

Dual track reforms and the honeymoon of European unemployment

Tito Boeri
(Università Bocconi)

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The words of the veteran

Jean-Claude Juncker (Mr. Euro):

“Politicians know what they should do, but they do not know how to be re-elected after they do the things that they know they should do”

Is it true?

- Lisbon strategy: “need to improve the adaptability of workers and enterprises.”
- Integrated Guidelines (IG 21): “Member States are asked to promote flexibility combined with employment security and reduce labour market segmentation, having due regard to the role of the social partners.”
- 2006 Spring European Council: “need to develop more systematically in the National Reform Programmes comprehensive policy strategies to improve the adaptability of workers and enterprises.... reforming labour market and social policies under an integrated flexicurity approach, adequately adapted to specific institutional environments and taking into account the need to combat labour market segmentation.”

Do they know how to do it?

Outline

- Taking stock of reforms in labor/product markets
Why more labor than product market reforms?
A political feasibility theorem
- Two-tier reforms. How do they operate? Do they generate support for radical reforms? The example of employment protection

The “fRDB Social Policy Reforms Database”

- Period: 1987 – 2005
- Countries: EU15 (except Luxembourg)
- 5 reforms areas:
 - 1) Employment Protection Legislation (EPL)
 - 2) Non-Employment Benefits (NEB)
 - 3) Public Pension Systems (PEN)
 - 4) Working Time (TIME)
 - 5) Immigration Policy (IMM)
- Focus on *qualitative* features of reforms

Direction and Scope

Reforms are classified along two main dimensions:

1. **Direction:**

Do they reduce or increase the generosity of pension and NEB systems? Improve working time flexibility?
Make EPL and migration policy more or less stringent?

2. **Scope:** *marginal or radical* reforms

(qualitative assessment of the norm; is it encompassing?)

Popular and Unpopular Reforms

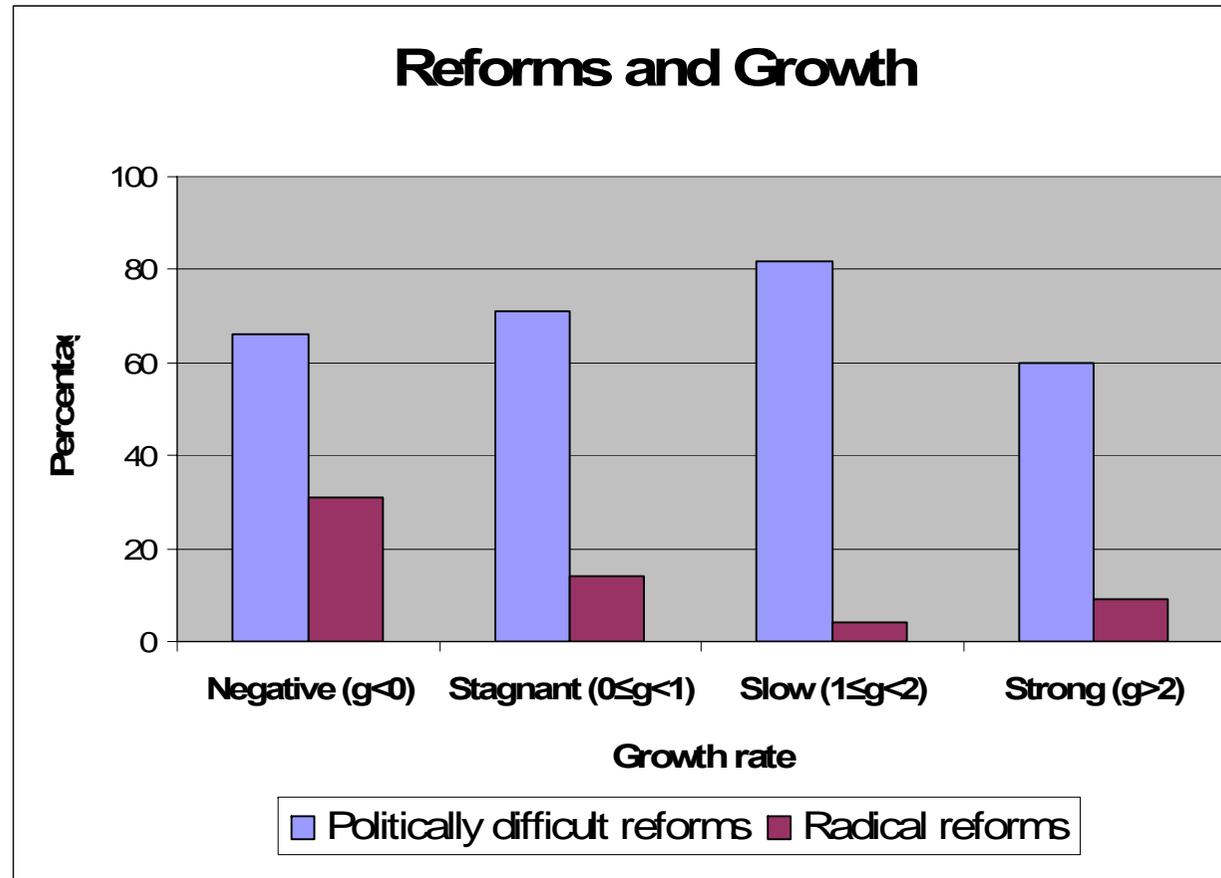
- Reforms are “popular” if:
 - increase employment protection
 - increase the generosity of the pension system
 - increase restrictions to immigration
 - reduce rewards from participation into the labour market (through an increase in non-employment benefits or loser activation schemes)
- The opposite holds for “unpopular” reforms

Counting reforms (1986-2005)

	Unpopular				Popular				Total per row	Of which unpopular (%)
	1986-90	1991-95	1996-00	2001-05	1986-90	1991-95	1996-00	2001-05		
EPL <i>marginal</i>	5	7	14	12	8	7	20	18	91	42%
<i>radical</i>	-	4	4	2	-	2	1	1	14	71%
NEB <i>marginal</i>	9	24	75	94	10	8	21	19	260	78%
<i>radical</i>	1	2	3	12	-	-	-	-	18	100%
PEN <i>marginal</i>	12	22	24	25	11	9	16	16	135	61%
<i>radical</i>	1	4	5	3	1	-	-	-	14	93%
TIME <i>marginal</i>	-	1	17	20	-	-	4	3	45	84%
<i>radical</i>	-	-	-	-	-	-	1	1	2	0%
IMM <i>marginal</i>	-	2	8	7	-	4	5	11	37	46%
<i>radical</i>	1	-	4	-	-	2	1	2	10	50%
Total per column	28	49	141	163	31	49	82	83	626	61%

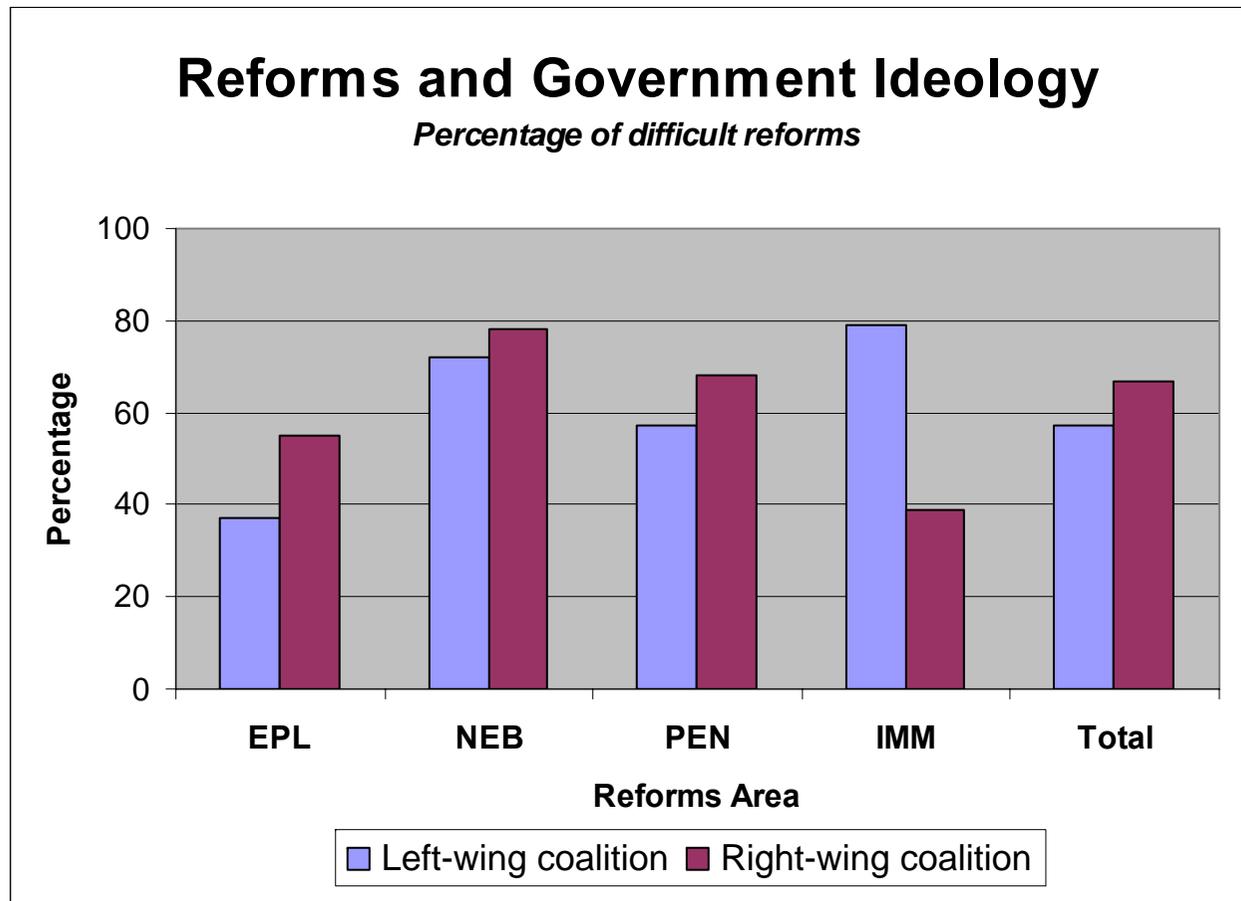
Reforms and Macroeconomic Conditions

Politically difficult reforms are more likely under "bad" macroeconomic conditions than under strong "growth"...



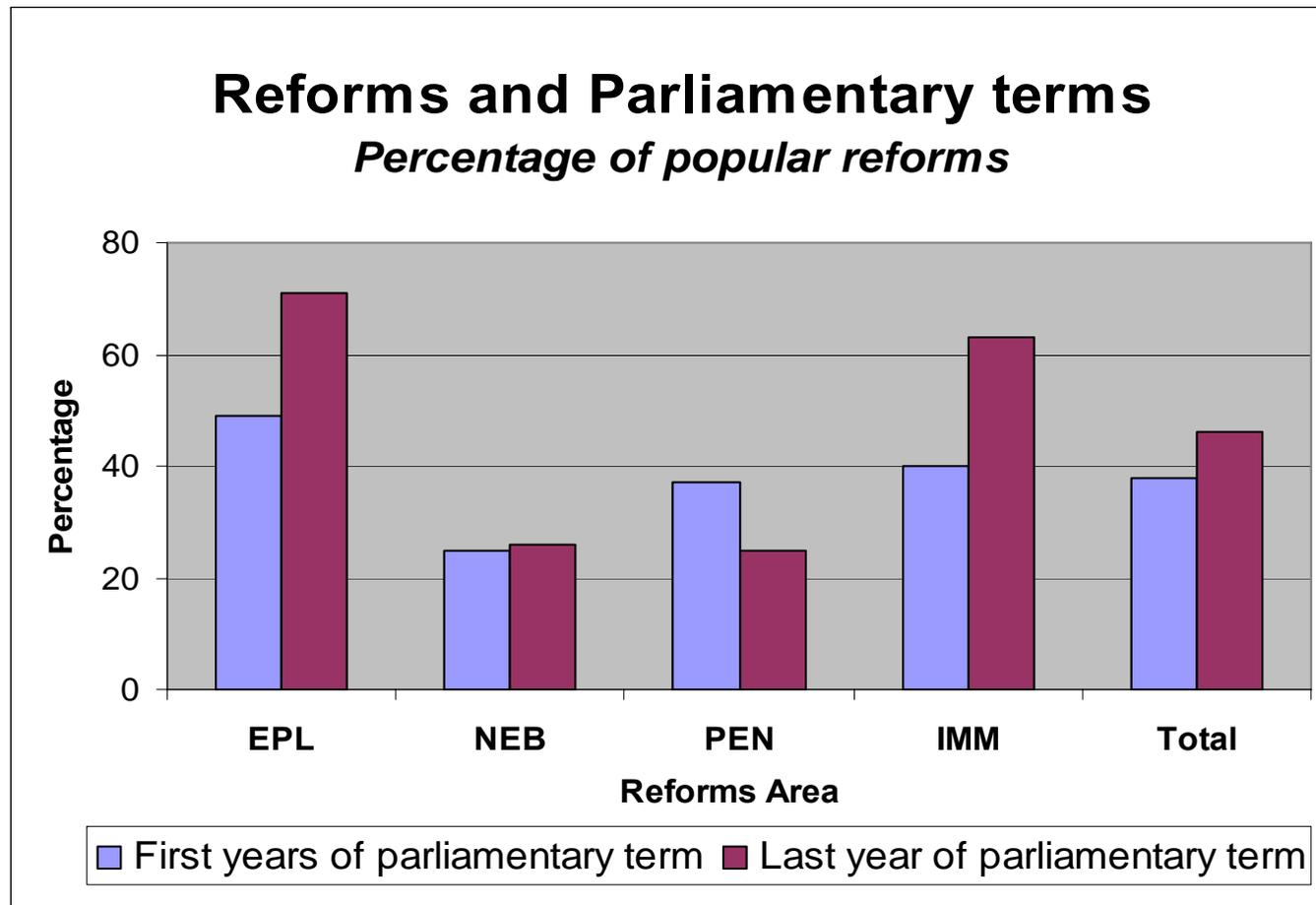
Reforms and Government Ideology

Comparative advantages? Reforms of immigration are done by the left, employment protection by the right



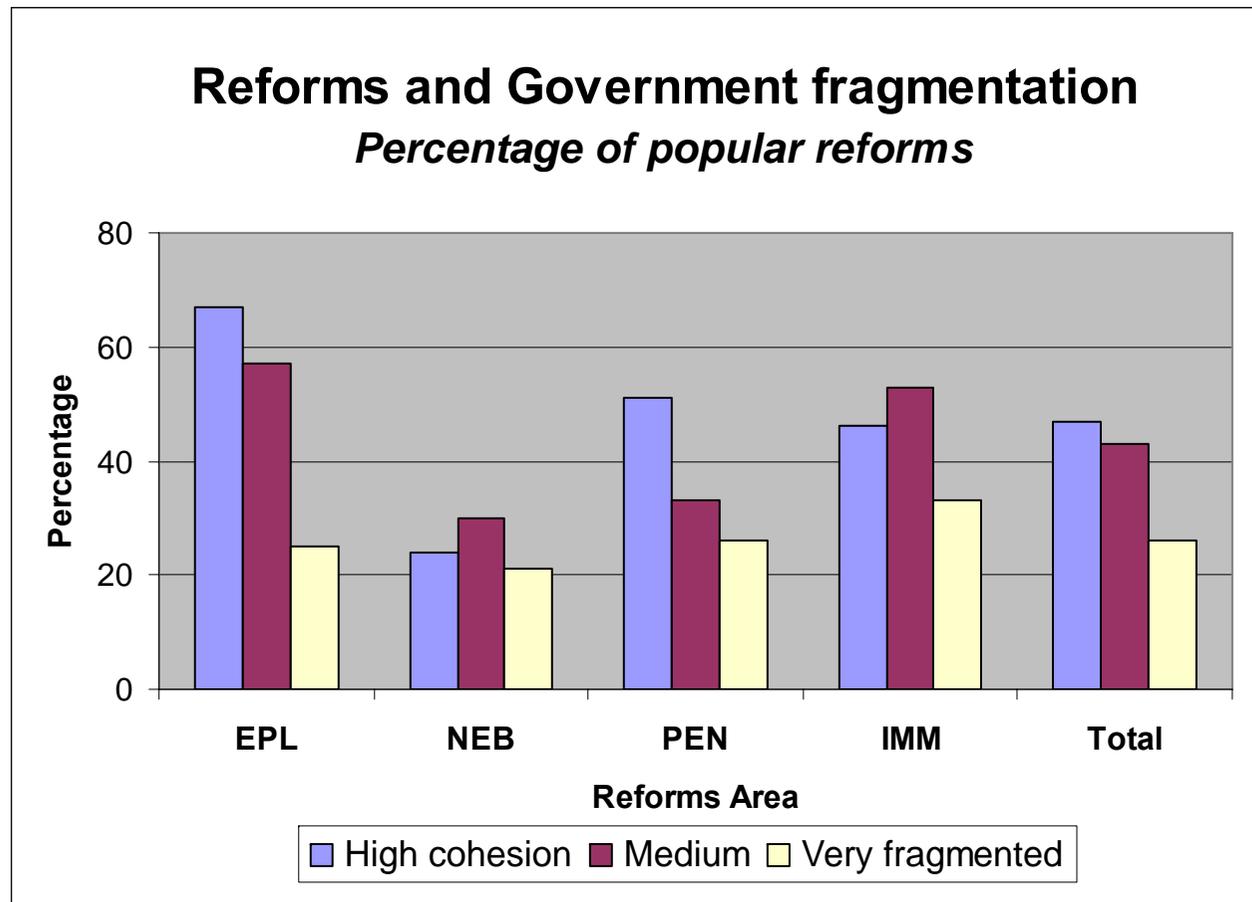
The timing of reforms

Unpopular reforms at the beginning of the legislature...popular at the end of it

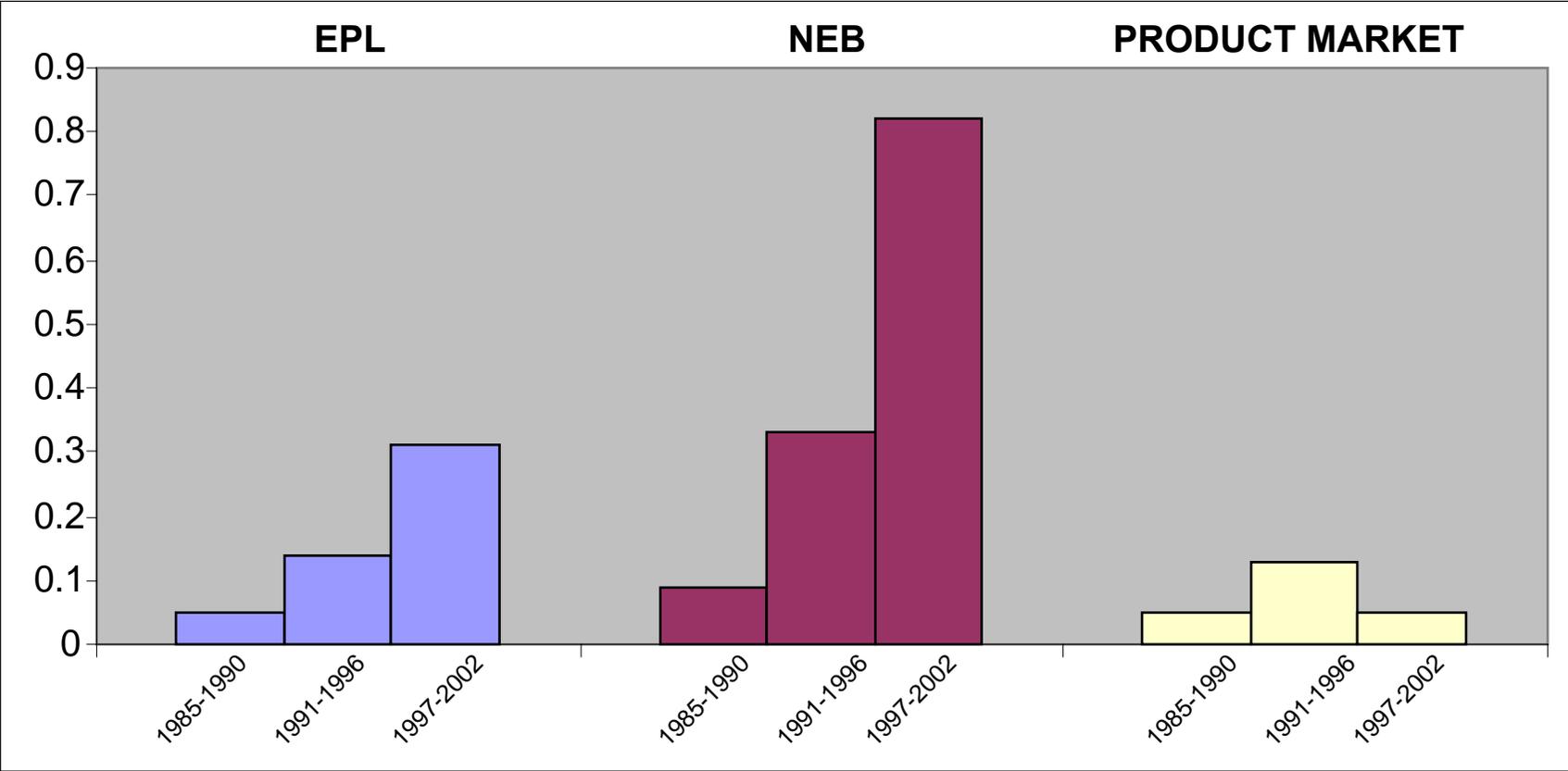


Reforms and Government fragmentation

Surprisingly, cohesive coalitions seem to implement more popular reforms than fragmented governments



Acceleration of labor market, deceleration of product market reforms



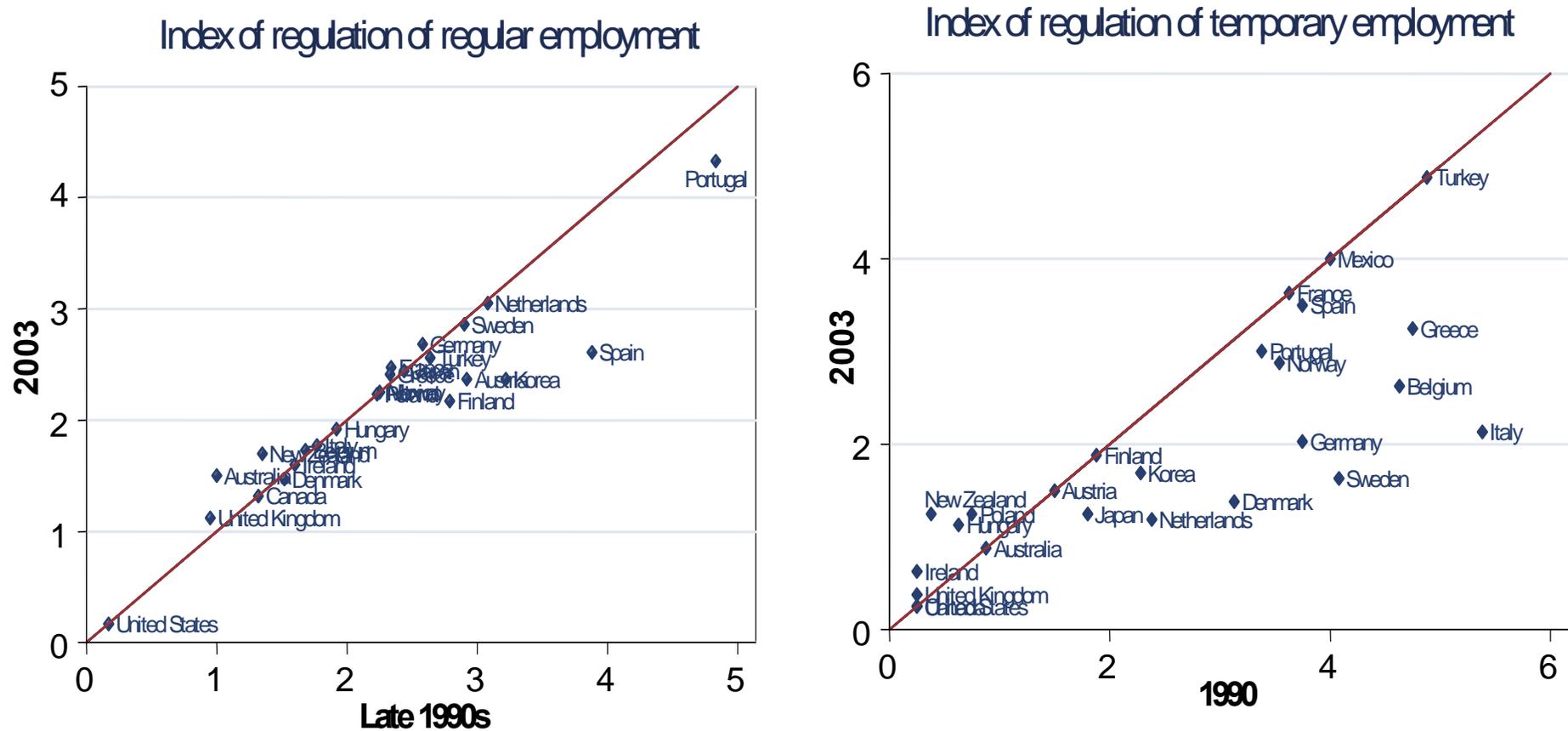
Source: *fRDB Social Reforms Database*

Boeri and Monti (2007)

Why is it more difficult to reform product markets?

- Reforms leaving aside incumbents as in labour markets are not feasible
- Dual track possible only across sectors (some sectors liberalized while others are not), but when liberalizing a few sectors, benefits of reforms are not perceived (as they are spread across many consumers), while losses are concentrated
- Progress was made only by delegating authority (blame?) to Brussels (Single Market)

Reforms of EPL confined to temporary contracts (except Spain)



while reforms of product markets are radical

		Increasing Competition			Decreasing competition			Total per row	Of which decreasing (%)
		1985-1990	1991-1996	1997-1998	1985-1990	1991-1996	1997-1998		
Airlines	<i>Marginal</i>	0	5	13	0	0	0	18	100
	<i>Radical</i>	3	9	0	0	0	0	12	100
Telecom	<i>Marginal</i>	4	45	9	0	0	0	58	100
	<i>Radical</i>	0	4	8	0	0	0	12	100
Electricity	<i>Marginal</i>	1	4	3	0	0	1	9	88.89
	<i>Radical</i>	1	3	2	0	0	0	6	100
Gas	<i>Marginal</i>	0	8	0	0	0	1	9	88.89
	<i>Radical</i>	1	1	0	0	0	1	3	66.67
Post	<i>Marginal</i>	6	5	2	1	0	0	14	92.86
	<i>Radical</i>	3	3	0	0	0	0	6	100
Railways	<i>Marginal</i>	0	0	0	0	0	0	0	-
	<i>Radical</i>	0	5	0	0	0	0	5	100
Road	<i>Marginal</i>	11	0	1	0	0	0	12	100
	<i>Radical</i>	4	1	1	0	0	0	6	100
Total per column		34	93	39	1	0	3	170	97.65
<i>Average per year</i>		5.07	16.03	19.05	0.02	0	1.05	12.14	

Summarizing

- Acceleration of labor market reforms, not of product market reforms
- Reform activity in labor markets driven almost entirely by marginal reforms (e.g., temporary contracts)
- Role of political obstacles. Reforms “at the margin” are often the only ones which are politically feasible

Outline

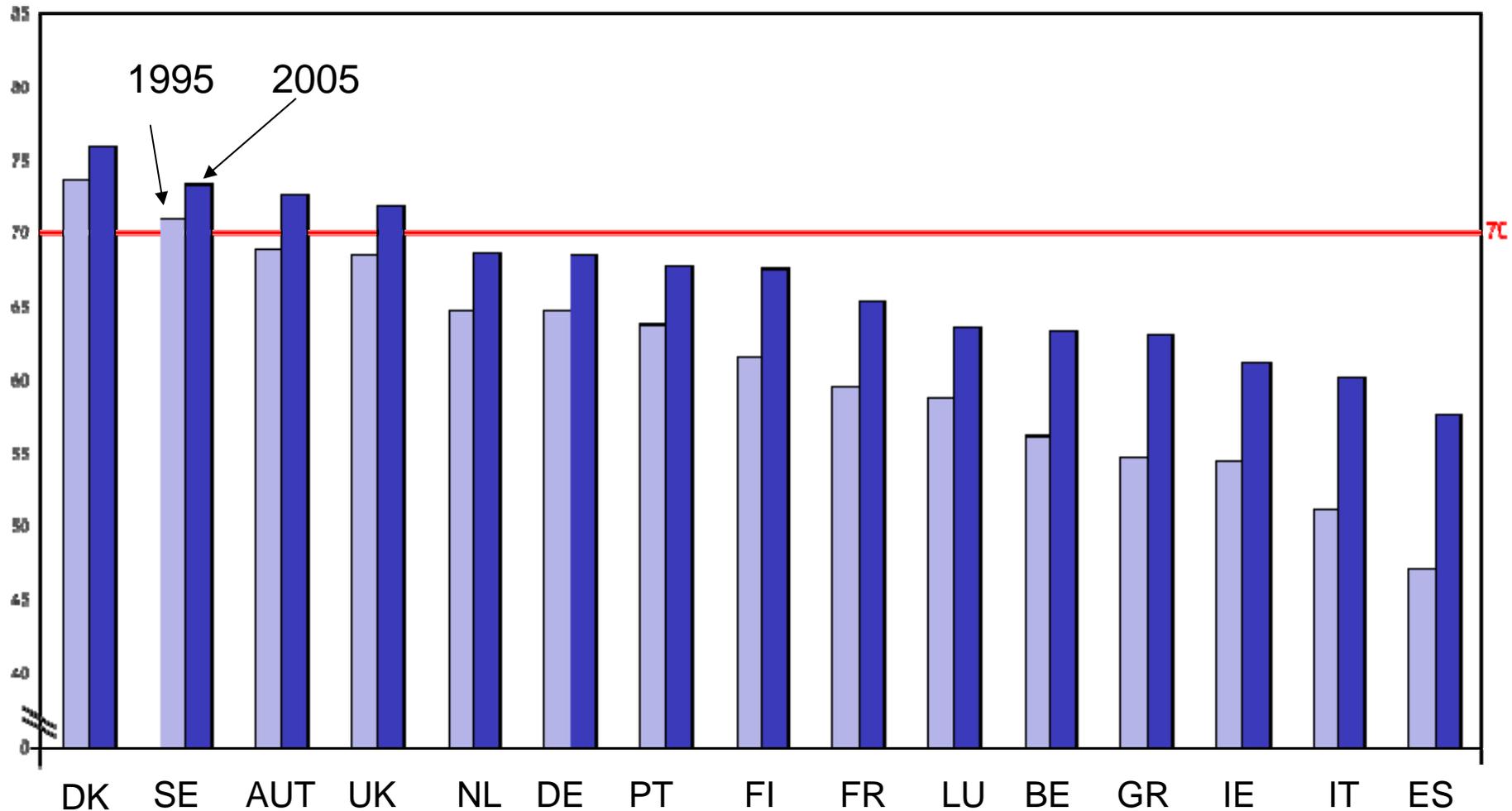
- Taking stock of reforms in labor/product markets
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The sea change

- 1994 OECD Jobs Study:
- “The labour market has become particularly worrying in Europe...
- slow employment growth has always been a feature of the Efta and EC regions...
- there are indications that employment has been unusually weak vis-à-vis output growth...
- In the EC employment growth has been generally sluggish....”

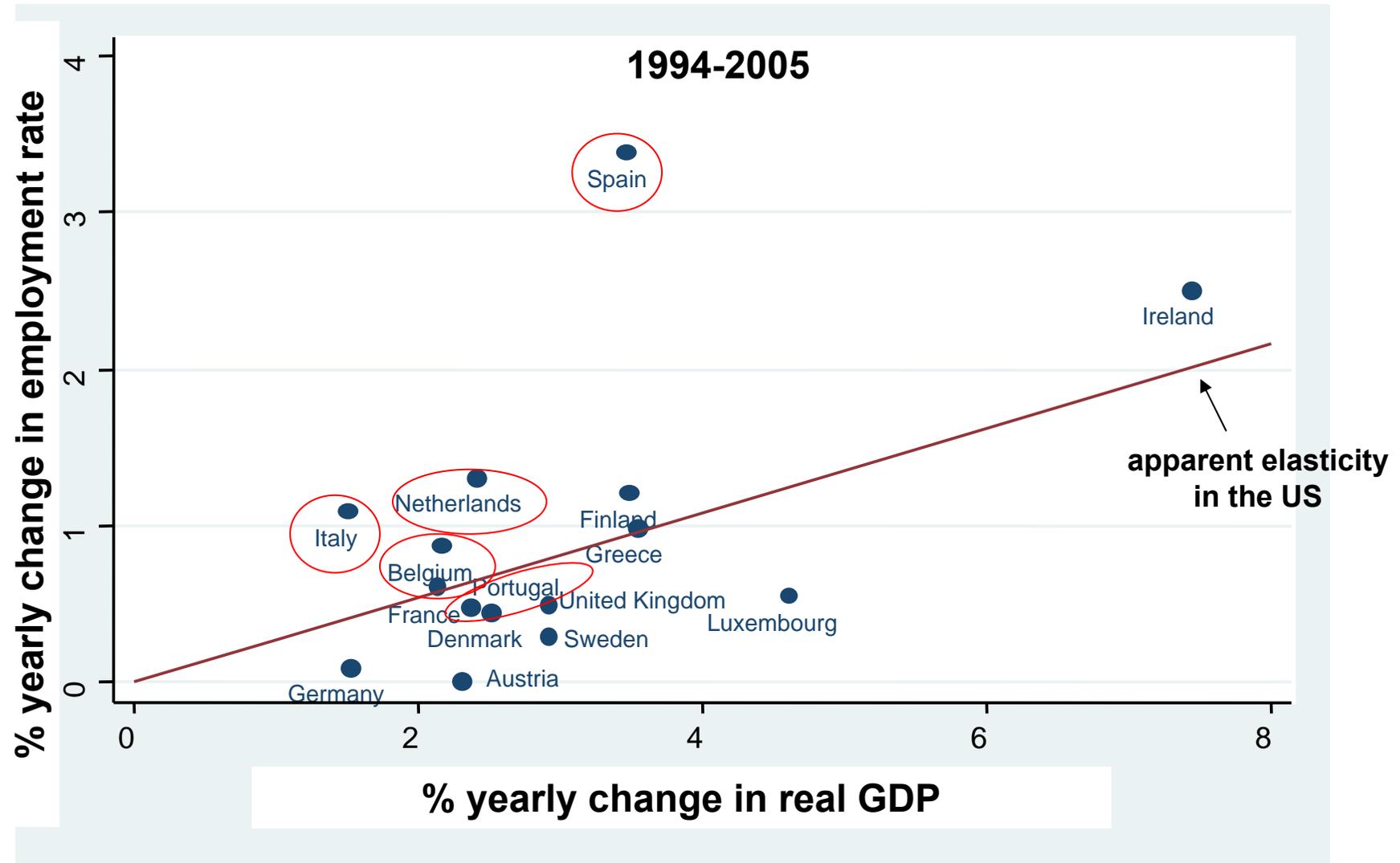
Since then...

Employment to population rates and the distance from Lisbon
(North-America)



Source: Eurostat

From jobless growth to growthless job creation?

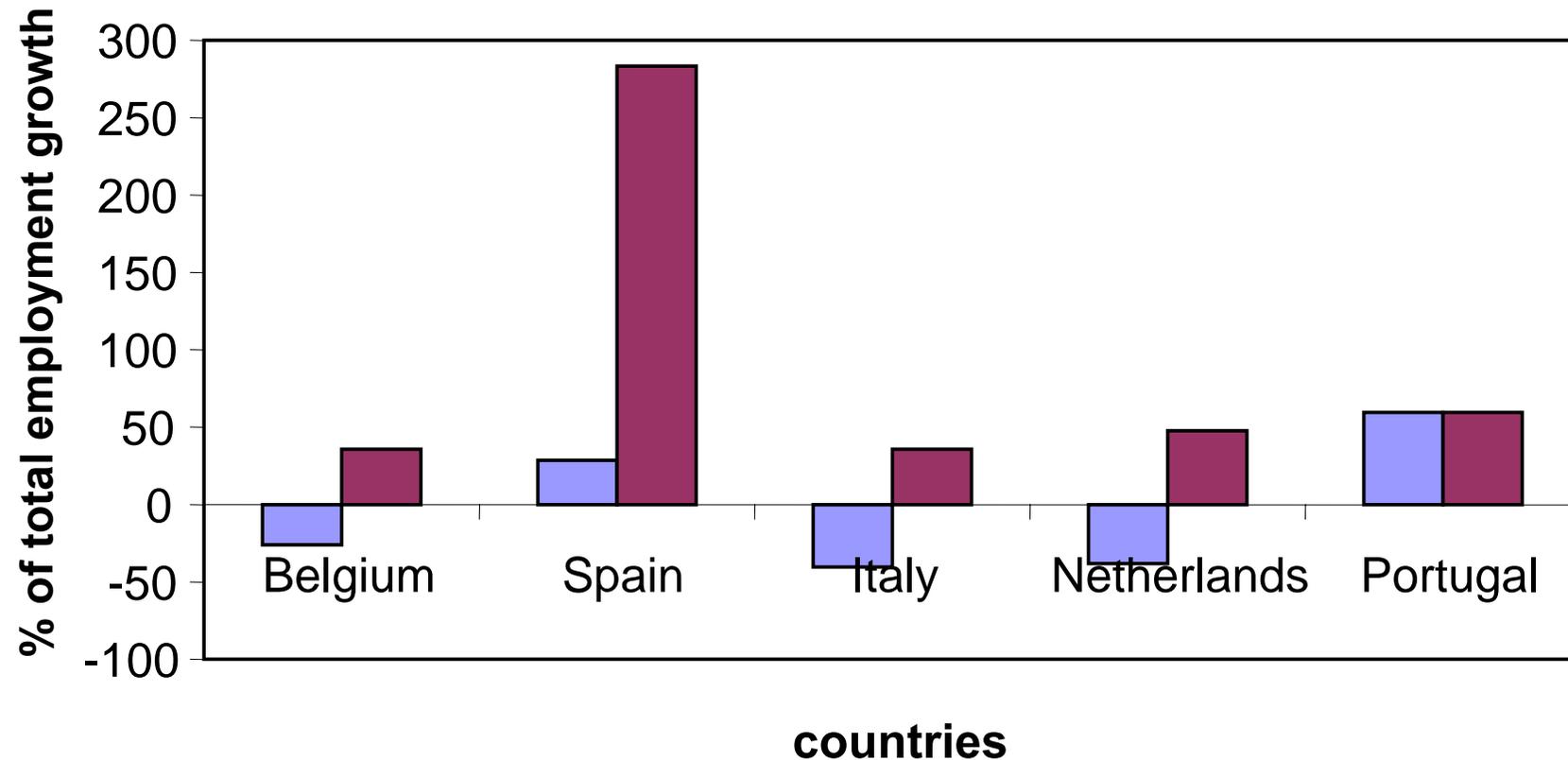


Why growthless job creation?

Two potential explanations:

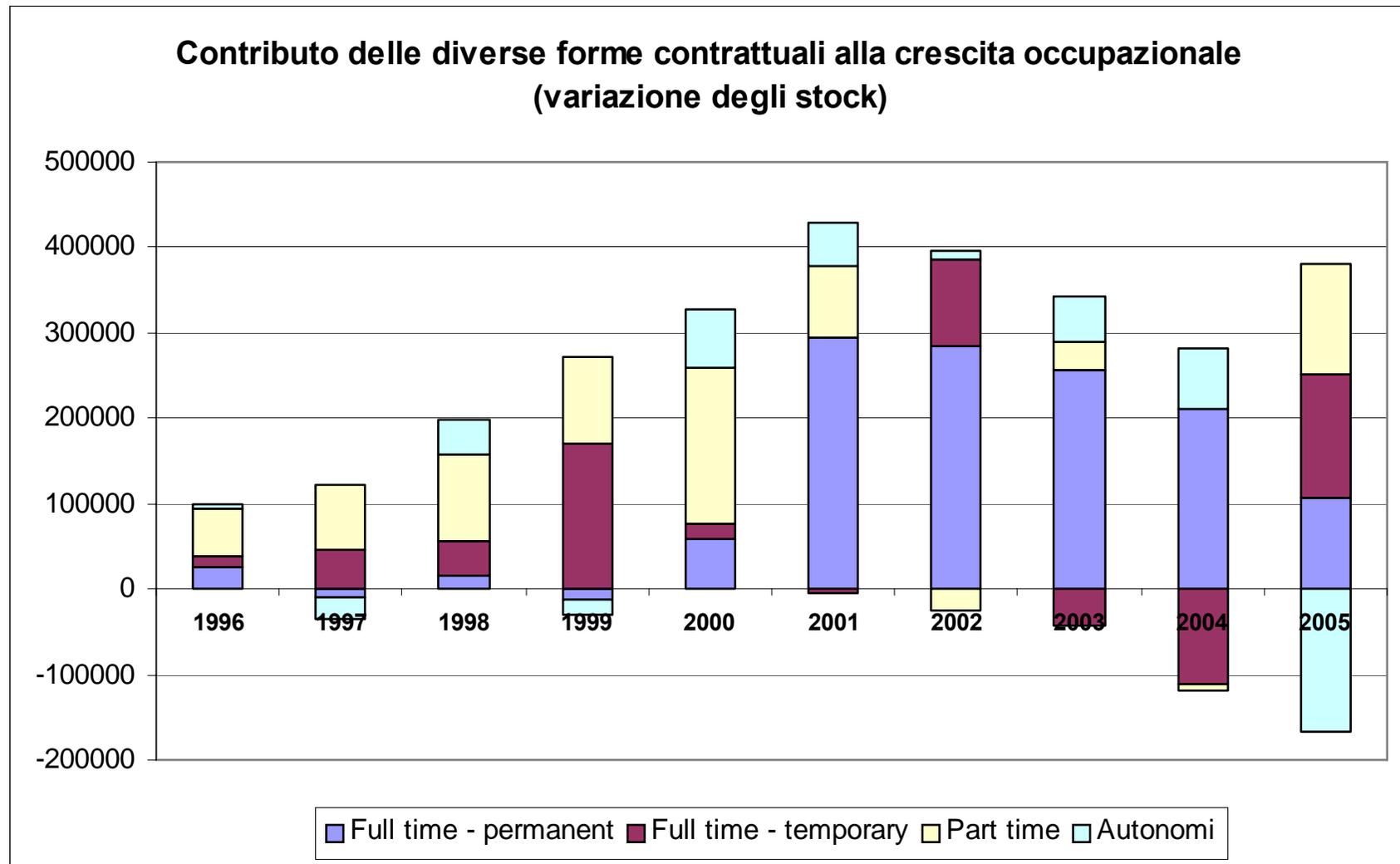
1. *Productivity*: Reforms reducing unemployment benefits and minimum wages made more low-skilled workers marketable. *It implies increased employment of low skilled workers*
2. *Flexibility*: Employers exploit flexibility at the margin, hiring workers under temporary contracts. *It implies increased employment of temporary workers.*

Contribution to employment growth of unskilled labour and temporary employment



■ Workers with primary and low education ■ Temporary workers

The role of temporary contracts in job creation



Consistent with Theory?

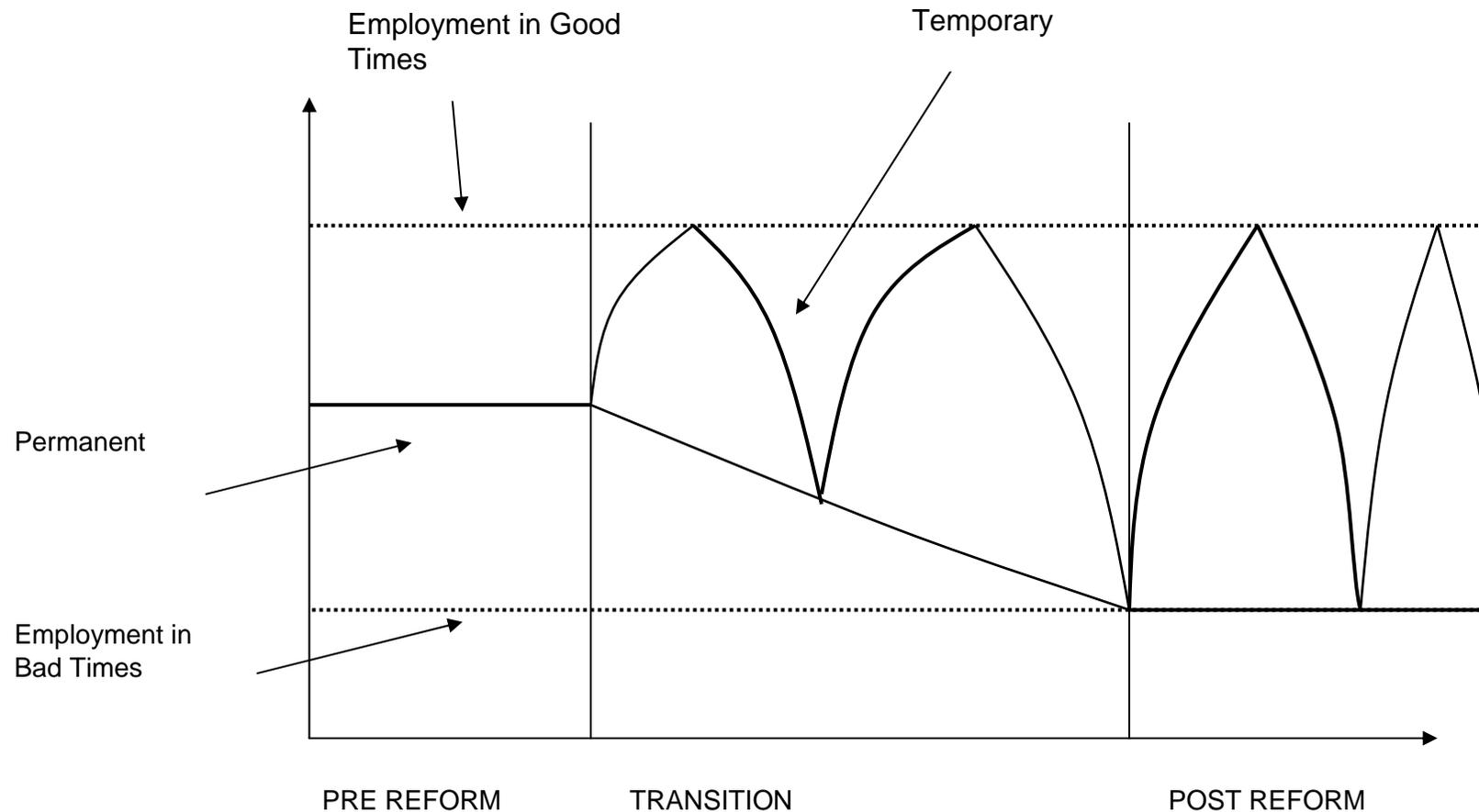
- Lazear neutrality. With flexible wages and risk-neutral agents (interested only in *average* wages over the period) EPL consisting of *pure severance* has **no effects** on employment and wages
- With rigid wages, EPL reduces profits (tax on capital) and reduces turnover/fluctuations, but does not affect steady state employment

Two-tier systems

- Need to investigate transitional dynamics of flexibility at the margin
- Under good times a “buffer stock” is built-up. Hiring of Temporary workers.
- Under bad times “temps” are laid-off
- Average productivity declines (under DRS)
- More turnover, accommodated by TEMPs

The mechanism: a Honey Moon Effect

Boeri and Garibaldi (2007) Under good times a “buffer stock” is built-up. Hiring of Temps. Under bad times temps are laid off. Average employment increases unlike standard models of EPL.



Optimal levels of permanent and temps in the transition phase

$$l_t^{perm} = (1 - \delta)l_{t-1}^{perm}$$

and

$$l_t^{temp} = l_t^{temp} = \begin{cases} \frac{A^h}{w} - l_{t-1}^{perm} & \text{if } A = A^h \\ 0 & \text{if } A = A^l \end{cases}$$

Intuition

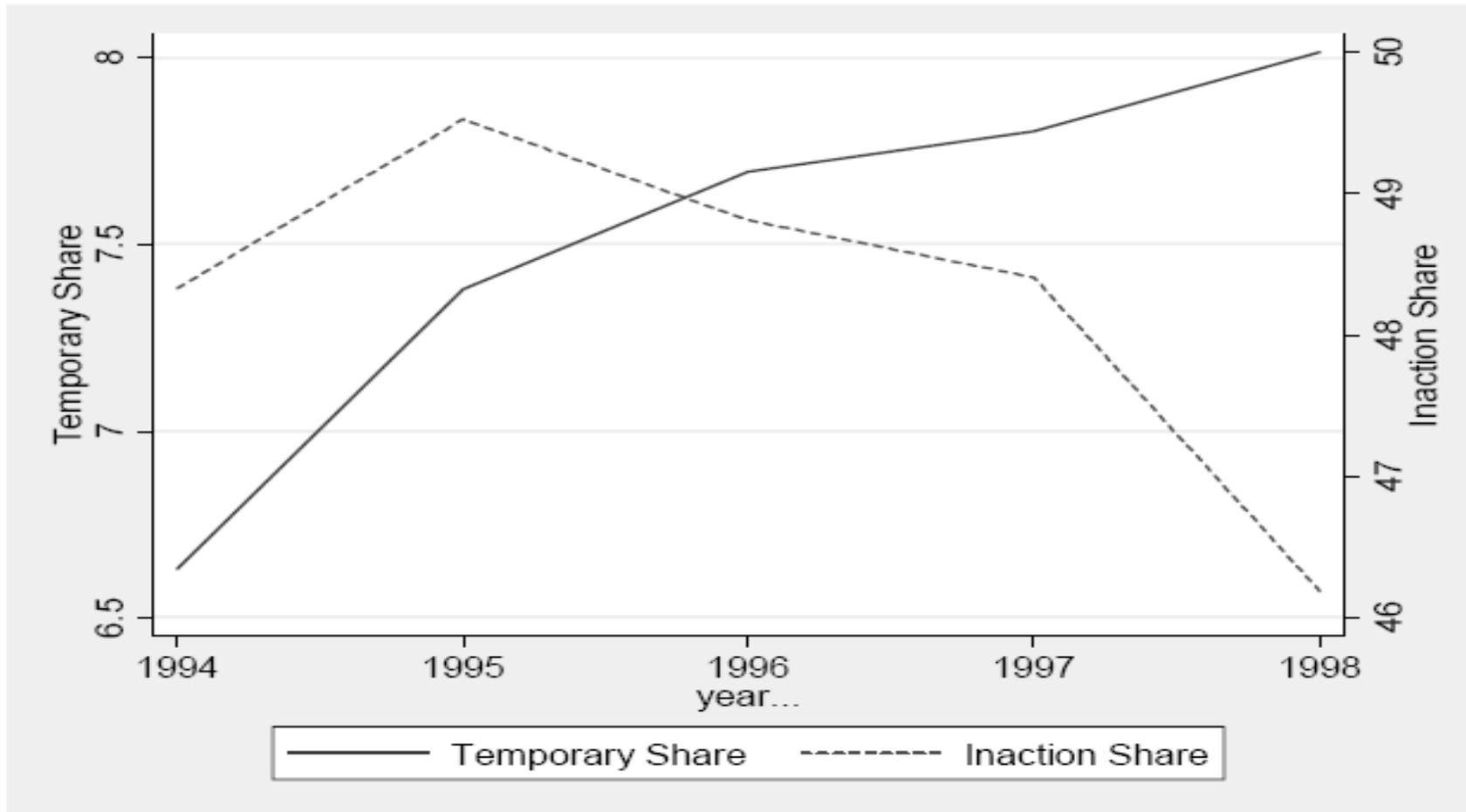
- With EPL no adjustment of labor to shocks. Employers choose the employment level maximising expected profits and stick to it
- Without EPL same employment, but more profits each period
- With a two-tier regime, efficient adjustment only during upturns. More profits than with EPL, less than without it

Key Implications of two-tier regimes

- More mobility (less inaction)
- Increasing share of temps.
- A temporary **positive effect on average employment.**
- A temporary **negative effect on average productivity.**

Country	Time Period	Employment Growth ^a <i>g_E</i> (%);	Employment to Output elast. ^b	Temporary Emp. Growth ^c (⁰⁰⁰); ΔET_t	Contribution of Temporary jobs ^d $\frac{\Delta ET_t}{E_0}$
Belgium	1987-1996	1.12	0.40	22.7	0.66
	1997-2005	1.36	0.64	135.3	3.54
	Δ	0.25	0.24	112.6	2.89
Italy	1987-1997	-0.22	-0.10	402.9	0.02
	1998-2005	1.61	1.84	823.2	4.11
	Δ	1.85	1.95	420.3	4.09
The Netherlands	1987-1995	3.73	0.29	340.1	5.79
	1996-2005	0.75	1.24	288.8	3.80
	Δ	-2.98	0.95	-51.3	-2.00
Portugal	1987-1996	0.42	0.10	-168.9	-4.10
	1997-2005	2.18	1.01	431.8	10.09
	Δ	1.76	0.91	600.6	14.19
Spain	1981-1984	-1.20	-0.74	0	0
	1985-1995	1.30	0.38	3377.1	28.50
	Δ	2.50	1.12	3377.1	28.50
Sweden	1987-1996	-1.02	-0.70	-138.9	-3.22
	1997-2005	1.35	0.41	189.2	4.82
	Δ	2.37	1.11	328.1	8.04

Some micro evidence 1



Boeri and Garibaldi, 2007

Some micro evidence 2

Table 5: Labour Productivity and Temporary Employment: 1996-2000

Dependent: Change in Value Added per Worker ^a					
	I	II	III	IV	V
Temporary ^b	-0.22 (0.083) ***	-0.22 (0.083) ***	-0.38 (0.09) ***	-0.42 (0.104) ***	-0.45 (0.105) ***
Low Skills ^c	-0.03 (0.032)	-0.035 (0.032)	-0.021 (0.032)	-0.03 (0.04)	-0.04 (0.04)
Investment ^d	-	-	-	0.001 (0.001)	0.001 (0.001)
Sectoral Dummies	NO	YES	YES	YES	YES
Size Dummies	NO	NO	YES	YES	YES
Geographical Dummies	NO	NO	NO	NO	YES
<i>R</i> ²	0.0102	0.0114	0.0403	0.0534	0.0606
Observations	843	843	843	630	625
^a Change in Value Added per worker ^b Average Temporary Workers Between 1996 and 2000 ^c Average Low Skill Workers Between 1997 and 2000 ^d Average Real investment between 1996 and 2000					

Boeri and Garibaldi, 2007

Difference-in-differences

Marginal effect of the probability of being dismissed (%)			
	permanent workers	temporary workers	Difference
Firms with			
less than 15 employees	1.7	0.8	0.9
more than 15 employees	0.9	2.2	-1.3
Difference	0.8	-1.4	2.2

Boeri and Jimeno, 2006

Thus

Honeymoon effect contributes to
explaining growthless job creation ...

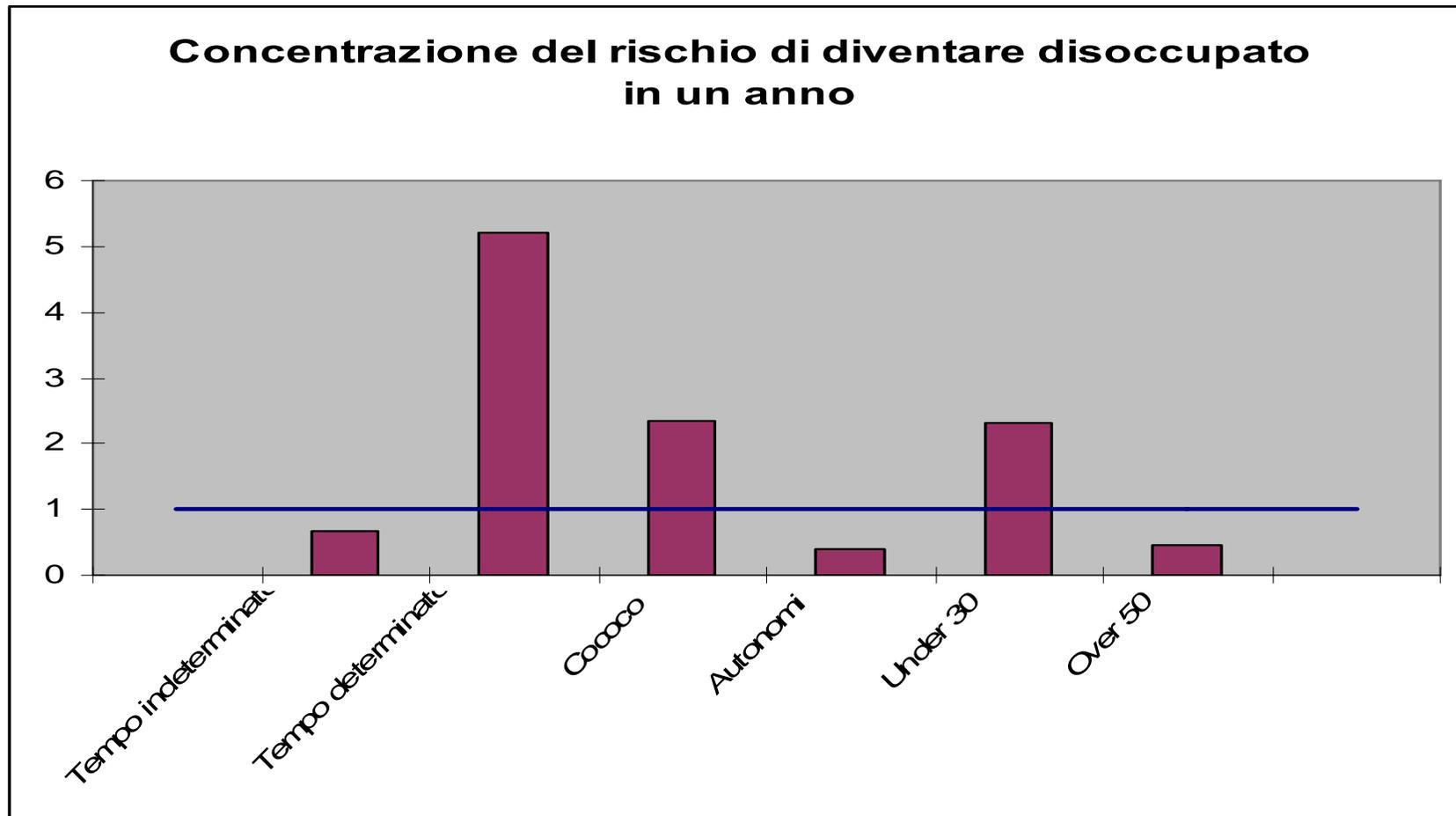
.. and the increase in the share of
temporary contracts..

... as transitory phenomena.

Does the honeymoon create political support for radical reforms?

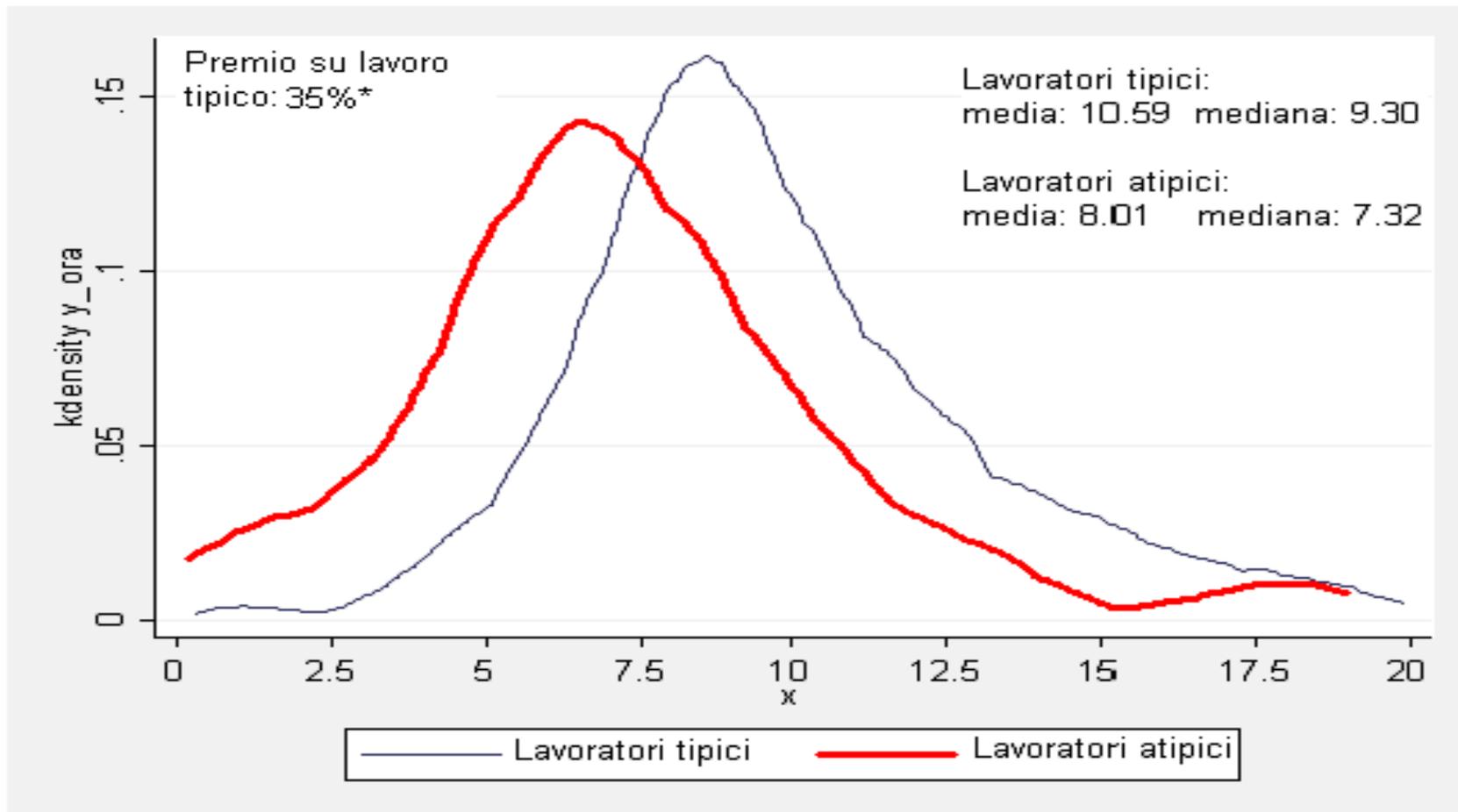
- Who wins and who loses
- Concentration of labor market risk on the temps
- Temps in between employment and unemployment: low wages at high insecurity
- Are temps (young people) represented?
Are they aware?

Relative risk of unemployment



Fonte: ISTAT, Indagini sulle forze di lavoro

Two wage distributions

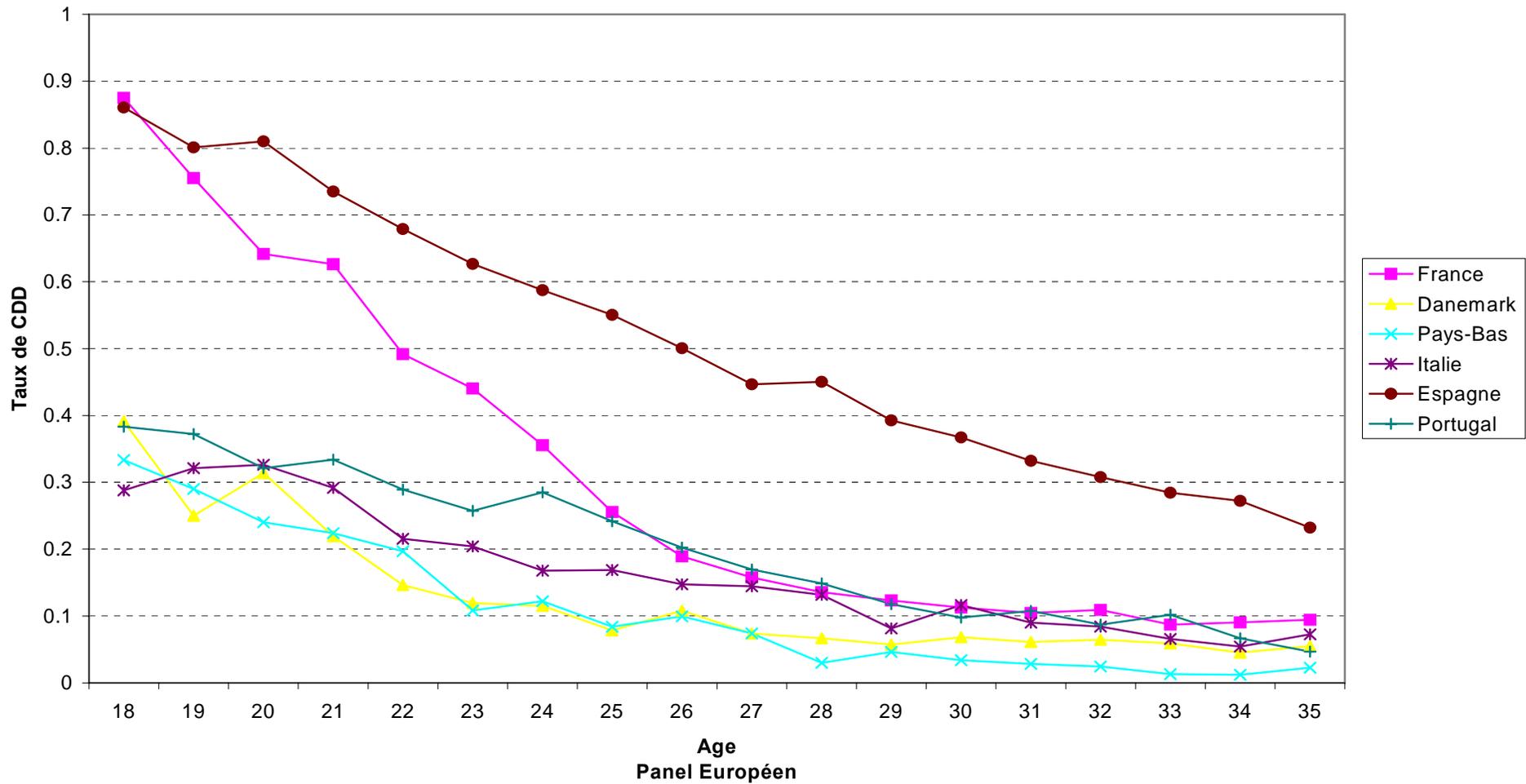


Note: * controllando per età, genere e livello di istruzione.



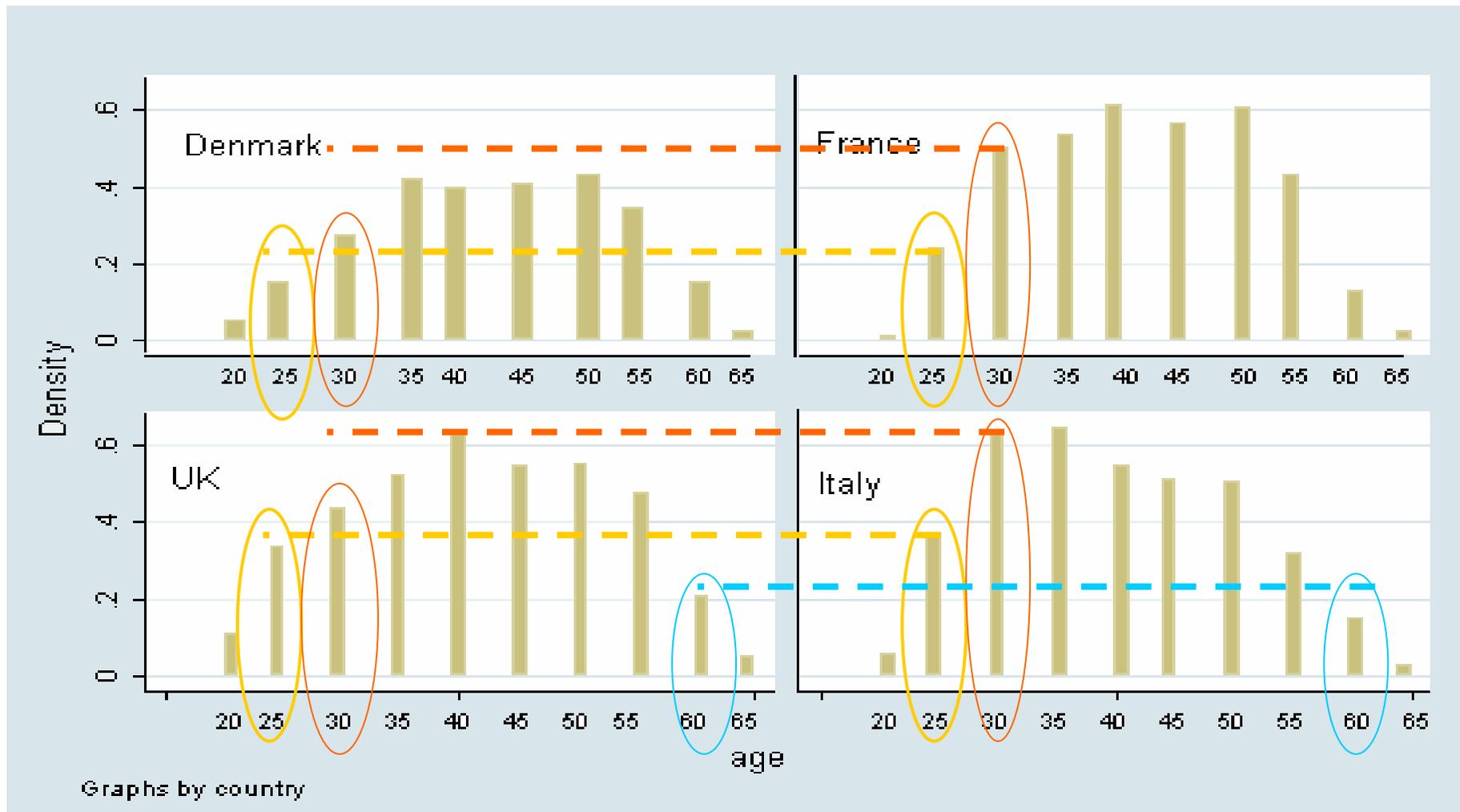
Fixed-term contracts are for young workers
Probability of moving to permanent contract
about .10 in Italy

Part de contrats précaires, parmi tous les contrats



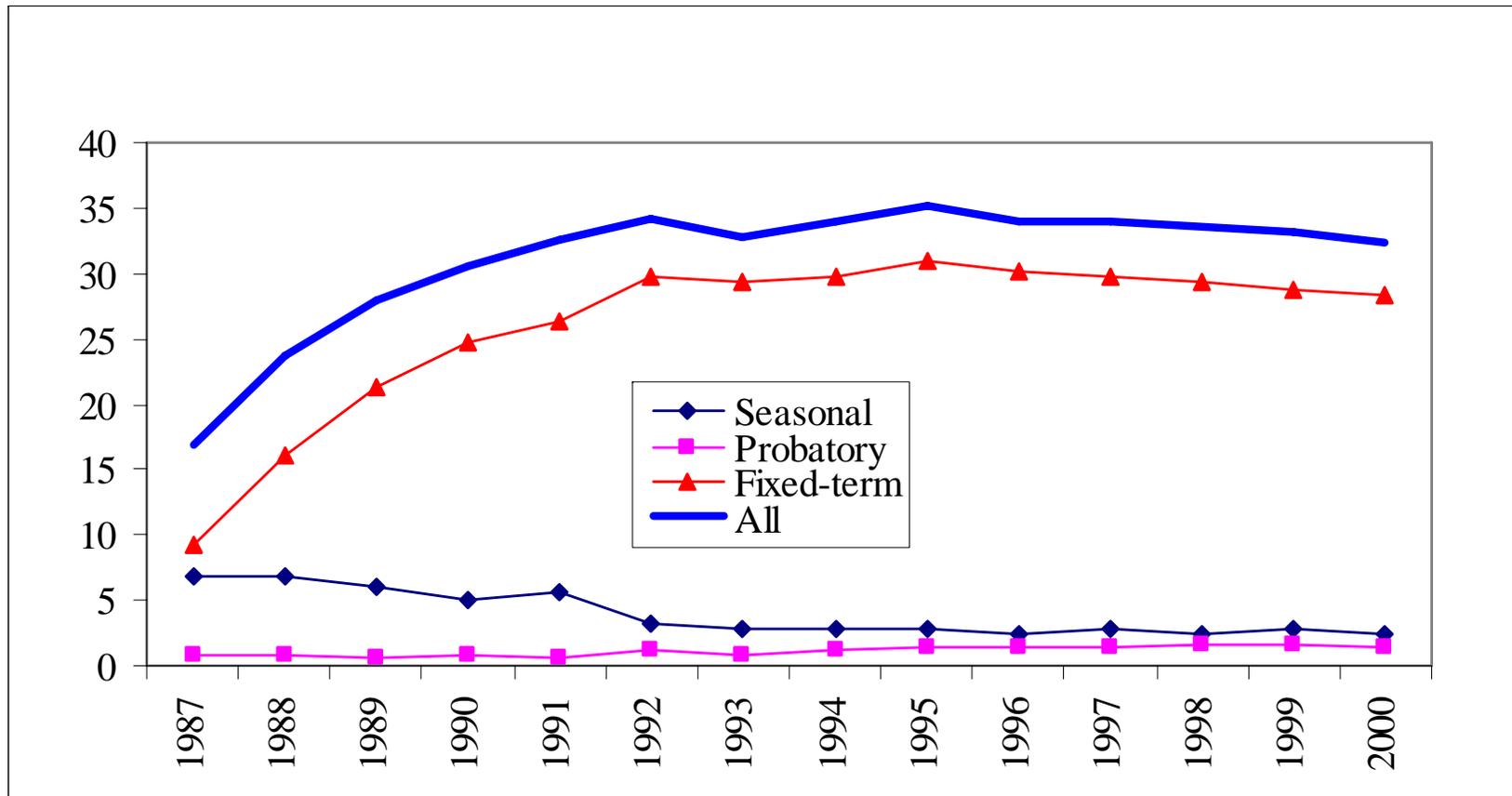
Perceived “Job insecurity”.

Concentrated among young people

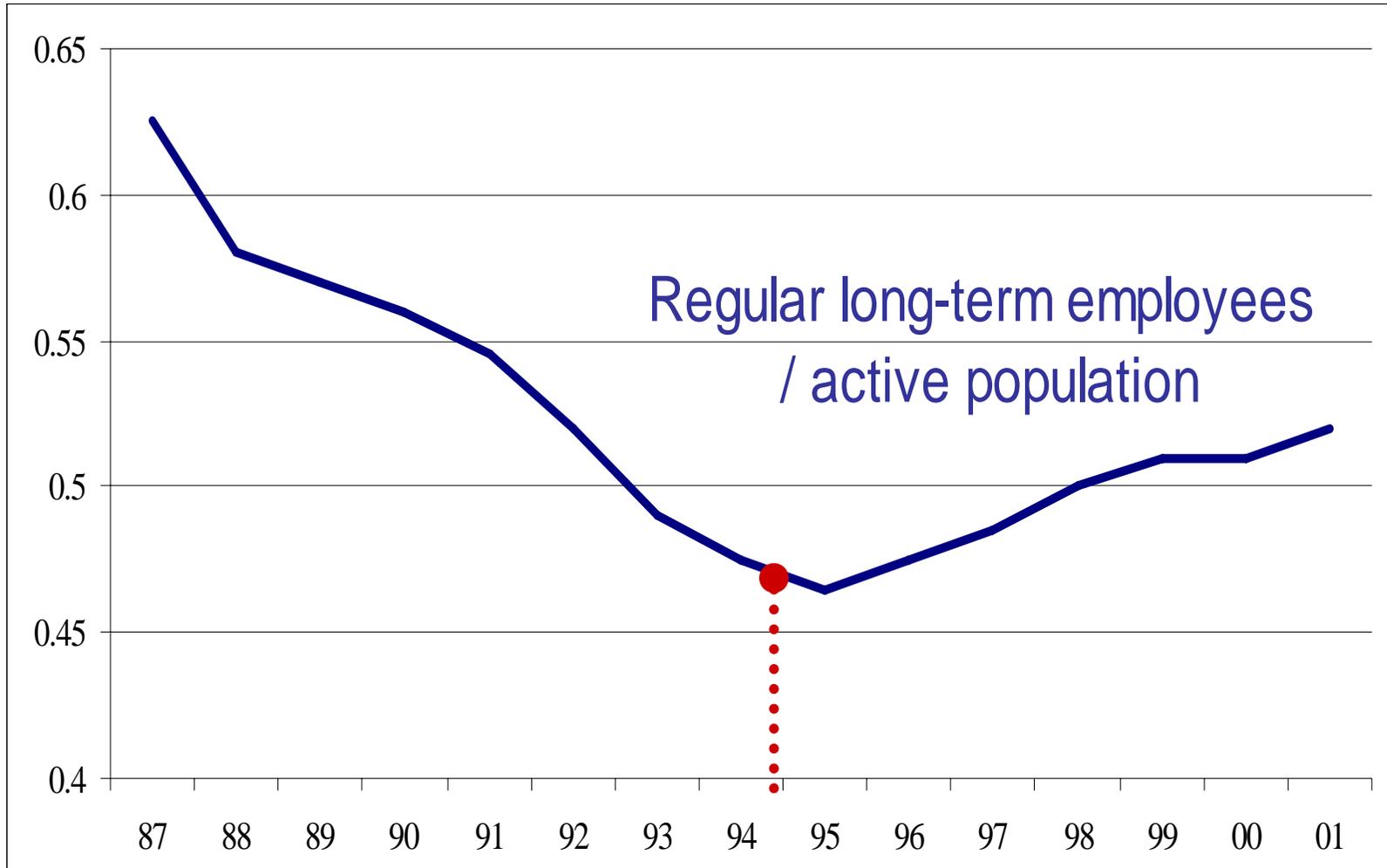


Temporary employment in Spain

(as % of total employees)



Timing of the radical reform in Spain



Final remarks

- Two-tier reforms as a politically viable strategy to reform labor markets
- They temporarily increase the employment content of growth, but create longstanding asymmetries between temps and open-ended contracts. Equity and efficiency concerns (Blanchard and Landier, Cahuc and Postel Vinay)
- Segmentation can be reduced by building up consensus for more radical reforms .. if policy-makers know how to do it