

# ETUI Policy Brief

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### Not for bad weather: flexicurity challenged by the crisis

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### Policy implications

Flexicurity is a European labour market policy adopted in 2007 as part of the European Employment Strategy. The policy aims at enhancing the flexibility of employment relations (easing firing and hiring, adjustable working hours, variable pay, etc.) and compensating for such changes by means of improvements in employment security and employment activation. This paper, based on a longer report (Tangian 2010), analyses the relationship between the economic crisis and flexicurity. It is shown with statistical certainty that countries with high labour flexibility are more damaged by the current crisis. The damage is expressed in terms of output gap (under-utilization of full economic potential), public debt, size of bailout packages and unemployment rate. It is concluded that flexicurity is insufficiently compatible with a sustainable economy. This implies that the policy of flexicurity requires profound revision and should not be continued in its current form. A better alternative to flexicurity would be "normalisation" of employment relations; in other words, less flexibility, which would also result in lower social security expenditure.

### Brief history of flexicurity

Since the 1980s, general employment insecurity has significantly increased in Europe. The strictness of employment protection legislation (EPL) has been gradually relaxed in most countries. This development is reflected by the OECD's EPL indicator (1999, 2004), which was last updated in 2008 (Venn 2009); see Figure 1. At the same time, the number of atypically employed (anyone other than permanent full-time employees) has grown disproportionately. According to the Eurostat *Labour Force Survey* (2010), in 2008 the share of atypical employment exceeded 40% in 10 of the 27 Member States; see Figure 2.

The notion of flexicurity was introduced in order to reconcile the European public with the increase in flexible employment, given that the latter entails less job security. Wilthagen and

Tros (2004) attribute the invention of the word "flexicurity" to a member of the Dutch Scientific Council of Government Policy, Professor Hans Adriaansens (Labour Party). In the autumn of 1995, Adriaansens launched the term in speeches and interviews, having defined it as a shift from job security towards employment security. He suggested compensating for decreasing job security (fewer permanent jobs and easier dismissals) by improving employment opportunities and social security benefits. By the end of 1997, the Dutch parliament

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had accepted the flexibility/security proposals and shaped them into laws, which came into force in 1999.

The OECD ascribes the origins of flexicurity to Denmark and its "golden triangle" of traditionally weak employment protection, highly developed social security and efficient active labour market policies. The interaction of these three pillars is described by the OECD as follows:

The Danish model of flexicurity thus points to a third way between the flexibility often attributed to deregulated Anglo-Saxon countries and strict job protection characterizing southern European countries ... Those who do not quickly go back to employment are assisted by active labour market programmes, before re-entering employment. The vast majority of unemployed persons who are members of a U[unemployment] I[nsurance] fund receive ... 90% of their previous income from the first day of unemployment and for a maximum of four years, including periods of activation ... The potential disincentives deriving from these high income replacement rates are addressed by requiring the unemployed to be actively seeking jobs and by offering mandatory fulltime activation programmes (OECD 2004, p. 97).

However, it is often left unmentioned that both the Dutch and the Danish models of flexicurity include a well-developed social dialogue as one of their components. According to Wilthagen and Tros (2004, p. 175), collective agreements can deviate from Dutch legislative norms in either direction. This unique feature of Dutch flexicurity gives collective bargaining a pivotal role in regulating employment relations. The weak level of employment protection in Denmark is also compensated by a strong intermediary role for trade unions, which, at 80%, have one of the highest densities in Europe (European Foundation 2007, p. 6, and 2009, p. 23). The role of collective bargaining in "employment protection as it works in practice" has also recently been recognized by the OECD; see Venn (2009, p. 13).

The EU referred to flexicurity for the first time at the Lisbon summit in 2000 (Vielle and Walthery 2003, p. 2). Subsequently, the words "flexibility" and "security" began to be used in juxtaposition in an increasing number of official documents. In November 2006, the European Commission's DG for Employment, Social Affairs and Equal Opportunities published a strategic Green Paper entitled *Modernising labour law to meet the challenges of the 21st century* (European Commission 2006b), while in June 2007, the Commission's concept of flexicurity was described in the communication *Towards Common Principles of Flexicurity: More and Better Jobs Through Flexibility and Security*, which was later published as a brochure (European Commission 2007); this publication will be cited in the following as the *Common Principles*. The *Common Principles* were accepted by the EU Employment and Social Affairs Council Meeting of December 5/6, 2007, and this decision was endorsed by the European Council on December 14, 2007 (Council of the European Union 2008, p. 14). The already 15-year-long history of flexicurity can be roughly divided into three periods.

**1995–2001 (security for flexibly employed).** This period spans the years between the first use of the word "flexicurity" and the first references to it by the EU at the Lisbon summit 2000. This first phase is characterized by labour market reforms in the Netherlands and the beginning of the academic debate on flexicurity (Wilthagen 1998, WSI 2000). During this period, flexicurity was understood more than anything else as a policy to protect atypical workers against the negative consequences of labour market deregulation. The European social partners did not participate in the debate.

**2001–2006 (flexibility–security trade-off).** The second period lasted until the publication of the first European strategic document – the Green Paper issued at the end of 2006. This phase saw the shaping of the idea of flexicurity as a trade-off between flexibility and security. The EU made occasional references to flexicurity as a balance between labour market flexibilization and social developments. The OECD (2004, 2006) and the European Commission (2006a) mentioned flexicurity positively in their analytical publications *Employment Outlook* and *Employment in Europe*, deeming the flexicurity approach appropriate for implementing their respective employment strategies. The European social partners began to be involved in the discussions.

**2006–today (security through flexibility).** In the Commission's Green Paper 2006 and especially in the *Common Principles*, flexicurity was understood as security through flexibility, or even as 'flexibility security', that is, securing flexibility by adapting labour force to flexible employment, primarily by lifelong learning. Flexibility was regarded as providing "more and better jobs" because it improves economic competitiveness and, accordingly, contributes to labour market performance. The EU has now adopted this understanding of the flexicurity approach as its official policy, discussed it with national governments and social partners, and provided support for flexicurity research. The concept of flexicurity has engendered a vibrant response in academic and public debate.

The current discussion on flexicurity is led mainly at the qualitative level. Some politicians and scholars warn that it is unclear which policy responses can be expected. The main normative argument – that flexibility improves economic performance – is still disputed. Since the current crisis has already called into question some fundamental normative beliefs, such as the advantages of financial liberalisation, it makes sense to empirically analyse the concept of flexicurity with regard to the crisis as well.

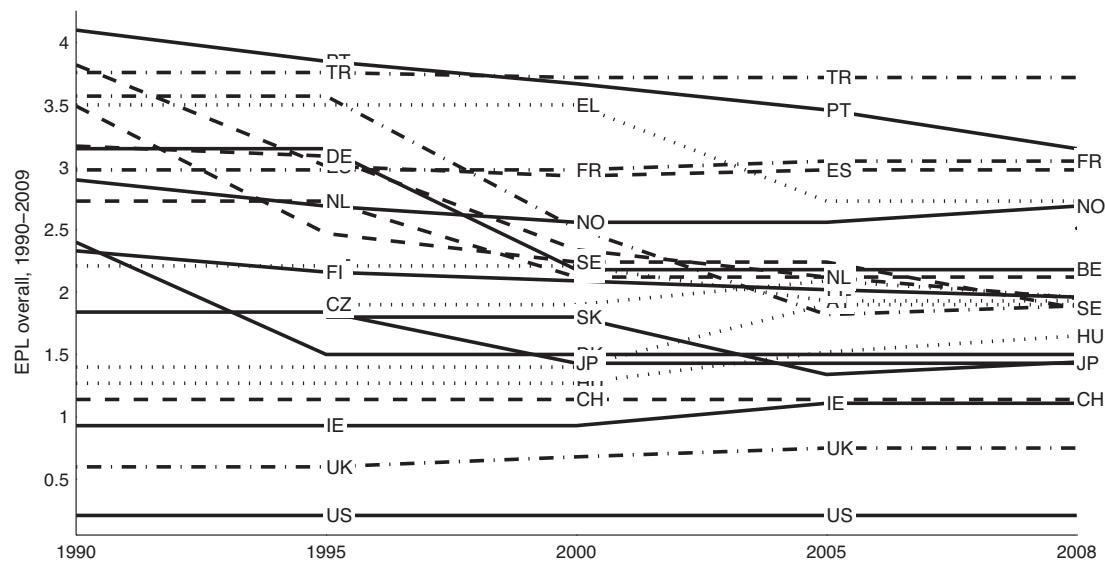
## Composite indicators of flexibility, security and macroeconomic situation

The variables for the analysis were selected to reflect flexibility, security and damage from the crisis at the macro level. The data for flexibility and security are taken for the latest available year before the crisis (2007) so as to reflect the state of each country when the crisis hit. The data used for the damage caused by the crisis are the changes in the most important macroeconomic indicators in 2008–2010.

Flexibility is broken down into institutional and factual flexibility. Institutional flexibility is represented by the OECD indicators of strictness of employment protection legislation both for regular and temporary employment. Factual flexibility is based on statistics on atypical work and involuntary part-time employment. Security is represented by general social security expenditure and social security benefits (cash benefits). To reflect **Aggravation of the situation in 2008–2010**, changes in the output gap and public debt, size of bailout packages and increases in the unemployment rate are considered. The output gap reflects the decline in the standard of living. The consideration of bailout packages

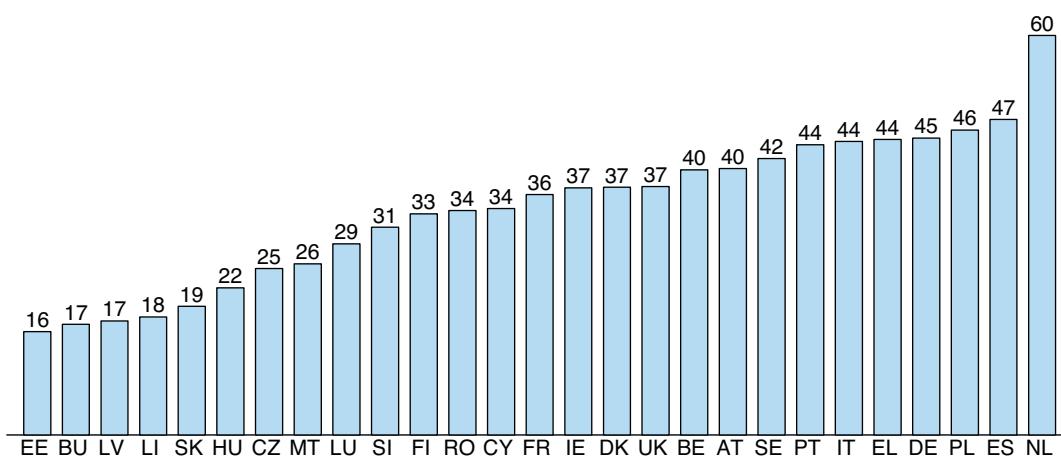
focuses on emergency expenditure with no expected returns, in other words, pure losses (by contrast, public investments in infrastructure, innovation, science, education, health, etc., can significantly increase the public debt but promise indirect returns in the future). Unemployment is regarded as the most negative social effect of the crisis, which is no less harmful than the economic downturn. These indicators are not independent of one another. For instance, public debt is partially driven by another two indicators: a decrease in production reduces the amount of taxes, while bailout packages also burden public finances.

Figure 1: Strictness of employment protection legislation (EPL) in 1990–2008.



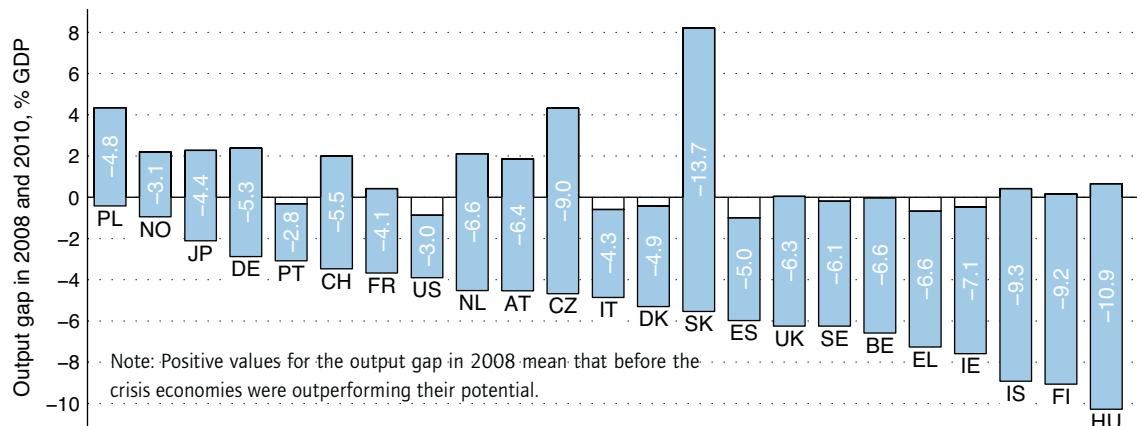
Source: OECD (2010) OECD.Stat.

Figure 2: Atypical employment as a percentage of total employment in 2008.



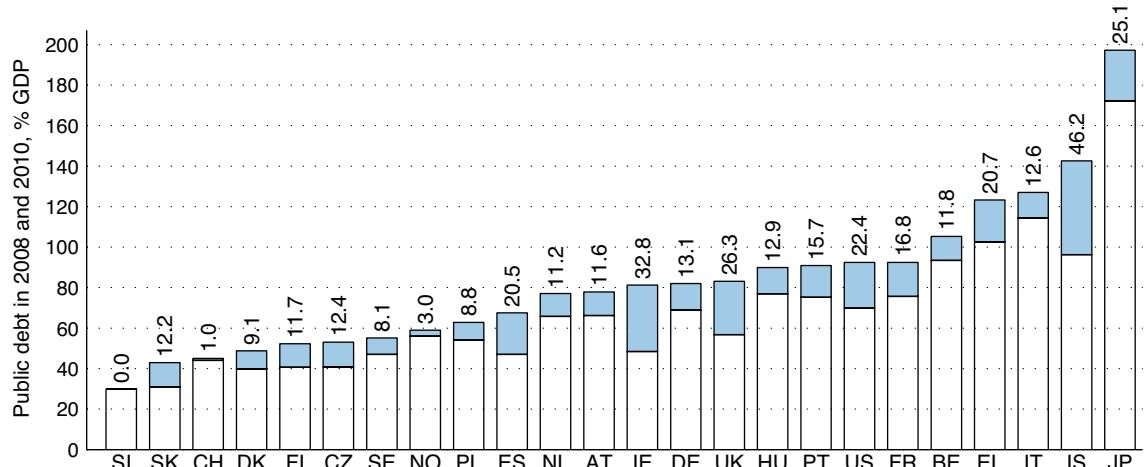
Source: Eurostat (2010), Labour Force Survey, extraction on request.

Figure 3: Change in output gap as % GDP, from 2008 (top of grey bars) to 2010 (bottom of grey bars).



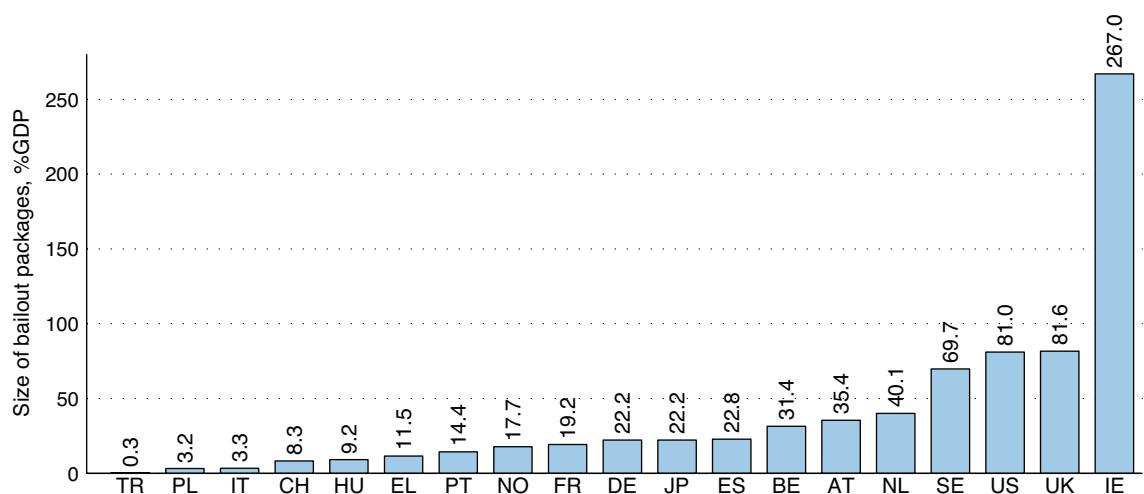
Source: OECD (2010) *OECD Stat*.

Figure 4: Change in the public debt as % GDP, from 2008 (bottom of grey bars) to 2010 (top of grey bars).



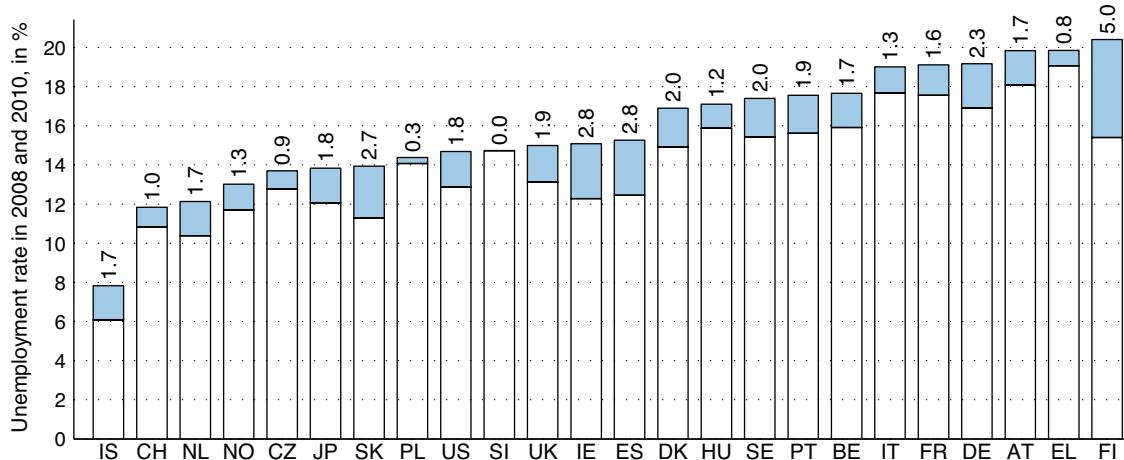
Source: OECD (2010) *OECD Stat*.

Figure 5: Size of bailout packages as % GDP.



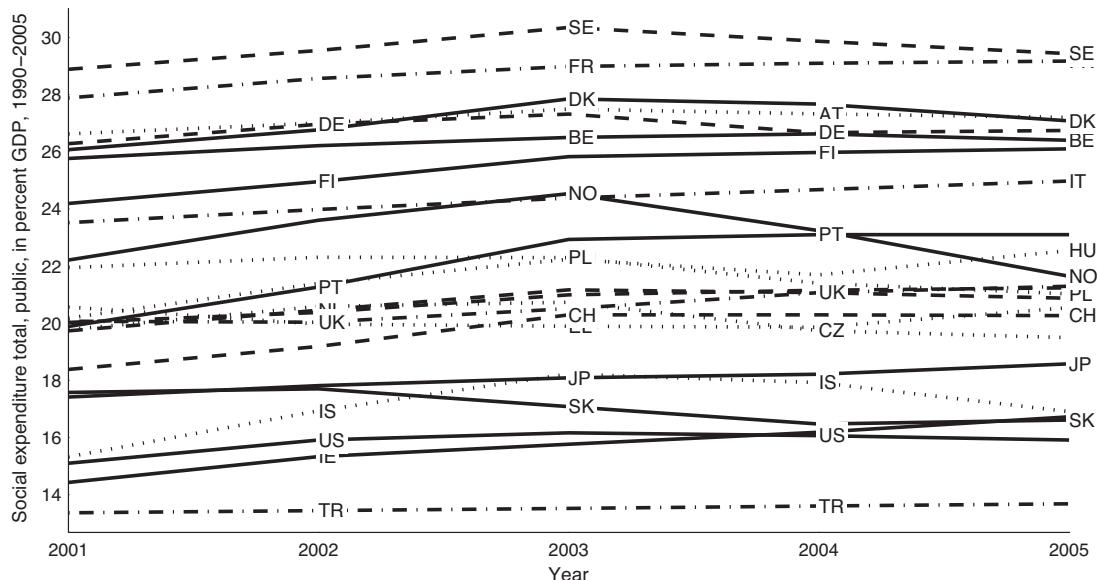
Source: IMF (2009), Table 2.1.

Figure 6: Change in unemployment rate in %, from 2008 (bottom of grey bars) to 2010 (top of grey bars).



Source: OECD (2010) *OECD.Stat*.

Figure 7: Total public social expenditure in 2001–2005 as % GDP.



Source: OECD (2010) *OECD.Stat*.

All the variables, grouped hierarchically, are presented here:

### Flexibility

#### *Institutional flexibility* (Figure 1)

1. Flexibility of regular employment (EPL indicator for regular employment, estimates in the range 0–6, taken with negative sign). Source: OECD (2010)
2. Flexibility of temporary employment (EPL indicator for temporary employment, estimates in the range 0–6, taken with negative sign). Source: OECD (2010)

#### *Factual flexibility*

3. Atypical employment (anything other than permanent full-time) as share of total employment in %. Source: Eurostat (2010), extraction on request (Figure 2)
4. Involuntary part-time employment as share of total part-time employment in %. Source: Eurostat (2010) complemented with OECD (2010)

## Security

### Public social expenditure

5. Total public social expenditure as % GDP. Source: OECD (2010). These figures are available only up to 2005. Figure 7 shows that they tend to change slowly, so that the figures for 2007 are unlikely to differ much from those for 2005.

### Social security benefits

6. Social security cash benefits as % GDP. Source: OECD (2010)

## Aggravation of situation in 2008–2010

### Aggravation of economic situation by 2010

7. Decrease in output gap (under-utilization of full economic potential) as % GDP, taken with the opposite sign. Source: OECD (2010) (Figure 3)
8. Increase in public debt as % GDP. Source: OECD (2010) (Figure 4)
9. Bailout packages as % GDP. Source: IMF (2009), Table 2.1 (Figure 5)

### Aggravation of social situation

10. Increase in unemployment rate in %. Source: European Commission (2010) complemented with OECD (2010) (Figure 6)

The countries for analysis were selected so as to be sufficiently (but not necessarily completely) covered by statistics. The indicators on institutional flexibility (EPL) are developed by the OECD for its member countries. We thus consider the European OECD countries, as well as the USA and Japan as the most important non-European OECD members. Their inclusion/omission does not influence our conclusions for Europe, given that the vectors for the USA and Japan lie very close to the regression lines/planes (the residuals are very small). Thus, a total of 25 countries are included in the model.

The composite indicators are constructed using the usual techniques (OECD 2005). The variables are first scaled using normalisation, that is, by reducing their range to 0–100% and then taking their means successively within the groups. For details, see Tangian (2010).

## Macroeconomic analysis of flexicurity

Let us first analyse the relationship between the manifestations of the crisis and flexibility, following the Commission's understanding of flexicurity as "security through flexibility".

Figure 8 shows the location of the 25 countries in the plane **Flexibility–Aggravation of situation in 2008–2010**. The steep

regression line with  $SLOPE_{Flex} = 0.79$  fitted to 25 observations illustrates the statistical relationship between "Flexibility" and "Aggravation of situation in 2008–2010", meaning the more flexibility the greater the damage from the crisis. The small  $R^2 = 0.27$  indicates that the cloud of observations is rather dense and not well distributed along a line. This can be explained by the fact that the national measures to surmount the crisis are irregular in the sense that they are determined by different national traditions, political priorities and financial possibilities, which vary significantly across countries (for detailed explanations, see Berkmen et al. 2009).

The almost negligible  $P_F = 0.01$  affirms that the relationship between "Flexibility" and "Aggravation of situation in 2008–2010" is statistically highly significant. All of these data can be interpreted as demonstrating that the gravity of the crisis really is linked to the degree of flexibility. Nonetheless, there are still some other important factors that can explain "Aggravation of situation in 2008–2010".

The bottom plot of Figure 8 shows the regression residuals and their 95%-confidence intervals with country-outliers emphasised. The paucity of outliers (Finland and Italy) attests to the explanatory capacity of the model. The residuals for the USA and Japan are among the smallest: this implies that the inclusion of these two countries in the model has a negligible impact on its analytical output. Their exclusion hardly affects  $SLOPE_{Flex}$ ,  $R^2$  and  $P_F$ , which in this case would deviate from the values displayed by no more than 0.01.

Thus, Figure 8 demonstrates that high labour flexibility shows no macroeconomic advantages under crisis conditions. When a crisis occurs, both economic losses in firms and labour adjustments occur on a massive scale, aggravating both the economic and the social situation (increase in the output gap and in unemployment). The burden on public finance (size of bailout packages and aid to the unemployed) further aggravates the situation. One possible explanation is that in "good times" the availability of an external flexibility option encourages employers to take higher risks, since potential losses can be recovered through unproblematic labour adjustments in the event of a crisis.

Low flexibility, on the other hand, restricts labour adjustments and thereby constrains risky economic behaviour. As a result, firms (a) operate in a more secure and stable way, (b) carry out fewer labour adjustments, which is positive for employment and, accordingly, (c) burden the state with less additional social expenditure for supporting the unemployed. In other words, flexibility is disadvantageous in times of crisis.

Now let us analyse flexicurity as it is commonly understood – as a combination of flexibility and security – with respect to the aggravation of the macroeconomic situation during the crisis in 2008–2010.

Figure 9 depicts the location of the 25 countries in the 3D space **Flexibility–Security–Aggravation of situation in 2008–2010**. The regression plane is fitted to the 3D observations in the

same way as the regression line is fitted to the 2D observations in Figure 8. The  $SLOPE_{flex} = 0.94$  along the Flexibility axis is steep, similarly to Figure 8, but the  $SLOPE_{secur} = -0.18$  along the **Security** axis has a negative sign. This means that the severity of the crisis is partially reduced in countries with generous social security.

The quality of fit  $R^2 = 0.33$  is somewhat better than in Figure 8, meaning that security contributes to explaining the damage caused by the crisis. The almost negligible  $PF = 0.01$  confirms that the dependence revealed by regression analysis is statistically highly significant.

To conclude, Figure 9 shows that the crisis manifests itself more in countries with high flexibility and somewhat less in countries with generous social security. As mentioned previously, high flexibility probably encourages risky economic behaviour on the part of firms and increases public expenditure during the crisis. On the other hand, highly developed social security, public works and other forms of state participation render the

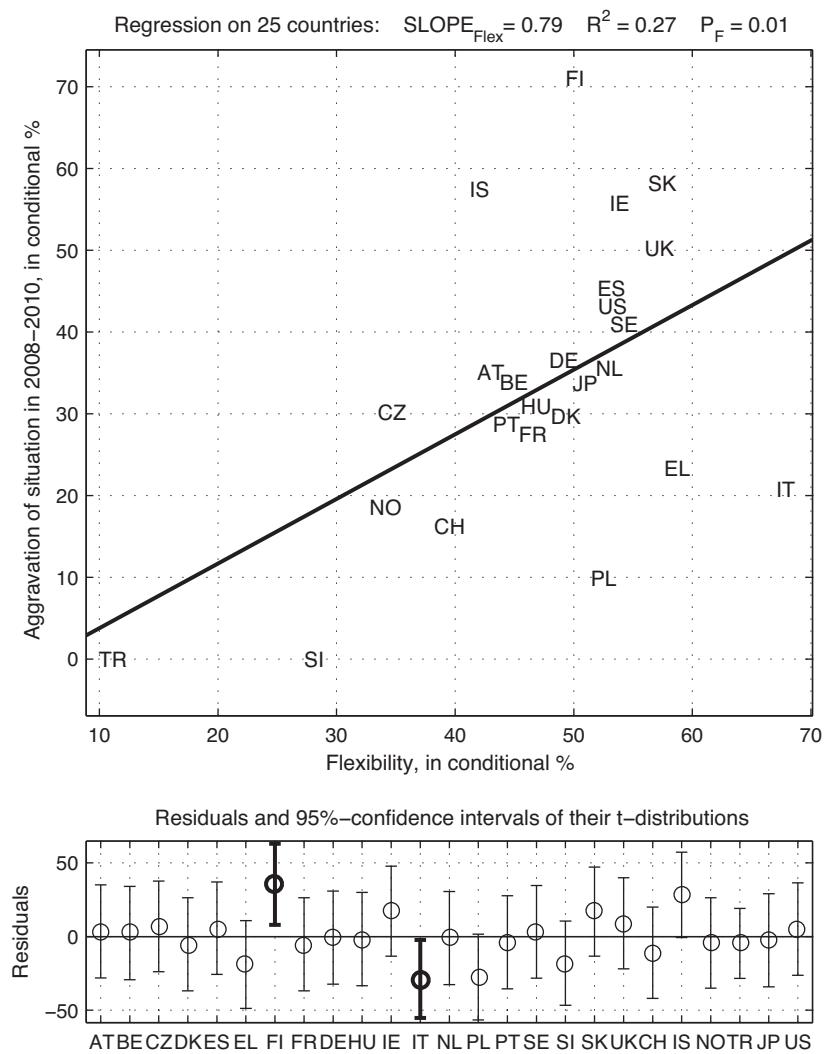
economy less dependent on the private sector and protect it from occasional shocks.

## Conclusions

Thus, seen from the point of view of the crisis, flexicurity in its common understanding as a flexibility–security combination looks disadvantageous, with some reservations for cases of generous social security. The Commission's latest concept of flexicurity as "security through flexibility" turns out to be unconditionally disadvantageous in a crisis.

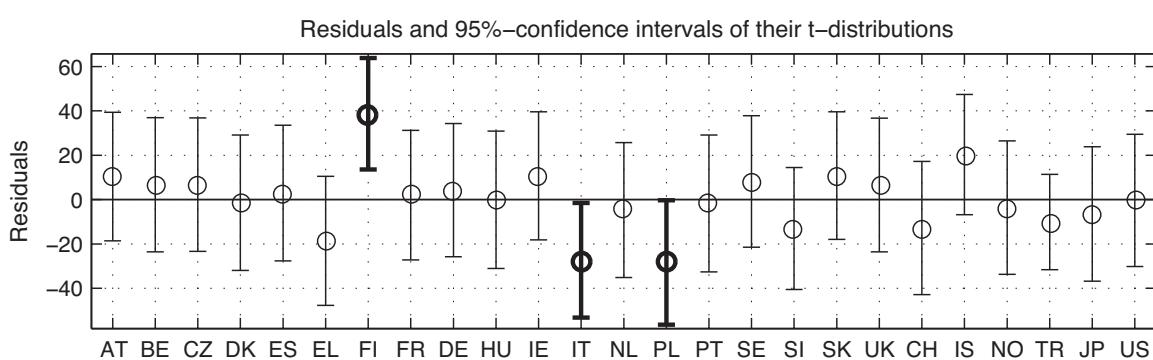
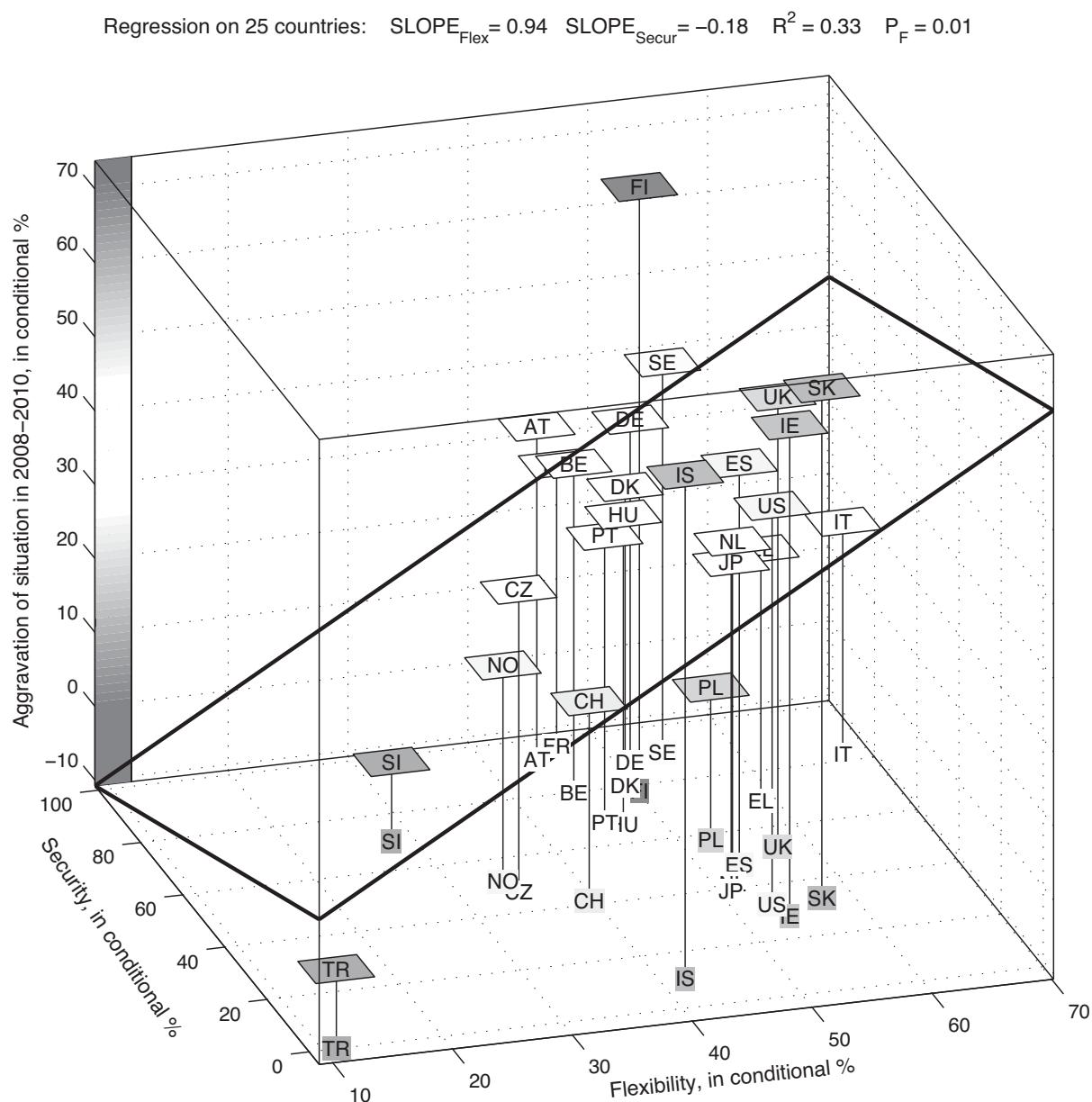
The flexicurity concept promoted by the European Commission therefore does not pass the test imposed by the crisis. This implies that the notion of flexicurity requires a profound revision and should not be further applied in its current form. A better alternative to flexicurity would be "normalisation" of employment relations, that is, a reduction of flexibility, which, among other things, would also result in less social security expenditure.

Figure 8: Dependence of aggravation of situation in 2008-2010 on flexibility for indices based on normalized variables.



Source: Tangian (2010) based on European Commission (2010) AMECO, Eurostat (2010) *Labour Force Survey* and OECD (2010) *OECD.Stat*.

Figure 9: Dependence of aggravation of situation in 2008-2010 on flexibility and security for indices based on normalized variables.



Source: Tangian (2010) based on European Commission (2010) AMECO, Eurostat (2010) Labour Force Survey and OECD (2010) OECD.Stat

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