

# A suitable Social Contract

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  - ② Being Guarantor of the Social Contract

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*Mario Draghi, Feb 2012 (interview to the WSJ)*



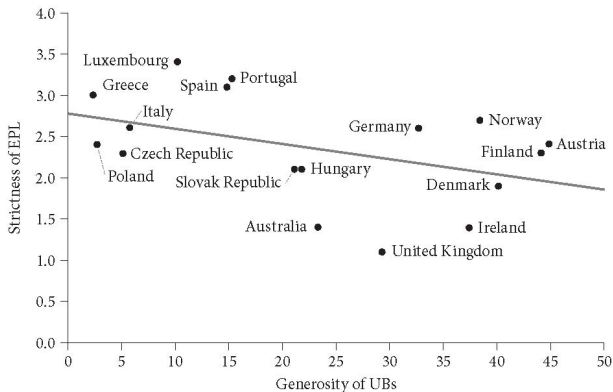
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*"We consider the following measures as essential:  
[...] A thorough review of the rules regulating the hiring and dismissal of employees should be adopted in conjunction with the establishment of an **unemployment insurance system** and a set of 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*

# Insurance vs. Protection against job loss



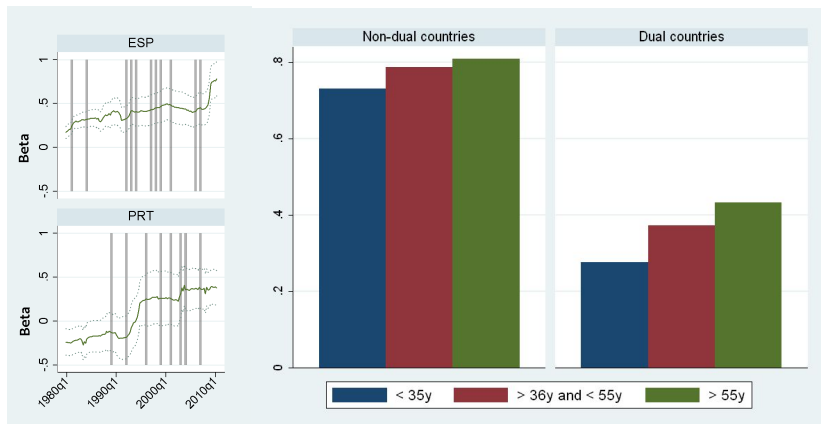
Source: Tito Boeri and Jan van Ours (2013), *The Economics of Imperfect Labor Markets*, PUP

- ▶ Flexicurity is less costs of dismissals (EPL), unemployment benefits (UB) with broader coverage and more pressure on beneficiaries of unemployment benefits (Hartz reform)
- ▶ Huge differences in productivity across regions and sectors, large mismatch of skills (PIACC survey)
- ▶ Up to 50% of productivity gains associated with the reallocation of jobs and of workers
- ▶ Employment growth is higher in firms with higher productivity growth.
- ▶ Finance and labor: firms hold more cash if higher hiring/firing costs
- ▶ Reallocation involves (privately) uninsurable risks: Governments can solve adverse selection, but not moral hazard. Activation addresses moral hazard.

- ▶ Two-tier reforms increase labor market segmentation: fixed-term vs open-ended contracts
- ▶ Increased volatility of employment/unemployment in dual countries
- ▶ Excess turnover does not allow automatic stabilizers to operate properly reducing the coverage of UBs rather than increasing it
- ▶ We get flexidualism rather than flexicurity

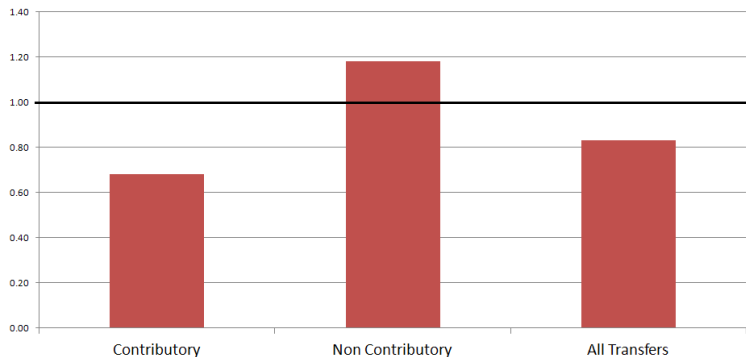
# Two-tier reforms and automatic stabilizers

Okun's Law Betas:  $\Delta u_t = \alpha + \beta \Delta y_t + \varepsilon_t$   
Employment volatility and two-tier reforms



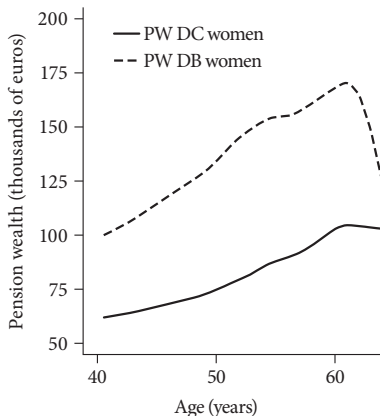
Source: Boeri (2011) Institutional Reforms and Dualism in European Labor Markets

Migrants vs. Natives odds ratios in the receipt of social transfers (EU15)



Source: Boeri (2009), Immigration to the Land of Redistribution

Pension Wealth under pre-reform (DB, dotted line) and post-reform (NDC, continuous line) rules for working women, Italy



Source: Boeri and Brugiavini (2008)

# The State as a Guarantor of the Social Contract <sup>f</sup> **R** **D B**

- ▶ A suitable social contract requires that the State is more an insurer than a provider of 'solidarity' transfers
- ▶ However, smaller size of the pie, more distributional conflict
- ▶ The bloody debate on 'golden pensions' in Italy and the '12 to 1' referendum in Switzerland
- ▶ Need to address broader dimensions of the social contract
- ▶ Governments should invest in trust, fighting corruption, tax evasion
- ▶ Free press, Internet watchdogs could help cutting down (and making more transparent) 'costs of politics'
- ▶ Evidence that distrusts is associated with stricter EPL, more regulation in product markets