The Political Economy of Two-tier Reforms of Employment Protection in Europe

WOLFGANG OCHEL

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Abstract

Reforms of employment protection (EPL) in Europe eased the recourse to temporary forms of employment while not reducing the strictness of EPL of permanent jobs (with the exception of Spain). Since 1990, such two-tier reforms have been implemented in Belgium, Denmark, Germany, Greece, Italy, the Netherlands and Sweden. The paper seeks to show why two-tier reforms of EPL have taken place in some countries and have failed on other occasions. This is done by having a loser look at the history of national reform processes. In addition the paper seeks to determine whether two-tier reforms later led to EPL reforms for permanent jobs.

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Keywords: employment protection, two-tier reforms, political economy.

Wolfgang Ochel
Ifo Institute for Economic Research
at the University of Munich
Poschingerstr. 5
81679 Munich
Germany
Ochel@ifo.de

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1 Introduction

In a globalised world structural change is essential if Europe is to preserve its competitive edge and reduce its unemployment. A major obstacle to structural change is employment protection. According to the OECD, the summary indicator of the strictness of employment protection legislation (EPL) is relatively high in European countries, with the exception of the United Kingdom, Ireland, Switzerland and Denmark.

During the last one and a half decades, reforms of EPL have taken place in some European countries. Governments, however, have pursued a highly selective approach. They have left the existing provisions for permanent (or regular) contracts practically unaltered (with the exception of Spain) and relaxed only EPL for temporary jobs. Politicians hesitate to implement reforms of EPL for permanent jobs because of the resistance of their holders.

To avoid conflicts with key constituencies, governments introduce reforms at the margin of the core labour market. They ease firms' recourse to temporary forms of employment while keeping the institutional arrangements for incumbent workers virtually intact. They pursue a two-tier reform strategy, "which consists of buying the support of incumbent employees by granting that the new arrangements will only apply to new contracts, not to them" (Saint-Paul 2000, 227). In the long run this strategy may, however, lead to a growing share of temporary workers in total employment and build up support for subsequent reforms of EPL for permanent workers.

Between 1990 and 2003 two-tier reforms have been implemented in Belgium, Denmark, Germany, Greece, Italy, the Netherlands and Sweden. Spain started its EPL reforms at the margin in 1984 and reformed the core of its labour market in the 1990s. Denmark (on another occasion in 2001) and France tried to reform EPL at the margin but failed. The most prevalent path of reform consisted in facilitating the use of fixed-term contracts (FTCs) and/or hiring workers from temporary work agencies (TWAs).

The paper seeks to show why two-tier reforms of EPL have taken place in some countries and have failed on other occasions. It analyzes the conditions prevailing in countries with implemented reforms and those prevailing in countries with reform failures.

This is done by having a loser look at the history of national reform processes. In addition the paper seeks to determine whether two-tier reforms later led to EPL reforms for permanent jobs.

2 Employment protection reforms since 1990

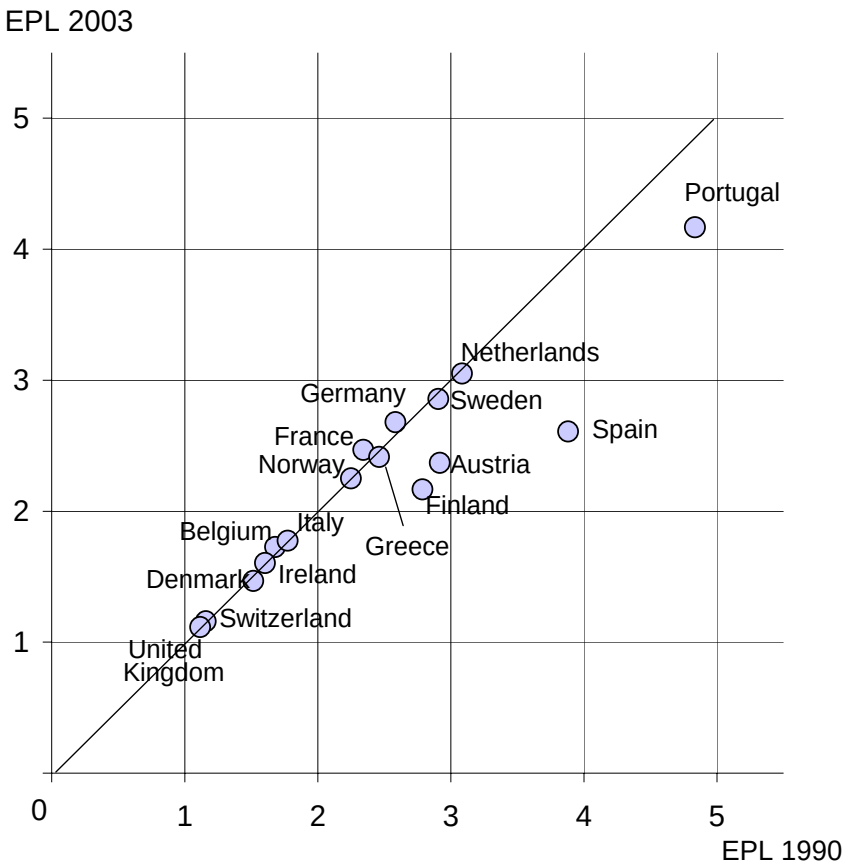
According to the OECD, the summary indicators of the strictness of EPL are much higher in continental European countries[1] than in English-speaking OECD countries, with higher scores representing stricter regulation. This is true for version 1 of the OECD summary indicators, which refers to EPL for regular and temporary jobs, as well as for version 2, which in addition includes the regulation of collective dismissals (OECD 2004, 117). The only exceptions are Switzerland and Denmark, which have a liberal EPL, comparable to the English speaking OECD countries.

Since 1990 reforms of EPL have taken place in several European countries. With the exception of Spain these reforms left, however, the existing regulations for regular contracts practically unaltered because of (potential) political opposition (see Figure 1 left side and Table 1). They focused instead on EPL for temporary forms of employment, because such reforms are not confronted with the opposition of incumbent workers to the same extent. Less strictness of EPL for temporary employment provides greater flexibility at the margin of the core labour market. Because of putting emphasis on only one part of labour contracts, such reforms are called two-tier reforms of EPL. However, the reforms did not take place in all European countries but only in some countries. These countries are - as already mentioned - Belgium, Denmark, Germany, Greece, Italy, the Netherlands and Sweden. In these countries firms' recourse to temporary forms of employment has been eased considerably, whereas EPL for incumbent workers has not been changed to a comparable extent (see Figure 1 right side and Table 1). Spain's reforms of ELP at the margin took place in the 1980s and led to reforms of regular employment in the 1990s.

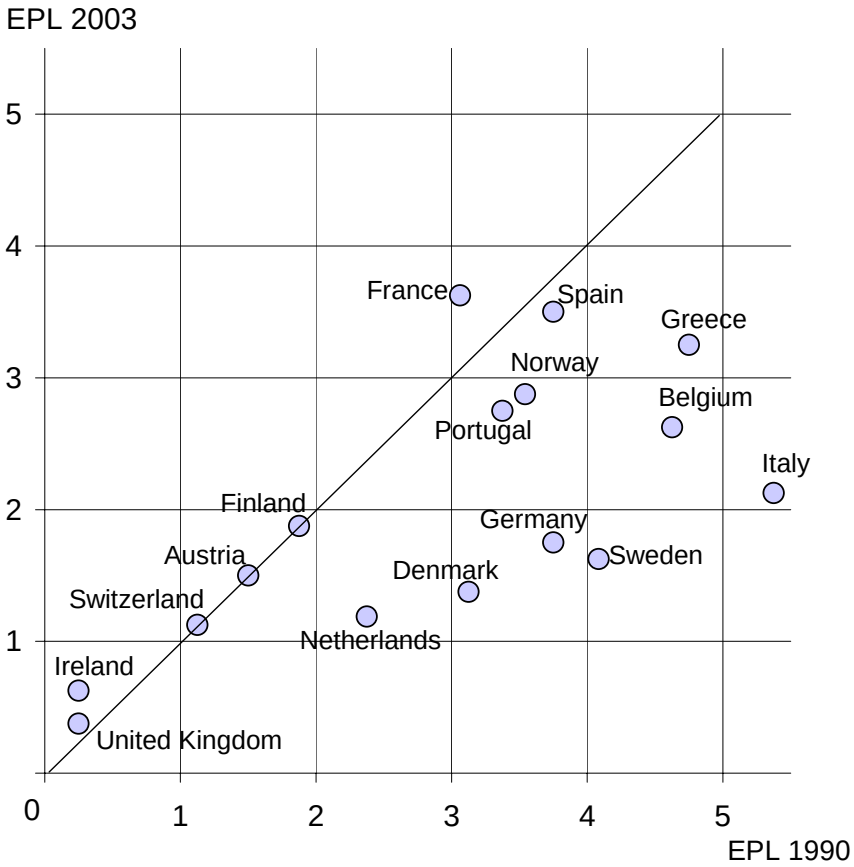
[1] The countries included in our study are Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, the Netherlands, Norway, Portugal, Spain, Sweden, Switzerland and the United Kingdom.

Figure 1 Employment protection regulation, 1990 and 2003

for regular employment



for temporary employment



Source: OECD, Employment Outlook 2004, 117.

Table 1 Changes in the strictness of EPL between 1990 and 2003 [a)]

	Regular employment (1)	Temporary employment (2)	(2) – (1) [b)]
Austria	0.5	0.0	-0.5
Belgium	0.0	2.0	2.0
Denmark	0.0	1.7	1.7
Finland	0.6	0.0	-0.6
France	-0.2	-0.5	-0.3
Germany	-0.1	2.0	2.1
Greece	0.1	1.5	1.4
Ireland	0.0	-0.3	-0.3
Italy	0.0	3.3	3.3
Netherlands	0.0	1.2	1.2
Norway	0.0	0.6	0.6
Portugal	0.5	0.6	0.1
Spain	1.3	0.3	-1.0
Sweden	0.0	2.5	2.5
Switzerland	0.0	0.0	0.0
United Kingdom	-0.2	-0.1	0.1

[a)] Score 1990 – score 2003.

[b)] Reforms at the margin are assumed to have taken place if (2) – (1) is greater than one.

Source: OECD, Employment Outlook 2004, 117; calculations of the author.

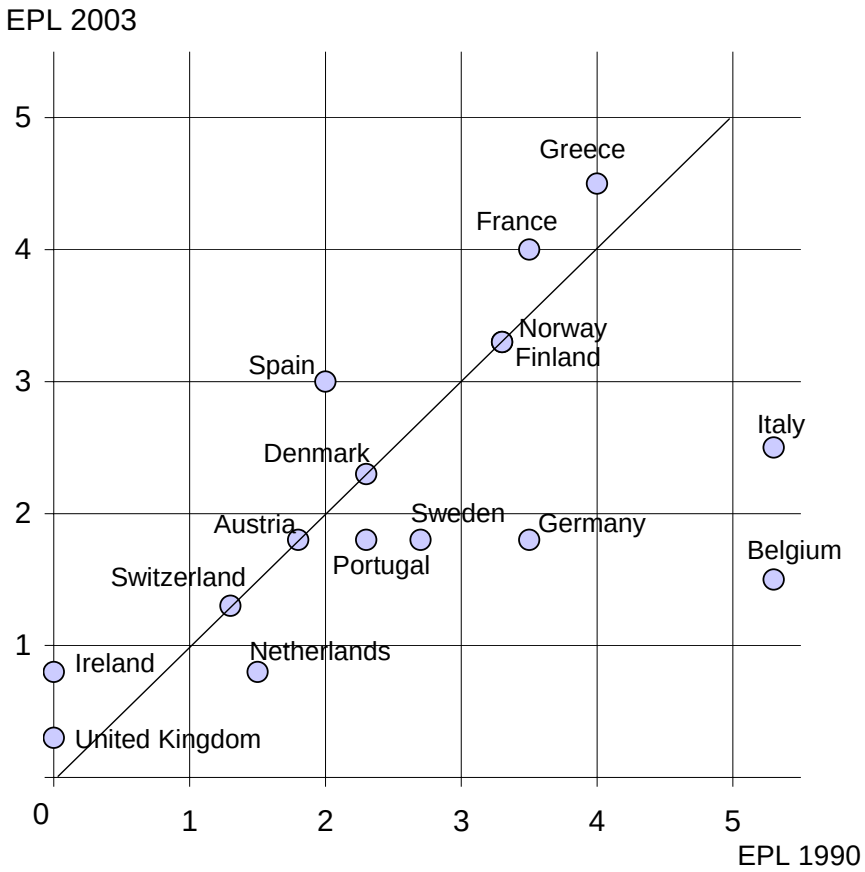
The reforms at the margin provide more leverage in hiring via temporary contracts. They facilitate the use of FTCs or other temporary contracts like hiring workers from TWAs. The countries engaged in two-tier reforms of EPL pursued different strategies (see Figure 2 and Table 2):

- Belgium mainly liberalised FTCs. The main reform took place in 1997.
- Denmark and Greece have put their main focus on making temp workers attractive for hiring firms. Denmark increased the scope of temporary agency work (TAW) in 1995. Greece promoted temporary employment by making the use of TAW easier in 2001.
- Germany, Italy, the Netherlands and Sweden reduced the strictness of EPL for both categories of temporary employment. Germany loosened TWA legislation in 1994

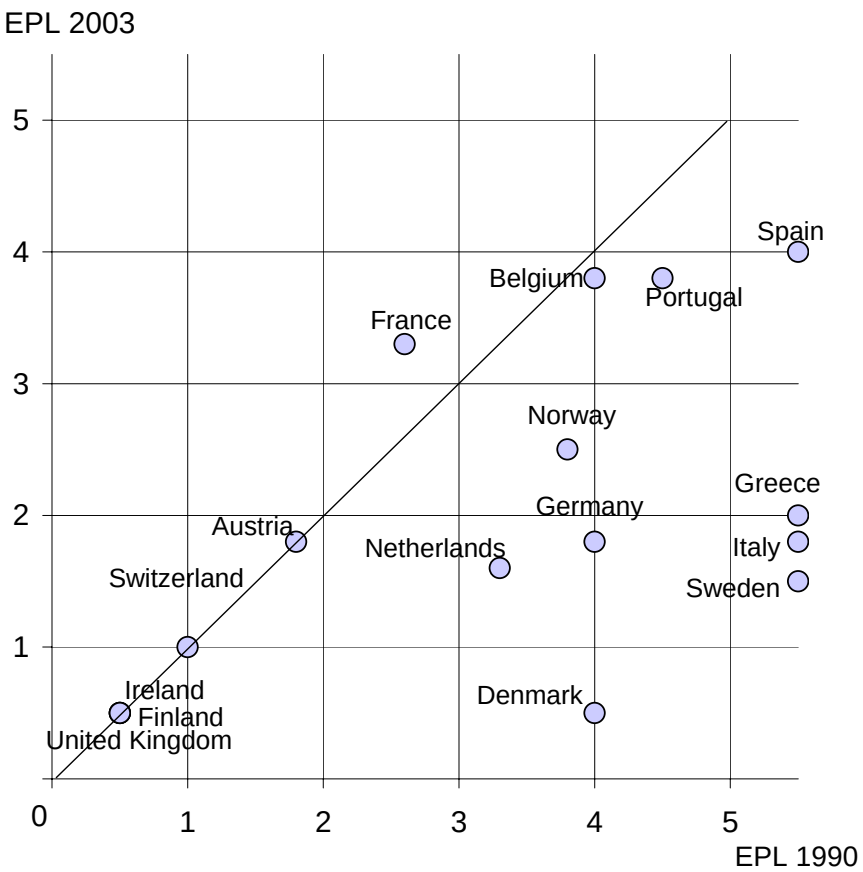
and extended the use of FTCs in 1997. The reforms were continued after 2002 within the bigger reform project “Agenda 2010”. In Italy the “Treu package” enacted in 1997 widened the use of FTCs and legalised TWAs. Later on these forms of temporary work were additionally liberalised. In the Netherlands the flexibility and security law of 1999 allowed two renewals of FTCs in three years and liberalised hiring of employees of TWAs. In 2001 it implemented the EU Directive 1999/70/EC on FTCs. Sweden permitted TWAs in 1993 and extended the scope of FTCs in 1997.

Figure 2 Employment protection regulation, 1990 and 2003

for fixed-term contracts



for temporary work agencies



Source: OECD, Employment Outlook 2004, 115.

Table 2 Reforms of EPL at the margin in Europe, 1990 – 2004

Country	Year	Reform description
Belgium	1997	FTCs became renewable; restrictions on TWAs were reduced.
Denmark	1995	The role of TWAs was recognised by social partners and their scope increased.
Germany	1994	TWA legislation was loosened.
	1997	The renewal period for FTCs and TWA contracts is extended; the maximum cumulative duration of successive FTCs increases from 18 to 24 months; FTCs can be renewed 3 times; the maximum duration of a TWA contract is 12 months.
	2002	Maximum duration of TWA contracts was brought to 24 months.
	2003	Duration of successive FTCs: 4 years (instead of 2 years) for newly created enterprises.
	2004	The restriction on the maximum duration of TWA contracts was abolished.
Greece	2001	Promotion of temporary employment by making the use of TAW easier.
	2003	Regulation of the terms and conditions of FTCs by PD 81/2003 in compliance with the EU Directive 1999/70/EC.
	2004	New restrictions on FTC job protection legislation by PD 180/2004.
Italy	1997	"Treu package" on FTCs widened the number of valid cases for the use of FTCs.
	1998	Legalisation of TWAs.
	2000	Extension of the use of TAW; restrictions concerning unskilled workers removed.
	2001	Decree no.368/2001 reduced constraints imposed on FTCs; it removed the list of circumstances in which the use of FTCs is legal.
	2003	Extension of the use of TAW.
Netherlands	1999	Flexibility and security law: A maximum of two renewals in three years is allowed; similar rules apply for employees of TWAs.
	2001	Implementation of the EU Directive 1999/70/EC on FTCs.
Sweden	1993	TWAs were permitted.
	1997	12 months FTCs available without restrictions; all enterprises are allowed up to five persons under such contracts; FTCs can be prolonged up to 18 months.

FTC: Fixed-term contract;
TAW: Temporary agency work;
TWA: Temporary work agency.

Sources: Fondazione Rodolfo Debenedetti Social Reforms Database; OECD, Employment Outlook 2004, 119-120; OECD Employment statistics database, synthetic indicators of employment protection indicators, a time series of EPL changes (1985-2003); Eiro, different country reports.

3 The political economy of EPL reforms: Some ideas

The theoretical literature analysing EPL reforms is rooted in the political economic literature and in the theory of institutions. An encompassing methodology of analysis has not yet been developed. As we will show the prediction of the theoretical literature on the driving forces of EPL reforms is ambiguous. According to the literature interest groups, politicians (incl. governments), political institutions and political strategies have to be taken into account when analyzing the political economy of EPL reforms (see for example Castanheira et al. 2006)

Interest groups try to influence policy decisions by voting, lobbying and demonstrating. The main interest groups in the case of EPL are the incumbent employees and their unions who want to protect their jobs by a strict EPL. The resistance of incumbent workers to EPL reforms is a function of the economic rents they fear to lose. The standard prediction is that when the amount of rents that can be appropriated is large and concentrated workers will better organize themselves and are more determined to oppose EPL reforms.

Economic rents are the difference between the employee's wage and his alternative wage which may be his unemployment benefit. Rents arise because of microeconomic frictions that prevent wages from adjusting and because of the existence of labour market institutions such as EPL. A strict EPL improves the bargaining position of insiders because they need not expect to lose their jobs with rising wages (Saint-Paul 2000, 2 and chap.1). EPL creates an own constituency by maintaining a fraction of the workforce in employment which resists EPL reforms. This "constituency effect" thus generates a status-quo bias of EPL (Saint-Paul 2000, 12).

Apart from fearing to lose rents incumbent workers might oppose EPL reforms because of uncertainty about the reform effect. If gainers and losers cannot be identified beforehand, there might be a bias against an EPL reform. All incumbent employees may oppose a reduction of employment protection, although only workers in unproductive jobs would be affected by the reform (OECD 2006, 195).

Whereas employed workers fear being negatively affected by a reduction of the strictness of employment protection, the unemployed stand to benefit. Their chances of finding a job would increase. But workers have a higher propensity to dominate political decisions. They are politically much stronger than the unemployed (Fernandez and Rodrik 1992, 1146).

Strong *governments* can overcome the resistance of incumbent workers to EPL reforms. The strength of government is related to the number of independent branches of government (executive and legislative branches), the party composition of these branches, the role of the 'judiciary' and 'sub-federal entities' as players in the political system, etc. (Henisz 2000). One determinant of the strength of government is the voting system which governs the party composition of government. According to conventional wisdom, majority voting systems provide more leeway to the politicians in designing EPL reforms than proportional representation. Broad coalition governments are considered to be an obstacle to reform. They tend to paralyze decision-making, due to hold-up power of some groups (Alesina and Drazen 1992). This opinion, however, has been questioned. Pagano and Volpin (2005) have found that the proportionality of the voting system is positively correlated with employment protection.

In addition to the characteristics of the political system the share of control of some areas of economic policy between government and social partners reduces the power of politicians to implement reforms independently. The concertation of policies amongst social partners and state actors (corporatism) has developed historically mainly in the Scandinavian countries, the Netherlands and Austria, but also in other European countries. It is part of their economic culture. Successful concertation is built on three pillars: Interest groups should have a strong representation, the interest organisations should be integrated into the process of policy formation and implementation by government and the strategies and actions of the actors should be directed towards coordination (Jochem 2003).

Policy-makers can overcome insider resistance to EPL reforms by following different *strategies*. They can implement a reform package including reforms that are complementary to EPL reforms. This package can offer compensating transfers to losers from the reform. Or they may introduce EPL reforms at the margin to reduce opposition from incumbent workers (OECD 2006, 196-200).

When *making use of policy complementarities* a reform of one institution creates political support for the reform of another institution (Saint-Paul 2004). Lower dismissal protection may be less worrying to insiders if unemployment benefits become more generous. Furthermore, reforms in related policy areas may cause mutually reinforcing effects on labour market dynamics. Positive economic complementarities increase the prospects of success of EPL reforms (Orzag and Snower 1999; Eichhorst and Konle-Seidl 2005).

Compensating transfers, however, can be difficult to enact. They must be financed by collecting revenues. Furthermore, losers from EPL reforms and their (different) losses

have to be identified. Given the problem of asymmetric information it will be difficult to provide adequate transfers. The cost of compensations will be higher than in the absence of imperfect information. And finally commitment power of decision-makers may be weak. Government coalitions in power today cannot commit future coalitions to continue their policy. Without a credible commitment governments will not be able to secure the political acceptance of EPL reforms by the losers (Roland 2002).

EPL reforms at the margin can overcome the status quo bias of EPL for permanent jobs. Incumbent workers are not directly affected by the reform and potentially they are made better off indirectly. According to the model developed by Saint-Paul (2000, 227-253) they can earn a higher wage because labour market tightness increases due to the higher demand for temporary jobs. And if they lose their job they will benefit from the greater job finding probabilities of the unemployed. Whereas incumbent workers seem to benefit from two-tier EPL reforms incumbent firms do not. They must pay higher wages and compete on unequal terms with new entrants who face fewer restrictions concerning dismissals.

In principle, incumbent workers should be in favour of two-tier EPL reforms but often they are not. Two-tier reforms gradually build up a stock of workers with temporary contracts. These workers have different interests than those who hold a fixed contract. They can be used as a "political constituency" (Saint-Paul 2004, 16) to support subsequent reforms of core labour market EPL that the government from the beginning may have intended to achieve. They must however be numerous enough to exert political power. The incumbent workers may recognise that two-tier systems could perhaps be used as an intermediate step towards a complete EPL reform that they are not in favour of. This may lead to a rejection of the reform (Saint-Paul 1996, chap. 11; Dewatripont and Roland 1992).

In order to smooth out the objections against two-tier EPL reforms being just an intermediate step towards a complete liberalisation of the labour market a conversion clause could be embodied in the reform. According to this clause temporary employment cannot go on indefinitely but only for a limited duration. Afterwards workers have to be offered a regular job (Saint-Paul 1996, chap. 11). The introduction of such a conversion clause would slow down the flexibilisation of the labour market.

Apart from reducing the resistance of incumbent workers to EPL reforms partial reforms - compared to full EPL reforms – have advantages and disadvantages. On the one hand they are less costly in terms of compensating transfers, they lower the costs of experimenting with EPL reforms and can be reversed more easily. On the other hand they

yield less efficiency gains, provide less learning about the consequences of EPL reforms and are faced with many of the problems of implementing an EPL reform for a regular job (Roland 2002).

4 EPL reforms at the margin

Denmark

Denmark is an exception among European countries insofar as dismissal rules in 1990 have been quite flexible. EPL for regular jobs was low. Only hiring workers from TWAs was severely restricted. That is why an EPL reform aiming at a reduction of the strictness of employment protection could only focus on the use of TAW and cannot be characterized as a two-tier reform in the strict sense. In 1990 the legislation on establishment and operation of TWAs was liberalised. More employment categories were allowed to use TAWs. The restrictions on the number of contract renewals were abolished and upper limits as to how long one can be employed on temporary work contracts no longer exist (Andersen and Svarer 2007, 405). Since 1995 the role of TWAs has been recognized by social partners and their scope increased. For example, the Danish Trade Union for Nurses accepted the role of TWAs in the health care sector and has entered into collective agreements with TWAs (European Foundation for the Improvement of Living and Working Conditions 2002, 26).

The OECD considers the second reform step – increasing the scope of liberalized TWAs - to be the more important one. This makes labour markets more flexible, and it also activates the unemployed and increases their employability by assigning them to client firms. The TWA reform is thus part of the package of reforms that started in 1994. These reforms sought to shift the focus from a rather passive labour market policy to a more active one. The policy tightened eligibility for unemployment benefits and their duration and introduced workfare elements into social policy. A more activating approach was adopted (Andersen and Svarer 2007, 391).

How was it possible to implement the 1994-1999 reform? First of all the reform was stimulated by high unemployment. Between 1987 and 1993 registered unemployment increased, reaching a high of 12 percent in 1993 and in 1994 (Andersen and Svarer 2007, 392). The rise in unemployment was partly due to the flexicurity system with its high net replacement rates of unemployment benefits, their long duration and soft eligibility criteria. The incentives to search for and accept a job had become insufficient.

Furthermore, the increase in unemployment was associated with a rising transfer burden on public finances. The financial constraints on government exerted pressure to reform the unemployment benefit system and to activate the unemployed. The latter aspect of the reform responded, moreover, to the increased uncertainty of the unemployed to find a new job.

The reform would not have been possible, however, without the approval of the social partners. This approval was given because the level of gross unemployment benefit replacement rates had been increasing at the time (see OECD summary measure of benefit entitlements). High unemployment benefits in Denmark are considered to be an indispensable complement to labour market flexibility. The government tried to avoid the negative employment effects of high replacement rates by putting greater emphasis on activating the unemployed and increasing their employability. TAW was considered as a useful instrument of activation, which at the same time leads to a further increase of labour market flexibility. Liberalising the use of TAW and increasing their scope were in line with the philosophy of the social partners. They just tried to influence the working and social conditions of TWA workers by collective agreements. The approval was, furthermore, the result of an intensive social dialogue at that time, which was in line with the tradition present among social partners in Denmark since the late nineteenth century. This dialogue included the government, the social partners and policy communities at the regional level. Governments in Denmark need this dialogue because they generally represent a coalition between minority partners and have to find support from different social groups (Larsen 2004).

Sweden

Contrary to Denmark, EPL in Sweden at the beginning of the 1990s was rather strict. It was comparable to continental European countries. Up to 2003 no major attempt was made to reduce the strictness of EPL for regular employment. Instead the main focus was put on EPL reforms at the margin.

In 1993 TAW was allowed by law. The new legislation was very liberal. Practically no regulation of either the TWA business itself or of temporary work assignments was enacted. As a result legal treatment of agency work was among the least interventionist in the European Union (Storrie 2002).

In 1997 regulation of FTCs was liberalised. All enterprises were allowed to employ up to five persons on an FTC for 12 months (during a three year period) without any restrictions, that is to say, without any need to specify a particular reason for employment,

as before. The period could be extended up to 18 months if the firm was newly established. The new law also addressed the issue of repeated contracts of fixed duration for leave replacements. It stated that if a leave replacement was employed for a total duration of three years during a five-year period, then the contract would become open-ended. A third element of the law was the opportunity to bargain on derogations from statutory law regarding FTCs at the local and not, as before, only at the national level (Holmlund and Storrie 2002).

The 1993 TWA reform was induced by the growth of unemployment at the beginning of the 1990s. The standardised unemployment rate increased from 1.7 percent in 1990 to 9.1 percent in 2003 (OECD 1999, 224). The reform was enacted by a coalition government led by the conservative party. The law was not the result of a tripartite agreement. Corporatism in Sweden had been in a crisis at that time (Jochem 2003). The reform was instead promoted unilaterally by the conservative government. It was not very controversial and did not significantly enter the public debate. The unions did not oppose the reform. It did not negatively affect incumbent workers. On the contrary, as unemployment had increased in Sweden in the early 1990s, workers feared losing their jobs and could possibly benefit from the greater job finding probabilities of the unemployed as a result of this two-tier EPL reform. The unions were, however, eager to establish acceptable working conditions by means of collective agreements (Storrie 2002, 16).

The conditions for the realisation of the FTC reform in 1997 were quite similar to those of the 1993 reform with the exception of the Social Democrats being in power again. The acceptance of that reform was increased by including a conversion clause.

Netherlands

Regarding employment protection for regular jobs, in the beginning of the 1990s the Netherlands had one of the most restrictive systems in Europe. Flexibility at the margin of the labour market was, however, higher than at its core. In the 1990s public policy increased the duality of the labour market. In 1998 and in 1999 two major reforms became effective.

The Law on the Allocation of Workers through Intermediaries (WAADI) of 1998 abolished rigid rules for TWAs. Agencies no longer needed a license and could assign workers to client firms in all sectors. There was no longer a maximum period for assignment. Agency workers could obtain a permanent contract with the agency and became eligible for fringe benefits (Camps 2004; Van Oorschot 2004).

The Flexibility and Security Act of 1999 made it somewhat easier for firms to use temporary employment contracts. The possibilities to renew a temporary contract increased substantially. An employer could offer an employee a temporary contract for three times, within a period of three years. In return, the Act aimed at increasing the prospect of a permanent contract for temporary workers. If the maximum period between the temporary contracts was less than three months, the fourth contract automatically became a permanent contract. Moreover, if the duration of consecutive temporary contracts exceeded 36 months, the contract automatically converted into a permanent contract. The Flexibility and Security Act thus contained a conversion clause (Camps 2004; Deelen, Jongen and Visser 2006).

The Dutch EPL reforms of 1998 and 1999 were formulated and implemented in the traditional framework characterized by strong social partnership. In the mid-1990s, the Cabinet submitted the proposal of the Flexibility and Security Act to the social partners for consultation. The Labour Foundation was asked for its advice and formulated recommendations known as the “Star Agreement”. This agreement represented a consensus of the social partners for adapting labour law. The Cabinet accepted the Labour Foundation’s advice virtually unchanged (Camps 2004).

The consensus between the social partners was reached because EPL reforms did not deteriorate the position of the incumbent employees and because the strictness of EPL at the margin was reduced only moderately. Moreover, the reforms contained a conversion clause in order to prevent an erosion of the core labour market. In addition, the reforms were composed of a package deal that provided compensation for accepting higher flexibility by raising employment security of flexible jobs and by providing higher benefits and training. Flexibility was combined with a careful balance of rights and obligations for employers and employees. The pragmatic tripartite decision-making was also supported by the strong position of expert committees (Eichhorst and Konle-Seidl 2005; Hemerijck 2003).

Germany

EPL in Germany is characterized by a high strictness of dismissal protection for regular contracts. Since 1990 no major reform took place in this field. Reforms only addressed the firm size threshold and the range of social selection criteria. Temporary employment was heavily restricted at the beginning of the 1990s too. Two-tier EPL reforms did, however, take place during the last 15 years. They adressed liberalisation of the use of FTCs and of TAW.

FTCs were first liberalised under the Kohl government in 1997. The maximum period of FTCs was increased from 18 to 24 months. After two years an individual could not be employed any longer on a temporary basis without valid reasons. In 2003 the SPD-Green coalition allowed the use of FTCs up to four years for newly created enterprises after their start-up. Deviations through collective agreements were, however, possible.

TWAs have been severely restricted in the past. TWA workers could be assigned only for a limited time. The assignment period was extended stepwise from nine months in 1994 to 12 months in 1997 and to 24 months in 2002. In 2004 the limit was completely abolished (Table 2). The most recent changes implemented as part of the Hartz reforms removed nearly all remaining restrictions. At the same time the equal treatment of agency workers and of the regular staff of hiring firms was established, unless collective agreements regulated wages of TWA employees (Ebbinghaus and Eichhorst 2006).

A reduction of the strictness of EPL for regular employment was seen as politically unfeasible because insiders of the core labour market defended by unions resisted deregulatory reforms. In Germany insiders have a strong position in politics through the workers wings in the Social-Democratic and Christian-Democratic parties, through influencing the results of elections and through their strong role in the field of industrial relations. German governments, which are relatively weak due to the necessity of forming coalition governments and of joint decision taking with the Federal Council, were not able to overcome this resistance. Furthermore, the two major political parties, the Christian Democrats and the Social democrats, did not advocate a fundamental EPL reform of the core employment relations. As the institutional prerequisites for tripartite negotiations were lacking, tripartite agreements could also not mobilise reforms of the core labour market. The little impact of tripartite negotiations was demonstrated by the “Alliance for Jobs, Vocational Training and Competitiveness” initiated in the late 1990s by the SPD-Green coalition. In contrast to Denmark und the Netherlands, Germany was not able to address the need to reform via social pacts (Ebbinghaus and Eichhorst 2006; Streeck 2003).

EPL reforms at the margin that do not call into question the labour market positions of insiders have been a feasible option for the German political system. They were at least a modest attempt to fight unemployment, which had risen because of structural adjustments in the course of German unification. But even the partial reforms were not easy to undertake. The modest reforms of the Kohl government in the mid-1990s were accused by the Social Democrates in the election campaign of 1998 of being socially unjust. The Hartz reforms und the subsequent “Agenda 2010”, which were implemented by the strong leadership of chancellor Schröder and his SPD-Green coalition after 2002 were

also difficult to implement. The complete liberalisation of TWAs had to be complemented by passing a law on the above-mentioned equal treatment of TWA workers and the regular employees in order to weaken the position of the TWAs. Nevertheless, resistance to this reform and to the other "Agenda 2010" reforms was great and led to a loss of electoral support of the Schröder coalition in 2005. The positive effects of the "Agenda 2010" were not yet visible at that time.

Italy

For a long time open-ended employment has been the standard contract in Italy. The strictness of EPL for regular jobs is high and has not yet been reduced. Temporary employment relationships were stringently regulated. Few activities were allowed to use temporary employment (Bertola and Garibaldi 2002, Box 3). Only since the mid-1990s have major steps towards the liberalisation of temporary employment been made.

The reform process was initiated in 1997 by the "Treu Law", named after then Labour Minister Tiziano Treu. Further steps aimed at creating a more flexible labour market at the margin were made up to 2003. The reforms focused on the liberalisation of FTCs as well as on TWAs.

FTCs were traditionally limited to few objective situations. In 1987, collective agreements were allowed to extend the use of FTCs, specifying target groups (youth and unemployed), motivations and employment shares. The statutory regulation concerning the utilisation and renewal of FTCs remained strict, however. FTCs could be extended only once and for a period shorter than the initial relationship. Otherwise the contract would have converted into a permanent one (Nannicini 2004). The "Treu Law" reduced the application of drastic sanctions in case of violation of FTCs' discipline and limited them to serious cases. Moreover, the number of applicable cases for the use of FTCs was widened. In 2001 the EU Directive on FTCs was implemented through a joint statement by two of the three major Italian trade union confederations. Decree 368 reduced the constraints formally imposed on FTCs. In particular, it removed the explicit list of circumstances in which the use of FTCs is legal (Table 2).

In addition to FTCs the "Treu law" legalised and regulated TWAs. It stated that TAW employment is allowed in all but the following cases: Lowest positions of the job ladder, replacement of workers on strike, firms that experienced collective dismissals in the previous 12 months, jobs that require medical vigilance. The budget law of 2000 ruled out the prohibition of TWAs for the lowest position of the job ladder. In 2003 the use of

TWA contracts was extended even more. The “Treu Law” does not set a maximum duration of assignments or legal motivations for using TWA workers (Nannicini 2004).

The provision of further regulation was left to collective bargaining. Collective agreements have typically stipulated that temporary workers cannot exceed 8 to 15 percent of normal employees (depending on the sector). Moreover, they have constrained the allowed motivations for using TAW: peak activity, one-off work and skills not available within the firm. Firms cannot extend an individual TWA contract more than four times for a cumulated period longer than 24 months (Ichino, Mealli and Nannicini 2005).

Up to the mid-1990s the strictness of EPL had hardly been reduced. The economic crisis of the early 1990s and the sharp rise in unemployment (Bertola and Garibaldi 2002) made an EPL reform urgent, however. Traditionally economic reforms in Italy are the result of tripartite negotiations between government, the strong employers’ association Confindustria and the trade union confederations CGIL, CISL and UIL. From April 1993 to the end of 2000, social partners have been confronted with seven different governments which were not strong enough to overcome the resistance of labour unions to reform EPL for regular jobs. Government was lacking continuity and credibility for a concerted fundamental reform (Negrelli 2000). Only an EPL reform at the margin that would not directly touch the interests of the incumbent workers was feasible. But although the liberalisation of TWAs was accompanied by a considerable rise of unemployment benefits between 1997 and 1999 (see OECD summary measure of unemployment entitlements), it was strongly debated.

The framework for political reforms changed with Berlusconi coming to power in June 2001. A concerted social policy, which implies that government, employers’ organisation and trade unions share responsibility in regulating economic and social policies, was replaced by social dialogue. This meant that government maintained its autonomy and restricted the influence of unions to merely participating in consultations (Puligano 2003).

Belgium

In 1990 EPL for regular employment was not very strict in Belgium, whereas the use of temporary employment contracts was highly restricted. During the last 15 years, however, FTCs have been liberalised, whereas the regulation of TAW has been broadly left unchanged since 1987.

Up to 1997 successive FTCs could be concluded if objectives reasons, such as the nature of work, were given. The reforms during the 1990s have made recourse to successive FTCs possible also under the following conditions: Four successive FTCs, each of which must be of at least three months duration, can be concluded during a maximum period of two years. Six successive FTCs, each of at least six months duration, can be concluded during a maximum period of three years with the authorisation of the social and labour inspectorate (Blanpain 2007).

The legal basis for the regulation of TWAs in Belgium is provided by the law on TWA of 24 July 1987. Assignments of TWA workers are only justified by objective reasons and prohibited in certain sectors. The maximum duration of an assignment is six months with one possible extension. Since 2000 long-term unemployed can be assigned on open-ended contracts (Arrowsmith 2006, 15-16).

Greece

At the beginning of the 1990s the Greek EPL of regular employment was characterised by a medium level of strictness, whereas the use of temporary employment contracts was highly restricted. During the last 15 years EPL of regular employment has not been liberalised. The legislation of FTCs has been reformed without reducing its strictness. Only the use of TAW has been legalised and at the same time liberalised.

Up to 2003 FTCs were conditional on objective reasons with the exception of public service. In 2003 the EU Directive on fixed-term work was implemented without any major modifications of the Directive (Soumeli 2003). In 2004 new restrictions on the use of FTCs were imposed by Presidential Decree 180/2004 (FRDB Social Reform Database).

In 2001 a regulatory framework was established for the use of TAW. The new legislation for the first time laid down specific rules for TWAs. They focussed on the usual fields of regulation (Soumeli 2001). According to the OECD (2004) the use of TWA workers has been made easier by the new legislation.

Spain

Inherited from the Franco era at the beginning of the 1980s the system of individual dismissal protection was very restrictive in Spain. In 1984, when the unemployment rate was 20.1 percent, the socialist government liberalised FTCs, while the protection of permanent contracts was kept. The use of FTCs for regular activities was eased considerably. FTCs could be created up to a maximum duration of three years. The termination of FTCs could not be appealed to labour courts. Little or no termination compensation was offered to workers. As a result the firing costs of FTCs were much lower than the firing costs of permanent employment contracts.

EPL reforms in Spain are normally negotiated in trilateral talks by government, employers and trade unions. Liberalisation of FTCs in 1984 was the result of very high unemployment, the low prospects of the unemployed to find a job and the increase of unemployment benefits, which forced the unions to make concessions. As a result of the reform a major portion of new hires were under FTCs (Dolado, Garcia-Serrano and Jimeno 2002).

5 Reform failures

Denmark

An example of a reform failure is the 2001 attempt of the Conservative government to reduce the costs of the unemployment benefit system, which is considered in Denmark as a complement of a flexible labour market. Hoping that the momentum of the successful 1994-1999 reform would facilitate their acceptance and implementation, the government submitted the following reform proposals: (1) only people working less than 21 hours a week (instead of 28) should be entitled to unemployment benefits; (2) temporary agency workers etc. should no longer receive extra benefits on a permanent basis and a maximum of 52 weeks' benefit should apply to all employees; (3) employees with a monthly wage of more than €3360 should have their first benefit postponed; (4) the benefit rate should be based on the average salary over the past six months (instead of three) (Castanheira et al. 2006, 185-186). Because of strong opposition from the employers' organisation and two out of three labour unions, the government withdrew the

project in 2003. In 2004 the government tried again to reduce the level of unemployment benefits but again had to withdraw the proposals.

The reform failure was due to mainly two factors. The government did not include the employers' organisation and the labour unions in the preparation of the reforms. It did not make use of the consensus-creating institutions in labour market policy, the corporatist steering arrangements, which are typical for Denmark. Furthermore, the government did not acknowledge that the intended reform would have altered the existing social pact. Especially labour unions in Denmark take it for granted that higher unemployment benefits have to offset higher labour market flexibility. Low unemployment benefits and high labour market flexibility are considered to be exclusive. Labour market reforms must take into account policy complementarities if they don't want to fail (Larsen 2004).

France

Another example of a reform failure is the 2006 attempt of the Conservative Government to enact the "Contrat Premiere Embauche" (CPE). In France, a country with a high level of EPL, reducing dismissal protection for regular employment is hardly possible. That is why government tried to promote flexibility at the margin of the labour market. In 2005, the "Contrat Nouvelle Embauche" (CNE) was enacted. It aimed at bringing flexibility to small companies by allowing employers to fire at will during the first two years of employment. In 2006, the government tried to apply the idea of the CNE to all young employees under 26. The CPE was very unpopular. It met with heavy resistance from students, all trade unions, the left-wing political parties and some centrist opponents. On April 10, 2006 the French government decided to withdraw the CPE.

Why did the French government fail to pass the CPE? The French government is strong in institutional terms (Levy 2005), but it was not supported much by the centre-right and by the left parties, which are not advocates of "neo-liberal" reforms. Furthermore its relations with unions, student and public employees are tense and prone to conflict (Eichhorst 2007). The government did not include the social partners and the students sufficiently in the preparation of the CPE. It was convinced that the previous CNE would facilitate the passage of the CPE. The government was surprised by the most significant public unrest since 1968. Negotiations with labour unions and students demonstrating in the streets proved to be impossible. In order to avoid defeat in the next elections, the government rescinded the CPE.

6 Comparative analysis: How to gain political support for two-tier EPL reforms

Since 1990 the strictness of EPL for regular jobs has not been reduced in the EU-15 with the exception of the 1994 and 1997 reforms in Spain. The resistance of incumbent workers to reform attempts has been strong and governments have preferred to avoid conflicts with unions. An increase in unemployment did not support EPL reforms of the core labour market because workers tried to protect their jobs.

EPL reforms at the margin have, however, been implemented in some countries. A rise of unemployment helped bring about this kind of reform. The unemployed were aware of the increase of their job finding probabilities. And the incumbent workers were convinced to win too.

Apart from the socioeconomic conditions reforms at the margin have only been realized if governments took into account the specific reform conditions prevailing in their countries: the interests of the public and of the social partners and the characteristics of the decision making processes of governments. In countries with relatively weak governments and strong social partners, governments had to come to an agreement with the social partners in order to implement reforms. A social dialogue had to precede negotiations within government and parliament. Governments in Denmark, generally representing a coalition between minority partners, used this dialogue in order to gain support from different social groups for their 1994-1999 reforms. The Dutch EPL reforms of 1998 and 1999 were formulated in the traditional framework too, seeking for a consensus with the social partners. The relatively weak governments in Italy and in Germany in the 1990s tried to find support of the unions for their EPL reforms at the margin. It proved, however, to be difficult to come to an agreement.

Governments that are relatively strong can overcome the resistance of social groups against EPL reforms more easily. The 1993 and 1997 reforms in Sweden had been promoted unilaterally by government because corporatism had been in a crisis at that time. The Hartz reforms and the subsequent “Agenda 2010” in Germany were implemented by the strong leadership of Chancellor Schröder, although resistance to these reforms was high. The Berlusconi government, coming into power in June 2001, was able to extend the use of TWA with the unions playing only a subordinate role in consultations.

If the preconditions for a successful implementation of reforms are not complied with, reform proposals fail. This has been the case in Denmark with the 2001 attempt to reduce unemployment benefits, which are considered as a complement to a flexible labour market. The government did not include the social partners into the preparation of the

reforms, a procedure which is untypical in Denmark. Because of strong opposition, the government had to withdraw the project. The same was true in France where government did not include the unions and the students in the preparation of the "Contrat Premiere Embauche" (CPE). Powerful demonstrations forced the government to withdraw the CPE.

Apart from taking into account the prevailing reform conditions, government can overcome the resistance against EPL reforms by offering compensations. In Denmark the liberalisation of the use of TAW was accepted by the unions because government increased the already high level of unemployment benefits. In the Netherlands the liberalisation of TWAs was made acceptable by providing higher unemployment benefits and training for workers with temporary contracts. In Italy and Spain unemployment benefits have been increased too. In Germany the liberalisation of the use of TWA workers was complemented by a law on the equal treatment of TAW and regular work.

Resistance against two-tier reforms may result from incumbent workers' fear that an increase of the proportion of temporary workers may lead to an EPL reform of regular workers, which they do not favour. In order to overcome these objections, a conversion clause can be embodied in the reform. This clause transforms temporary contracts into permanent contracts under certain conditions and thus limits the increase of temporary contracts. Conversion clauses played a role in the Netherlands' 1999 reform and in Sweden's 1997 reform.

7 Induced reform of EPL of regular employment

The main idea of two-tier reforms of EPL is as follows. To avoid conflicts with incumbent workers, governments introduce EPL reforms at the margin. The existing dismissal protection of incumbent workers is kept. This approach reinforces labour market duality. The proportion of temporary workers in total employment increases. With a greater part of the labour force in unstable jobs, the political constellations change. Support for subsequent reforms of core labour market EPL may gradually build up.

A precondition for this to function is an increase in the proportion of temporary workers in total employment. The European Community Labour Force Survey provides information on FTC employment but excludes TWA employment and other types of temporary employment. Table 3 shows that the liberalisation of the use of FTCs resulted in an increase of the proportion of FTC employment in total employment. This increase started

in 1997 in Belgium, Germany, Italy and Sweden and in 1984 in Spain. Only in the Netherlands has FTC employment increased (since the first half of the 1990s) without any major previous reform. In all the countries the proportion of FTC employment in total employment did not surpass 16 percent. Only in Spain did this proportion surge rapidly in the second half of the 1980s, staying above 30 percent since 1990. Adding TWA employment does not lead to a substantial increase of temporary employment compared to FTC employment, as the number of TWA workers is relatively low (Table 4).

Table 3 Employment on fixed-term contracts as % of total employment

	1985	1990	1995	2000	2005
Belgium	6.9	5.3	5.3	9.1	8.9
Denmark	12.3	10.8	12.1	9.7	9.8
Germany	10.0 a)	10.5 a)	10.4	12.7	14.1
Greece	21.1	16.5	10.2	13.5	11.8
Italy	4.8	5.2	7.2	10.1	12.3
Netherlands	7.5	7.6	11.4	13.7	15.5
Spain	15.6	29.8	35.0	32.2	33.3
Sweden	11.9	10.0	12.5	15.8	16.0
EU-15	8.4 a)	10.4 a)	11.5	13.7	14.4

a) Excl. the new German Länder.

Source: EU, Employment in Europe, var. vol.

Table 4 Temporary agency workers as % of total employment

	1999	2004
Belgium	1.6	2.2
Denmark	0.7	0.3
Germany	0.7	1.2
Greece	0.0	…
Italy	0.2	0.6
Netherlands	4.0	2.5
Spain	0.8	0.8
Sweden	0.8	1.0
EU-15	1.4	…

Sources: Column 1: Storrie (2002, 28); Column 2: Arrowsmith (2006, 6).

The increase of temporary employment did not result in EPL reforms of regular employment with the exception of Spain. In the majority of the countries, the proportion of temporary employment in total employment was presumably too small to change the political environment for EPL reforms. In Spain, however, EPL reforms of the core labour market took place in 1994 and in 1997, although the reforms were opposed by the unions since their members felt threatened by the massive dismissals during the serious recession between 1992 and 1994. But the resistance of the unions was not strong enough.

Dolado and Jimeno (2004) provide the following explanation for the implementation of the 1994 and 1997 reforms. Due to the growing number of temporary workers, the share of regular workers in the total active population had dropped below 50 percent in 1994. The median voter was no longer a regular worker but rather a temporary or an unemployed person, a fact which might have influenced the decision of the government. This fact may also account for the relatively low resistance of the unions (representing first of all the incumbent workers) towards reforms that increase the chances of temporary workers and unemployed persons to obtain a regular job and lower job security of the incumbent workers. The 1984 reform had thus created the conditions for the reform of regular contracts ten years later. The low resistance of the unions may have also been due to the government offering compensations, such as providing higher unemployment benefits, additional rights for temporary workers, a better regulation of training etc. (Castanheira et al. 2006, 231).

The 1994 and 1997 reforms aimed at "undoing the liberalisation of 1984" (Dolado et al. 2002, F274) and reducing the incidence of temporary employment. In 1994, the conditions for the use of FTCs were restricted, while the costs of individual dismissal of regular workers were reduced. In 1997, negotiations initiated by the Conservative government led the social partners to sign an agreement calling for the creation of a new permanent contract with lower firing costs in the case of unfair dismissals, entailing a mandatory severance pay of 33 days' wages per year of seniority with a maximum of 24 months of wages (instead of 45 and 42, respectively, under the regular permanent contracts). This new contract could be used for most new hires over a four-year period (Dolado et al. 2002, F274).

8 Conclusions

During the last one and a half decades, reforms of EPL in Europe eased the recourse to temporary forms of employment while not reducing the strictness of EPL of permanent jobs (with the exception of Spain). Such two-tier reforms have been implemented in Belgium, Denmark, Germany, Greece, Italy, the Netherlands and Sweden. Spain started its EPL reforms at the margin in 1984 and reformed the core of its labour market in the 1990s.

Two-tier EPL reforms are confronted with less resistance from incumbent workers than EPL reforms of permanent jobs. Nevertheless, not all European countries have implemented EPL reforms at the margin. Two-tier reforms have been realized when governments have taken into account the specific reform conditions prevailing in their countries. In Denmark, France, and the Netherlands, coalition governments had to come to an agreement with the social partners in order to implement reforms. (In Denmark governments succeeded and failed on different occasions, in France government failed.) When governments were relatively strong, as was the case in Sweden in the 1990s, in Germany under the leadership of chancellor Schröder and in Italy under Berlusconi, they overcame the resistance of the unions against EPL reforms more easily. The implementation of reforms was supported by offering compensations, mainly as higher unemployment benefits. This was the case in Denmark, the Netherlands, Germany, Italy and Spain. Conversion clauses have weakened the objections against two-tier EPL reforms too, as is demonstrated by the Netherlands' 1999 reform and Sweden's 1997 reform.

With the exception of Spain, two-tier reforms did not induce EPL reforms of permanent employment. Presumably the achieved proportion of temporary employment in total employment did not change the political constellation to such an extent that EPL reforms of permanent employment would have become possible. In Spain, however, the share of permanent workers in the total active population dropped below 50 percent in 1994 due to the growing number of temporary workers. The median voter was no longer a regular worker, a fact which seemed to have influenced the behaviour of the unions and the decisions of the government.

It is questionable whether the strategy of reducing the strictness of EPL for permanent jobs via two-tier EPL reforms is a feasible strategy. A precondition for this reform chain to work is a radical EPL reform at the margin in the beginning. It is unlikely that a reform as radical as in Spain after the end of the Franco era will be implemented in other countries. Minor reforms which are not ambitious will however be implemented.

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