CAN FIXED-TERM CONTRACTS PUT LOW SKILLED YOUTH ON A BETTER CAREER PATH? EVIDENCE FROM SPAIN

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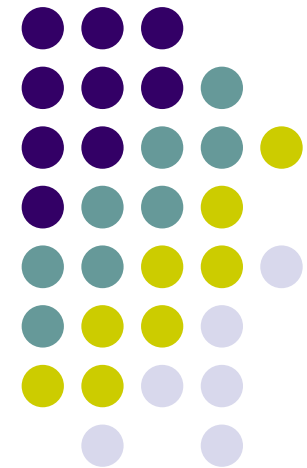UNIVERSIDAD PABLO DE OLAVIDE & FEDEA

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1. INTRODUCTION

- European countries typically have a high level of **employment protection legislation** (EPL), making it expensive to dismiss workers on permanent contracts.

- While EPL does not reduce overall employment, it has an <u>adverse effect on the employment of marginal workers</u> (youth or low-qualified ones).

- To address this problem, a number of European countries have made it easier for firms to use **<u>fixed-term contracts</u>** with lower firing costs.

1. INTRODUCTION

But do fixed-term contracts really help?

- **In theory**, fixed-term contracts, by decreasing firing costs, can help workers with uncertain credentials obtain employment.

- Moreover, fixed-term contracts may help workers accumulate human capital.

- On the other hand, there is a danger that marginal workers go from fixed-term contract to fixed-term contract, with no progression towards better jobs.

- Hence, the impact of fixed-term contracts on the labor market outcomes of affected workers is **ambiguous**.

1. INTRODUCTION

But do fixed-term contracts really help?

- **The empirical evidence** on the impact of fixed-term contracts on the labor market outcomes of affected workers is also **ambiguous**.

- A number of papers examine the stepping stone hypothesis according to which temporary work helps workers land permanent jobs.

- The evidence at the European level is mixed:
  - Some evidence of the stepping-stone hypothesis: D'Addio & Rosholm (2005); Booth, Francesconi & Frank (2002)
  - Some other authors find that temporary contracts do not improve access to permanent contracts: Zijl, Van Den Berg & Heyma, (2004).

1. INTRODUCTION

- Even if fixed-term contracts can help workers secure permanent jobs, the **long-term effects remain uncertain**.

- Indeed, when workers lose a permanent job, they may be back on a fixed-term contract and their return to stable employment may be delayed.

- The current literature only addresses the impact of temporary work within a few years of the first temporary job.

- Therefore, the long-term impact of temporary work on affected workers' careers remains an open question.

- In this paper, we use **Spanish social security data to assess the long-term impact of fixed-term contracts** on employment and earnings.
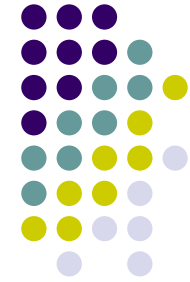
1. INTRODUCTION

- **Spain is an ideal ground** for our research because fixed-term contract use was liberalized in 1984 (now Spain is the OECD country with the highest share of fixed-term contracts).

- To assess the impact of fixed-term contracts, we track cohorts of workers who enter the labor market before and after the 1984 reform, when the use of fixed-term contracts was liberalized.

- We focus specifically on male high school dropouts as they are most likely to be affected by fixed-term contracts.

- Using a **cohort regression discontinuity design**, we find a negative impact of fixed term contracts on labor market outcomes.

# 2. History and current rules of temporary contracts in Spain

- During the time of Franco's regime, the Spanish labor market was heavily regulated with a single trade union and where all jobs were full-time jobs of a permanent nature.

- It was not until 1980 when the strongest modernization of the labor relations system was introduced in Spain with the approval of the Workers' Statute.

- This law assumed every contract to be an open-ended contract as a general case, whereas temporary contracts were intended to be used only for jobs whose nature were temporary.

- During the first half of the 1980s, the Spanish unemployment rate experienced a rapid growth and it went over 20%.

2. History and current rules of temporary contracts in Spain

- This prompted the Spanish government to introduce a new reform in 1984 designed to liberalize the use of temporary contracts and to reduce dismissal costs for this type of contracts.

- As a result of this legislative change, the proportion of employees under temporary contracts increased from 10% during the 1980's to over 30% in the early 1990's.

- Between 1985 and 1994, over 95% of all new hires were employed through temporary contracts and the conversion rate from temporary into permanent contracts was only around 10% (Güell & Petrongolo 2007).

- The reform generated a huge segmentation in the Spanish labor market.

Unemployment rate and temporary contracts in Spain (males aged 15-24)
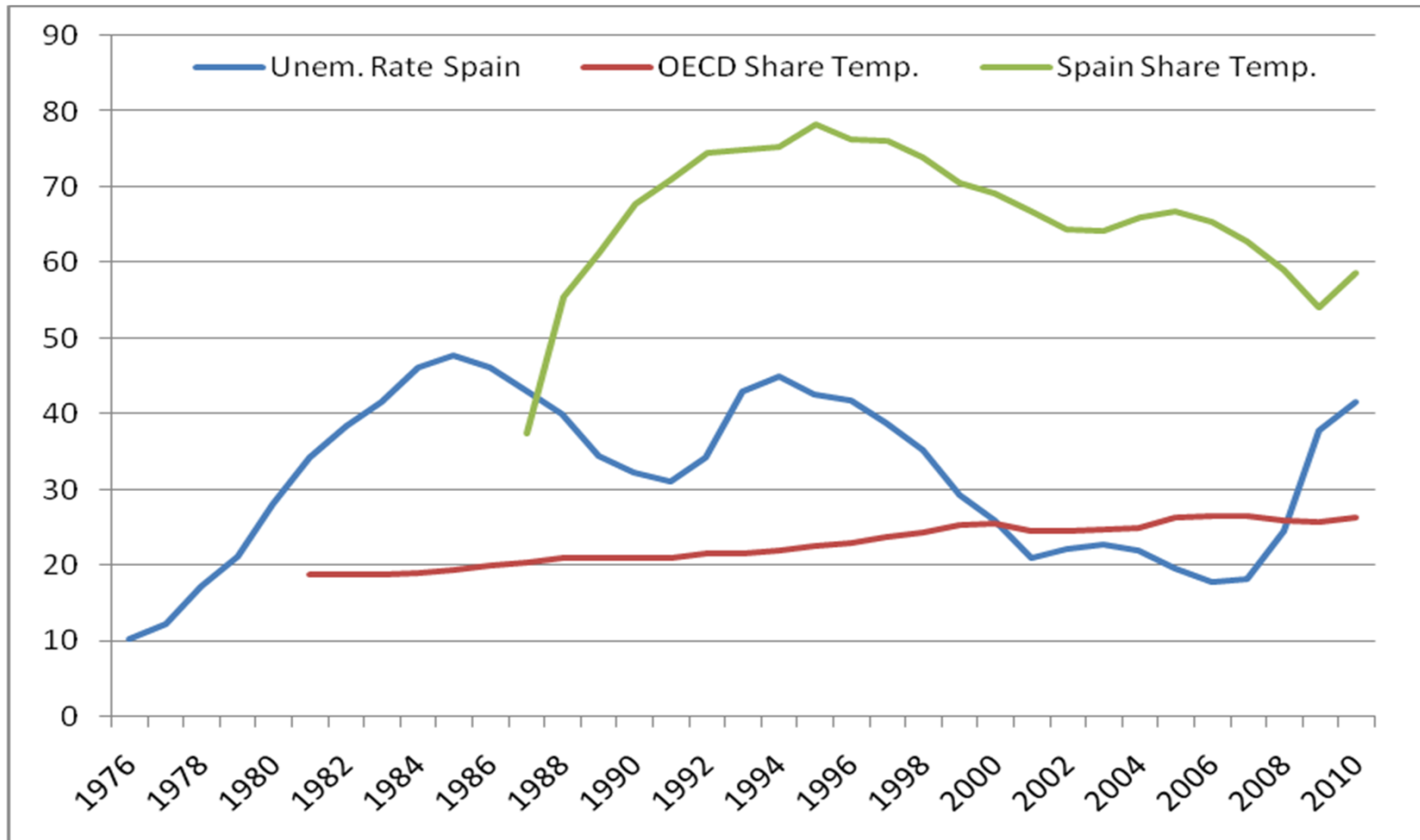
Empirical Approach

- We will use a **cohort regression discontinuity strategy** comparing high-school dropout men that reach the labor market entry age of 16 before and after the reform.

- This study will use the **Continuous Sample of Working Lives** ("Muestra Continua de Vidas Laborales", **2006-2010**) which is a microeconomic dataset based on administrative records provided by the Spanish Social Security Administration.

- We restrict the analysis to the **native male sample** in order to avoid sample-selection issues ➔ it is very rare for native men at these ages not to have any relationship of at least one day with the Social Security administration during the four year period we are considering.
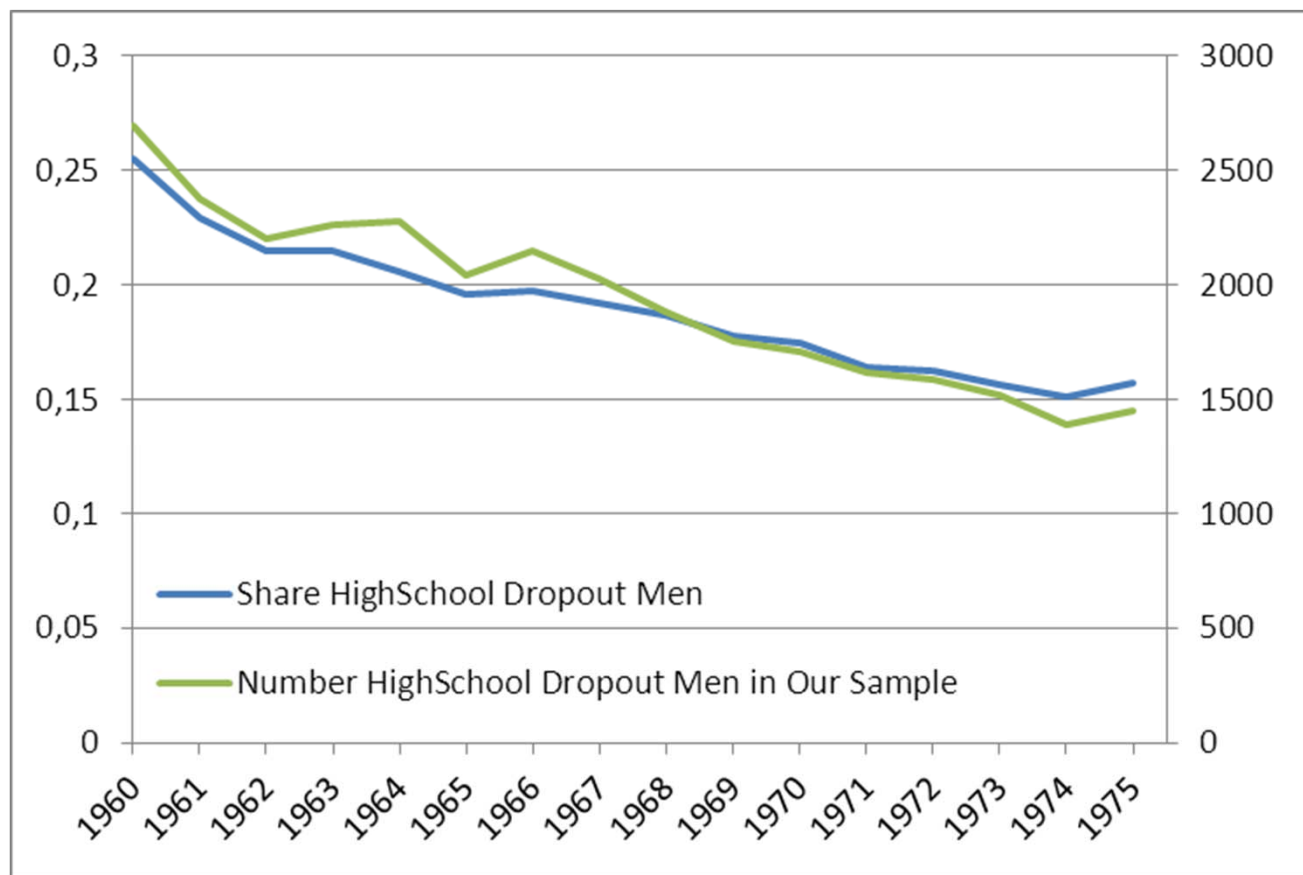
Empirical Approach

- Our sample includes all high-school dropout native males who were born between 1960 and 1975.
- As the reform was introduced in 1984:
  - **Individuals born between 1960 and 1967** are used to determine what happens <u>before the reform</u>, with a tight regulation of fixed-term contracts
  - **Individuals born in 1969 and 1975** are used to assess what happens <u>after the reform</u>, with a lax regulation of fixed-term contracts.
- We have 29.060 native males in the sample, 18.033 workers born between 1960 and 1967 and 11.027 born between 1969 and 1975.
- Our strategy relies on the use of a regression discontinuity design.
  - The year of birth is our running variable and we use the liberalization of fixed term contracts in 1984 as the cutoff point.

Empirical Approach

- It seems that the reform has not affected much the probability of individuals studying more or less.

Empirical Approach

- We analyze the effect of the reform on a set of long-term career variables measured at the individual level and in the same year, 2006:

  - Accumulated number of days worked,

  - Accumulated wages,

  - number of fixed-term contracts, firms, employment and unemployment spells.

- We use the following regression discontinuity model:

$$Outcome_i = \alpha + \beta_1(BirthYear_i - C) + \beta_2(BirthYear_i - C)\mathrm{I}(BirthYear_i \geq C) +$$

$$\beta_3\mathrm{I}(BirthYear_i \geq C) + SectorFE_i + UnemRateEntry_j + \beta_4(BirthYear_i - C)^2 +$$

$$\beta_5[(BirthYear_i - C)\mathrm{I}(BirthYear_i \geq C)]^2 + \varepsilon_i$$

Results: Number of Fixed-Term contracts by 2006

VARIABLES		
Effect (β_3)	0.993***	1.066***
	(0.247)	(0.246)
Trend (β_1)	-0.554***	-0.521***
	(0.136)	(0.128)
Post-trend (β_2)	1.000***	0.958***
	(0.159)	(0.155)
Trend^2 (β_4)	-0.0332**	-0.0322**
	(0.0121)	(0.0118)
Post-trend^2 (β_5)	0.0488**	0.0425*
	(0.0195)	(0.0215)
UR at entry	0.190***	0.162***
	(0.0217)	(0.0189)
Sector dummies		X
Constant	2.014***	2.105***
	(0.551)	(0.572)
Observations	29,060	29,060
R-squared	0.016	0.053

Results: Number of Fixed-Term contracts by 2006

- We get that men who entered the labor market in 1985 accumulated, all other things equal, **1.07 more fixed term contracts** between 1991 and 2006 than men who entered the labor market in 1983.
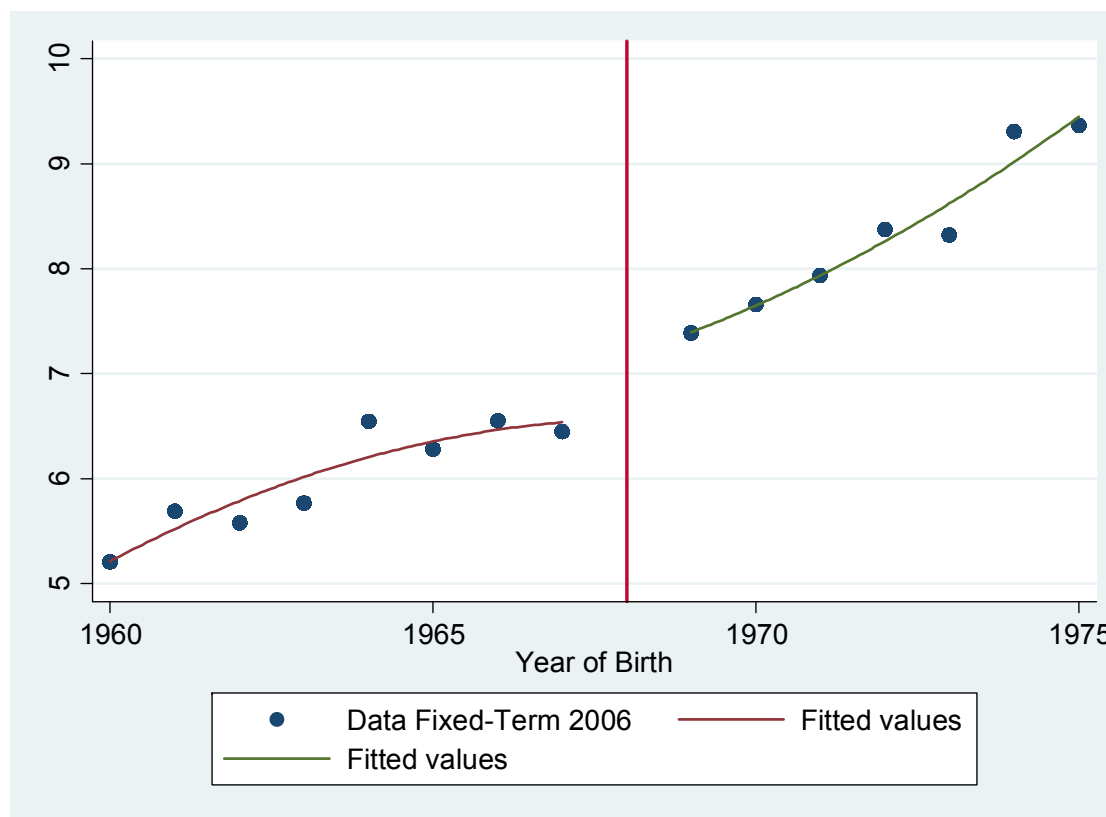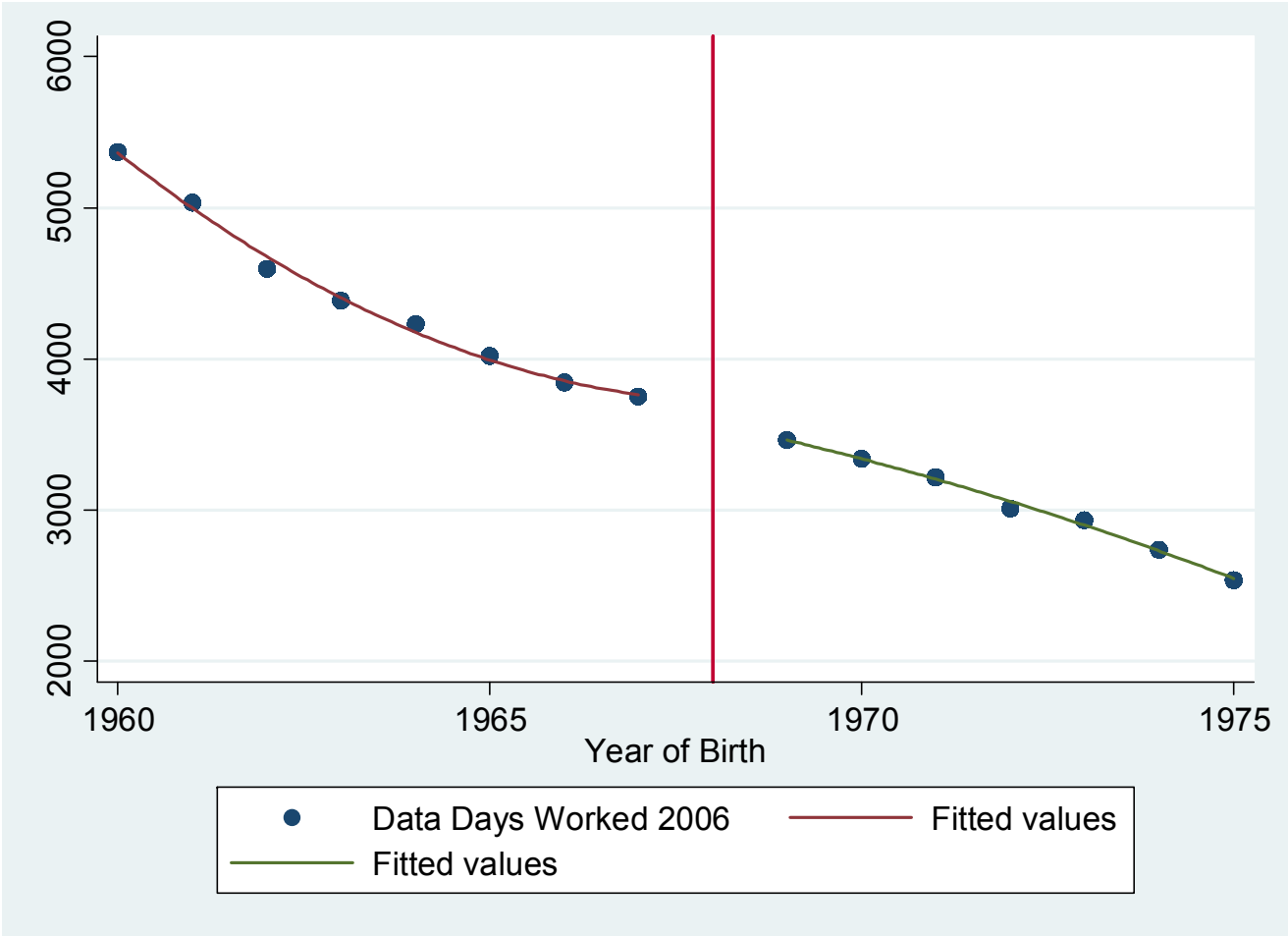
Results

- We now look at different employment outcomes over the long-run (all measured in 2006).

- It should be noted that the **declining trend** showed in the following graphs is due to each cohort having less labor market history by 2006 because each cohort is one year younger than the previous one.

- Therefore, the key point for identifying the effect of the reform in these long-run labor market outcomes is to analyze **whether there is a jump up of the outcome variable** for the generation entering the labor market under laxer fixed term contract regulation.

Results: Number of days worked until 2006

VARIABLES	Days Worked	Days Worked
Effect (β_3)	-329.9*	-313.2**
	(155.1)	(138.4)
Trend (β_1)	267.4***	241.5***
	(78.81)	(69.97)
Post-trend (β_2)	-482.4***	-455.6***
	(91.14)	(81.99)
Trend^2 (β_4)	29.12***	28.16***
	(5.710)	(5.224)
Post-trend^2 (β_5)	-33.93***	-31.89***
	(7.447)	(7.404)
UR at entry	-88.10***	-80.11***
	(10.88)	(9.308)
Sector dummies		X
Constant	5,830***	5,807***
	(342.9)	(357.2)
Observations	29,060	29,060
R-squared	0.126	0.157

Results: Number of days worked until 2006

Results: number of employment and unempl. spells

VARIABLES	Empl.Spells	Empl.Spells	Unem.Spells	Unem.Spells
Effect (β_3)	1.445***	1.554***	1.453***	1.566***
	(0.461)	(0.504)	(0.461)	(0.506)
Trend (β_1)	-0.652**	-0.608**	-0.676**	-0.633**
	(0.227)	(0.239)	(0.227)	(0.240)
Post-trend (β_2)	0.445	0.387	0.507*	0.449
	(0.260)	(0.275)	(0.258)	(0.273)
Trend^2 (β_4)	-0.0349	-0.0336	-0.0371*	-0.0357
	(0.0206)	(0.0222)	(0.0207)	(0.0224)
Post-trend^2 (β_5)	0.0370	0.0300	0.0359	0.0287
	(0.0238)	(0.0266)	(0.0238)	(0.0265)
UR at entry	0.0703*	0.0356	0.0797*	0.0441
	(0.0379)	(0.0354)	(0.0384)	(0.0357)
Sector dummies		X		X
Constant	11.14***	11.04***	10.44***	10.37***
	(0.908)	(1.016)	(0.914)	(1.017)
Observations	29,060	29,060	29,060	29,060
R-squared	0.001	0.028	0.001	0.029

Results: number of employment and unempl. spells

- It seems that under a lax fixed term contract regulation, more fixed term contracts are used, which means that people lose employment more often.
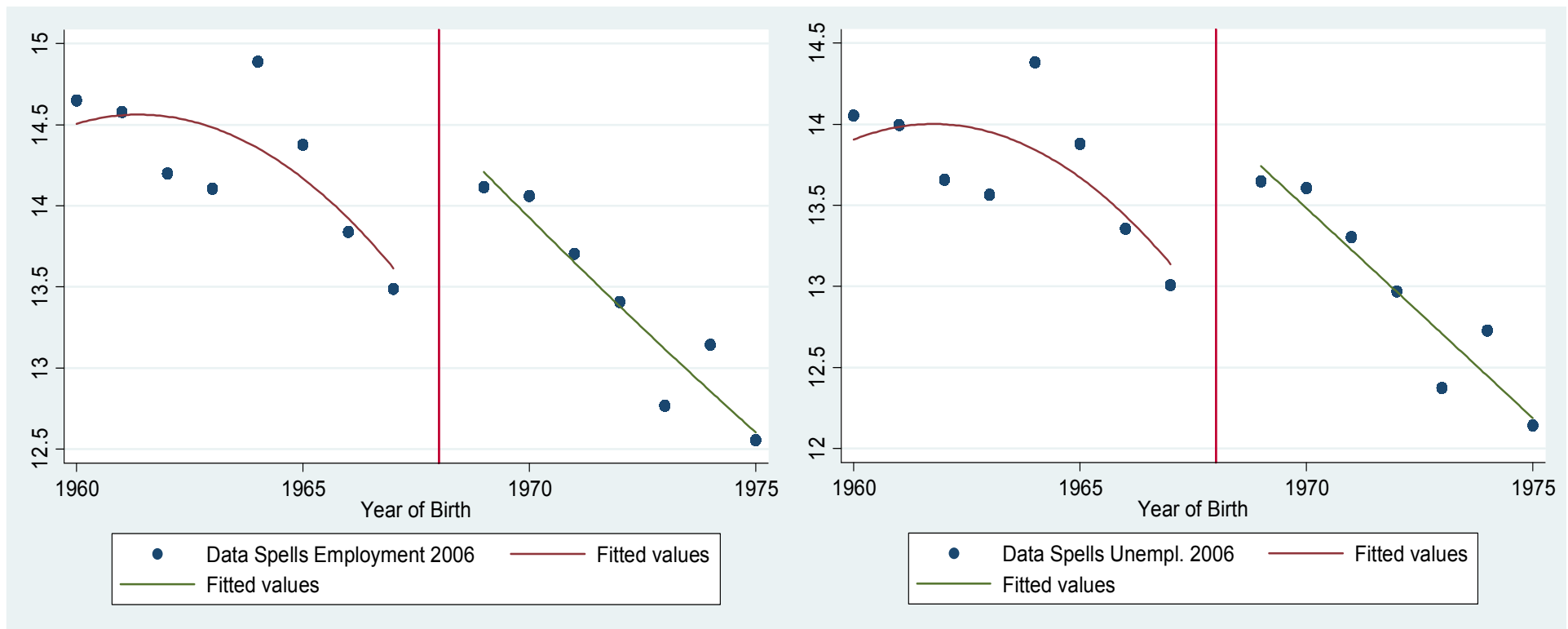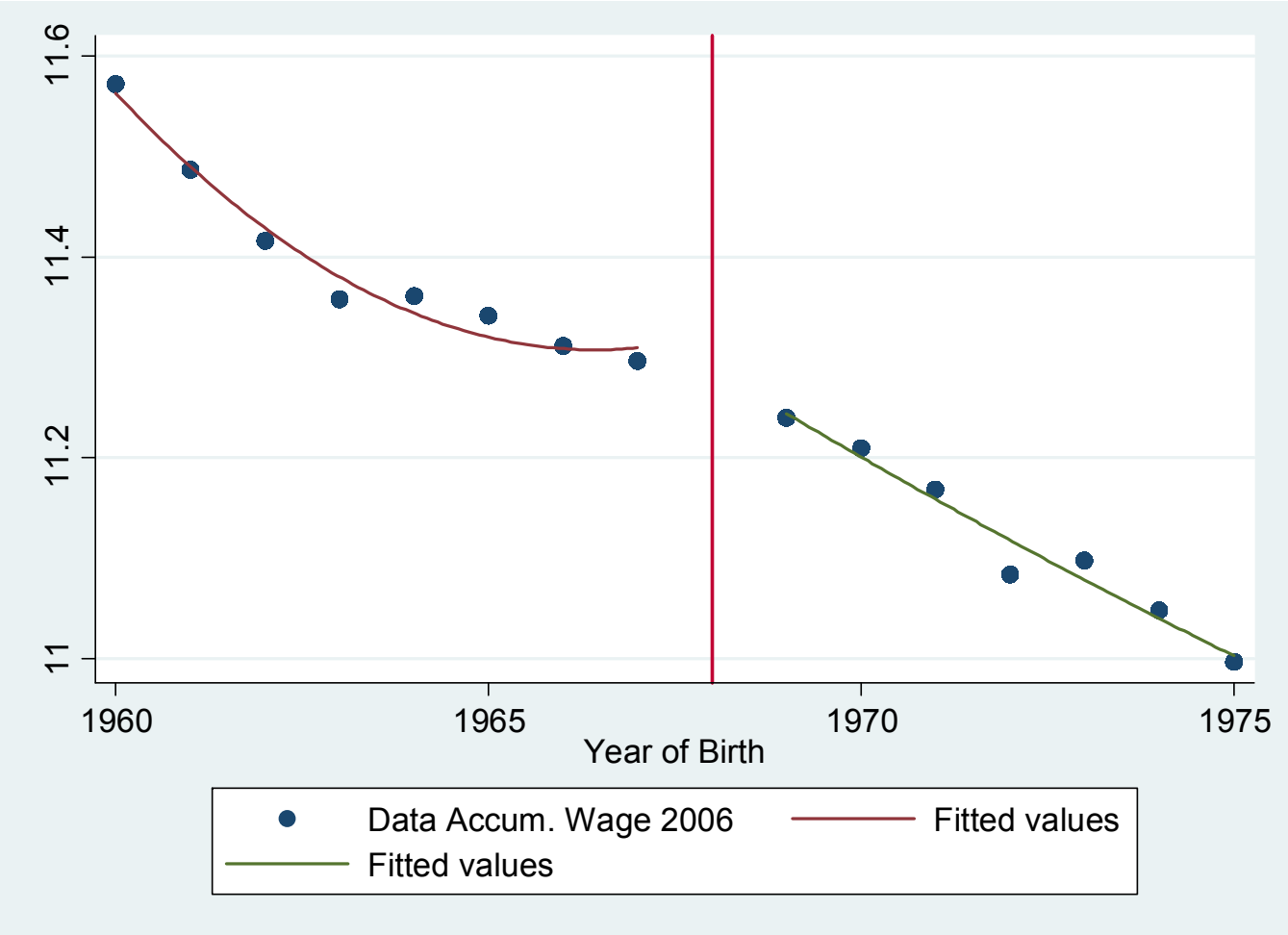
Results: Log of Accumulated Wages until 2006

VARIABLES		
Effect (β_3)	-0.132*	-0.119*
	(0.0643)	(0.0592)
Trend (β_1)	0.113***	0.104***
	(0.0286)	(0.0271)
Post-trend (β_2)	-0.189***	-0.181***
	(0.0326)	(0.0310)
Trend^2 (β_4)	0.00832***	0.00801***
	(0.00232)	(0.00226)
Post-trend^2 (β_5)	-0.00744**	-0.00669**
	(0.00300)	(0.00302)
UR at entry	-0.0290***	-0.0271***
	(0.00174)	(0.00149)
Sector dummies		X
Constant	12.04***	12.02***
	(0.0896)	(0.0967)
Observations	27,316	27,316
R-squared	0.033	0.056

Results: Log of Accumulated Wages until 2006

# Results: Log of Accumulated Wages until 2006

- We get that men who entered the labor market under a laxer regulation of fixed term contracts accumulated **lower earnings (-11.9%)**.

- Can this earnings loss be explained by the lower days of employment accumulated by the cohort entering the labor market after 1984?

  - Based on the trend estimated from cohorts entering the labor market prior to the reform, the 1969 cohort has suffered a 8.1% loss in terms of years of employment by 2006.

  - Therefore, about 2/3 of the earnings loss experienced by this cohort could be explained by the fewer days of work accumulated by this cohort.

  - The rest might be connected to the well-known wage gap between permanent and temporary workers (See Jimeno & Toharia, 1993)

Concluding remarks

- In this paper, we study the <u>impact of entering the labor market under a lax regulation of fixed-term contracts</u> on subsequent labor market outcomes.

- Using Spanish social security data, we found that cohorts of native male high school dropouts who entered the labor market under a lax regulation of fixed-term contracts **experienced worse labor market outcomes** than cohorts that just preceded them.

Concluding remarks
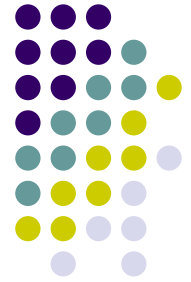
- Hence, our findings suggest that, on balance, **making fixed-term contracts more readily available reduced the welfare of low skilled workers**.

- Even though these contracts <u>seem to allow low skilled workers to access a more varied work experience</u> by accumulating more employment spells in different firms, **the long-run consequences are negative**.

- We conclude that, far from being a stepping stone, **fixed-term contracts are a stumbling block for the career of low skilled workers**.