New settings for the European labour markets: the *flexicurity* model

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Compared to US macroeconomic variables, the EU countries have had a significantly lower average employment growth, employment rate and amount of hours worked since the beginning of the 1990s. This suggests some structural obstacles posing a limitation to the use of the labour factor and the increase of productivity rates. Doing away with these obstacles requires structural reform in labour markets to have a more flexible labour organisation and a review of the social welfare systems in place. It has often been said that relatively low employment rates observed in many European countries are an inevitable drawback to the preference of their societies for stable employment and unemployment coverage as institutions developed to serve both goals discourage from creating jobs.

The need for reform in the European labour markets

The important task carried out by the EU to build up the single market, support and finance R&D and establish the single currency has not been fully used to create more dynamism in the labour markets in all countries of the area. So it seems that Europe needs to undergo deep reform in this respect to adapt its social institutions, mostly established in the 1950s and 1960s, in times of a very stable and predictable economic environment, to the reality of a global setting moving at an accelerating pace, which has created increasing discrepancies in labour markets.

According to André Sapir (2005), the dichotomy raised today among European politicians is not whether to abandon or maintain the institutional framework of labour markets but whether to tackle or ignore necessary reform. Going on ignoring reform will not only affect the capacity to create employment in European countries but – as has been seen on the occasion of the discussion about the services directive – it can also challenge the Union's foundations themselves, that is, the single market, the euro and enlargement, so instead of being perceived as the best tools to tackle globalisation they eventually become threats:

«This is especially true in the Old Europe, where those losing their jobs often find difficulties in being employed again. Then, citizens tend to see enlargement [of the Union] as a zero-sum game, where benefits of newcomers are made at the expense of those who already were there. [...] This burden not only adds to the threats of offshoring and competition of imports but also grows the ghost of migration, as could be seen in the fears about the 'Polish plumber'.» (Sapir, 2005).

The dichotomy raised today among European politicians is not whether to abandon or maintain the institutional framework of labour markets but whether tackle or ignore necessary reform.

The unity in monetary policy has turned the orientation of all markets to flexibility more important as devaluation as an instrument to correct any competitiveness gap is now impossible. The lack of flexibility in the markets can lead to use fiscal policy as a temporary remedy, but its use can challenge the Growth and Stability Pact on which the monetary union is grounded as it would be threatened by unsustainable fiscal policies of some countries as well as unrest of citizens in the light of unpopular measures that may be adopted to maintain the Pact.

The *flexicurity* concept: the Denmark case

Comparing labour markets is a complex task as its institutional setup, made of a wide range of features, is a fundamental variable of its way of functioning. Among the most relevant features is usually legislation on job protection (i.e. barriers in the shape of statutory compensation and other mandatory guarantees for redundancy), unemployment benefits, active labour policies, trade union membership or the degree of centralisation and coordination of collective bargaining.

In many cases, the effect of a given setting of these variables can also be ambivalent. Thus a high degree of employment protection can pose difficulties to layoff, but at the same time it makes companies more cautious in recruiting new people, which affects chances to find a job with groups having more difficulties to be hired. However, a higher degree of unemployment benefits can have a positive effect on productivity as it allows employees a higher margin to find a job better suited to their skills, but affects negatively overall employment figures as it gives less incentives to return to remunerated activity.

Sapir considered that it was useless to talk of one single European social model and established a classification for the EU-15 countries based on four models enjoying considerable acceptance: the Northern (Denmark, Sweden, Finland and the Netherlands), the Anglo-Saxon (UK and Ireland), the Continental (France, Germany, Austria, Belgium and Luxembourg) and the Mediterranean (Greece, Italy, Portugal and Spain). Chart 1 summarises the institutional features of these labour market models.

Within the discussion on which is the most appropriate institutional setting of European labour markets, the goal was set to reach a balance between flexibility and security components, a combination that led to the new word *flexicurity* as a term referring to it (COMMISSION OF THE EUROPEAN COMMUNITIES, 2007; OECD, 2006).

However, flexibility and security applied to the labour market are not concepts with one single meaning. Economic literature particularly establishes

***Chart 1*. Institutional setting of the different labour market models (EU-15)**

	NORTHERN MODEL	ANGLO-SAXON MODEL	CONTINENTAL MODEL	MEDITERRANEAN MODEL
	Denmark, Sweden, Finland & Netherlands	UK & Ireland	France, Germany, Austria, Belgium & Luxembourg	Greece, Italy, Portugal & Spain
Employment protection legislation	Low	Very low	Average	High
Unemployment benefits (1)	80%	65%	70%	38%
Active employment policies	High	Average	Average	Low
Continuous training	Very high	High	Low	Very low
Product market regulation	Average	Low	High	Very high
Taxation on labour	Very high	Very low	High	High
Trade union membership	Very high	Low	Low	Very low
Coordination of collective bargaining	Very high	Low	High	High

(1) Reposition rate (ratio between employee remuneration while employed and unemployment benefit) for 5 years unemployment.

Source: SAPIR, A. (2005).

European countries have been tackling employment policies according to four big models.

Chart 2. Flexibility and security modalities

FLEXIBILITY modalities	
External numeric flexibility	Facility in sacking and hiring employees.
Internal numeric flexibility	Facility in adapting working times to circumstantial needs of the company, related to working time regulation.
Functional flexibility	Facility in modifying tasks allocated to employees, also related to the volume of and efficiency in spending on continuous training and active policies.
Labour cost flexibility	Facility in adapting salaries to labour market conditions and individual productivity, related to trade union membership, collective bargaining mode and salary indexing.

SECURITY modalities	
Security at the working place	Probability of keeping the present job, directly related to the requirements of legislation on employment protection.
Employment security	Probability of being employed, though not necessarily in the same job.
Income security	Ability to keep a relatively stable income level, related to the setup of unemployment benefits.
Combined security	Facility in balancing job and family or studies.

Source: Own, based on Moral *and* Vacas, *2009*

▲ Economic literature establishes a difference between flexibility and security modalities.

a difference between each of the terms the modalities of which are detailed in Chart 2.

Generally speaking, the OECD (2006) characterises *flexicurity* along the following lines:

- moderate legislation to protect employment (external numeric flexibility);
- high participation in permanent learning (functional flexibility);
- high expenditure in both passive and active labour market policies (employment security);
- generous unemployment benefit schemes (income security) balancing rights and duties;
- social welfare schemes providing wide coverage (income security) and relevant trade union action.

To simplify, the core of the *flexicurity* proposal goes along two lines:

- Flexibility in reducing legislation on employment protection (specifically the part on compensation for termination of open-ended contracts).

- Security in income through generous unemployment benefits by means of powerful active training policies linked to benefits based on conditional clauses.

Although all labour market models combine flexibility and security items, some analysts have attributed success in creating jobs in Denmark to the distinctive institutional setup of the labour market, which comes very close to the theoretical concept of *flexicurity*, to the point that Denmark has become a role model in this respect.

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The Danish labour market is characterised by coexistence of a high degree of flexibility (obtained through relatively low redundancy costs) and an equally high degree of social protection (through generous unemployment benefits, albeit subject to several conditions). On the result side, the Danish labour market featured the highest overall employment rate of all EU-15 countries in 2005 (75.5% against 65.9%, respectively), the most remarkable gap being with women (12.3 points), youth (20.7 points) and employees aged 55+ (15.2 points). Additionally, the overall unemployment rate (4.9%) is the lowest in the EU-15 and long-term unemployment (25.9%) is among the lowest.

José González Mínguez and Carlos Vacas (2007) point out that one of the key points in the success of the Danish model are powerful active labour market policies including vocational training, aid in job search, employment programmes and recruitment subsidies. Since the 1994 reform, the number of users has doubled in relative terms (reaching 40% of unemployed) and priorities have focused on skill improvement programmes, especially in training, while public employment programmes halved. Despite the reduction in the number of unemployed, both the increase in the number of users and the improvement of programmes have kept the budgetary burden of active policies at a virtually constant value as of GDP (around 1.8%). Although statistic data and econometrics point towards a considerable correlation between labour market success and the Danish way of *flexicurity* setup,

«[...] *it cannot be fully excluded that Danish results are at least partly due to factors apart from the current labour market setup in this country. On the one side, reform introduced in recent times coincided with the implementation of macroeconomic policies geared to stability, particularly to a deep process of tax adjustment based on curbing expenditure. On the other side, it has been said that there is a certain trend towards exaggerating the merit of models working well during a certain period of time. For instance, the Japanese employment for life and the German vocational training and employee share in management schemes, so much praised in the 1980s, fell in disgrace one decade later as both countries were experiencing lengthy economic stagnation.*» (González Mínguez and Vacas, 2007).

The success of the Danish model is based on powerful active labour market policies including vocational training, aid in job search, employment programmes and recruitment subsidies.

A significant difference featured by the Danish *flexicurity* model is that, as opposed to the models with a demanding legislation on employment protection (redundancy compensation) usually supported by private funds, both unemployment benefits and active policies have a high cost for public finance, which translates in high taxation. In this respect, Sapir (2005) points out that the review of European labour market models demonstrates that efficiency is not related with taxation: a model like the Northern one combines high taxation with high efficiency, but also the Anglo-Saxon (much more flexible than secure, but with good results in labour market indicators) is notably efficient at lower taxation. This item is precisely one that may pose most difficulties to general adoption of the *flexicurity* model:

«[...] *as already mentioned, the Danish model places a high cost on public authorities, which in its turn results in high taxation on labour, with the negative effects this has on the offer of this production factor. The costs of the model are probably more bearable in the light of sectorial disturbances, as in this case it allows precisely quick reabsorption of resulting unemployment in other branches. However, disturbances affecting the whole economy may result in substantial expenditure increase. In this respect, the high cost of the model may not be appropriate, at least initially, for countries with high public deficit and unemployment as it would be more difficult to take on the cost under such circumstances.*» (González Mínguez and Vacas, 2007).

Implementation of *flexicurity* in European labour markets

The European Council asked the Commission to envisage the elaboration of a set of common principles on *flexicurity* together with member states and social partners in order to use them as a useful benchmark to reach more open and responsive labour markets as well as more productive jobs. This requirement came out of acknowledging that in order to manage change and new social risks caused by transition to a dynamic and prosperous knowledge-based economy, Europe needs to create more and better jobs, reduce segmentation of labour markets, the number of precarious jobs and promote sustainable integration and capacity-building. The outcome has been the communication by the Commission of the European Communities (2007), in which the OECD definition of *flexicurity* has been adopted with some shadings. In this respect, eight common principles of *flexicurity* are suggested for the EU:

- *Flexicurity* includes flexible and reliable contract terms, global strategies of permanent learning, efficient active labour market policies and modern social welfare systems.
- *Flexicurity* is based on the balance between rights and responsibilities of all stakeholders participating in the market.
- *Flexicurity* shall adapt to circumstances, labour markets and specific labour relations in each member state.
- *Flexicurity* shall reduce the gap between «those inside» the market and «those outside» it.
- It shall allow bottom-up mobility (both inside and outside the company) and mobility between unemployment/idleness and employment.

Europe needs to create more and better jobs, reduce segmentation of labour markets, the number of precarious jobs and promote sustainable integration and capacity-building.

- *Flexicurity* needs to be supportive of gender equality.

- *Flexicurity* requires a climate of trust and dialogue between public authorities and social partners.

- *Flexicurity* policies have an effect on the budget and their application shall also contribute to solid and sustainable budgetary policies from a financial viewpoint.

However, the European Commission acknowledges heterogeneity of economic structures and institutional settings of labour markets in the different member states, so the eight principles will need to be adapted (regarding implementation priorities and formulas) to the hard facts of each case; in this respect, the Commission proposes four paths/types to implement *flexicurity*.

Spain is part of path 1, the goal of which is to tackle contractual segmentation in countries with a high degree of employment protection and low unemployment protection.
Contractual segmentation is understood here as the evolving creation of two distinctive groups in the labour market: employees on an open-ended contract on one side and temporary workers and unemployed on the other.

The Commission's recommendations for this path are the following:

- redefining open-ended contracts and promote change of rules on redundancy, for instance by increasing benefits progressively;

- strengthen learning and active employment policies (especially public employment services);

- regarding social welfare systems, the possibility for temporary workers to accrue rights and transfer them between companies and branches.

However, some authors (Sapir, 2005) are sceptical that a coordinated strategy of EU countries will work correctly in a labour market reform as this is within the jurisdiction of the member states, which might prefer to wait and see how others implement the reform (taking on the cost) to benefit through the single market from the effects of relaunching their economy. In his opinion, this is the cause for the failure of the Lisbon Agenda. Hence what is needed is to focus all the effort on EU-wide policies, particularly on deepening the European single market by further liberalising product and services markets, which will ultimately induce necessary labour corrections.

The overview over labour market policies tackled by EMU countries in the 2000-2006 period (Moral and Vacas, 2009) proves this approach right.

Undertaken reform has been mainly focused on active employment policies, retirement benefits, labour taxation and social benefit cuts. The aim of these measures has been to increase the job offer in a context of economic expansion and increase of labour demand. This reform task seems to have been particular deep in countries with the worst employment rates at the onset.

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However, tackled reform has not been very deep nor has an integral reform of the institutional architecture been undertaken. Regarding *flexicurity*, progress has rather gone the opposite way: employment protection legislation has been an area in which no significant change has taken place in the studied period, and in social benefits the trend has been to reduce coverage, the length of unemployment benefits and overall tightening of eligibility requirements, with a decline in reposition rates (e.g. reform packages introduced in Germany between 2003 and 2005).

Among the countries having introduced reform is the case of Austria, which was also singled out by the governor of the Bank of Spain at a recent conference. Starting in 2003, a new compensation scheme was implemented in Austria that obliges companies to deposit a monthly flat rate on a personal account the holder of which is the employee. Employees can withdraw funds from this account in case of redundancy and the amount will vary according to change at the company, no matter if it is the employee who sets an end to the labour relation.

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The Austrian solution provides some interesting ideas: first, it turns economic rights based on service at a specific company (classical compensation) into rights linked to the total time of service; secondly, it encourages intercompany mobility without affecting previous rights of the employee; and finally, it honours the right without waiting for a situation (economic hardship at the company) that could make payout difficult.

Is implementation of flexicurity needed in the Spanish labour market?

Regarding the labour market, Spain is within the Mediterranean model, thus featuring an institutional setting quite opposed to that defined by the *flexicurity* model: high degree of employment protection and relatively low unemployment benefits.

In relation with Europe, one of the distinctive features of the Spanish labour market is its high temporary employment rate (31.7% in 2007), not only related to the EU-15 average (14.8%) and the eurozone (16.8%) but also to the other countries within the Mediterranean social model, as can be seen on Graph 1.

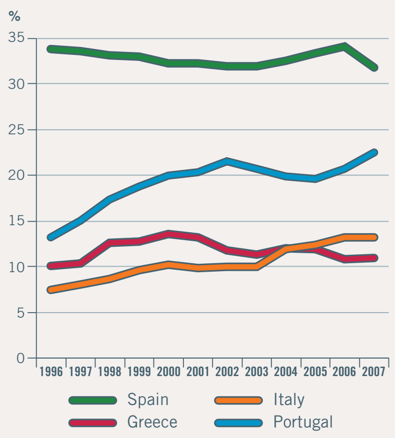
According to a classical interpretation, this fact could be explained by the high costs arising for he employer from terminating an open-ended contract, so there is a relative preference on their behalf to cover new personal needs through temporary employment modes. However, as can be seen on Graph 2, empirical evidence is considerably different: up to the early 1990s, the increase of the temporary employment rate in Spain went along the pattern described above, but with recovery and growth of the employment rate following the 1993-1994 recession, the temporary employment rate started a slight decline before picking up in 2003 and falling again together with employment after 2007. Generally speaking, the trend in Europe in the 1996-2007 period has been a slight increase in temporary employment rates (from 12% to 14.8% in the EU-15 and from 13.1% to 16.8% in the eurozone), though stronger in some countries following the Mediterranean social model (Portugal and Italy).

One of the distinctive features of the Spanish labour market is its high temporary employment rate.

The segmentation process in the Spanish labour market – duality between employees on open-ended contracts and the rest – increased rapidly during the 1980s, reaching a peak during the recession in the early 1990s, in a moment when the absolute figure of employees on open-ended contracts was below that of temporary employees and unemployed. The intense employment creation process experienced from the late 1990s till late 2007 was basically founded on open-ended recruitment, which fostered a reduction in labour market segmentation (Graph 3).

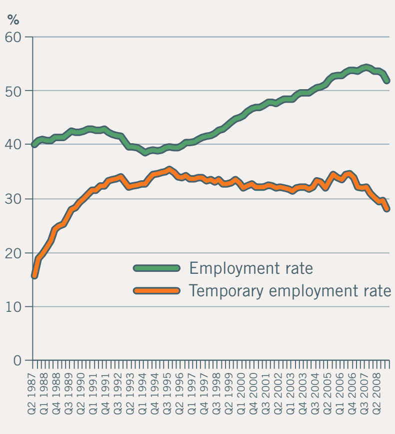
Reforms introduced into the institutional setting of the Spanish labour market during this process, with the creation of a new open-ended contract modality with reduced termination costs and rationalisation of temporary modes, helped fixing labour segmentation, but the main explanation has been the remarkable economic growth experienced during this period. With the outbreak of the current recession, this situation may change significantly; the first data show an important decline in both open-ended and temporary recruitment, but a reduction of redundancy costs will hardly correct this, at least in the short term, as the process is an adjustment to deterioration of economic activity that does not seem to have

Graph 1. Temporary employment rates in European countries on the Mediterranean social model (1996-2007)



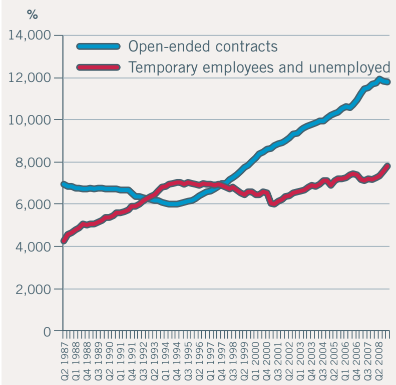
Source: Own, with Eurostat data

Graph 2. Overall and temporary employment rates in the Spanish labour market (Q2 1987 - Q4 2008)



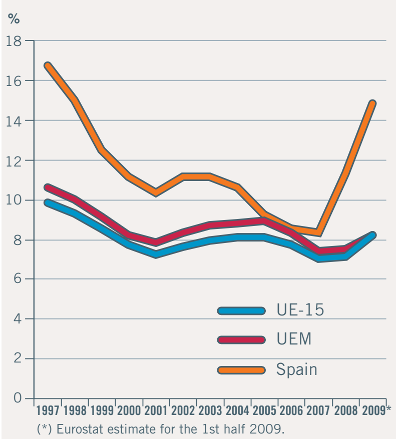
Source: Own, with INE data (EPA)

Graph 3. Open-ended contracts vs. temporary employees and unemployed in the Spanish labour market (Q2 1987 - Q2 2008, in thousands of people)



Source: Own, with INE data (EPA)

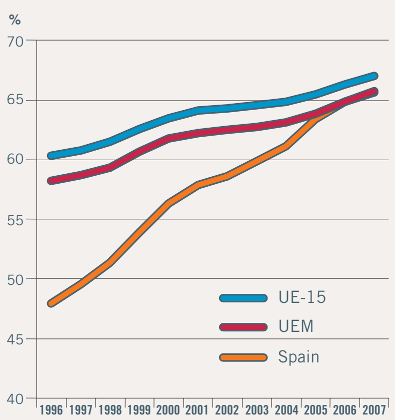
Graph 4. Unemployment rate evolution in Spain and European average rates (1997-2009)



Source: Own, with Eurostat data

▲ Regarding the labour market, Spain is within the Mediterranean model, thus featuring an institutional setting quite opposed to that defined by the flexicurity model.

Graph 5. Employment rate evolution in Spain and European average rates (1996-2007)



Source: Own, with Eurostat data

▲ One positive change in the Spanish labour market has been convergence with European employment rates.

finished yet. All in all, another turn in the labour market as occurred in the early 1990s shall not be excluded.

The gap opened by the Spanish unemployment rate in relation with the European one (Graph 4) gives more reason to think that despite the strong process of convergence taking place between both, facilitated by a higher dynamism in employment between 1995 and 2007, there are still structural deficiencies in the Spanish labour market deepening job destruction in a recession as the present one. Nevertheless, the most relevant question is to what extent the introduction of labour market reform will right now be able to redress the trend towards increasing unemployment shown by the Spanish economy. To a large extent, empirical data allow to think that the recovery of the labour market will go hand in hand with economic recovery and not so much with labour reform, but it is also true that a determined attitude on behalf of the government in fostering reform can restore confidence to economic operators and facilitate a recovery that could be more efficient in creating jobs if it occurred in a context of already implemented reform.

The recovery of the labour market will go hand in hand with economic recovery and not so much with labour reform.

However, there is another important item to be considered in a reform process as it is moving towards a *flexicurity* model. Most mechanisms of this model require transferring the cost of ensuring a given income level for workers losing their job on an open-ended contract from the private (redundancy compensation) to the public sector (increased employment benefit), with fiscal imbalance in terms of public expenditure this may introduce.

One of the most positive changes in the Spanish labour market in the last years has been progressive convergence with European employment rates (Graph 5). The main reason for this is obviously the strong employment creation process we referred to earlier, but a considerable part is also due to the increase of the activity rate (i.e. effective readiness of people to work or look for a job).

Between 1994 and 2008, the activity rate in Spain grew from 50.9% to 60.1% – with a workforce increase of roughly 7 million people in absolute terms – basically due to a higher increase in the female activity rate and the contribution of the migrant population, featuring a very high activity rate. The significant point about this figure is that if the peak unemployment level of the 1990s (24.5% in the 1st quarter of 1994) is reached again, we will not have 3.9 but 5.6 million unemployed, with the cost in social benefits and active policies this will mean.

The cost of applying the _flexicurity_ model is likely to be more bearable only in the light of specific sectorial disturbances.

As González Mínguez and Vacas point out in an earlier quotation (2007), the cost of applying the flexicurity model is likely to be more bearable only in the light of specific sectorial disturbances. In spite of its enormous scope, industrial recovery of the Spanish economy in the late 1970s and early 1980s could be an example of the situation in which migration of employment from areas without any future to new emerging sectors occurs, but in the present recession there is no similar path traced, as although there may be a clear idea about the declining branches (especially building), the new emerging sectors creating employment have not been fully identified yet.

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Notes

1. Miguel FERNÁNDEZ ORDÓÑEZ (2009). «La economía española después de la crisis». *Boletín Económico del Banco de España*, February, p. 24-33.

2. Ratio between employees on a temporary contract and total employees.