GLU

Global Labour Column

http://column.global-labour-university.org/

Number 32, September 2010

CSID CORPORATE STRATEGY AND INDUSTRIAL DEVELOPMENT

Precarious work makes for a precarious recovery

by Ronald Janssen

This week, trade unions in Europe will stage massive protests against the sharp turn economic policy in Europe has taken. After having saved the banking system from total collapse, governments throughout Europe are not only cutting public services and social benefits. On top of this harsh fiscal austerity, several member states also intend to inject an even greater dose of flexibility into their labour markets. These governments adhere to the conventional wisdom that, by allowing business to get rid of workers more easily, employers will advance in time the decision to (re)hire workers. In turn, the additional purchasing power coming from the front-loading of jobs would support aggregate demand and accelerate economic recovery.

Meanwhile, business is certainly more than ever interested in easy firing or flexible labour contracts and this for two reasons in particular. Having in mind the sudden and spectacular collapse of demand and activity that companies faced at the end of 2008, management is now reluctant to hire workers on the basis of open ended contracts. Another motive for business to turn to short term contracts is the credit squeeze that many companies have been or still are facing as a result of the financial crisis. To reduce dependency on bank lending, business is now keen to maximize profits as a source of new capital and one way to cut wages and increase profits is to hire temporary workers who tend to be cheaper than regular labour (see below).

By engaging in this flexibility crusade, policy makers are making a big mistake and are running the risk of accomplishing the opposite effect of stalling and weakening economic recovery. To understand this, one needs to understand the nature and extent of the damages temporary contracts inflict upon workers.

First of all, temporary contracts come with a high wage discount. A recent study by the IMF finds that, even when correcting for factors such as education and tenure of permanent contracts, temporary workers systematically receive lower wages than workers in open ended contracts (IMF 2010). For most European countries, the wage gap is around 15 to 25%, with one country (Sweden) recording a wage gap as high as 44%. While the size of the wage gap between temporary contracts and regular work contracts is casting doubts on whether the principle of 'equal pay for equal work' is being respected around Europe, the fact that there is such a wage gap is in itself not so surprising: temporary workers are vulnerable workers. Employers have the power not to prolong the temporary contract or, alternatively, employers become 'invisible' to their own work force by using agency work. This makes temporary workers willing to do the same job for lower wages. And with employers hiring workers on a temporary basis instead of on the basis of open ended contracts, the additional purchasing power that is injected into the economy is seriously reduced.

Second, not only do workers in temporary contracts gain lower wages, they also tend to consume less and save more. One reason is the insecurity that is inherent in the nature of these contracts and which drives workers to increase precautionary savings. There is also a 'Ricardian' effect at work here: with rates of transition into regular contracts sometimes as low as 12% even after a period of one year (IMF 2010), temporary contracts often work as a 'bad job' trap. When hiring, employers often discriminate against workers having a history of temporary contracts. Business also tends to provides temporary workers with less access to continuous training. Facing the possibility of remaining stuck in a chain of insecure and low paid fixed term contracts for years to come, these workers will discount the prospect of future depressed revenue flows into lower consumption at present.

Third, and in contrast to the widespread view that core workers are too protected to be affected by flexibility, there are spillover effects on the rest of the workforce. The sheer use of temporary contracts functions as a severe threat to workers under open ended contracts to be careful not to lose their job and find themselves in a situation in which they in turn would be forced into pre-

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carious contracts when re entering the labour market. This makes the work force to be more inclined to accept wage cuts, longer working hours and other degradations of their rights in order to preserve their present job situation.

In short, 'flexibility' all too often boils down to 'flexploitation'. This raises a key question: can flexibility compensate for its negative impact on wages and aggregate demand by generating sufficient new jobs? The answer to this is negative. In fact, the illusion that flexibility improves an economy's job performance has been shattered by the same institution which has been relentlessly pushing the case for flexible labour markets for more than a decade. In 2006, when examining the outcomes of its so-called 'Jobs Strategy', the OECD itself was forced to admit that the evidence to support the claim that flexible labour markets are good for jobs simply was not there (OECD 2006).

Moreover, the analysis should be taken a step further. Since the beginning of the 1990s, reforms of labour law in rich countries have systematically provided business with several alternatives to hiring workers under open ended contracts. As a result, the share of temporary contracts in dependant employment has seen a structural increase, from 12% in the mid-90s to 14% in 2008. The rising incidence of temporary work, combined with the OECD conclusion that flexibility does not create jobs, implies that there have been important substitution effects: Thanks to more flexible labour laws, 'bad jobs' have driven out 'good jobs'. Business is now able to turn jobs which are basically stable and which would have been created anyway into short term labour contracts. The economic reality is often that the same worker has been doing the same job for the same company for many years whereas the legal reality is that this worker is caught in a chain of fixed-term contracts.

The bottom line is that labour market flexibility does not result in 'job rich growth' but in 'job destructive stagnation' instead. Any potentially positive effect that might arise because employers would hire workers in a somewhat earlier phase of the business cycle, simply pales against the negative effects on aggregate demand coming from the spread of temporary work practices (serious wage discount, rising precautionary savings, more acceptance of wage moderation by core workers and, last but not least, the transformation of regular jobs into precarious contracts). Flexibility therefore represents an important downwards risk for the present recovery: If the initial and fragile recovery of demand, which is now mainly coming from exports to the rest of the world, evaporates into the black hole of an increasingly flexible, insecure and underpaid work force, any hope of moving the economy into a process of strong and self-sustaining growth will disappear with it.

The irony is that by resorting to temporary work practices, business itself is shaping the hesitating and weak recovery companies are afraid of in the first place. So instead of once again giving in to the short sighted wishing list of European business, governments need to do the opposite and intervene to keep individual companies from imposing precarious labour relationships on their work force. To save the recovery, labour law in Europe needs to be strengthened instead of being weakened. A strict implementation of the new agency work directive and the principle of equal pay for equal work would be a first step forward. Another step would be to upgrade existing social directives and agreements by seeing to it that the principles of these directives are respected to the letter, with particular emphasis on the principle that atypical jobs should remain the exception and not become the rule.

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