

Discussion of: The Effects of Introducing a Single Open-ended Contract in the Spanish Labor Market

by J Ignacio Garcia Perez

- 1 What the Paper Does
- 2 Comments: Theory
- 3 A Proper Calibration?
- 4 Is it an Evaluation of the SC?
- 5 A Final question

Outline

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Ex-ante Policy Evaluation

Simulation of the effects of a **Single Contract** (SC) proposal (Propuesta para la Reactivación Laboral in España) endorsed by some 100 top Spanish economists. Three key steps:

- 1 Extension of standard MP model to account for *contractual dualism* (coexistence of open-ended and temporary contracts)
- 2 Calibration of the model to the Spanish labor market
- 3 Evaluation of the Reform both at the Steady State and in the Transition (winners/losers)

Key Results

- SC decreases unemployment by 21 %
- Job destruction is halved in contracts with a tenure < 4 years
- Longer job tenures on average and not lower for more than 90 % of workers
- Lower tenures for 5 % of the unemployed, the 8.9 % of permanent workers and the 12.2 % of temporary
- Firms experience a 9 % reduction in their expected severance costs

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1. The role of Severance

- EPL as pure mandatory transfer tenure-related. Rules known to both parties. No moral hazard: all dismissals are fair.
- Under Nash-bargaining they are also privately jointly efficient (quits or layoffs?)....
- ... and are undone by wage increasing in tenure. No effects on layoffs, except if binding (on entry wage) minimum wage.
- Dual workers typically not covered by collective bargaining. What is the role then of Severance in TC for this model?

TC as a tenure-track

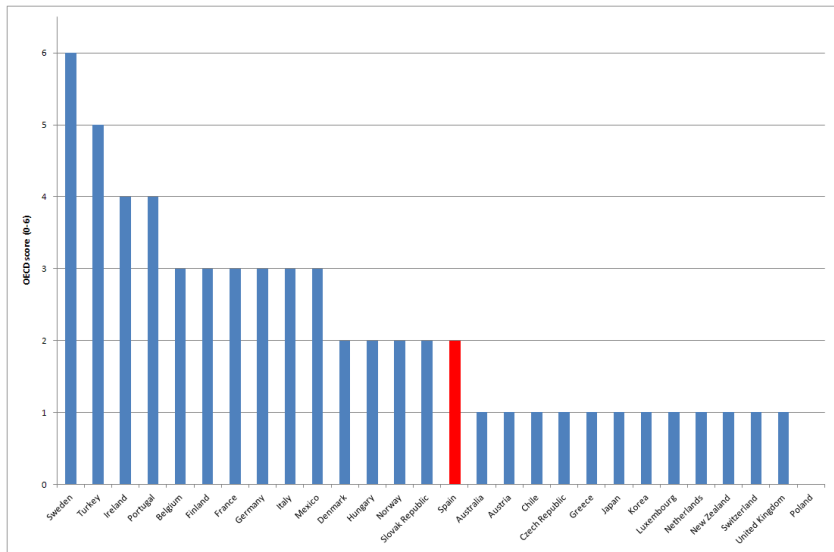
Moreover

- Severance also when TC at the end of its duration is not converted into PC. If converted jump to a steeper severance-tenure profile.
- As same severance at termination and within the contract nominal duration, from the standpoint of a worker and an employer two TC of different nominal durations (s.t. $d < d_{max}$) are equivalent?
- No participation constraint: should we impose that $w_{min} > b$?

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Compensation for Unfair Dismissals: Spain and OECD



Tax Component of EPL: Spain and OECD

Country	Level	Share in EPL (%)	Country	Level	Share in EPL (%)
Japan	21	75%	Slovak Republic	13	36.11%
Japan	21	75%	France	12	41.38%
Austria	19	70.37%	Poland	12	50%
Norway	18	62.07%	Spain	12	37.5%
Portugal	18	33.33%	Hungary	11	44%
Finland	17.5	59.32%	Belgium	10	32.26%
Luxembourg	17	48.57%	Ireland	10	50%
Netherlands	17	53.13%	Mexico	10	41.67%
Czech Republic	16	42.11%	Australia	9	52.94%
Germany	16	45.71%	Turkey	9	26.47%
Greece	16	51.61%	Turkey	9	26.47%
Sweden	16	45.71%	Switzerland	8	42.11%
Italy	15	68.18%	UK	8	50%
Italy	15	68.18%	UK	8	50%
Korea	13.5	57.45%	Denmark	6	27.27%
Korea	13.5	57.45%	US	5	100%
New Zealand	13	72.22%	US	5	100%

The tax component is calculated as a sum of OECD scores (0-6) for items REG1 (Notification procedures), REG5 (Definition of unfair dismissal), REG6 (Length of trial period) and REG9 (Maximum time to make a claim of unfair dismissal). The tax component (%) is calculated over the sum of these items and REG2 (Delay before notice), REG3A-B-C (Length of notice period), REG4A-B-C (Severance payments) and REG7 (Compensation following unfair dismissal).

Calibration to Spain

- Do we need the y_{gap} between PC and TC? Any EPL *tax* higher in PC would deliver wage premium of PC over TC
- Parameters matched to aggregate unemployment duration (declining in share of TC)
- No matching to hazards at different tenures: is there a spike at 3-4 years? (fig 2 not clear)

Costs of dismissals for PC modeled differently than in the model (there is compensation for unfair dismissals):

severance_{PC} = yearly wage

** [(days of "procedural compensation" independent of tenure*

** fraction of dismissals involving "procedural wages")*

*+ years of seniority * [(fraction of dismissals in collective layoffs, mediated and acknowledged as unfair + fraction of dismissals going to Court * percentage of Court rulings favourable to employees*

** statutory severance in case of unfair dismissals per year of seniority) + fraction of dismissals going to Court * percentage of Court rulings favourable to employers]*

** statutory severance per year of seniority in case of fair dismissals]]*

- this fixing composition of dismissals, fraction of Court rulings favorable to workers, etc.,
- For TC costs severance is modeled as simply 20 days per year of tenure, whatever the nature of the dismissal, like in the model.

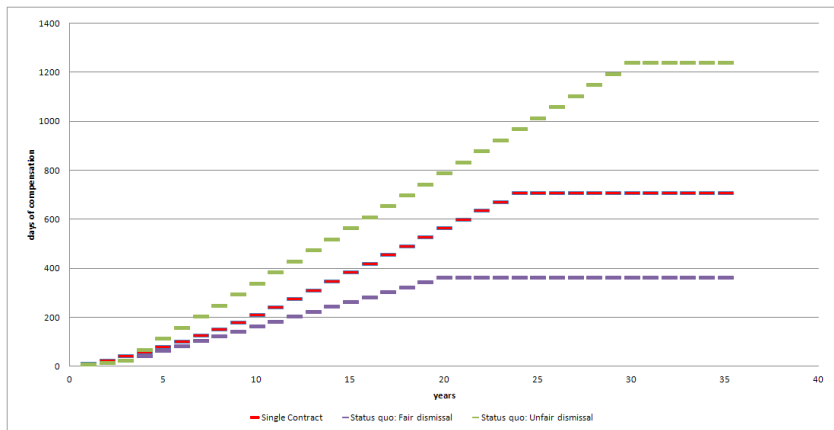
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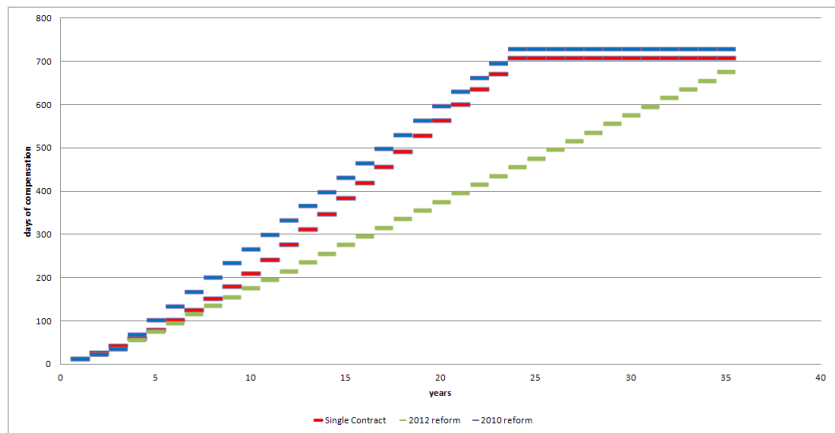
The Propuesta

12-36 Single Contract SC starts with 12 days of severance, each additional year of tenure yields 2 additional days per year up to 36 days at 12 years of tenure. From then on 36 days per year up to two years at 24 years of seniority. Irrespective of fair vs. unfair dismissal: same treatment. No involvement of judges except if discriminatory dismissals. The key reform is not in the severance mechanism but in the "freedom from jurisprudence". But this reform cannot be evaluated in a model without moral hazard.

Severance in the SC, status quo and reforms



Severance in the SC, 2010 and 2012 reforms



Simulation of the Transition

- Very important the simulation of the transition (from a political economy perspective)
- What is the productivity in the SC? The one in TC or PC?
- Why not looking at income-consumption fluctuations (better than total severance or tenure per se)?

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Final question

Why Propuesta not taken up?

Workers

- Costs of the transition: layoffs of workers with short tenures on PC replaced with SC workers? Minority but perhaps more represented by unions. Is it so?
- Notice that this problem is not present in countries like Italy where protection to PC is not (strictly) tenure-related
- Too few workers (28 per cent) unaffected? The reform does not truly insulate the insiders
- If no difference between fair-unfair dismissals and flexible wages, then T is undone by bonding wage scheme (Lazear result)

A Final question (cont.)

Why Propuesta not taken up?

Firms

- Fear of negative effects on productivity: no difference between fair-unfair dismissals may induce more shirking
- Small firms forced to pay higher wages when disciplinary and economic dismissals are treated alike (Boeri and Jimeno, 2005)

Government: concern that reform would reduce voluntary quits and reallocation of workers? Longer tenure, but lower productivity outcome?

Overall

- Very useful paper.
- Made me thinking a lot about the SC.
- I do not think that it is a good idea to have severance independent of fairness/unfairness of dismissals.
- We cannot avoid judges in dismissals.