

ENHANCING  
EUROPEAN COMPETITIVENESS

Third Report to the President of the European Commission,  
the Prime Ministers  
and Heads of State

June 1996

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June 1996

Dear Mr President,

On behalf of the Competitiveness Advisory Group, I hereby submit the Third Report, dealing with competitiveness and employment. The issues in this Report are closely related to the wider subject of the competitiveness of the European Union. A higher level of competitiveness would effectively be the best way to create more jobs. In addition, a better use of the labour resources in the Community would also mean that the waste of productive people being idle would be reduced, thus improving our competitive position.

We do make a number of suggestions which are, where possible, supported by examples taken from various countries.

The preparation of the Report was largely done under the chairmanship of Dr Ciampi who, as you know, resigned mid-May following his appointment in the new Italian Government.

Yours sincerely

*F. A. Maljers*

Mr Jacques SANTER  
President  
European Commission  
Brussels

# I. SUMMARY AND CONCLUSIONS

In its first two Reports, the Competitiveness Advisory Group (CAG) focused on issues which Europe must resolve if it is to meet today's global challenge. These included completion of the internal market, steps toward EMU, progress in the priority trans-European networks, public-private partnerships, the East-West win-win opportunity, expansion of Europe's vibrant small and medium-sized enterprise sector. The CAG also stressed the role environmental policies and education and training policies play in establishing the competitiveness framework.

This Third Report moves to what is often regarded as an even more central area, the labour market, employment, and competitiveness. We start from a basic fact: unemployment is too high in Europe. The waste of resources this represents is one side of the coin. The social consequences, the real hardship, even the potential political repercussions, are all just as important. Europe's current dismal performance is fairly new. Historically, we did better than our trading partners. The time has come to see why we no longer do so, and how we can do better. There are other labour market models outside Europe. These have some apparent advantages in terms of job creation, yet each carry with them definite costs. Europe has to find its own way, in the context of a social model based on consensus, agreement, and involvement.

The competitiveness of an economic system cannot be divorced from the range and scale of employment prospects it offers its people. Better functioning of the labour market in Europe is generally acknowledged to be vital for competitiveness, just as competitiveness itself is a determining factor for the level of employment. We cannot avoid policy changes — as well as changes in attitudes — and not only in labour matters. There is a view of unemployment as the inevitable corollary of the present stage of industrialization. This must be countered by both sides in the employment equation — workers and employers. In terms of labour market modernization, the perceived dichotomy between efficiency and solidarity need not be so stark. This is one CAG message. In combination with a supporting macroeconomic policy, we need to encourage mobility, positive flexibility and

change in the labour market, avoiding rigidities which become disincentives to work and to take on new employees. The CAG is convinced that reforms in this direction need not conflict with Europe's high standards of social protection, nor affect provision of the safety net which those most exposed to hardship as a result of joblessness have a right to expect.

The Report is in three sections. Part I traces the current situation and how it has developed over time. It analyses what should be done — and what can be done — to establish positive flexibility in labour markets and to reform labour relations in Europe. Parts II and III adopt a novel methodology. They develop the CAG's established bottom-up approach, illustrated by case studies, applying it both to a country-by-country, as well as to a company-by-company, analysis. The benchmarking of countries provides practical illustrations from the Europe of today of measures that can be taken to increase employment and, particularly, to decrease unemployment in exposed groups. The companies and organizations analysed are known to have undertaken changes in work organization, giving greater flexibility to achieve enhanced competitiveness with job creation and job enrichment, and benefits to employers and employees.

In its work, the CAG discovered a significant lack of comparative evidence relating to socioeconomic policy across the European Union. This is clearly regrettable and should be rectified. The Report aims to offer first indications for such comparative analysis, a start on which benchmarking which will enable us to agree the parameters of debate and so start the process of reform.

The Report makes a series of key recommendations in the following policy areas.

1. Modernization of the labour market needs to be carried out in the framework of a **growth-oriented scenario**. This includes completion of the single market to realize the European dimension of our economy, infrastructural investment, a fresh commitment to education to provide the full range of core skills which must be available in the workforce of a successful economy operat-

ing in the global marketplace. But the benefits of reform and restructuring will not materialize if macroeconomic policies do not play their role in ensuring that the potential increase in the output of the economy is matched by an expansion in demand.

2. There is an ongoing need for **wage moderation**. Wage moderation facilitates the task of maintaining low inflation and keeping public finances under control, and achieves the Maastricht criteria. But excessive reliance on wage moderation only can generate serious problems of inadequate demand and even incur the risk of deflation. A broad consensus is required. For this reason, national social pacts, in the light also of the overall scenario set out in President Santer's Confidence Pact, will enable us to move forward simultaneously on the stability and on the employment front.

The question of relative wage levels must be seen in context, given by age, sector, region. Minimum wages help contain excessive wage inequality, but may hurt those seeking to (re-)enter the labour market.

3. An important contribution to kick-starting Europe's labour markets would be a sizeable **lowering of employment costs for the lower-skilled and the long-term unemployed**. The aim should be to reduce the cost of labour without reducing the return on that labour. The CAG recommends the suppression of employers' social security contributions and the reduction of wage taxes for the lowest paid. In this connection it is important that Member States agree to refrain from tax competition on capital and energy.
4. **Training** is intangible investment with real benefit to company and worker. We give examples of competence development and extensive company training that retain workers and lead to more jobs. Training is also a

key weapon in our fight to reduce long-term unemployment.

5. Measures to facilitate **mobility between companies, regions and countries** will make an important contribution to reducing unemployment. There is a clear correlation between low mobility and high unemployment. Changing this will require new housing market provisions and allowing transfer of pension rights across Member States' boundaries.
6. **Flexibility in working hours** in a day or a week, across the business cycle has been proven to increase competitiveness, with better response to market, higher customer satisfaction, more secure employment and new jobs. Such flexibility is obtained through local agreements, with sectoral and national agreements providing a general framework. Today's more decentralized labour market is also marked by different and changing tasks as well as novel forms of work organization often deriving from the application of advanced information and communication technologies. All this implies new challenges to workers and employers, and to their respective organizations, with the need for them to adapt to new forms.
7. The social partners should act in concert to facilitate recourse to **part-time jobs** which can be of special benefit to groups such as people with family responsibilities, the young and those approaching retirement.
8. More effort should be dedicated to the **cost-benefit analysis of EU social legislation** foreseen in the Maastricht Treaty.
9. The CAG reiterates its belief that modernization of the labour market, and the fight for more employment in Europe, are not only social policy; they are essential for our **long-term economic competitiveness**.

## II. LABOUR MARKET, UNEMPLOYMENT AND COMPETITIVENESS

### The growth in employment

European unemployment in 1995 stood at 11.1%. Economic recovery since 1993 has had only marginal impact on the number of the jobless. This pattern is by no means new. Since 1973, each downturn of the business cycle seems to have led to a further, unprecedented, peak in the unemployment rate. Conversely, economic recoveries provide only temporary relief to the otherwise uninterrupted rise in the unemployment rate. Compared to the USA, **unemployment in Europe is much more persistent**, particularly at the individual level. It is true that the probability of losing a job is substantially lower for a European worker than for one in the USA; however, following job loss or at entry into the labour force, the probability of overcoming unemployment and finding a job in Europe is far below that in the USA. As a result, **unemployment in Europe is typically of long duration**. Long-term unemployment accounts for 42.9% of total unemployment, against 10% in the USA and 15.4% in Japan.

### The lack of employment opportunities

European economies have also failed to create an adequate number of employment opportunities. The employment gains between 1986 and 1990 were all but lost in the subsequent recession. Since 1980, employment growth in Europe has averaged only 0.15%, in stark contrast to other OECD countries. In Japan, employment growth was 1.26% during the same period. In the USA, it reached 1.54%. The difference between Europe and the United States of America cannot be ascribed to a faster rise in the population of working age in the USA. As a matter of fact, the ratio of employment to working age population grew in the USA from 71% in 1980 to 77.1% in 1995. During the same period, it stagnated in Europe, passing from 66.2 to 66.3%. **High unemployment rates and limited employment creation have taken a toll on the willingness of many Europeans to keep actively**

**seeking jobs**. Traditional ways of measuring unemployment are thus bound to underestimate the deterioration in the labour market. Allowing both for discouraged workers (those who would be willing to work but have stopped searching because they have little hope to succeed) and for involuntary part-time workers (those who work part-time being unable to find a full-time job) raises the 1993 unemployment rate quite dramatically, from 11.5 to 14.7% in France and from 10.4 to 18% in Italy (Bureau of Labour Statistics, 1995). The exit of so many able workers from the labour market is a forceful indication of Europe's inability to put the available human and productive resources to good use.

### Unemployment and competitiveness

Widespread unemployment represents a major threat to the cohesion of the European society. The view of unemployment as an unacceptable waste of existing productive resources is correct, but too narrow. First of all, **high levels of unemployment foster both poverty and emargination**. They therefore erode social cohesion, create a sense of social disfranchisement and may, at times, breed social conflict. Furthermore, they often undermine an individual's incentive to invest in his or her own human capital. Finally, with unemployment in two digit figures, the loss of a job can imply a long spell of unemployment, bringing real hardship. Plant closures can trigger the decline of entire neighbourhoods, even regions. It is difficult for those concerned to accept the logic. As a result, **growing unemployment typically strengthens political pressures in favour of more protectionism**, thereby further weakening the ability of European economies to take advantage of new opportunities and adjust. All these factors undermine our competitiveness. The fight against unemployment is not social policy: it is an economic imperative.

## The causes of unemployment

The rise in endemic unemployment can to a large extent be traced back to a set of shocks that hit most industrial countries from the mid-1970s on. These include the two **oil shocks**, which compelled major restructuring of industry; **restrictive demand policies**, aiming to offset the inflationary impact of higher oil prices in 1979 and of the German unification in the early 1990s; **high taxes**, also made necessary by the need to finance the rising costs of the welfare State; fierce **competition from newly emerging countries**, that hit labour-intensive sectors particularly hard; a pattern of **technological progress** that has put unskilled labour at a disadvantage. The impact of these shocks was then to some extent exacerbated by the lack of any coordinated response from European policy-makers. Similarly, **weak coordination** did not allow European economies fully to exploit the opportunities offered by a number of favourable developments in the second half of the 1980s, with the precipitous fall in real oil prices and decline in inflation and in the 1990s, the single market.

### II.1. The need for a flexible response

#### Adjusting to a changing environment

Trade and technology are often blamed for rising unemployment. Their effect however is easily misjudged. History, particularly European history, teaches us that **technological progress and expanding international trade in time have always provided opportunities for sustained growth and employment**. By themselves, they cannot and should not take the blame for European unemployment. Technological progress and international competition can, however, be a source of dislocation and job loss, both in the short run and at a regional level. Workers can indeed be made redundant by increasing productivity at unchanged output or by growing competition from imports. In order fully to **exploit the opportunities offered by trade and technology, firms, workers and governments alike must strive to adapt in a flexible and dynamic way to a continuously changing environment**. It is a great challenge. Firms may realize that cherished products or long-standing management procedures, once a source of strength, no longer retain their validity and have even become a brake on competitiveness. Workers and unions may find that old practices and even the notion of the lifelong job may have

become untenable in a steadily changing and competitive environment. Governments need to adapt as well, with policies which are more proactive, aiming to exploit new opportunities rather than merely manage the problems of adjustment. Policies should be aimed at cushioning the price of adjustment, but they should be designed to protect people, not to protect jobs. Too often these simple messages have been all but forgotten in the past, at great cost to the European economy and to its people.

#### The need for action

The rise in European unemployment calls for courageous and coordinated action by Europe's policy-makers. We should not forget that things have not always been like this. In the 1960s and until the mid-1970s, unemployment in Europe fluctuated around 3%, just half the level in the USA. Today, it stands at 11.1%, almost 6 percentage points above the American level. We can and should do better. We must look at best practices both in Europe and elsewhere to devise a comprehensive strategy against unemployment. We need to examine the experience of other countries. This does not mean that we should try to replicate mechanically what has been done elsewhere. **Labour market institutions have been forged also to reflect the aspirations of European people**. They should not be discarded, but rather reformed after careful scrutiny of their social, political and economic role. For instance, minimum wage regulations are often said to be the main culprits for youth and unskilled unemployment. Yet, these regulations have helped Europe avoid a precipitous fall in the unskilled wage and a deterioration in income distribution. In the USA, by contrast, income distribution deteriorated further, and this despite its initially highly unequal pattern. Europe's ability to preserve greater equity in income distribution is even more remarkable given that the unemployment rate among unskilled workers, albeit increasing, is no higher than in the USA. All this being said, **the European social model does need to be reviewed and modernized so that it can better cope with the profound economic, social and demographic changes taking place throughout the world economy**. We argue that this reform can best be done by achieving a high degree of consensus among social partners in support of the necessary changes.

#### Towards a comprehensive strategy

The CAG believes that a sizeable reduction in unemployment is essential to strengthen the



competitiveness of the European economy. Devising a strategy against unemployment is, however, a complex task. Prescriptions may differ between the different countries. No short-cuts are available. While each country retains responsibility for devising its own approach, we believe that **a comprehensive and coordinated European strategy in the fight against unemployment** should be developed. Such a strategy must emphasize the following factors.

- (a) **Establishing a growth-oriented scenario.** For this we certainly require financial rigour, a check on inflation and a supportive macroeconomic framework to avoid insufficient demand hampering employment growth. We also must move more rapidly to full implementation of the single market programme.
- (b) **Implementing the infrastructure investments** necessary to manage and fully exploit opportunities offered both by new technologies and completion of the single market.
- (c) **Promoting the growth of small and medium-sized enterprises**, known to be the major source of employment growth in Europe.
- (d) **Promoting lifelong learning** so as to allow workers flexibility to adapt to the continuously changing needs of modern economies.
- (e) **Promoting a new system of industrial relationships**, based on a cooperative approach between firms and unions to strengthen the ability of firms to compete in the international economy and provide workers with enhanced protection against the risk of unemployment.
- (f) **Modernizing the institutions governing the labour market and the other markets** which have hampered employment performance. Any proposed policy should aim at controlled deregulation, or reregulation, in all these markets (for labour, goods and services and capital) where institutional barriers stifle competition and employment growth, and at reforming so as to strengthen social institutions underlying our welfare systems.

The CAG has already stressed many of these factors, particularly the need for infrastructural investment, the role of small and medium-sized enterprises and the benefits of lifelong education and learning. In this Report, **we focus on the role of macroeconomic policies, the need for**

**incisive labour market reforms and the scope for a new approach to industrial relations.** We try to draw indications from companies and countries across Europe. In attempting this task, we have been surprised to discover that no benchmarking analysis of Europe's experience with labour market reforms and evolving industrial relations has ever been conducted. We hope that the bottom-up approach taken in this Report will allow Europe to identify lessons from best practices and to develop effective policy recommendations.

## II.2. Establishing a growth-oriented scenario

### A supportive macroeconomic framework

Macroeconomic policies can provide a major contribution to reducing unemployment by creating the conditions for sustained, non-inflationary growth. Three key variables have a shared responsibility in the maintenance of stable, low inflation. These are **monetary policy, fiscal policy and the evolution of wages**. Even if the ultimate responsibility for price stability lies with monetary policy, the more fiscal policy and wage behaviour are in line with the objective of low inflation, the more accommodating monetary policy can be. Macroeconomic policy can take into account the beneficial effects of structural reform in labour markets. Reform can, for instance, allow faster growth in output and employment without igniting inflation. Similarly, **the benefits of structural reform in terms of lower unemployment will not materialize if the macroeconomic stance is too restrictive**. A supporting macroeconomic policy is required to ensure that any potential increase in supply is matched by an expansion in aggregate demand.

### The role of fiscal policies

Fiscal policies can play a crucial role in smoothing the impact of economic fluctuations. In the long run, fiscal policies must be designed so as to prevent expanded government borrowing crowding out private investment and growth. Moreover, expansionary budgetary policies may clash with the Maastricht criteria. **The reduction in deficits should not, however, be accomplished by indiscriminate cuts in public investment expenditures**, as too often has been the case in the past. This temptation must be strongly resisted. In line with its previous Reports, the CAG recommends that the programme for

infrastructural investment (in particular, trans-European networks) be implemented as scheduled. This will boost the process of European integration as well as employment. We also believe that the Maastricht criteria regarding budget deficits should be interpreted in such a way as to acknowledge the crucial role that productive public investment (that financed, for instance, by the EIB) plays in enhancing competitiveness, employment and growth. Finally, we share the belief that the effectiveness of fiscal policy, both as a macroeconomic policy instrument and as a major influence on the pattern of resource allocation, would be greatly improved by the development of a common European fiscal policy.

### **The scope for monetary stimuli**

In recent years, monetary policies have eased considerably, with ex-post short-run real interest rates in Germany falling from a high of 5% in 1992 to 2.3% in 1995. Over the same period, the real interest rate differential between Germany and the USA dropped from 5.1 to -1.6%. **Further declines in real interest rates in Europe are both possible and necessary.** At present, however, they are precluded by continuing exchange rate uncertainty, credibility problems in the peripheral countries and a widespread fear that the **European monetary union** may be associated with laxer anti-inflationary policies. All this hampers growth by discouraging both domestic and foreign direct investment. These problems can only be exacerbated if the schedule for monetary unification is delayed. The CAG believes that **the resolution of monetary uncertainty is an essential step toward lower interest rates.** It may even require acceleration, certainly not delay, along the path toward monetary unification.

### **The role of wage policies**

The task of macroeconomic policies would be made easier if wage settlements could also incorporate the objective of low inflation. Employers and the unions naturally have conflicting interests in the wage-setting process. All social partners should, however, acknowledge that a stable macroeconomic environment is a necessary prerequisite for high and sustained growth. Recurring spurts of inflation have a negative impact on growth. They discourage investment and force policy-makers to take corrective measures. Since 1993, however, wage restraint in Europe has overshot the target of 1% below productivity gains set in the Commission White

Paper on growth, employment and competitiveness. Moderate wage growth should prompt policy-makers to adopt policies supporting growth, otherwise moderation in wage bargaining could merely result in weak aggregate demand, not growth in employment and output. Appropriate behaviour in wage negotiations is therefore a necessary counterpart to any employment policy, both for micro and for macroeconomic reasons. **Moderation in nominal wage demands is necessary to avoid an inflationary spiral and to allow growth to proceed uninterrupted. At the same time, moderation in real wage demands can 'buy' more employment by favouring a more labour-intensive pattern of growth and by boosting competitiveness and investment.** Finally, in addition to the wage level, the wage structure is bound to play a crucial role in determining employment performance. In particular, **more flexible wage differentials can enhance employment opportunities for disadvantaged workers** (young people, the low-skilled, workers in less favoured regions, etc.). Achieving the three goals of nominal and real wage moderation and relative wage flexibility may require a differentiated approach. **Nominal and real wage moderation may be facilitated by a centralized incomes policy framework; the goal of relative wage flexibility calls for a decentralized approach.** An appropriate institutional framework, that recognizes the differences in wage institutions across the EU, will have to emerge to reconcile these different objectives. Income policies can play a useful role in this process. They can also be instrumental in ensuring that a reduction in inflation is not achieved through higher unemployment. Income policies must not, however, be seen by social partners as a way to extract concessions from central government which, in the end, end up aggravating the budgetary situation.

## **II.3. Reforming labour market institutions and building new industrial relations**

### **Reconciling social protection and flexibility**

Introducing a more flexible regulation of the labour market has been the focus of much debate on unemployment. With respect to labour market institutions, greater flexibility first of all means removing limitations that have impeded the birth and development of several market segments (for instance, agencies for temporary workers are still forbidden in some Member States). This is also an issue involving

the regulation of several product markets (for example, restrictions on retail opening hours) and the institutional environment for the development of non-traditional activities (such as the non-profit sector). Recognizing the need to strike a balance between the need of firms for flexibility and that of workers for security, **part-time work and temporary contracts** can increase employment opportunities for groups such as people with family responsibilities, young people and the elderly and offer a palatable alternative to early retirement. More widespread use of temporary contracts will also contribute to employment growth. Finally, **reform of welfare systems must emphasize limiting labour supply disincentives produced by certain welfare mechanisms and boosting labour demand, by lowering non-wage labour costs, particularly for less-skilled and disadvantaged workers.** In the second part of the Report, we take a closer look at Europe's experience with labour market reforms, with a view of identifying best practices which combine the objective of social protection with the need to improve the functioning of labour markets and reduce long-term and youth unemployment.

### **For a cooperative approach to industrial relations**

Greater flexibility is often interpreted as tilting the balance of power in favour of employers. It can therefore be opposed by trade unions. Yet a more positively flexible labour market could, in

many circumstances, benefit both workers and firms. For this to come about, it is essential that greater flexibility be achieved through a collaborative approach linking unions and employers. This is the essence of the Confidence Pact that President Santer has proposed to Europe's social partners. **A cooperative approach to a different organization of work within the firm will improve industrial relations, allow greater worker participation in decisions and potentially lead to better product quality.** The latter in fact represents an essential component in any strengthening of the competitiveness of the European economy. Collaboration between unions and employers is also essential to achieve greater flexibility in working hours, thereby allowing firms to achieve a better match between utilization of the labour force and fluctuations in product demand, while at the same time protecting workers against sudden layoffs. Overall, more flexible working hours will allow more effective use of the firm's productive capacity. They will lead to a reduction in labour costs and possibly to an expansion in employment. Similarly, unions and employers should strive to achieve a less restrictive approach to individual job descriptions so as to allow both more flexible utilization of the existing labour force and improved incentives for on-the-job individual learning and the accumulation of human capital. In the third part of this Report, we look at several experiences in Europe in which a flexible and participative approach to industrial relations benefited both firms and workers.

# III. LABOUR MARKET REFORM

Credibility and confidence are essential to generate the desired degree of labour market flexibility without creating greater uncertainty and hardship, and to avoid the waste of productive resources that arises from industrial conflict and loss of motivation.

Confidence pacts and collective agreements can bring about a change in attitudes, moving away from the logic of conflict towards one of mutual understanding and cooperation. There are countries that have already taken steps in this direction. More action is needed, at both EU and Member State level, taking into account national characteristics.

In the following, we examine a number of collective agreements and (more or less developed) nationwide confidence, or social, pacts. Labour market reforms are then examined, along with the lessons to be drawn, in a number of key areas: youth unemployment, the low-skilled unemployed, minimum wages, unemployment and poverty traps, long-term unemployment and (regional) labour mobility. Finally, we put forward concrete policy proposals.

## III.1. A supporting framework: collective agreements and confidence pacts

At a time when structural adjustment is needed, a certain amount of **decentralization of wage and employment negotiations becomes desirable**. Collective agreements at the sectoral or plant level take into account the local situation. The confidence, or social, pacts can give an overall macroeconomic coherence.

### **Collective agreement in the German chemical industry**

Some 90 000 jobs have been lost in the German chemical industry since 1991. This agreement concerns 605 000 employees:

- (i) a limited nominal wage increase (2%) in return for a moratorium on job cuts from June 1996 until June 1997;
- (ii) a lower wage for new entrants (including trainees) during their first year of employment: 95% of the normal wage, reduced to 90% for long-term unemployed workers;
- (iii) an official statement by social partners to encourage flexibility in working hours and differentiation, promote part-time work and the hiring of trainees;
- (iv) employees over 55 to have access to flexible part-time arrangements paying 85% of the previous wage and spread over five years; new workers to be hired to take the jobs made available;
- (v) overtime work to be compensated by reduced working hours later, rather than by wage payments.

### **Macroeconomic policy and confidence pact in Ireland**

There is an explicit wage moderation agreement between the Irish government, employers and employees. Nominal wages may increase in line with anticipated inflation; rises in real wages must remain below productivity growth. This agreement has allowed Ireland to take full advantage of the beneficial effects of sound fiscal policy (with a sharp reduction in the public debt that reduced the debt burden and eventually contributed to a rise in household disposable income) and of devaluation of the Irish pound. The recovery, initially due to export growth, is continuing now fuelled by growth in domestic demand (private investment and consumption). The expected GDP growth rate for 1996 is expected to continue to exceed significantly the EU average. The increase in domestic demand has benefited the local (labour intensive) service sector. The Irish unemployment rate remains high however, as a result of increasing participation rates.

## The 1993 social pact in Italy

The agreement signed by the social partners in July 1993 related to income policy, wage negotiation procedures and labour market issues including short-term contracts. Two formal round tables bringing together government, employers' representatives and workers are now scheduled every year (in May and September), to facilitate consultation between social partners before definition of the principal economic policy objectives.

The July 1993 agreements gave Italy for the first time a formal, organized system of industrial relations. They define negotiating rules between employers and employees, both at national (for each sector) and at plant levels. The national level determines minimal wage increases. With the end of automatic wage indexation following confirmation of suppression of the *scala mobile*, wage negotiations take place every two years. If no consensus is reached after three (respectively six) months, wages are automatically increased by an amount equal to 30% (respectively 50%) of the forecast inflation rate. Conciliation procedures have been set up. At the decentralized level, wage increases are linked to productivity gains or to quality improvements.

The agreement also stipulated that the Italian government would set up and implement an economic programme aimed at stimulating the economy and increasing employment (including spending on R&D, infrastructure, urban renewal), especially in the South.

These agreements helped Italy avoid inflation after the steep devaluation of the lira. The strong economic recovery that followed in 1994-95 (mainly driven by exports) led to record capacity utilization rates. Investment and private consumption expenditure remain relatively low however. This follows from uncertainty regarding public investment programmes, restrictive fiscal policy and wage moderation.

### **The role of collective agreement and confidence pacts**

Similar examples of collective agreements and social pacts could be taken from other countries (including Belgium, France, Germany, the Netherlands). **From an EU point of view, it is important to ensure that wage moderation does not become synonymous with wage competition and/or create deflation. Wage moderation is to be seen as part of an overall macroeconomic strategy.**

## III.2. Youth employment

The unemployment rate of workers under 25-years old, is substantially higher than the aggregate unemployment rate (often twice as high) in almost all countries, including the USA. In Europe, the rise in the aggregate unemployment rate has made the problem unacceptably more acute. Unemployment among the young is on average over 20% and, in some countries, over 30%. The issue is now of primary concern. **Youth unemployment higher than the national average is related to various factors: inadequate training, minimum wage constraints, employment regulations (via their effects on flows in and out of unemployment).** Over recent years, a number of policies aimed at reducing youth unemployment have been implemented. We examine here the effects of active labour market policies implemented in France. Minimum wage effects will be discussed later.

### **Training programmes in France**

Various types of active labour market policies were implemented in France in the second half of the 1980s. They provided subsidized job opportunities and on-the-job training for young unemployed workers. The policies differed in the amount of training provided, the length of the employment contract and the nature (private or public) of the employer. Training usually involved both the private employer and a vocational training agency. Incentives for a private firm to enter such a scheme were the opportunity to take on labour at a rate below the official minimum wage and exemption from all social security contributions.

Econometric evaluation of the effects of these policies on the employability of the beneficiaries has been made on the basis of panel data. The main results can be summarized as follows:

- (i) firms select the relatively more educated or experienced workers;
- (ii) a subsidized training scheme has a significant impact on the employability of the young workers and the probability of becoming long-term unemployed is reduced by 50% for workers with relatively low educational attainment;
- (iii) the higher the training content of the scheme, the higher the probability of obtaining a stable job in the future; whatever the educational level of the beneficiary, public jobs (TUC) have the lowest

impact on the probability of leaving unemployment;

- (iv) for the workers concerned by these schemes, the duration of unemployment benefits has no impact on the probability of becoming long-term unemployed; benefit duration has a positive effect on chances of getting a stable job at the end of the period of unemployment.

### **The effect of training policies for the young**

These results imply that **specific, carefully targeted and structured training policies involving private firms can help young workers enter the labour market**. They are especially useful for those who have a reasonably good educational attainment level (secondary school). Similar conclusions have been reached in other countries. Germany provides the best-known example of a very comprehensive and successful training and apprenticeship system. The French case study shows that good results can be obtained in other countries. **An important element of these schemes is the incentive that is given to private firms to participate, in the form of lower wage costs**, in part supported by the worker (the wage is below the official minimum rate), in part by the State (exemption from social security contributions). In Germany, 70% of jobs for young people are apprenticeships which pay from 26 to 37% of adult wages. Private companies may contribute (and in some countries do contribute) to this effort by subsidizing or funding schools. Although the macroeconomic effects of such policies may, by themselves, be limited (as subsidized workers may take the place of other workers or might have been hired anyway), they do contribute to reducing the relative unemployment rate of young workers.

### **III.3. Low-skilled unemployment**

The unemployment rate of low-skilled workers is usually above that of high-skilled workers. This is true in the USA as well as in the Union. This phenomenon was already observed in the late 1970s. **Low-skilled workers have, however, been especially hard hit by the economic trends of the last 20 years**. Their relative unemployment rate has risen in most EU countries. Low-skilled unemployment now represents, on average, 50% of total unemployment in Member States — more than 60% in some. This situation can be explained either by the so-called 'ladder

**effect'**, by which high-skilled workers take the jobs of the low-skilled when the economy is hit by a negative macroeconomic shock, or by a genuine **structural change in the demand for labour** not matched by corresponding changes on the supply side or by relative wage costs. Both phenomena reflect **downward rigidity at the lower end of the wage scale**.

Improvement in the macroeconomic performance of European economies would contribute to solving this problem. Rigidity in relative wage costs is none the less an important issue. It can be tackled in several ways: by a decrease in minimum wage levels or cuts in taxes on labour, by subsidizing low-skilled employment, by a mixture of these three. Tax wedges are now so high (the total wedge stands at around 40% of the cost of labour in many EU countries, with 24% coming from employer contributions) that a substantial relative cost change can be achieved in this way, without affecting take-home pay.

#### **Social security contribution exemption in Belgium**

In November 1993, the Belgian government decided to reduce employers' social security contributions for low wages (up to BFR 42 000) by 50%. The exemption is progressively reduced for higher wages and disappears for wages above BFR 60 000. The exemption from social contributions amounts to a 10% decrease of the total cost of wages for the lowest end of the scale. The direct loss of revenue to the Belgian government is less than half a percentage point of GDP.

The effects of such a policy are not easy to evaluate, especially taking into account the need to make up for revenue lost from other taxes (VAT, CO<sub>2</sub>, withholding tax on interest income, etc.) or from cuts in other expenditure. Employment gains can come from a slow-down in capital-labour substitution as well as from genuine employment creation, for instance in services. Furthermore, it takes time for all the effects to appear. Macroeconometric models suggest employment gains of the order of 0.5 to 1% of total employment (some 22 000 to 35 000 jobs), or alternatively around 10 to 20% of the number of unemployed workers with low educational attainment. These are not negligible figures. Full exemption from employer social contributions for those on the lowest wages would double them.

#### **Incentives to employ the unskilled**

**Exempting low wages from employer social security contributions could contribute signifi-**

cantly to improving the relative position of the low-skilled, without increasing income inequality. There is perhaps one caveat. Significant job creation for the lowest-skilled workers is only possible in the services sector. **A number of personal, and local, services are now kept out of the formal labour market (underground economy, do-it-yourself, unsatisfied needs) because of excessive costs and inadequate incentives. The change in relative cost needed to bring these services back into the official market is probably much larger** (compared to 10% in the above example). Such a radical change can only be obtained via well-targeted and specific initiatives aimed at fostering demand-solvency and 'structuring' the supply side. An EC study on possible local employment initiatives in France, Germany and the UK estimates the employment potential of such actions at around 400 000 jobs a year. Several countries have taken steps in that direction (service vouchers in France, local employment agencies in Belgium, a new law in Germany aiming at reducing administrative and financial costs of job creation in the personal service and health-care sectors).

### III.4. Minimum wages

**A decrease in minimum wages should help create new jobs for the most vulnerable workers**, as suggested by the above examples concerning youth and low-skilled unemployment. Still, the effect of minimum wages on employment remains a much debated issue. Case studies in the USA have suggested that a decrease in minimum wages may have little, or even negative, impact on employment. In Europe, France and the United Kingdom provide two contrasting cases.

#### Minimum wages in France

There is an economy-wide minimum wage (Smic), fully indexed to the cost of living and partially indexed to labour productivity. The government may (and on several occasions did) decide additional increases. From 1967 to 1986, the minimum wage increased steadily relative to the average wage. Since then, it has remained fairly stable. In the 1970s, the ratio was similar to that in the USA (around 0.45). It continued to rise during the first half of the 1980s (up to 0.50) and then remained fairly stable, while it steadily decreased in the USA (down to 0.36 in 1989). The proportion of workers paid at the minimum wage more or less doubled in France over the period (12% in 1987), while it was almost

cut in half in the USA (5% in 1988, against 9% in 1981).

The effect of the minimum wage on employment in France remains much debated. Econometric analysis of its effects on youth as opposed to adult employment indicated that the Smic has a significant long-term effect on young workers' wages and little effect on adult (25-year olds and above) wages. The effects on youth employment are negative though limited. Looking at the effect of the minimum wage on low- compared to high-skilled employment, the effect seems potentially greater, although the link between the minimum wage and the average low-skilled wage rate is not firmly established.

#### Minimum wages in the UK

There is no economy-wide minimum wage. During the 1980s, wage councils provided a system of industry-based minimum wages, setting minimum pay for low-paid workers not covered by collective agreements and representing around 10% of total employment. At variance with other EU countries, the ratio of minimum to average wages has decreased in the UK since 1979. The ratio of the minimum to average hourly wage in wage council sectors dropped from 0.82 in 1979 to 0.68 in 1990. Wage councils were abolished in August 1993.

Several microeconomic studies suggest that changes in minimum wage significantly affected wage dispersion. There is no strong evidence, however, that they significantly affected employment in the sectors directly concerned.

#### The effect of minimum wages

The impact of the minimum wage on employment is not easy to assess, probably because it depends on other inter-related factors. Its effect may vary from one sector to the other, depending, *inter alia*, on the degree of openness of the sector considered. It must be judged in the context of other policies and institutions (for instance, unemployment benefit levels). **Simple dismantling of the minimum wage system may have more impact on wage inequality than on employment.** To the extent that economic policy seeks to strike a balance between solidarity and economic efficiency, **the aim should rather be specific, targeted minimum wage adjustments**, especially to create more job opportunities for those (re)entering the labour market.

### III.5. Unemployment and poverty traps

Tax and transfer systems have progressively become more sophisticated. Complexities lead in some cases to extreme distortionary effects. **Marginal tax rates are sometimes so high at low income levels as to discourage people of working age and unemployed workers from taking a job in the regular economy.**

#### Unemployment traps in Belgium

In Belgium in 1993, a jobless married couple with no unemployment benefit entitlement would have received a transfer of BFR 26 000 per month (minimex). Both husband and wife would be allowed to earn, each month, up to BFR 6 000 as earned income (about one fifth of the net monthly minimum wage rate). This implies that they would probably never accept a full-time job offering them less than BFR 32 000 (or even BFR 38 000), net of taxes.

#### Ways of eliminating unemployment and poverty traps

There are probably many examples like this in most EU countries. Every effort should be made to avoid this type of situation, while at the same time maintaining our commitment to alleviate hardship for the poor. Some people have suggested simplifying our present welfare systems by issuing benefits (as social dividend or participation income) independently of employment status, thus replacing existing forms of social transfers (unemployment benefit, family allowance, pension, etc.). Such a system would eliminate unemployment traps, but it could be extremely costly to implement. An earned-income tax credit (as used in the USA) may provide an alternative, and easier to administer, solution. **The combination of unemployment benefits and earned-income credit is comparable to a subsidy per worker (focused on the low-paid), independent of employment status. It could thus help eliminate unemployment traps.** The difference from participation income is that these transfers are only paid to workers.

### III.6. Long-term unemployment

Long-term unemployment represents on average in EU countries about 50% of total unemployment. It is less than 10% of the total in the United States. The European figures do not take into account all workers in early retirement or social assistance schemes. This depressing situa-

tion is the outcome of several factors and we have already discussed some of them under youth unemployment, the weakened position of low-skilled workers, the effects of unemployment traps.

**Long-term unemployment is of course related to the characteristics of the unemployment benefit system.** It is not only the level, or the duration, of unemployment benefit that matters, but also all the institutional features of the system. The more the system can be monitored so as to avoid abuses, the more it can afford paying generous unemployment benefits without creating long-term unemployment.

#### The UK restart programme

The restart programme was introduced in April 1987. It consists of a compulsory interview for each unemployed person after they have been registered as unemployed for six months. The interview, with an official of the Employment Office, is designed to help unemployed workers find a job by way of advice and counselling. It may also facilitate direct contact with employers or training agencies. A crucial feature of the programme is the threat of having benefit suspended if the worker does not attend the interview or is not considered to be actively seeking a job. From this point of view, the restart programme can be seen as one way to circumvent fraud; it replaces administrative criteria for the allocation of benefits.

Analysis of the effects of the programme shows that:

- (i) the restart programme increases the probability of receiving an (at least temporary) job offer;
- (ii) it has no effect on the probability of getting a training offer;
- (iii) it has a substantial self-selection effect, by inducing many people not genuinely seeking a job (or not satisfying the imposed criteria) to withdraw their benefit claims.

#### Active labour market policies for the long-term unemployed.

The problem created by long-term unemployment is twofold. First, avoiding over-reliance on benefit (or actual fraud) without, however, at the same time increasing the hardship of those who are genuinely looking for a job. Second, avoiding social disenfranchisement among the latter. As the UK example suggests, **interviewing and**



**counselling unemployed workers can be helpful** from both points of view. Another kind of active labour market policy that has been used in several countries is to subsidize the hiring of long-term unemployed workers. It is now well-known that such policies do not create many additional jobs (as the subsidized workers may take the place of other workers or might have been hired anyway). Still, they may help avoid the social disenfranchisement of long-term unemployed workers. The question is, for how long. Offering systematically a temporary (subsidized) job to long-term unemployed workers amounts in a sense to combining both policies.

### III.7. Labour mobility

Unemployment rates vary greatly not only across countries, but also across regions in a given country. Regions may suffer from region-specific economic problems or may be hit differently by current economic trends (de-industrialization, lower growth rates). Transfers across regions (through regional development funds) may help correct such asymmetries to the extent that they are used to speed up the structural adjustment process. The latter can also be facilitated by relative wage adjustments, geographical mobility, or changes in participation rates.

#### Geographical mobility and regional unemployment

It is not clear whether regional mismatch has systematically increased in EU countries over the past 20 years. Still, **the comparison between internal migration rates and cross-regional differences in unemployment rates suggests a negative correlation between the two.**

Even within the same country, regional mobility is much weaker in Europe than in the USA. The lack of regional mobility, together with rigid relative wages are given as key factors to explain the persistence of regional unemployment differences in Spain. Italy is another prominent example of a country with huge and persistent differences in regional unemployment rates, and simultaneously little responsiveness from migration flows and regional wages to economic variables. In both, empirical evidence suggests that regional unemployment rates affect regional wage levels to only a limited extent. The main determinant of wages in a given region within a given sector is the level of wages in that sector in the rest of the economy. The situation is likely to be similar in several EU countries.

In urging a review of the above, the CAG emphasizes that persistently high differences in regional unemployment rates affect social cohesion and are likely to slow down the adjustments needed both to achieve the single market and to face the challenges of technological progress and global competition.

### III.8. Policy recommendations

The cases discussed in this Report can help define concrete policy proposals. They indicate the direction in which we must go.

1. **Collective agreements at the sectoral or plant level can give the flexibility necessary to avoid that structural adjustments translate into unnecessary and costly job destruction.** Today's labour market regulations now also have to take into account the growing importance of atypical patterns of working such as teleworking.
2. We have to facilitate the entrance of **young workers** into the job market, above all to ensure that they do not end up swelling the ranks of long-term unemployed. This means **provision of adequate training, linking private firms and training agencies with the right economic incentives, including both a lower minimum wage and exemption from social security payments.**
3. The relative cost of **low-skilled workers** has to be reduced. One way is to **exempt prospective employers from all social security contributions.** This measure has to be financed from other taxes or from cuts in expenditure but, for the fight against unemployment, it is crucial that now we reverse the upward trend in taxes on labour. For this to happen, however, it is important that Member States agree to retrain from tax competition on resources such as capital and energy.

Exemption from social security contributions may not be enough to maximize employment gains from growth in **personal, and local, services.** These can create many low-skilled jobs. Member States must consider other practical measures and **targeted incentives** (for example, service vouchers).

4. **Minimum wages** play a substantial role in avoiding the worsening of current inequalities in income distribution. However, the rules governing minimum wages need to be adjusted so that, while safeguarding against

- hardship, they can **better facilitate (re)entrance into the labour market** and reflect diversity in terms of age, sector and region.
5. More effort must be given to eliminating unemployment and poverty traps. Different adjustments in different countries are called for. Use of **earned-income tax credits and/or in-work benefits targeted to the low-paid** should be considered whenever necessary.
  6. Long-term unemployment (together with early retirement schemes) is an enormous social and economic burden, for the workers and their families and for the State. Specific counter measures are required. **Making systematically available counselling and temporarily subsidized jobs** (via in-work benefits replacing unemployment benefits) can both monitor the unemployment benefit system and mitigate social disenfranchisement.
  7. The present difficulties hampering **regional mobility** within and across EU countries have to be eliminated. Among ways to tackle this problem are:
    - (i) changes to **housing market provisions**;
    - (ii) easier **transfer of pension rights**;
    - (iii) an end to institutional barriers restricting the mobility of professionals and high-skilled workers (non-recognition of diplomas and professional qualifications);
    - (iv) stimulation of cross-border competition in labour-intensive sectors such as services and construction, starting with public procurement.

# IV. THE COMPANY AND EMPLOYMENT

The skills, creativity, and commitment of its workers have always been some of the most important assets any company can possess. Yet, historically, as assets they have not been fully exploited. In the past, European companies have tended to organize their activities according to the principles of Taylorism. This is now changing.

As their competitive situation evolved, a number of companies developed different, more participative and complex relationships with their employees. Successful companies have adopted new strategies. They have sought to differentiate themselves on the basis of added value and high quality, rather than on cost, and to maximize flexibility. At the same time, however, such companies have sought to match today's now global standards of cost. Achieving these goals has required major investment, greater focus on the core business, the creation of comprehensive networks throughout the value-chain (involving cooperation with suppliers and customers and public-private partnerships) and organizational innovation.

This Report illustrates, for the first time, a series of organizational initiatives undertaken by both large and small, private and public, organizations in several Member States. The bottom-up approach attempts to highlight the benefits such initiatives bring in terms of value added, job enrichment, employment creation and preservation; the obstacles to adopting similar innovations; policy recommendations for extending the usage of these new forms of organization and positive labour flexibility to improve Europe's competitiveness.

## IV.1. A case study approach

A number of case studies have been developed. These illustrate changes in work organization, working practices, corporate cultures, training and reward systems. They span a wide range of sectors and include small, medium-sized and large companies, as well as private and public sector organizations, State-owned enterprises, and not-for-profit organizations.

The approach helps identify the lessons to be learned and policy recommendations.

## Manufacturing companies, job protection and job enrichment

Taylorism has its origins in the introduction of mass production in manufacturing industry. It maximizes productivity and reduces costs through complex, hierarchical organizational structures and extensive division of labour — simple jobs and the rigid separation of 'thinking' and 'doing'. It focuses on production and volume, and upon the standardization of work within strong functional and technical structures.

The case studies illustrate that new forms of work organization have evolved which challenge these principles. They are based on **teamwork, decentralization, personal autonomy, flat organizational structures, and more complex jobs requiring a wide range of skills**. Communication and coordination take place both horizontally and vertically. The focus of the organization is upon the customer, continuous improvement, learning, and flexibility. New forms of remuneration complement the overall approach. The case studies demonstrate that these innovations in organization lead to improved business performance, better job protection and job enrichment.

The first case study is the Baxi Partnership, illustrating the introduction of **new forms of work organization** and training to cope with significant changes in the competitive environment.

### Baxi Partnership

Baxi Partnership is a major competitor in the UK domestic heating appliance market. Founded as a family firm over a century ago, ownership was transferred to the workforce in the 1980s. With a turnover of ECU 108 million, Baxi has 1 400 employees.

In the late 1980s, Baxi faced four key problems: declining demand, a more competitive market, rising overheads, and recurring quality problems. Baxi had to make fundamental changes to survive.

Baxi undertook a major restructuring of the company. Key features include:

- (i) reorganization of the business into customer-focused strategic business units and the creation of self-governing teams. These teams are multi-skilled and empowered to schedule their own work;
- (ii) a reduction in the number of management levels from five to three;
- (iii) the introduction of continuous improvement programmes;
- (iv) major investment in training, including the creation of an on-site Open Learning Centre.

As a result, Baxi has maintained profitability and increased market share throughout the severe recession of the 1990s. The pace of innovation has improved significantly and manufacturing cycle times have been dramatically reduced. Productivity has increased by over 20%. The level of participation and commitment of the workforce is high. Individual companies have their own employee directors and elected councils. The majority of jobs have been protected, manpower numbers now being similar to those a decade ago, as reductions in manufacturing have been offset by increases in R&D and investments in new products.

The Nokia case study illustrates the importance of **corporate culture, training, and flat organizational structures** in managing growth in a high-tech global industry.

### Nokia

The Finnish firm Nokia has transformed itself from a manufacturing conglomerate into a focused telecommunications company with world-wide operations and global leadership in the cellular infrastructure and handset markets. Nokia has a turnover of ECU 6 billion. It employs 34 000 staff.

Nokia faced the challenge of managing rapid growth, sustaining entrepreneurial agility and enhancing organizational learning, in a highly competitive and fast moving market. Solutions have been both cultural and structural, covering organization and management.

- (i) The cornerstones of Nokia's corporate culture — the value of customer satisfaction, respect for the individual, achievement, continuous learning — are being internalized on a global basis.

- (ii) Training and development activities, which have been closely linked with business strategy, are complemented by cross-functional job rotation and new assignments. Technology is also used to facilitate information sharing, personal development and learning across the organization.
- (iii) The structure of the group has been kept as flat as possible, with operations built around businesses and processes. Cross-functional account teams operate with maximum decision-making authority.

As a consequence, Nokia has expanded its business substantially and, despite fierce competition, strengthened its position as market leader. Sales of telecommunications units more than tripled between 1992 and 1995. Some 13 000 new employees have been taken on in the past two years, whilst maintaining Nokia's flexibility and its capability to innovate.

The ABB Sweden T50 case study illustrates a case of **employee involvement and competence development**.

### ABB Sweden

From functional organization to process organization: in ABB Sweden, the customer focus programme was conceived to create 'customer value through involvement of all employees'. An overall target of reducing cycle time by 50% over a three-year period was set. The T50 programme focused primarily on employee involvement and competence development. By making a thorough analysis of cycle time and process steps involved in fulfilling customer demands, most of the 100 ABB companies restructured their activities from traditional functional organizations to process organizations.

Building target-oriented teams: a cornerstone in this development has been to set up target-oriented teams. In these, individual employees in teams are able to take responsibilities for their performance and fulfilment of goals. Today, more than 1 000 different teams are in operation in ABB Sweden under the following T50 team structure:

- (i) process flow teams (6 to 10 people) that focus on improving the quality and

productivity of the order process for delivery;

- (ii) cross-functional teams, working over a more limited time period for new product and market development;
- (iii) plant system teams focusing on fulfilling large plant projects.

Competence development: to create the necessary flexibility within the teams, much effort has been put into developing the skills and competence of all employees. Competence development is defined as:

- (i) on-the-job training in the teams in which members subsequently learn each others' tasks;
- (ii) job rotation between different positions within the companies;
- (iii) traditional course training.

In 1995, it was decided that all employees should have their own personal competence plan defined as part of the annual reviewing process.

The new T50 programme produced a dramatic improvement in productivity and employee involvement in cycle time and on-time delivery over five years of change.

For ABB Sweden, the results are the following:

- (i) net company result improved five-fold
- (ii) inventory in product businesses reduced by 15%
- (iii) cycle-time reduced by more than 50%
- (iv) orders received increased by 53% in five years
- (v) productivity (revenue per employee) improved by 45%
- (vi) process orientation resulted in the creation of more than 1 000 small target-oriented teams
- (vii) competence plans for all employees established.

### **Service organizations, job creation and job enrichment**

The application of Taylorism has not been confined to manufacturing companies, nor to the private sector. The organization of work in the service sector, and in parts of the public sector, has been heavily influenced by its principles.

As the following case studies illustrate, innovative service sector and public sector organizations have developed new forms of work organization to overcome the inadequacies of what came to be called 'scientific management'. These innovations emphasize **continuous learning**,

**complex jobs, work flexibility, teamwork, horizontal coordination and communication, flat structures, personal autonomy and new forms of remuneration.** The case studies also illustrate use of such organizational techniques by fast-growing service sector businesses.

The case of Bremer Landesbank illustrates the use of **more flexible working time** to improve customer service and increase job satisfaction.

### **Bremer Landesbank**

Bremer Landesbank is the largest bank in Germany's north-west coastal region. It is publicly owned. Lending activities focus on public sector and business customers. With a turnover of ECU 40 million, it has over 1 000 employees.

In the face of changing customer needs and successive reductions in contractual working hours, negotiated with the trade union, Bremer Landesbank was finding it increasingly difficult to provide acceptable standards of customer service. In addition, staff dissatisfaction had increased.

Bremer therefore introduced a new variable working time model. Key features include:

- (i) the replacement of the traditional flexitime concept of 'core time' with 'function time', which varies from function to function and reflects the requirements of both external and internal customers;
- (ii) the empowerment of each team to determine staffing arrangements;
- (iii) extensive consultation with staff.

The new system of variable working time has enabled Bremer Landesbank to better meet the requirements of its customers for longer opening hours and hence to improve the level of customer service provided and expand the number of its customers. Job satisfaction has improved as staff are better able to determine their own working time and achieve more freedom in balancing their personal and working lives. As a result, staff motivation and loyalty have increased.

The Nationale Nederlanden case illustrates the role of **employee participation** in the process of change and the importance of effective support through IT, education and training.

### Nationale Nederlanden

Nationale Nederlanden (NN), a subsidiary of ING (the International Netherlands Group), is the market leader in the insurance sector in the Netherlands. With a turnover of ECU 6 billion, it employs 4 000 people in two main divisions: Life Insurance and General Insurance. This case describes changes made in the General Insurance Division, employing 2 000 staff with a turnover of ECU 1 billion.

Historically, most sales were made through a network of insurance intermediaries. In 1990, the company identified threats from competitors using direct selling and from fast-changing customer needs.

The principal changes introduced were:

- (i) a move from a traditional product-based organization (with clear separation of responsibilities between different groups) to a market-based structure which integrates field and support staff;
- (ii) a reduction in the number of levels of management;
- (iii) a change in staff responsibilities: more employees now deal more quickly with a wider range of customer needs; they also have greater authority to solve problems and to seize opportunities;
- (iv) a fundamental redesign of IT systems to make them knowledge-based and user-friendly;
- (v) heavy investment in large-scale training programmes for employees, team leaders and managers.

A critical feature of the process of change was its participative nature. Employees, managers, the board of NN and the works council were actively involved throughout. Sufficient time was allowed to obtain understanding and commitment at every stage. In consequence, NN has improved its relationships with its customers, and independent insurance intermediaries, through shorter processing periods, lower error rates and improved productivity. Employment has grown by 2.5% in 1995 and job satisfaction has improved due to broader job responsibilities and greater accountability.

### SMEs and job creation

The CAG Report of December 1995 already stressed that two thirds of all European employ-

ment is provided by companies with fewer than 250 employees. Europe's SMEs have also taken advantage of the revolution in organizational thinking to develop innovative forms of work organization that enhance their flexibility and competitiveness.

As the following case studies illustrate, a number of fast-growing SMEs have developed organizations based on **continuous learning, teamwork, job complexity, flat structures, new forms of remuneration, personal autonomy and working flexibility**. These innovations have helped to create jobs, and to enrich the quality of employment.

The Netwerke Service case illustrates how **new forms of organization, working practices and reward systems** facilitate fast growth.

### Netwerke Service

Netwerke Service GmbH (NSG) is a fast-growing company in the information technology and telecommunications market in Germany. Founded in 1989 by its current CEO, it has a turnover of ECU 60 million, and now employs 700 people at 22 different locations in Germany.

NSG faced the problem of managing fast growth. It has focused on keeping fixed costs under control, managing working capital, keeping up to date with rapid developments in technology and responding to fast-changing customer needs. To do this, it has used flexible and participative forms of organization.

Key features include:

- (i) a non-hierarchical structure; there are only three levels between the CEO and the customer;
- (ii) multi-skill teams throughout the organization, including multi-skill training with key suppliers;
- (iii) a system of 'internal job posting', under which employees can apply for jobs in new areas and at new levels, with appropriate training; only new-to-company skills are recruited from the market;
- (iv) a profit-sharing scheme and additional incentive and bonus schemes for individuals and teams;
- (v) strong staff participation and communication in the decision-making process.

As a result, customer responsiveness is high, and NSG has loyal, well-trained, multi-skilled staff who are highly motivated. Substantial growth in turnover, profitability, and employment has been achieved. Turnover has

increased by a factor of 35 since 1989. There has been considerable growth in high-tech jobs. Employee numbers have increased by a factor of 8 over the last six years.

The Spano case illustrates the value of **flexible working patterns** in creating jobs and improving the operating efficiency of an SME in a mature sector.

### Spano

Spano is a medium-sized company with 350 employees. Based in Belgium, it manufactures chipboard for a wide range of domestic, commercial and industrial uses. A large proportion of its sales are for export.

The company faced two problems. First, product demand did not fit with the five day working pattern of its staff. Second, it needed to decide on a major plant replacement. Until 1994, it coped with the first problem through overtime working. However, faced with the need to invest a significant sum in a new power press, more radical solutions to both problems became imperative. Spano chose to introduce new working patterns, and use existing machines more productively, rather than continuing with the existing way of working but investing in a new machine. This avoided a major capital investment and created 40 new jobs.

New working practices were introduced which matched production to demand, and eliminated the need for overtime working. This was achieved through:

- (i) a 'five teams scheme' whereby each employee must work two weekends in every five;
- (ii) a reduction of hours worked per employee by less overtime working.

As a result, Spano has avoided major capital expenditure, retaining scarce cash resources for other uses. Existing assets are worked more intensively, raising capacity utilization. Demand and production are now matched more closely, customer responsiveness has been improved, stocks reduced and productivity increased. Forty new jobs have been created — an exceptional performance for an SME in a mature sector.

The Telepizza case illustrates how **devolved responsibility and new remuneration techniques** can harness the entrepreneurial talents of staff, with exceptional results for sales and jobs.

### Telepizza

Telepizza, a Spanish retailer of take-away food, is one of Europe's fastest growing companies. Established in 1988, it has 200 outlets in Spain and 50 elsewhere. It has pioneered the development of the Spanish pizza home deliveries market. From very small beginnings, with a turnover of ECU 40 million it now employs 1 600 people.

As everywhere, the fast-food market in Spain is expanding rapidly. The key issue facing the company was how to grow quickly whilst continuing to meet high standards of quality and service at acceptable levels of cost. Telepizza recognizes that staff motivation is critical to its success. It has therefore:

- (i) built a corporate culture based on decentralization, empowerment and minimum bureaucracy;
- (ii) ensured that front-line people are imbued with entrepreneurial spirit and rewarded appropriately. For example, delivery staff are given direct responsibility for building business within a small geographic area. They are rewarded for their success through sales incentives and bonus packages.

Telepizza has created a highly motivated team with a strong entrepreneurial spirit. The company has achieved phenomenal growth, with a 30-fold increase in turnover over the last five years. Employment has grown from just 50 employees in 1989 to over 1 600 in 1994.

The ETAP case study illustrates the use of a new **voluntary flexible working time** system.

### ETAP NV

ETAP is a medium-sized company manufacturing lighting systems in Belgium. It has 300 employees.

ETAP has introduced a new voluntary flexible working system. There are two schemes.

- (i) Employees volunteer to work four days out of five each week (the 80% of working time scheme). Teams of five people who carry out similar work are formed. For each team working on this basis, a new employee is taken on by the company.
- (ii) Employees volunteer to work half-time (the 50% working time scheme), alternating between two and three days a week. Each post included in this

scheme is occupied by two employees, permitting engagement of new staff.

Remuneration in both schemes is reduced in proportion to the hours worked. Employees following the 50% scheme also agree to flexible working arrangements whereby they work extra hours in certain circumstances. These hours are compensated during less busy periods. The company receives a temporary and limited subsidy from the State for each new employee recruited. In addition, each existing employee joining the scheme receives a small premium from the Flemish government for two years.

The original objective of the scheme was to find 25 volunteers to follow the 80% scheme, and hence create five new jobs. In the event, 70 people have joined (i.e. 14 teams) and 14 new jobs have been created.

### **Companies and youth unemployment**

A number of businesses have taken steps to reduce unemployment, particularly among young people.

The Renault case illustrates the importance of **helping academically unsuccessful youngsters** to obtain the vocational skills needed in modern manufacturing.

#### **Renault**

In 1992, Renault agreed with the French government to train approximately 600 young people who have failed academically. The training is designed to provide these youngsters with vocational skills relevant to modern manufacturing. It is provided on Renault's sites, within their production teams.

At the end of the training period, the youngsters receive a vocational training certificate. In addition, Renault and government agencies then work with other manufacturing enterprises to find job opportunities for the successful trainees.

The case of Air Rianta illustrates how customer service can be improved by providing **jobs for unemployed youngsters**.

#### **Air Rianta**

Air Rianta manages Ireland's airports. Its most important airport, Dublin, is located close to an area of extremely high unemployment. To reduce unemployment and improve services, it persuaded a local job centre to establish a small service company. This business recruits local people to provide services such as portering, left luggage facilities, and taxi-rank management at Dublin airport.

As a consequence of this initiative, 26 new jobs have been created. In addition, Air Rianta now provides a better service to its customers.

### **Innovative union approaches to organizational change**

The new forms of work organization pose particular problems for trade unions. Organizations using them frequently seek to create a culture within which the views and interests of employees and the company are aligned directly through cooperative relationships. Furthermore, such innovations frequently challenge historic forms of job demarcation and work organization. The changes appear, at first sight, to reduce **the role of the trade unions** and to undermine their importance. However, as the following case studies illustrate, many trade unions have sought to work with the firms concerned. They have helped them to introduce innovative forms of work organization which take advantage of new ways of working whilst protecting jobs and increasing job satisfaction.

This next case study illustrates the way in which the Irish Congress of Trade Unions (ICTU) intends to **adapt to the profound changes taking place in organizational structures, management style and industrial relations practices** in both public and private sectors.

#### **Irish Congress of Trade Unions**

In 1994, the Executive Council of the ICTU established a review group to consider issues arising from company restructuring and the implications for trade unions. This group was asked to assess the extent of change in the business environment (such as globalization of competition, new technologies, deregulation, reductions in State aid) and their implications for management



and unions. They were asked to recommend better ways of handling change in the workplace by management and workers, to recommend improvements in union procedures for negotiating change in the workplace and in decision-making and to assess the adequacy of training programmes in equipping trade union officials to deal with the management of change.

As a result of this review, the ICTU believes that trade unions:

- (i) must prepare themselves for change. This will involve the development of expertise in the management of change and an understanding of the economic and other factors which are driving change;
- (ii) must critically examine their own practices, including industrial relations procedures, and adapt them to the new commercial reality (especially in the public sector);
- (iii) must put greater emphasis on public sector reform of accessibility and accountability, in order to win support from the public for provision of public services;
- (iv) must be proactive, not just reactive, to proposals brought forward by employers. The key to increased competitiveness lies in improving the efficiency of Irish industry and the quality of the products and services it produces and markets. Where companies do not respond to competitive threats, unions should take the lead in identifying what needs to be done and demand action by management.

In addition, the ICTU believes that:

- (i) strategic reorganization of companies is necessary;
- (ii) detailed analysis of training needs is essential. This should be conducted throughout the trade union movement to identify detailed training needs so as to enable trade unions to respond to the process of change within companies.

## IV.2. The direction of change, the benefits, the obstacles

### The changes made

The case studies illustrate the principal outlines of a revolution that is taking place in the way

that work is organized within companies. Taylorism, with its complex organization and simple jobs, has been replaced in some companies by a diverse mix of approaches characterized by complex jobs and simple organization.

The main changes have been in the following areas.

**Internal flexibility has been increased:** including more flexible working time, working patterns, job groups and job content.

**New organizational structures have been introduced:** including process-based organizations, market-based organizations, multi-skilled teams and flatter, decentralized structures.

**New techniques and best practices have been introduced:** including continuous improvement, knowledge-based IT systems, closer relationships with suppliers and customers and quality management.

**Education and training have been improved:** including improved job skills and the introduction of wider management-type skills throughout the organization, such as problem-solving, group working and learning skills.

**New working practices have been implemented:** including greater internal flexibility, 'multi-skilling', greater use of temporary and part-time workers, new management models based on coaching and support, more devolved responsibility and empowerment.

**New reward systems have been adopted:** including payments for knowledge, performance bonuses, profit-sharing schemes and share ownership programmes.

**New corporate cultures have been developed:** including more participation, greater personal autonomy, better alignment of employee and business objectives, increased consultation, focus on the customer and focus on quality.

### The benefits

These new forms of work organization, when combined with other strategic initiatives, provide European companies with ways to improve their competitiveness. In turn, this leads to enhanced marketplace and financial performance. **Company competitiveness is improved** because of:

- (i) **improved innovation** in products and processes as a result of lower costs, improved cooperation between departments and greater flexibility;
- (ii) **increased operating efficiency** as a result of improved productivity, reduced costs, higher quality and increased flexibility;

- (iii) **improved structural adjustment** as a result of greater awareness and acceptance of the need for major changes by employees.

Employees also benefit from these innovations in work organization. The benefits include:

- (i) **increased job opportunities** as a result of more opportunities for those who wish to work atypical hours;
- (ii) **improved security of employment** as a result of companies becoming more competitive;
- (iii) **greater job satisfaction** as a result of increased responsibility for a wider range of tasks, greater personal autonomy and empowerment.

For the EU economy and citizens there are a number of potential benefits for the European economy overall, including:

- (i) **improved standards of living, increased employment and enhanced job security**, through an increase in the volume and the value of sales of existing products and services, and an increase in sales of new products and services;
- (ii) **increased employment and enhanced job security**, by improving the competitiveness of the EU economy;
- (iii) **increased job satisfaction**, through an improvement in the scale and the scope of jobs.

### The obstacles to change

There is still a wide variety of different labour market practices and cultural specificity between companies and countries in Europe. Companies which have successfully introduced new forms of work organization have made major improvements in their competitiveness.

However, there appears to be a number of powerful obstacles to change, specifically:

- (i) **Lack of awareness amongst certain companies of the new forms of work organization and their benefits.** If managers and employees do not know what is possible, then the forces of change will be weakened.
- (ii) **Negative attitudes among some managers, workers and trade unions inhibiting the adoption of new forms of work organization.** These are based on 'traditional' views about the 'correct' relationship between workers and management, as well as on the natural tendency for change to be opposed by those who benefit from the current situ-

ation and those who are uncertain about the impact of any change.

- (iii) **Barriers** limiting internal employment flexibility in areas like working time, and atypical work; product market regulations and practices reducing competition; collective bargaining arrangements unnecessarily limiting the freedom of negotiation at plant level.
- (iv) **Practical difficulties in implementing the new forms of work organization.** It is not easy to introduce innovative ways of working into a company. The 'technology' is complex and must be adapted to each company. In addition, implementation requires major disruption of existing activities. The programme of change must also continue for a number of years before the benefits are won. These major practical difficulties make organizational change unattractive to many companies.
- (v) **The financial cost of implementing the new forms of work organization.** Taking advantage of these new methods of organizing work can require major expenditure. Companies must spend money on employee training, the acquisition of the technology, programme design, and implementation support. In addition, there are opportunity costs arising from diverting management from other activities, as well as from possible short-term disruption of sales. If all of these factors are taken into account, the introduction of new forms of organization within a company is a significant investment, albeit in an intangible asset. Moreover, as with many other investments in intangible assets, it is difficult to quantify the benefits. This leads in some cases to companies believing that they are acting rationally in refusing to incur the costs associated with the introduction of new forms of work organization.
- (vi) **The inability of companies, particularly SMEs, to introduce new organizational techniques because they lack the capacity and resources to make the necessary changes.** Deficiencies include: lack of skills among managers and staff, lack of management time, lack of financial resources.

### IV.3. Policy recommendations

There is no single driver of change in work organization and industrial relations, nor is there a single correct model for change in Europe. Our attempts to bring about reform and President Santer's Confidence Pact, proposed to the Council, must start from this awareness.

1. We need to know more. Based on existing material, the Commission must immediately embark on a **comprehensive benchmarking exercise at EU level analysing positive labour market flexibility initiatives**. The test is to identify those that have produced the greatest benefits in terms of job protection, job enrichment and especially job creation. Confirmed by an analysis of what has already been done, if at limited sectoral level primarily in Europe's smaller countries, the social partners can move forward decisively to tackle much needed reforms.
2. We must do better what we do already. Pan-European, **private/public benchmarking of positive labour-market flexibility must also be used to improve current government and private sector training programmes**, their priorities and budgets.
3. We must learn from experience. This **benchmarking must take into account current Commission monitoring of Member State labour policies** (tableau de bord) with the aim of identifying not only best practices, but also recommendations to help Europe achieve concrete improvements in positive labour market flexibility.
4. We need to focus our efforts. Europe's employment and training organizations must work in a more efficient way with the social partners. To reduce dilution of energy and financial resources on critical employment, training or quality of work programmes and issues, **the scope and resources of existing and new institutions**, such as the European Foundation for Working and Living Conditions and the European Industrial Relations Observatory, **should be reviewed and better coordinated**. We must reduce unemployment, but not by having more people studying the subject.
5. We need to look to the future. The Commission and the Council should entrust to the most appropriate single institution and to a selection of innovative European companies a single **programme to increase job creation initiatives and apprenticeships for young people across the EU**, linking to the existing work in this area, for instance in the Erasmus programme.
6. We have to be aware of the true cost. A forward looking competitiveness strategy must be geared more toward job creation than job preservation. With the involvement of the social partners, **the Commission should proceed with the cost/benefit analysis of EU social legislation as laid down in the Maastricht Treaty**, highlighting the most successful examples of incentives improving working conditions and industrial relations.

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