DENOUNCING THE MOST POPULAR MYTHS ON LABOUR MARKET DEREGULATION

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The belief that reforms to make labour markets much more flexible are indispensable and highly necessary is deeply ingrained in the thinking of international economic institutions such as the European Commission, the OECD and the IMF. To advance their policy agenda of labour market deregulation, these institutions repeatedly use specific arguments and examples that are supposed to show how a policy agenda that weakens job protection, unemployment benefits and/or collective bargaining systems brings great benefits, either in the form of improved job creation and/or in the form of getting the rising incidence of precarious work practices under some form of control.

This note spells out some key but simple arguments and examples that can be used to question this conventional wisdom on labour market reform. It is based on a recent publication from the ETUI that analyses in detail the recent experience of 9 European economies with deregulation (See @ETUI https://www.etui.org/Publications2/Books/Myths-of-employment-deregulation-how-it-neither-creates-jobs-nor-reduces-labour-market-segmentation).

1. The German Jobs miracle: Little to do with competitiveness and mainly part time

The mainstream argument is that deregulation (Hartz reforms reducing duration of unemployment benefits from two to one year, opening clauses in wage bargaining) made the labour market much more flexible, thus improving competitiveness and resulting in a boom in jobs. One particular idea here is to claim that the rising incidence of low pay in the service sector has kept costs in export oriented manufacturing sectors down.

> ***"Germany's jobs boom is not driven by competitiveness"***

This mainstream argument does not square easily with the fact that the bulk of job creation took place in public or quasi-public sectors. Indeed, half of overall employment growth (expressed in number of people/heads at work) between 2000 and 2008 and 40% of total job creation between 2008 and 2013 was in education, health and social care. In terms of the volume of working hours, the outstanding performance of these quasi-public sectors is even more striking: Their number increased by a staggering 11% between 2000 and 2015, while working hours in the total economy only went up by a mere 1.9% and fell by 6% in manufacturing.

Education, health and social care however do not have much of a link with manufacturing sectors or export markets. Hence, improved competitiveness and increases in export flows cannot explain the main part of the overall jobs boom that Germany experienced. Other explanations need to be put forward:

- With capital markets flooding German bunds during the euro crisis, Germany did not resort to austerity policy to the same extent as many other European economies. Instead, falling and low interest rates on public debt allowed Germany to finance the job expansion in these quasi-public sectors.

- Delayed expansion of child care facilities. This (both directly as indirectly) created jobs for women. Note that 80% (!) of jobs growth between 2000 and 2015 is female employment

- An ageing population increasing demand for social care and health services

> ***"Mainly part- time"***

Between 2000 and 2015, the German economy added 3.1 million new jobs. This number becomes a lot less impressive when taking into account that:

- All job creation consisted of part time work (from 1 to 34 hours a week). Meanwhile, the number of full time employees (more than 25 hours) went down by 210.000. So the German jobs miracle is more about re-distributing a rather limited increase in working hours (1.9% over 15 years) across a much larger number of employees (this number increased four times as much as working hours, by 7.8%).

- This trend of re-distribution of working hours actually started well before the 'Hartz' reforms so the question can be raised what role these reforms actually played in this.

- Even the limited increase in working hours from 2000 to 2015 (1.9%) is not really brilliant as this means that the number of working hours in 2015 is still below its 1991 level.

- Moreover, many of the jobs created have a rather insecure or precarious character. Around one third are either fixed term, mini- jobs, agency workers or part time work below 20 hours a week.

2. Insiders versus outsiders? Reducing job protection for regular workers does not discourage business to keep using flexible, short term contracts

The mainstream argument is that strict job protection of regular workers forces employers to make greater use of all sorts of flexible contracts that offer much less rights and security for workers, thus creating labour market segmentation and inequalities between workers. The policy prescription that follows is to reduce the rights and protection of regular workers so that the employers' incentive to resort to these precarious forms of work is reduced.

Over the past decade, several European economies indeed followed up on this policy prescription and reduced job protection rules for regular workers. The results however have been disappointing:

- Estonia, in 2008, relaxed the protection of regular contracts by cutting redundancy notice periods (from 2 to 4 months to 1 month), by reducing severance payments (from 2 to 4 months to 1 to 3 months), by transferring that part of the severance payment that exceeds one month pay from the employer to the unemployment insurance fund and by easing procedures in case of collective redundancies.

The result? The share of fixed term workers, instead of falling or remaining at its low level, actually increased between 2009 and 2011 by two percentage points, from 2.5–3.4% to 4.4–5.6%.(This, arithmetically, represents an increase of up to 100%…..).

- The UK loosened up already very flexible arrangements for regular contracts even more in 2013. The notice period for large scale dismissals (+100) to 45 days was halved and fees for making a legal claim on unfair dismissal were introduced.

The result? Despite workers in regular contracts having some of the lowest protections in Europe, the jobs recovery in the UK consisted overwhelmingly of non-standard employment forms. Self-employment and zero hour contracts exploded, representing more than 80% (4 out of 5) of the 2 million total increase in employment between 2008 and 2016.

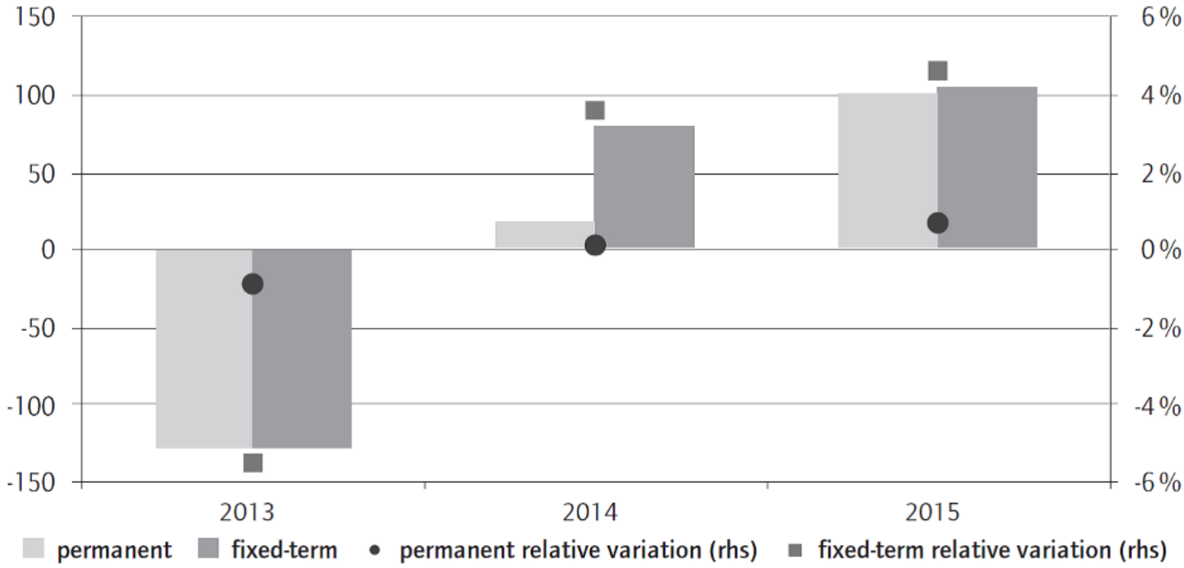
- Spain has one of the highest shares of workers on temporary contracts (34% before the financial crisis, around 25% after the crisis). Moreover, one quarter of these contracts has duration of fewer than seven days and just 0.4% is for more than one year. A labour law reform was implemented in 2012, reducing the level of job protection for regular workers by, amongst other things, putting in a maximum floor of 12 months of severance pay (20 days per year).

The result? Apart from a short-lived and very modest upward blip in the share of new open ended contracts in 2012, that share is back to where it was after the crisis with just 8% of all new labour contracts in Spain being signed in the form of an open ended one.

- In 2014, Italy approved its famous Jobs Act. This act also had the intention to reduce the incidence of temporary and insecure employment. A labour contract where protection, after a long trial period of two years, gradually increased over time replaced the existing open ended contracts. And the obligation to reinstate workers in the case of dismissal without just cause was abolished and replaced by a severance payment equal to two months per year worked. Importantly, this was accompanied by fiscal measures, granting companies exemptions from social contributions for three years, for open ended contracts signed in 2015 (both new contracts as well as conversion of existing fixed term contracts).

The result ? Fixed term work continued to increase and this even at an accelerated pace. Whereas the number of fixed term workers went up by some 70.000 in 2014, the increase was 100.000 in 2015 (or an increase of around 5% see graph).

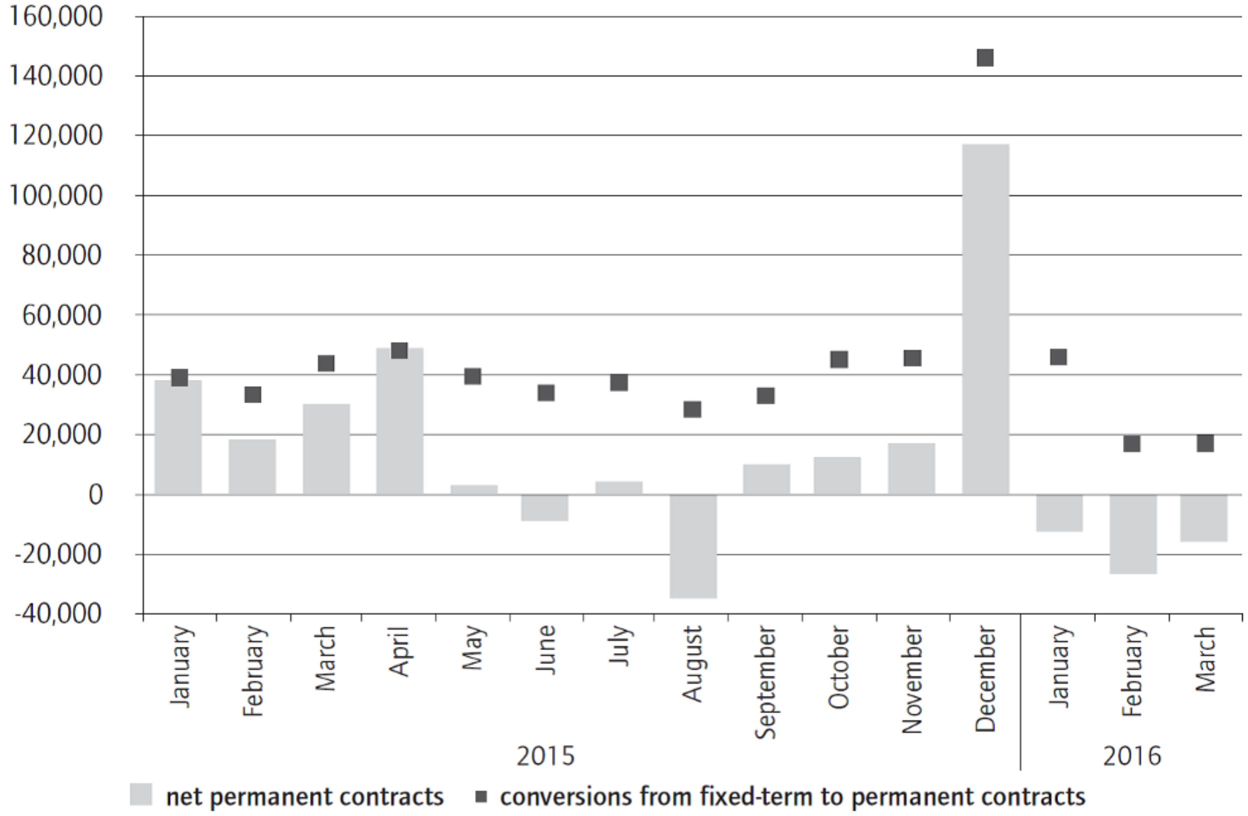
Figure 4 **Annual variation in absolute (in thousands) and relative terms of the stock of workers on permanent and fixed-term contracts (2013-2015)**



Source: calculated from ISTAT

The number of workers on open-ended contracts also accelerated in 2015 (112.000 added). However, the bulk of the increase for the whole year took place in one month, in December 2015, just before the fiscal incentives for permanent contracts were to be halved (in January 2016). In other words, fiscal incentives, not job protection reform, are behind the increase in the stock of permanent contracts in Italy. This is confirmed by econometric analysis from the Bank of Italy.

Figure 5 **New permanent contracts and conversions of fixed-term to permanent contracts (January 2015-March 2016)**



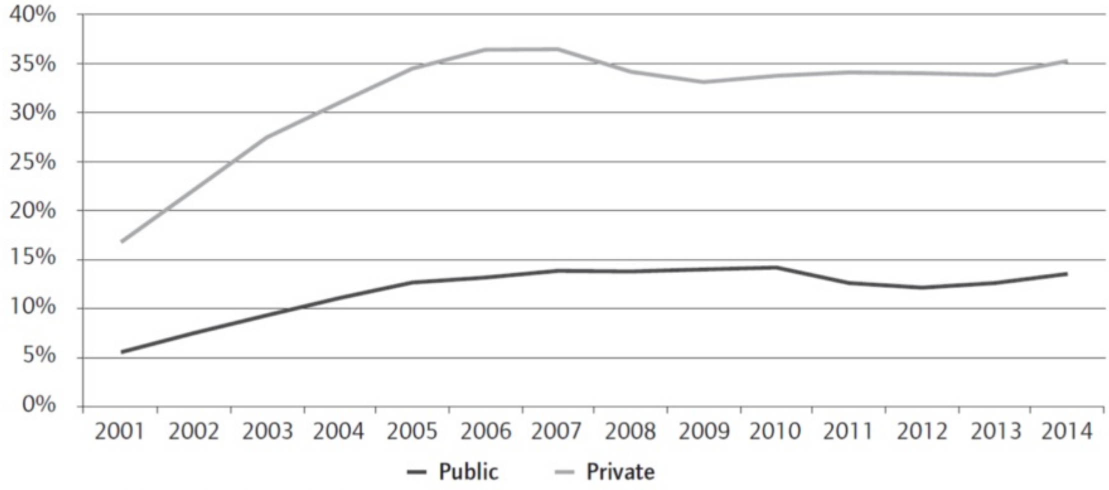
Source: the authors based on INPS data

- From 2002 to 2014, almost all job that were created in Poland (2.07 million) can be attributed to temporary employment (1.97 million), making Poland the economy with the highest share of temporary employment in Europe (28.3% in 2014). At the same time, a quarter of all workers under a fixed term contract have been employed in the same workplace for over four years, indicating that temporary contracts are systematically used to fill stable job positions.

What is striking is that this explosion of temporary jobs took place despite the absence of any change in regular job protection. The mainstream argument that Polish employers 'had' to resort massively to temporary contracts because policy decided to toughen up the protection of the 'insiders' does not fly.

Other factors have played a role instead: The state itself has played a role by tripling its share of fixed term work (see graph), labour inspections are too much focussed on small infringements of the law and the fact that notice periods to terminate a fixed-term contract have been shorter compared to open ended contracts until 2016 was not helpful either.

Figure 11 **Incidence of temporary jobs in the private and public sectors in Poland, 2001-2014, per cent of paid employment**



Source: own calculations based on Polish LFS data

3. Insiders versus Outsiders? 'Easy firing" of regular workers does not improve upwards mobility for non-standard workers

The mainstream argument is that strict job protection for regular workers reduces labour turnover because workers do not want to give up on the job protection rights already acquired in the present job. This limits the number of regular job vacancies open to workers on non-standard- jobs, thereby reducing their opportunities of moving upwards into an open ended contract and keeping them trapped in a chain of insecure short term contracts.

- The experience with reforms in Germany shows that the interaction between 'insiders' and 'outsiders' works in a much different way than is assumed in the mainstream argument above. Indeed, what has been observed in Germany since the period of structural reforms is that labour turnover has decreased since the upswing around 2000 and that half of his decrease is due to the reduction in voluntary leavers. This was clearly not supposed to happen. But what did happen (falling labour turnover) can be explained by the negative effects of the reforms: Unemployment became to be associated with much more risk and insecurity, both in terms of shorter duration of unemployment benefits as well as in terms of the jobs on offer being more often atypical, insecure and low paid ones. As a result, workers are now more reluctant between jobs and give up the protection acquired in the existing job: If anything goes wrong in the new job, the fall-back options are not so as many of the jobs on offer are low paid, unstable fixed term and temporary agency contracts. This puts the mainstream 'insider-outsider' argument upside down: "Outsiders" do not suffer because 'insiders' are too well protected. Instead, non-standard workers' risk increases because standard workers are also negatively affected by the rise in precarious contracts.

- Similar experience is observed in Estonia where job-to-job flows decreased from 9% in 2007 to 6% in 2011 despite the cut in job protection. What did increase however was the probability of losing one's job and ending up in unemployment which increased by 3.5 percentage points.

4. Danish flexicurity is not exactly what it is thought to be

The mainstream argument is that all of us should become like Denmark: Provide employers the flexibility of easy firing while giving workers security through benefit and training.

This description of the Danish system relies on OECD indicators that are outdated. In older OECD indicators (from 2008 and before), Denmark was placed in at the bottom of job protection systems in OECD countries and close to the UK-ranking. However, the OECD in 2013 seriously upgraded their job protection score by also taking into account notification periods that are negotiated in collective agreements. The level of job protection in

Denmark currently finds itself in the middle of the OECD distribution and almost at the same level as the protection of regular jobs in Spain.

While (blue collar) workers in manufacturing and transportation sectors may have up to 3 months of advance notification, salaried employees can be entitled to 6 months (see table). Workers in construction on the other hand, have much more limited notification periods. Hence, the ‘flexibility’ of the Danish system lies more in the differentiation it allows across sectors than in an overall low level of job protection across the entire economy.

Table 1 **Examples of notice periods in selected industries**

	After 1 year of employment	After 5 years of employment	After 10 years of employment
Construction	3 days	10 days	10 days
Manufacturing and transportation	21 days	56 days	90 day
Salaried employees	3 months	4 months	6 months

Sources: Collective agreements for manufacturing, 2014-2017; for construction, 2014; and the law on salaried workers

5. Flexible wage and company level bargaining do not save jobs

The mainstream argument is that company level bargaining because it allows negotiating deals where pay can be exchanged for jobs. Economies can thereby adjust along the ‘intensive’ margin (wages) instead of adjusting along the ‘extensive’ margin (job restructuring).

Experiences from Estonia and Spain do not confirm this theory that jobs and wages can be easily exchanged against each other.

- Estonia has pushed the model of wage flexibility rather far: Performance related pay, hence wage flexibility, was already quite common among workers. Moreover, a (2008) labour law reform gives employers the possibility to reduce wages temporarily in case of unforeseen circumstances (and on line with a proportional reduction in the workload of employees). More than 50% of workers experienced a reduction in wage by the end of 2009.

The result? Wage flexibility did not stop employers from firing workers and most of the adjustment still occurred by reducing the number of employees. In 2009, total payrolls fell by 15% with the main part of this being driven by a 9% reduction in staff numbers.

- Spain in 2012 also reformed the collective bargaining system by giving priority to company level agreements over sector agreements as well as by giving employers opportunities to set wages unilaterally in case of a danger of economic difficulties.

The result? The extent to which changes in economic activity (in GDP) are translated into changes in employment (so called ‘elasticity of hobs to growth) displayed anything but a helpful pattern. In 2012 and 2013 (years when Spain was still in recession), this elasticity continued to be at 2–2.5, implying that the 1.7% decrease in activity in 2013 translated into fall in jobs of 3.4%. When Spain started to recover from 2014 on, the elasticity fell back to levels similar to what was observed in the early 2000’s economic upturn. Reforms did not make economic growth more labour intensive.