

# The political economy of flexicurity

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- Lisbon strategy (2000): “need to improve the *adaptability* of workers and enterprises.”
- Integrated Guidelines (2002): “Member States are asked to promote *flexibility combined with employment security* (...).”
- 2006 Spring European Council: “need to develop comprehensive policy strategies .... reforming labour market and social policies under an *integrated flexicurity approach*.”
- 2007 Recommendations of the Flexicurity Group
- European Parliament deliberations with the agreement of social partners. Support of the ETUC. Flexicurity is politically correct.

## Will ever come true?

The words of the veteran, Jean-Claude Juncker:

*“Politicians know what they should do, but they do not know how to be re-elected after they do the things that they know they should do”*

Do they really know how to do it?

# Outline

- Why we need flexicurity.
- Learning from differences between labour and product market reforms. A political feasibility theorem
- Two-tier reforms. How do they operate? Do they generate support for radical reforms?
- The missing link: wage setting and temporary employment

# Why flexicurity?

Every year in a typical OECD country:

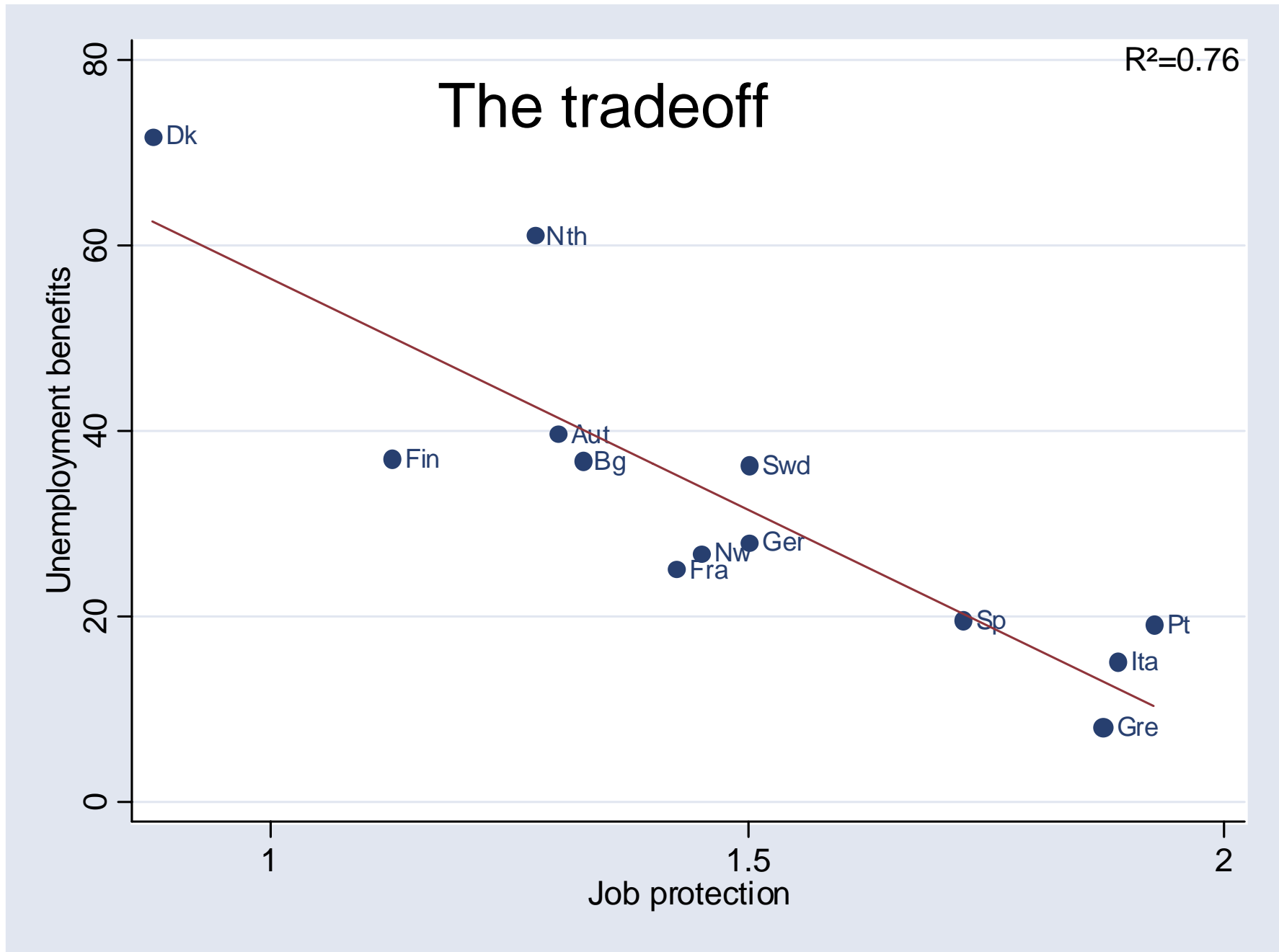
- 15 percent of jobs destroyed and about the same proportion created
- a firm with 100 employees has about
  - 30 hirings
  - 30 separations
- (higher turn-over in service industries than in manufacturing industries)

# Reallocation, growth and security

- The reallocation of jobs and of workers is associated with productivity gains (up to 50% of productivity gains associated with reallocation)
- Employment growth is higher in firms with higher productivity growth
- Process of creative destruction described by Joseph Schumpeter *Capitalism, Socialism and Democracy*, 1942
- Problem: workers face important risks

# How to reconcile reallocation with protection?

- Two common ways of protecting individuals against the risks of unemployment:
  - unemployment insurance (UI)
  - legal restrictions against dismissals (EPL)
- There exists a clear trade-off between the use of EPL and the use of UI.
- UI is more mobility friendly than EPL
- *Flexicurity* involves high UI and low EPL.



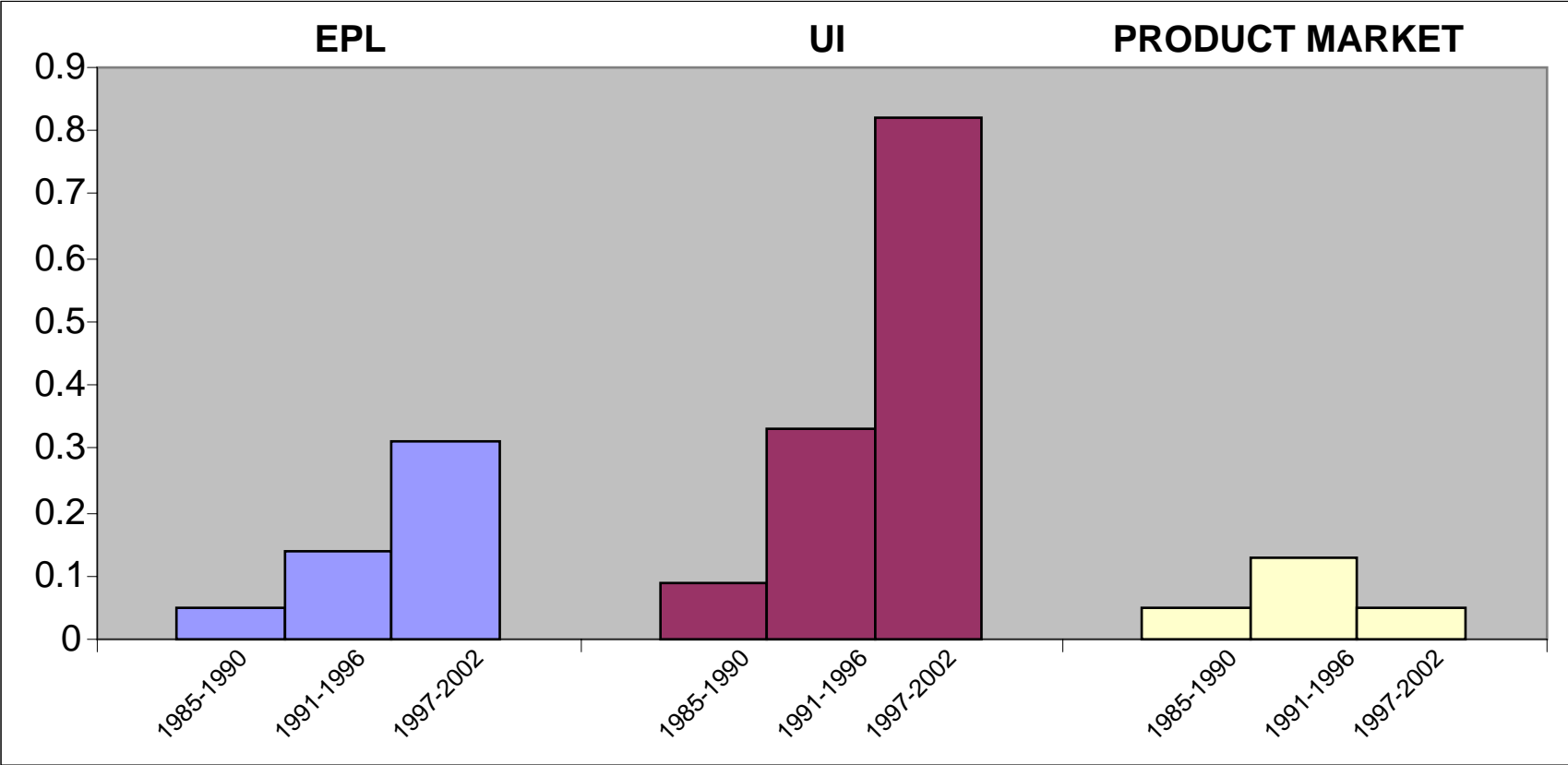
Unemployment benefits and job protection in the end of the 90's



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# Acceleration of labor market, deceleration of product market reforms

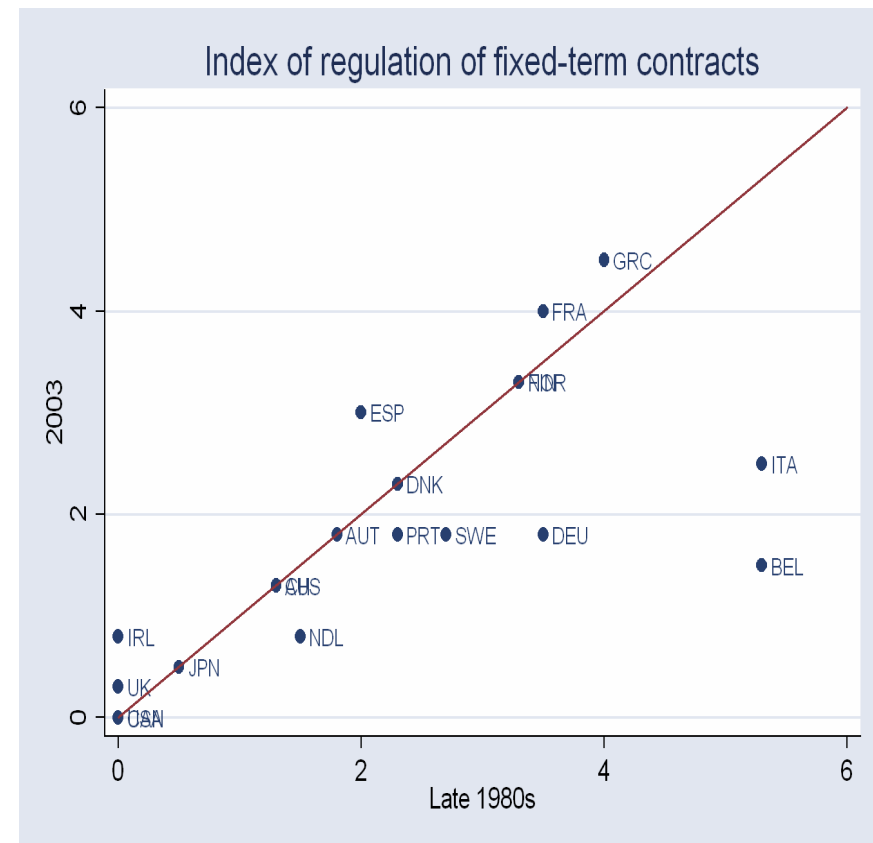
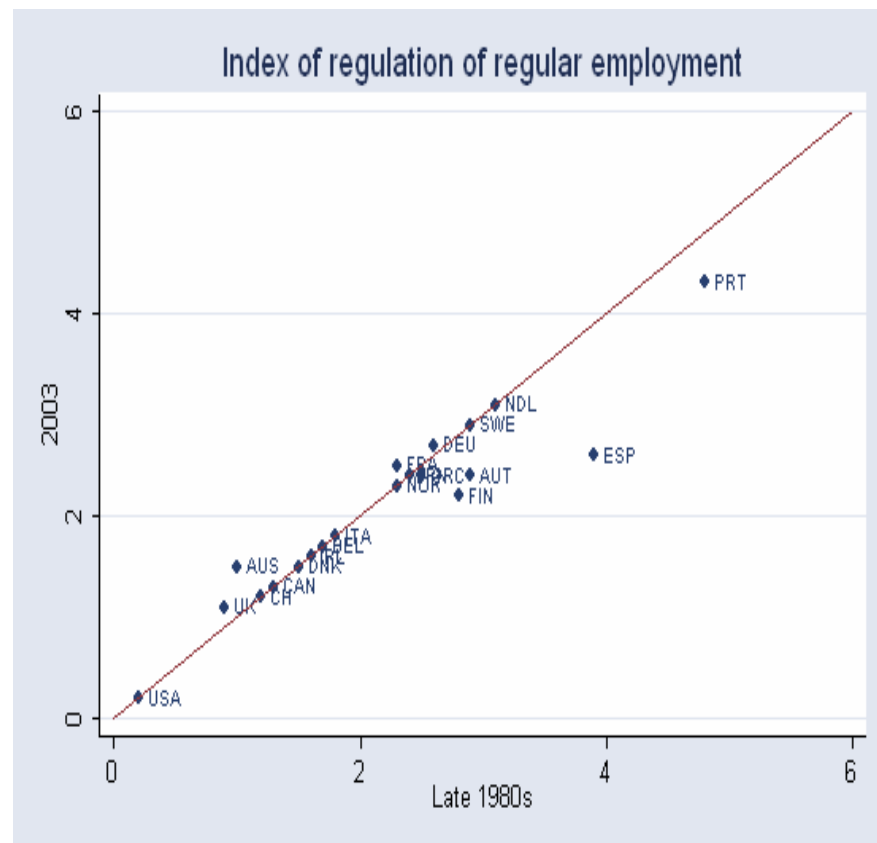


Source: fRDB Social Reforms Database

Boeri and Monti (2007)

# Reforms of EPL confined to temporary contracts

## Dual track strategy



# while reforms of product markets are radical

		Increasing Competition			Decreasing competition			Total per row	Of which decreasing (%)
		1985-1990	1991-1996	1997-1998	1985-1990	1991-1996	1997-1998		
<b>Airlines</b>	<i>Marginal</i>	0	5	13	0	0	0	<b>18</b>	100
	<i>Radical</i>	3	9	0	0	0	0	<b>12</b>	100
<b>Telecom</b>	<i>Marginal</i>	4	45	9	0	0	0	<b>58</b>	100
	<i>Radical</i>	0	4	8	0	0	0	<b>12</b>	100
<b>Electricity</b>	<i>Marginal</i>	1	4	3	0	0	1	<b>9</b>	88.89
	<i>Radical</i>	1	3	2	0	0	0	<b>6</b>	100
<b>Gas</b>	<i>Marginal</i>	0	8	0	0	0	1	<b>9</b>	88.89
	<i>Radical</i>	1	1	0	0	0	1	<b>3</b>	66.67
<b>Post</b>	<i>Marginal</i>	6	5	2	1	0	0	<b>14</b>	92.86
	<i>Radical</i>	3	3	0	0	0	0	<b>6</b>	100
<b>Railways</b>	<i>Marginal</i>	0	0	0	0	0	0	<b>0</b>	-
	<i>Radical</i>	0	5	0	0	0	0	<b>5</b>	100
<b>Road</b>	<i>Marginal</i>	11	0	1	0	0	0	<b>12</b>	100
	<i>Radical</i>	4	1	1	0	0	0	<b>6</b>	100
<b>Total per column</b>		<b>34</b>	<b>93</b>	<b>39</b>	<b>1</b>	<b>0</b>	<b>3</b>	<b>170</b>	<b>97.65</b>
<i>Average per year</i>		5.07	16.03	19.05	0.02	0	1.05	12.14	

f R  
D B

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## Why is it more difficult to reform product markets?

- Reforms leaving aside incumbents as in labour markets are not feasible
- Dual track possible only across sectors (some sectors liberalized while others are not), but when liberalizing a few sectors, benefits of reforms are not perceived (as they are spread across many consumers), while losses are concentrated

# A “political feasibility” thm

- Reform at the margin.
- Leave aside incumbents.
- New comers are not represented in the political process.
- But is dualism transitory or persistent?
- Is dual track leading to flexicurity or to segregation?

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- The missing channel: wage setting institutions

# Two-tier systems

- EPL reforms affect both hiring and separations. Small, if any, effects on employment/unemployment.
- Transitional dynamics of flexibility at the margin is different: under good times a “buffer stock” of “temps” is built-up. Under bad times “temps” are laid-off
- Average productivity declines (under DRS)
- More turnover, accommodated by TEMPs



# Intuition

- With EPL no adjustment of labor to shocks. Employers choose the employment level maximising expected profits and stick to it
- Without EPL same employment, but more profits each period
- With a two-tier regime, efficient adjustment only during upturns. More profits than with EPL, less than without it

# Explains the sea change

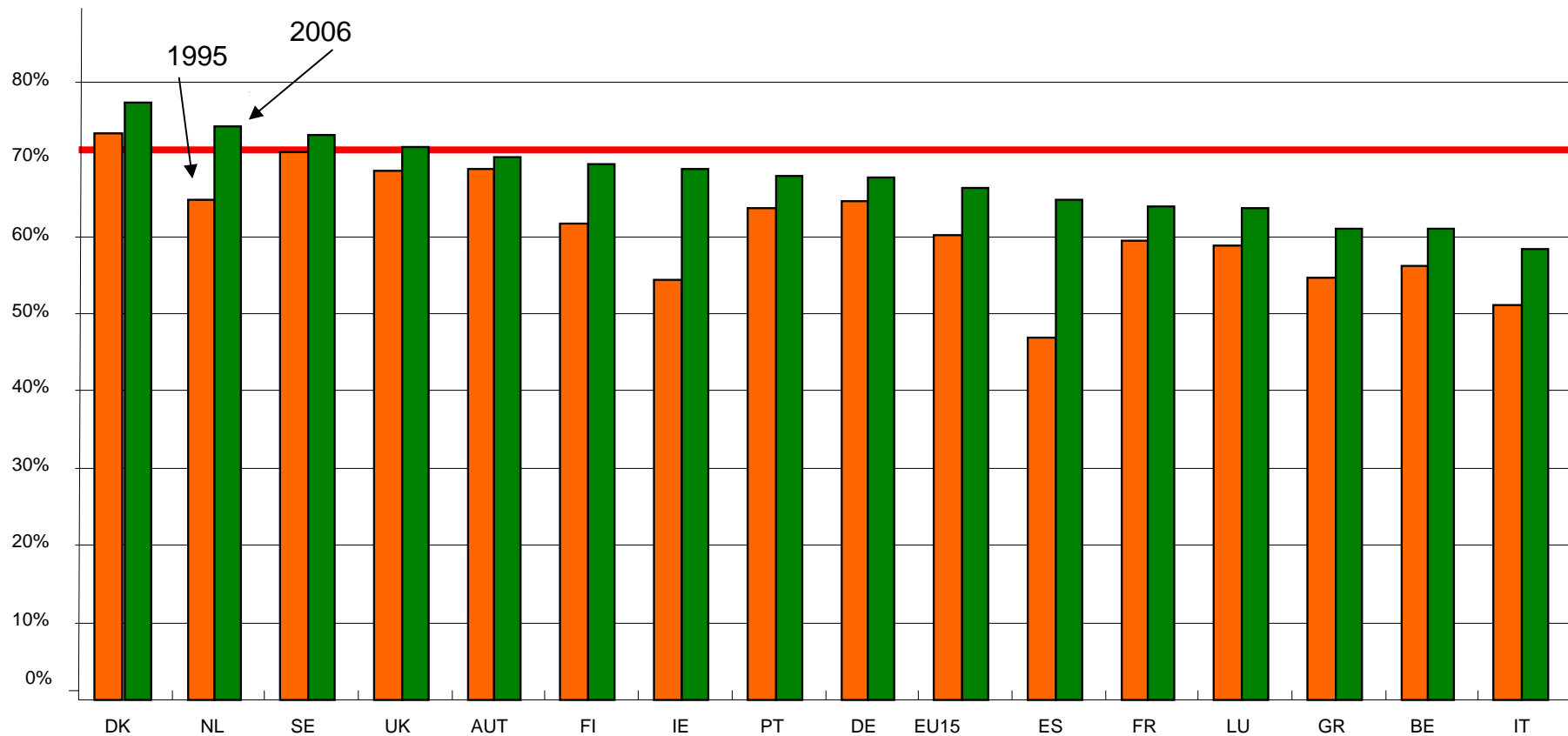
- 1994 OECD Jobs Study:
- “The labour market has become particularly worrying in Europe...
- slow employment growth has always been a feature of the Efta and EC regions...
- there are indications that employment has been unusually weak vis-à-vis output growth...
- In the EC employment growth has been generally sluggish....”

# Since then...

f R  
D B

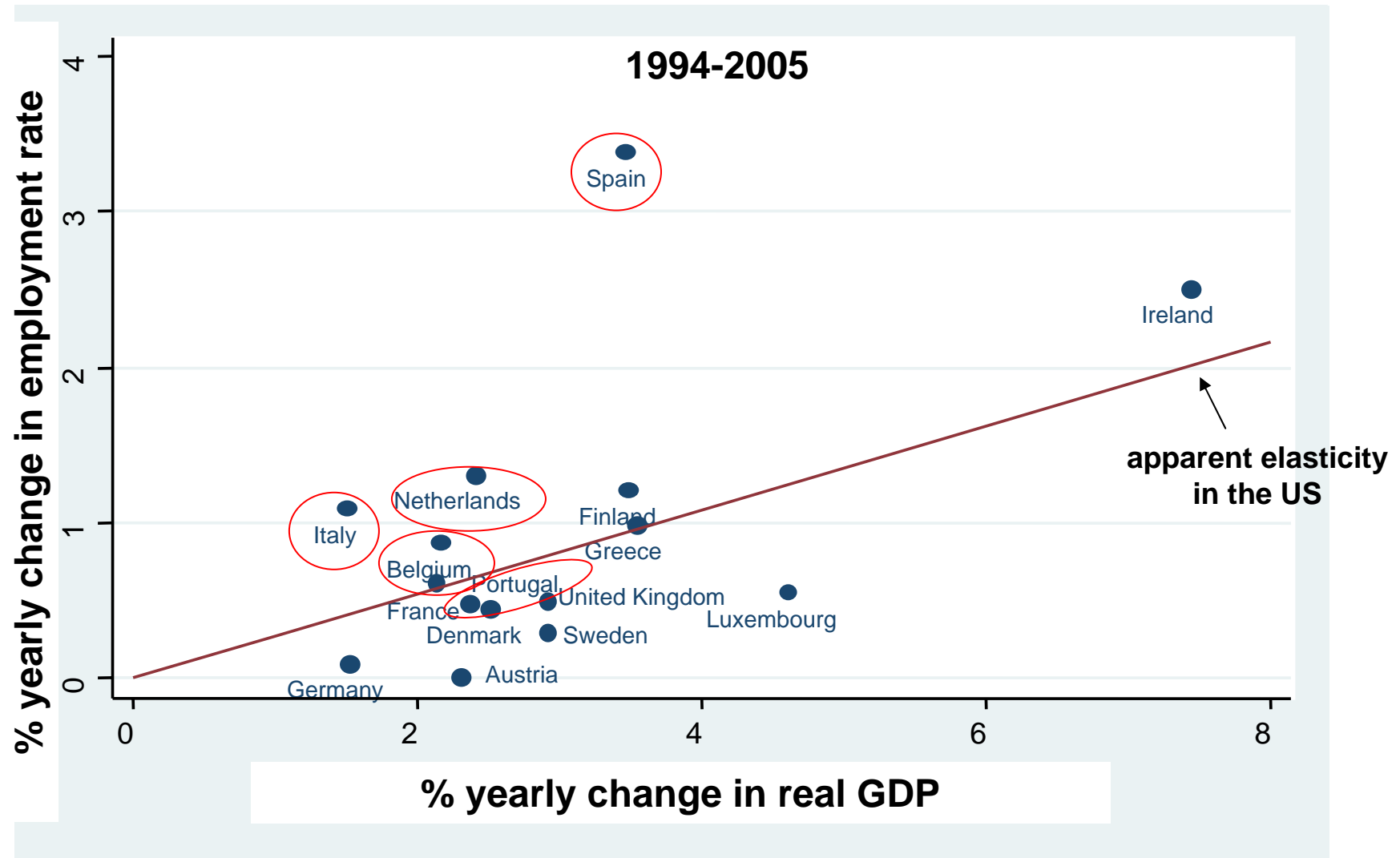
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Employment to population rates and the distance from Lisbon  
(North-America)



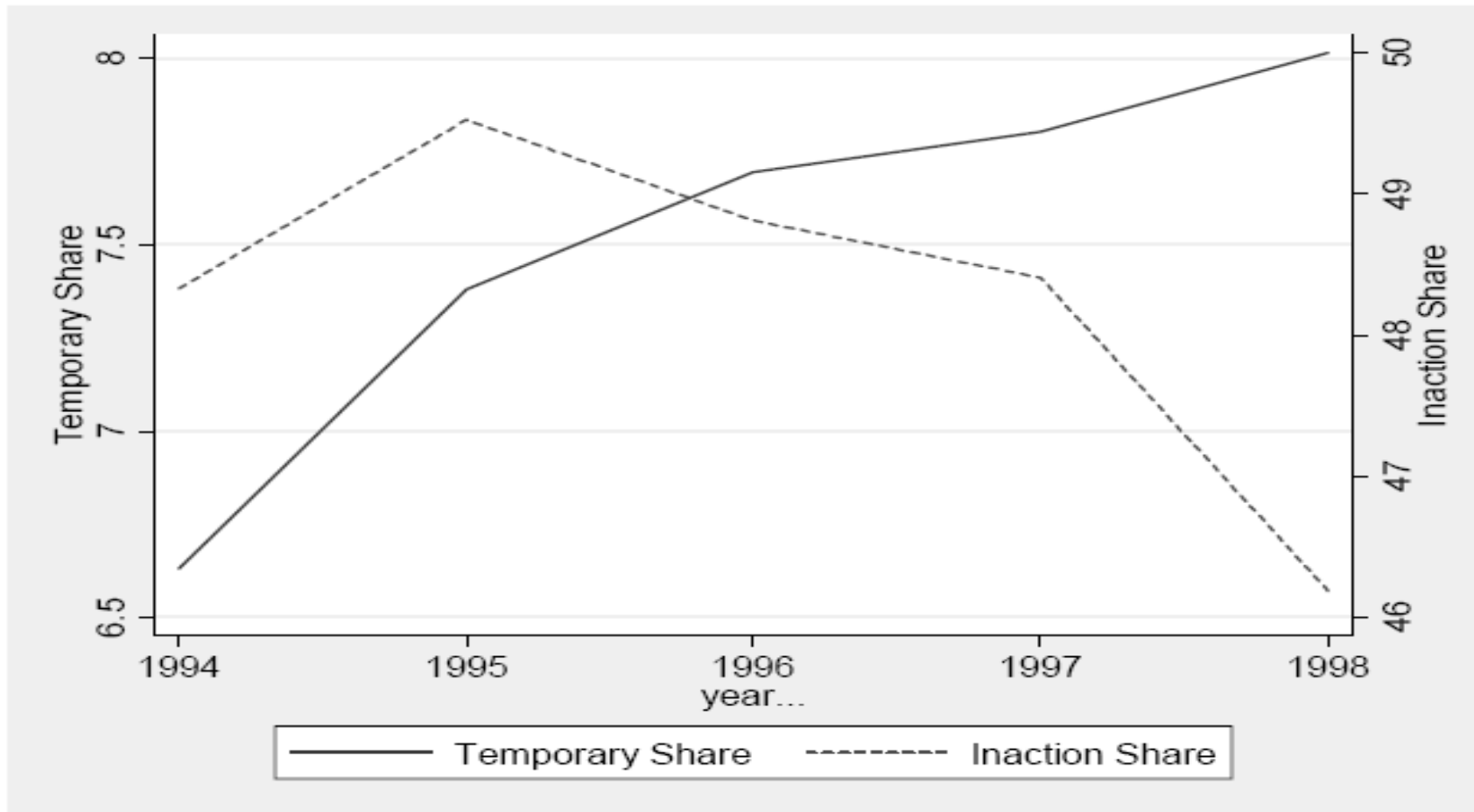
Source: Eurostat

# From jobless growth to <sup>f</sup> R growthless job creation? <sub>D B</sub>



Country	Time Period	Employment Growth <sup>a</sup> <i>g<sub>E</sub></i> (%);	Employment to Output elast. <sup>b</sup>	Temporary Emp. Growth <sup>c</sup> ( <sup>000</sup> ); $\Delta ET_t$	Contribution of Temporary jobs <sup>d</sup> $\frac{\Delta ET_t}{E_0}$
Belgium	1987-1996	1.12	0.40	22.7	0.66
	1997-2005	1.36	0.64	135.3	3.54
	$\Delta$	0.25	0.24	112.6	2.89
Italy	1987-1997	-0.22	-0.10	402.9	0.02
	1998-2005	1.61	1.84	823.2	4.11
	$\Delta$	1.85	1.95	420.3	4.09
The Netherlands	1987-1995	3.73	0.29	340.1	5.79
	1996-2005	0.75	1.24	288.8	3.80
	$\Delta$	-2.98	0.95	-51.3	-2.00
Portugal	1987-1996	0.42	0.10	-168.9	-4.10
	1997-2005	2.18	1.01	431.8	10.09
	$\Delta$	1.76	0.91	600.6	14.19
Spain	1981-1984	-1.20	-0.74	0	0
	1985-1995	1.30	0.38	3377.1	28.50
	$\Delta$	2.50	1.12	3377.1	28.50
Sweden	1987-1996	-1.02	-0.70	-138.9	-3.22
	1997-2005	1.35	0.41	189.2	4.82
	$\Delta$	2.37	1.11	328.1	8.04

# Some micro evidence 1



Boeri and Garibaldi, 2007

# Some micro evidence 2

Table 5: Labour Productivity and Temporary Employment: 1996-2000

Dependent: Change in Value Added per Worker <sup>a</sup>					
	I	II	III	IV	V
Temporary <sup>b</sup>	-0.22 (0.083) ***	-0.22 (0.083) ***	-0.38 (0.09) ***	-0.42 (0.104) ***	-0.45 (0.105) ***
Low Skills <sup>c</sup>	-0.03 (0.032)	-0.035 (0.032)	-0.021 (0.032)	-0.03 (0.04)	-0.04 (0.04)
Investment <sup>d</sup>	-	-	-	0.001 (0.001)	0.001 (0.001)
Sectoral Dummies	NO	YES	YES	YES	YES
Size Dummies	NO	NO	YES	YES	YES
Geographical Dummies	NO	NO	NO	NO	YES
<i>R</i> <sup>2</sup>	0.0102	0.0114	0.0403	0.0534	0.0606
Observations	843	843	843	630	625
<sup>a</sup> Change in Value Added per worker <sup>b</sup> Average Temporary Workers Between 1996 and 2000 <sup>c</sup> Average Low Skill Workers Between 1997 and 2000 <sup>d</sup> Average Real investment between 1996 and 2000					

Boeri and Garibaldi, 2007

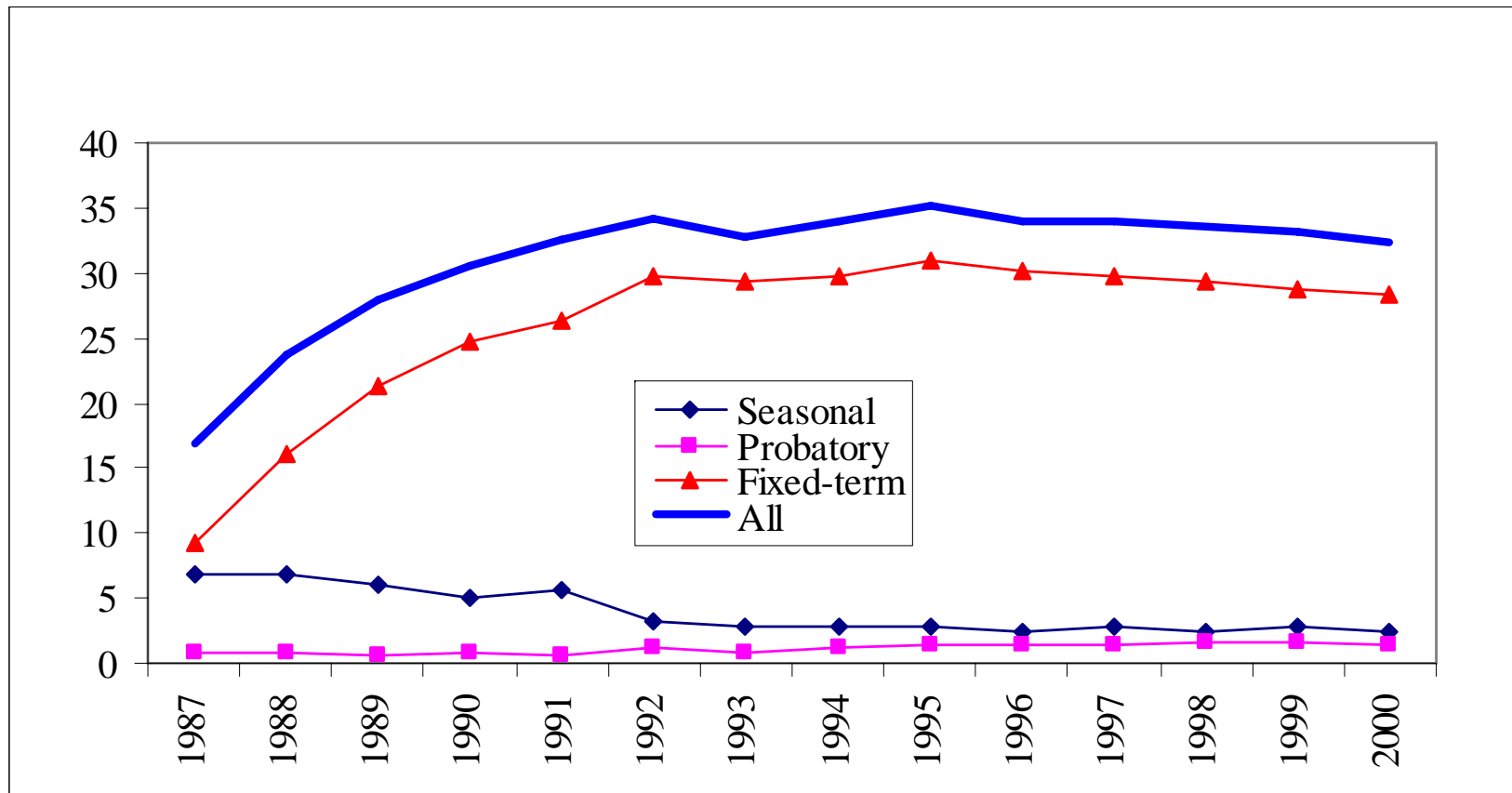
## Does the honeymoon create political support for radical reforms?

- Changing majorities but ..
- Concentration of labor market risk on the temps. More insecurity.
- Temps in between employment and unemployment: low wages, low on the job training and high insecurity

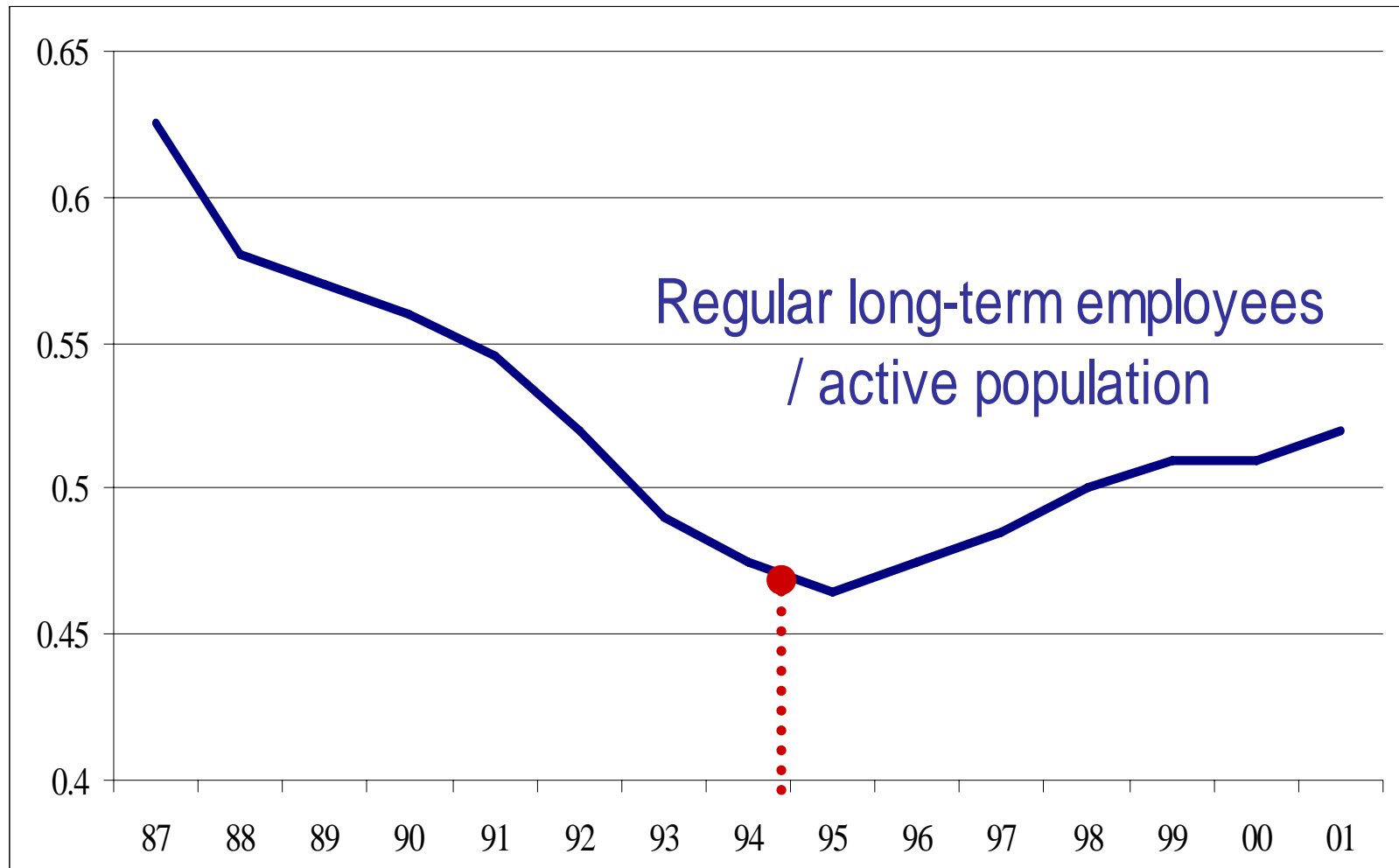


# Temporary employment in Spain

(as % of total employees)



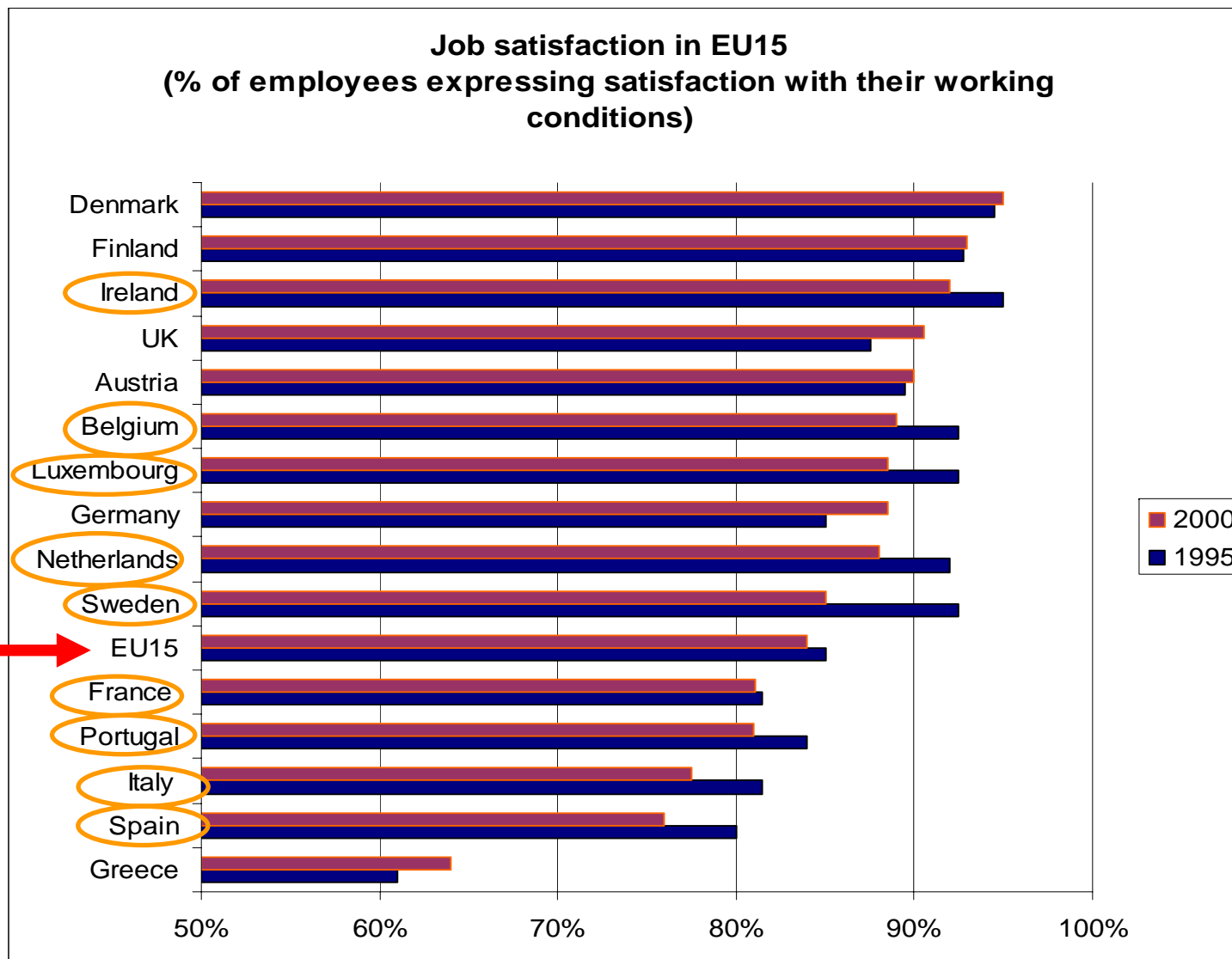
# Timing of the radical reform Spain



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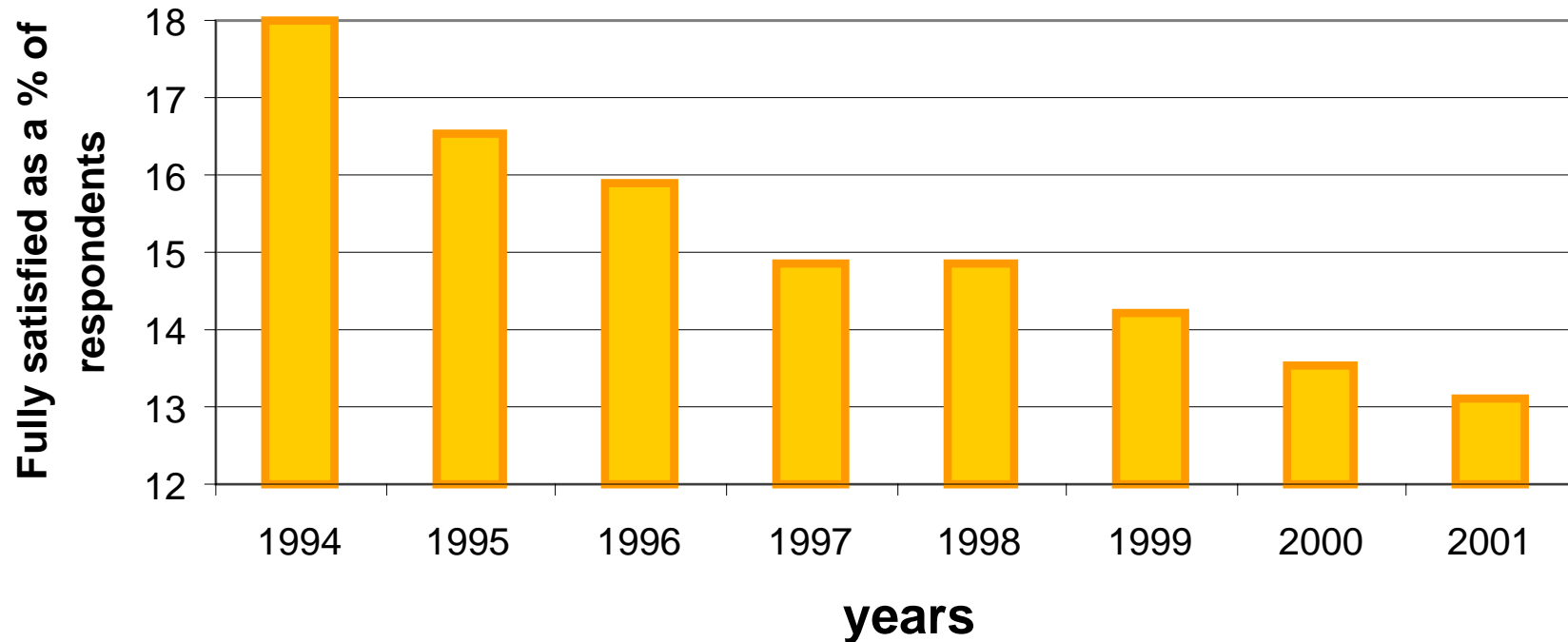
# Declining job satisfaction in the countries with the strongest unemployment decline



Source: [www.eurofund.europa.eu](http://www.eurofund.europa.eu)

# ...Europeans are unhappy

Satisfaction with work or main activity in EU10



Source: ECHP

## 1985 – 1988

	Employment <sub>t</sub>	Unemployment <sub>t</sub>	Inactivity <sub>t</sub>
Employment <sub>t-1</sub>	93,1	3,2	3,7
Unemployment <sub>t-1</sub>	29,0	56,5	14,1
Inactivity <sub>t-1</sub>	2,8	1,7	95,5

$$\text{Mobility Index} = (S - \text{tr}(M)) / (S - 1)$$

where S denotes the number of labour market states and tr(M) the trace of the transition matrix

28%

**In Europe more mobility across labour market states than 15-20 years ago**

## 2001 – 2004

**Mobility Index**

32%

	Employment <sub>t</sub>	Unemployment <sub>t</sub>	Inactivity <sub>t</sub>
Employment <sub>t-1</sub>	93,5	3,0	3,5
Unemployment <sub>t-1</sub>	30,0	47,3	22,6
Inactivity <sub>t-1</sub>	3,7	1,8	94,6

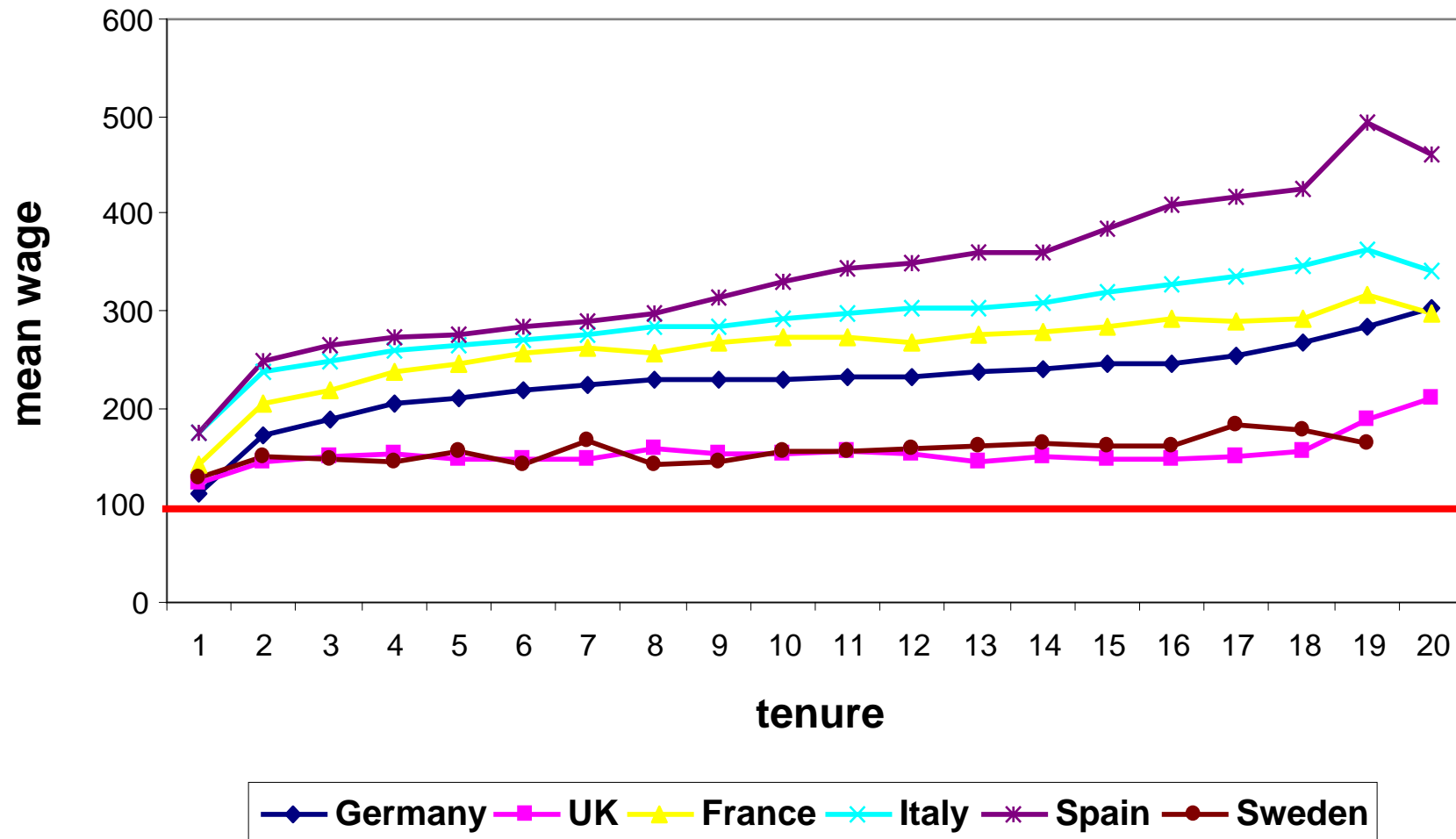
# Largely related to temps

## *Spain*

2003 \ 2004	Permanent Contracts	Fixed Term Contracts	Unemployment	Inactivity
Permanent Contracts	97.2	1,1	1.0	0,7
Fixed Term Contracts	4.8	82,6	9.0	3,5
Unemployment	2,5	20,1	67,0	10,4
Inactivity	0,4	2,4	3,9	93,3

# Any change involves wage losses insofar as wage increases are mostly related to tenure

(unconditional wage-tenure profiles, source ECHP)





# How to complete the transition to flexicurity?

Difficult to expand UI coverage at low tenures

Better to create **tenure track** to permanent contracts (no segregation into temporary contracts)

And **decentralised wage bargaining** that rewards productivity rather than simply tenure

# Final remarks

- Two-tier reforms as a politically viable strategy to reform labor markets
- They temporarily increase the employment content of growth, but create longstanding asymmetries between temps and open-ended contracts. Equity and efficiency concerns
- Segmentation can be reduced by building up consensus for more radical reforms .. if policy-makers know how to do it