Conseil d'orientation pour l'emploi

Labour markets reforms in Europe

Executive summary

5th November 2015

This report aims to present a detailed overview of the reforms made to European labour markets in recent years, to clarify the background and relevant issues in each country where reforms have been enacted and, wherever possible, to present initial feedback on outcomes of the reform process.

The COE restricted its analysis to ten countries: Austria, Denmark, Germany, Italy, Ireland, the Netherlands, Portugal, Spain, Sweden and the UK.

The report is made up of a cross-country analysis and ten individual monographs.

Background to reform: a major crisis in already fast-changing labour markets

Labour markets were changing even before the crisis

The many reforms to the labour market introduced since the crisis broke are often viewed purely as a consequence of the crisis. In fact, Europe's labour markets were already undergoing deep changes before the crunch hit, in response to severe economic, social and financial upheavals: slowing growth, financialisation and the growing importance of services as a share of the economy, increased competition due to globalisation, demographic shifts and the expanding role of women in the place the impact of new technologies and an ever-faster cycle of reskilling demanded by the jobs market, changes in the nature of the demands met by companies and modes of production and a squeeze on budgets. All of these trends were creating pressure for greater flexibility and individualisation in the way production was organised. Most also demanded that costs be brought down.

In addition, many labour markets had for years been wrestling with the challenges of unemployment, long-term unemployment and dualisation.

On the ever of the crisis, these needs and challenges had been either ignored or inadequately addressed in the organisation and functioning of institutions in all labour markets.

Impact of the crisis on jobs and unemployment

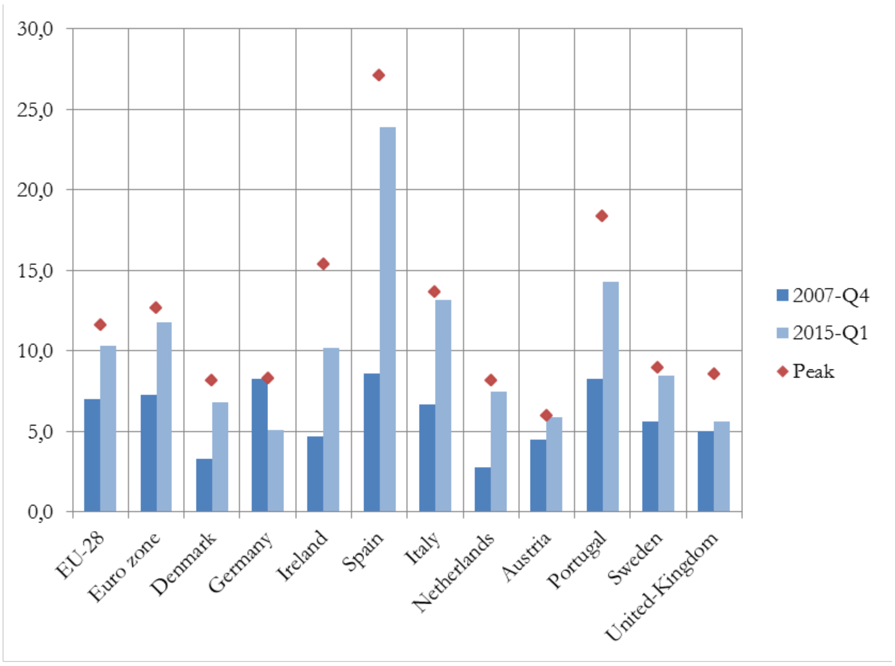
It was against this backdrop of rapid change in Europe's labour markets that in 2008 came the Great Recession. Its scale, duration and multiple dimensions (financial crash, economic crisis, squeeze on public finances) led to a major impact on Europe's labour markets, an impact that persists to this day. The resulting job shortage is still far from resolved.[1] The unemployment rate in the EU and euro zone may have fallen back from its 2013 peak but remains well above 2007 levels.

[1] In the EU 28 there were a total of 217.7 million jobs in 2014, compared to 222.8 million in 2008. In other words, the continent lost 2.3% of its employment between these two years.

The general improvement in labour markets also masks different stories in different countries :

- some countries are broadly back to their pre-crisis state : Germany, Sweden, the UK ;
- others have suffered persistent long-term damage, despite recent improvements in their employment markets : Italy, Portugal, Spain ;
- some hover in between these extremes: Austria, Denmark, Ireland, the Netherlands.

Unemployment since the 2008 crisis



Interpretation: in the EU-28, unemployment was 7.0 % in the 4th quarter 2007, rose to a peak of 11.6 % and then fell back to 10.3 % in the 1st quarter 2015.

Source: Eurostat

The crisis exacerbated existing labour market imbalances

When the crisis began, Europe's labour markets differed markedly from country to country. Mostly, the crisis only worsened existing imbalances. It also threw into relief those challenges all countries had in common.

Challenges shared by nearly all countries :

- youth unemployment and an increasing proportion of NEETs, young people not in employment, education or training. This stood at 16.6 % in 2014, more than 2 points higher than in 2007;
- the growth of long-term unemployment : the number of those out of work for more than one year doubled between 2007 and 2014.

Country-specific issues :

- the share of part-time work rose, sharply in several countries (Spain, Ireland, Italy) ;
- a greater risk of dualisms in labour markets, with slower transition from temporary to permanent employment, the persistence or expansion of some atypical types of employment, whether salaried, such as German *mini-jobs* or British *zero hours contracts*, or self-employed, such as Portuguese *recibos verdes* or Italian *para subordinato* contracts, and informal work ;
- the emergence of a variation in active population trends from country to country ;
- mismatches in the supply of and demand for labour, often because skill sets failed to keep pace with technological change and sector trends within the economy.

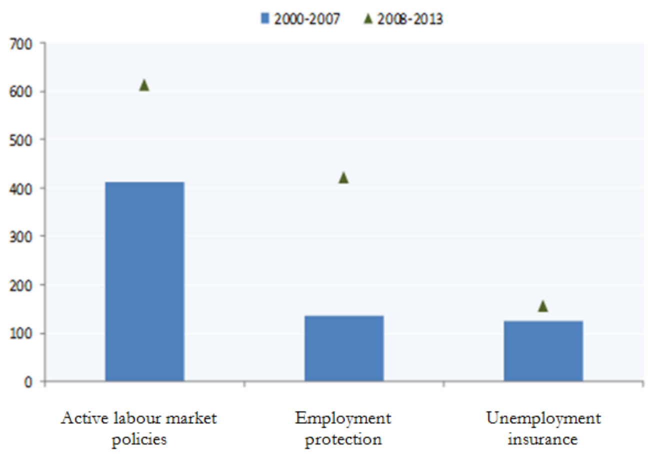
Structural reforms in Europe

The crisis triggered a rush of reforms

Working from existing data bases, most notably those of the European Commission and the International Labour Organisation, the COE ran an initial quantitative analysis of the reforms carried out in Europe.

Labour markets, because of their economic importance, role in social life and the range of developments that are permanently impacting them, require continuous reform to adapt them to changing circumstances and make them more efficient. Even so, it seems that the number of reforms to labour markets, which had already risen considerably since the mid-1990s, increased markedly from 2008.

Number of measures approved in EU-28 countries



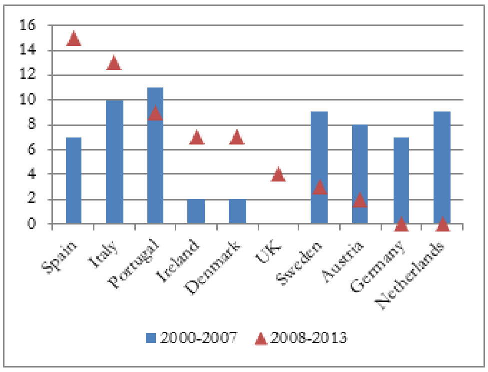
Interpretation: between 2008 and 2013, more than 600 measures were passed under active labour market policies in the EU-28 countries.

Source: testimony of Raymond Torres to the COE on 14 April 2015.

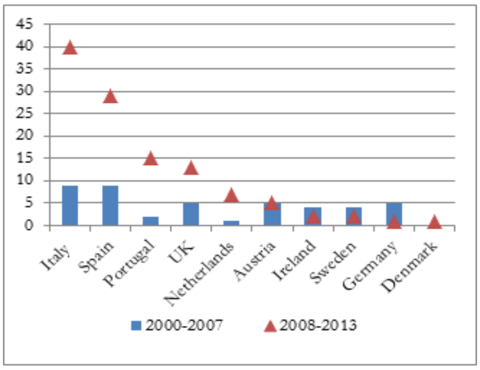
The general trend, however, masks disparities between the countries and policy areas most affected. Reforms were most numerous in southern Europe, particularly as regards employment protection and unemployment insurance. These countries had the biggest mismatches between the way their labour markets and economieses worked. In contrast, the least-reforming countries since 2008 were those which had already put through large-scale reforms before the crisis.

Number of measures passed by country

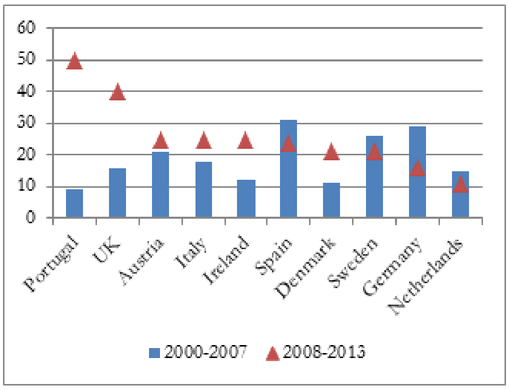
a. Unemployment insurance



b. Employment protection



c. Active labour market policies



Source: ILO, formatted by COE.

Crisis resets the context for launching and carrying through reforms

External pressures

A unique factor in the reforms made to Europe's labour market post-crisis is that many were pushed through under heavy external pressure. Strongly encouraged as part of the new European governance regime, the drafting and implementation of labour market reforms was successfully demanded in exchange for financial aid in Ireland, Portugal and, less so, Spain. Pressure from the Troika was seconded by pressure from financial markets for whom structural reforms became an essential condition for keeping interest rates down to reasonable levels.

Less space for social dialogue

In the first phase of the crisis, social dialogue was dynamic and marked by a consensus on the need to act fast to support employment and mitigate the economic shock but was substantially eroded as time wore on. As economic weakness persisted and governments embarked on major deficit reduction programmes there was ever less scope for social dialogue to find common ground between the positions of the different players, particularly in southern Europe.

Reforms that often from part of larger processes

Reforms put in place often came as part of a wider package of measures, addressing, over the same time scale, the main functional areas of the labour market (employment contracts, collective bargaining, reducing labour costs, active policies). Sometimes these formed part of a reform process that went beyond the labour market and sought to reinvigorate the wider economic system to foster growth and job-rich growth.

Labour market reforms have conformed to several broad patterns

Any analysis of labour market reforms must consider the initial pre-crisis state of labour markets and their associated institutions. In Europe, the situation in 2008 was very different across countries, in terms of employment protection legislation, the role of collective bargaining, the scope and level of unemployment insurance and the importance of active labor market policies.

To different degrees and with different intensities, depending on factors such as the starting point of each market, the reforms undertaken have all revolved around five key themes.

A general loosening up of laws on employment contracts, substantial for permanent jobs, less so for temporary or atypical work

Reforms to permanent employment since 2008 have been more or less radical in different cases. Generally, they have tended to be more wide-ranging in countries that previously enjoyed strong employment protection, such as Italy, Spain or Portugal. Various aspects of regulation have been affected: grounds for redundancy (Spain, Netherlands, Portugal), redundancy procedures (Spain, Portugal, UK), redundancy payments – tending to reduce legal compensation on departure[2] (Portugal, Spain, Netherlands) – and a reworking of legal remedies in proven cases of wrongful dismissal – either by restricting the right to reemployment (Spain, Italy), or by restructuring the scale of court compensation (Spain, Italy, UK). Reforms also sought to promote conciliation (UK and Italy), limit recourse to the courts (Italy, UK, Ireland) and develop systems for breaking employment contracts by mutual consent (Italy). They also addressed collective redundancies, which were made easier to implement (Spain, Portugal).

Reforms to temporary or atypical work regimes have been more varied. While protections for fixed-term contracts were eased in some cases (Italy) in others they were better framed (Spain, Netherlands, Sweden, Italy again). The biggest improvements in regulation addressed specific patterns of work on the fringes of employment: elimination of *para subordinate* contracts in Italy, overhaul of *mini*- and *midi-jobs* in Germany, tighter rules on zero hours contracts in the UK.

[2] We are speaking here of redundancy compensation paid at the time of redundancy – something that does not exist in all countries and which should be distinguished from subsequent compensation awarded in the case of wrongful dismissal.

Decentralisation of collective bargaining and greater flexibility for organisations

Decentralisation has been enacted through a number of often coordinated reforms :

- overhaul of the regulatory hierarchy to allow lower level opt-outs from higher level agreements or even statutory obligations in some cases, or employer opt-outs from the terms of collective agreements (Portugal, Spain, Ireland, Italy) ;
- time-limits on agreements and restrictions on the renewal of sector agreements (Spain, Portugal) ;
- introduction or extension of an option to negotiate company agreements with elected representatives (Italy, Portugal) ;
- reforms to union representation and requirements for agreements to be deemed valid (Italy) ;
- greater flexibility for companies to make unilateral amendments to employment contracts (Spain, Portugal).

Pursuit of wage restraint and reduction of labour costs, the recent introduction or upgrading of national minimum wages in some countries

Since 2008, the tools of wage regulation have frequently been reformed or subject to new practices - generally as part of the abovementioned changes to collective bargaining rules. Usually the aim has been to restrain wage rises. In 2009-2014 there was a significant slowing in the pace of real wage growth, most notably due to :

- freezing or lowering of legal minimum wages (Portugal, Ireland) ;
- capping of statutory salary increases (Italy, Spain, Denmark) ;
- reductions in social security contributions and taxes on jobs (Italy, Sweden, Spain), justified in some cases as a way to incentivise permanent hiring (Italy, Spain).

More recently, the role of national minimum wages seems to have been strengthened: Germany has introduced its first federal minimum wage, negotiations are ongoing to introduce one in Italy, a big rise has been announced in the UK.

Germany, a very special case

If we consider the list of labour market reforms since 2008 Germany appears to have done little. This, however, is not because Germany's labour market remains unreformed but because the bulk of its structural reforms were already in place before 2008.

In the 1990s, Germany faced a massive shock stemming main from reunification with the ex-Communist East. Reunification had deeply destabilised the German economy, seriously impairing competitiveness and stalling growth, and unbalanced its labour market. Unemployment soared from 5.5 % in 1991 to 9.6 % in 1997, dipped slightly, then rose again to 11.2 % in 2005.

Faced with this challenge, Germany embarked on a string of reforms - Chancellor Schröder's "Agenda 2010" in 2002 being the most prominent example – while simultaneously encouraging changes in its companies corporate practice designed to restore competitiveness and revive employment. This was also happening against the background of an ageing population.

These reforms and changes revolved around several key themes :

- easier redundancy arrangements for companies with fewer than 10 employees (previously the threshold for application of the redundancy law had been 5 employees);

- development of atypical low-cost employment patterns (*mini*- and *midi-jobs*) and deregulation of temporary work ;

- major decentralisation of collective bargaining from sector to company level (starting in 1997 with the agreement in the chemicals industry allowing "flexibility clauses", subsequently extended to other sectors including metallurgy with the 2004 Pforzheim agreement) enabling greater internal flexibility and narrowing the purview of statutory agreements ;

- control of labour costs (unit labour costs were lower in 2007 than in 2000) thanks to vigorous wage restraint and reduction in social security contributions in 2007 (paid for by a 3 point rise in VAT) ;

- an overhaul of the unemployment insurance system to shorten the period of entitlement and merge unemployment and social support payments with a resulting general reduction in the amount paid ;

- reforms to the public employment service, including transformation of the Federal employment agency and stricter requirements for claimants to seek work and take eligible job offers ;

- new active policies: an end to early retirement, salary subsidies for taking on the unemployed, support for new start-ups, return-to-work contracts.

Reforms since 2008 have generally only tweaked at the margins the changes made between 1996 and 2005. The only real structural reform in this period was the introduction of a legal interprofessional minimum wage on 1 January 2015.

Unemployment insurance and social security systems that incentivise return to work and are often open to more people

While in the first phase of the crisis unemployment insurance was deployed as a counter-cyclical tool, schemes were subsequently reformed to accelerate people's return to work : reducing the proportion of income paid as benefit and introducing or accentuating a decline in this ratio over time (Sweden, Spain, Portugal, Italy), shortening the period of benefit entitlement (Sweden, Denmark, Portugal, Ireland, Netherlands) and stricter checks on job search (Portugal, Spain, Italy, Netherlands).

In contrast, in cases where benefits covered only a small part of salaries the scope of coverage was in some cases extended, either by adjusting the minimum subscription time to receive benefits (Italy, Portugal), or by offering insurance to certain non-salaried workers (Italy, Portugal).

A drive for efficiency savings in public employment services and the reinvigoration of active labour market polices

Public employment services have undergone major reforms: closer linkage of compensation with the numbers placed in work (Netherlands, Ireland, Italy), less decentralisation (Sweden, Spain, Italy, Denmark), better tailoring of services to each jobseeker (Sweden, Germany, Denmark, Portugal, Ireland), outsourcing of support services in most countries (Sweden, Spain, UK, Portugal, Ireland, Italy), increased monitoring (Netherlands, UK, Ireland, Italy).

This stepping up of active policies at a time of restraint in public finances led to a finer targeting of policies, either toward people deemed the most vulnerable (particularly the young and long-term unemployed) or toward priority programmes (particularly professional training and apprenticeships).

Initial analysis of the impact of reforms

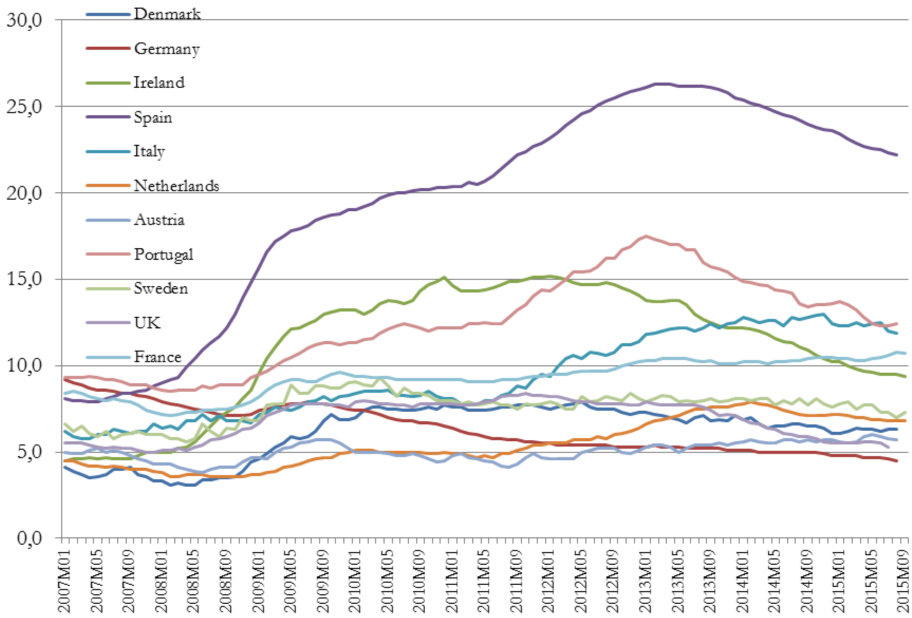
The reforms considered in this report are mostly recent, which makes it hard to evaluate their effects as yet. Any analysis of their impact demands that we take into account a range of factors :

- reforms have taken place in interrelated countries. This interrelationship is strengthened in countries which are part of the same currency area as they cannot rely on exchange rate movements to reduce differences in price competitiveness (including differences stemming from the reforms);
- reforms may, depending on the economy and their nature, be quicker or slower to produce their results ;
- labour markets are not isolated from the rest of the economy: the impact of labour market reforms therefore depends on their internal consistency and linkage with other types of reform ;
- reforms implemented since the crisis are insufficient to explain the respective performances of different labour markets: these performances also relate to other factors such as the country's growth model and rate of growth, demographics or structural labour market reforms before the crisis hit, which must also be considered ;
- finally, the impact of labour market reforms cannot be assessed only in the light of unemployment and employment indicators, even if these are essential ; it must also consider the quality of jobs created, any segmentation of employment by sex or age, whether new jobs give workers an adequate standard of living and the competitiveness/cost to companies.

Taking all these factors into account, the COE has attempted an initial analysis of the impacts of reforms on three areas.

Have the reforms had any effect on employment and unemployment ?

Unemployment (2007-2015)



Source: Eurostat

Though they were not the only factors at play, the ability of pre-crisis reforms to address structural imbalances in labour markets and the timing of their introduction, before and during the crisis, have had an impact on employment and unemployment trends since the crisis hit.

Countries which had corrected structural imbalances in their labour markets before the crisis and deployed employment protection policies were less hard hit and recovered more easily: this was the case in Germany, the UK, Austria, Denmark and Sweden.

In contrast, countries which had not been able to resolve their main labour market weaknesses before the crisis – duality (emergence of a disadvantaged underclass), low active populations, employment structure, level and structure of skills in the active population - due to a failure to reform appropriately or sufficiently, suffered a stronger and longer degradation of their jobs market. Unemployment took longer to start coming down, irrespective of its level going into the crisis.

In these countries (Ireland, Spain, Italy, Portugal) which are also those where the most recent reforms have been the most radical, improvements in the employment situation are mostly due to the return of growth. They are also partly related to early impacts of these reforms although it is impossible at this stage to isolate their actual impact.

Taking Italy as an example, the first analyses available, from the Bank of Italy, which need to be confirmed, suggest that improvements in employment, both quantitative (faster job creation) and qualitative (rising proportion of permanent contracts in new hirings) are due first and foremost to a recovery in economic activity but some part of the impact, around a quarter, is also due to the Jobs Act (of which one third is due to new redundancy rules and two-thirds to social security exemptions).

In Spain, unemployment has come down but remains high and duality has far from disappeared: while the 2012 reforms increased the numbers moving from unemployment to permanent employment, someone who is unemployed is still ten times more likely to get a temporary than a permanent job.

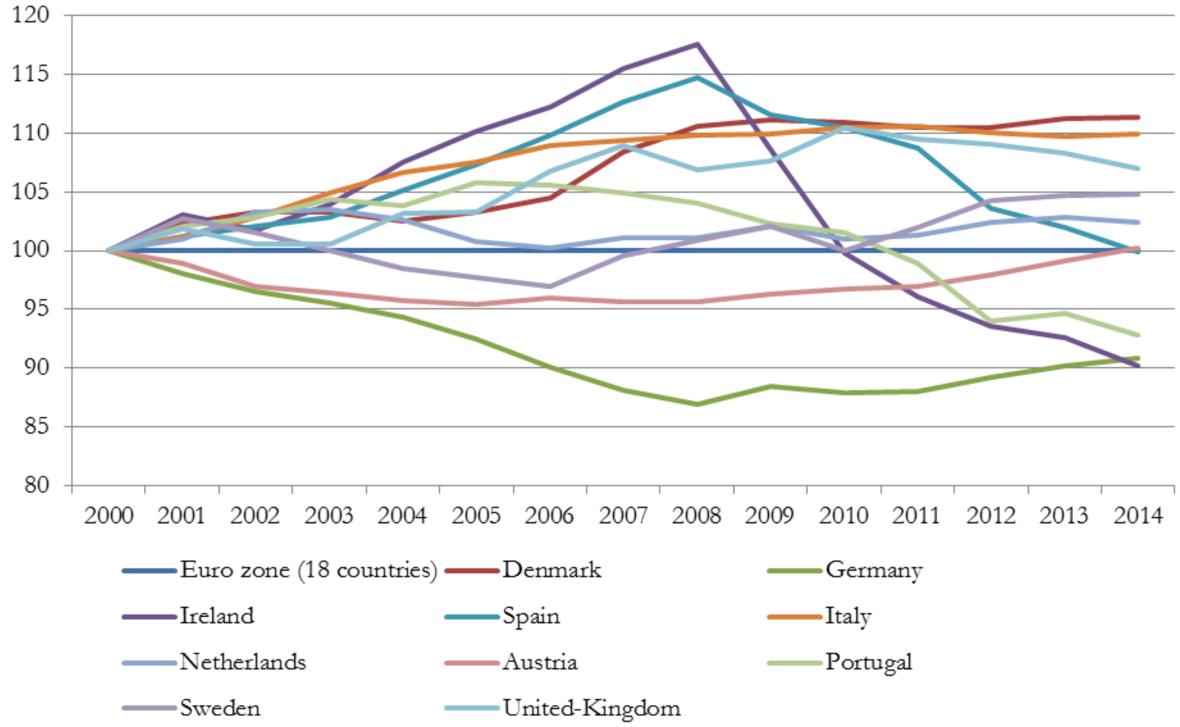
Have reforms improved economic competitiveness ?

Looking at unit labour costs, while accepting that there is more to competitiveness than just this measure, we find that :

- before the crisis, we saw big divergences in the trends of unit labour costs in different countries ;
- since the crisis, in parallel with the reforms and wage restraint policies, we see some narrowing of these differences, even though productivity trends still vary widely between countries. Reforms undertaken by struggling countries have therefore helped improve their cost-competitiveness.

Nominal unit labour costs 2000-2015

(index 2000=100, versus euro zone average)



Source: Eurostat

Have reforms affected inequality and poverty ?

It is hard to draw a direct line between labour market reforms adopted or in the process of adoption and recent trends in inequality and poverty due to the many factors that explain these phenomena.

Before the crisis, the average poverty rate in the EU was 16 %. Two well-defined groups of countries stand out from this average:

- the Nordic and continental countries report poverty rates below EU-average levels. However, it should be said that in parallel with the implementation of the

Hartz reforms, poverty rates in Germany rose by nearly 3 points just before the crisis ;

- the Anglo-Saxon and Latin countries have poverty rates at least 2 points above average, although their rates have tended to decline over the period.

Similar trends were observed in inequality.

Since the crisis, coinciding with the programme of reforms undertaken, the situation seems more mixed :

- inequalities, measured using the Gini coefficient have slightly increased since 2007. Using an analysis grid designed by the ILO we can identify the sources of these changes, in terms of inequalities between the richest and poorest 10 %, back to 2010 and it is not generally possible to attribute changes to labour market effects (employment and salary impacts) or other effects (mainly redistribution): the two effects play differently in different countries ;
- observed poverty, both in-work and general, has risen since 2007. It is, however, hard at this stage to draw any automatic correlation between the type, pace and intensity of reforms and changes in poverty. In the countries that had most radically reformed their labour markets before the crisis (Germany, Austria, Denmark, Sweden, the UK), the trend in poverty rates also seems to reflect a lower impact from social transfers. In contrast, in countries which only started to reform once the crisis hit (Spain, Ireland, Italy, Portugal), the increase in poverty seems mainly to be related to the workings of the labour market (employment and salary effects). Before transfers, the rise in poverty rates is high, but the impact of social transfers mitigates the impact.