial action in the United Kingdom

	Days lost ('000s)		Stoppages	
	Private	Public	Private	Public
1996	299	856	138	127
1997	163	71	127	89
1998	165	117	88	78
1999	172	70	102	103
2000	136	363	99	113
2001	128	397	83	111
2002	200	1123	85	61
2003	130	369	87	46
2004	163	742	62	68
2005	59	99	56	60
2006	98	656	71	87

Source: Office of National Statistics

Figure 10 Industrial action in the UK, 1981-2006



Source: Office of National Statistics

³¹ DTI (2006)

4 Minimum wages

One of the most significant changes introduced by the New Labour government was the national minimum wage (NMW) which came into operation in 1999, initially at quite a low rate. Previously, there had been some protections afforded by sectoral Wages Councils covering up to 2 million workers. With the exception of agricultural workers, these were abolished in 1992. The stage for the NMW was set by the Low Pay Commission set up in July 1997 by the incoming Labour government, with a mandate to make recommendations on minimum wage levels and increases, while taking into account likely repercussions on employment levels and inflation, as well as the impact on business competitiveness, particularly for smaller companies. The commission is made up of nine members including workers' representatives, employers' representatives and independent experts.

In March 2006, the Department of Trade and Industry decided to ratify the recommendations made by the Low Pay Commission on increasing the three minimum wage rates, meaning that from October 2006, the minimum wage for adults was £5.35 per hour, for 18-21 year olds £4.45 per hour and for 16-17 year olds £3.30 per hour³². Justifying his decision, the Minister Alan Johnson said: 'In a period when the economy is robust, benefiting from one of the longest ever periods of growth and from almost 2.4 million jobs created since 1997, it is right that we should help those who earn the least.' With this increase, the National Minimum Wage will have spectacularly increased by 49% since its introduction in April 1999. It will also have been extended to the 16-17 age group, which was not included in the system at the outset. Of course, the minimum wage set off from a particularly low level compared with other European Union countries, but it has now practically reached the level of the French *SMIC* (minimum wage) in terms of gross hourly rate and it is now higher if we calculate using the monthly rate, even when taking into account differences in purchasing power between the two countries (figure 12). A further increase has just been agreed, again on the basis of rates recommended by the Low Pay Commission (2007).

In a country where the tradition of collective bargaining was based on the government not being involved, demanding a set minimum wage was not plain sailing

³² Applying the exchange rate in force on 20th October 2006, the hourly minimum wages in Euros are: € 7.68, € 6.39 and € 4.74.

for the trade union movement. In fact, the issue undoubtedly marked a change in strategic policy for the TUC in the face of the problems inflicted by Thatcher's policy and a considerable increase in low-waged jobs and poverty during the 1980s. While the British model is regularly held up as an archetypal example of employment flexibility in debates on employment, the National Minimum Wage is undoubtedly an important development – around 1.5 million workers have benefited from it, 70% of whom are women.

Though initially criticised for setting the minimum wage at a low rate, the government has since pushed it up at a faster rate than average earnings. According to a recent Eurostat report, the UK minimum wage at the beginning of 2005 was €1197, exactly the same as in France. On 1 October 2006 the main rate, applied to workers aged 22 and above was raised to an hourly figure of £5.35 an hour, from £5.05 in 2005 – an increase of just under 6%. Since it was introduced in 1999, the rate has risen from £3.60 an hour to £5.35, an increase of 49% in nominal terms and about 35% in real terms.

There were three further (and lower) rates for other groups, of which the first was abolished in 2006, leaving only the development rates for youths:

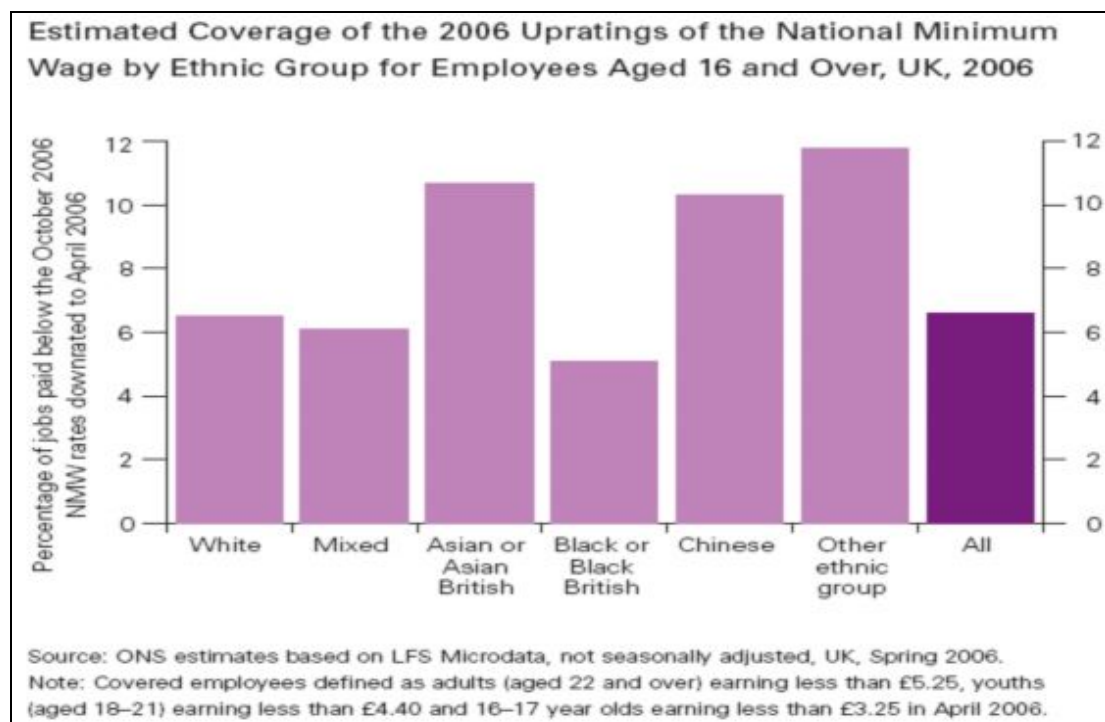
- A training rate for workers aged 22 and over who are receiving accredited training in the first six months of a job with a new employer: it reached £4.25 in 2005
- A 'development' rate for 18-21 year olds: now £4.45 an hour, from £4.25 in 2005
- A 'development' rate for 16-17 years olds set at £3.30 an hour, up from £3.00 when it was introduced in 2004.

The increase in the NMW has taken it from 47.6 of median earnings when it was introduced to around 52% following its increase implemented in October 2006. As Metcalf (2007) points out, it has meant a substantial increase in the real value of the minimum wage. Depending on the price index used, the adult rate of £3.60 an hour would have had to rise to between £4.02 and £4.34 to compensate for price increases. To keep pace with average earnings, it would have had to rise to £4.88, so that the 2006 rate of £5.35 represents a substantial increase in relative wage of those paid the NMW. Metcalf also shows that the gender pay gap, measured using median earnings, declined by five percentage points from 16.4% to 10.8% between 1998 and 2006. He attributes much of this change to the NMW and demonstrates that the gap narrowed most at the lower end of the pay distribution. Metcalf also cites work by

Dickens and Manning (2006) that shows that the NMW has made a sizeable difference to wage inequalities, reversing the trend that had been apparent over two decades since the late 1970s. Moreover, the decline in inequality occurred despite the high level of immigration, which, *ceteris paribus*, would have been expected to increase inequality.

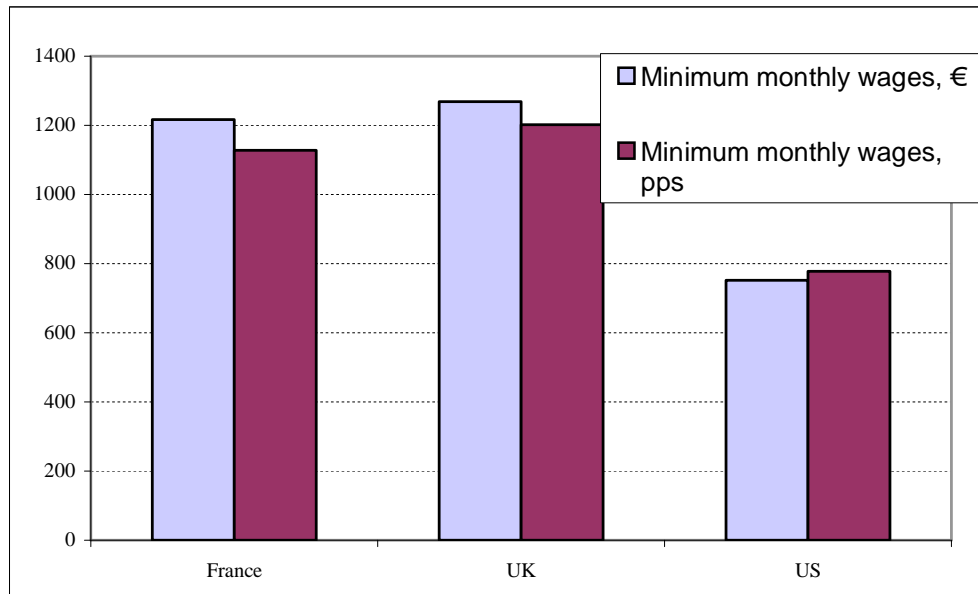
The overall coverage of the minimum wage has increased as its real level has grown, but as figure 11 shows, the coverage is just over 6.4% of employees. Work by the Low Pay Commission (2007) shows that there are ethnic differences in the coverage, with employees of Asian and Chinese origin more likely to be employed on minimum wages. The minimum wage, at least in its early years, does not appear to have much effect on employment and only a small impact on the overall pay bill, but has clearly helped to reduce the gender pay gap (Dickens and Hall, 2005). Over two thirds of the beneficiaries are women.

Figure 11



Source: Low Pay Commission (2007)

Figure 12 Comparisons of monthly minimum wages



Note: Hourly rates were converted into a monthly rate using the following factors:

- France: 35 hours x 52 weeks, divided by 12
- United Kingdom: 39.4 Hours x 52 weeks, divided by 12
- The United States: 40 hours x 52 weeks, divided by 12

Source: Eurostat, 2006

Effects on employment

The effects of the minimum wage on employment – the subject of often alarming claims in the run-up to the introduction of the minimum wage - have now been analysed in a number of studies (Low Pay Commission, 2007). Broadly, the conclusion of these, is that the impact has been insignificant. Studies commissioned by the Low Pay Commission have not managed to establish whether the National Minimum Wage has a negative effect on employment. A report carried out in 2005 reached the following conclusion: *‘We show that profitability was significantly reduced by the minimum wage. Importantly, we also show that low wage firms were not forced out of business by the higher wage costs resulting from the minimum wage. One possible explanation is that firms were making profits from paying low wages prior to the minimum wage introduction and that one consequence of the introduction of the minimum wage to the UK labour market was to moderate these excess profits by channelling them back to the wages of low paid workers.’*

Moreover, even the large increase implemented in 2003, which exceeded the growth in average earnings, does not appear to have altered this conclusion (Dickens and Draca, 2005). There is, however, tentative evidence (Stewart and Swaffield, 2004) that the minimum wage may have slightly reduced hours worked by the low paid – though whether this is employer or employee choice could not directly be ascertained. Surveying the evidence, Metcalf (2007) finds that the effect of the NMW on employment has been minimal – contrary to many expectations derived from standard theories – and assesses twelve different explanations for this finding. He immediately rejects two ideas on the basis of direct evidence: that MW was set below the competitive wage or that its coverage was incomplete. The next five explanations are also rejected, though for more subtle reasons, leaving a focus on five more plausible reasons. A first is that the NMW does seem to have been associated with rising productivity in firms where the number of workers paid the NMW is significant, especially in service industry firms. Metcalf is not able to ascertain whether the rise in productivity is explained by capital deepening or other processes, but finds enough support for the idea that it offers a weak explanation for why employers do not shed labour. He finds some evidence that employers have been able to pass the higher costs through to prices and also that firms with large complements of NMW workers have seen a loss of profits. There is, in addition, some evidence that the NMW has been offset by reductions in hours worked. The last explanation, that firms have a degree of monopsony power that enable them to hold employees in local labour markets, might also be valid insofar as a minimum wage set a little above the wage preferred by employers will result in higher pay but stable employment.

Table 3: The impact of the minimum wage in the UK

			Adult NMW as a percentage of gross hourly earnings excluding overtime for all aged 18 and over				Gender pay gap for full-time employees (female hourly earnings as a percentage of male hourly earnings)	
	Date (April)	Adult NMW	Lowest decile	Lowest quartile	Median	Mean	Median	Mean
ASHE without supplementary information	1998	na					16.4	20.4
	1999	£3.60	87.0	68.3	47.6	36.7	15.7	19.7
	2000	£3.60	83.3	65.7	46.2	35.3	13.8	19.0
	2001	£3.70	82.2	64.8	45.2	34.2	14.0	19.0
	2002	£4.10	86.7	69.0	48.1	36.0	13.5	19.2
	2003	£4.20	84.0	67.5	47.5	35.7	12.7	18.7
	2004	£4.50	87.2	69.4	48.5	36.7	12.1	17.1
ASHE with supplementary information	2004	£4.50	87.5	70.0	49.0	37.4	12.2	16.7
	2005	£4.85	91.0	72.9	51.1	38.6	11.1	16.5
	2006	£5.05	91.2	72.8	51.1	38.6	10.8	16.8
Predicted bite	2007	£5.35	92.8	74.4	52.1	39.3	-	-

Source: ONS, Annual Survey of Hours and Earnings (ASHE) without supplementary information, 1998-2004, ASHE with supplementary information, 2004-6. Notes: (i) There is a change of definition in ASHE in 2004 which improved the coverage of low paid workers. (ii) The data for 2007 assume that lowest decile, lowest quartile, median and mean hourly earnings grow by the average earnings forecasted by the Treasury Panel of Independent Forecasts, viz 4.2%. (iii) The gender pay gap data refer to workers on adult rates whose pay was not affected by absence.

Source: Metcalf (2007)

At a macroeconomic level, too, Metcalf finds an association between the share of profits in the economy and the NMW. He draws on work by, *inter alia*, Boyd (2004) and Glyn (2007) to show that the profit share rose in the twenty years after the mid-1970s, to peak in 1997, but has since fallen by two percentage points, with the wage share registering an equivalent rise.

Impact on income inequality

While the National Minimum Wage has greatly increased since it was first introduced in 1999, it is still below 50% of the mean gross hourly income for men, fixed as a compromise between the unions and Labour during the 1992 elections. In 2004, it represented 48.5% of the median wage, 87.2% of the first decile (the worst paid) and 21.7% of the last decile (the best paid), with those figures being the same as the 1999 statistics.

The second period in power of New Labour (2001-2005) was slightly better for the poorest workers (table 4), with an annual average increase in incomes of 2.8% for the first quintile (20% of the poorest households) compared with 2.4% during his first mandate (1997-2000). The richest quintile experienced slower growth (1.6% during the second period in power as opposed to 2.6% during the first mandate). With

the further relative increases in the NMW over the past two years, the third mandate is reinforcing this trend in favour of the poorest workers.

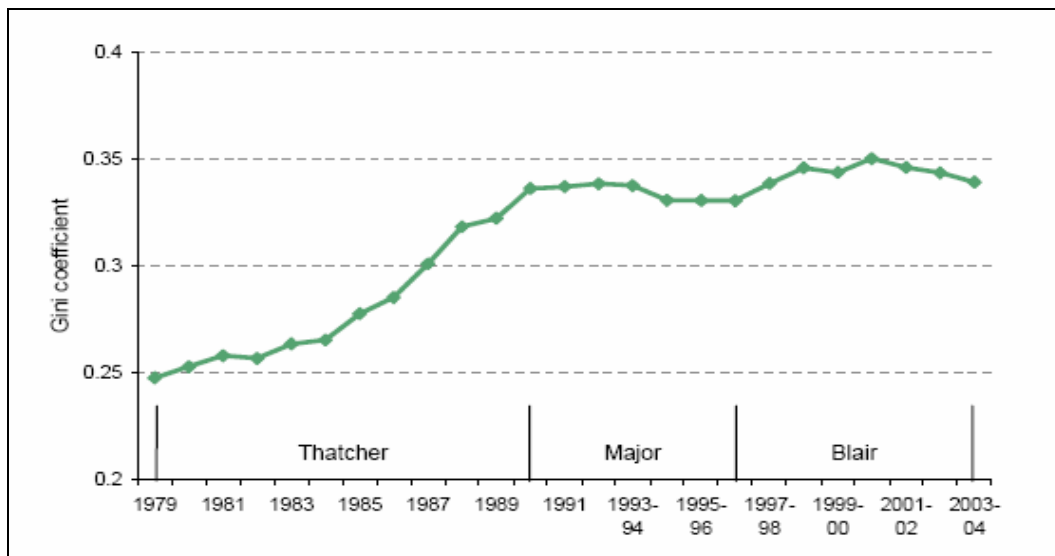
Table 4: The National Minimum Wage in terms of salary distribution

Minimum adult rate in terms of the:	1999	2001	2004
1 st decile (the poorest 10%)	87.0	82.2	87.2
1st quartile (the poorest 25%)	68.3	64.8	69.4
The median	47.6	45.2	48.5
The average	36.7	34.2	36.7
The last quartile	31.3	29.5	31.6
The last decile	21.6	20.3	21.7

Source: Low Pay Commission

The recent progress in narrowing wage inequality has to be put into perspective in the light of changes recorded during previous governments (figure 13). While there has been a slight drop in poverty since the end of the 1990s, poverty increased considerably during the previous government's eighteen-year period in power: 14% of the population lived on less than 60% of the median wage (after allowing for the cost of housing) in 1979 but this had increased to 25% in 1997. Increased inequality has been a feature of nearly all EU countries in the last twenty years, but the extent of it is greater in the UK than in most of the EU. The 2004 level is 21.7% (Brewer *et al.*, 2005). In terms of poverty, the National Minimum Wage has clearly improved the lot of the 'working poor', but for those without employment, poverty is still the norm and old-age poverty is also a significant phenomenon. 20 % of retired people are living below the poverty threshold. 50% of single parents with at least one child, mainly women, are living in poverty, a high figure by comparison with most other EU Member States. This is mainly due to insufficient redistribution and also to the sheer scale of short-term, part-time working (the average working week for part-time workers is 15 hours). For the women who work in these jobs, the National Minimum Wage does not constitute a living wage.

Figure 13 Changes in income inequality in the UK



Source: Brewer et al., 2005

5 Report on interviews with labour market actors

In April 2006, interviews have been conducted with a range of labour market actors and policy-makers and the list of those interviewed so far is provided in the appendix. This note summarises the findings from the interviews conducted. The interviews revealed a surprising consensus on a number of aspects of the development of the UK labour market in recent years and its current position, but greater differences of opinion on unresolved problems and how it will evolve in the coming years.

The importance of macroeconomic trends

For many of the interviewees, a starting-point is the macroeconomic position, which, it should be recalled, has been very benign. The UK was one of the first European economies to pull out of the deep recession of the early 1990s and has enjoyed stable and, compared with previous decades, fairly impressive growth since then, avoiding any significant downturn, unlike several of the continental European economies. The upshot has been a steady increase in living standards, regular employment creation and falling unemployment.

More strikingly, inflation has shown no sign of resurgence and has stayed at the lower end of the range of EU economies. This presents a marked contrast with

previous experience of much greater cyclical volatility. There is no strong analysis of why inflation has been subdued. One interviewee argued that evidence that it was attributable to globalisation-induced pressures was weak, and pointed to the effects of immigration in relieving cost-push pressures. However, as discussed below, others assign find little impact of migration. Certainly, it is difficult to envisage a return interest rates in double figures as they were at the end of the 1980s, although it can also be argued that the experience of that era also had a marked effect on labour market actors. There are macroeconomic challenges facing the UK economy, such as the volume of consumer debt and its counterpart in a persistent balance of payments deficit. Yet there was no great sense of alarm from the interviewees that these imbalances might presage more severe macroeconomic problems.

No interview could offer any insights into the changing share of wages in the economy and, indeed, did not regard it as a salient question. However, one issue that was mentioned by different interviewees was that there are various connections between the housing market and the labour market.

The Thatcher legacy and subsequent developments

It is also clear that most labour market actors regard the major supply-side changes that were wrought during the Thatcher years as an important part of the backdrop to today's labour market. Nevertheless, there was no real support for the characterisation of the UK as a free-wheeling, ultra-liberal system devoid of protections and replete with working poor. Indeed, most of the interviewees stressed that there had been a significant swing back from the more extreme Thatcherite features.

Although some shortcomings are, perhaps inevitably, identified by certain interviewees, the more striking finding is, again, the consensus that the UK approach has broadly been a successful one. It seems to be a variant on *flexicurity* that has both attenuated the worst excesses of the Thatcher model, but also retained enough incentives to push benefit claimants towards work.

Many different explanations for the trends in the economy arose. Tertiaryisation is one, given that not only are there far fewer workers in traditional industries, but also that the newer activities are less unionised, more fragmented in terms of

companies and also at both ends of the skills spectrum. Relatively fewer jobs have been created in the middle of the distribution.

Unions lost badly during the Thatcher years and have been kept at arms length under New Labour. One manifestation of this is that there is no sign that the social partners will acquire a more extensive role in the economy: a Continental style social dialogue still seen as alien. However, various rights have been restored. Unions seem to be entering a phase of consolidation, which is likely to result in a smaller number of more diversified unions. For the unions, one major issue is the UK's continuing opposition to the Working-Time Directive. Unions have also been learning from counterparts in other English-speaking countries in developing new partnership approaches in working with employers, with issues such as training and pensions often high on the agenda, instead of just pay and conditions as in the past.

Approach to activation

Another key element in understanding the UK labour market is the approach that has developed over the last decade to activation. In particular the approach has attempted to achieve a much closer integration of social protection and labour market policies. It includes a link between labour market activity and not just unemployment benefit, but also social assistance – in contrast to other countries. One interviewee suggested, however, that the socially excluded may not be well covered by this approach. Employability has been central, manifesting itself in the welfare to work agenda that has been at the heart of New Labour policies. It is expected that this trend will continue in the coming years, with reduction in the number claiming incapacity benefit seen as the next frontier for increasing the employment rate, with a target of 80%. A criticism heard in other countries that the UK simply disguises its unemployment by labelling the unemployed as incapacitated is belied by the high employment rate, although some interviewees did accept that the number of incapacity claimants was too high.

Commenting on data showing that the UK spent far less than other Member States on active labour market policies, one interviewee explained that a reason is that the UK approach relies much more on provision of information than on subsidies, whether for training or to lower social charges. Instead, the Job-centre plus approach is at the heart of the UK activation model. It obliges unemployed individuals to attend

interviews and there are sanctions for those who do not. In essence, therefore, the approach is one that makes receipt of benefit conditional, in contrast to systems where it is a right. One interviewee was sceptical about the value of subsidised training because of the high deadweight that is so often found with such schemes.

The UK has shown a willingness to innovate in a number of areas. For example, the pathway to work initiative is seen as a way of confronting one challenge, the low employment rate of single parents. There is also a preference for assuring protection at the level of the household rather than the individual, which, in turn, tends to add to the pressure on the individual to obtain work.

Employment protection

It is an open question whether the nature of employment law has played a part in labour market developments and on this question there were diverging views. One interviewee suggested that the common law basis of English law may have played a part in simplifying employment contracts in contrast to the much more codified system in other countries (such as France). As regards employment protection legislation (EPL), there was a fair amount of consensus that there has been a rebalancing since 1997, with some of the protections restored. Interviewees from all sides seemed also to agree that the current EPL was about right, having achieved an appropriate balance between flexibility and protection. However, one interviewee mentioned that protection for the most vulnerable remains unsatisfactory, as a result of which the UK does not match the Nordic countries in this respect. Another made the emphatic point that the UK offers much less protection to insiders than other countries.

Low pay and the minimum wage

The introduction of the minimum wage has been a significant change in the UK labour market and, although it was initially set at a low level that had little impact on the labour market. It has since risen significantly relative to average wages and is now having more of an effect on wage bargaining, despite the proportion of workers paid the minimum being quite low. One interviewee suggested that many employers were reluctant to be stigmatised as offering ‘only’ the minimum wage, but that the

latest increases had removed this constraint. As in France, the result may be to compress the bottom end of the wage distribution.

Low pay has been transformed by the introduction of the minimum wage (NMW), its gradual relative increase and – reflecting the integration of the social protection and labour market systems – the working families tax credit. Initial opposition from employers to the NMW has dissipated and there seems to be agreement that it has had a beneficial effect. Several interviewees observed that the system will be more severely tested now that the NMW has reached levels at which far more workers are paid. A concern about the NMW is that not enough is done to ensure enforcement and that this could become a more pressing issue. In particular, immigrant workers are not always adequately protected in this respect.

Immigration

The immigration story is a significant one. Despite the recent arrival of a very high number of migrants from recently acceded Member States (figures suggest an inflow of the order half a million working-age individuals), the consensus among the interviewees seems to be that there have not been any adverse effects on the UK labour market, a finding that belies many of the fears that had been articulated (and which still resonate in those other EU Member States that have kept their doors closed)³³. An explanation offered is that immigrants have largely filled jobs that the indigenous population has shunned

Unresolved issues

Problems in the UK labour market are, manifestly, not all solved. The interviewees cited a variety of shortcomings that remain to be adequately addressed. They include a concern about quality of work and the ‘commodification’ of labour, equality and about social mobility.

Low productivity is a continuing problem for the UK economy, since it still has some way to go to reach the best levels achieved by EU partners, and still lags the US by some way. Various issues arose in the interviews in this regard. One interviewee urged caution in interpreting the data because the much higher

³³ Since the interviews were conducted, it has been announced that the UK will be less hospitable to immigrants from the two countries due to accede to the EU in 2007, Bulgaria and Romania

employment rate in the UK means that more ‘marginal’ workers are included in the data. In addition, the high share of private services leads to measurement problems. Others stressed that the quality of jobs is a concern that needs to be addressed, and that short-termism (the search for rapid financial gains instead of seeking to build physical, human and social capital) may still be a weakness of the UK economy.

Although there is legislation regarding equality of pay and of opportunity, practice reveals problems. Women’s pay still lags some 20% below that of men. One interviewee mentioned that there is evidence of discrimination against the disabled and ethnic minorities.

6 Strengths and weaknesses of the UK ‘model’

The UK labour market almost certainly does not correspond to the image it has in so many circles of being a neo-liberal free market one that offers few protections. This image is both overly simplistic and at odds with the evidence the UK labour market has been delivering the goods in terms of jobs and incomes. Nor, however, is it an example of all that is best, as there are weaknesses that will continue to challenge policy-makers.

According to a report by de Koning, Layard, Nickell and Westergaard-Nielsen (2004), there has been a substantial reduction in what they call ‘the sustainable rate of unemployment’. They attribute this reduction (they assert that the rate had fallen from 8.5% in the late 1980s to 5% by 2003), above all, to changes in the way unemployed people are treated, although they also ascribe some influence to the increased wage flexibility that resulted from the trade union reforms of the 1980s. They point to three phases in the evolution of policy towards the unemployed:

- Up to the mid-1980s, they identify a gradual relaxation in the test of ‘willingness to work’ as a condition for receiving unemployment benefit
- In the subsequent decade, various measures were adopted to reconnect benefit to search for work, culminating in the *Jobseekers’ Allowance*, introduced in 1996, which assigned a personal adviser to the unemployed person, with a mandate to advise on obtaining a job.

Following the election of the Labour government in 1997, the conditions imposed on the unemployed person were made stricter, but accompanied by a commitment to spend money on the individual to facilitate integration into the labour market.

Skill levels are seen as a weakness in the UK system (Hutton, 2005), though it is recognised that the position is improving. In addition, low productivity has long been on the government's agenda, yet thus far without especially encouraging results. There is a possibly linked phenomenon, which is the quality of jobs, especially in the booming service industries that are responsible for the surge in UK employment. Fagan *et al.* (2005) show that service industry jobs can be high quality but are also prone to instability.

Governance of the labour market

Since their heyday in the 1970s, the social partners have been marginalised in policy-making. The Thatcher years saw a series of assaults on trade union power that eroded union influence and, despite the longstanding links between the union movement and the Labour Party; the change of government in 1997 did not result in much change.

The UK continues to have an uneasy relationship with EU initiatives in the labour market, the most prominent example being resistance to attempts to bring the UK into the fold on the 48 hour week.

Metcalf (2007) echoing repeated complaints from the Low Pay Commission (on which he served until 2007), is critical of the weak enforcement of the NMW, but also observes that it is almost surprising how many employers do comply. Certainly, a concern among trade unions is that the increase in immigration offers rogue employers an opportunity to breach the rules.

The 1999 Employment Relations Act led to a resurgence in trade union recognition agreements. Dickens and Hall (2005) report that the impact of the Act has come about much more through what they describe as the 'shadow of the law' – the change in the socio-political setting – than the direct use of the provisions of the law. But it is also noticeable that workplace relations have been largely consensual, except in a small number of cases. There is systematic monitoring of the new policy framework (DTI, 2005, for example, summarises the approach).

The Labour party has, traditionally, been close to the trade unions and obtained much of its funding from them. Unions remain one of three constituencies in the electoral college that will elect Tony Blair's successor. However, a key change in British politics post-Thatcher is that 'New' Labour has sought to distance itself from the union link. If the unions expected to regain influence after the 1997 election, they have been disappointed. Moreover, Labour has had to woo the middle-class, middle-England vote to retain power and has deliberately looked outside its traditional supporters for party financing³⁴. In political economy terms, what matters is that New Labour is no longer as closely identified with the working class base as it used to be, a trend that is reflected in many of its policies. Labour now stresses an image as the party of economic competence with a pro-competitiveness stance. A striking example is the reaction to the closure of the Rover company in 2005 with no real attempt to orchestrate a rescue. There has been hardly any resistance to the takeover of large UK companies such as the Abbey National Bank or even BAA (both acquired by Spanish companies), the company that owns the main airports and might – in other political contexts – be seen as a provider of services of general interest to be protected at all costs. Here again the contrast with the political economy of the 1970s is striking. Private finance initiatives (PFI), pushed by the government despite union opposition, have been illustrative of the new arms' length approach to engaging with the unions.

Compliance with the working time directive has been patchy and a sizeable proportion of workers has taken advantage of the UK's continuing opt-out from the 48 hour limit. Studies reveal conflicting findings about the degree to which workers have been pressured into working beyond the 48 hours, although the weight of evidence seems to be that most of those consenting to work longer hours do so voluntarily. In this respect, the additional income on offer appears to have been a key parameter.

Employment protection is not strong in the UK, but, as de Koning *et al.* (2004) point out, it 'has not been a major source of controversy'. Rather, they argue that the political concerns have centred on the conditions under which benefits are granted. There is evidence that where the unemployed face conditions for receipt of benefit, they are more likely to fill available vacancies.

³⁴ With sometimes damaging effects, witness criticisms that led to ministerial resignations in the late 1990s and the 'cash-for-peerages' episode that has blighted Blair's last year in power

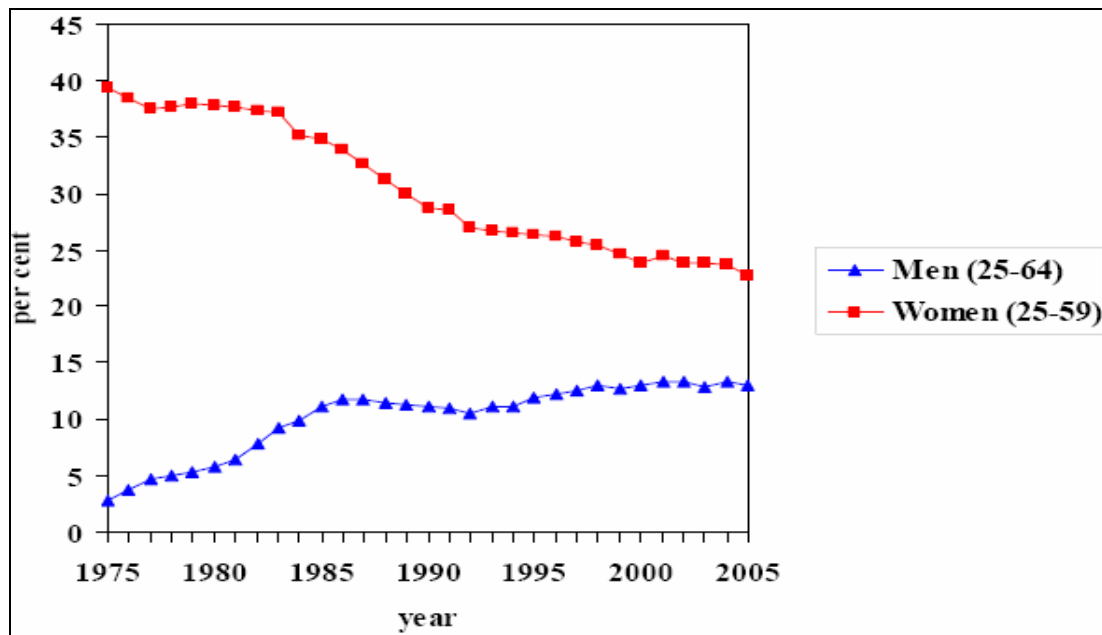
The inactivity puzzle

Although the UK has seen a sharp drop in unemployment since it last peaked in the early 1990s and has maintained a high employment rate, there has also been a high level of inactivity of working age people. There are many explanations for this phenomenon, one of which is that it simply represents disguised unemployment. Institutional factors and the incentive properties of different benefit schemes have played a part, as a policy analysis by the Centre for Economic Performance (2006) shows. The principal cause of increased inactivity is the increase in the number of inactive males, especially those who lack skills or whose skills have become redundant. Figure ** shows the long-run trend in which it can be seen that proportion of inactive women has declined steadily, but has been offset by an increase in inactive males.

The labour market shakeout of the early 1980s saw a sizeable number of older men withdraw from the labour force, whereas in the 1990s, the increase was more among men of prime age (25-54). The proportion of inactive men in this group has grown throughout the OECD, but in the UK (8.6%) is a little higher than the EU-15 average of 7.8%, although the activity and employment rates of older men are higher in the UK (Centre for Economic Performance, 2006). It can be inferred that some of the inactivity in the UK is disguised unemployment and thus that the low figure for registered unemployment is flattering to the UK (Ardy and Umbach, 2003). But it also has to be borne in mind that the high employment rate reflects the proportion of working age people in and out of employment, whether the latter are classified as unemployed or inactive.

Most of the rise in inactivity has been unskilled workers, who have become detached from the labour market rather than remaining unemployed. A decline in demand for unskilled workers meant that those with additional disadvantages (especially chronic sickness or disability) became increasingly hard to place in the labour market, and a response of the social security system was therefore to push them to claim invalidity (now incapacity) benefit. There is also evidence that doctors, who are obliged to support claims of invalidity, were generally willing to confirm claims (National Audit Office, 1989). The fact that invalidity benefit was more generous and did not impose pressures to seek employment helps to explain the shift (Centre for Economic Performance, 2006).

Figure 14 Inactivity trends by gender 1975-2005



Source: Centre for Economic Performance (2006)

The recognition that the stubbornly large number of what is now incapacity benefit claimants represents an unused reservoir of labour has become central to the UK government's latest policy initiatives. A (consultative) Green Paper on welfare reform, published in 2006, put forward various proposals for increasing the employment rate to 80%, with a substantial reduction in the number of incapacity benefit claimants as a key component of the strategy.

Good jobs, bad jobs?

Job quality and satisfaction has been studied by Brown et al. (2006) who find that job satisfaction has improved somewhat in recent years, following deterioration in the 1990s. They also note, however, that employees report greater work effort and higher levels of job-related stress. A key change has been improvements in perceived employment relations which, allied, to improved perceptions of job security account for much of the overall increase in job satisfaction.

In a country where labour market mobility rates are the highest in the European Union (*Employment in Europe 2004*, chapter 4), the question of job quality only takes on any kind of meaning if it is linked to the question of transitions. The United Kingdom is characterised by powerful 'trap' effects linked to low wages: while the rate of transition between temporary and permanent contracts is relatively

high, workers on low wages are some of the least likely in the European Union to move on to earning a higher wage.

Mobility is also a major factor, particularly for workers in the industrial sector, which has been hit by many plant closures over the past ten years. The 6,000 MG Rover workers who were made redundant in 2005 with a cheque for £3,000 in their pockets after fifteen years of service can bear witness to this, as can the 2,300 workers from Peugeot's Ryton site will suffer the same fate. In the Midlands, which has seen many recent closures in manufacturing, the redeployment of workers is far from certain and often comes at a cost: that of a lower salary. *'British workers must no longer be the European workforce that it is easiest to sack when things aren't going well'* said Brendan Barber, general secretary of the TUC, during a demonstration on 1st May 2006, thus refuting the idea that these redundancies are met with indifference. Nevertheless, the main difference compared to the so-called *flexibility and security* Scandinavian model is the dearth of laws, which would make workers' careers more secure. A weak unemployment benefits system and income support system. There is also a lack of continuous professional training with companies having no legal obligations in this area.

While not being totally absent, the term 'insecurity' is not frequently used in the British debate on employment. The expressions 'bad jobs' or even 'dead-end jobs' are more widely used, thus highlighting the fact that workers' main worries do not concern the exact nature of employment contracts. In fact, in the UK someone can be, to a greater extent than elsewhere, an employee with a permanent contract who has no promotion prospects and who lives in poverty. While the British government proved reticent about the implementation of European criteria on employment quality after the 2000 Lisbon summit, academic research, which is often linked to trade union concerns, was increasing in the UK in order to try to define what quality meant. Based on data from the national *Working in Britain 2000* study, which covered a representative sample of slightly more than two million workers³⁵, McGovern *et al* (2004), defined 'bad jobs' using four so-called negative characteristics: being low-waged (the threshold being set at half of the average salary), lack of sick leave cover, lack of pension provision apart from the basic State Pension and the lack of promotion

³⁵ The sample is aligned with the Labour Force Survey in terms of age, gender, social category and employment status. The self-employed were not included in the survey.

prospects (see, also, Lefresne, 2005). The number of workers whose job falls into at least one of the four categories is between 25-50% of the survey sample. The distribution of these characteristics in terms of job type (Table 5) shows that having a temporary or part-time job significantly reduces job quality, which is defined based on the average number of negative characteristics. In the case of identical job types (permanent or temporary), the situation of the part-time worker is nearly always worse than that of the full-time worker. For any given indicator, being a woman, young, belonging to an ethnic minority or not having qualifications significantly increases the probability of having a 'bad job'.

Collective bargaining coverage has a key role as regards this issue. For workers who are covered (36%), wages are undergoing real increases - on average much higher than what has been observed in France - and employment contracts give access to satisfactory social protection. However, for those not covered, this is far from being the case. The European Commission's *Employment in Europe 2004* publication shows that the UK is characterised by a considerable low-wage trap: while the rate of transition between temporary and permanent contracts is relatively high, workers on low wages are some of the least likely in the European Union to move on to earning a higher wage. It is part-time working – the scale of which is one of the specific characteristics of the UK labour market (more than a quarter of all employment, 77% female) – which goes a long way towards explaining this low-wage trap. While the transposition of the relevant European directive has helped limit discrimination, it is difficult to apply in companies where the trade unions have no foothold. The low levels of some salaries also automatically exclude a section of the population from insurance coverage against some social risks. In fact, apart from National Insurance Contributions (£97 per week), neither employers nor workers contribute to basic rights such as pensions, unemployment benefit or maternity leave. Taking into account the spread of part-time working, two million women and 500,000 men are in this situation and therefore have to resort to government help.

Table 5: Distribution of ‘bad job’ characteristics

	Worker distribution	Percentage of low wages	Percentage without sick leave	Percentage without pension provision	Percentage without career prospects	Average number of negative characteristics
Full-time	77.2	22.3	31.1	31.1	46.3	1.27
<i>permanent</i>	71.2	21.4	29.2	29	44.9	1.21
<i>temporary</i>	6.0	32	53.7	57.4	64.4	2.07
<i>fixed-term*</i>	2.6	13.7	47.6	43	58.4	1.72
Part-time	22.8	52.4	53.1	55.8	67.1	2.21
<i>permanent</i>	20.1	52.7	50.3	54.3	68.2	2.18
<i>temporary</i>	2.7	32	53.7	57.4	64.4	2.07
<i>fixed-term*</i>	1	29.7	57	51.1	46.2	1.87
Total	100 (n=2,124,000)	28.9	36.1	36.7	51.1	1.48

* Fixed-term contracts are the most widespread form of temporary work.

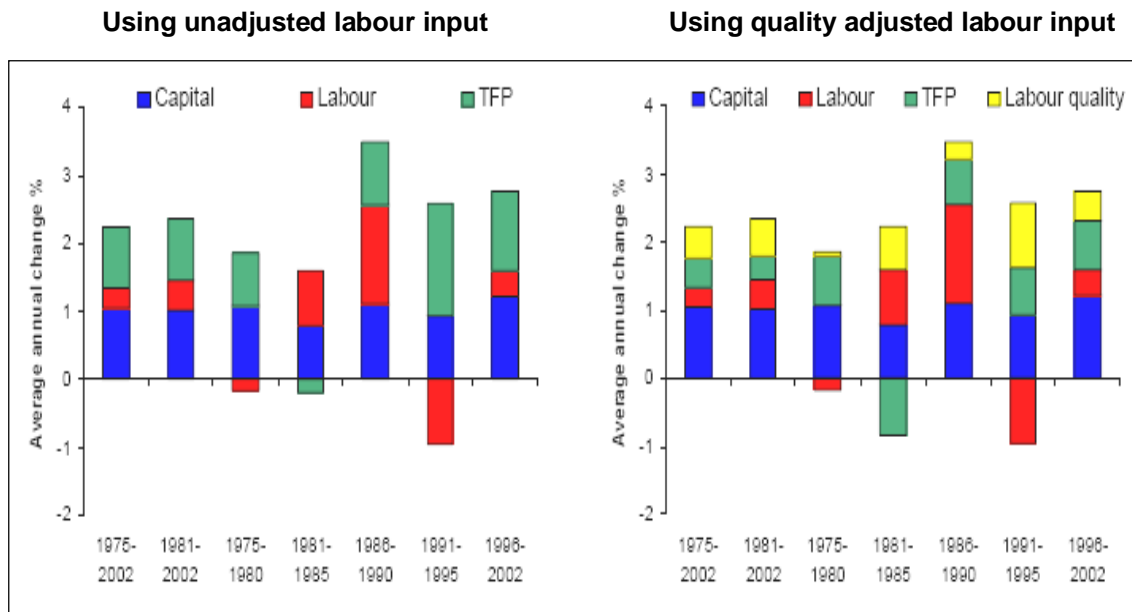
Source: McGovern et al. (2004)

Skills and labour quality

The contribution of labour to growth in the UK has fluctuated considerably over the last thirty years and has clearly been a factor in recent years as immigration to the UK has grown. Most assessments of the effects of immigration suggest that it has not crowded-out native workers and has been a positive influence overall on the labour market. In an interesting recent study, Bell *et al.* (2005) have constructed data on labour quality in which they show that part of what is conventionally measured as TFP (Total Factor Productivity) can be shown to be attributable to improvements in labour quality. Labour quality improvements contributed substantially to growth in the first half of the 1980s and again in the first half of the 1990s on their measure, with correspondingly lower inputs from TFP (figure 15).

Hutton (2005) finds that the UK now has a much improved approach to skills and that new approaches are beginning to make inroads into what was previously a rather uneven skills base. High quality university education was offset by a relatively low level of basic skills for many workers. Hutton notes, though that there is still a long way to go, especially in relation to life-long learning.

Figure 15 Contributions to UK growth



Source: Bell et al. (2005)

Immigration

Immigration into the UK, a substantial proportion of which has been from the recently acceded EU Member States, appears to have improved the workings of the labour market, reduced wage and inflationary pressures and lowered the natural rate of unemployment, according to Blanchflower et al. (2007). The UK is considered to be an attractive destination for migrants, partly because of the stance of immigration policy and partly because of favourable macroeconomic conditions

Much of the evidence on migration suggests that migrants tend only to have marginal impacts on host country wages and that a high proportion of the migrants are complementary to, rather than competitive with indigenous labour (see the survey in Blanchflower *et al.*, 2007). There is also some suggestion that, contrary to 'lump-of labour' notions, migrants help to increase productivity and to reduce the sustainable unemployment rate. The lack of impact of immigration on UK wages is explained by Manacorda et al. (2006) by the finding that immigrants and native workers are very imperfect substitutes. Indeed, they find that increased immigration has only held down the wages of other immigrants.

7 Policy prospects

The next stages of policy development are being developed on the basis of a statement of objectives for the current Parliament Success at Work (DTI, 2006) and a review of the options for the future of welfare to work programmes commissioned by the Depart of Work and Pensions (Freud, 2007). An essential part of the UK 'model' is a labour market characterised by diversity and flexibility in which there is a strong emphasis on opportunities for employment. The DTI document lays great stress on the importance of an inclusive labour market in which there is clarity about rights and responsibilities on both sides. Priorities articulated include:

- Breaking down barriers to employment, especially for target groups, with a low employment for ethnic minority groups highlighted
- Reducing regulatory compliance costs
- A stress on improving the quality of work and workplace organisation
- Reducing the gender pay gap
- Upgrading skills
- Consolidating and simplifying the different strands of equality law into a single Act.

Box 3**Employment Law Simplification Review**

The aim of this work is to make progress on the areas of employment law set out below and to identify any other areas, which are difficult to understand or administer, or cause confusion. We want to help both employees and employers get on with the business of doing business. To inform our thinking, we will look at ways in which other countries deliver clarity for employees and employers, and how they deliver information and advice. We will also rationalise guidance, publicise sources of advice and reduce administrative burdens. We will do this without in any way diluting employee and trade union rights and protection.

The bulk of the costs of employment law are the costs of providing the necessary minimum protection to workers and trade unions. We make no apologies for these. We are committed to making sure that the law has the effect we intended while ensuring compliance with it is as clear and easy as possible.

With the aid of stakeholders we have already identified a substantial number of specific areas of employment law to review. In addition over the coming year we will, with stakeholders and a panel of practitioners, seek to identify and bring forward proposals on any other areas of employment law where simplification and clarification can be achieved. Our ultimate goal is to reduce the compliance costs and complexity for business while continuing to deliver excellent regulatory outcomes.

Already identified areas for review

We will:

- * Review the scope to reduce the number of cases going to Employment Tribunal including the full review of the Dispute Resolution Regulations
- * Develop proposals for a new employment standard that would help firms understand and meet their minimum employment law responsibilities including looking at its value as a way of disputes going to tribunal
- * Simplify the guidance on maternity leave and pay. Once the measures in the Work and Families Bill have been introduced, we will consider the case for further simplification of the way in which employers administer Statutory Maternity Pay
- * Simplify the law on employment particulars and make it easier for employers to comply when the law changes
- * Simplify the statutory redundancy scheme and its guidance
- * Consult on replacing the current right to time off for public duties with a right to have such requests seriously considered

Separately we are also reviewing all areas of discrimination law, both in the workplace and wider, to increase its clarity and effectiveness, improve guidance and make it easier for employers to understand and comply with discrimination law.

Source: DTI (2006)

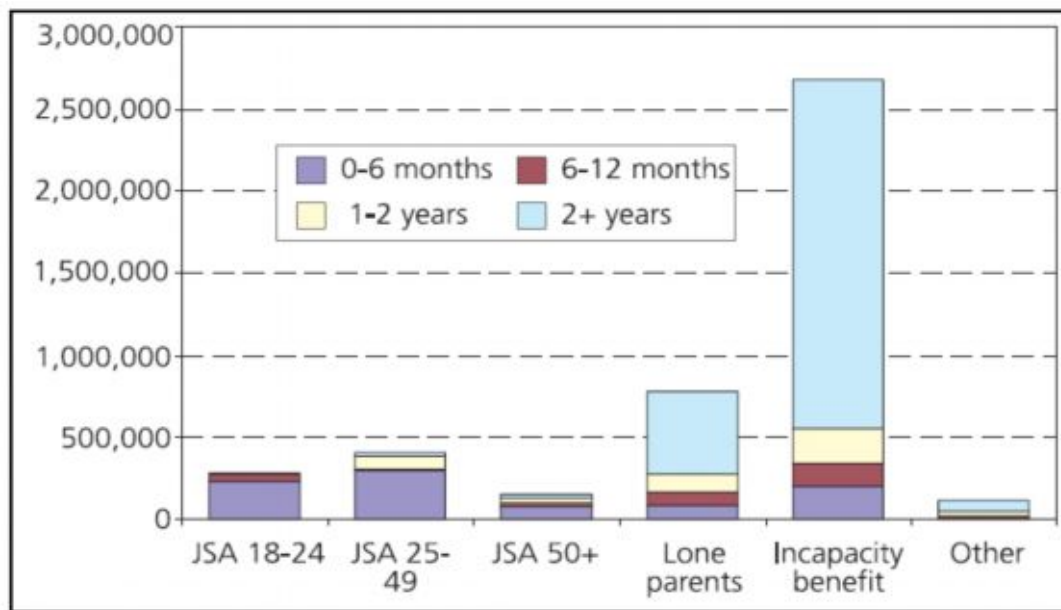
The Freud review of welfare to work highlights the challenges that will be faced in moving towards the target of lifting the employment rate to 80%. It notes the much more specific problems of those furthest from the labour market and calls for

more individualised support for these groups, whereas existing procedures administered by Jobcentre Plus are better suited to those closer to the labour market. Drawing on the findings of the Leitch report (2006), Freud also emphasises the skills gap in the UK and the continuing shortcomings in intermediate and lower skills, compared with competitor countries.

The Freud review notes that there has been great progress in reducing long-term benefit dependence for the economically active, but that among the inactive, long-term dependency continues to be a problem. Figure 16 shows the contrast. Hardly any claimants of job-seekers' allowance (JSA), whether in the youth group or older workers, have been on the register for two years and for the great majority the period of unemployment is under six months. Most of those receiving income support as lone parents or on incapacity benefit, conversely, have been claimants for two years or longer. Indicative figures for the changes that would be needed to achieve an 80% employment rate are reducing the numbers on lone parent support or incapacity benefit by about 40% and activating 5% of the inactive aged over 50. Some 40% of those of working age who have been inactive for two years or more would need to be integrated into the labour market.

The current Pathways to work experiment is advocated as the basis for a more extensive policy programme. The Freud report also canvasses the idea of a single benefit system on the grounds that 'complexity in the benefit system acts as a disincentive to entering work, and that badly designed systems create unemployment and/or poverty traps.

Figure 16: Durations of claims for key benefits



Source: Freud (2007)

8 Conclusions

The UK labour market has changed enormously over the last thirty years, helping to transform an economy justifiably labelled as the ‘sick man of Europe’ in the late 1970s into one of Europe’s success stories. In the process, the UK has, arguably, developed a new model combining flexibility, activation and security that belies the increasingly misleading ‘Anglo-Saxon’ image derived from the work of Esping-Andersen (1990). While many of the reforms initiated during the eighteen years of the Thatcher/Major governments pushed unambiguously in the direction of market liberalisation and labour market deregulation, the last decade has seen considerable re-balancing in favour of social justice.

The ‘performance’ of the labour market in the UK does seem to have improved, if standard indicators are used. The NAIRU – if one believes in the concept – seems to have fallen insofar as the much lower unemployment of recent years does not seem to have rekindled inflation. De Koning *et al.* (2004) hint that the cumulative effect of the labour market reforms may have helped in this regard and they also stress that the UK has not been adversely affected by efforts to raise the supply of labour through the employability agenda. Vacancies notified to Jobcentre plus, the public employment service, capture only a proportion of total vacancies, and are currently

around half a million, about 60% of the number of job-seekers. Estimates of the Beveridge curve linking vacancies and unemployment are relatively flattering for the UK, although if some allowance is made for the disguised unemployment implicit in the high level of incapacity claimants, the picture is less rosy. Work by Alcock *et al.* (2003) and Ardy and Umbach (2004) suggests that, especially in some of the less dynamic parts of the country, unemployment is much more persistent, as well as being under-recorded. Nevertheless, the aggregate data on the employment rate do still signal a labour market that is tolerably successful in providing employment.

A more critical assessment of the New Labour approach from a right of centre perspective is provided by Shackleton (2005). He argues that, although the re-regulation of the labour market that has occurred since 1997 has not – so far – been associated with a deteriorating labour market performance, this has been because of other favourable influences. In addition to a favourable macroeconomic setting, he cites the drive to increase product market competition, increased out-sourcing of government spending and the reluctance to bail out failing companies. Shackleton warns, however, that these favourable factors are now at risk.

Certainly, it is misleading to espouse the simplistic notion of a British model reduced as little more than labour market flexibility. To a great extent, it has been the re-regulation of the labour market (minimum wage, restoration of collective bargaining and public investment) which combined with a stable macroeconomic policy framework, which have proved to be the real assets of the British Economy. The lack of career security and the widening gap between rich and poor in the labour market, accentuated by the strength of collective bargaining in some sectors and not in others, are major obstacles, which stand in the way of regulations, which promote growth, wages, job quality and mobility in a fair and long-lasting way.

It is important to stress that the reforms of economic and social policy in the UK since the 1970s have been not just extensive and radical, but have also been enacted in a wide range of policy areas. The UK story can, therefore, only be properly understood by looking across the board at policy reform and rejecting the notion that economic and social policies have followed a pre-determined ‘British’ approach. In particular, it has to be emphasised that today’s New Labour is very different from the model of its Conservative predecessor. Half the new jobs created in the UK since 2000 are in the public sector. The UK is the only EU country that has seen a sizeable

increase over the last decade in public expenditure, which has risen to 44 % of GDP, and much of the job creation has been in the public sector.

It is an open question whether the whole package of post-1997 legislation is as coherent as is claimed by the government. The 1998 White Paper *Fairness at work* set out the proposed approach as being one in which employees could expect to be fairly treated in return for consenting to a flexible labour market. Dickens and Hall (2005) note the cardinal principle as being ‘that fairness at work and competitiveness go hand in hand, and that one must reinforce the other’, but express some doubts about whether this principle is followed in practice.

No overall study of the effects of all the pos-1997 legislation has been conducted. However, employers are becoming increasingly critical not so much of the orientation of the legislation as of the administrative burden of compliance – deemed to be excessive.

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Appendixes:

1. Method of calculation of growth
2. List of interviewees

Appendix 1: Method for calculation of growth

Based on an accounting breakdown of the employment growth rate:

Rate of Employment = GDP – (PHW + ADW + AR + WAP)

Rate of employment (number employed out of labour force)

GDP

PHW: Productiveness per hour worked

ADW: Annual duration of work

AR: Activity Rate (share of the labour force within the working age population)

WAP: Working age population

GDP makes a positive contribution to employment. Hourly productiveness, the annual duration of work, the activity rate and the working age population make a negative contribution to employment. This breakdown compares France, the United Kingdom and the 15-member state European Union over the 1993-2003 period.

Comparison of Job Performance 1993-2003

	Rate of Employment	GDP	Productiveness per hour worked	Annual duration of work	Activity Rate	Working age population
France	0.21	2.13	2.07	- 0.96	0.50	0.31
UK	0.62	2.89	2.12	- 0.29	0.03	0.40
15-member state EU	0.13	2.08	1.48	- 0.41	0.67	0.21

Source: IRES (2005)

Explanation: in France, the rate of employment increased on average by 0.21% per year over the 1993-2003 period, GDP went up on average by 2.13% per year over that period and the annual duration of work went down on average by 0.96% per year.

In France employment (measured by the employment rate) increased on average by 0.21% every year between 1993 and 2003. This increase was due to the fact that GDP increased on average by 2.13% every year during that period,

compensating for both the average rise of 2.07% per year in hourly productiveness, the increase in the activity rate (0.5% per year) and in the working age population (0.31%) (a labour force increase of 0.81% per year on average between 1993 and 2003).

In the United Kingdom, employment rose on average by 0.62% every year from 1993 to 2003 – a higher rate than in France. Britain's performance can mainly be explained by the fact that the country's GDP grew more than France's (British GDP on average grew by 2.89% per year between 1993 and 2003, whereas French GDP grew by 2.13% per year) and by a slower increase in the working age population compared with the situation in France (the British labour force on average increased by 0.43% per year between 1993 and 2003, while the French labour force increased on average by 0.81% per year).

Appendix 2: List of interviewees

Department of Work & Pensions: Bill Wells, Jonathan Portes

French Embassy: Diego Colas

Work Foundation: Will Hutton, David Coates

Bank of England: Bob Hills

TUC: Ian Brinkley

Treasury – Hedvig Ljungerud and several colleagues

LSE: David Marsden

Low Pay Commission: William Brown, David Metcalf

CHAPTER 5 - Sweden:

Striving to reinvent its social model

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The Swedish labour market and the social accommodations that it encompasses are often put forward as positive examples that other EU Member States should seek to emulate. Typically, such endorsements are offered in the context of advocacy of the 'Nordic' social model, with its supposed combination of flexibility and security as captured in the expression 'flexicurity'. In fact the Swedish model has a long and distinguished, but also distinctive history and even cursory examination of the detail of the various Nordic labour market models rapidly makes it clear that there are significant differences between them, as well as obvious common traits.

In understanding policy developments in Sweden in the last fifteen year, perhaps the major influence was the severe recession that hit the country in the early 1990s, which had repercussions in a number of domains. Before 1990, Sweden had enjoyed a very high employment rate and low recorded unemployment. Data quoted by Anxo and Niklasson (2006) show that in 1990, Sweden's employment rate was above 83% and its unemployment rate was just 1.6%, adding-up to an activity rate of 84.8%. When the recession struck between 1990 and 1993, there was a ten percentage point fall in the employment rate, while unemployment rose fivefold to 8%, an implication of which was that inactivity increased sharply as some of those who lost their jobs withdrew from the labour force. Anxo and Niklasson suggest that most of the increase in inactivity can be accounted for by an increase in numbers in education and on active labour market programmes.

This chapter briefly describes the underlying social model, discusses the problems that it encountered following the 1975 oil shock and the difficult transition the economy endured over the subsequent two decades, and reviews the subsequent recovery and prospects. The chapter starts by giving an overview of the model, then presents a snapshot of the labour market. It then discusses the transformation that have taken place in Sweden in different dimensions of policy, starting with the

macroeconomic framework and performance, then going on to look at labour market challenges and policies.

The Swedish social model

Sweden has a long-standing commitment to full employment and an egalitarian society. The so-called 'Rehn-Meidner' model in which strong social partnership and consensual industrial relations with centralised bargaining were key elements, is considered to have underpinned Swedish economic success up to the mid-1970s. The contribution of a robust welfare state was also important. A succinct description of the model is provided by Fischer (2006) – see box 1.

Centralised wage bargaining in Sweden has been an enduring feature of the model, with the unions through the LO (the confederation of blue collar unions) as one of the most influential actors. Encouragement of labour force participation is also a key principle. Especially noteworthy is that the Swedish system is voluntary, with very limited resort to legally binding frameworks. The AMS, the agency responsible for ALMP is formally an agency of government, but in practice has had a considerable degree of autonomy.

One of the necessary conditions for the model to function was (and still is) powerful employers' and employees' organisations, able to co-operate on wage setting and the regulation of the labour market, while also interacting with the state. The capacity of the social partners to 'deliver' their members meant that there could be effective central co-ordination of wage bargaining. Co-ordination is not just between the social partners (horizontal), with mediation by the state, but is also subject to change depending on the shape of the government, with vertical links between the LO (the main union confederation) and the social democratic party, on the one hand, and between the Confederation of Swedish Enterprise and right of centre parties on the other. It allowed disparities between sectors to be limited and avoided what was seen as potentially damaging competition between firms. The model also succeeded in maintaining full employment and was also gender equality. A key point about the Swedish model is that the different components fit together in ways that are not always intuitively obvious: high public employment, for example, provided services that made lower wages for highly-qualified workers more palatable, and so on.

Box 1**The Rehn-Meidner Model**

The underlying aim of the Rehn-Meidner model is to promote structural change and growth, while assuring price stability in a small open economy, yet also ensuring a high degree of equality. As described by Fischer (2006: 2):

“In this model there is a clear division of roles with the social partners responsible for wage-setting within a framework of centralised wage negotiations and the government responsible through fiscal, labour market and monetary policies for the management of unemployment and inflation. Rehn and Meidner proposed that restrictive economic policy keep inflation under control. Government intervention should keep aggregate demand below equilibrium while compensating for the demand slack in regions, sectors or categories of workers, with selective labour market policies. In addition to the egalitarian wage structure, restrictive general government policies “push” unprofitable firms out of the market while more profitable firms pay lower wages than what they can actually afford. The excess profits give room for accumulation of physical capital. This “creative destruction” generates short-term unemployment, countered by intense active labour market policies channelling the unemployed back into work. A guiding principle in the approach to labour market policies is the “work line”.

This involves protecting income levels rather than jobs: openness to structural change is the trade-off for income security. In the centre of this system stand the collective agreements negotiated by the key umbrella trade unions (LO for blue collar workers, SACO for academics and TCO for white collar workers) and the central private sector employers’ organisation (Swedish Industry)”

Growing stresses

Despite the apparent long-run success of the model up to the mid-1970s, it subsequently came under increasing strain because of inflationary pressures and the resort to devaluations as a means of maintaining competitiveness. Job creation was sustained by progressively increasing the share of public employment in the economy, necessitating higher public expenditure that was only partly funded by tax increases. As a result, public debt increased over the decade 1975-1985 from an average of around 25% of GDP in the first half of the 1970s to over 60%. Although the upturn of the latter half of the 1980s saw a reduction to 42% by 1990, the subsequent recession saw it rise sharply again. By 1990, however, inflation had increased markedly and the macroeconomic imbalances in the economy contributed to the severity and depth of the recession of the early 1990s.

Research conducted for an NBER study (reported in Freeman et al., 2006) showed that structural problems had also multiplied. Wage compression inhibited private sector employment creation, making it necessary for public employment to absorb the net growth in the labour force; hours worked per person were low, facilitating a de facto sharing of work and there were also marked disincentive effects that adversely affected entrepreneurship and other shortcomings in economic policies. High spending on ALMP, for example, appears to have fallen well short of achieving its objectives and may have simply become an expensive form of unemployment benefit while disguising the true extent of unemployment. In addition, centralised bargaining progressively gave way, from early in the 1980s, to more fragmented deals, notably in the high productivity engineering sector (with the Metall union breaking the mould by agreeing a deal with the engineering employers in 1983). The upshot was a break-down of price and wage stability and various forms of leap-frogging.

As Freeman et al. make clear, the crisis of confidence in the Swedish model was acute. Public expenditure peaked at nearly 70% of GDP and the authors observe that the private sector had not created any jobs since the 1960s. Nevertheless, the underlying principles of the model are still evident in Swedish policy today, albeit with differences in a number of the key policy areas. Interesting questions can therefore be posed about whether the crisis was a temporary aberration in a sound model, or whether the changes introduced during the 1990s represent a more fundamental shift. Anxo and Niklasson (2006) reject the idea that the problems between the mid-1970s and the early 1990s could be attributed largely to exogenous shocks, and consider the early 1990s crisis to have been ‘home-made’. They point especially to policy errors that undermined the stability orientation of macroeconomic policy during the 1980s, followed by an overly tough policy response in the 1990s in the attempt to curb burgeoning inflation. As in the UK, this tough stance could not be sustained in the face of speculative pressures and the currency depreciated by some 20% after being floated late in 1992.

Key features of the contemporary Swedish labour market

Sweden's labour market has a number of distinctive characteristics:

- Despite the shakeout of the early 1990s, the employment rate is still among the highest in the EU, at 73% in 2006³⁶, and has been consistently so over the last decade. Moreover, Sweden achieves a high female employment rate of 71% which is only four percentage points lower than for males and is some thirteen points above the EU-15 average; only Denmark has a higher female employment rate. Sweden's employment rate of 70% for older workers is by far the highest in the EU where it averages just 43%.
- However, an enduring problem is the extent and persistence of inactivity, a facet of the labour market that loomed large in the 2006 elections and has since given rise to a number of policy shifts aimed at pushing inactive individuals towards employment.
- There is also a problem of social exclusion, not least among immigrants and, more disturbingly, Swedish born children of immigrants who arrived in earlier decades after the second world war. Among newly arrived immigrants, exclusion is most pronounced for those who arrived from outside Europe, many of whom are either asylum seekers or refugees.
- There is a heated debate in Sweden about the true unemployment rate. The official figure for unemployment excludes those on ALMP schemes and thus tends to be some 2 percentage points lower than the harmonised Eurostat figure. But there are also arguments for including those on sick leave, parental leave and early retirement. As in the UK, therefore, the implication is that there is a much higher volume of disguised unemployment than is revealed by the published data. Yet the same argumentation as for the UK also applies, namely that the high **employment** rate still testifies to a relatively successful labour market.
- Although many of the standard labour market indicators suggest that Sweden's labour market is performing well, a particular concern is the high rate of sickness and the implications for hours worked. According to Davis and Henrekson (2006)

³⁶ According to Eurostat data; Swedish national data use a different definition which suggests a significantly higher employment rate of close to 80%

hours worked per working age person in 2005 were barely 1% higher than in 1993, the trough of the recession.

- A very specific problem is the high level of absence of work because of sickness. It is suggested that this may be attributable to the moral hazard associated with relatively generous sickness benefits, not least because other data suggest that Swedes have generally become healthier and are employed in less hazardous jobs. As Freeman et al. (2006: 12) observe: ‘despite several changes in the rules governing insurance for sickness absence Sweden still struggles with attaining a balance between aiding those truly unable to work and discouraging those who exploit the system’.
- It has a high rate of unionisation, with union density at 80% and a coverage of collective agreements reaching 90% (data quoted by Anxo and Niklasson, 2006). Moreover, these ratios have been remarkably stable despite the turbulence in the Swedish economy after 1990.
- Gender equality has been a long-standing policy aim, and is reflected in the high female employment rate and the low rate of female long-term unemployment (1.0% in 2005, compared with an EU-15 figure of 3.7%). Yet according to Eurostat data, the gender pay gap is above the EU average. Part of the explanation is the high proportion of female employment in (relatively low-paying) public services³⁷ and in hours worked.
- An important feature of wages in Sweden is the compressed wage distribution, an outcome that reflects the aims central to the Rehn-Meidner model. Inequality has risen somewhat since the 1980s, but Sweden still has a much more equal income distribution than nearly all other EU Member States.
- The negotiated minimum wage in Sweden is high relative to many other EU countries (including those where it is statutory), at some two thirds of median manufacturing wages
- There is quite strict employment protection, which is highlighted by the OECD (2007) as one of the potential obstacles to Sweden reaping the benefits of

³⁷ Freeman et al. (2006) cite evidence that employment in local government in Sweden tripled between 1964 and 1993 and that women account for 90% of the (large) increase of some 800 thousand workers

globalisation. This high level of employment protection differs markedly from the much weaker arrangements in Denmark.

- Private sector service employment is on the low side

Macroeconomic framework

The contemporary macroeconomic framework in Sweden is very much a stability orientated one. Thus, the Riksbank became independent in 1999 and has a mandate to assure price stability, as well as a safe and efficient payment system. The Riksbank's interpretation of price stability is a low and stable rate of inflation and it has adopted a 2% inflation target, using a consumer price index as the benchmark. In fact, inflation targeting in Sweden was initiated in 1993, the last year of severe recession, but the approach to monetary policy has since been refined, notably following the granting of independence to the central bank. In many respects the approach followed³⁸ is very similar to that adopted by the Bank of England. In particular, the use of a symmetrical target with a one percentage point range distinguishes the Riksbank and the Bank of England from the approach adopted by the European Central Bank. However, in line with most other European central banks, the Riksbank gives primacy to price stability and only has regard to growth and employment objective without prejudice to the price stability aim.

Despite not having a formal opt-out, Sweden has stayed out of the single currency, and had its stance reinforced by the result of the referendum held in 2003, which yielded a decisive no vote. After the successive devaluations of the 1980s, the government chose to peg the exchange rate to the ECU. However, the rate became unsustainable because of high inflation forcing a substantial depreciation in 1992. Since then, the Krona has been relatively more stable, although it has fluctuated in a manner that has probably eased cyclical management. Figure 1 show the movement of a trade competitiveness weighted exchange rate for the Krona against a basket of currencies since the link to the ECU was broken in November 1992. After a sharp initial devaluation, the Krona recovered during the mid-1990s, before depreciating again in the slowdown after 2000. Since 2001, however, the Krona has been pretty stable, especially against the euro, fluctuating in a band from 9.0 to 9.5 Krona per

³⁸ See <http://www.riksbank.com/templates/Page.aspx?id=10543>

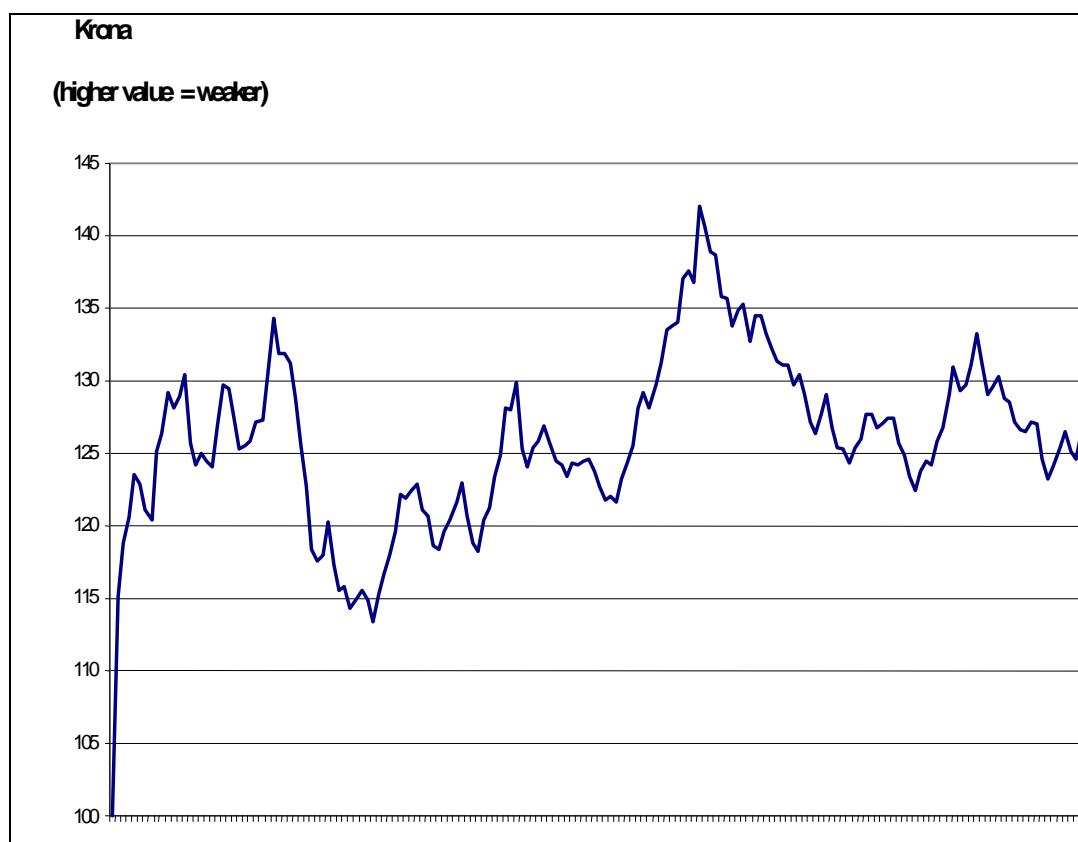
euro. The inference to draw is that exchange rate fluctuation has not been much used over the last five years as a policy instrument, but is a policy weapon the authorities will not hesitate to use if necessary.

Following a change introduced in a budget law in 1996, fiscal policy is also now subject to rules with an underlying target of a surplus of 2% of GDP over the economic cycle, a value set to reflect the need to build up net public assets in anticipation of rising pension demands. The fiscal framework implemented since the beginning of 1997 has a number of distinctive features (see Hansson Brusewitz and Lindh, 2005, who describe it as a "top-down" budget process led by the Ministry of Finance). It has targets for both general government expenditure and for the budgetary balance. There were also procedural innovations, including a rolling multi-annual framework and a two-stage decision-making process setting the aggregate first then apportioning spending under 27 headings. Any increase in spending in one area must, therefore be balanced by a cut elsewhere, a device that may have contributed to greater discipline. The new system proved to be robust to the slowdown of 2001-3, though the surplus averaging 5% of GDP in previous years fell to close to balance, with the main reason being discretionary spending, rather than just the operation of automatic stabilisers.

Wage moderation has also been restored, marking a sea-change from the 1980s. Commenting on the long-run trend of wage agreements in Sweden, Fregert and Jonung (2006) observe that the period since 1995, which they characterise as 'the inflation-targeting regime', has been one that stands out. Since 1995, four three year collective agreements have been negotiated, representing the most stability since pacts were first introduced in 1908. Moreover, in contrast to the twenty-year period up to 1990, the do not include indexation. An inference to draw is that the stability orientated policy is highly credible and has exerted a strong influence on bargaining. Fregert and Jonung also draw attention to the fact that the 1995 agreement pre-dated the major institutional reforms affecting fiscal policy and central bank independence.

Figure 1. Trade competitiveness weighted index

(November 18, 1992 = 100)



Source: Riksbank

Recent macroeconomic trends

As the OECD notes in its 2007 survey of Sweden, the transformation since 1993 in the macroeconomic position of Sweden has been impressive. Public debt had reached 73% of GDP in 1994 (when the deficit – aggravated by the downturn – attained 11% of GDP), but by 2006 had fallen to 47%. There has been a structural surplus in the public finances since the late 1990s, with most of the budgetary improvement achieved by lowering public expenditure. Even so, the tax rate is still above 50%, some ten-percentage points above the EU-15 average. Table 1 presents a range of summary indicators.

Despite the macroeconomic recovery, the rate of job creation in Sweden had been comparatively slow until recently, although it is set to accelerate. According to the website of the Swedish *Konjunkturinstitutet*, the Swedish economy was in a ‘highly expansionary phase’ in 2007, and the projections suggest that the employment

rate (on the will attain 80.3% in 2008, with unemployment dropping to 4.5%. Unlike in many other EU countries, low-skill jobs in services are noticeably less prevalent. Real wage growth has been low, and has lagged behind productivity growth, allowing falling unit labour costs. Sweden has, latterly, enjoyed an export boom that has seen its current account surplus grow to exceed 7% of GDP. The OECD (2007) suggests that migration may have exerted a moderating effect not only by increasing labour supply, but also by providing workers willing to work in lower productivity service industries.

Together with competitive pressures from imports, wage moderation has helped to keep inflation low and it has undershot its 2% target in most years since the target was set after the reforms of 1993. However, one apparent weakness is that although there has been job creation, Sweden has not recovered the jobs lost in the crisis years of the early 1990s and unemployment has remained above the rates experienced prior to 1990. There are, in addition, conflicting views about the true level of unemployment, and also of the degree of slack in the labour market. It has been argued, in particular, that counting those on ALMP programmes, students seeking work and a sizeable proportion of sickness benefit recipients as inactive disguises higher unemployment. An up-to date picture of the various forms of unemployment can be garnered from data presented in the Riksbank's June 2007 inflation report (see figure 2).

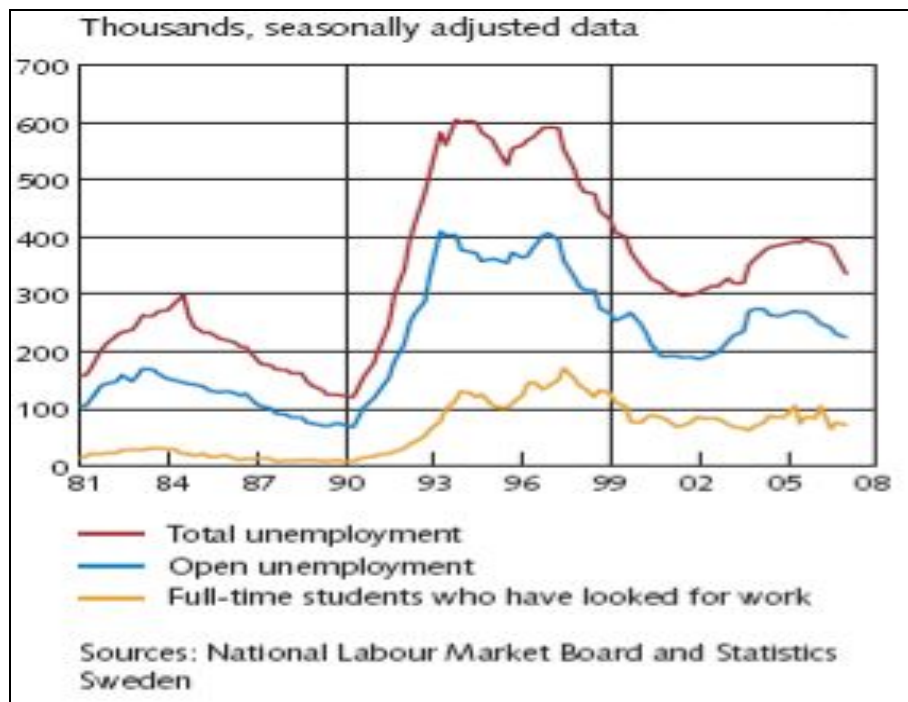
Table 1 Key indicators on the Swedish economy

Annual percentage change and percent, respectively					
	2004	2005	2006	2007	2008
GDP at market prices	4.1	2.9	4.4	3.9	3.4
GDP, calendar-adjusted	3.5	2.8	4.8	4.1	3.3
Real GNI per capita	2.0	1.8	4.2	3.8	2.8
Current account ¹	6.5	5.8	7.0	7.1	7.2
Employment	-0.5	0.7	1.9	2.2	1.2
Employment rate ²	77.2	77.2	77.7	79.3	80.4
Unemployment ³	6.0	5.9	5.4	4.8	4.3
GDP gap	-1.6	-1.7	-0.2	0.3	0.6
Hourly earnings, business sector (STWS)	3.0	3.2	3.2	4.1	4.5
Labour costs, business sector (NA) ⁴	3.8	3.0	2.4	5.4	5.1
Productivity, business sector ⁴	5.3	2.6	3.7	2.4	2.3
CPI, Dec.-Dec.	0.3	0.9	1.6	2.1	2.4
UND1X, Dec.-Dec.	0.7	1.2	1.2	1.2	1.8
Repo rate ⁵	2.00	1.50	3.00	3.50	4.00
Interest rate, 10-year government bonds ⁵	3.9	3.4	3.6	4.1	4.5
Index for the Swedish krona (KIX) ⁵	111.0	120.9	112.8	115.0	113.9
General government net lending ⁶	0.6	1.9	2.1	2.3	2.7
Cyclically adjusted net lending ⁷	1.7	2.7	2.5	2.4	2.3

¹ Percent of GDP. ² Regular employment, percent of population aged 20–64.
³ Percent of labour force. ⁴ Calendar-adjusted. ⁵ At year-end.
⁶ Percent of GDP excl. PPM. ⁷ Percent of potential GDP.

Sources: Statistics Sweden and NIER.

Figure 2 Unemployment trends in Sweden



Sweden does have something of a problem of long-term unemployment, although it should be recalled that the incidence of unemployment (and disguised unemployment) is high by the standards of post-war Swedish history, rather than by comparison with many other EU Member States. Freeman et al. (2006) attribute the rise in unemployment in large part to inappropriate incentives to make work pay. The tensions between the negative effects of a possibly overly compressed wage structure and the national consensus on income equality are evident. A tax wedge resulting from taxes on labour may also be an obstacle to low wage employment as is the high negotiated minimum wage.

Data on hours worked in Sweden suggest something of a paradox: the measured employment rate is amongst the highest in the EU, comfortably exceeding all the Lisbon targets of 70% overall, 60% for women and 50% for older workers, yet Swedes work fewer hours annually than any other EU country except the Netherlands. The principal reason for the latter figure is that although typical weekly hours and holiday weeks are close to the EU average, Swedes have more time off for other reasons than workers in other countries, see table 2.

There are several possible explanations for the stagnation in hours worked, despite an impressive growth rate since the mid-1990s. Productivity growth has been high, with

the implication that the employment intensity of growth has taken second place to raising competitiveness. Indeed, the real exchange rate has benefited from the conjunction of the productivity gains and muted wage increases. Nevertheless, as the table shows, 'absences for other reasons' are double the unweighted average of other OECD countries. While days off for sickness constitute a sizeable part of the difference, the OECD suggests other forms of leaves also contribute, citing long-term parental leave, study leave and an option to take sabbatical leave. The OECD acknowledges that these various schemes have social aims and advantages, but raises the question of whether the balance is right. The OECD also observes that one explanation for low hours worked in Sweden is that high marginal taxes set in early, weakening incentives to work longer hours.

Labour market issues: a model in transition?

The consensual system of industrial relation is at the heart of the Rehn-Meidner model. However, by the early 1990s, the tenets of the industrial relations model had been eroded by disputes, persistent inflation and employer dissatisfaction with the tripartite arrangements. There has been some weakening of the central role in recent years, to the extent that there is now considerably more room for negotiation of contracts at local level, although centralised bargaining still establishes an overall framework including for minimum wages. In the early 1990s, the employers withdrew from various consultative bodies. Pontusson and Swenson (1996) suggest that the employers used a shift in the balance of power as the opportunity to break a consensus that was increasingly untenable, not least in the face of demands for a more flexible production system. Yet in 1996, the engineering unions paved the way for a restoration of co-ordinated bargaining and in 1997, a significant agreement was concluded, covering 17% of the employed population. This agreement not only set up a revised framework for wage setting, including norms related to wage movements in competitor countries, but also established new rules of procedure aimed at mitigating the effects of any disputes. As Fischer (2006: 3) describes the current position: 'in general, the broad framework and common rules including minimum salaries are decided at central level while individual salaries are set locally. This coordinated decentralisation seems to have paid off in terms of labour market performance'.

Employment protection

According to OECD estimates, Sweden was among the European countries with the highest levels of employment protection (EPL) in the late 1990s, in stark contrast to its neighbour, Denmark. Indeed, in its most recent survey of Sweden, the OECD (2007a) states that its EPL is second only to France's in its intensity. A result has been that insiders tend to have a significantly greater say than elsewhere in labour market institutions and policies, giving rise to pointed political debate about 'outsiders'.

Sweden has been especially hostile to temporary employment contracts, although these have been allowed since 1997, as a result of which the OECD considers that the country has significantly eased its protection of temporary workers compared with earlier decades. Four years earlier, restrictions on temporary work agencies had been lifted. As in other countries where EPL is strong, temporary work has been the tactic adopted by employers, leading to something of a dual labour market.

Table 2 Breakdown of annual hours worked

Decomposition of average annual hours worked by full-year equivalent workers (dependent employees working full or part-time weekly hours, 2002)

	Annual hours of work	Average weekly hours on all jobs	Usual weekly hours of work on the main job	Extra hours on main job (overtime, flettime, etc)	Hours on additional jobs	Annual weeks worked	Holidays	Absences for other reasons
	(a) = (b) * (f)	(b) = (c)+(d)+(e)	(c)	(d)	(e)	(f) = 52-[(g)+(h)]	(g)	(h)
	Hours	Hours worked per week				Weeks worked/not worked		
Poland	1 817	41.8	40.2	0.3	1.3	43.4	6.2	2.4
Greece	1 816	40.7	40.2	0.1	0.4	44.6	6.7	0.6
Hungary	1 798	40.9	40.3	0.4	0.2	43.9	6.3	1.8
Slovak Republic	1 761	41.8	41.4	0.3	0.1	42.2	6.9	2.9
Iceland	1 714	43.2	39.9	1.7	1.7	39.6	6.1	6.3
Czech Republic	1 692	41.3	40.4	0.7	0.3	41.0	6.2	4.8
Portugal	1 688	40.4	39.3	0.3	0.8	41.8	7.3	2.9
Spain	1 639	38.8	38.6	0.1	0.2	42.2	7.0	2.9
Switzerland	1 586	37.5	34.3	2.7	0.5	42.3	6.0	3.7
Ireland	1 585	36.3	35.8	0.2	0.3	43.7	5.7	2.6
Luxembourg	1 582	37.9	37.3	0.5	0.1	41.7	7.5	2.8
United Kingdom	1 546	38.2	37.2	0.7	0.4	40.5	6.5	5.0
Italy	1 533	37.4	37.2	0.1	0.1	41.0	7.9	3.1
Austria	1 497	38.4	36.6	1.4	0.4	39.0	7.2	5.9
Finland	1 491	38.8	36.9	1.4	0.4	38.5	7.0	6.5
Germany	1 480	36.5	35.2	1.1	0.2	40.6	7.8	3.6
France	1 467	36.2	35.2	0.8	0.3	40.5	7.0	4.6
Belgium	1 451	36.3	35.7	0.3	0.3	40.0	7.1	5.0
Denmark	1 410	36.3	34.8	0.8	0.7	38.9	7.4	5.7
Sweden	1 349	38.1	36.0	1.4	0.7	35.4	6.8	9.8
Norway	1 339	37.3	34.8	1.8	0.7	36.0	6.5	9.5
Netherlands	1 223	31.8	30.1	1.3	0.4	38.4	7.5	6.1
Unweighted average	1 567	38.5	37.2	0.8	0.5	40.7	6.8	4.5

Note: For all countries, absences due to sickness and maternity are counted twice to adjust for an estimated 50% under-reporting of absences in labour force surveys. See Annex 1.A1 of the OECD Employment Outlook 2004 for a detailed discussion of this and other assumptions underlying the estimates in this table.

Source: OECD estimates based on European Labour Force Survey and EIRO (2002), "Working Time Developments - 2002", www.eiro.eurofound.ie/2003/03/update/tm0303103u.html. See OECD Employment Outlook 2004 for further details.

Active labour market policies

Although the extensive use of active labour market policies is a hallmark of the Swedish model, some of the evaluations of the approach have articulated reservations about their effectiveness. Calmfors et al. (2002), for example, observe that the policies ‘have probably reduced open unemployment, but also reduced regular employment’. They advocated reducing the scale of the policy and ensuring better targeting. They note, especially, a possible conflict between the advantages for individuals and potential macroeconomic crowding-out effects, and they also suggest that schemes targeted at youths have had substantial displacement effects. Auer et al. (2004) are more sanguine about the benefits of ALMP, citing the Swedish example.

Calmfors (2004) points to a number of shortcomings in the Swedish approach to ALMP which, at its peak during the mid-1990s, covered 5.5% of the labour force – see box 2. He comments that the overall verdict is dismal, and argues that there are a number of lessons to be learned. In particular, he warns against large-scale programmes, in favour of more targeted schemes. He also asserts that too much ALMP may interfere with the activities of the public employment service in placing individuals into ‘real’ jobs.

Box 2**The findings from evaluations of Swedish active labour market policies**

Calmfors (2004) states that the following results emerge:

- “Looking at the outcomes for individuals participating in various training programmes, results are very disappointing: training programmes appear either to have had *no effect* at all on future employment opportunities or a *negative effect* .
- In contrast, some types of subsidised employment seem to have increased employment probabilities of participants substantially also after programme completion: not very surprisingly the results are better, the closer such a programme has been to regular employment.
- But, unfortunately, subsidised employment seems also to cause large displacement of ordinary jobs: crowding-out effects on regular employment are usually of the order of magnitude of 60-70 percent.
- As expected, training programmes do not seem to be associated with displacement of ordinary jobs.
- The results are particularly bad for youth programmes. It is unclear if programmes increased the employment prospects of participants. At the same time, the youth programmes seem to have caused particularly large crowding out effects.
- Both training and subsidised employment programmes seem to have reduced rather than increased labour mobility”.

One aspect of ALMP that was arguably quite damaging was that, until 2000, an individual who completed an ALMP scheme was then able to qualify afresh for unemployment benefit. Freeman et al. (2006) suggest that this had hindered job search and accentuated displacement effects. Richardson and van den Berg (2006) find that although, on immediate exit from the most extensive and costly training programme (known by its acronym, AMS) former trainees tend to find jobs, the effect quickly dissipates. They conclude that, after taking account of the time spent on the scheme, the ‘effect on the mean unemployment duration is often close to zero’.

Immigration

Immigration into Sweden was, until the late 1980s, predominantly motivated by employment opportunities and thus tended to fluctuate in response to labour demand. The OECD (2007b) notes that, subsequently, the main motivations for immigration have become refugee and humanitarian, including family reunification. With people born outside the country accounting for over 12% of the population and a further 12% first-generation Swedes, born to immigrant parents, integration of migrants is manifestly a major policy issue. Sweden, along with the UK and Ireland was one of only three EU-15 countries not to restrict the entry of migrants from the new members that joined the Union in 2004. However, the integration of immigrants into the labour market has long been problematic and continues to be a social challenge. Immigration into Sweden for humanitarian reasons is proportionally higher than in the EU as a whole and this has contributed to lower employment rates. Evidence on discrimination against immigrants is inconclusive, although Lemaitre (2007) argues that the fact that Swedish born children of immigrants have less favourable outcomes in the labour market, after allowing for other factors, may indicate some bias. The severe economic downturn of the first half of the 1990s and its aftermath have not been favourable to immigrants. Even so, Lemaitre notes some convergence in immigrant earnings towards those of native Swedes, though a gap remains.

The heterogeneity of the immigrants has to be taken into account, with large differences in labour market attributes evident. Those coming from new EU Member States have high employment rates, whereas immigrants born outside Europe or in former Yugoslavia have struggled to obtain jobs. The OECD (2007b; see also Halleröd, 2007) argues that the differences among groups reflect language skills and skills mis-matches, but there is also a suggestion that discrimination plays a part. Halleröd also points out that immigrants are often over-qualified for the jobs they obtain and are more likely to be subject to adverse conditions of employment. In addition, immigrants and first generation Swedes have lower educational attainment.

The importance of integration of immigrants lies, notably, in the fact that – for obvious arithmetical reasons – they comprise a group with a larger potential to

contribute to the stated objective of raising the employment rate. According to the OECD (2007a), long-run fiscal sustainability relies in part on closing the employment rate gap between immigrants and native-born Swedes, yet it is debatable whether the recently enacted general measures to raise employment will suffice. Instead, it may be necessary to have targeted schemes that reach out to those most distant from the labour market. The OECD (2007a: 91) also suggests that greater wage flexibility should be considered, arguing that the problem may be 'that the traditional labour market model favours a homogenous predictable population, because high job security and difficulty of dismissal makes it costly for employers to hire someone who turns out not to be the right person for the job'.

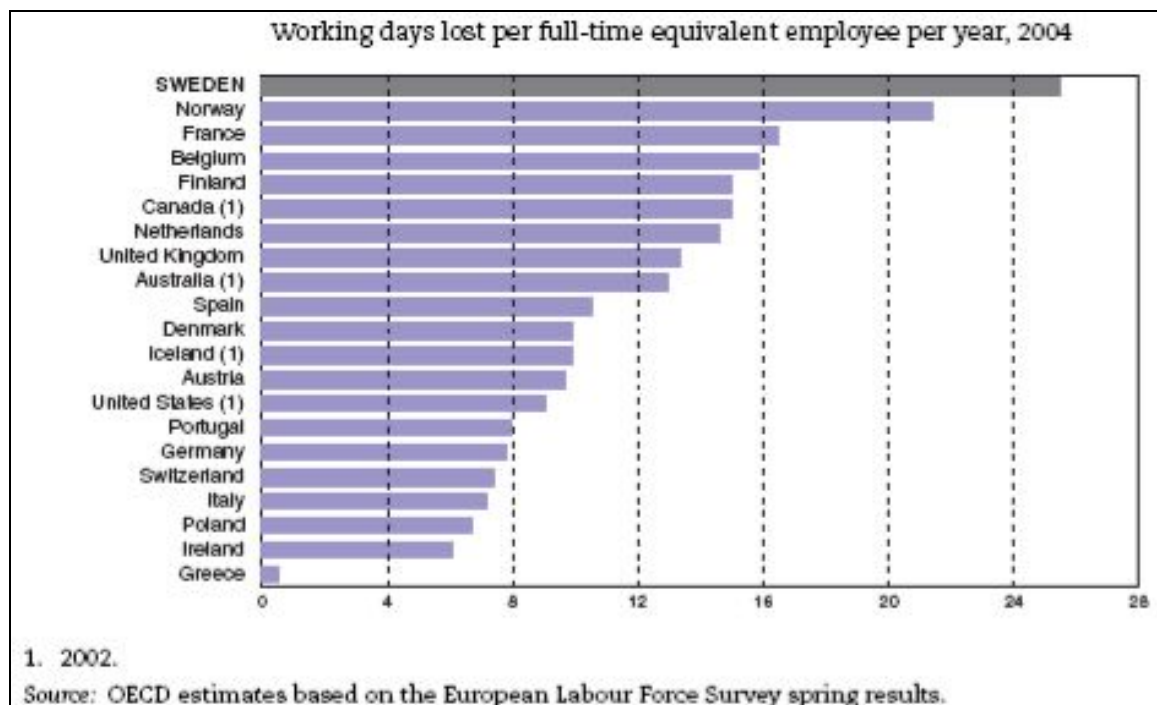
Sickness and disability

As noted above, a high rate of absenteeism for reasons of sickness has characterised the Swedish labour market in recent years. The OECD (2007a) suggests that the problem has abated somewhat compared with two years ago (OECD, 2006), but remains a concern. The magnitude of the problem and the consequent policy challenge were explained by the OECD (2006: 66): 'on an average day, around 14% of the working-age population is either on sick leave or on a disability benefit. This amounts to a significant drain on labour supply, incomes and economic activity. Recognising this, the government has set a target to halve the number of sick-listed people between 2002 and 2008'. Comparative data show that Sweden had by far the highest incidence among OECD countries of time off because of sickness (figure 3). The total is made-up of those on various forms of long-term sickness benefit (who are regarded as economically inactive) and those in work who take time off for sickness. In both categories, more detailed data show that Sweden has a high incidence compared with other OECD countries.

The OECD explores possible reasons for the high level of Swedish days lost to sickness, including demographic composition, the general health of the population and the gender mix of employment. While it finds that the Swedish working age-population is relatively old and notes that there is a general tendency for sickness rates to be higher for older workers, it argues that general health standards and longevity offset this trend. Female sickness rates are double those of males and may therefore

offer a possible explanation³⁹. The data also show that public sector workers take more time off and, since Sweden has a high share of public employment, this too may be part of an explanation. Overall, however, the OECD's assessment is that the simple reason for the high number of days lost is that sickness benefit is both easy to obtain and generous. The generosity of publicly funded insurance has varied, falling during the crisis years of the 1990s, but increasing slightly thereafter. However, the OECD notes that collective agreements often top up the public support, allowing income replacement rates for those off sick to reach 100% in many cases.

Figure 3. Days lost to sickness in the OECD countries



Current directions for change

Recent developments have seen some re-assertion of the importance of central deals, with the internationally traded goods sector exercising a wage leadership role. Anxo and Niklasson (2006) argue that there are three reasons for the emergence of a new compromise between central and local bargaining:

³⁹ The rate is notably higher for women with young children, which may imply that days off for sickness are, in reality, child care.

- First, employers place a premium on industrial peace by preventing disruptive competition between segments of the labour force
- Second, limiting transactions costs and the risk of wage drift that undermines competitiveness
- Third, what they refer to as ‘guaranteeing a *principle of subsidiarity* [emphasis in original text]’ under which there is enough flexibility at the enterprise level to share out industry wide collective agreements

Anxo and Niklasson (2006) describe the hybrid, or two-tier wage negotiation system of today as one that facilitates ‘*negotiated flexibility*’. Although the current degree of social partner engagement is far from the intensity of the past, it is still considerable relative to other countries. A key influence was an initiative in 1996, bringing together union and employers' interests, to establish a norm for wage setting, leading to the so-called Industry Agreement reached in 1997, described above

In relation to ALMP, the widely-shared doubts about the effectiveness of the system have undermined its support, yet it has evolved to give a greater emphasis to training. In the process, it may well be reverting to its original role as a supply-side measure, rather than a demand side one (Anxo and Nilkasson, 2006). Certainly, a change towards more emphasis on the market can be detected and across a range of areas, notable shifts occurred:

- Replacement rates for unemployment and sickness insurance were reduced, improving incentives
- Inequality has increased, but Sweden remain an equitable society that has struck a reasonable balance between equity and efficiency
- Government spending has gradually diminished
- Private sector employment has started to grow

An intriguing test of the Swedish model of industrial relations was the Vaxholm (also known as ‘Laval’) case in which a Latvian construction company was awarded a contract to build a school. It sought to employ Latvian workers on Latvian pay rates, but was opposed by the Swedish trade unions who argued that the arrangement was in breach of a collective agreement. A union blockade saw the Laval company withdraw, but the case is now before the European Court. Though not yet settled, the latest stage in the process was an opinion of the Advocate-General finding

in favour of the Unions and thus supporting the insistence on a respect of a collective agreement.

For Anxo and Niklasson, the new compromise reflects both the undoubted competitive pressures on a small open economy and the desire to sustain the underlying social model. They maintain that the emerging system achieves the employers' need for enough flexibility, while enabling unions to ensure that employment and real incomes continue to grow. In this way, they believe that Sweden has managed to make the transition to an adapted model of industrial relations suited to a post-industrial society. While no single change was dramatic, put them all together and the extent of the transformation becomes more apparent: by 2005. Freeman et al. (2006: 7) observe that 'the Swedish model is recognizably different in detail'. Pension reform can be adjudged to have been a particular success, combining a continuing reliance on 'pay-as-you-go' with a funded element and more defined benefits in a way that appears to assure long-term sustainability of the system.

Change in political power, 2006

The right of centre government that came to power in autumn 2006 could be viewed as a surprisingly negative reaction by voters to a strong economy, rather than a change motivated by a sense of crisis, although the social democratic part had been in power for twelve years and for much of the previous fifty, no doubt contributing to a politics of 'time for a change'. Several important changes have been, or are in the process of being, introduced by the Reinfeldt government which has embarked on a series of market orientated policies, including a privatisation programme, and has initiated a number of social policy reforms. A first package approved by the Riksdag at the end of 2006 included the following:

- Cutting replacement rates for unemployment insurance initially falling from 80% to 70%, then further to 65%
- Making eligibility for unemployment benefit tougher and raising contributions
- Reducing sick pay
- Exemption of very small firms from respecting the last-in-first-out rule for redundancies
- Establishment of a new form of temporary contract

- A 'New Start' scheme to promote employment of newly arrived refugees and their families
- Toughening of checks on sickness insurance by requiring medical certificates
- Other measures being introduced or proposed include:
- Incentives to employers to recruit workers previously on long-term unemployment, disability or sickness benefits
- Reducing administrative and other obstacles to SMEs so as to stimulate private service sector employment
- Increasing private finance in health and education
- A reduction in tax on earned income compared with taxes on social transfers, intended to 'make work pay'.
- Cuts in places on active labour market programmes
- Lower employers social charges for youths
- A substantial re-organisation of the public employment service, to make it into a single integrated agency instead of a rather fragmented set of linked ones. Part of the motivation is to improve the matching of jobs and job-seekers, but there is also a desire to enhance private involvement in job placements.
- A new measure that will ease restrictions on job offers that limit them to the local area of the job-seeker. There will also be mandatory payments into unemployment insurance funds.
- Creation of 'new start' jobs aimed at youths, long-term unemployed or inactive individuals aged 25 and over and at immigrants.
- A job guarantee for youths will be introduced at the end of 2007
- Incentives for newly arrived migrants are to be offered.
- Attempting to reduce the high marginal tax rate on entering the labour market by introducing an in-work tax credit for low paid workers. This is a costly initiative, expected to amount to 1.3% of GDP, but the expectation is that it will be offset by raising output and employment. However, the OECD argues that Sweden, with its compressed earnings differentials is less suited to such a scheme than countries with wider pay distributions. It therefore suggests that the benefits of the proposed

measures will depend above all on the simultaneous reduction in the generosity of unemployment benefits.

The Konjunkturinstitutet (2006) argues that the various measures will have a gradual impact in the labour market in raising the supply of labour, but the Institute also argues that they are being implemented at a good time, given the underlying strength of the economy. The changes affecting active labour market policies will mean that a category of working age individual previously counted as inactive will become active in the labour market, with the result that measured unemployment will increase in the first instance by about 0.2 percentage points. At the same time, the Institute projections suggest that potential employment will rise by as much as 1.5 percentage points. Overall the projections suggest that because of activation policies, the supply of labour will increase a little faster than demand for labour, and will forestall inflationary pressures in the labour market. The OECD argues that Sweden has suffered both from an inactivity trap and a low-wage trap, but that tapered benefits have mitigated these effects compared with many other countries and the new policies should further reduce these problems. Housing benefits for under-29s are, however, mentioned as a possible impediment to making work pay. In addition the changes are expected to result in lower disguised unemployment and higher average hours worked per capita of the working age population.

Concluding comments

Sweden has come a long way since the profound crisis of the early 1990s. In particular, since the mid-1990s, the Swedish economy has enjoyed sustained growth and progressive recovery from the traumas of the early 1990s, with a recovery of the employment rate and a halving of measured unemployment. Devaluation of the currency manifestly played a role, but extensive changes in social policy and labour market policy also played a part, while a more stability orientated macroeconomic policy helped to avoid the inflationary pressures that had contributed to the onset of recession after 1990.

Consequently, Sweden now appears to have a framework for macroeconomic policy that is delivering sustained growth, to have adapted its system of industrial relations successfully to the exigencies of globalisation, yet to have preserved the broad thrust of its social model. Anxo and Niklasson (2006: 35) claim that ‘the

Swedish model today appears *more* in accordance with the three core elements of the original Swedish model' [Emphasis in original text], and they regard the period from 1975 that culminated in the recession of the early 1990s as an aberration and departure from the original principles. They believe that the changes wrought since the early 1990s have created an 'institutional framework favourable to the emergence of negotiated flexibility and a return towards a balanced economic and employment growth. In our view these developments reinforce the coherence of the Swedish model'. Moreover, to the dismay of some critics, employment continues to be fairly well protected. However, questions remain about the effectiveness of active labour market policies and whether they do much more than disguise unemployment.

There are, too, differing perspectives on the extent to which the original co-ordinated model remains in place. Davis and Henrikson (2006) present evidence that wage dispersion increased after the break initiated by the metal workers in 1983, yet they also note that the dispersion among blue-collar workers slowed after 1995. However, in the decade after 1995, the real wages of white-collar workers rose by 43%, double the rate of blue-collar workers. The distinctive hybrid between a centralised framework and local bargaining suggests a form of flexibility that may offer a compromise between either extreme that will be of interest to other countries.

Taking account of the different standpoints, a reasonable conclusion is that Sweden has managed to maintain much of its original model, in spite of having to recalibrate it. It has also taken effective steps towards dealing with those facets of the model that had broken down or become exaggerated. As a result, the medium term prospects look highly encouraging which should facilitate the resolution of problems such as inadequate integration of immigrants or perverse incentives in certain social policies. Yet the election, in the autumn 2006, of a government with a mandate to reform the Swedish model suggests that all might not be well. Some alarm bells are, in addition, sounded in the NBER study completed in 2006 (Freeman et al., 2006), which implies that structural problems may have been masked by possibly short-lived improvements in economic performance.

Sweden has prospered under globalisation and, in doing so, has created a platform for continued prosperity and social justice. The model may have been successfully reinvented for now, but can it stand the test of time?

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