

How much flexibility do we need?

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Summary

The paper analyzes the distributional implications of dual EPL reforms in Italy.

- ▶ The data reveal a similar pattern as elsewhere (notably Spain)
 - ▶ Rapid build-up of a large stock of temporary contracts;
 - ▶ Low transition rates from temporary to permanent jobs;
 - ▶ Unequal incidence across cohorts;
 - ▶ Wage premium for permanent jobs;

- ▶ The author builds a search-theoretic model to account for these facts
 - ▶ The introduction of temporary contracts provokes a shift from a pooling to a separating equilibrium;
 - ▶ Junior workers are hired on temporary contracts and only the most productive seniors are upgraded to permanent contracts;

Plan

- ▶ Stepping stones or traps?
- ▶ Model choices and robustness
 - ▶ Peculiar effects EPL (“no flexibility seems needed”)
 - ▶ Ex-ante versus ex-post heterogeneity
 - ▶ (Im)perfect segmentation
- ▶ Suggestions
 - ▶ Change in focus to solutions for dual labor markets
 - ▶ Quantitative evaluation of proposed reforms

Stepping stones or traps?

The documented evidence is interesting. But the richness of the data should be exploited to identify the cohorts for whom temporary contracts constitute traps.

- ▶ Focus on labor-market entrants (school-to-work transition)
- ▶ Cohort-specific transition rates by education level
- ▶ Longer time-horizons
 - ▶ Compare labor market status after say 2 years conditional on current status (unemployed vs. temporary job)
 - ▶ Labor market transitions during first 5 years
 - ▶ Time period until first permanent contract

This information is necessary to answer the question in the title and useful for the calibration exercise.

Model choices and robustness

- The model takes the concept of a dual labor market to the limit and is hard to take to the data.
 - ▶ All high-productivity workers flow into permanent jobs;
 - ▶ None of the low-productivity jobs ever reaches a permanent job;
- EPL plays a somewhat peculiar role
 - ▶ The benchmark model is characterized by efficient separations;
 - ▶ Temporary contracts force inefficient destruction due to (stochastic) limit on renewals;
- Separation is not driven by firing costs *per se*. With equal cost parameters (vacancy creation, social security) a pooling outcome with permanent contracts seems optimal again.

Basic setup

- ▶ Matching model with heterogeneous workers
- ▶ Types are revealed with delay and not verifiable
- ▶ Random matching within markets. But possibility of directed search across markets
- ▶ Nash bargaining with perfect commitment
- ▶ Exogenous destruction shocks

Benchmark

Only permanent contracts. Firing is not allowed. Only mutually beneficial separations after a productivity shock.

Equilibrium

A pooling equilibrium in which:

- ▶ All workers face the same unemployment risk conditional on experience
- ▶ The experience-earning profile is the same for high- and low-productivity workers

Temporary jobs

- ▶ Firms can choose between temporary and permanent jobs. The former are cheaper to create and pay lower social security contributions, but there is a stochastic limit on renewals.
- ▶ Once this limit is reached, the worker has to leave the firm.
- ▶ This tradeoff determines the contract choice. Temporary contracts are cheaper but more unstable and create inefficient separations.

Equilibrium

A separating equilibrium in which:

- ▶ Firms use temporary contracts to screen workers
- ▶ The most productive workers are upgraded to permanent contracts.
- ▶ The least productive workers are renewed on temporary contracts until legal limit on renewals is reached.

Observations

The separating equilibrium is interesting but it seems to rely on strong (implicit) assumptions and is probably not generic.

- ▶ Moderate cost differences between permanent and temporary jobs
- ▶ Firms can commit to skill requirements for permanent jobs
- ▶ Promotion to permanent contract is ruled out once limit on renewals is reached. Would the result persist if promotion is allowed at this date?

Strong between-group inequality, but no within-group inequality.

Models with heterogeneous types typically lose tractability with imperfect segmentation.

Alternative setups

It seems most of the results can be obtained in a simpler model with ex-post heterogeneity *à la* Mortensen-Pissarides (1994).

Necessary elements

- ▶ Permanent and temporary contracts
- ▶ Differences in firing costs between the two types of contracts
- ▶ Stochastic limits on renewals of temporary contracts
- ▶ Recurrent match-specific shocks

Equilibrium features

- ▶ All newly hired workers are offered a temporary contract
- ▶ Only workers above a certain productivity threshold are upgraded to permanent contracts

Advantages

The MP setup offers various advantages

- ▶ The model is tractable and generates imperfect segmentation;
- ▶ Differences across skill groups can be analyzed by introducing a common and idiosyncratic productivity component;
- ▶ Easy to bring to the data;
- ▶ The model can accommodate a variety of specifications for dual EPL
 - ▶ Firing costs force firms to maintain inefficient jobs and reduce job creation
 - ▶ Jump in firing costs upon transformation
 - ▶ Continuity of equilibrium outcomes

A similar setup is used in a number of papers that study the cyclical dynamics of unemployment in Spain (Bentolila et al. 2010, Costain et al. 2010, Toledo & Silva 2010)

Scope of the analysis

The economic implications of dual employment legislation are fairly well-understood. Much less is known about the most efficient strategy to achieve (1) a more equal distribution of rights (2) a sufficient degree of flexibility for firms.

The author considers the possibility of introducing “long-term temporary jobs”. This policy is beneficial in her setup but there are better options like the single contract.

Possible research strategies:

- ▶ single contract for newly-hired workers vs. marginal reduction in the differences in firing costs for all jobs
- ▶ tenure-track structure vs. gradually increasing redundancy pay
- ▶ appropriate limits on fixed-term contracts
- ▶ evaluation of more job security when young and less when old in incomplete market setting
- ▶ political economy of single contracts