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In search of optimal
labour market institutions

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Preface

The presumed effects of globalisation on the economies and the labour markets of the world have triggered a new interest in the working of institutions in general and in labour market institutions in particular. The stylised facts in this debate seem to be: globalisation introduces more volatility in labour markets, with more entries and exits of both firms and workers and therefore the capacity to constantly adjust – again both for firms and workers – becomes crucial. “Rigid” labour market institutions thus become a binding constraint, as they are assumed to hinder efficient adjustment, resulting in productivity losses and inefficient (re-)allocation of labour on labour markets. In addition, generous social security benefits would equally hinder quick adjustment, because of the work disincentive that is part of such schemes. However, this view, which blames an important part of worker’s security for exacerbating labour market and economic problems, is not shared by everyone and the debate on labour market institutions continues unabated: on the one hand ever more sophisticated econometric models are used to suggest that at their present levels, labour market institutions cause distortions in labour markets and are thus responsible for unemployment, low employment levels, informality and inequality. The defenders of institutions respond to the critics of institutions in equally sophisticated models and show that with changes in time spans, variation of number or kind of countries selected for analysis or the integration of additional variables, the models cannot be used to prove such negative effects of institutions. But even defenders seldom prove the positive contribution of institutions to labour market functioning.

This paper adds to the debate in analysing on a less sophisticated level the relationship between three of the important labour market institutions: 1) employment protection, 2) social protection, in particular unemployment benefits and active labour market policies and 3) the social dialogue. The relationships between these areas of worker’s protection are at the core of the labour market institutions debate centred often on the flexibility/security nexus. The three elements cited are also key strategic objectives of the ILO and form – together with international labour standards – the four parts of decent work.

The paper shows that in a cluster of OECD countries that might be called “numerically flexible” one finds performing labour markets: employment rates overall and rates for relevant groups (young/female/older) are higher and unemployment rates lower than in most countries with less flexible labour markets. This would support those advocating a lower degree of regulation to improve labour market performance. However, when enlarging the subject to efficiency/ equity issues, at least two other dimensions have to be considered: productivity and the quality and security of employment. For productivity to be high countries need also a considerable degree of stability of employment combined with internal forms of flexibility. This is produced or at least supported by such labour market institutions as employment protection legislation. For job quality and employment security to be high, besides basic stability in the employment systems, “protected mobility” or “flexi-curity” is required: good unemployment cum active labour market policy schemes that allow for transitions in the labour market. Performing countries with an efficiency/equity balance have also institutions of social dialogue and cooperative labour relations that allow for bargaining over possible employment stability, flexibility and security trade-offs. In a nutshell: for efficient production of goods and services and for worker’s security one needs labour market institutions. This is a better starting point for a discussion among the social partners than the sterile debate on “institutions do or don’t matter” that is so frequent in the economic analysis of institutions. There can still be a debate on particular forms and particular restrictive practices of both employment protection and social

protection, but this debate could be waged in more serene and trustful way, when the essential functions of institutions both for productivity and worker's security are acknowledged. The paper is part of a series of publications resulting from research on labour market institutions, regulations and policies done by the Employment Analysis and Research Unit that is headed by Peter Auer.

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1. Introduction

The effect of globalisation on the labour markets of the world has triggered a new interest in the working of institutions in general and in labour market institutions in particular. Major labour market institutions¹ reported in the literature are employment protection regulation, unemployment protection and active labour market policy programmes as well as those governing wage formation, including minimum wages. The latter concern also unions and employers' organization and collective bargaining (and thus the industrial relation system) as another important institution relevant for the labour market. Major institutions in the sense of policy formulation and delivery organizations on the labour market are the ministries of labour and the labour exchange (public and private employment services, which often administer also unemployment benefits and active labour market programmes).

This article will mainly discuss employment protection regulation and the employment related parts of the social protection system (unemployment benefits and active labour market programmes) in an optic of an optimal institutional setting for allowing workforce adjustment in relative security, without jeopardising productivity and labour market performance. Insofar as such an optimal system can also be seen as the outcome of bargaining processes between the social partners, including the government, efficient institutions of industrial relation form part of such an optimal setting.

There is a debate about optimal institutional design in labour markets in economic theory (e.g. Blanchard, 2005; Blanchard and Tirole, 2004) and preliminary conclusion of this stream of work is that high social protection can be provided to workers, without large sacrifices in efficiency provided that generous benefits are combined with active search and job-taking, and are handled by an efficient agency. Employment protection should – according to these authors – come in form of layoff taxes rather than judicial intervention (e.g. the cost of lay-off is paid by the firm preferably to an unemployment agency). The rationale for the latter is that the firms know better their adjustment need than judges, but have also to pay the price for negative externalities created through dismissals. There is also a socio-economic research stream, associated with research around the flexibility/security nexus which is in search of an institutional setting which adequately responds to the challenges on the labour markets of the 21st century (Wilthagen, 1998, Schmid, 2002, Gazier 2003). Closely related are scholars who search for the optimal labour contract, which is a sort of variant of those searching for an optimal institutional setting as they also put the relationship employment protection and social protection in the centre of their interest (Cahuc and Kramarz, 2005). However, a big group of labour economists is concerned by questions like “do institutions matter or don't they matter” and are searching for the impacts of a whole array of labour market institutions and regulations (and lately also product market regulations) on employment and unemployment.

However, a caveat applies. There will be no one size-fits-all institutional system, nor is there a long-term institutional model that is superior to all others. As Rodrik (1999) observes “an approach that presumes the superiority of a particular model of a capitalist economy is quite restrictive in terms of the range of institutional variation that market economies can (and do)

¹ The term institution is ill defined and in the literature “labour market regulation” is often used synonymously. LM institutions are a set of regulations (laws and collective bargaining and customs and practices) policies and organizations that govern the labour market and working and employment conditions of workers. They impact on the way firms are doing business also. To qualify as institutions that shape the behaviour of agents in predictable ways, those rules and organizations must have certain longevity. For example, dismissal protection will influence the behaviour of employers and workers, e.g. the hiring and firing practices of firms and the voluntary and involuntary exit and entry behaviour of workers.

admit". Also Freeman discusses the varieties of institutional features and settings throughout his paper on the "war of the models: which labour market institutions for the 21st century? (1997) and rather than seeing one model winning he predicts a blending of institutional elements from a variety of "models" to result in a sort of new country specific institutional species, once we have the techniques permitting a finer analysis. Blanchard (2005) also hints at this variety when he notes "what may be optimal for Sweden may not be optimal for Chile" (Blanchard, 2005, p. 367)

But besides some agreement on evidence of the variety hypothesis,² there is much controversial debate and dispute in the field of labour market institutions. For example, Heckman and Pagés (2000) criticize a sensed "prevailing view" expressed by Abraham and Houseman (1994), Blank and Freeman (1994) and Freeman (2000) that labour market regulations come at low costs and no effects for employment and show instead that job security policies have a substantial impact on the level and the distribution of employment in Latin America. In the same vein the IMF (2003) has found that Europe would gain in both GDP growth and reduced unemployment in adapting the low regulatory level of the US labour market. Other contributors to the debate, for example Layard, Nickell and Jackmann, 1993, reckon some impact, but are more careful with their policy conclusions.³ The OECD (1999, 2004 and 2006) sees a minimal or even neutral impact on employment and unemployment levels, but some on the structure of unemployment. Others, for example Baker, Glyn, Howell and Schmitt (2005) show the limits of studies as the one done by the IMF and conclude that the impacts of institutions on unemployment remain uncertain. Two German studies conclude that changes in German employment protection laws (introducing looser protection in smaller firms) "had no significant impact on employment or unemployment" with possible (but not yet researched) impacts on the structure of employment/unemployment (IZA, 2005).⁴

While one has to be careful to conclude on this debate the findings suggest a contradictory view, depending on data, countries and models. In any case EPL seems to impact more on the structure of employment/unemployment (protecting insiders) than on the levels of unemployment. In addition, high coordination of bargaining across sectors would help to cancel out eventual negative effects. In a way then employment protection legislation does what it should do, namely protect the insiders, but with weak evidence that the scrapping of protection will result in net gains in employment and unemployment for outsiders. Indeed, an improvement of the labour market performance of outsiders might coincide with a worsening for insiders, at least in developed countries, where insiders still form the majority of workers. Another problem with scrapping the protection of insiders is that in dynamic labour markets the future insiders are past outsiders and once the protection gone, they will never enjoy the benefits of an insider job. Nevertheless, many countries have embarked on reforms in the area of employment protection, but – in the OECD area at least – most of the reforms have been marginal (in the sense that they affect the outsiders on temporary contracts and not the insiders on regular contracts) and in about 30% of cases restricting rather than loosening such regulations (Boeri, 2005).

For the second element, employment related social protection (unemployment benefits and assistance and active labour market policies) a similar debate exists. Again there are those who find that the "generosity" of unemployment benefits (either the level of wage replacement or some combination of wage replacement rate and benefit duration), does not impact negatively on unemployment or employment levels and those who show that indeed they do. The former camp consists again of economists like Baker, Glyn, Howell and Schmitt (*op. cit.*), which review a

² For example, Soscice and Hall, in their work on Varieties of Capitalism (2001), point to this variety.

³ Their conclusion is that "on balance, employment protection laws are probably bad for employment [...] but there are equity arguments in their favour, and the evidence on adverse employment effects is not strong enough to warrant a total abandonment of the practice (Layard, Nickell and Jackmann, 1993, p. 108).

⁴ But despite having found no significant impact of changed EPL on employment, they advocate scrapping existing dismissal protection in Germany and replace it by severance payments.

range of studies on the impact of replacement rates on unemployment and conclude that the quantitative impact is quite unclear. At least with rare exceptions authors cited seem to be quite cautious to jump to strong policy conclusions from their uncertain findings. Coudouel and Paci (2005) also screen some of the same literature and conclude that UB generosity seems to have a **mild** but statistically significant and negative effect on unemployment levels. The OECD (2006) finds a significant negative impact of replacement levels on unemployment and employment, but finds that the negative effect disappears, when generous unemployment benefits come together with effective active labour market schemes.

The (again heroic) conclusion of this debate would be that the duration of UI benefit payments has some effect on the duration of unemployment,⁵ but replacement levels alone have a marginal effect which is furthermore depending on policy combinations. But also here, reforms have been many. It appears that these reforms have altered in a restrictive sense replacement rates and especially duration of benefits.⁶

There is also a debate on the effectiveness of active labour market policies with defenders and opponents and many uncertain results as shown in a review of evaluation literature around the world. On a macro level it can be shown that they are effective in mitigating the impact of adverse economic shocks (OECD, 2006) and on the micro level, their impact depends on their design and implementation, with narrow targeting, intensive placement schemes and selected supply and demand side schemes showing good results (Martin and Grubb, 2001; Betcherman *et al.*, 2004; Auer, Efendioglu and Leschke, 2005).

While these studies are instructive, they remain usually uncertain and inconclusive about the right policy conclusions. For example there is a growing debate on policy combinations and reform packages, which implies complex policy coordination⁷, but should yield better results as isolated policies. For example at the time when early retirement was still the main solution for workforce adjustment in big firms, such schemes offset the adjustment barrier of strict dismissal regulation; another example of policy combination is the mitigating effect of effective active labour market policies on possible work disincentive effects of generous employment benefits. What is often omitted in the debate is the positive contribution that institutions can make if they are rightly designed for a specific function and adapted to context. A short reminder of some of these positive aspects might be helpful: for example Williamson acknowledged that institutions reduce transaction costs in the economy and may contribute to effective labour (and product, financial) market functioning (Williamson, 1985). In their absence, transaction costs (e.g. for repeated hiring, screening and firing) will be eventually higher than the costs of employment protection, which occur when firms have to fire tenured workers. In the micro-economic literature, tenure, which is among others things a product of employment protection institutions, can be positive for productivity as it induces firms to carefully select workers and to train them. Marinescu, 2006, showed for example that the return in British labour law from a two year to a to a one year “probation period” with easy dismissal, had positive results for job matches and training investments by employers without negative effects on employment. But institutions also have equity goals: for example unemployment benefits should indeed guarantee income for those becoming unemployed and active labour market policies should speed reintegration. In the 2006 “Employment Outlook”, the OECD acknowledges that active labour market policies significantly reduce the unemployment impact of adverse macroeconomic shocks. The benefits received by the

⁵ But no clear causality, because it might well be that unemployment persistence causes benefit persistence: this seems at least clear in countries like the US, where duration is normally restricted to 6 month, but where it is common to prolong the duration of benefits, when the recession is deep.

⁶ This not always directly by reducing the replacement rate, but for example by tightening eligibility and lowering reference wages.

⁷ Raising complexity in policies, implying policy coordination of many diverging interests, poses an important challenge to policy making.

unemployed on such schemes or through the unemployment benefit system serve in turn to support consumption and therefore growth and legitimise social spending on economic grounds.

Labour markets are dynamic and characterised by various degrees of labour and job turnover (voluntary and involuntary quits, job destruction and creation) and labour market dynamic seems to increase when economies become more open. There is a business cycle variation in job creation and job loss, but there is also a structural component. While new jobs are created, other jobs are lost. But loss and creation do usually not occur in the same sectors, firms and regions of a country; and do not occur at the same time. Sometimes jobs are lost in one country and created in another. Jobs destroyed and created usually differ in terms of pay, skills, age, sex and so on. This structural heterogeneity between jobs created and lost is one of the reasons why, even in the presence of a hypothetical quantity match of supply and demand of labour, painful qualitative adjustments are the outcome for many. The pain increases with the level of inadequacies between demand and supply and the time needed to adjust. This is one of the main causes of structural unemployment, which observers usually attribute to the supply side (the profiles of job seekers not well adapted to the profiles of jobs) when in reality it is caused by both shortage of or ill adapted supply **and** shortage of or ill-adapted demand. A lack of jobs is still the dominant cause for unemployment.

Globalisation is supposed to bring about more flexible labour markets. As adjustment to shocks (such as trade liberalization) becomes more frequent, the labour force has to adapt more quickly and the employment relationship becomes more volatile and short-term, this calls for new forms of security, stretching beyond the frontier of a single firm. In the words of Rodrik “A modern market economy is one where change is constant and idiosyncratic (i.e., individual-specific) risk to incomes and employment is pervasive. Modern economic growth entails a transition from a static economy to a dynamic one where the tasks that workers perform are in constant evolution [...] And the risks that have to be insured against become much less manageable in the traditional manner as markets spread” (Rodrik, 1999) Most observers see indeed dramatic changes in the employment relationship and some even see the end of (salaried) work (Rifkin & Heilbroner, 1995; Beck 2000) or at least a system that evolves “beyond employment” (Supiot, 1999).

The long-term employment relationship (and the employment contract) is seen as being part of the defunct Fordist and industrial model, which is being replaced increasingly by a much more heterogeneous and volatile service sector economy. Given what one hears daily about recessions, downsizing, unemployment and precarious jobs, one could be forgiven for believing that holding a longer-term job is the exception rather than the rule and that (numerical) flexibility has finally got the upper hand in this phase of globalisation.

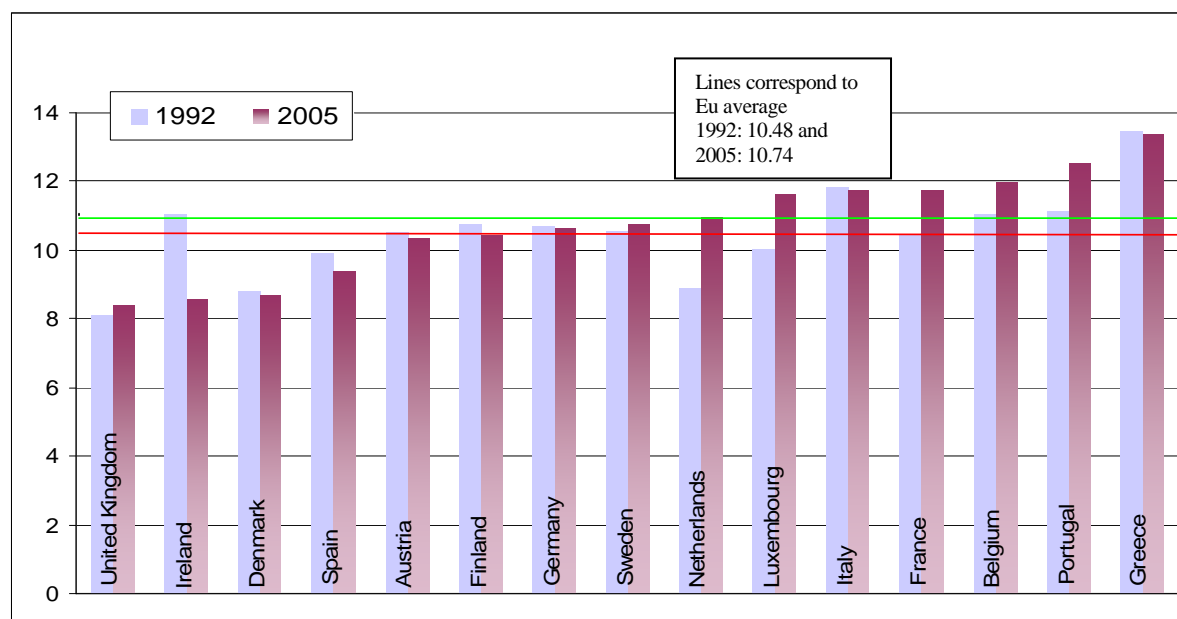
The rest of this paper is organized as follows: A first part is devoted to the question whether or not the longer-term employment relationship, and with it employment stability has disappeared and given way to flexible labour markets. The paper then discusses shortly the impact of stability/flexibility on productivity and at more length the impact on workers perception of security, as well as on a series of labour market indicators, especially for EU15 countries. A third part discusses the need for a new combination of employment security and social security and puts this in the context of the industrial relations systems. The conclusion discusses the implications of these findings for a new framework of protected mobility (or protected LM transitions), which is one possible form of an optimal institutional setting for a globalising world, at least for the developed world.

2. The end of stable jobs?

It is commonly assumed that globalisation and technological change will erode the long-term employment relationship. However, this assumption has to stand the test of empirical prove. Former work on the issue (ILO, 1996; OECD, 1999; Auer and Cazes, 2003; Neumark, 2000) has already concluded that all OECD countries have a varying, but substantial share of long-term employment relationships and are characterised by a degree of stability in their employment systems that is remarkable in view of the dominant view of a much more volatile labour market. This has recently been confirmed by national and international comparative studies, working with various data sets (Erlinghagen and Knuth, 2004; Doogan, 2004; Souza-Poza, 2004). Stevens (2005) shows that even in the United States, with markedly lower average tenure, “long-term relationships with a single employer are an important feature of the US labour market in 2002, much as they were in 1969. [...] Just over half of men ending their careers in 1969 had been with a single employer for at least 20 years; the same is true in 2002” (pp.1 and 24).

If this is the case in the “flexible” US labour market this must even be more so in the European labour markets. Indeed, as shown in Figure 1, there is some reason for being more optimistic than the “end of work” prophets and those who think that globalisation will lead to the disappearance of all long-term employment relationships. Despite such claims, employment stability, measured by average tenure, has hardly changed over the period 1992 to 2005, confirming earlier findings.

Figure 1: Average employment tenure EU 15 1992 and 2005



* Ranked by year 2005. Comparable figures for the US are 6.7 for 1992 and 6.9 for 2004. Average tenure in Japan was 12 years in 2000 (Source: US: Bureau of Labour Statistics, Japan: Ono, 2006).

Source: Own calculations based on Eurostat

There is large country variation in tenure, but apart from Ireland, most countries show stable or increasing values bringing the unweighted European average to 10.74 years up from 10.48 in 1992. In fact the countries with lower average tenure are also those with higher numerical flexibility, as can be seen by the US and the UK, but also Denmark and the Netherlands. In

contrast, most countries on the right side of the graph are those known for strict dismissal regulation, a fact confirmed by recent OECD analysis (OECD 2004).

However, while the average remains unchanged, the different elements that make it up have been subject to change. Changes relate to gender, age, sector composition of the economy, etc. For example, we observe an increase in women's tenure and decrease in male tenure and a slight increase in the share of shorter tenured jobs (<1year) and a slight decrease in longer tenured jobs (>10years), the decrease in longer term jobs being particularly strong in Ireland (minus 13 percentage points). There is also a trend towards more heterogeneity in European labour markets as is shown by an increase in the standard deviation both for short and long tenured jobs.

Changes have occurred, and controlling for business cycle and age confirms this: younger workers face systematically shorter employment spells, and flexibility is very much concentrated on young people. In 2001, average tenure was only two years for the 15 to 24 age group, but more than eight years for the 25 to 44 years old group and it stood at 17 years for those older than 45.

Despite these changes all evidence points to the conclusion that the long-term employment relationship is still the major form of employment in many European countries and a long way from disappearing. Yet today it increasingly includes also part-time employment. In fact, the European Labour Force Survey reveals that about 85 per cent of full-time and part-time employment in Europe is of indefinite contractual duration. While the significance of the "indefinite" or "permanent" status of contracts depends on the legislation and practice of hiring and firing in countries (see below) the fact of the resilience of the long term employment relationship in a time of flexibility and globalisation is remarkable and hints at the value attached to these forms of contracts.

Bosch (2002) shows that the most remarkable change that has occurred in the standard employment relationship is the increase in women's participation and the parallel rise in part-time work. But this is not to be understood as a simple erosion of the standard employment relationship because many part-time jobs – especially for women – are in fact voluntary and often become regular jobs in double earner families allowing work/family integration and correspond therefore also to changed preferences on the supply side. One sign of this "regularisation" might be seen in the growth of long-term part-time jobs. Indeed, Doogan shows that the remarkable growth of part-time employment in Europe (from 14 per cent of all jobs in the European Union in 1992 to more than 19 per cent in 2005) is accompanied by a rise in the share of long-term part-time employment (+10 years).

3. Are stable jobs good jobs?

The apparent "stability" of the longer-term employment relationship does not mean that there are not significant changes. Labour markets are not static, but dynamic: job changes are either voluntary and then often career enhancing, but often involuntary. Dismissals and lay-offs are usually dramatic for those affected and their families and whole localities and regions, when mass-layoffs occur. But there is also a core of stable jobs and the core differs in size by country, sector, etc. There is also a concentration of stable and instable jobs on different groups in the population.

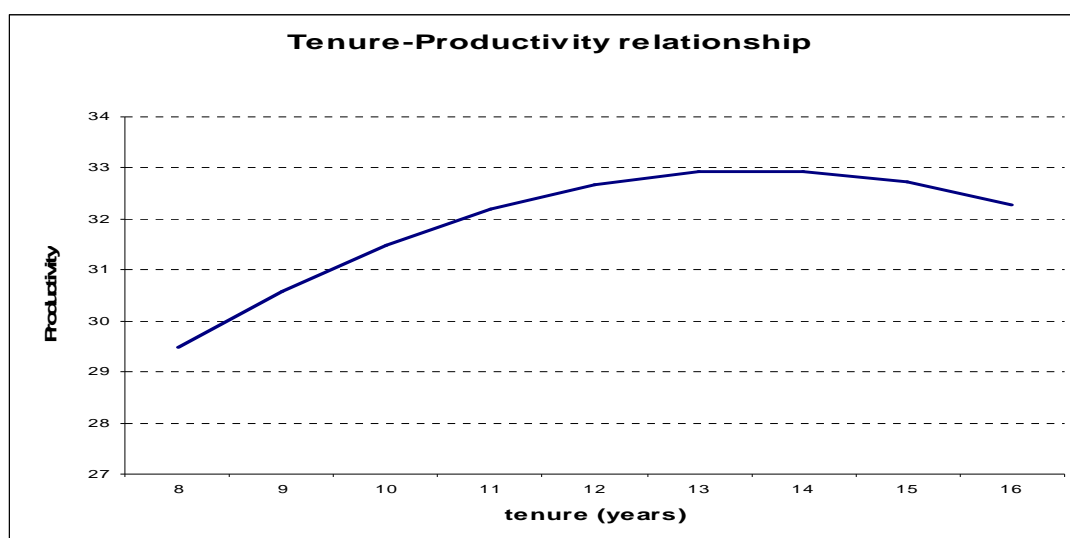
However, stable jobs are not always equivalent to good jobs: stable jobs can be involuntary part-time jobs, undesirable jobs (e.g. people are locked into their jobs without being able to change) and (small) parts of so-called stable jobs are in fact recurrent temporary jobs. The OECD shows that about 10 per cent of temporary jobs (that is about 1.5 per cent of all jobs) are long-term temporary jobs with duration of up to five years.

But, our empirical observations do not allow concluding that there is a general demand driven erosion of the employment relationship, because employers also value longer-term attachment of their workers and no general supply side driven erosion because workers and their unions place a high value on longer-term employment relationships. There is probably a growing mismatch between jobs offered by employers (labour demand) and jobs sought by workers (labour supply) in terms of job quality and tenure expected, and it seems reasonable to believe that the forces of globalisation and technological and organizational change will eventually widen this gap between expectations in supply and demand. What is to be expected is not a race towards the extremes but to some new “equilibrium” between flexible and stable jobs with the former gaining some percentage points at the expense of the latter.

Employment stability is beneficial for productivity.....up to a point

In the discussion on the benefits from flexibility it is usually assumed that both labour market performance and productivity will benefit from the increased adjustment capacities on the labour markets. The argument is that quicker reallocation from old jobs in less productive sectors to new jobs in more productive areas will increase overall productivity. While this might hold true, it misses one point: not all jobs reallocated are of higher productivity (e.g. declining manufacturing usually has higher productivity than many service activities) and not all jobs in the economy are constantly reallocated between sectors. As outlined above there is much stability in the labour markets despite globalisation and increased competition. Efficient firms adjust also internally and use the potential of their labour force. Microeconomic studies thus give much value to tenure both for wage increases and for training investments. Investment in training has to be recouped and logically requires some tenure. Where the break even point between too much and too little is, is hard to say but our own studies on the issue have revealed that high tenure can go together with high productivity, whereas too much flexibility or too much stability can result in low productivity. Our data are aggregated on the European Union level (13 countries and cover all economic sectors). They show that for all workers in these countries taken together a turning point of productivity is at almost 14 years. At that point the productivity/tenure relationship is optimal and declines thereafter (Auer, Berg and Coulibaly, 2004).

Figure 2: Relationship between tenure and productivity



Data are from Eurostat for the period 1992-2002, Productivity = output per hour in EUROS; Tenure= average tenure in years. Source: Auer, Berg, Coulibaly (2004)

It is important to keep in mind, however, that this finding, based on an econometric model, is the *average* tenure for the 13 European countries between 1992 and 2002. Per sector or country, these estimates would vary; but more importantly at the individual level, it cannot be stated that this represents the appropriate length of time to retain a worker. In other words, while an “optimum tenure” may exist, when that point is cannot be stated precisely. It is merely evident from the empirical exercises that in general, short tenure (less than one year) and long tenure (particularly above 15 and 20 years) can have negative productivity effects. Studies on the micro level come to similar conclusions: Kramarz and Roux (1999) find that French firms with high shares of workers with between 4 and 10 years of tenure are more productive than firms with high shares of shorter tenured or very long tenure.

Tenure seems also to be important for innovation: Pacelli et al. (1998), in a study of 2,800 Italian firms over the period 1985-1991, find that workers in innovative industries have a much lower probability of separation than workers in traditional industries, after controlling for other firm and worker characteristics. They argue that this supports the hypothesis that more innovative firms cultivate more resilient employer-employee relationships. Similarly, Michie and Sheehan (2003), using primary data on UK firms, find a negative correlation between innovating firms and a lack of employer commitment to job security, the use of short-term and temporary employment contracts and low levels of training. They find that low labour turnover and functional flexibility are positively correlated with innovation and they argue that this “may reflect the importance of employees’ tacit knowledge for the successful introduction of process innovations” (p.139).

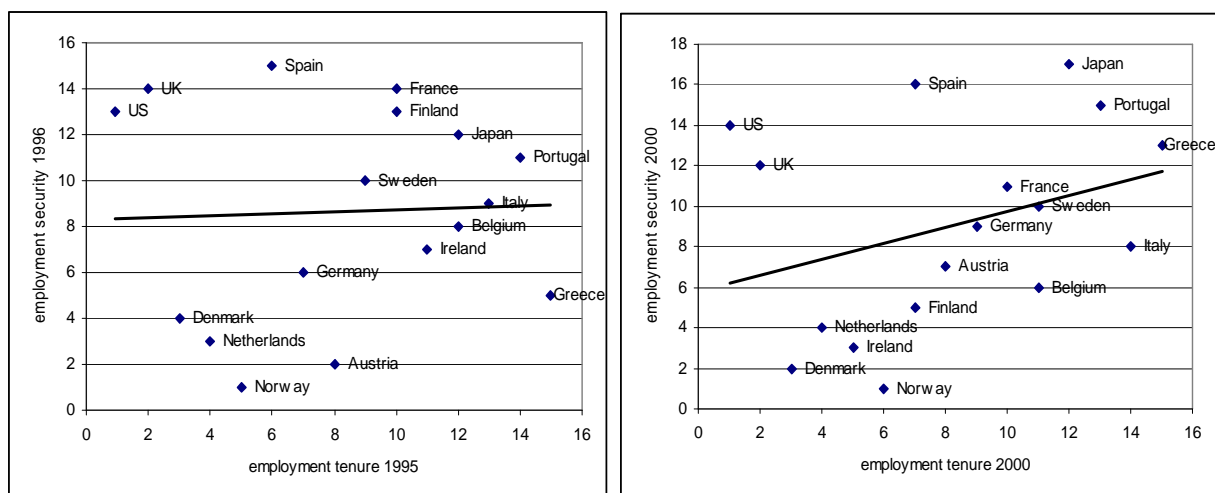
As seen from the last citation, functional, internal flexibility plays a role. There is indeed a choice between external and internal adjustment by firms, with consequences on the labour market. While Capelli and Neumark (2004) show that efficient US firms use all forms of flexibility and that there is no clear sign for such a trade-off, in other countries there is evidence on substitution between internal and external forms of adjustment. An example is the arrangements at Volkswagen in Germany, where reductions in working time have been used instead of lay-offs. On a more general level, Abraham and Housemann (1995) compare workforce adjustment in Germany and the United States and find evidence that while the magnitude of adjustment in labour volume is comparable, internal adjustment (helped by a short-time work-scheme) is preferred to external adjustment in Germany, while in the US external adjustment through lay-offs are preferred.

Employment stability does not result in employment security: A paradox

Having observed a certain stability in the employment systems, that does not seem to be detrimental to productivity, the question remains, whether such stability also conveys employment security. Many would agree with the statement that stable jobs convey more security than unstable, short-term jobs and this has been frequently observed. In general temporary jobs yield less security than stable jobs and public jobs show a positive correlation with perceived security (Clark and Postel-Vinay, 2006). However, in the private sector, the higher protection of stable jobs does not always correspond to higher perceived employment security. In fact, the correlation between average tenure and the perception of employment security shown below does not support the security enhancing role of stricter protection. The relationship found is weak and not statistically significant, and even pointed in the wrong direction (suggesting at the very least that it is not sufficient to have a long tenured job to feel secure, see Figure 3). One could argue that the share of part-time jobs in an economy increases the perception of insecurity but it does in fact correlate positively and not negatively with perceived employment security. Workers in the Netherlands (highest part time share among EU countries) feel more secure than workers in Greece, where the part time share is low. It seems that the subjective feeling of employment security is not only determined by the elapsed length of tenure but is also influenced by the general state of the labour market (e.g. job opportunities and probabilities of becoming long term

unemployed) and the economy. For example, security perception correlates quite significantly with the unemployment rate and it seems also that the general state of the economy (in recession or not) has a great impact on subjective feelings. This is the case of Japan, for example, where the perception of employment insecurity is strong, probably because of the long recession, while average tenure is among the longest of all countries surveyed.

Figure 3: Employment insecurity and tenure 1996 (left) and 2000 (right)



Note: Coefficients are not significant (in both graphs the country ranks are shown: Security 1= highest share of employed with perceived security; Tenure 1= lowest tenure).

Source: Data supplied by International Survey Research, OECD, Eurostat and national sources.

These results are somewhat puzzling but show that past tenure does not apparently systematically influence future expectations of employment security. While job security plays a quite substantial role in the perception of job satisfaction (see European Commission, 2001), if we rank countries according to the three criteria of job quality, employment security and average tenure, no apparent clear-cut pattern emerge (see Table 1). We see countries with comparatively low tenure, but high-perceived employment security and a high share of good quality jobs and countries with high tenure but a low share of quality jobs and low perceived security.

At first sight this seems to indicate that employment tenure is not a good predictor of perceived employment security and that maximizing tenure and dismissal protection seems not to lead to the expected results in terms of workers' employment security. Similar findings are reported by the OECD: the overall strictness of employment protection regulation that correlates strongly with tenure does not convey the feeling of security that it is supposed to convey (OECD 2004, p.92). However, workers feel most secure in permanent public jobs and most insecure in temporary jobs.⁸ The unexpected negative relationship between tenure and perceived security is also confirmed by using alternative security data, such as those resulting from the Second European Survey on Working conditions (1995/96) in which the share of non secure jobs for EU15 countries was surveyed.

⁸ In a recent study based on data from the European household panel, Clark and Postel-Vinay (2006) show indeed that the non-security enhancing role of employment protection legislation (or tenure in our analysis) holds particularly for private sector permanent jobs, the bulk of all jobs.

Table 1: Job quality, average tenure and employment security

Ranks in:	Quality 1=highest	Tenure 1=lowest	Security 1=highest
Norway	n.a.	6	1
Denmark	1	3	2
Ireland	8	5	3
Netherlands	3	4	4
Finland	2	7	5
Belgium	6	11	6
Austria	5	8	7
Italy	10	14	8
Germany	4	9	9
Sweden	n.a.	11	10
France	n.a.	10	11
United Kingdom	7	2	12
Greece	12	15	13
United States	n.a.	1	14
Portugal	11	13	15
Spain	9	7	16
Japan	n.a.	12	17

Quality : Ranking of share of good jobs in a country : good jobs are defined as paying good wages, giving job security, good access to training and good career prospects, data for 1996 (EU Commission, *Employment in Europe 2001*).

Tenure: Ranking of average tenure in years, data for 2000 (ILO 2003, see above).

Security: Ranking of combined indicators of people worried or unsure about their job, data for 2000 (*International Survey research*, OECD).

n.a. = not available

Upward mobility

Besides increasing uncertainty in the face of globalisation, coming together with company restructuring, outsourcing, off shoring, mergers and acquisitions, part of the puzzle of long tenure not conveying the expected feeling of security that workers may also need some (upward) mobility in order to feel more secure. Being locked in a bad quality job with no alternative of change may indeed be one reason for low job satisfaction.

The upshot from an analysis of this question is that countries with higher numerical flexibility are indeed also those which have better transformation rates of temporary into permanent jobs and also of low quality jobs into jobs of higher quality (European Commission, *Employment in Europe 2001, 2004*).⁹

Denmark and the Netherlands in particular have good records on both counts and also Ireland and the UK transform many temporary jobs into permanent jobs and lower quality jobs into higher quality jobs. However, the UK does not much better in transforming bad into good jobs than, for example, Portugal. But the starting levels are different as well: with the exception of the Netherlands, the flexible countries have low shares of temporary jobs (see below table 2). In terms of good quality jobs, we see consistently high shares in DK and NL but lower shares in the United Kingdom.

⁹ For a definition of good quality jobs see notes for table 1.

4. Different employment systems

If we now cluster the “old” European 15 countries by degree of flexibility in the labour market (using average tenure, the distribution of tenure in short and long employment spells and the OECD indicator for employment protection legislation in regular jobs) it appears that all countries in case C, those with a high share of shorter tenured jobs and a lower share of long tenured jobs, shorter average tenure and looser EPL, have – taken together – by far the highest employment rates of all countries and for all groups in the labour markets such as women, older workers and youth. Group C countries have also the lowest unemployment rates in general and for selected groups.

Table 2 : Economic, labour market and social performance in the EU

Country groupings	Greece, Luxembourg, Italy, Belgium, Portugal, Sweden	France, Germany, Finland, Spain	Denmark, the Netherlands, Ireland, United Kingdom (C+ DK and NL)	
	A	B	C	C+
Average Tenure**	11.9	10.3	9	9.85
Ratio -1year/+10years of tenure**	1:4.2	1:2.2	1:1.6	1:2.5
Employment Protection Strictness, regular jobs	2.6*	2.5	1.8	2.3
Productivity level and growth (1990US\$ and 1980=100)	28US\$ 158	30.3US\$ 174	32US\$ 185	32.5 US\$ 152.70
Poverty and Inequality (below50%median and Gini)	9.7 30.5	8.6 28.5	9.2 27.7	5.15 23.8
Employment rates for 15-64	63.1	64.2	71.7	74.35
Employment rates for 15-24	32.5	35.5	58.4	65.0
Employment rates for 55-64	41.4	42.3	52.6	52.5
Employment rates women	53.8	56.8	64.5	68.2
Share of temporary jobs	11.8	18	8.8	11.9
Share of part-time jobs	12	12.9	22.9	33.2
Total unemployment rate	6.8	9.8	4.6	4.6
Youth unemployment rate	17.6	18.8	8.9	8.1
Long-term unemployment rate	3	3.6	1.2	1.1
Expenditure on labour market policies (per 1% of unemployment)	0.17++	0.3	0.6	0.9

* Excluding Austria and Luxembourg due to missing data. ** Data for 2002 *** productivity per hour 1980-2004: level in 1990 US\$, growth index 1980=100 (source KILM data base)**** Poverty: percentage of people below 50% of median income, Gini coeff. 100=total inequality, 0= perfect equality
+Data per 1% point of unemployment (2002/2003), except for labour market policies spending in Ireland: data from 2000). ++ Excluding Luxembourg due to missing data. Source: EU Commission: Employment in Europe 2005. Tenure data provided by Eurostat, own calculations. Notes: all data are group averages and refer to 2003 unless otherwise stated.

The table tells us that low average tenure and a low ratio between short and long tenured jobs, suggesting more mobility, goes together with good results in many of the labour market indicators that are used by the European Employment Strategy to assess a country's success. At this level of analysis, no causal relationship is suggested, only covariance: for example, the higher employment rates for youth, which are paralleled by low unemployment rates for youth could explain tenure distribution rather than tenure distribution explaining employment rates.

However, the more flexible countries spend more on labour market policies and have a much higher share of part-time employment (but a markedly lower share of temporary jobs). The countries in group C have also a much better growth-employment elasticity: the combined gross arc elasticity for the years 1993-2003 is 0.46 for 1 percentage point of growth, whereas it is only 0.25 in the countries of group A.

We note also that in terms of the overall competitiveness index produced by the World Economic Forum, group C countries fare better than the two other groups (WEF, 2005).

Table 3: WEF indicators and European country clusters

	Group A	Group B	Group C
Global Competitiveness	4.86	5.37	5.46
Hiring and Firing	2.75	2.80	4.0
Wage setting	3.6	3.7	3.6
Employer/union relations	4.6	4.6	5.5

Global Competitiveness index: scores from 5.85 (best) to 2.50 (worst) 117 countries

Hiring and Firing index: value 1=most regulated/ value 7= set by employer

Wage setting index: value 1= centralized/ value 7= company determined

Employers/Union relations: Value 1= confrontational/ value 7= cooperative

Values for 2005. Source: The global competitiveness Report 2005-2006, WEF, 2005

Table confirms indeed the results of table 2: the more flexible countries C in Europe perform better and arrive at high values on the global competitiveness index. The WEF does not collect indicators on workers security and welfare or on job quality so that the full arguments for flexi-curity cannot be derived from existing data. But the table suggests also that there is almost no difference in wage determination (fairly centralized in all three groups) across the three groups. However, good performers have cooperative labour relations, which might confirm former work on the generally positive effect of coordination/cooperation on economic outcomes (Elmeskov, Martin and Scarpetta, 1998).

While the tables look like a confirmation of the view that rigid labour market regulation leads to lower labour market and economic performance, the story is much more complicated. There are countries which have good LM performance with stricter regulation (Sweden and Luxemburg and one notes also a stark difference between Denmark and the Netherlands). Also the distance between group B and C countries in the WEF's ranking is small, an indication that the roads to prosperity are manifold. Only some of the flexible countries can deliver on job quality and perceived employment security by workers. Indeed, if we go back to our initial ranking of three indicators on job quality, employment security and tenure (Table 1) and if we integrate information on social equity we see that some of the countries in Group C have a higher ranking on the quality and perceived security indicator than others. Denmark, for example, comes in first in the share of good jobs and second in terms of perceived employment security with the third lowest tenure among the 17 countries ranked. The Netherlands is placed third for the quality share and fourth for perceived employment security. However, the UK arrives only in seventh place on the quality ranking and in twelfth place on the perceived security ranking, while it has the second

lowest tenure. The US arrives in fourteenth place (high perceived employment insecurity) with the lowest tenure of all countries. If we break down the Flexible group C countries into the UK and Ireland (Anglo-Saxon model?) on the one hand and Denmark and the Netherlands (two flexicurity countries) on the other, differences are striking in a number of areas such as Gini coefficients, poverty rates etc.

There are countries that have flexible labour markets with good labour market performance but high levels of perceived insecurity and rather bad ranking in terms of job quality while others are flexible without the negative effects of flexibility for workers' security and job quality. This seems to be the case of Denmark and the Netherlands, for example. However, in general, countries with relatively "rigid" labour markets as measured by average tenure and tenure distribution (such as Greece, Italy, Japan and Portugal) rank worse.

Clustering countries along other criteria such as those originally developed by Esping-Andersen (1999) modified for example by Visser (2001), would show that results might in fact be determined by country patterns and practice of industrial relations: Cooperative and regulated "Nordic" countries (SWE,DK,FIN, NL) would then be best performers with a combined score of 5.6 on the competitiveness index, with the "deregulated" and less cooperative Anglo-Saxon (UK, Ireland, and for this purpose the US) countries being very close (5.5) but the Southern "confrontational" countries (EL;ES, PT, IT) coming in far distance with a score of only 4.5.¹⁰

Two "models" would then be equal performers in terms of overall effectiveness and labour market performance. The choice (if there is such a choice at all) would then be between a model that ranks high on indicators of worker's security, job quality and cooperative employment relations with strong actors despite a flexible labour market and one that values the market rather than institutions with suboptimal outcomes in a series of social indicators such as perceived employment security, job quality, income dispersion and poverty rates.¹¹ However, the real problem cases seem to lie between these two extreme cases: the countries with dissatisfying performance both on their labour markets and the economy. Recommendations for these countries would then depend on the choice between the two models: in short markets with low or high level of institutional "framing". A caveat applies, country clustering (on whatever criteria) is only illustrative: in deeper analysis there are many differences between the countries clustered and all "models" (e.g. the three, four or whatever worlds of the welfare state) might not stand the test, once one scrutinizes their common traits.

¹⁰ Visser (2001) identifies four models in Europe: (1) Northern corporatism, (2) Central Social partnership, (3) Anglo-Saxon pluralism and (4) Latin confrontation; and highlights their differences regarding the degree of coordination versus confrontation, the role of the State as well as the relationship among the social partners. For example, collective bargaining in the Northern corporatism and Central Social partnership models is carried out at the sectoral level with the State acting as a facilitator, while in the Anglo-Saxon pluralism model collective bargaining is decentralized to the company level and the State abstains from the process. The relationship between the different industrial relations models and average length of employment tenure is not straightforward, though a generalized grouping gives the impression of longest tenure in the Latin confrontation countries followed by Central Social partnership countries, Northern corporatism countries and lastly, Anglo-Saxon pluralism countries. In terms of labour market spending the leaders would be the Northern corporatist countries (average spending of 2.8 per cent of GDP on LMP and 1.20 per cent on ALMP) while Anglo-Saxon countries are usually low spenders (1.3 per cent on LMP and 0.75 per cent on ALMP) with the other two in the middle (CSP 2.5/1.00 per cent and LC 1.75/0.76 per cent).

¹¹ For a similar view, see also OECD, 2006.

5. Flexi-curity, an alternative organisation of the labour market?

Only in some of the group C countries, we can then speak of flexibility that does not come at the expense of security for workers, because unemployment benefits and active labour market policies, as well as new social rights such as parental and training leaves result in what some call “flexi-curity” (Wilthagen, 1998; Madsen, 2003) others “protected mobility” (Auer, 2005), “balancing flexibility and security” (Cazes and Nesporova, 2003) or “transitional labour markets” (Gazier, 2003; Schmid, 2002; Auer and Gazier, forthcoming). Flexi-curity is an important theme in the European Union, but the term is now discussed in many and diverse parts of the world such as India (Shyam Sundar, 2005), China or Latin America.

The flexi-curity approach in its simplest form advocates some rearrangement between employment protection legislation and social protection (unemployment benefits, active labour market policies) to allow for labour market adjustment to a more volatile and uncertain economy without jeopardizing worker’s security. However, some of the “new” social rights, such as parental or training leaves, play also a role as they provide flexibility and security. But can flexi-curity arrangements, implying in some cases a shift from (too strict) employment protection at the company level to more social protection at the societal level¹² result in “optimal” institutional settings in which necessary workforce adjustments can be made, while workers remain protected, but are more rapidly (re)integrated into the labour market? Again, the great diversity of institutional arrangements across the world, mentioned at the beginning of this text, makes a straightforward answer difficult and hint to the coexistence of different models and no “one-size-fits-all” flexi-curity model. But some of the models seem to yield superior performance when both efficiency and equity consideration are taken into account.

And, while the variety condition holds, some basic principles should apply: the elements at stake are (1) employment protection legislation and collective bargaining arrangements for employment security, (2) social protection, especially those work related items like unemployment benefits and active labour market policies, (3) an array of “new” social rights such as a right to training, parental leave, reversible part-time/full time schemes, etc. and (3) the bipartite and tripartite social dialogue as an obligatory element for changes that concern both parties of industry and the government – as legislator and one of the main providers of social security. (Auer and Gazier, 2006).

As outlined above the process of change and the dialogue with the parties concerned are important. Not observing this fourth condition may bring change that is perceived as imposed and/or might lead to suboptimal outcomes as the social partners are carriers of knowledge and integrating their views in the change of regulation is a necessary (but not sufficient) condition for all labour market reforms towards flexi-curity. The recent experience with the “First employment contract” (CPE) in France and the decision by the government coalition partners in Germany to introduce a two year probation period in employment contracts (as in the French contracts) serves as illustration. While in the first case the fourth condition was not observed, in the second case there is complaint from both worker and employer organisations that the intended (but not implemented) change is a step towards worsening rather than enhancing working conditions and the conditions for doing business.¹³ In low trust environments, sequencing of reforms is crucial, such as introducing the security elements, before adjustment flexibility can be realised.

¹² Optimization implies in some cases also a tightening or at least better enforcement of employment protection at the company level and the building of a better and more generous social protection system with good coverage.

¹³ Unions complain about the loss in security for workers and employers point to the fact that the present legislation which allows for temporary contracts is better than a regulation that only would allow for unlimited term contracts with a two year probation period.

In conclusion, it seems then, that for achieving decent work (illustrated by good ranking in both the quantity and the quality indicators) more is required than just stable or just flexible employment relationships. There is some country specific optimum combination of employment protection and labour market institutions and policies that provide income, social and employability protection, which seems to yield more job security than stable jobs alone in an uncertain environment. This may also partially explain why in countries which have such a combination job quality is higher: workers able to quit jobs/ or being protected when dismissed might evaluate present jobs held more favourably than those workers which have to stay in their jobs, either because of few opportunities or the absence of protection, even if they do not appreciate them. Having choices and protection seems to be better valued than having protection with few choices.

Trade-off between employment protection and protection by labour market policies?

On a macro level these choices are illustrated in Table 4. The table shows very schematically the interaction between tenure (or better its proxy which here is a ranking of employment security legislation for the Nineties compiled by the OECD) and labour market security (proxied by expenditure data for labour market policy). In some countries, there is a trade-off between the two: looser employment protection goes together with relatively high spending on labour market policy. The institutional setting of Denmark exemplifies this case while the reverse is shown by Japan: high employment protection goes together with low spending on labour market policy.

Table 4: Employment security or labour market security?

	High LMP spending	Low LMP spending
High Employment Protection	France (EPL21 / LMS08) (AT11.1 / S16)	Japan (EPL25* / LMS24) (AT12 / S25)
Low Employment Protection	Denmark (EPL08 / LMS01) (AT8.3 / S02) PROTECTED MOBILITY (flexi-curity)	United States (EPL01 / LMS25) (AT6.6 / S21)

Rank 1: EPL=Employment Protection Legislation strictness, 1 = less strict, 26 = most strict (*Estimation for Japan as in pure legal term EPL is not particularly strict but this is compensated by employers practice)

Rank 2: LMS=Labour Market Security, Expenditures for labour market policy, 1 = highest, 25 = lowest;

Rang 3: S=Perceived Employment Security = 1 = most secure, 26 = least secure.

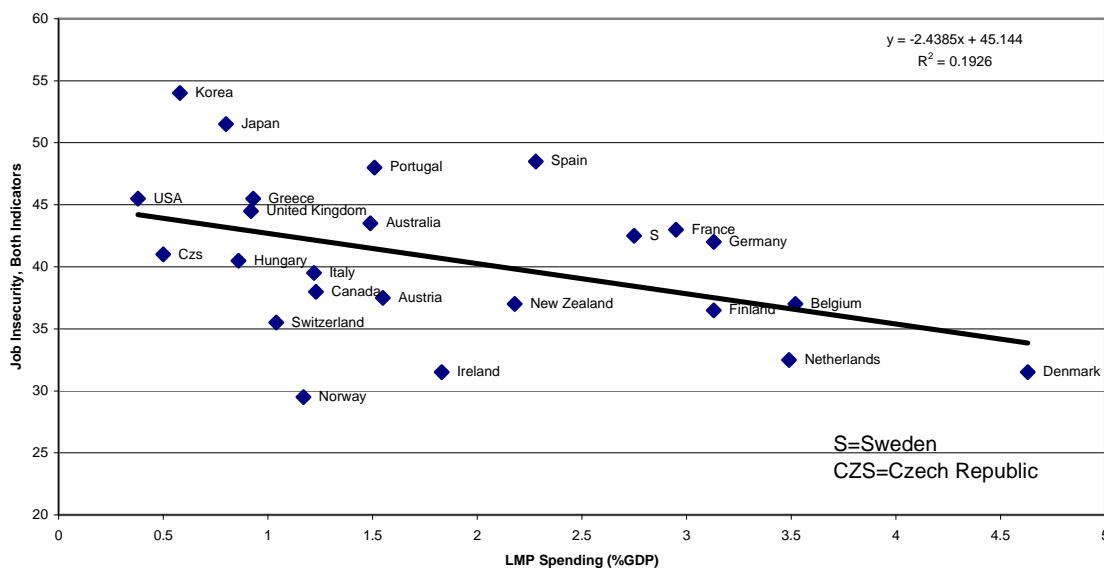
AT= Average employment tenure (years)

Ranks among 26 (25 if data missing) OECD countries.

Source: OECD, Eurostat.

Both together seem not only to yield good labour market performance, but also a higher perceived employment/employability security and this institutional setting has also positive effects on job quality.

Figure 4 shows the relationship between perceived employment security and the expenditure for LMP measures. There is indeed a positive relationship between these two variables, which tends to confirm the security enhancing role of labour market policies that we have found and that is confirmed by the analysis of the OECD (2004, 2006) and Clark and Postel-Vinay (2006).

Figure 4: Job insecurity and Labour Market Policies, 2000

Note: Job insecurity is the average percentage among two indicators: 1) workers worried about the future of their company and 2) those unsure of a job with their company even if they perform well. Source: Data on job insecurity from International Survey research, cited in OECD, 2001; Data for LMP spending from OECD, 2004. (Data for Ireland from 2001).

The fact that most of the European countries that have higher mobility are in the loose employment protection/high social protection group suggests that in these countries, transitions and mobility are institutionally backed. This is not true to the same extent for all, but at least applies to Denmark and the Netherlands, and to some degree also to Finland and also some other countries like Ireland. This leads us back to the comments made above: in these systems something like “protected mobility” seems to emerge: while employment is less stable and secure at the company level than in some other high employment protection cases, this lesser security seems to be compensated by better labour market security through unemployment benefits and participation in LMP programmes, but also by the development of social rights such as parental and training leave schemes.

There seem then to be strong arguments in favour of “protected flexibility” or flexicurity arrangements for labour market transitions that combine a fair degree of stable employment (and EPL) with flexible jobs that are embedded in a system of social protection. Flexibility, stability and security can be imagined dynamically as distributed over the life cycle of individuals with flexible jobs at younger ages and stable jobs once family formation starts and intermittent times of protected transitions (e.g. parental leave, training periods, but also short-term unemployment spells in relatively generous systems, supplemented by active labour market schemes) and job changes. But flexi-curity and “transitional labour markets” for being effective need also zones of stable employment, both in the public and the private sector. Indeed, transitions can be considered as bridges to employment and not as traps for exclusion.

With regard to existing Industrial Relation (IR) regimes, the only country that has today something of a fully-fledged labour market security system that combines looser employment protection with passive and active labour market policies is Denmark. Visser (2001) classifies this country among the “Northern corporatist regimes”. The IR regime indeed contributes to shaping the employment system of a country because the set-up of such systems requires many bargaining rounds between the tripartite constituents of business, labour and government. The feasibility of the setting up of such “protected mobility” systems will therefore also depend on the prevailing IR regime. Antagonisms in the Industrial Relation system might have made it necessary for the

governments to legislate in the more confrontational systems, very often to enshrine bargaining gains in terms of security of employment by unions. A further and complementary hypothesis is that less commitment on the part of the State to provide labour market policy measures and “generous” unemployment benefits for quitting or laid-off workers has encouraged unions to advocate for more employment protection. Alternatively, an active commitment by the State to act as provider to displaced workers may – as seen above – increase workers’ feelings of job security, encourage worker mobility and result in medium or low tenure. In the latter case, employment protection stringency is ‘traded’ against access and coverage of social protection, which results in both firms and workers being “embedded” in institutions for adaptation and security. And as the above analysis has shown some variants of Northern corporatism seems to be the nearest to the model of a trade-off between employment protection and labour market security.

6. Conclusion: Better security for the globalised economy

In the introduction we have seen that globalisation tends to affect labour markets and to increase the perception of employment insecurity. Although globalisation overall has not destroyed the longer-term employment relationships, it increases flexibility at the margin and raises the fear of job loss, leading workers to accept less favourable working conditions and raising fears of a “race to the bottom” and a basic trade-off between flexibility and security.

While flexible labour markets yield some gains in terms of employment rates, job quality and decent work requires more than just flexibility, it requires core stability in the employment system and a sound institutional environment with labour market policies that provide a security-in-transition framework. There is today a school of labour market researchers that claim that insured transitions are the basis of a new insurance against labour market risks. They distinguish between the “security of the wings and the security of the shell” but acknowledge the need to protect transitions between different labour market statuses (between jobs, jobs and unemployment, jobs and training, etc.). Labour markets featuring such supply side empowered flexibility that is protected by regulations and policies have been coined “transitional labour markets”. See Gazier (2003) and Schmid (2002). A security-in-transition framework seems to yield both good results in terms of labour market performance and decent work. For triggering flexibility and security it is essential that looser employment protection is accompanied by sound labour market policies and new social rights that also increase women’s participation in the labour market. Changing the possible trade-offs between stability, flexibility and security into a complementarity for globalized labour markets requires bargaining on an enlarged agenda that includes adjustment and productivity concerns of firms and security and welfare concerns of workers, as well as the sustainability of productive and welfare systems concern of the state. This is urgently needed, as globalisation will increase, rather than decrease, the need for an insurance against labour market risks and for protected transitions (Agell, 1999; Auer *et al.* 2005).

To sustain flexibility cum security systems, however, high employment rates are required and security should be work- and not welfare-based for those able to work. Therefore, the goal of increasing the employment rates of the population as stated by the European Employment Strategy and implemented through National reform plans is indeed of utmost importance for the survival of European welfare states. In light of the analysis above, social partners who should be involved in designing such labour market security could agree on the following: a certain level of labour market flexibility can be accepted by unions, when it does not equate to the loss of the standard employment relationship and is embedded in labour market security allowing protected transitions, because this enhances rather than destroys workers’ welfare.

And the observation, that employment stability – up to a point – is effective for productivity¹⁴ suggests that a fair level of employment stability (external numerical stability) of the workforce is positive for firms, and should thus also be an employer's goal, as it is required for productivity, human capital investment and worker motivation. Such a level of employment stability is ideally combined with internal forms of adjustments. Thirdly, governments should provide for an efficient labour market security system based on labour market policies that supports also internal adjustments. Tripartite bargaining on optimal combinations of flexibility, stability and security in the labour markets and a common acceptance that all three elements are needed for a productive economy and a well-functioning labour market yielding decent work is an essential part of optimal labour market institutions that will be country specific with some common elements.

¹⁴ and also for worker's security (as without any employment protection the complementarity between employment protection and the social protection system is unimaginable)

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