

Labour market flexibility and technological innovation or, desperately seeking a trade-off*

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Abstract

Lack of labour market flexibility has often been accounted for the low growth rates in the European Union. A recent report on "An Agenda for a Growing Europe", better known as the Sapir Report, discussed this issue and clearly stated the terms of the trade off between growth and lack of flexibility. The Report acknowledges that flexibility involves a range of social and economic drawbacks. Nonetheless it contends that "At a time of very rapid change and a need to adjust both production and skills quickly, flexibility comes at a premium.". In this paper I focus on a range of microeconomic issues, involving the conceptual plausibility of the claimed trade off and the implications that a policy based on such a trade off may have in terms of both growth and social welfare. I argue that the assumptions underlying the trade off are not clear because the notion of innovation in the Report is rather confused. Contrary to what the Report claims, flexibility turns out to be irrelevant for the innovation it purports. Flexibility might produce some effects but only with innovations that the Report neglects. I contend that the effects of flexibility may be to reduce innovation and the potential for growth. Truly, flexibility may allow firms to introduce new technology, but it may also lead firms away from innovation in so far as it allows them to pursue profit through other means, i.e. through cost scrapping. My final argument is that the notion of trade off that the Report refers to is misleading in that it in no way takes account of the social costs that flexibility would determine. I conclude my discussion by drawing a few implications for economic policy.

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