

Do we need more flexibility and more security?

Tito Boeri

Università Bocconi and Fondazione Rodolfo De Benedetti

March, 10 2011, Bruxelles

The real issue is coverage

Reforms actually implemented in EU countries did not increase or reduce employment protection or increased the generosity of unemployment benefits for everybody.

- In the 1980-2007 period there were only 8 structural reforms out of 201 reforms of EPL. Only 12 out 253 reforms of UB were structural.
- Most reforms created long-lasting asymmetries between different categories of workers
- Effects of these asymmetric or **multi-tier reforms** are much different than those of reforms changing the rules for **all workers** and have yet to be fully understood

Theoretical Predictions about Two-tier Reforms

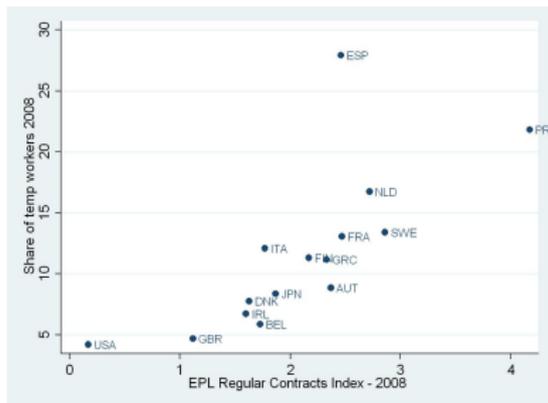
Based on extensions of the Mortensen and Pissarides model of job reallocation and equilibrium unemployment.

The larger the asymmetry created by the reform between temporary and permanent contracts:

- the larger the share of employment in temporary contracts
- the lower the probability of converting fixed-term into permanent contracts
- the larger the wage differentials between temporary and permanent contracts.

EPL for regular contracts and

$$\rho = 0.81$$



Share of Temporary Contracts in Total (Dependent) Employment

$$\rho = -0.72$$



Transition Probability from Temporary to Permanent Contracts

Wage premium on permanent contracts

$$\log w_i = \alpha + \beta_1 EDU_i + \beta_2 EDU_i^2 + \gamma_1 TEN_i + \gamma_2 TEN_i^2 + \mu PERM_i + \varepsilon_i$$

	Premium temporary-permanent μ	St. Err.	Obs.
Austria	20.1***	0.023	9867
Belgium	13.9***	0.017	7948
Denmark	17.7***	0.015	8009
Finland	19.0***	0.011	8940
France	28.9***	0.016	15260
Germany	26.6***	0.010	25448
Greece	20.2***	0.013	6978
Ireland	17.8**	0.069	1583
Italy	24.1***	0.008	30177
Luxembourg	27.6***	0.018	7889
Netherlands	35.4***	0.021	15845
Portugal	15.8***	0.016	7550
Spain	16.9***	0.007	22626
Sweden	44.7***	0.036	5412
United Kingdom	6.5*	0.037	7000

Dualism over the Cycle

- Increase in volatility of employment and unemployment.
- Temporary job creation (honeymoon) effect during expansions (contributes to explain increase of employment rates in the EU in the 1995-2007 period).
- During downturns job destruction concentrated on fixed-term contracts, insulating from the adjustment permanent workers.

Spain - Change on a year before, thousands



The Legacy of the Great Recession

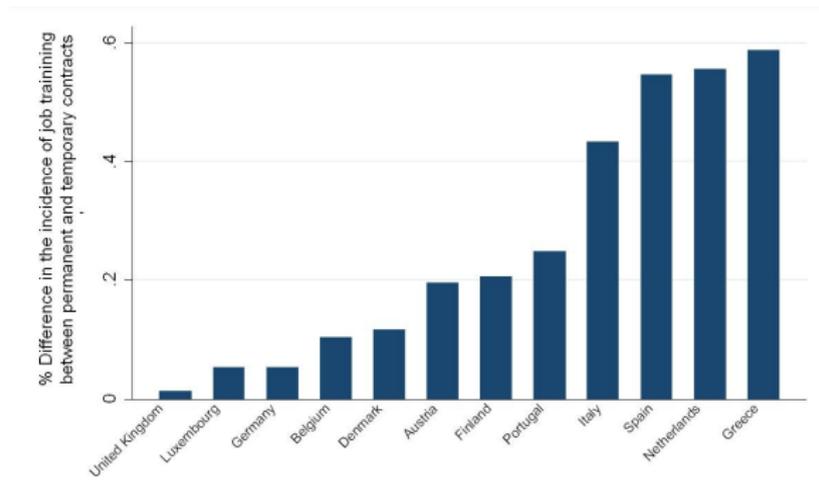
Percentage decrease (increase) of the stock of employees during (after) the crisis.

	Share of Temporary Workers over Total Employment 2008Q3	Fixed-Term Job Losses as % of Total Job Losses during the crisis	Fixed-Term New Jobs as as % of Total New Jobs after the crisis
EU	14.26%	34.19%	87.65%
Greece	12.19%	11.92%	261.71%
Spain	29.53%	76.94%	113.20%
France	14.26%	12.81%	139.66%
Italy	13.63%	54.30%	169.20%

Source: Eurostat

Longer term effects: scarring and human capital formation

Scarring effects of unemployment at early stages of a career. Less training is offered to fixed-term workers compared to permanent contracts. The difficult future of the generations entering the labor market after the Great Recession.



Source: ECHP

An Exit Strategy from Dualism

Removing temporary contracts would mean reducing also employment creation in the recovery after having experienced the negative side of dualism. Better to go beyond dualism, working on employers' incentives. Need to balance two forces

- Let firms enjoy flexibility at entry. On the labour demand side, firms benefit from a labour market where experimentation is allowed
- Set a well defined path to stability for workers, through a long run entrance with an open-ended labour contract
- Flexibility is important in the entry phase. Problem of asymmetric information
- Tenure tracks to stable jobs

Contrato Unico, Contratto Unico di Inserimento, Contrat Unique

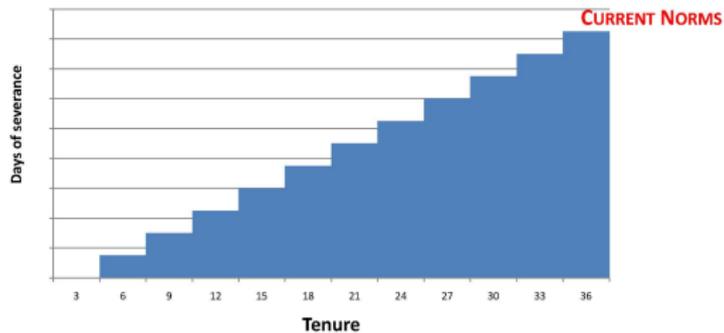
Proposals developed in Spain (Bentolila, Dolado and 100 academic economists), France (Blanchard-Tirole, Cahuc-Kramarz) and Italy (Boeri and Garibaldi): tenure track to stable jobs with protection increasing with tenure. Differences according to national regulations.

Il Contratto Unico di Inserimento

Italian draft bill differentiates entry through experimentation from genuinely fixed term jobs. Open ended contract with two phases:

- *Entry Phase* (up to the third year): the worker has the right to severance payments proportional to tenure (independently of firm size): dismissal without just cause requires up to six months in severance payments (5 days of severance every month). Entry phase lasts three years
- *Stability Phase* (from third year onward): current legislation (for dismissal without just cause: reinstatement right in firms above 15 employees and six months severance in small firms)
- Fixed term contracts and de-facto dual workers (yet self employed in the books) only with higher salaries (top decile of the current distribution of wages for these contracts) and higher contributions to unemployment benefits

Graded Employment Security



32

and Unemployment Benefits?

- Extend the **coverage** of unemployment benefits also to relatively short-term jobs.
- While strengthening **insurance** principles.
- Temporary contracts with higher contributions to unemployment **insurance** than other contracts.
- Short-time work (STW) also did not cover dual workers. The challenge is to extend the coverage of STW without increasing moral hazard problems: it should be experienced-rated. STW is also a poor substitute for decentralized bargaining over hours, employment levels and wages.