

# Reforms under Stress

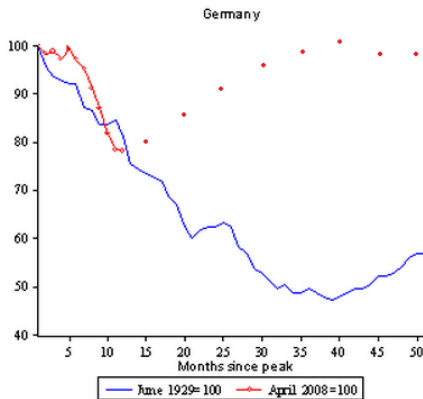
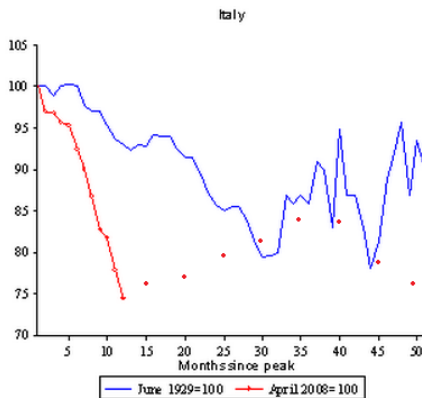
Tito Boeri, Bocconi University, LSE and fRDB

Annual Conference Norwegian Economic Association

# Outline

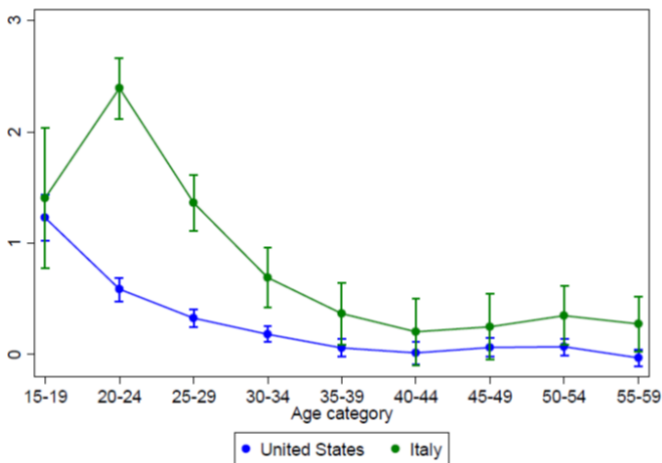
- The shock in the South (and in the North)
- The scope for reforms of collective bargaining
- Reforming Employment Protection while dealing with Contractual Dualism
- Was it the right thing to do in the midst of a major recession?

# Worse than in 1929 and 1933?



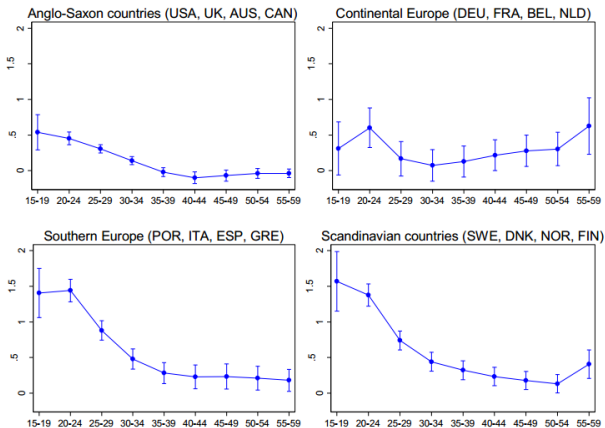
Index of industrial production (beginning of the crisis=100)

# The generational divide



Regression of group specific unemployment against total unemployment by region and over time, 2008-2013

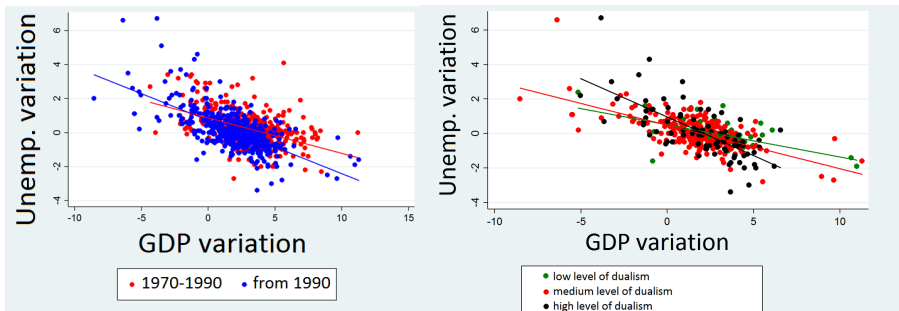
# The Nordics look like Southern Europe



Notes: data from harmonized OECD-LFS, methodology as in Hoynes et al. (2012)

Regression of group specific unemployment against total unemployment by region and over time, 2008-2013

# Temporary employment and Okun's law

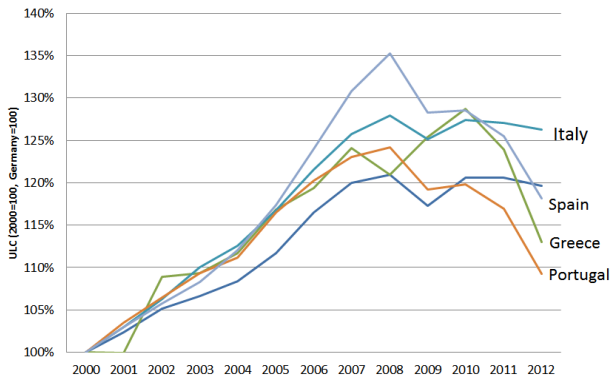


Author's estimates of Okun's law elasticities

# Outline

- The shock in the South (and in the North)
- **The scope for reforms of collective bargaining**
- Reforming Employment Protection while dealing with Contractual Dualism
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# The Troika diagram



Unit labor costs in countries with two-tier bargaining structures (2000=100)  
relative to Germany (=100 in all periods)



## Mostly two-tier bargaining countries

(France), Greece, Italy, Spain, and Portugal have *two-tier bargaining* structures, where

- 1 there is both multi-employer (centralized) and single-employer (decentralized) bargaining, and
- 2 the plant level can only add-up to centralized agreements based on the *favourability principle*

Some exceptions are provided to this rule (derogations to the 1st tier), but under rather extreme circumstances

# Why two-tier?

- Way of unions to resist to pressures for decentralization of bargaining
- *Controlled decentralization* preventing firms to undercut wages (Bertrand competition) in countries where many (small) firms are not unionized
- In principle should allow to reconcile macroeconomic stability with microeconomic flexibility
- inducing a closer link between productivity and pay
- allowing for wage and hours (rather than only employment) adjustment to shocks
- and, at the same time, preventing excessive wage inequality

## However, in practice ...

... two-tier takes place only in large firms as unions impose second-level to (reluctant) employers.

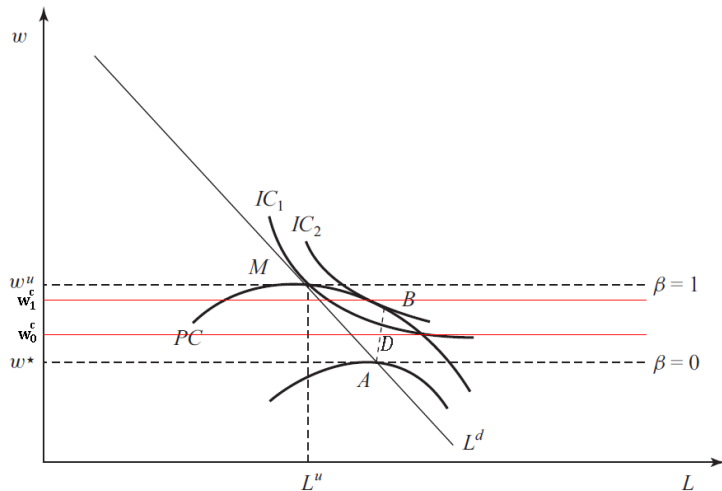
- Declining power of unions implies that only centralized bargaining survives...
- .. and where both levels are present, the advantages of decentralization may not materialize
- but you do not have the benefits of centralized bargaining in terms of economic stability
- Being in the middle of the river is not particularly desirable

# Reforms moving away from two-tier

Supported by the Troika in program countries

- Greece in 2010/11 introduced the possibility to derogate from conditions set at higher level and extended the right to negotiate at the firm-level to workers' representatives.
- Spain in 2012 gave priority to plant-level over national agreements
- Portugal in 2012 facilitated bargaining at firm level and reduced the firm threshold allowing worker councils to sign collective agreements.
- France and Italy expanded the scope of derogations to the 1st tier

# Economic rationale I



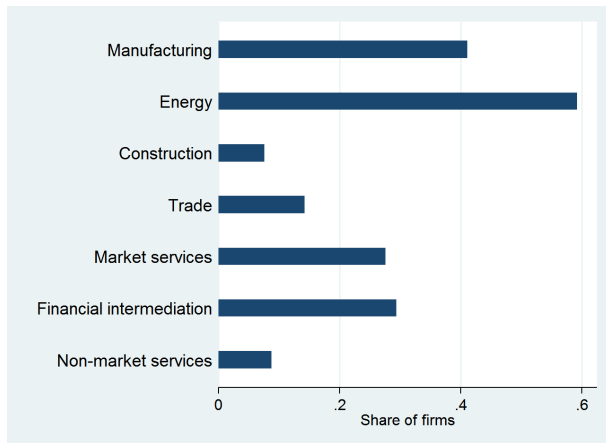
## Economic rationale II

Cost minimization in presence of

- ① fixed (and recurrent) costs per worker, and
- ② predetermined wages

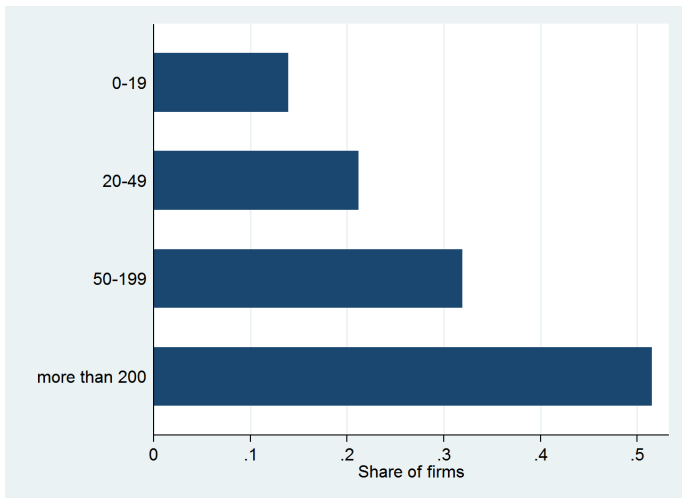
makes hours of work, unlike employment, independent of output levels, all adjustment falls on the extensive margin which may not be desirable in presence of temporary shocks

# Who does both levels under two-tier?



Source: WDN (Wage Dynamic Network) database

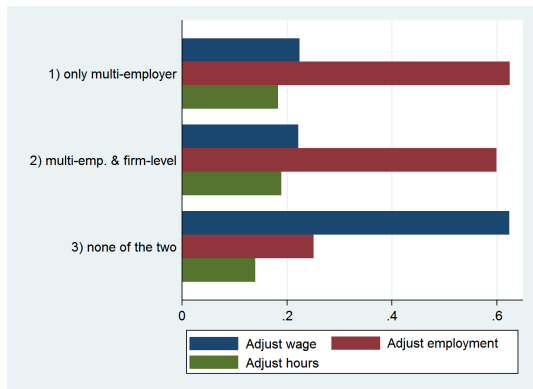
## Who does plant-level under two-tier?



Source: WDN (Wage Dynamic Network) database

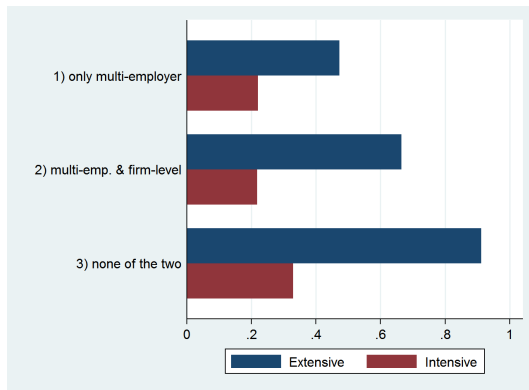


# Does it allow for wage-hours adjustments under temporary shocks?



Source: WDN (Wage Dynamic Network) database

# Does it allow for productivity-related pay?



share of firms using PRP (Extensive)

average share of the wage that is PR among firms paying PRP (Intensive)

Source: WDN (Wage Dynamic Network) database

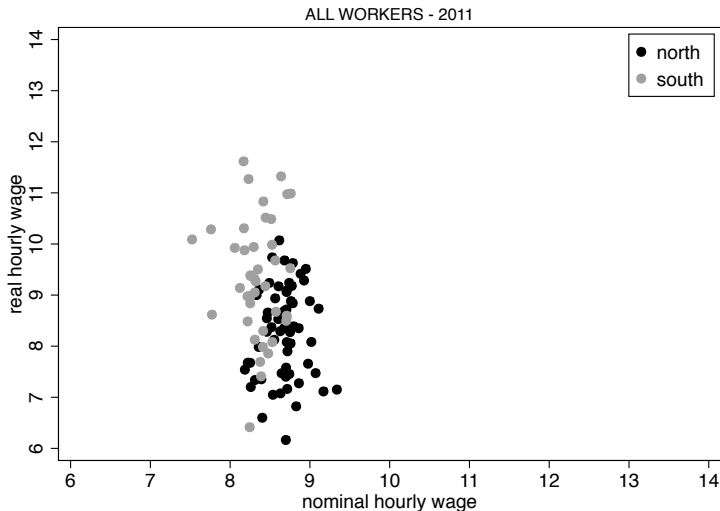
# Does controlled decentralization mitigate earning inequality?

Ongoing work with Andrea Ichino and Enrico Moretti measuring inflation across space.

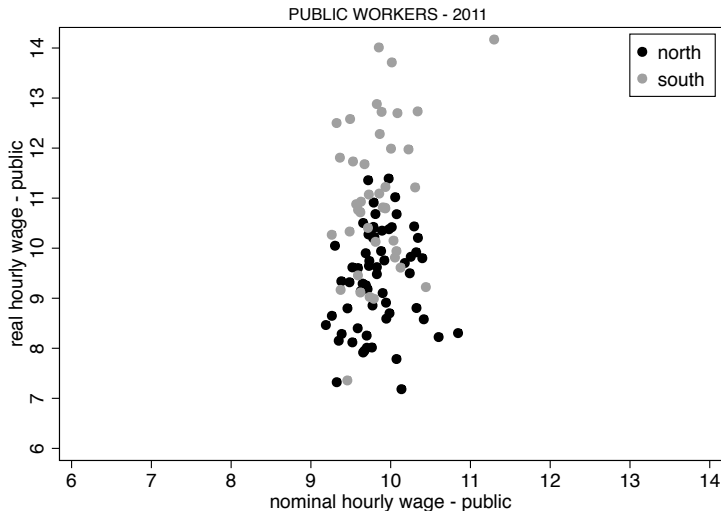
We follow Moretti (2013) to obtain Consumer Price Index at the level of each province (local labor market) that

- gives to local housing expenses their correct importance in the family consumption basket (34% in 2011 compared to 9% of Istat)
- adjust other local prices for the attraction effect of housing prices

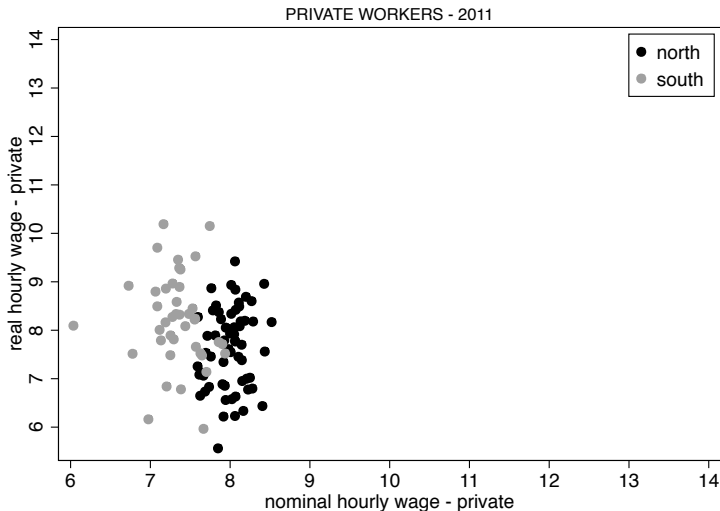
# Nominal and real wages across Italian provinces



# Nominal and real wages across provinces - public sector



# Nominal and real wages across provinces - private sector



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# How about Contractual Dualism?

"We consider the following measures as essential:

- Reform the collective wage bargaining system allowing firm-level agreements to tailor wages and working conditions to firms' specific needs and increasing their relevance with respect to other layers of negotiations.
- *A thorough review of the rules regulating the hiring and dismissal of employees should be adopted*
- in conjunction with the establishment of an unemployment insurance system
- and a set of active labour market policies capable of easing the reallocation of resources towards the more competitive firms and sectors."

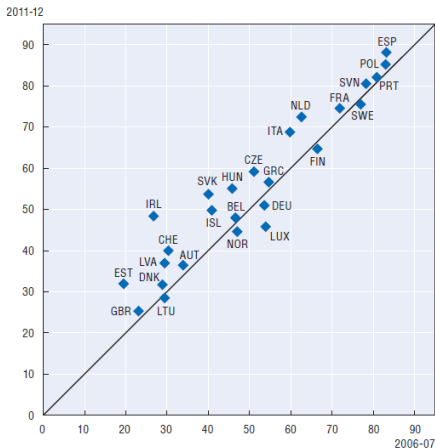
M. Draghi and J.C. Trichet, confidential letter to Italian Govt before starting LTRO programme, August 8th, 2011



# Unforgivable omission. I

Figure 4.1. **Fixed-term contracts among new hires, 2006-07 and 2011-12**

Percentage of employees with no more than three months of tenure

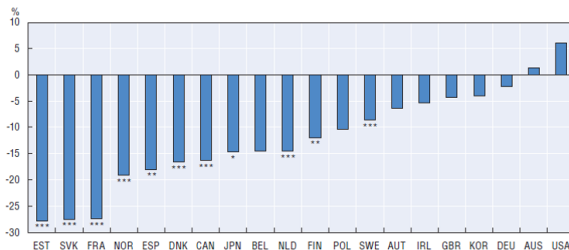


Source: OECD calculations based on microdata from the European Union Labour Force Survey (EU-LFS).

# Unforgivable omission II

**Figure 4.14. Temporary workers and employer-sponsored training**

Estimated percentage effect of temporary contract status on the probability of receiving employer-sponsored training, 2012

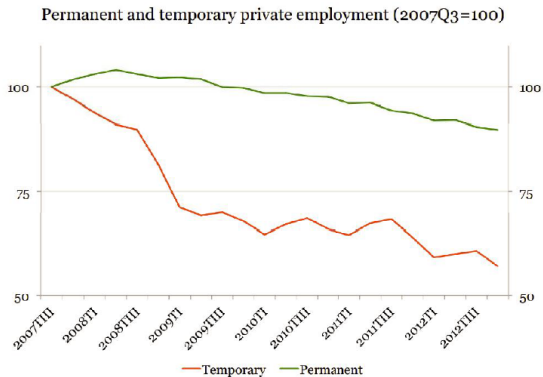


Note: Estimated percentage difference between temporary and permanent workers in the probability of having received training paid for or organised by the employer in the year preceding the survey, obtained by controlling for literacy and numeracy scores and dummies for gender, being native, nine age classes, nine occupations, nine job tenure classes and five firm size classes. Data are based only on Flanders in the case of Belgium and England and Northern Ireland in the case of the United Kingdom.

\*\*\*, \*\*, \*: significant at the 1%, 5%, 10% level, respectively – based on robust standard errors.

Source: OECD Survey of Adult Skills (PIAAC) 2013, <http://dx.doi.org/10.1787/9789264204256-en>.

# Unforgivable omission III



Source: INE, Labor Force Survey.

# Optimal Severance

Ongoing work with Pietro Garibaldi and Espen Moen The optimal severance pay is increasing in

- the investment-training cost over the working life
- the inefficiency of the legal system (probability that shirkers get away with it)

Intuition: in presence of wage deferrals

- severance is a way to commit the firm not to fire workers who invest in firm-specific training with uncertain returns
- disciplinary layoffs yields no severance but there is moral hazard. some shirkers can get the severance

# Graded security contract

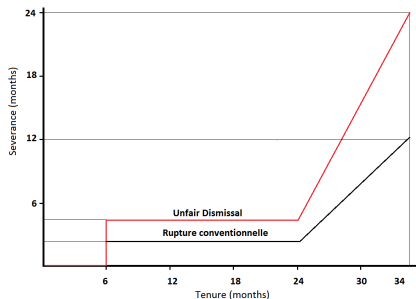
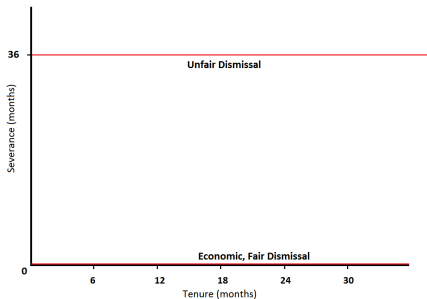
Optimal severance is increasing *with tenure* if:

- marginal cost of effort-training increases with tenure
- the probability of getting away with it is increasing with tenure (higher leniency toward senior workers)

# Reforms

- *Greece* lowered the thresholds for collective dismissals, shortened the notice period and reduced severance pay, extended probationary period, and expanded the scope of temporary work.
- *Spain* shortened duration, limited renewals and increased firing costs for temporary contracts, extended the use of permanent contracts with reduced severance payments, limited probationary period for temporary contracts and created a special fund for severance pay.
- *Portugal* reduced notice period and severance pay, facilitated dismissal procedures, limited the use of temporary contracts, created a fund to finance severance payments for firms going bankrupt.

# Reforms: the Graded security contract in Italy!



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- **Was it the right thing to do in the midst of a major recession?**
- Will the reforms work?



# Literature on the optimal timing of reforms

- The effects are much faster than usually envisaged
- Gnocchi (2014) decentralization of bargaining increases the correlation of wages and productivity over the business cycle
- Kraft and Notowidigdo (2014) and Landais (2014): unemployment duration elasticity to benefits much lower when unemployment is high (US)
- Optimal UB should be countercyclical

# Allowing for GE (wage) effects

- Jung and Kuester (2014): layoff taxes (and hiring subsidies) should be higher in recessions
- Reforms of EPL increase volatility of employment during recessions (Imf, 2010; Gnocchi, 2014) notably when they are two-tier
- Reforms of EPL introduced on a flow basis and reducing dualism may be more appropriate during recessions
- Short-time work can be less costly (and more effective) than enhanced UBs if shocks are large, but temporary (Boeri Bruecker, 2011)

# Political economic considerations

- How to commit Government/unions to countercyclical policies?
- Suppose that we increase UB duration during downturns: will it be possible to reduce it during upturns?
- And how about EPL becoming more stringent during recessions?
- Need of rule based systems balancing the budget over the cycle
- Less of an issue for reforms of collective bargaining: they are, in any event, gradually enacted, as bargaining takes place at rather low frequencies

# Will the reforms in the South be effective?

- Real time policy evaluation still a dream
- but it is not too early to prepare evaluation framework, do randomized experiments or use natural experiments
- Implications relevant also for "dual" Nordic countries
- Reforms of collective bargaining do not occur uniformly across the board: find proper treatment and control groups
- See Catalan et al. (2014) on Spain and Guimaraes et al. (2014) on Portugal
- Use threshold size of firms to monitor EPL reforms
- Will there be lessons for the Nordics?

# Evaluating Troika conditionality

- Operated in the right direction in case of reforms of collective bargaining but these are time consuming and not done by Governments
- It missed contractual dualism in reforms of EPL making employment/unemployment more volatile
- Fiscal consolidation prevented expanding the coverage of UBs
- and short-time work was not considered
- Please take the applied literature more seriously!