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Flexicurity – An Answer or a Question?

Abstract

Lately, the concept of flexicurity has been enthusiastically discussed in the European Union. It has become commonplace to advocate flexicurity policy as the solution to all the economic problems of the EU countries. The European Commission has described it as a welfare state model with four components: flexible and reliable contractual arrangements, comprehensive lifelong learning strategies, effective active labour market policies and modern social security systems. However, although such policies may seem very desirable, you could also argue that the widespread use of such a vague concept as flexicurity is potentially dangerous. It is possible to identify at least four potential problems: a tendency to mix up instruments and objectives, a tendency to pretend that all good things can be achieved simultaneously without the need to analyse difficult trade-offs, the view that social dialogue and consensus are always a desirable means to achieve a well functioning labour market, and the view that it is desirable to adopt common principles of flexicurity in the EU. The main danger is that the practice of trying to subsume a number of different policy approaches under the common heading of flexicurity leads to less clarity regarding the policy options available.

Introduction

From time to time popular catchwords find their way into the public economic policy debate. A recent example is the concept of *flexicurity*. In much of the European discussions it has come to be regarded more or less as synonymous with a well-designed labour market model providing both flexibility and security.

The popularity of the concept is easy to understand. Although it is not clear that the pace of structural change has increased over time, the general perception appears to be that this is the case. This impression is related to processes of globalisation, increased European integration and technological development. In this situation, it is not surprising that there is a large perceived demand for both flexibility, so that the European economies can adjust to new economic challenges, and economic security, so that individuals exposed to these processes of change have adequate income protection.

There is a mass of writings on flexicurity. A recent contribution is the communication from the European Commission published in June 2007 aiming to "explore the development of a set of common principles on flexicurity" (European Commission 2007). The communication is a response to a call from the European Council (Presidency Conclusions 2006, 2007). The focus on flexicurity is motivated by "the need to achieve the objectives of the renewed Lisbon Strategy, in particular more and better jobs, and at the same time to modernise the European social models" (p 4). The communication defines flexicurity "as an integrated strategy to enhance, at the same time, flexibility and security in the labour market" (p 4).

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Components of flexicurity

According to the communication from the Commission, there is agreement within the EU that flexicurity policy should include the following components:

- *Flexible and reliable contractual arrangements* through modern labour laws, collective agreements and work organisation.
- *Comprehensive lifelong learning strategies* to ensure the continual adaptability and employability of workers, particularly the most vulnerable ones.
- *Effective active labour market polices* that help people cope with rapid change, reduce unemployment spells and ease transitions to new jobs.
- *Modern social security systems* that provide adequate income support, encourage employment and facilitate labour market mobility.

Using these very broad terms, it is very hard to see how anyone can be against flexicurity. Looking at the text in more detail, it is clear, however, that the policy package set out can probably best be characterised as an attempt to define a European alternative to the Anglo-Saxon labour market approach. The alternative has to a large extent been modelled on the labour market systems of countries such as the Nordic ones, Austria and the Netherlands. These countries have been able to combine a fairly high employment level with a high level of social protection and an even income distribution. More precisely, the communication advocates a policy package with the following characteristics:

- Moderate employment protection legislation encompassing all employees to avoid the segmentation of the labour market that occurs in many European countries, where employees with open-ended employment contracts are heavily protected, whereas employees with fixed-term contracts have very little protection.
- Stronger incentives for lifelong learning. These can include tax deductions for employees as well as the substitution of funding at the branch level for current funding by individual employers of their staff (because individual employers may be discouraged from investing in the skills of their employees by the risk that trained staff may be recruited by other employers).
- Generous unemployment insurance that is combined with activation measures to offset any negative effects on the intensity of job search activities.
- A "corporatist" approach where a consensus on flexicurity measures should be reached between employers, unions and the government" through an active "social dialogue".

Dangers with the flexicurity concept

All this may sound as perfectly sensible and desirable policies to adopt. One could also argue that it is a good thing if the marketing of these policies can be facilitated through the use of a catchy label such as flexicurity. One could, however, also argue that the concept is potentially dangerous because of its vagueness and the possibility it offers to sweep important problems under the carpet. There seems to be a tendency for everyone to have their own definition of flexicurity and then to subsume everything they like under that label. This tends to lead to very unproductive discussions on the proper definition of the concept that diverts interest away from the fundamental issues of the exact measures required to achieve a set of clearly defined objectives. It is as if you have first constructed a label and are subsequently struggling to fill it with contents.

It is possible to identify at least four potential problems:

1. A tendency to mix up instruments and objectives.
2. A tendency to pretend that all good things can be achieved simultaneously without the need to analyse difficult trade-offs.
3. The view that social dialogue and consensus are always a desirable means to achieve a well functioning labour market; and
4. The view that it is desirable to adopt "a set of common principles" of flexicurity in the EU.

Instruments and objectives

A first potential problem with the flexicurity concept is a tendency to confound instruments and objectives. This deviates from the usual methodology in economics of identifying certain well-specified objectives and then analysing which of the available instruments are the most appropriate ones for achieving these objectives. The overriding objective of flexicurity is, according to the Commission's communication, to "create more and better jobs and strengthening the European social models" (p 9). At the same time, it is taken more or less for granted that this can only be achieved "by providing new forms of flexibility and security to increase adaptability, employment and social cohesion" (p 9). It is a bit like arguing that the way to increase employment and social cohesion is to increase employment and social cohesion.

Insufficient analysis of trade-offs

The gravest problem is probably the insufficient analysis of trade-offs between different objectives. The Commission's communication seems to disregard a number of serious conflicts of goals and take it for granted that it is always possible to achieve a number of desirable objectives simultaneously. This is most clear when it comes to unemployment benefits. In an appendix, the communication identifies four different "flexicurity pathways", which should be applicable to different groups of countries. It is noteworthy that all four pathways involve generous unemployment benefits and that in three of the pathways benefits should be raised relative to current levels.

The belief that generous unemployment benefits are not an obstacle to high employment has been a recurring theme among proponents of flexicurity. This view is very often motivated by references to the experiences of Denmark, which has over the last decade been very successful in reducing unemployment. This has been attributed to a combination of low employment protection and high unemployment benefits. A typical example of this type of reasoning is Sapir (2005), who argues that "protecting jobs with employment legislation is definitely detrimental to employment, whereas protecting workers with unemployment insurance is potentially useful for employment". The underlying idea is that low employment protection makes employers more willing to hire, at the same time as generous unemployment insurance reduces employee resistance to structural change.

A main problem with the above line of reasoning is that there is overwhelming empirical evidence that higher unemployment benefits tend to raise unemployment (see, for example, OECD 2006). This is also in accordance with theoretical modelling of how more generous unemployment benefits tend both to reduce the search intensity of the unemployed and the taking up of job offers and to raise aggregate wage levels through their effect on collective bargaining (higher unemployment benefits reduce the adverse consequences for trade union members who become unemployed due to wage increases and therefore weaken incentives for wage moderation). Other theoretical models have focused on how generous unemployment benefit levels tied to previous earnings could result in very high *effective replacement* rates (high benefits relative to earnings in a new job, which for a person who has experienced a long period of unemployment might be substantially lower than earnings in the previous job). This could reduce the attractiveness of finding a new job significantly (Ljungqvist and Sargent 2006).

A closer look at the Danish experience also gives another picture of developments than the one suggested by Sapir and other proponents of flexicurity policy. It is true that unemployment benefits are very high in Denmark by international standards and that employment protection is low by Western European standards. At the same time, it is clear that the decline in unemployment over the last decade has been associated with a large reduction in the generosity of unemployment benefits: the maximum duration of benefits has been cut dramatically (from in practice unlimited duration to four years), the replacement rate (the benefit level relative to the earlier wage level) has been reduced for those with high incomes (because the ceiling for benefits has not been fully indexed), and there has been a substantial reduction in benefit levels for young people (Andersen and Svarer 2006, EEAG 2007). In contrast, employment protection has remained more or less the same.

The Commission's communication reveals some awareness of incentive problems (lower search activity and less willingness to take up job offers on the part of the unemployed) created by generous benefit systems. However, there appears to be a strong belief that this can be handled through systems providing an appropriate "balance between rights and responsibilities for employers, workers, job seekers and public authorities" (p 9). This is another way of saying that the strict control of the unemployed may counteract adverse labour market effects of high unemployment benefits. There exists a fair amount of evidence that supports this hypothesis (see, for example, OECD 2006).

A stronger emphasis on activation programmes for the unemployed – with an obligation after some time to take part in such programmes as a precondition for receiving unemployment benefits – has been a major component in recent Danish employment policy. However, evaluations of programme effects on labour market outcomes have usually not been very encouraging (Andersen and Svarer 2006). Most programmes do not appear to have raised regular employment opportunities of participants, because locking-in effects of programmes during their duration have dominated the small increases in transitions to regular employment that, according to some studies, have occurred after completion of the programmes. Instead, activation policies seem mainly to have had ex ante *threat effects,* shortening unemployment duration by changing the behaviour of the unemployed prior to programme participation (Rosholm and Svarer 2004). If activation programmes work in this way by being so "unpleasant" that the unemployed try to avoid them, new difficult policy trade-offs arise. It is by no means guaranteed that it is a better solution to try to raise employment through harsher requirements on the unemployed than through limited benefit reductions.

The issues raised in this section are subject to a lot of discussion among economists and there exists no consensus on what exact policy combinations are the most appropriate ones. It is, however, an important shortcoming of the Commission's analysis of flexicurity that the difficult trade-offs involved are more or less swept under the carpet. This is not helpful for an informed choice of policies.

The value of a social consensus

The Commission argues in favour of a corporatist approach to flexicurity policy. "Active involvement of the social partners" and a well-developed "social dialogue" involving "representatives of employers, workers, government and other parties" are seen as vital ingredients in a successful policy. As a generalised conclusion this is highly questionable. Of course, it is beneficial if an effective strategy to achieve certain labour market objectives can be based on broad social consensus, since this increases the chances of a consistent long-term policy. Labour market reforms in, for example, the Netherlands and Denmark have followed such an approach. In other cases, however, the consensus requirement might just block any possibility of reform. Many economists have, for example, argued that benefit systems have been so generous in some European countries (such as Germany, France and Sweden) that it is possible through limited reductions in benefit levels (or employment tax credits) to achieve quite large employment gains at the cost of only small increases in income inequality (see, for example, EEAG 2004, 2007). In such cases, it might be a more viable policy strategy not to let the absence of a full consensus block reforms, and instead carry them out even if there is a great deal of resistance: if the reforms prove effective in raising employment levels without any significant costs in terms of a widening income distribution, political acceptance may come later.

The desirability of developing common principles of flexicurity

Finally, you can question the value of trying to reach a consensus at EU level on common principles of flexicurity. An active discussion on how well different policies in the various EU countries work is naturally very beneficial, a discussion where countries can learn from each other's experiences. This is the essence of the so-called *open method of coordination* in the EU, which applies in the labour market area. This is not, however, the same thing as adopting common principles of policy. Rather, the open method of coordination builds on "institutional competition", where countries can try different policies so that we get a "laboratory" where various experiments are performed.

The possibility of comparing different countries' policies is based on the precondition that differences in policy can be clearly identified. This becomes much more difficult if you put the same flexicurity label on a large number of different policies. In a way, this is what the Commission's communication does when it tries to find the common denominator of different policies at the same time as it acknowledges that "flexicurity is not about one single labour market model or a single policy strategy" (p 9). Using the flexicurity label as a catch-all for many different policy approaches does not promote clarity in policy comparisons.

Can we do without the flexicurity concept?

The critical comments here should not hide the fact that the Commission's communication on flexicurity contains a number of reasonable ideas. It is desirable to facilitate structural change (flexibility) at the same time as those that have to change jobs should be given adequate social protection during an adjustment period (security). Providing more equal opportunities for lifelong learning is also potentially very desirable. In most countries, a great deal can probably be achieved through more effective activation policies.

The analysis of employment protection in the communication is also reasonable. Rigid employment protection is not the way of achieving high employment levels. Even though it might slow down job destruction, it will also hamper the job creation required for long-term growth. It tends to harm marginal groups in the labour market, such as young people and the long-term unemployed, who will find it harder to find employment. There are some good arguments for why the current segmentation in many countries between very strict employment protection for a majority of employees on open-ended contracts and very low protection for a minority on fixed-term contracts might cause problems: for example, the low employment protection for the latter group creates a "buffer stock" of easy-to-fire workers (outsiders) that shields the large group of heavily protected insiders from unemployment risks. The latter, therefore, have much weaker incentives to exert the wage moderation necessary to reach high employment levels.

The question is how much we gain from trying to squeeze in a number of different policies under the one catchword flexicurity. Does it help to clarify our thinking or does it muddle it? When writing this article, the author's computer protested consistently every time the word flexicurity was written. The computer would not acknowledge that such a word exists. This is probably a sign of healthy scepticism. It would probably be a good thing if many politicians showed the same scepticism and were more clear about what exact policies they advocate rather than trying to sell them using the flexicurity label.

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