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Article

Creaking Labour Markets: Migrating into Unemployment?

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I want to draw on the experience I gathered in my previous position as Chief Economist of Findustria to give some thoughts on the politics of labour market reforms and dealing with the trade unions. Reforming the labour market and the welfare system is necessary, but it is tremendously difficult. In Italy, our problem is somewhat different from the key problem in Germany, where you have big benefits. In Italy, the main problem, more serious than in Germany, is the rigidity of labour markets which to a large extent means rules about firing. We have had two years of very long and very intense social conflicts over the issue of flexibility, and overall, we have been able to obtain relatively modest results.

Why is it so difficult to get a consensus on labour market reforms? Of course, the standard answer is that trade unions defend their co-workers who benefit from protection. That may be the main part of the story, but I think there are other important reasons and I want to list four:

1. The basic argument, that flexibility is good for employment, is intrinsically a very complex argument which is almost impossible to explain to the voters. Maybe people can understand that flexibility helps growth because it helps adapting to shocks, etc. But why employment? People will tell you that if you make it easier to fire, first you will fire and then maybe you will hire someone else. At best this is a zero-sum game in the long run. You hurt real voters in the short run and you benefit hypothetical voters in the long run. That is a lose-lose proposition. The true story is that if you have more growth and a higher GDP over time, you have a better trade-off between wages and employment. You can either afford higher wages at given employment or higher employment at given wages or a combination of the two. This is very difficult and there has been a lot of confusion, even in the economic profession, about this.

2. People in most European countries already experience a lot of flexibility in the so-called marginal labour market, in the grey market or the market with short-term contracts of various sorts. So you have to explain the link between excessive rigidity in the core market and excessive flexibility in the marginal market. If core workers are overprotected, markets will find their way around it. We have a paradox here, a paradox that exists all over Europe. People think that the flexibility we have in the marginal market is due to the reforms, because every government claims to have made reforms to make labour markets more flexible. And people think that due to these reforms you see all these young people with precarious jobs. But in fact they have precarious jobs precisely because the reforms have not been made. But people say: enough is enough.
3. Unemployment does not seem to cause much social unhappiness. This is true not only in countries with very high benefit levels, which is very easy to understand, but also in countries like Italy and Greece where unemployment benefits are rather low. Perhaps, more people work in the grey market there. Of course, there is a lot of unhappiness in all our countries about high taxes, poor social services, etc. but nobody seems to see the link between poor social services and high taxes on the one hand and low growth and low employment on the other. The big difference between the United States and Europe is that in the United States more people work and people work more compared to Europe. And it is even more difficult to link the symptoms of social unhappiness to labour market rigidity.
4. The most fundamental reason is that, at least in my perception, there is a growing demand for protection and welfare all over Europe. The articles of the European constitution, which Hans-Werner Sinn cited this morning, show this clearly. You should not think that the fact that the constitution writes down the things about rights to protection and to welfare is a mistake. This is Europe! In ECOFIN meetings and meetings of

the finance ministers they always talk about more flexibility and lower welfare. They talk. But ministers of labour and social affairs and the European Parliament take decisions that go in the opposite direction. Look at legislation on working time, on mobbing, on consultational workers, etc. And there is also, as George de M  nil has said, an important role for the courts. I bet that ten years from now we will not have a lighter welfare state and that, as far as the rules on labour are concerned, we may well have a heavier welfare state.

My conclusions: (1) I think it is important to try to carry out the necessary structural reforms. But if you want to do it, be aware that your arguments sound weak to the voters. They are very strong scientifically, but they sound weak to the voters. (2) Unless you are sure you can play Mrs. Thatcher, try to keep the unions involved in the process. Explain to them that they have a role to play in the reforms. (3) Be ready to pay. You must give something in exchange, like more money for some social welfare programme. (4) Invent something that is unpleasant for big business. (5) Do not blame it on the IMF or on Brussels. That is counterproductive. You must do the things that are good for your country, not for someone else. (6) Good luck!