

THE CONTESTED MEANING OF LABOUR MARKET FLEXIBILITY:
ECONOMIC THEORY AND THE DISCOURSE OF EUROPEAN
INTEGRATION

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Simon Deakin
ESRC Centre for Business Research
University of Cambridge
Austin Robinson Building
Sidgwick Avenue
Cambridge
CB3 9DE

Hannah Reed
ESRC Centre for Business Research
University of Cambridge
Austin Robinson Building
Sidgwick Avenue
Cambridge
CB3 9DE

Phone: 01223 335243
Fax: 01223 335768
E-Mail: sfd20@econ.cam.ac.uk

Phone: 01223 335286
Fax: 01223 335768
E-Mail: hr208@econ.cam.ac.uk

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Abstract

This paper argues that in order to facilitate informed debate and to develop a coherent social and employment policy in Europe, it is necessary to clarify the different meanings of the term 'labour market flexibility'. It questions whether the deregulation of the labour market is an inherent component of increased flexibility. The paper then examines the EU's employment strategy and argues that it must be understood in terms of its linkages to social policy on the one hand, and the process of economic and monetary union (EMU) on the other. It suggests that a coherent alternative to neoliberal policies, of the kind apparently promised by a 'third way' agenda for the labour market, has yet to emerge at European level. There is a danger, instead, that the institutional arrangements for the conduct of social and economic policy (broadly conceived) within the Community are making it impossible to forge the linkages between labour standards, active labour market policy and the macroeconomic framework of the kind which are needed to renew the 'European social model'. It therefore questions whether, under present institutional conditions, the goals of third way advocates can be met.

Key words: labour market flexibility; employment policy; European Union

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THE CONTESTED MEANING OF LABOUR MARKET FLEXIBILITY: ECONOMIC THEORY AND THE DISCOURSE OF EUROPEAN INTEGRATION

1. Introduction

The debate over labour market flexibility, which began in the 1980s as an issue for national-level policy makers, has come to have an increasing influence over the direction of social and economic policy within the European Union. Concern over high levels of persistent unemployment and low levels of employment in many Member States has led many to argue that the ‘European social model’, which is based on systems of social protection and collective employee representation, has obstructed the operation of labour markets, limiting the necessary adjustments to changes in demand, hindering innovation, and restricting job creation (Addison and Siebert, 1991). Highlighting the economic experiences of the UK and the US, advocates of this viewpoint claim that employment growth in EU countries can only be achieved through the deregulation of employment legislation and the dismantling of institutional barriers to wage flexibility. While a programme of labour market deregulation has not been formally adopted at a European level, there have been growing calls for the elimination of ‘rigidities’ in labour markets in order to widen wage differentials in places, to increase sectoral and occupational mobility within the labour force, and to encourage the use of ‘flexible’ working patterns, all with a view to expanding overall employment levels.

If there is growing recognition that the central issue facing European policy makers is how to increase the employment rate at a time of rapidly shifting economic conditions, shaped by transnational economic integration, technological developments, and changes in patterns of demand for products and services, there is nevertheless little or no consensus on the means by which this goal might be achieved. The Commission’s 1998 communication, *An Employment*

Agenda for the Year 2000, used the language of deregulation in arguing for ‘a radical rethink of all relevant labour market systems... to adapt them to a world of work which will be organised differently, in which the concept of security of workers has been reformulated, focusing more on security based on employability in the labour market rather than security in a specific job’¹. But this strategy contrasts sharply with the proposals outlined in the Commission Green Paper on *Partnership for a New Organisation of Work* in 1997.² Here, it was argued that enhanced competitiveness and productivity in European firms could most effectively be achieved through improvements in the quality of employment and the transition to new forms of work organisation, based on high skill, high trust and high quality. The promotion of longer term and stable employment was seen as necessary to enable firms to respond to changes in the product demand and to secure worker co-operation in technical development, product enhancement and general quality control.

Some commentators see in recent developments the adoption by the Community of a ‘Third Way’ agenda which seeks to reconcile flexibility and security. Hence Wolfgang Streeck has argued that the debate over the ‘Third Way’ is about the ‘search for a new balance between protection and risk, security and opportunity, collective solidarity and individual responsibility, public authority and private exchange – for a new structure of incentives that elicits additional effort to substitute for redistributable slack, enabling public policy to concentrate the scarce resources available for solidarity on those that truly cannot help themselves’ (Streeck, 1999: 3). As part of this agenda, the European social model would be renewed through a strategy of ‘competitive solidarity’ in which social policy interventions would be aimed at enabling individuals, sectors and, indeed, nation states to survive in an internationally competitive economy. In a similar vein, Jeff Kenner has suggested that the new Employment Title epitomises a Third Way approach under which ‘[h]igh levels of employment and social protection are linked with competitiveness’ (Kenner, 1999: 51).

This paper starts from the premise that in order to facilitate informed debate on these central issues for the future development of European integration, it is necessary to clarify the different meanings which the term 'flexibility' may have in the context of labour market policy. This is the focus of section 2 which uses the 'new institutional' economics of law to show that there are a number of theoretical positions on the role of legal and institutional mechanisms in promoting the efficient operation of labour markets. The policy implications of these positions are outlined with reference to a positive role for mechanisms of intervention at both national and transnational levels. We argue that this kind of economic analysis is not inherently antagonistic to labour market regulation, and that it is possible to envisage combinations of measures through which social justice and economic efficiency might be reconciled.

We then turn in section 3 to a closer examination of the way in which labour market flexibility has entered into the discourse of social and economic policy within the Community. We focus here on two settings in which social and economic policy are closely intertwined, and in which the discourse of labour market flexibility has become particularly prominent in the construction of European integration: these are, firstly, the various programmes of economic convergence and stabilisation which underpin EMU, and, secondly, the employment strategy which was recently crystallised in the form of the Employment Title and associated measures. We argue, on the basis of our analysis, that a coherent alternative to neoliberal policies, of the kind apparently promised by a 'Third Way' agenda for the labour market, has yet to emerge at European level. There is a danger, instead, that the institutional arrangements for the conduct of social and economic policy (broadly conceived) within the Community are making it impossible to forge the linkages between labour standards, active labour market policy and the macroeconomic framework of the kind which are needed to renew the 'European social model'. We therefore question whether, under present institutional conditions, the

goal of Third Way advocates can be met.

2. The Many Meanings of Labour Market Flexibility

Although ‘flexibility’ has for some time been advanced as the panacea for all ills within labour markets (and beyond), the term itself is elusive, defying a watertight definition. Some analyses focus on changing patterns of demand and supply for labour; others see the issue primarily in terms of the system of regulation. These separate approaches offer radically different policy prescriptions.

2.1. Demand and supply models

2.1.1. The demand side: the flexible firm

The model of the ‘flexible firm’ focuses on the micro-level of labour demand, that is to say, employers’ strategies with regard to the form in which labour is contracted (Atkinson, 1985). In particular, the emphasis is on attempts of employers to vary labour inputs according to fluctuations in the state of external demand. *Numerical* flexibility allows the firm to modulate the numbers employed, while *working time* flexibility permits it to raise or lower hours through overtime or through variations to normal hours. *Financial* flexibility describes practices such as performance-related pay which link remuneration directly to output. Finally, *functional* flexibility refers to the multi-skilling of workers which permits them to move round between tasks and to adapt their working practices to new technological and organisational requirements.

A prediction of the ‘flexible firm’ model was the employers would increasingly segment their workforces into a ‘core’ of full-time staff, for whom functional flexibility was the norm, and a ‘periphery’ of part-time, fixed-term and casual workers employed on the basis of numerical and financial flexibility. Evidence for the existence of this type of practice is disputed, but there is no doubt that the model has

had a considerable influence on government policy, particularly in the United Kingdom where it was used in the 1980s and early 1990s to offer support to government measures aimed at expanding the scope of autonomy enjoyed by management at firm or company level. These included encouragement from government for the decline of multi-employer bargaining, changes to employment protection legislation which extended the period of time required to qualify for basic dismissal protection, and resistance to efforts to put the rights of part-time workers on a footing with those of full-timers. This resistance only ended when the House of Lords decided that employment protection thresholds which excluded certain part-time workers from protection contravened the principle of equal pay between men and women in the then Article 119 of the EC Treaty.³

2.1.2. The supply side: ‘family-friendly’ policies

It is also possible to see flexibility as an issue of labour supply. From this point of view, the growth of non-standard forms of employment, such as part-time work, temporary employment and self-employment, may represent changing priorities of workers, new lifestyle choices, and responses to the changing division of labour within the household. The growth of non-standard work *may* therefore represent an enhancement of employment opportunities for groups previously discriminated against by the law’s emphasis on protecting workers in the ‘standard’ employment relationship of full-time, permanent employment, in particular women with childcare and other family commitments (Mückenberger, 1989). However, commentators have pointed out that many of the non-standard jobs which have come into existence since the mid-1960s tend to be poorly paid and to offer few prospects for career advancement (Dickens, 1992).

Until recently, relatively few policy initiatives have succeeded in instituting flexibility of the kind which would enable individuals to move between different forms of work – in particular full-time and part-time work – in such a way as to retain the value of their ‘human

capital' (or their investments in skills and training) and to preserve their career path. However, there is now a growing impetus for this type of supply-side flexibility. The first beginnings were made when sex discrimination legislation was used to provide the possibility of a right to move between part-time and full-time employment according to the family and other commitments of individual workers. Employers' refusal to provide this option could be regarded as indirectly discriminatory (since it is almost invariably women workers who are adversely affected), although in Britain the courts and employment tribunals have not consistently held in favour of workers making this type of claim. Several recent EC initiatives, including the Sex Discrimination Burden of Proof Directive⁴ and the Directive on Parental Leave,⁵ have helped to move the law forward in this area, albeit to a limited extent (the Parental Leave Directive does not provide for leave to be *paid*).

The demand-side and supply-side conceptions of flexibility therefore point in opposite directions: the former would grant employers greater autonomy to shape personnel practices to changing market conditions, while the latter would require them to adopt 'family friendly' policies which accommodate changes in the household division of labour. These conflicting pressures are evident in the 1997 Directive on Part-Time Work.⁶ On the one hand, Member States and the social partners are required to observe the principle of equal (or at least proportionate) treatment between part-time and full-time workers. Employers must provide information to workers on the possibility of transferring between part-time and full-time work. On the other hand, the Directive speaks to a deregulatory agenda when it calls on Member States and the social partners to identify and review potential obstacles to part-time work and, where possible, to eliminate them, subject only to the principle of non-discrimination between part-time and full-time workers.

2.2. Flexibility and regulation

2.2.1. Deregulation and allocative efficiency

Flexibility can also be seen as a function of the system of labour market regulation in a wider sense. A view which is widely held, and which, in the UK at least, has assumed the status of a conventional wisdom across the political spectrum, is that legal and other regulations cause ‘rigidities’ in the market; flexibility, then, is the consequence of the *absence of regulation*. More precisely, flexibility is a condition of ‘unregulated’ markets in which the price mechanism is able to hinder unimpeded. This view informs the argument that economic efficiency can be restored through deregulation. According to Professor Horst Siebert, the president of the Kiel Institute for World Economics:

‘Institutional arrangements can influence the clearing function of the labour market in basically three ways: by weakening the demand for labour, making it less attractive to hire a worker by explicitly pushing up the wage costs...; by distorting the labour supply; and by impairing the equilibrating function of the market mechanism (for instance, by influencing bargaining behaviour)’ (Siebert, 1997: 43).

Elements of rigidity in the European social model are said to include centralised collective bargaining, high unionisation rates, the ‘tax wedge’ of employment taxes and social security contributions, job protection legislation, and earnings-related unemployment benefits. The effect of such regulation is that ‘flexibility is prevented by institutional conditions’ (*ibid.*, p. 53).

A crude comparison between unemployment levels in the EU Member States and those in the USA would tend to support this contention. In 1998 the US unemployment rate stood at 4.5%; the average unemployment rate of the 15 EU Member States was virtually 10%⁷ However, it is widely considered that the unemployment measure is

misleading as a measure of economic exclusion, since the US figures exclude a large number of the economically inactive (in particular the very large prison population).

Partly for this and other reasons, analysts have focused on differentials in employment rates. In 1998, for example, the employment rate (defined as the proportion of the working age population in employment) was just 61.1% in the EU compared to around 73.8% in the USA and 69.5% in Japan.⁸ The US has enjoyed an apparent advantage in terms of the growth of jobs since the mid-1980s. However, it is necessary to control for population here; a large part of the increase in numbers in employment in the USA is caused by its rapid growth in population during a period when the population of the EU Member States grew much more slowly (Blank, 1994).

A more sophisticated approach is to measure flexibility in terms of the effectiveness of market mechanisms in matching supply and demand (Siebert, 1997). The claim that European labour markets are inflexible is based largely on the relatively limited degree of wage dispersion (or, put differently, wage inequality) in Europe compared to the United States. Wage equality is perceived to be a sign of inefficiency, since it implies that wages are only imperfectly matched to the differing qualities, capacities and endowments of individuals. Another factor is said to be the greater length of time it takes for wages in most EU systems to adjust to changes in the level of unemployment, again with the United States as a benchmark (although the empirical validity of this claim has been doubted (Nickell, 1997)). Slow adjustment implies that wages are relatively unresponsive to shifts in the demand for labour; hence, the market mechanism is not working as it should do to bring supply and demand into line.

Together these effects can be taken to suggest that a 'segmented' or 'dual labour market' exists, in which market forces influence wages to only a very limited degree. According to one version of this theory, the unemployed and low paid are not in direct competition with those

in better paid and more secure jobs. The result is increased unemployment: unemployment is ratcheted up as the low skilled are progressively excluded from access to better paid and more productive jobs. The solution lies in measures which allow for more direct and intense competition over terms and conditions by, for example, allowing employers to escape from multi-employer collective agreements, permitting 'two-tier' bargaining structures with differential terms and conditions for newly-hired workers, and removing protections for the 'core' workforce which insulate them from competitive pressures. The unemployed themselves can be provided with improved incentives through the elimination of earnings-related social security benefits and the tightening of benefit-disqualification rules (Siebert, 1997).

A difficulty with this view is that the evidence which might link particular regulatory 'rigidities' to increases in unemployment is much more ambiguous than is popularly supposed (Nickell, 1997). For example, labour flows – the rates at which workers move in and out of employment – do not differ greatly between Europe and the United States, as they might be expected to. Moreover, within the EU, flow rates are lowest in systems which are apparently the most 'flexible', such as the United Kingdom. In the United States, there is a greater degree of mobility of workers between jobs, but this is a consequence of a much higher level of inter-regional mobility than has historically been the case in Europe (Alogoskoufis, *et al.*, 1995; Nickell, 1997).

Other seemingly obvious targets of the deregulatory approach, such as the 'tax wedge', look less obvious on closer inspection. The real issue here is not the extent of employment or payroll taxes, but the overall tax burden on labour which, economists remind us, should properly include consumption taxes. There is no evidence that shifting the balance of taxation away from payroll taxes to consumption makes any difference to levels of employment and unemployment. For example, it does not appear that Denmark, which has no *mandatory* payroll taxes, has achieved markedly better employment levels, over

the long term, as a result, in part because extensive pension and social security contributions tend to be levied by employers as part of occupational welfare schemes (Nickell, 1997).

In general, employment participation rates differ very considerably across the EU Member States. The differences appear to be deep-rooted in the cultural traditions of certain Member States, rather than being a direct consequence of the system of labour market regulation. For example, the low overall employment rates of some countries (such as Spain and Italy) appear to be attributable to the relatively low participation of adult women in paid employment (Buchele and Christensen, 1995).

2.2.2. Labour regulation as a response to structural imperfections in the market

Moreover, there are many variations on the theme of flexibility and regulation. The basic premise of the deregulatory approach is that in the absence of regulation, the ‘equilibrating mechanism’ of the market will lead to an automatic adjustment of supply and demand. This is the crux of the issue; however, labour market theorists disagree on whether the labour market, if left alone, actually will function in this way. Some models predict the presence of market ‘imperfections’ of various kinds even under conditions of pure competition. The reason for the persistence of these imperfections is that the market can only attain equilibrium under extremely unusual conditions – such as complete information and costless contracting. Economists influenced by a variety of ‘new institutional’ approaches increasingly recognise that these conditions are rarely if ever satisfied in the case of the labour market (Deakin and Wilkinson, *forthcoming*). However, there is less consensus on what to do about it, and this is where the debate is currently most intense.

A common theme of recent theoretical work is that norms or practices which have efficiency-enhancing effects at the micro level may have

harmful third-party effects which are felt elsewhere in the system, and vice versa. This is a central finding of a body of theories known as 'efficiency-wage theories'. These predict that *involuntary* unemployment may result from employer strategies aimed at retaining and motivating their skilled or 'core' employees. Rules (apparent rigidities) operating at workplace level for the protection of the expectations of employees, such as the loose expectation of continuing job security, may induce functional flexibility at the micro level in the form of a greater co-operation between (core) employees and management. However, the very same rules have the effect of excluding 'outsiders' – the unemployed, low paid and less highly skilled – in the sense of reducing their opportunities for entry into 'primary' occupations or labour market segments. This form of exclusion is, in one sense, a 'rigidity'. 'Rigidities' may arise, then, as a consequence of norms and practices which are privately rational for the parties immediately concerned, but which have adverse effects on third parties, or 'externalities'.

Some applications of this theoretical work suggest that certain regulatory rigidities may in fact be desirable. One school of thought holds that 'labour market rigidities partially diversify uninsurable risks when fully contingent contracts are neither verifiable or enforceable' (Alogoskoufis *et al.*, 1995: 82). In other words, perfectly efficient employment contracts are not achievable, because of the costs and complexity of bargaining under conditions of radical uncertainty. Regulation compensates for, or offsets, the inadequacies of private bargaining. However, the mere existence of a market imperfection is not adequate grounds for regulatory intervention, since the regulation itself may have a distorting effect, in particular where it is the product of 'rent seeking' by powerful vested interests (Saint-Paul, 1996). Hence the view just expressed is qualified by the insistence that rigidities induced by regulation are 'a very blunt tool for pushing market allocations nearer to an unachievable first-best' (Alogoskoufis *et al.*, 1995: 84). Put slightly differently, labour regulation is much too blunt an instrument to be used as a means of

‘perfecting’ the market.

This position would suggest that economic analysis does not unequivocally condemn labour standards; but nor does it provide much of an argument in their favour. According to this view, then, if there is a case to be made for labour standards, it is better made on grounds related to equity.

2.2.3. Labour standards and dynamic efficiency

More explicitly ‘institutional’ approaches argue that norms and regulations ‘are not rigidities and constraints upon micro and macro adjustments, but they can be opportunities and advantages in order to solve the trade-off between efficiency and equity which is inherent in the wage labour contract’ (Boyer, 1994: 26). Inherent in this approach is the suggestion that rigidities which may have short-run ‘disequilibrium’ effects may also be the source of longer-term, so-called ‘dynamic’ efficiencies, through stimulating technical and organisational innovation based on trust (Sengenberger, and Campbell, 1994, Deakin and Wilkinson, 1994, Marsden, 1995, Buchele and Christensen, 1995).

This branch of labour economics holds to the view that there is a highly complex relationship between systems of regulation and labour market behaviour. The point was reflected in the 1997 Commission Green Paper on *Partnership for a New Organisation of Work* which argued that a normative framework for the employment relationship is not just compatible with, but is possibly a precondition of, ‘high performance’ relations at workplace level. The argument is that the spread of ‘lean production’ techniques has made management more highly dependent upon the co-operation of labour, not just in the short-term sense of meeting highly variable patterns of demand, but also, in the longer term, in adapting to new skills requirements. In this context, it has been suggested that some form of institutionalised employee representation is necessary in order for co-operative relations to be maintained

(Marsden, 1996).

Another example of this effect is the minimum wage. By preventing firms from competing on the basis of low pay, in effect, it gives them a choice of either going out of business or attempting to compete on the basis of better training and investment in human capital, the so-called high road' to competitive survival. In the words of the United Kingdom's Low Pay Commission, considering the possible effects of a statutory minimum wage:

'Whatever the nature of the labour market, it is likely that a National Minimum Wage will have a greater effect on the structure of employment than on its level. Businesses which are inefficient or which produce low value-added goods may need to reorganise working practices. If the National Minimum Wage is properly enforced, business and employment are likely to transfer to more efficient firms or to those offering higher value-added products and services... minimum wages may cause a transfer of jobs between groups such as the substitution of more skilled for less skilled workers...'⁹

From this point of view, labour standards – regulation governing both the substantive terms of the employment relationship and the procedures by which the terms and conditions are set – are an indispensable element of a productive economy (Deakin and Wilkinson, *forthcoming*). This, in itself, does not conclude the debate about the nature and level of statutory standards, but it does suggest that both positive and negative effects of labour standards need to be taken into account at the policy level. Moreover, it implies that the idea that completely positive effects can be achieved simply by removing statutory regulation is highly misleading.

2.3. Flexibility in the production of rules: competition or coordination?

2.3.1. A race to the bottom?

The final dimension of flexibility which we consider here refers to the process of rule-making itself. Opponents of harmonisation in the field of social policy (and elsewhere) argue that the most effective means to arrive at an efficient solution to the problem of labour standards is to put the different systems of the Member States into competition with one another, through the mechanism of the internal market. Once free movement of economic resources is guaranteed, automatic processes can come into play for the selection of efficient legal rules. *If* it is the case that systems with high labour standards enjoy, for this reason, a competitive advantage over those which rely on a lower level of minimum regulation, then under conditions of free trade we would expect resources, over time, to gravitate to the former. This is because the components of the welfare state or labour market system are ‘none other than an additional component of a country’s competitive position as a supplier of goods and services and as a location for production’ (Paqué, 1997: 108). Once trade is freed up, the advantages and disadvantages of a particular system are revealed for all to see. Thus ‘international competition in the field of the welfare state serves as a kind of process of discovery to identify which welfare state package – for whatever reason – turns out to be economically viable in practice’ (*ibid.*, p. 109).

It is argued that harmonisation of labour standards, by contrast, would lock the Member States into a range of potentially inefficient solutions. In effect, it would foreclose the process of market discovery of which is the most effective procedure for arriving at an efficient regulatory solution. Moreover, if harmonisation were to be confined to particular areas, such as social policy, on ethical grounds which were unrelated to economic considerations, distortions would follow: ‘why should some parameters of international competition be removed through *ex ante* harmonisation while others such as infrastructure, education and skills of the workforce, and environmental quality continue to determine the structure of the international divisions of labour?’ (*ibid.*, p. 108).

We do not intend to revisit here the debate about ‘social dumping’ and the ‘race to the bottom’ in European social policy. Nevertheless, in the present context it may be useful to summarise some of the arguments which have been made at greater length elsewhere (Deakin and Wilkinson, 1994; Deakin, 1997) about the relationship between harmonisation and competition in the production of labour standards. The first point to make is that harmonisation of social policy at the level of the European Community has never had uniformity, or a single welfare state model, as its goal. Directives in the social policy field tend to set minimum or basic standards below which the Member States may not go. They do not rule out higher standards being set by the Member States. In this respect, they are like labour standards operating within Member States, which generally allow for what is called *derogation in melius*, or improvements on the legally mandated standard (Wedderburn, 1992), although they differ from standards set in other fields of EU regulatory policy such as environmental and product regulation, which often forbid derogation in either direction. The second point follows from the first, namely that it is not the aim of social policy intervention to achieve a parity of costs or even a ‘level playing field’. Such an aim is plainly incompatible with the preservation of space for Member States to apply protective standards above those laid down in the relevant Directive.

What then is the economic purpose of social policy intervention? Rather than prohibiting competition over rules, it *regulates* that process, in effect giving it a steer away from the direction of a ‘race to the bottom’. It forecloses certain options of Member States, while allowing others. For free market purists, this is not much of an improvement upon an outright prohibition. However, the key issue here is whether a completely unregulated market for social policy systems within the EU would select the most efficient available solution. There are good reasons for thinking that it would not. Firstly, the conditions for effective competition between rule systems within the EU may not exist. Unlike in the United States, where inter-

regional mobility is considerable, there is relatively little movement of labour between Member States. Capital movements are more considerable, but still limited by comparison to the United States. Under these conditions, the expectation that economic resources would flow to the most effectively functioning system would seem to be optimistic indeed.

Secondly, it is not clear that an efficient solution would necessarily emerge even under circumstances of greater mobility of capital and labour. Studies of the process of 'regulatory competition' in the USA show that state legislators can be heavily influenced by lobbying activity and rent-seeking by pressure groups. Hence it is argued that Delaware's corporate law is highly receptive to the arguments of corporate managers since it is they (and not the shareholders) who decide where to incorporate the business (Roe, 1993). Managerial influence is also evident in the practices of the 'right to work' states in the south and west of the USA, many of which adopted anti-union labour laws in the 1950s and 1960s in order to attract capital flows. A race to the bottom could easily result in a 'low level equilibrium' where no jurisdiction felt able to take steps to raise its standards, for fear of capital flight and further 'social devaluations' by its rivals.

Of course, there are limits to how far the process of 'social devaluation' could go before systems exhausted the capacity for downgrading their labour standards. To that extent, the process might be said to contain the capacity for self-correction. But whether there is any point in initiating a race to the bottom on the ground that it might eventually reverse itself is another matter.

The issue of regulatory competition is important in the wider context of the debate over the European social model, since it helps to clarify the appropriate role for transnational-level institutions. Some features of inter-jurisdictional competition – those which are rather crudely characterised as a 'race to the top', but which may be alternatively

described in terms of the benefits to be drawn from mutual learning between states – may be highly desirable. From this point of view, it should not be the aim of harmonisation to remove the Member States’ autonomy in the social policy field, in the manner of US-style ‘pre-emption’ of state laws by the federal legislature. Rather, the goal of harmonisation should be actively to *preserve* diversity at Member State level, by ruling out the kind of destructive inter-jurisdictional competition which, in the US context, leads to Delaware-type solutions becoming universally adopted.

2.3.2. Labour standards, competitiveness and active labour market policy

If the ‘defensive’ argument for transnational labour standards would see them as having a role to play in averting a mutually destructive race to the bottom, then a more constructive role would be to make a virtue out of the potential contribution of labour standards to the promotion of competitiveness based on dynamic efficiency, as explained above. This would fit together with an idea which has surfaced from time to time in European social policy without ever becoming fully accepted, namely the concept of social policy as an ‘input into economic development’ (Deakin and Wilkinson, 1994).

The economic benefits of ‘social cohesion’ operate at a number of levels. For example, the greater the extent to which firms and organisations seek to compete on the basis of high quality goods and services, the wider the range of good job opportunities which are available to workers. For present purposes, we wish to stress a somewhat neglected issue, namely the links between the core of social policy – labour standards relating to individual rights and collective procedures – and the area of ‘active labour market policy’ or, as it is sometimes called, ‘employment policy’.

‘Active labour market policy’ covers a number of mechanisms aimed at improving vocational training, assisting job search, and

encouraging employers to take on additional workers. It mostly takes the form of targeted public expenditure and subsidies to enterprises. As Mark Freedland has explained, at EU level the term ‘employment policy’ has come to be used to describe ‘the policy agenda relating to job creation and maintenance, and the maintenance of enhancement of employment skills by means of vocational training’ (Freedland, 1996a, p. 277; see also Freedland, 1996b).

As such, it interacts with ‘social policy’ – or, at least with that part of it relating to labour standards – in a number of complex ways. In contrast to the specific statutory form which is given to most interventions in the social policy field, active labour market policy is authorised only by general legislative provisions which confer broad discretionary powers upon governmental bodies. In this sense, active labour market policy is characteristic of ‘promotional’ labour standards, the purpose of which is to promote employment growth and the reintegration of excluded groups into the labour force (Sengenberger and Campbell, 1994; Deakin and Wilkinson, 1994; Freedland, 1996a). The point we wish to emphasise here is that the growth of active labour market policy at EC level could be seen as a natural, perhaps inevitable, consequence of the decision to strengthen social policy through the adoption of the ‘Social Chapter’. This is because of the complex economic effects, partly negative and partly positive, which the imposition of transnational labour standards may be expected to have.

As we have argued, long-run dynamic effects of labour standards, in terms of raising productivity and hence the competitiveness of industries and firms, have to be set against potentially disruptive effects in terms of the exclusion from employment of the less highly skilled and the long-term unemployed. The scale of these negative effects is hard to estimate, particularly in the light of the empirical evidence, referred to earlier, to the effect that the impact of labour standards on employment rates is often minimal (Nickell, 1997). However, it is because these offsetting effects of labour standards

may operate to the disadvantage of certain groups that active labour market policy measures must be designed so as to interact as far as possible with interventions in the field of social policy. In Sweden, for example, a particularly extensive system of active labour market policy has been responsible for most of the post-war period in keeping unemployment at low levels (Nickell, 1997: 62), in this way compensating for the effects of labour standards and wage determination policies which put firms under continuous pressure to improve productivity. In short, a 'high wage, high productivity' route to competitiveness based on an extensive floor of labour standards presupposes an equally extensive range of administrative and financial measures aimed at promoting training and investment in human capital, reintegrating the unemployed into the labour market, and maintaining sustainable levels of demand for labour so as to limit 'churning'.

Conversely, it seems doubtful that active labour market measures can work effectively in isolation from other elements of labour market regulation. The 'displacement' of workers who would otherwise be employed in regular work, and the 'deadweight' effect of schemes which subsidise the employment of those who would have got jobs anyway, pose familiar problems of cost effectiveness for employment policy. Under conditions of reduced or falling demand for labour, or under circumstances where employers can hire and fire at will, a further problem is that subsidy schemes tend to result in 'churning', as individuals simply move from subsidised work back into unemployment. This has been identified, for example, as a potential problem for the United Kingdom's 'New Deal' scheme of subsidised employment placements, which was implemented during a period when youth unemployment was in any case falling: 'a key question for the New Deal will be whether the apparently high rates of outflow into unsubsidised employment can be maintained under less favourable labour market conditions'.¹⁰ There is a case for saying, then, that rules relating to employment security and the effectiveness of macroeconomic policy in stabilising employment levels play an

important role in underpinning employment policy.

For these various reasons, it is the *linkages* between social policy (or labour standards), employment policy (in the form of measures directed at enhancing labour market participation on the basis of investments in human capital), and macroeconomic policy (the setting of general conditions for stable and sustainable economic growth) which matter. The realisation of an integrated approach to labour market regulation would represent a highly significant step in the modernisation of the European social model; the traditional core of social rights, with its emphasis on protection and compensation, would then extend to the *right to participate in the labour market on the basis of meaningful employment opportunities*.

Whether or not the strategy which we have just briefly outlined (Deakin, 1997; Wilkinson and Tarling, 1997; Deakin and Ewing, 1997) can be adequately described in terms of the ‘Third Way’ is debatable. It shares with the ‘Third Way’ an emphasis on reconciling equity and efficiency, and on seeing social policy as having a positive role to play in maintaining competitiveness (and vice versa). However, it departs from the analyses of writers such as Streeck (1999) and Giddens (1998) in envisaging a positive role for labour standards and macro-economic interventions in making the labour market function effectively. To that extent, the debate is as much about means as ends – in other words, it turns on whether the mechanisms proposed by Third Way thinkers are, in fact, appropriate to the goals which they are aiming to achieve. In particular, we doubt whether a conception of flexibility which sees labour standards as inevitably undesirable ‘rigidities’, and rejects any role for a demand-orientated macroeconomic policy, can succeed in maintaining social solidarity.

Extending this point, we would suggest that the feasibility of Third Way strategies at Community level is constrained by the institutional arrangements which guide economic and social policy interventions.

To see how these constraints operate, we turn next to a closer examination of how the flexibility debate has been translated into the discourse of social and economic regulation in the related fields of employment policy and EMU.

3. Translating Theory into Practice: Labour Market Flexibility in the Discourse of European Integration

The idea of labour market flexibility is no longer merely a theoretical one; it has a growing role within the formal language or discourse of European construction. In this section, we focus on the uses of flexibility in the key area for the resolution of conflicts between economic and social policy objectives, namely the overlap between employment policy and EMU. We begin by identifying more precisely what is involved in the idea of a ‘high employment rate’ which motivates current employment policy at European level, and then look in more detail at the way in which labour market flexibility has become a reference point for the achievement of this goal.

3.1. From ‘full employment’ to a ‘high employment rate’

The Treaty of Amsterdam adopted a number of measures including the new Title on Employment which, together, have been described as amounting to the ‘constitutionalisation’ of employment policy (Barnard, 1997). Prior to 1997 there were numerous employment policy initiatives, but these were spread across several different areas of Community action – vocational and educational training, the structural funds, and resolutions of various meetings of the European Council (Freedland, 1996a). The use of structural funds to subsidise and support training and labour mobility has a long history going back to the ECSC Readaptation Aids scheme under Article 56 of the Treaty of Paris, which was used to provide financial support to workers in the coal and steel industries. The Social Fund provisions of the EC Treaty were also used to support active labour market measures, in particular after Council Regulations of 1988 and 1993,¹¹ which laid

out a number of objectives for the structural funds, including combating long-term unemployment, facilitating the integration of young workers into the labour market, and facilitating the adaptation of workers to industrial changes and changes in production systems. The Maastricht Treaty strengthened the competence of the Community to act in relation to vocational training by inserting a new Chapter on Education, Vocational Training and Youth. In 1994 the Council used its powers under Article 127 of the EC Treaty (now Article 150 of the Consolidated Version of the Treaty) to establish the 'Leonardo' programme of vocational training support.¹²

The idea of using the central organs of the Community to co-ordinate employment strategies at the level of the individual Member States only began to take shape around the time of the publication of the White Paper on *Growth, Competitiveness and Employment* in 1993 (EC Bull., Suppl. 6/93). The White Paper addressed the issue of the low employment rates prevailing in EC countries by comparison to Japan, the USA and the then EFTA states. In addition to making a number of proposals for the general improvement of the competitiveness within the Community, it suggested a role for large-scale public works and investments in infrastructure which, it was hoped, would stimulate job creation in the Member States. However, in the event, the Commission's budget was not increased to anything like the level needed to bring these schemes to fruition (Barnard and Deakin, 1996).

It was at this point that attention turned instead to the articulation of a common approach to measures designed to raise the employment rate. In 1994 the Essen European Council proposed seven areas for policy initiatives from the Member States, some of which were aimed at an apparently deregulatory agenda – greater flexibility in organisational practices, reductions in indirect labour costs – while others referred to the need to target public expenditure on raising skills levels and reintegrating excluded groups into the labour market (COM 94(333)). The Essen Council also established procedures for monitoring the

steps taken by Member States and for exchanging information on different practices at national level. These were later extended at further European Councils, in particular the Florence Council of 1996 which approved the terms of the Commission's 'Confidence Pact' on employment, and the Dublin Council of 1997 which issued a 'Declaration on Employment'.

The issue was raised again during the Inter-Governmental Conference which preceded the Amsterdam Treaty, when the Swedish government proposed the inclusion of an Employment Chapter which would commit the Union to the pursuit of 'full employment', in part as a counterweight to the policy of pursuing a stable macroeconomic policy through EMU. However, the British, Dutch and German governments opposed the insertion of a reference to 'full' employment, and succeeded in replacing it with the aim of achieving a 'high level of employment'. They also insisted on linking employment with the pursuit of 'competitiveness'. The negotiations were thrown into some confusion at almost the last minute by the election in June 1997 of the French socialist government under Lionel Jospin. The French raised again the question of using Community funds to stimulate job creation directly, through a central 'growth fund', and proposed an expansionary macroeconomic policy to offset what were seen as the negative effects on employment of EMU. However, these proposals were successfully resisted by the German government (Duff, 1997, Moss, 1998).

The context within which the Employment Title was formulated was therefore one in which the Member States had rejected plans for a macroeconomic policy aimed at achieving full employment through 'demand-side' measures. This was a highly significant step. The prevailing consensus became one of support for a 'stable' macroeconomic policy based on meeting the convergence criteria for EMU, coupled with suggestions that Member States should take steps to implement 'structural' labour market reforms aimed at enhancing competitiveness. Although the Treaty of Amsterdam also achieved the

incorporation of the Maastricht Agreement on Social Policy into the body of the EC Treaty,¹³ thereby bringing the United Kingdom fully into the process of social policy making, this was, by comparison, a largely symbolic and in some ways backwards looking step, since the substance of the Agreement was very little altered. All in all, then, the Amsterdam Treaty decisively rejected an approach integrating an extension of labour standards with demand-orientated macroeconomic policy, notwithstanding the efforts of some Member States and the Commission, at least under the Delors presidency, to pursue this line.

3.2. The implications of EMU for the labour market

To appreciate the significance of the decisions taken at the Amsterdam Treaty for the future of social policy and of employment (or active labour market) policy, it is necessary to consider the body of law which has grown up around procedures for the implementation of EMU. These procedures derive initially from the so-called economic convergence criteria which were laid down in the Maastricht Treaty. The convergence criteria require those Member States participating in the third stage of EMU (full monetary union leading to the single currency, the euro) to maintain retail price inflation within certain limits, restrict national debt to 60 per cent of gross domestic product (GDP), and confine budget deficits to no more than 3 per cent of GDP. The provisions governing excessive levels of national debt and excessive budget deficits (now contained in Art. 104 of the EC Treaty, formerly Art. 104c) set up a monitoring and reporting process which, in the last resort, can result in sanctions being applied to a Member State.

In addition, Article 99 of the EC Treaty (formerly Art. 103) provides for the Community to issue 'broad guidelines for the economic policies' of the Member States. A 'multilateral surveillance procedure' is established for monitoring and reporting on the policies being followed by the Member States; it was this model, dating back to the Maastricht Treaty, that was adapted for the purposes of the new Employment Title at Amsterdam. Under Article 99(4), if a Member

State's economic policies are not consistent with the broad economic policy guidelines, or if those policies 'risk jeopardising the proper functioning of economic and monetary union', the Council has the power, acting on a qualified majority on the basis of a recommendation from the Commission, to make a recommendation to the Member State concerned.

These Treaty-based procedures are supplemented by the Stability and Growth Pact which was formally agreed by the Member States at the Amsterdam European Council in 1997 (having been the subject of earlier discussion and informal agreement), and which is contained in two Regulations¹⁴ and a Council Resolution.¹⁵ Regulation 1466/97 on the strengthening of the surveillance of the budgetary procedures and the surveillance and coordination of economic policies puts in place an 'early warning system' designed to alert the Council to the possibility that a Member State participating in the third stage of EMU may be running up an excessive deficit. Regulation 1467/97 on speeding up and clarifying the implementation of the excessive deficit procedure provides, among other things, for the mode of calculation of the deposit payable by a Member State for failure to comply with its obligations to maintain budgetary stability.¹⁶ Amplifying Article 104, it also provides that if the Member State has not rectified the situation within two years of the decision to require it to make the deposit, the deposit shall be converted into a fine.¹⁷ Here, then, there are not just guidelines and warnings, of the kind which, as we shall see below, apply in the case of employment policy, but also sanctions for failure to comply.¹⁸

The Council Resolution on the Stability and Growth Pact of 17 June 1997, although not 'hard law', is also highly significant for employment policy, in that it 'underlines the importance of safeguarding sound government finances as a means to strengthening the conditions for price stability and for strong sustainable growth conducive to employment creation'. Alongside this measure, the Council issued a further Resolution on Growth and Employment.¹⁹ In

language drawn straight from the debate over flexibility and deregulation, it states:

‘it should be a priority aim to develop a skilled, trained and adaptable workforce and to make labour markets responsive to economic change. Structural reforms need to be comprehensive in scope, as opposed to limited or occasional measures, so as to address in a coherent manner the complex issue of incentives in creating and taking up a job.’

To this end, the Resolution calls not just for the coordination of economic policies with the procedure laid down in the Title on Employment²⁰ but also, in a direct reference to social policy, for more ‘employment-friendly’ tax and social protection systems aimed at ‘improving the functioning of the labour market’.²¹

The implications of EMU for both employment and social policy are further spelled out in the Council Recommendation 97/479 of 7 July 1997,²² setting out the framework for the ‘broad economic policy guidelines’ envisaged by the then Article 103 of the Treaty, now Article 99. The Recommendation sets as the main objectives ‘growth, employment and convergence’, noting that the Community ‘must progressively achieve a high employment rate’. It then identifies five areas for policy coordination: the ‘growth and stability-oriented macroeconomic policy mix’, price and exchange rate stability, sound public finances, better functioning product and services markets, and ‘fostering labour market reforms and investment in knowledge’. As part of macroeconomic policy, it is proposed that ‘real wage developments should be below the increase in productivity in order to strengthen the profitability of employment-creating investment’. Under labour market reforms, the Recommendation identifies five areas to which priority should be given. These are ‘higher employment growth’ through wage levels that take into account appropriate regional differences and variations in workers’ qualifications; reductions in non-wage labour costs and income

taxation; reform of the taxation and social protection systems; new patterns of work organisation, including more flexible working time arrangements ‘tailored to the specific needs of firms and workers’; and adaptation of the training and education system to the need to invest in human capital, including measures aimed at ‘improving the employability of the unemployed’.²³

The broad economic policy guidelines, then, see flexibilisation of the labour market as a key component of economic policy aimed at achieving ‘high employment’. Article 99 and the Stability and Growth Pact together constitute an attempt to lock Member States into a path of economic development based on economic convergence around tight budgetary controls and the maintenance of price stability. Labour market flexibility, in the sense of ‘structural reforms’, is the corollary of this process. Some of these reforms, it is clear, would be deregulatory, in the sense of removing indirect labour costs through reforms to employment protection legislation and the tax-benefit system. This is evident from the economic policy guidelines which were agreed by the Council in March 1999. Here, it is argued that ‘the functioning of labour markets in the European Union can be improved significantly and this would make a major contribution to the reduction of high unemployment’.²⁴ Reforms to the tax-benefit system and reviews of employment protection legislation are prominent among the guidelines issued to individual countries. Thus the version of labour market flexibility being pursued here is very largely one based on a deregulatory, neoliberal approach.

At the same time, however, both the Stability and Growth Pact and the broad economic policy guidelines make reference to a somewhat different conception of labour flexibility. This sees social policy and, in particular, the social dialogue as playing a more affirmative role in maintaining the conditions for economic growth and competitiveness. In particular, the EMU procedures see the social dialogue as playing an important part in the formulation of wage determination policies

which are compatible with employment growth. The Commission is called on to promote social dialogue at Community level ‘notably on macroeconomic policy issues’.²⁵ Similar language may be found in the Commission communication of 20 May 1998 on *Adapting and Promoting the Social Dialogue at Community Level*: ‘the incorporation of a new Employment Title in the Amsterdam Treaty and the application of these arrangements has changed the nature of the tripartite dialogue’.²⁶

However, on closer examination, the linkage of social dialogue to macroeconomic policy is of a very particular kind. The role of social dialogue is spelled out more precisely in an important passage in the 1997 Recommendation laying down the framework for the broad economic policy guidelines, which envisages a neo-corporatist role for the social partners in tripartite, national-level dialogue over the employment consequences of EMU:

‘As regards wages, which are determined by autonomous social partners according to individual countries’ practices, stability-oriented monetary and budgetary policies and the impossibility of exchange rate movements within the euro area will reinforce both the conditions and the incentives for an adequate evolution. These incentives should also be strengthened by an intensified social dialogue with all relevant parties, where possible and according to prevailing traditions, at the national level. A well-functioning wage formation process is a necessary requirement for high economic growth and reduces unemployment.’²⁷

This reference to social dialogue can be seen in a positive light. The importance of social dialogue as mechanism for promoting the appropriate conditions for growth has been reflected in experiences at Member State level since the early 1990s. Some Member States have a long tradition of tripartite bargaining between government and the social partners over labour costs, flexibilisation and wage growth. This tradition is strong, for example, in Italy, Spain and France. What

is striking is that similar ‘social pacts’ should have been introduced in other systems which have no such tradition. Hence, the more recent introduction of tripartite bargaining in Ireland is seen, in the view of some commentators, as playing an important role in promoting the sustained economic growth which that country has enjoyed over the past decade (O’Donnell, 1998).

In principle, coordinated wage bargaining could play a role in reducing inflationary pressures and promoting competitiveness in a way which was compatible with the preservation of social solidarity. For this to occur, however, a genuine extension of the process of social dialogue to cover bargaining over the distribution of productivity gains in the forms of vocational training and reduced working time would have to take place. Efforts to promote dialogue along these lines are so far confined to a few sectors where the framework for negotiation along these lines already exists, such as in the engineering industry (Pochet, 1999: 274). Such a framework is entirely lacking in under-organised sectors, such as retail and distribution, and, at country level, in certain Member States such as the UK, in which the institutional basis for multi-employer bargaining has been whittled away by policies of labour market deregulation (Deakin and Ewing, 1997).

Moreover, what is lacking in the European-level discourse at present is any attempt to link social dialogue over wage restraint to wider support for job growth. Rather, the 1997 Recommendation is a frank recognition that the process of convergence in the third stage of EMU will place particular pressure on labour market to provide flexibility which is no longer available to national governments through budgetary expansion or through exchange rate movements. Put most bluntly, ‘[i]n EMU, with a single monetary regime, the link between wages and employment will become more strict’.²⁸

This prompts the question: what kind of social dialogue will it be that fills the void left by the removal of national autonomy in economic

policy making? The suggestion in the Council Resolution on Growth and Employment that the social partners should ‘fully face their responsibilities within their respective sphere of activity’,²⁹ coupled with the direction in the broad economic policy guidelines (noted above) that real wage levels should be pegged below increases in productivity so as to provide incentives for investment, suggests that the main role for social dialogue is to consist in suppressing wage growth. Although this idea goes back to the Delors *White Paper on Competitiveness* of 1993, in the context of the White Paper it was coupled with the Commission’s support for a growth-orientated macroeconomic policy, which, as we saw above, now no longer forms part of the Community’s approach to employment policy. Thus the quid pro quo for wage restraint – active measures taken by government to boost labour demand – is no longer present.

3.3. Tensions within employment policy

When we turn to employment policy, we see a somewhat more extensive role for social dialogue and, conceivably, for labour standards as parts of the emerging employment strategy of the Community.³⁰ However, the shift away from the goal of ‘full employment’ is evident throughout the process of implementing the employment strategy and this, in turn, has meant that deregulatory elements are also to the fore. Moreover, the ‘soft law’ nature of the Community’s intervention in this area, while in many ways an advantage in allowing for a decentralised approach to policy formulation and for mutual learning between Member States (Biagi, 1998; Kenner, 1999) is less of an advantage when it comes to defining a clear role for social policy in the face of the intense pressure for economic convergence which is provided by EMU.

The leading provision of the Title on Employment is Article 125 (formerly Article 109n), by virtue of which:

‘Member States and the Community shall, in accordance with the

Title, work towards developing a co-ordinated strategy for employment and particularly for promoting a skilled, trained and adaptable workforce and labour markets responsive to economic change with a view to achieving the objectives defined in Article 2 of the Treaty on European Union and in Article 2 of this Treaty’.

This formalised the process of coordination which was begun at the Essen Council. The main innovation in the new Title, by comparison with the procedure first established at Essen, is the process of formulating guidelines which, if they are not observed by Member States, can give rise to recommendations, in effect warnings for failure to comply with the guidelines.³¹ A major difference with EMU, however, is that under the employment policy procedures, the worst that can happen to a Member State is to receive a non-binding recommendation. Under EMU, as have seen, a Member State which fails to observe warnings issued by the Council in relation to excessive levels of national debt and excessive budget deficits may be subject to a fine. Moreover, under Article 129, the powers of the Council in the area of employment policy are explicitly stated not to extend to the power to harmonise laws and regulations of the Member States.

At the Extraordinary European Council in Luxembourg in November 1997 (the so-called Jobs Summit) it was agreed that the procedures for monitoring employment policy would be implemented ahead of the coming into force of the Amsterdam Treaty. Under what has since become known as the ‘Luxembourg process’ the first guidelines, issued to member states in October 1997, outlined policy areas for 1998. Member States then drew up their National Action Plans (NAPs) in the first quarter of 1998 and a preliminary assessment was made by the Commission and discussed at the Cardiff Council in June 1998. The Member States subsequently submitted their assessment of their NAPs, and these together formed the basis of the 1998 *Joint Employment Report*³² by the Commission and Council.

The first sets of guidelines have centred on four main ‘pillars’. Table 1 indicates the relationship between pillars and guidelines as they were initially formulated in 1998 (they have since been the subject of some relatively minor amendments). Altogether, the employment guidelines are a curious mix of neoliberal policy objectives, which stress deregulation and individual responsibility for training and labour market mobility, and neo-corporatist strategies, which envisage collective solutions to the reconciliation of flexibility and security. The *entrepreneurship* pillar appears to embody a deregulatory agenda of the kind which sees the removal of regulation and taxation as essential to providing the necessary conditions for economic growth. The *employability* pillar is more ambiguous in that it places a strong emphasis on lifelong education and training as a means of enhancing the quality of the labour supply, which implies an extensive role for state intervention. However, in stressing the obligations of individuals to enhance their skills and earning powers, it also downplays the responsibilities of employers to provide secure employment. This is in contrast to the *equal opportunities* pillar, which emphasises the reconciliation of supply-side flexibility with individual employment rights in the areas of equal access to work, family-friendly policies, and the needs of people with disabilities.

We wish to focus in more detail here on the *adaptability* pillar, which has provided a focus for functional flexibility of the kind which arguably comes closest to realising the ‘Third Way’ objective of reconciling flexibility and security. Member States are called on to initiate measures aimed at negotiation over the improvement of productivity through the reorganisation of working practices and production processes. The reduction and re-negotiation of working time, the flexible implementation of labour standards, and information and consultation over training issues have also come under this heading, and the role of social dialogue in promoting these goals has been explicitly recognised.

In this vein, the Commission's response to the 1999 NAPs noted that '[t]he adaptability pillar calls for the development of a strong partnership at all levels – European, national, sectoral, local and enterprise levels – with the aim of modernising the organisation of work and adjusting to structural change', but found that '[t]he evidence so far provided by the majority of Member States suggests that we are still quite distant from this objective'. It concluded that in the UK, as well as in Portugal and Greece, 'more needs to be done in involving the social partners at all levels to develop initiatives and actions in relation to work organisation'.³³ Its proposals for amendments to the employment guidelines for 2000 envisage an expansion of the role of social dialogue under the adaptability pillar on the following lines:

'The social partners are urged to agree and implement a process in order to modernise the organisation of work, including flexible working arrangements, with the aim of making undertakings productive and competitive and achieving the required balance between flexibility and security. Subjects to be covered may, for example, include training and re-training, the introduction of new technologies, new forms of work and working-time issues such as the expression of working time as an annual figure, the reduction of working hours, the reduction of overtime, the development of part-time working, and access to training and career breaks'.³⁴

Similar views have been expressed in related policy developments. In particular, the Commission Communication of 25 November 1998 *Modernising the Organisation of Work – A Positive Approach to Change*, which followed on from its earlier Green Paper on *Partnership for a New Organisation of Work*, argued that:

'The overriding objectives of the EU are **competitiveness** and **employment**. In this context there is considerable agreement that improvements in **productivity**, through a better organisation of work, are necessary if individual enterprises are to improve their

competitive position and if the Community is to achieve its objectives. In addition, a positive approach to reconciling the needs of firms for **flexibility** and the needs of workers for **security** in change, is essential'. (bold in original.)³⁵

Similarly, the *Report of the High Level Group on the Implications of Industrial Change*, also published late in 1998, concluded that 'top-performing companies have a good social dialogue with their employees because motivated people are the vital component for commercial success'.

The key issue to arise from this process of clarifying and amplifying the meaning of the adaptability pillar is how far the affirmative role for social dialogue which is envisaged at the micro-level – the level at which the social partners are seen as engaging in a process of negotiation over flexibility at firm and/or sector level – is compatible with the macro-level framework for economic and social policy which has been set by EMU. One of the few attempts to link the macro and micro levels is the notion of a 'European Employment Pact', which was discussed at the Vienna summit in 1998 and adopted at the Cologne summit in the following year. According to the Commission, as part of the 'Employment Pact':

'the Social Partners should continue to support the European employment strategy, notably through appropriate wage developments in line with the 1999 Broad Economic Policy Guidelines, and contribute to implementation of the Employment Guidelines, including joint initiatives to modernise the organisation of work'.³⁶

The greater involvement of the social partners in the negotiation of flexibility could potentially provide a quid pro quo for their role in maintaining wage restraint at the macro level. But here, the institutional priority accorded to EMU over social and employment policy limits must be taken into account. The EMU process is explicit

in aiming to bring about a high level of convergence in the economic policies of the Member States,³⁷ and is underwritten by sanctions which can, at the end of the day, be deployed against a recalcitrant Member State in order to ensure that this degree of economic convergence is maintained.

By contrast, the Community's employment strategy does not require Member States to maintain any particular level of *social convergence* as a condition of participating in the process laid down in the Employment Title (except, implicitly, to the still-limited extent envisaged by the social policy provisions of the EC Treaty and related harmonising measures). It is, of course, possible that the employment strategy may lead over time to a degree of convergence in the way in which active labour market policies are conducted (Biagi, 1998). But there is no guarantee that there will be convergence around a core of social rights. There is, for example, no mechanism yet in place which could require the United Kingdom to comply with the Commission's recommendation, made in the context of its review of the UK's 1999 National Action Plan, that it should 'promote concrete commitments by the social partners at all appropriate levels on the modernisation of work organisation'. On the contrary, the British government remains free to oppose the expansion of social dialogue through systems of employee representation along the lines suggested by the proposal for a directive on information and consultation at national level, which it has successfully blocked at Community level. As long there is no institutional means by which the harmonisation of social rights can be built into the employment strategy, there is a danger that the kind of convergence to which the Employment Title will give rise is one based on the kinds of 'structural adjustment' which are envisaged by EMU – or, in other words, deregulation.

4. Conclusions

In the words of the *Joint Employment Report* for 1998, the new institutional framework for employment policy 'supports a

coordinated approach to employment policy, facilitates an exchange of best practice and brings together various Community policies in order to contribute to an employment strategy'.³⁸ However, the main driving force behind employment growth is still seen as the process of EMU: 'in the longer term, the successful launch of EMU will "lock in" sound macroeconomic policies, expectations and policy-making processes towards favouring stable high employment-creating growth in the EU'.³⁹ Compared to this, the suggestion that 'vigorous and resolute implementation of the Employment Strategy, especially the Employment Guidelines, will also help to bring the employment rates to previously-recorded high levels within the foreseeable future'⁴⁰ seems at the very least to be premature.

This is because of limitations which are inherent in the process established by the Employment Title. Notwithstanding the recent reforms to the European Social Fund (Szyszczak, *forthcoming*), the Commission lacks the budgetary capacity to underwrite significant active labour market expenditure in its own right. The Amsterdam Treaty confirmed that the Member States were not prepared to endorse the type of demand-side, growth-orientated strategy for job creation which was mooted by the Commission in the early 1990s.⁴¹ Stability rather than growth is the priority of the mis-named Stability and Growth Pact.

Both employment and social policy are currently being influenced by the view which associates flexibility with 'structural' reforms to the labour market, including changes to employment legislation and the tax-benefit system. Reforms to employment protection legislation and the shifting of the tax burden from employment to consumption are seen as means of eliminating 'rigidities' within the labour market. In some quarters (see Robinson, 1998), this version of flexibility is viewed as a natural corollary to the process of EMU. As national governments lose the power to adjust to changing economic conditions by modulating the exchange rate and altering the balance between taxation and public expenditure, the burden of adjustment is

thrown on to the labour market, which is now required to operate with maximum flexibility in the sense of bringing wages and terms and conditions into line with changes in demand. In this scenario, the process of economic integration creates a momentum of its own for deregulation at national level. A further impetus for this 'race to the bottom' would then be provided by the entrepreneurship and employability pillars of EU employment policy, with their stress on the need to lift the burden of regulatory controls.

None of this is necessary, nor is it desirable. We argued in the first half of this paper that there are many different versions of labour market flexibility, and that it is highly misleading to envisage a straightforward trade-off between flexibility and regulation. Labour standards may have a number of complex economic effects, some of which may enhance long-term growth and competitiveness based on high productivity. We also saw that promotional standards – active labour market policy measures aimed at raising investments in training and education and re-integrating excluded groups into employment – are an indispensable part of a comprehensive strategy aimed at reconciling continuous improvement in productivity with a high level of employment participation.

This view is reflected in the adaptability and equal opportunities pillars of the employment guidelines. However, these elements of the employment strategy are in fundamental conflict with the language of deregulation and 'structural adjustment' which is found, above all, in the entrepreneurship pillar. Rather than forming a coherent whole of the kind which could represent a viable 'Third Way', the employment strategy remains riven by conflicts which may yet prove to be irreconcilable.

An extensive social policy at Community level should imply an equally far-reaching employment policy. However, the missing link, at present, is the macroeconomic framework. As long as the priorities of EMU remain as they are, social policy will be under threat, and

there is a danger that the potential of the employment strategy will remain unfulfilled.

Notes

1. Commission Communication, DG5 (Brussels, 1998).
2. COM (97) 127 final.
3. *R v Secretary of State for Employment, ex p EOC* [1994] IRLR 176.
4. Council Directive 97/80/EC of 15 December 1997 on the burden of proof in cases of discrimination based on sex. See also Council Directive 98/52/EC of 13 July 1998 on the extension of Directive 97/80/EC on the burden of proof in cases of discrimination based on sex to the United Kingdom of Great Britain and Northern Ireland.
5. Council Directive 96/34/EC on the framework agreement on parental leave concluded by UNICE, CEEP and the ETUC.
6. Council Directive 97/81/EC of 15 December 1997 concerning the Framework Agreement on part-time work concluded by UNICE, CEEP and the ETUC - Annex : Framework agreement on part-time work. See also Council Directive 98/23/EC of 7 April 1998 on the extension of Directive 97/81/EC on the framework agreement on part-time work concluded by UNICE, CEEP and the ETUC to the United Kingdom of Great Britain and Northern Ireland, OJ, L 131, 5.5.1998.
7. *OECD Employment Outlook*, (Paris: Office for Economic Cooperation and Development, 1999), at p. 224, Table A.
8. See *OECD Employment Outlook*, 1999, at p. 225, Table B.
9. *The National Minimum Wage. First Report of the Low Pay Commission*, 1998, at p. 115.

10. The source of this assessment is the *1998 Joint Employment Report* of the Council and Commission (Luxembourg: OOPEC), p. 34; see further section 3, below.
11. Regulations 2052/88 and 2081/93. See Freedland, 1996a: 294-295.
12. Council Decision 94/819. See Freedland, 1996a: 300-307.
13. Now contained in Arts. 136-145 of the consolidated version of the EC Treaty.
14. Council Regulation 1466/97, OJ L 209/1, 2.8.97 and Council Regulation 1467/97, OJ No L 209/7, 2.8.97.
15. Resolution 97/C 236/01, OJ No C 236/1, 2.8.97.
16. Regulation 1467/97, Art. 12.
17. *Ibid.*, Art. 13.
18. For the results of the first multilateral surveillance exercise under this provision, see ‘Budgetary Surveillance in EMU’, *European Economy*, Supplement A, Economic trends, No. 3 (March 1999).
19. Resolution 97/C 236/02, OJ No C 236/3, 2.8.97.
20. *Ibid.*, para. 6.
21. *Ibid.*, para. 11.
22. OJ L 209/13, 2.8.97.
23. See OJ L 209/18, 2.8.97.

24. Recommendation 99/570, at para. 3(3). See OJ L 217/34, 17.8.99.
25. Recommendation 97/249, para. 2(iii).
26. COM (98) 322, at p. 10.
27. Recommendation 97/249, para. 2(iii).
28. Recommendation 99/570, para. 2.4.
29. Resolution 97/C 236/02, para. 13.
30. It is not our intention here to give a full account of the employment strategy, nor of its ‘flanking policies in the areas of structural funds, employment aid, and the activities of the European Investment Bank. For such analyses, see Goetschy and Pochet, 1997; Biagi, 1998; Goetschy, 1999; Kenner, 1999; Pochet, 1999; Szyszczak, *forthcoming*.
31. This is the effect of Art. 128 of the EC Treaty (formerly Art. 109q).
32. See http://europa.eu.int/comm/dg05/empl&esf/empl99/joint_en.htm. At the time of writing, a draft *1999 Joint Employment Report* had been issued.
33. *Commission Recommendation for Council Recommendations on the Implementation of Member States’ Employment Policies*, 1999, para. 6.
34. *Proposal for Guidelines for Member States’ Employment Policies*, 2000, p. 9.

35. Para. 2.1.1.
36. *Community Policies in Support of Employment*, 1999, p. 4.
37. This is particularly so, of course, for Member States which are now part of the euro zone, but other Member States are also subject to the multilateral surveillance procedures and to the general obligations under Article 99 to coordinate their economic policies. See Commission, 'Budgetary surveillance in EMU' in *European Economy*, op. cit.
38. *Joint Employment Report 1998.*, op. cit., p. 2.
39. *Ibid.*
40. *Ibid.*, p. 9.
41. European social and economic policy sometimes moves rapidly, but as yet the unusual conjunction of social democratic governments in virtually all the EU Member States has not produced any change of direction in this respect.

TABLE

Table 1. Employment Pillars and Guidelines, 1998.

Pillars	Guidelines
Employability	Preventive approach to reduce the inflow into long-term unemployment (1-2) Shifting people from dependency on welfare to work and training (3) Developing partnership in the provision of training and lifelong learning (4-5) Facilitating the transition from school to work (6-7)
Entrepreneurship	Reducing overhead and administrative costs for businesses (8) Promoting self-employment (9) Promoting job creation in the social economy and at local level (10) Examining ways of reducing VAT in labour-intensive sectors
Adaptability	Agreements by the social partners on modernising the organisation of work, balancing flexibility and security (13) Introducing more adaptable types of contracts while providing adequate levels of security (14) Encouraging in-house training and investment in human resources (15)
Equal opportunities	Tackling gender gaps in employment and unemployment (16) Reconciling work and family life (17) Facilitating reintegration into the labour market (18) Promoting the integration of people with disabilities into working life (19)

Note: the numbers in brackets refer to the numbers of the Guidelines.

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