W.E. UPJOHN INSTITUTE FOR EMPLOYMENT RESEARCH

Employment Research Newsletter

Volume 1 | Number 1 Article 1

1994

Job Security v. Labor Market Flexibility: Is There a Tradeoff?

Susan N. Houseman
W.E. Upjohn Institute, houseman@upjohn.org

Citation

Houseman, Susan N. "Job Security v. Labor Market Flexibility: Is There a Tradeoff?" Employment Research 1(1): 1, 3.
https://doi.org/10.17848/1075-8445.1(1)-1

W.E. Upjohn Institute for Employment Research
Employment Research - *Spring 1994*
Susan N. Houseman

Job Security v. Labor Market Flexibility

Is There a Tradeoff?

American workers, on average, have less job security than European workers. When faced with a need to reduce their workforce, U.S. companies typically resort to layoffs much more than do their European counterparts. European companies rely more on alternatives to layoff, including work sharing and attrition.

Many Americans believe that layoffs, and weak job security, are the price that must be paid for a healthy economy. Many also believe that strong job security in Europe reduces labor market flexibility, thereby obstructing change and inhibiting growth. However, my research with Katherine Abraham suggests that job security can be compatible with labor market flexibility.

Labor Adjustment in Europe and the United States

In statistical studies of labor adjustment in the manufacturing sectors of Germany, Belgium, France, and the United States, we find that, when faced with similar declines in sales, European manufacturers generally make labor reductions similar to those made by U.S. manufacturers. What differs is the way those cuts are achieved. U.S. companies tend to lay off many workers immediately, while European companies reduce workers' hours in the short term.

Work sharing is an important mechanism for adjusting to downturns in all of the European countries we study. In German manufacturing, for example, we find that work sharing accounts for over half of the initial drop in labor input when sales fall. By combining work sharing in the short term and attrition over the longer term, European companies can make similar cuts in labor hours with fewer layoffs than their U.S. counterparts.

Labor Market Policies in Europe and the United States

Differences in labor adjustment strategies of American and European companies are partly attributable to differences in labor policies. European countries discourage the use of layoffs by regulating them. All European countries require that employers notify workers prior to dismissal, and many require that employers compensate laid-off workers under certain circumstances. Most European countries also require that employers notify public authorities and notify and consult with worker representatives before implementing a mass layoff.

Although the U.S. Congress passed legislation in 1988 requiring that employers notify workers sixty days prior to a mass layoff, this legislation is quite weak by European standards. A company need give no advance notice if the layoff is due to unforeseen business circumstances or if the company has been seeking capital to avoid or postpone a shutdown. And U.S. law does not require companies to compensate laid-off workers or consult with worker representatives.

A recent study by the Government Accounting Office found that three quarters of all companies that appeared to meet the criteria requiring advance notice either failed to file notice or gave less than sixty days' notice. In most cases, then, companies either slip through the law's large loopholes or simply violate the law.

Although Europe's dismissal laws make layoffs more costly, other policies lower the costs of using alternatives such as work sharing. For example, European unemployment insurance systems allow workers whose hours have been cut because of slack work to collect prorated benefits. This availability of short-time compensation encourages the use of work sharing in lieu of layoffs.

While European unemployment insurance systems encourage work sharing, the U.S. unemployment insurance system features a pro-layoff bias. Because under our unemployment insurance system some of the cost of a layoff is passed on to the government, U.S. employers are encouraged to lay off too many workers. Moreover, while unemployment insurance benefits are available for workers who are laid off, they generally are not available for workers whose hours have been cut for economic reasons, further encouraging layoffs over work sharing.

Only 17 states have introduced short-term compensation. Interestingly, work sharing was used widely in the United States during downturns early in this century. Labor historians attribute its decline - and the increase in layoffs - to the introduction of the current system of unemployment insurance in the 1930s.

Policies in many European countries also provide incentives for companies to invest in workplace training. Workplace training increases job security in several ways. Employers are more reluctant to lay off workers in whom they have heavily invested, particularly during a temporary downturn. Employers may avoid laying off excess workers by transferring them into positions vacated by those who quit or retire. In Europe, this process of internal transfers is facilitated by the fact that the workforce possesses a broad set of skills. Finally, if workers are laid off, their training helps them find new work more quickly.

Although few statistics on workplace training exist, it is widely believed that American companies invest far less in their workers than do their European counterparts. A study by the U.S. Office of Technology Assessment, for example, estimated that German companies invest twice as much as U.S. companies in training their workers.

Implications for U.S. Policy

Although many fear that strong job security inhibits workforce reduction and slows economic adjustment, our research suggests that, with appropriate policies to facilitate adjustment through alternatives to layoff, it is possible to have both job security and labor market flexibility. Given this finding, is there reason to support policies - such as stronger advance notice requirements, short-time compensation, ans workplace training incentives - that would encourage greater use of alternatives to layoff in the United States?

Reducing layoffs would be more equitable. Laid-off workers, who often suffer large income losses, loss of health insurance, and other personal problems, bear the brunt of economic adjustment. Alternatives such as work sharing help spread the costs of economic change across workers.

Reducing layoffs also could increase economic efficiency. Current U.S. policy encourages companies to lay off too many workers and these excessive layoffs waste investments in worker training and lower productivity in the economy.

Susan N. Houseman is a senior economist at the Upjohn Institute

Suggested Readings

Katherine G. Abraham and Susan N. Houseman. *Job Security in America: Lessons from Germany*. Washington: Brookings Institution, 1993.

Katherine G. Abraham and Susan N. Houseman. “Does employment Protection Inhibit Labor Market Flexibility? Lessons from Germany, France, and Belgium.” In *Social Protection versus Economic Flexibility*, edited by Rebecca Blank. Chicago: University of Chicago Press, 1994 pp. 59-93.

Susan N. Houseman and Katherine G. Abraham, “Labor Adjustment under Different Institutional Structures: A Case Study of Germany and the United States,” Upjohn Institute for Employment Research Working Paper, 94-26, April 1994.