

Labour Market Segmentation: Spain and Beyond

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Outline

- 1 Not only Spain: Documenting Two-tier Reforms in Europe
- 2 Aggregate Effects of Segmentation: some theory
- 3 Empirical Relevance
- 4 An Exit Strategy from Dualism

Two-tier and Marginal Reforms

Institutional **reform**: change in the design of an institution

- **Two-tier (vs. complete)** reform: focus on the scope/coverage; the reform is confined to a subset of the potentially eligible population (alternatively its complete phasing in involves a very long transitional period)
- **Incremental (vs. discrete)** reform: focus on the size; the reform involves a small change in the overall institutional level-indicator
- **Structural** reforms: either complete and discrete reforms

Examples

Examples of Two-Tier reforms:

- The battery of reforms of EPL carried out in Italy in the 1997-2003 period expanded the scope of fixed term contracts, introduced Temporary Work Agency, increased the potential duration of fixed-term contracts and introduced new types of atypical contracts leaving regulations on the dismissals of workers with open-ended contracts unchanged.
- The 1989 reform of the British UB system reduced replacement rates for the short-term claimants, by increasing the length of the minimum waiting period required for eligibility to benefits for this category of workers only.

The Taxonomy

Size	Discrete Two-tier	Structural
	Incremental Two-tier	Incremental Complete
	Scope	

Tracking Reforms in Europe

A snapshot from Fondazione Debenedetti database (1):

Spain - EPL database

Year	Month	id	Number	Law	Description	Topic	Target
1980	3	ES077	1	Ley 51/1980, Basic Employment Law (Ley Básica de Empleo)	Regulations governing the contract of employment, making contracts of employment more flexible; permanently established workforce representatives as a way to regulate workers' participation; and consolidated the status of collective agreements, as opposed to Labour Ordinances, as the principal source of industry-wide and occupational provisions.	Trade union rights	employees
			2		Regulation on termination of employment contracts.	Individual dismissals - Procedural obligations	employees
1981		ES078	1	Real Decreto 1362/1981	Regulation of fixed-term contracts	Fixed-term contracts	Fixed-term contracts
1984	8	ES001	1	Ley 32/1984	Restrictions for fixed-term contracts are substantially relaxed. Legal norms that established the circumstances under which a fixed term contract could be stipulated are practically over rided by the principle of promoting employment through the extension of its use. The so called "Contrato temporal de fomento del empleo" (Temporary Employment Promoting Contracts - TEPC) has a maximum duration of 3 years and a minimum of 6 months. The limit to the maximum number of TEPC to be signed is eliminated.	Fixed-term contracts	Fixed-term workers

Tracking Reforms in Europe

A snapshot from Fondazione Debenedetti database (2):

Spain - EPL database

Topic	Target	Sign	Overall sign	Two-Tier vs. Complete	Two-Tier vs. Complete - Overall	incremental vs. discrete	Source	Other policy area?
Trade union rights	employees	increasing	increasing	complete	complete	incr	EMIRE	
Individual dismissals - Procedural obligations	employees	increasing		complete				
Fixed-term contracts	Fixed-term contracts	decreasing	decreasing	two-tier	two-tier	incr	NATLEX	
							IBERLEX - Base de datos -	

Two-Tier Reforms

- Two-tier reforms involve less than 50% of potentially eligible population

Reform area	Two-tier	Complete	Total per row	Of which two-tier
EPL	103	96	199	52%
UB	116	137	253	46%
AP	155	87	242	64%
ECI	74	50	124	60%
ER	49	16	65	75%

where EPL = employment protection legislation, UB unemployment benefits, AP activation policies, ECI employment conditional incentives and ER early retirement.

Incremental Reforms

- Incremental reforms involve change of less than 10% of the average period cross-country standard deviation in the level of the institution (OECD indicator)

EPL reforms by size and scope as a percentage of the total

Size	Discrete	8.5%	3.5%
	Incremental	43.3%	44.7%
		Two-tier	Complete
		Scope	

How LM institutions are reformed: a summary

- Many LM reforms
- Sometimes undoing previous reforms: net changes in the values of the indicators conceal a lot of action
- Two-tier reforms majoritarian
- Not only Spain, not only EPL
- Way to engineer politically feasible reforms
- Trade-off between size and scope

Setup: qualitative description

Equilibrium job search model. Endogenous job creation and destruction. Four types of Institutions:

- 1 an exogenous firing **tax** T (not transfer) levied on termination of job-worker matches
- 2 an **unemployment benefit** $b = \rho \bar{w}$ offered as a replacement of the average wage, \bar{w} , at the rate $0 < \rho < 1$ throughout the entire unemployment spell (ρ measures the generosity of unemployment benefits)
- 3 an **employment subsidy** (or tax credit), $e < b$ also provided on a flow basis at continuing jobs.
- 4 a **hiring-recruitment subsidy**, $h < c$, reducing the flow costs of unfilled vacancies, c

Job creation and destruction margins are affected by these institutions either directly and indirectly, that is, via their effects on wages-wedges. Govt budget constraint not considered.

Two-tier Regimes in the MP model

A two-tier reform of employment protection reduces firing taxes for entry jobs ($T_0 = 0 < T$), while leaving employment protection unaltered for continuing jobs.

New jobs last until they are hit by a productivity shock. If the new realization is below a reservation productivity specific to entry jobs, R_0 , the match is dissolved and ends with a flow into unemployment. If instead the new productivity realization is above R_0 , jobs are converted into permanent contracts, covered by the standard firing taxes, T

Insider and Outsider Wages

Two-tier regimes generate two wage equations from Nash bargaining. The first wage equation determines workers pay in entry jobs or the wage of *outsiders* (dual workers), denoted by the subscript 0. The second wage equation applies to continuing jobs and provides *insider* wages at all productivity levels above the reservation productivity level. The difference between insider and outsider wages at the entry productivity level is given by

$$w(1) - w_0 = (1 - \beta)w(\rho - \rho_0 + e_0) + \beta(rT)$$

Even for lower x , $w(x) > w_0$ in this setting. Continuing jobs have lower average productivity but higher average wages than entry jobs. Partial equilibrium of two-tier reforms: increase wage differentials between entry jobs and continuing jobs.

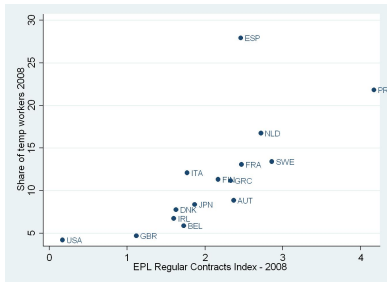
Comparing Two-tier and Complete Reforms

Comparative Statics Results of Two-Tier Reforms

Comparative Statics of Reforms	Two-tier			Complete			
	ρ	T	e_0	ρ	T	e	h
<i>Effect of an increase in \implies</i>							
<i>on \downarrow</i>							
Job loss rate (from dual jobs)	0	+	+				
Job loss rate (from continuing jobs)	+	-	0				
Job finding rate	0	+	+				
Wage premium temporary-permanent	+	+	+				
Conversion temporary-permanent	0	-	-				
Dual jobs as % of total employment	+	+	+				
Job loss (temp)	0	+	+				
Job loss (perm)	+	-	0	+	-	-	+
Job finding	0	+	+	-	-	+	+
Conv. temp jobs %	+	-?	-?	+	?	-	?

Dualism and Strictness of EPL for Regular Contracts

$$\rho = 0.81$$



Strictness of EPL for Permanent Contracts and Share of Temporary Contracts in Total (Dependent) Employment

$$\rho = -0.72$$



Strictness of EPL for Permanent Contracts and Transition Probability from Temporary to Permanent Contracts

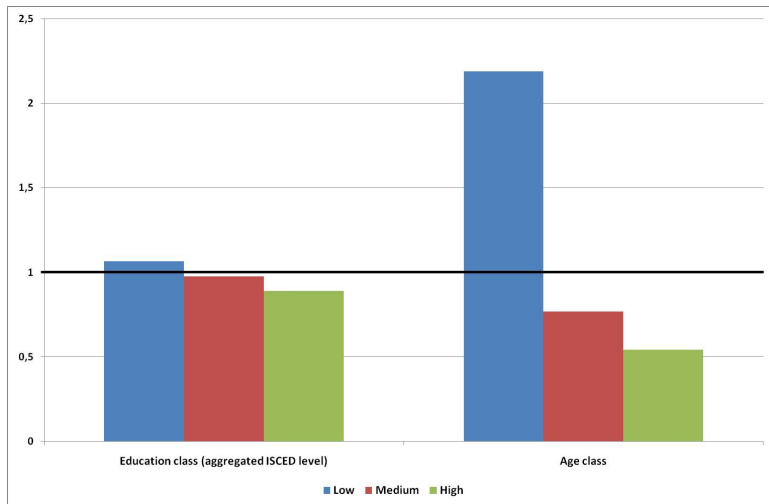
Two-tier wage structure

$$\log w_i = \alpha + \beta_1 EDU_i + \beta_2 EDU_i^2 + \gamma_1 TEN_i + \gamma_2 TEN_i^2 + \mu PERM_i + \varepsilon_i$$

	Premium temporary-permanent μ	St. Err.	Obs.
Austria	20.1***	0.023	9867
Belgium	13.9***	0.017	7948
Denmark	17.7***	0.015	8009
Finland	19.0***	0.011	8940
France	28.9***	0.016	15260
Germany	26.6***	0.010	25448
Greece	20.2***	0.013	6978
Ireland	17.8**	0.069	1583
Italy	24.1***	0.008	30177
Luxembourg	27.6***	0.018	7889
Netherlands	35.4***	0.021	15845
Portugal	15.8***	0.016	7550
Spain	16.9***	0.007	22626
Sweden	44.7***	0.036	5412
United Kingdom	6.5*	0.037	7000

Who are the dual workers?

Odds ratios: EU countries, 2008



Source: EU-SILC 2008

Unemployment and Dual Contracts

Education and the Relative Incidence of Unemployment and Temporary Employment

Incidence of temporary workers:

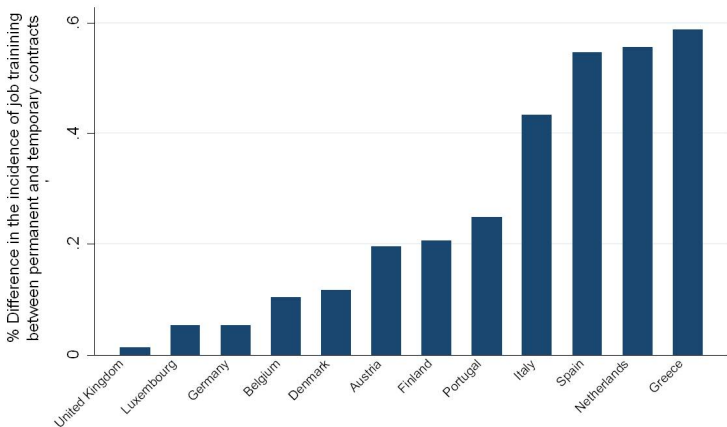
$$\frac{(temp_{skill} / empl_{skill})}{temp / empl}$$

Incidence of unemployment:

$$\frac{(u_{skill} / lf_{skill})}{u / lf}$$

Source: EU-SILC 2004-2008

Dualism = less on-the-job training



Source: ECHP

Complete Reforms with a long phasing-in

- Transitional dynamics may depart significantly from steady state outcomes of complete reforms.
- Are deviations increasing with initial level of the institution and the size of the reform?

Complete Reforms with a long phasing-in

Example of two-tier reforms of Epl (Boeri and Garibaldi, 2007)

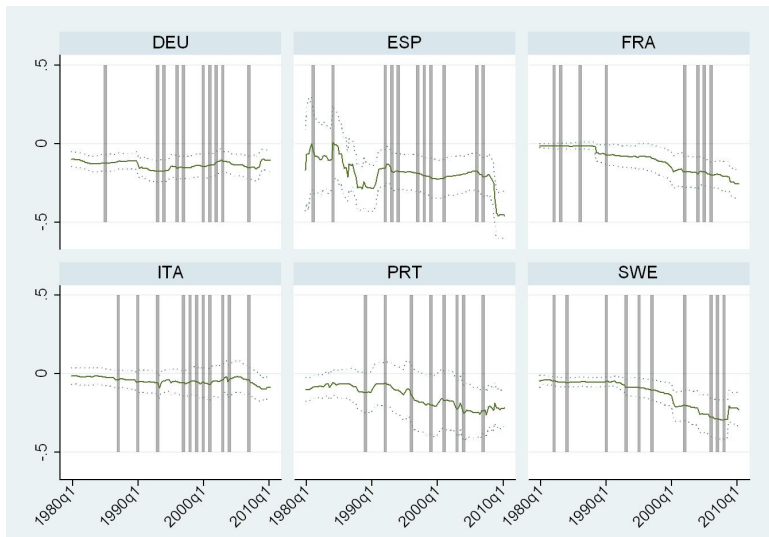
Pre-Reform EPL Strictness and Post-Reform Temporary Employment

Country	Time Period	EPL strictness (Regular Index)	EPL Strictness (Temporary Empl.)	Temporary Emp. Growth ΔET_t (000)	Contribution of Temporary Jobs $\Delta ET_t / E_0$
Belgium	1987-1996	1.68	4.63	22.7	0.66
	1997-2005	1.71	2.63	135.3	3.54
	Δ	0.03	-2.00	112.6	2.89
Italy	1987-1997	1.77	5.38	402.9	0.02
	1998-2005	1.77	2.82	823.2	4.11
	Δ	0	-2.56	420.3	4.09
The Netherlands	1987-1995	3.08	2.38	340.1	5.79
	1996-2005	3.06	1.45	288.8	3.80
	Δ	-0.02	-0.93	-51.3	-2
Portugal	1987-1996	4.56	3.34	-168.9	-4.10
	1997-2005	4.29	2.94	431.8	10.09
	Δ	-0.27	-0.40	600.6	14.19
Spain ¹	1981-1984	3.83	-	0	0
	1985-1995	3.67	3.66	3377.1	28.5
	Δ	-0.16	-	3377.1	28.5
Sweden	1987-1996	2.88	3.28	-138.9	-3.22
	1997-2005	2.86	1.63	189.2	4.82
	Δ	-0.02	-1.65	328.1	8.04

¹ For Spain, 1981-1984, the EPL index is the overall index, as in Nickell (2006)

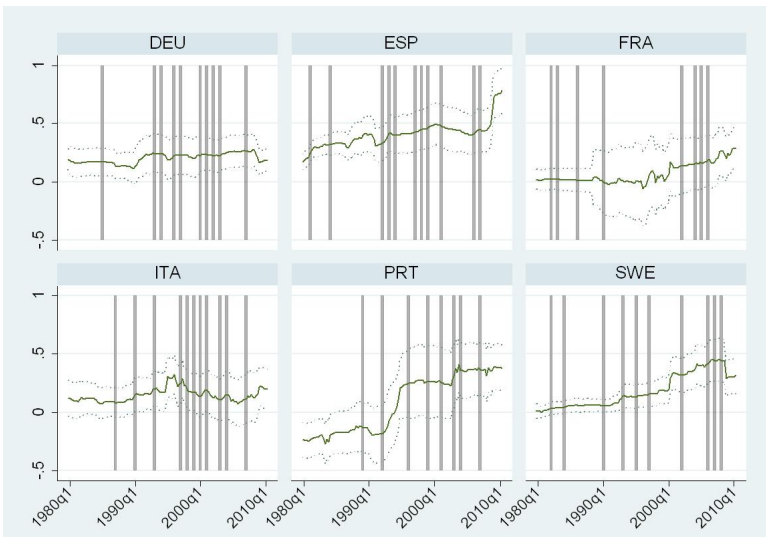
Honeymoon effect and unemployment volatility

Estimating Okun's Law Betas: $\Delta u_t = \alpha + \beta \Delta y_t + \varepsilon_t$



Honeymoon effect and employment volatility

Estimating Okun's Law Betas: $\Delta e_t = \alpha + \beta \Delta y_t + \varepsilon_t$



Is financing becoming procyclical?

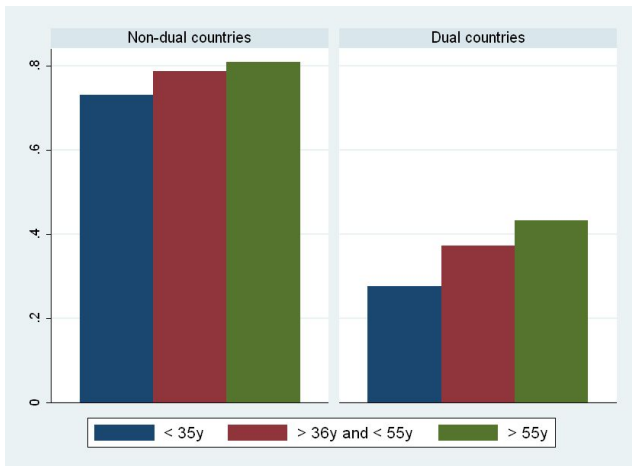
Effective social security contributions (as a % of employees' compensation) and GDP (first differences) correlations

Ireland	pre-1995 0.018	post-1995 -0.198*	UK	pre-1995 0.022	post-1995 -0.203
Netherlands	pre-1995 -0.007	post-1995 0.181*	Sweden	pre-1995 -0.018	post-1995 0.191*
France	pre-1995 -0.284**	post-1995 0.048	Germany	pre-1995 -0.125	post-1995 -0.087

Significance: *** if $p < 0.01$, ** if $p < 0.05$, * if $p < 0.1$

In spite of low coverage of unemployment benefits?

Unemployment benefits coverage by age in 2008



Source: EU-SILC 2008

Undesirable Effects of Dualism

Concentration of labour market risk on temporary workers. The fact that they are young does not mean that the costs are temporary.

- Ellwood (1982): poor start induces lower lifetime wages and lower employment opportunities
- Mroz e Savage (2006): unemployment at 22 implies earning 30 per cent lower at 25. At age 30-32 below -2-3 per cent
- Kletzer and Fairlie (1999): lifetime wages lost over the lifetimes 8 per cent for men and 13 per cent for women
- Gregg and Tomlinie (2001): wage losses 13-21 per cent.
- Arulampalam (2001): increase in risk of new job losses
- Bell and Blanchflower (2009) von Wachter (2009): health effect even 20 years after

Further undesirable Effects of Dualism

- More volatility of employment
- Automatic stabilizers do not operate efficiently
- Higher social costs of recessions
- Reduced Human Capital Investment: less on-the-job training for Dual Workers, lower education wage premia, lower incentives to investment also in formal education
- Risk of Loss of the Crisis Generations. This is what happened in Japan and Sweden after the financial crises of the 1990s

We need smart reforms

Removing temporary contracts would mean reducing also employment creation in the recovery after having experienced the negative side of dualism. Better to go beyond dualism, working on employers' incentives. Need to balance two forces

- Let firms enjoy flexibility at entry. On the labour demand side, firms benefit from a labour market where experimentation is allowed
- Set a well defined path to stability for workers, through a long run entrance with an open-ended labour contract
- Flexibility is important in the entry phase. Problem of asymmetric information
- Tenure tracks to stable jobs.

Contrato Unico, Contratto Unico di Inserimento, Contrat Unique

Proposals developed in Spain (100 academic economists), France (Blanchard, Tirole, Cahuc) and Italy (Boeri and Garibaldi): tenure track to stable jobs with protection increasing with tenure. Differences according to national regulations.

Il Contratto Unico di Inserimento

Italian draft bill differentiates entry through experimentation from genuinely fixed term jobs. Open ended contract with two phases:

- *Entry Phase* (up to the third year): the worker has the right to severance payments proportional to tenure (independently of firm size): dismissal without just cause requires up to six months in severance payments (5 days of severance every month). Entry phase lasts three years
- *Stability Phase* (from third year onward): current legislation (for dismissal without just cause: reinstatement right in firms above 15 employees and six months severance in small firms)
- Fixed term contracts and de-facto dual workers (yet self employed in the books) only with high salaries and higher contributions to unemployment benefits