

# The Trap of Dual Labor Markets

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# Plan of the talk

## Motivation

Many European countries have opted for an increasingly dual labor market, especially through temporary contracts. I will argue that this is not a good idea, using Spain as a case study.

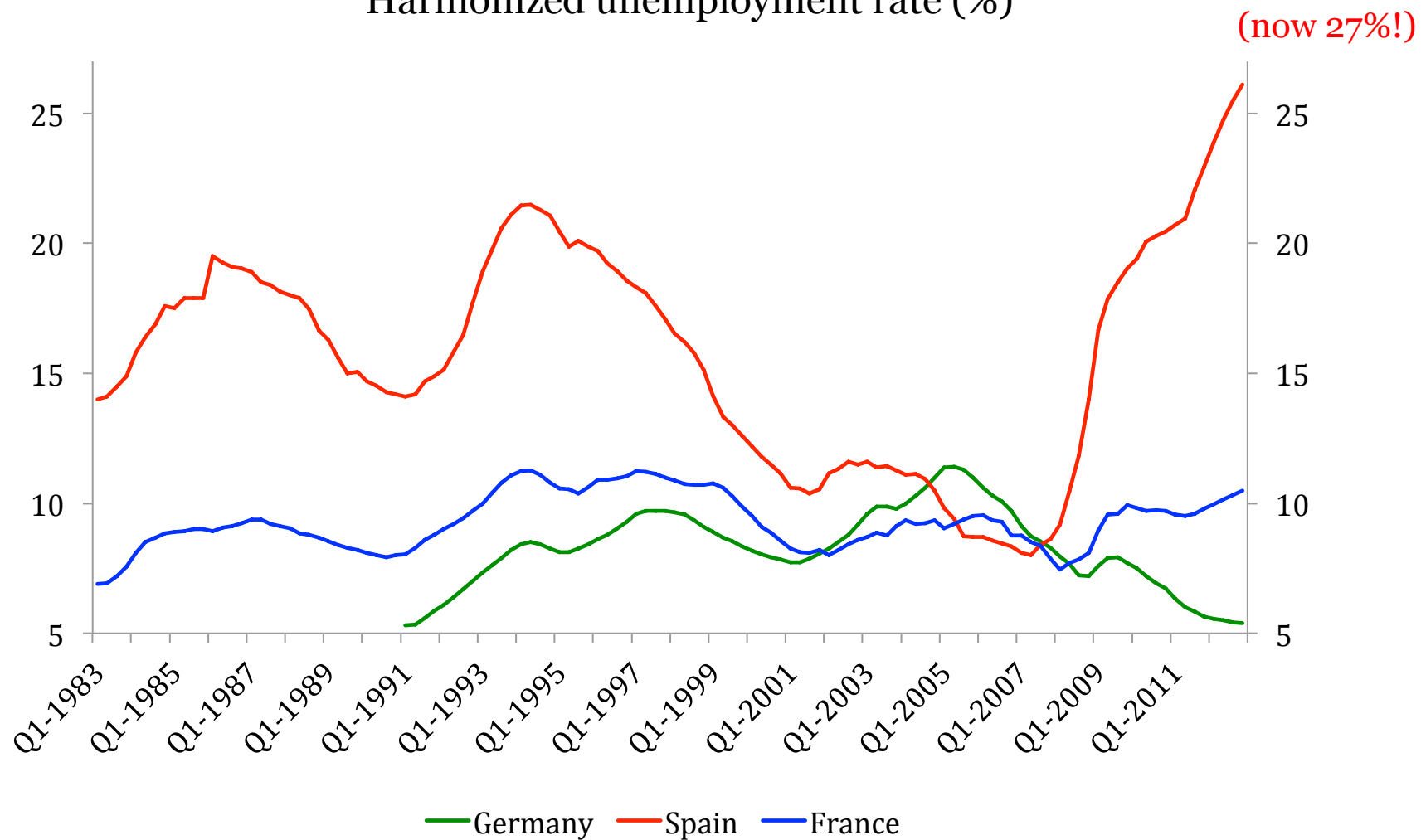
## Items

1. The Great Recession in Spain
2. The effects of temporary contracts
3. Why so bad?
4. The political economy trap
5. Recap

# The Great Recession in Spain

# The worst unemployment rate on record

Harmonized unemployment rate (%)

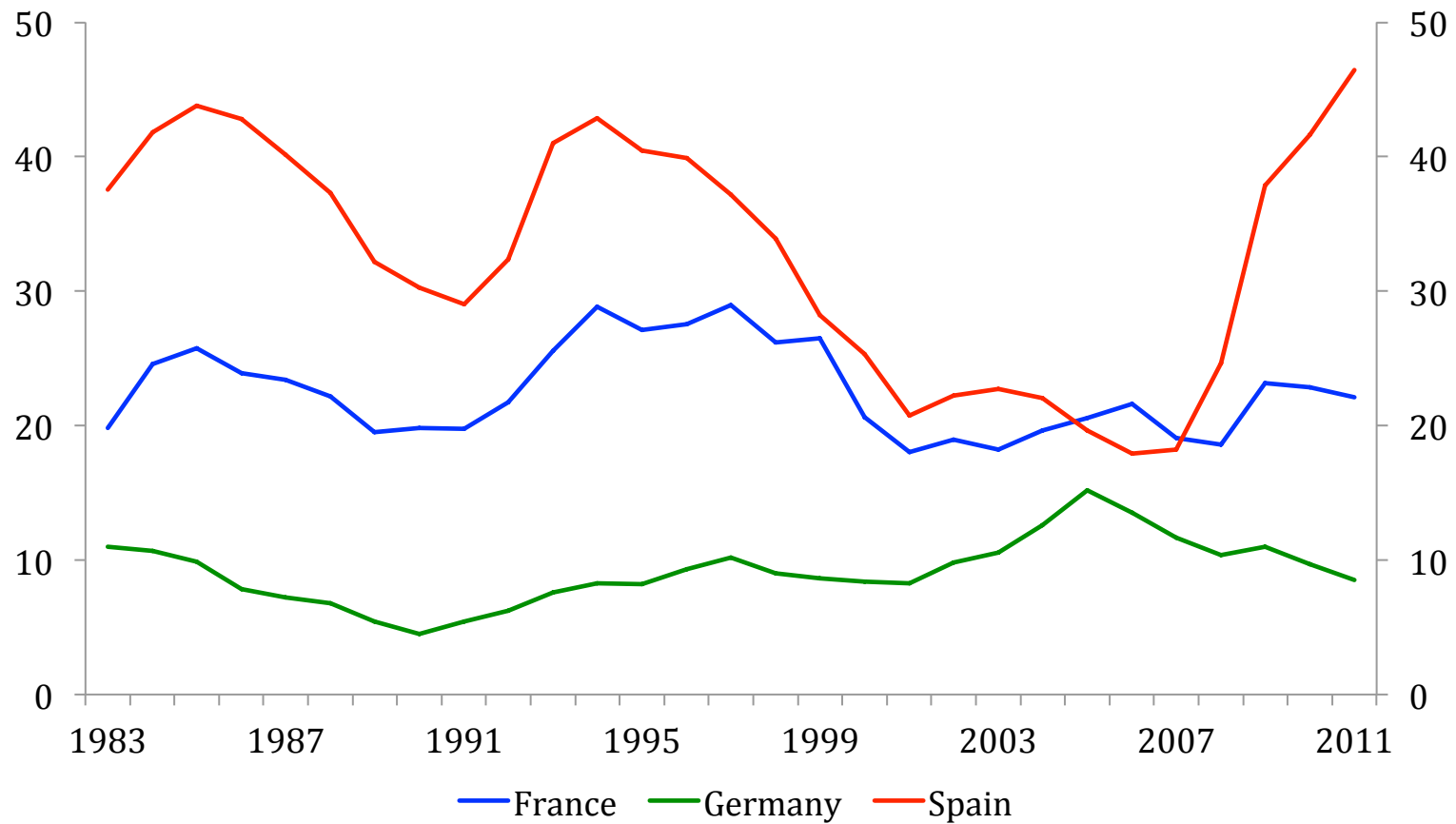


Source: Online OECD Employment database.

## And a tragedy for Spanish youth...

Unemployment rate, 15-24 y. o. (%)

(now 57%!)



Source: Online OECD Employment database.

## Minimal macro background on the GR in Spain

### Boom (1996-2007) and bust (2008-2013?)

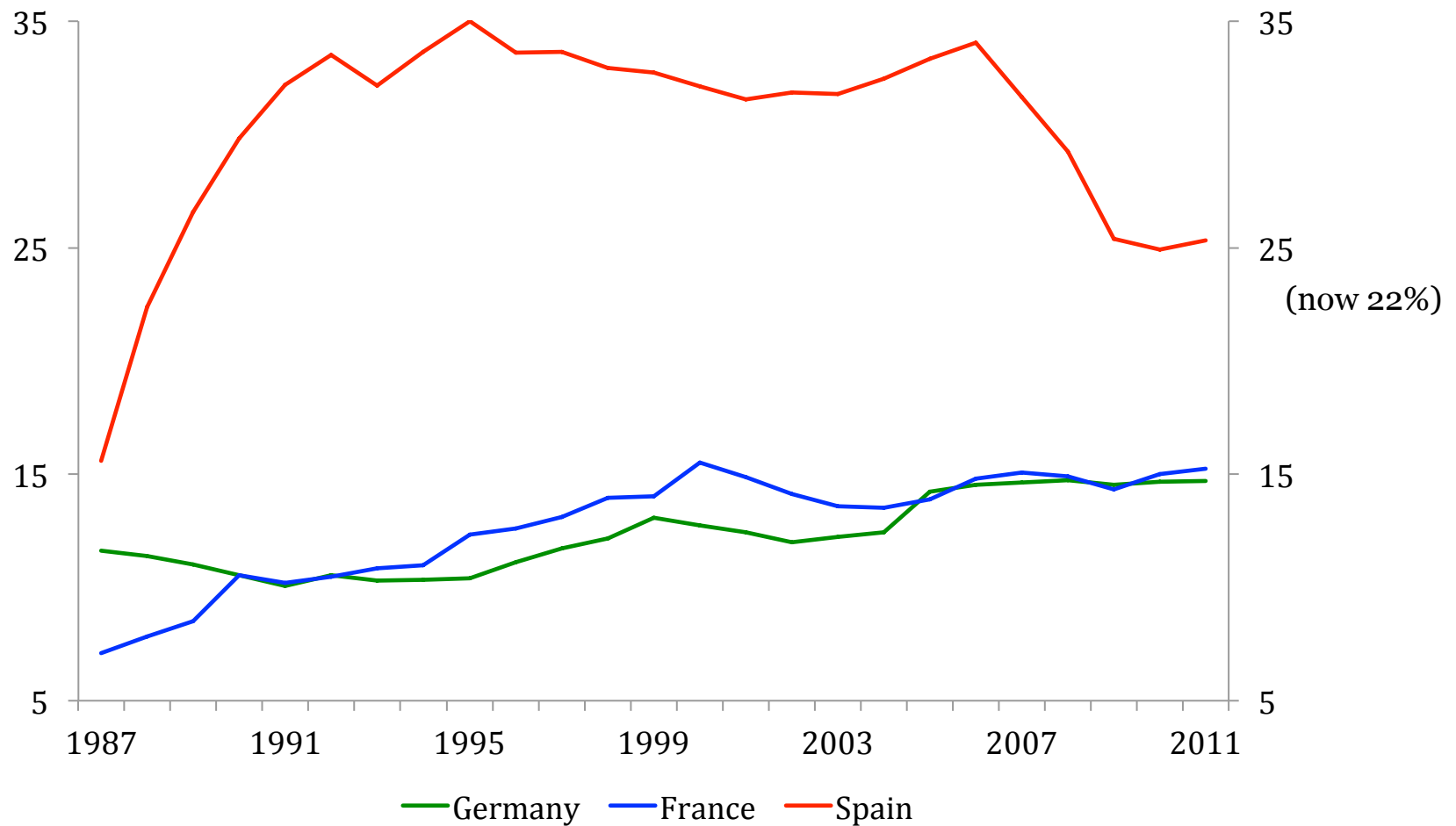
- Credit boom → Credit crunch
- Housing bubble (trebled 1996-2007) → Bursting (31% fall)
- High immigration inflow (11% 1996-2007, unskilled)

### Weakness symptoms

- Negative TFP growth since 1995
- Competitiveness loss (30% u.l.c. w.r.t. EZ, 1999-2008)
- Current Account deficit (10% of GDP, 2007)

## A big outlier in temporary jobs

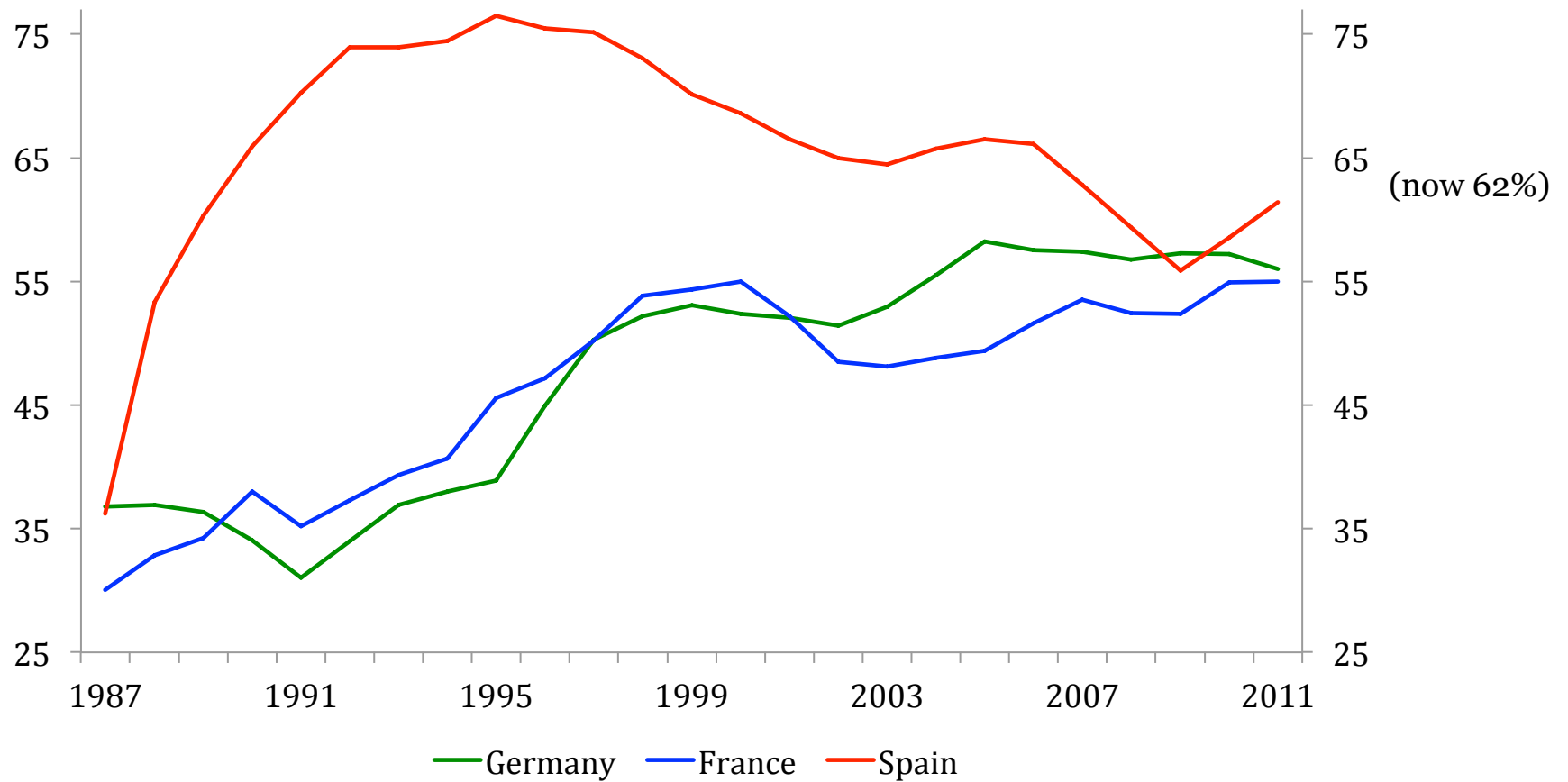
Temporary employment rate in employees (%)



Source: Online OECD Employment database.

## Also regarding young workers

Temporary employment rate in employees, 15-24 (%)



Source: Online OECD Employment database.

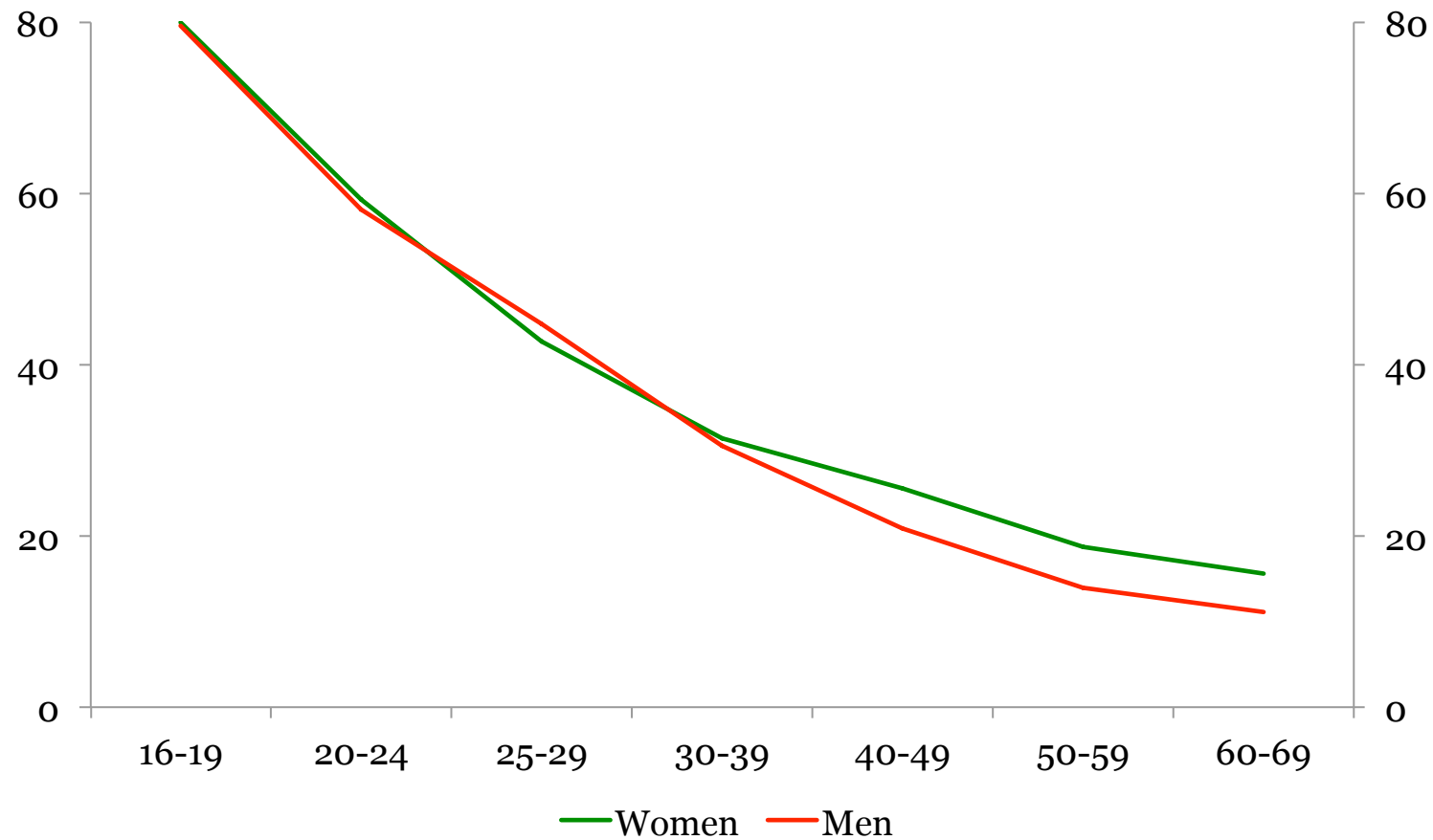




# The effects of temporary contracts

## Different incidence by age, more than by gender

Temporary employment rate in employees by gender and age, 2007 (%)



Source: INE, Labor Force Survey.

## Very high labor market turnover (churning)

### Temporary contracts signed during 2010

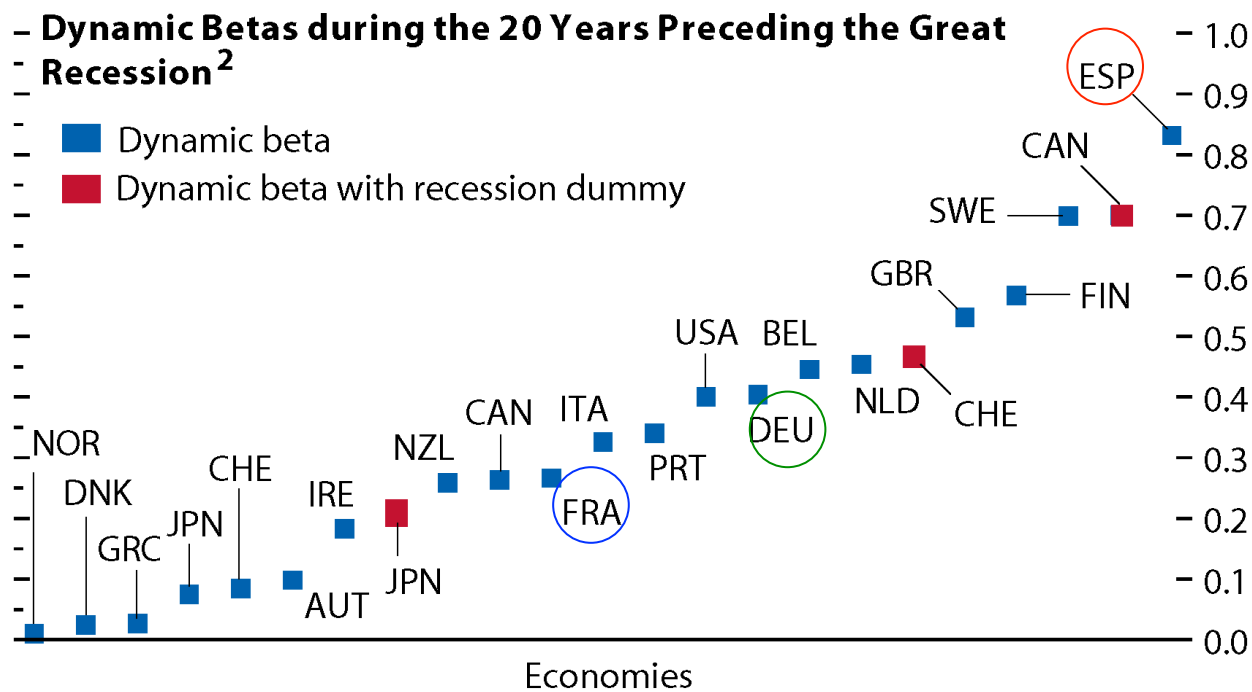
	Thou.	Share (%)
Up to one month	4.826	62.0
1-3 months	1.554	20.0
3-6 months	1.037	13.3
6-12 months	299	3.8
More than 12 month	71	0.9
Known duration	7.787	100.0
Unknown duration	5.402	
Total	13.189	

Employees	Thou.	Share (%)
Permanent	11.524	75.1
Temporary	3.823	24.9
Total	15.347	

Source: Employment and Labor Ministry (MEYSS), Registered labor flows.

See also: García-Serrano and Jimeno (1999), Boeri (1999).

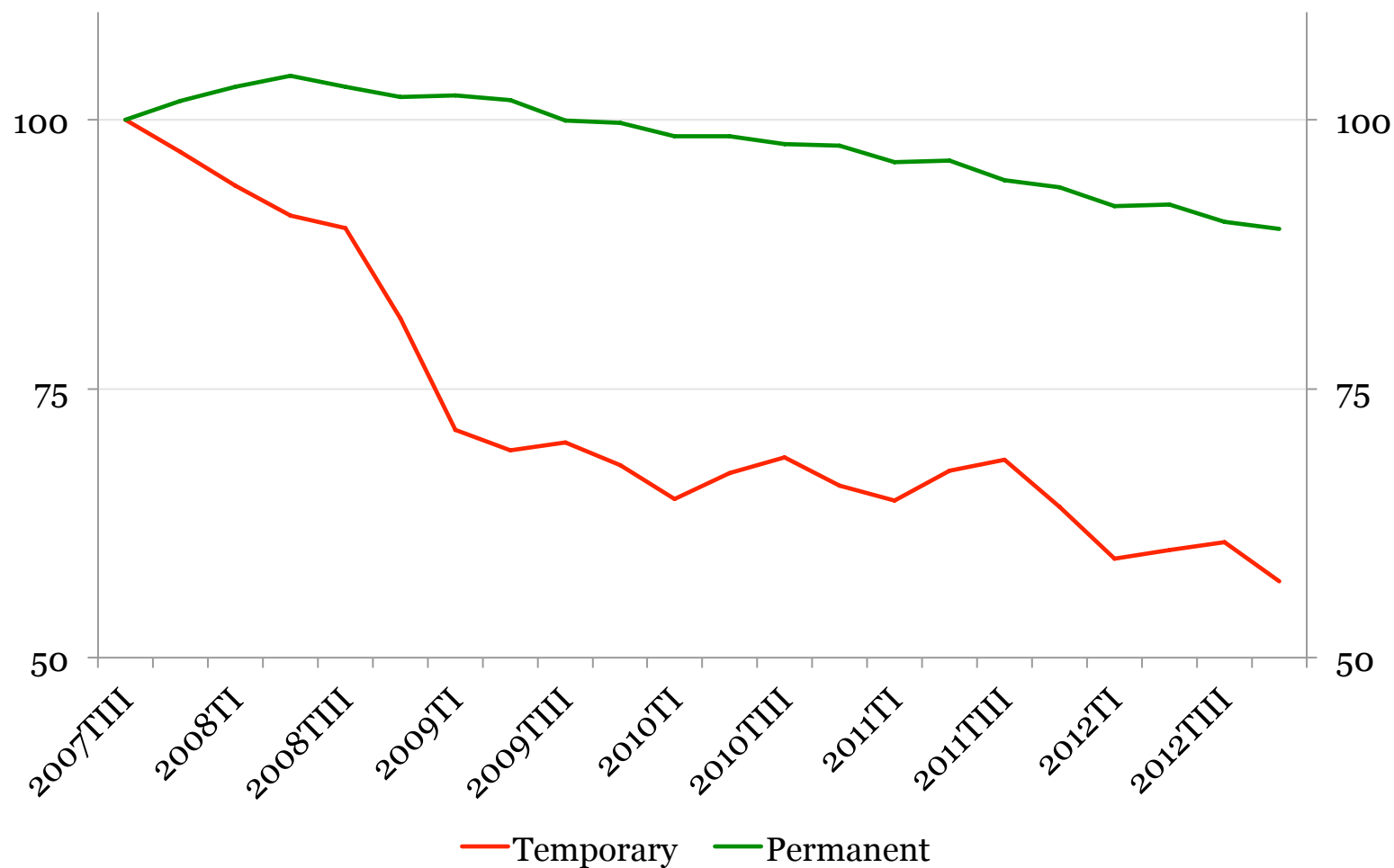
## Extreme unemployment elasticity to output (volatility)



Source: IMF *World Economic Outlook*, April 2010.

# Temporary employees bear the brunt of the adjustment

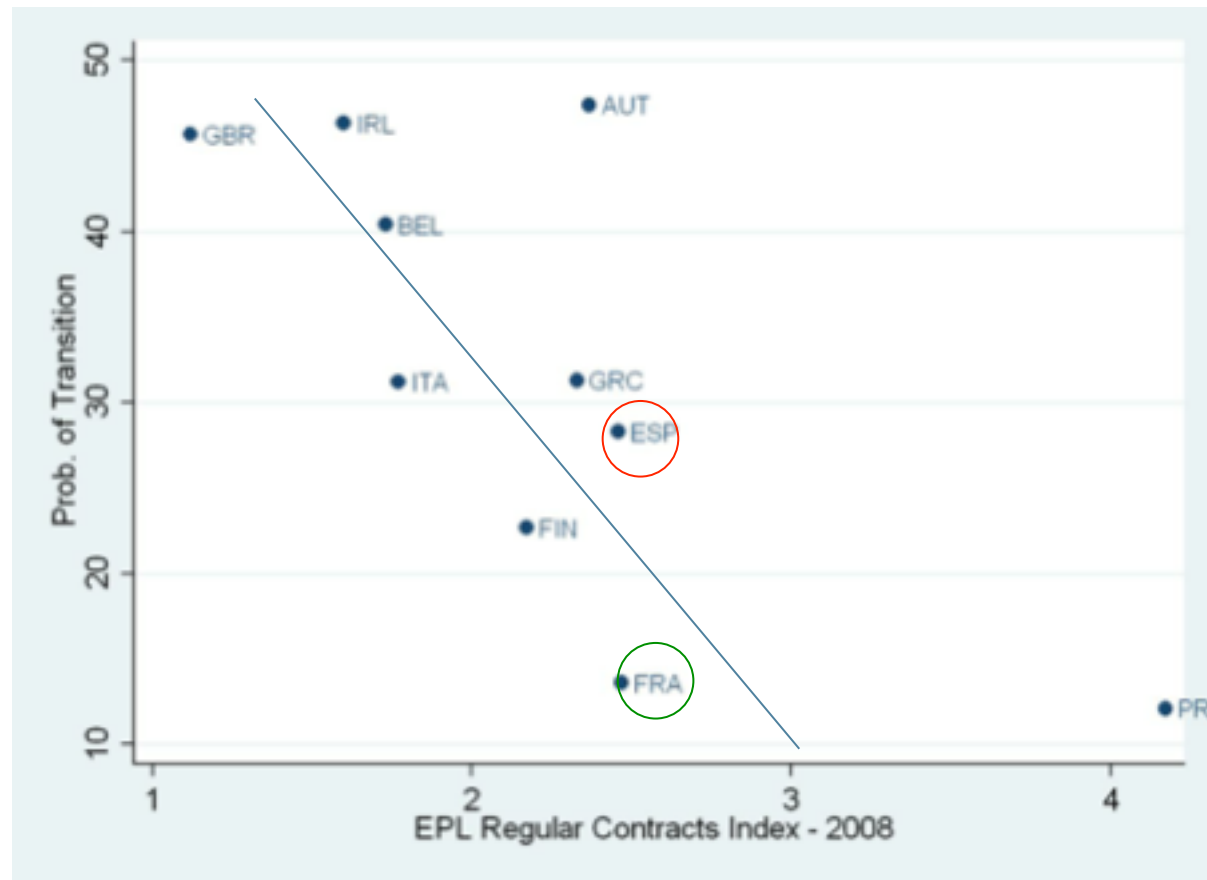
Permanent and temporary private employment (2007Q3=100)



Source: INE, Labor Force Survey.

## The dual labor market trap: Transition to permanent jobs

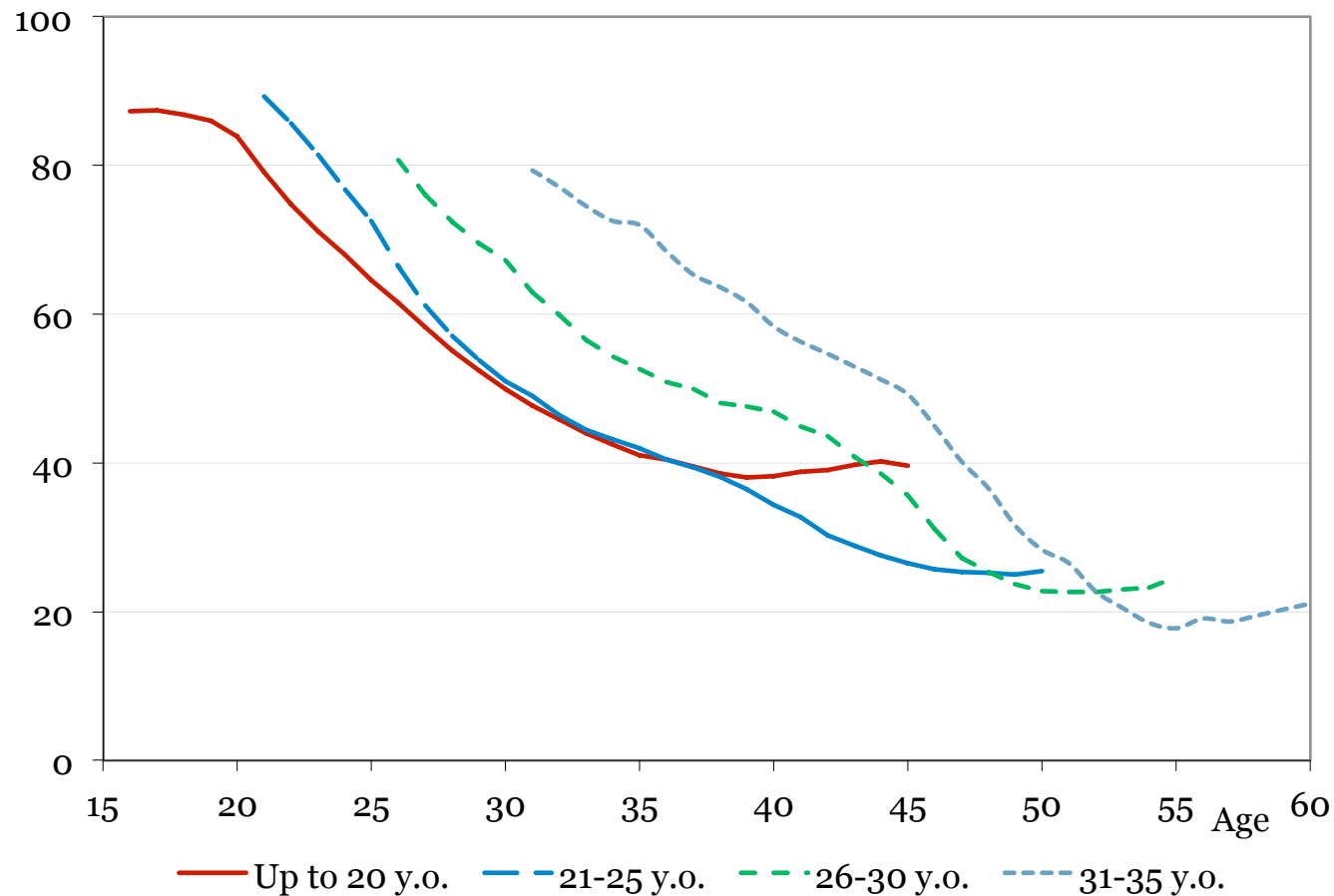
Strictness of EPL for permanent contracts and transition probability from temporary to permanent contracts (%)



Source: Boeri, T. (2011), "Institutional Reforms and Dualism in European Labor Markets".

## The dual labor market trap: Persistence (longitudinal)

Share of workers remaining in temporary jobs by entry cohort (1990-2009, %)



Source: Conde-Ruiz, J.I., F. Felgueroso, and J. I. García-Pérez (2011): “Reforma laboral 2010: Una primera evaluación y propuesta de mejora”.

## Other effects of temporary jobs

- **Wage inequality** (unrelated to productivity) (Boeri, 2011)
  - **Less training:** little incentive to invest (Arulampalam and Booth, 1998; Boeri, 2011)
  - **Lower productivity** (low stability harms incentives) (Blanchard and Landier, 2002; Dolado, Ortigueira, and Stucchi, 2012)
  - **Deferred parental home-leaving and family formation** (Becker, Bentolila, Fernandes, and Ichino, 2010)
  - **Biased productive specialization** (Saint-Paul, 1997) - bubble
- ... And yet no evidence of lower unemployment rate



## Wage differentials (controlling for productivity)

**Table 12** Wage premia on permanent contracts.

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

<sup>a</sup> Significant at 90%.

<sup>b</sup> Significant at 95%.

<sup>c</sup> Significant at 99%.

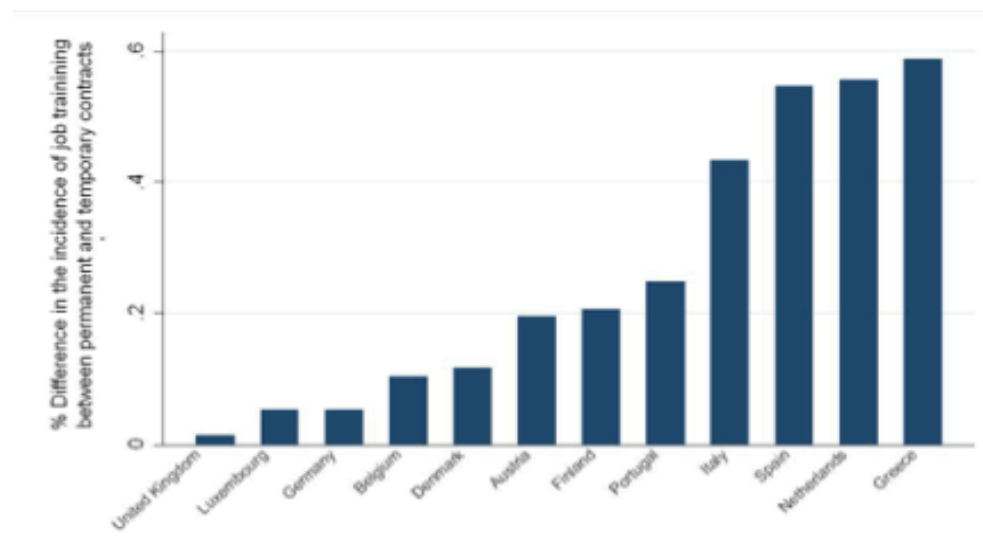
Source: Boeri, T. (2011), “Institutional Reforms and Dualism in European Labor Markets”.

## % Difference in training between permanent and temporary workers

The Legacy of the Great Recession

### Dualism: Underinvestment in Human Capital

Much less training is offered to fixed-term workers compared to permanent contracts.



Source: ECHP



# Why so bad?

## Don't temporary contracts have some good effects?

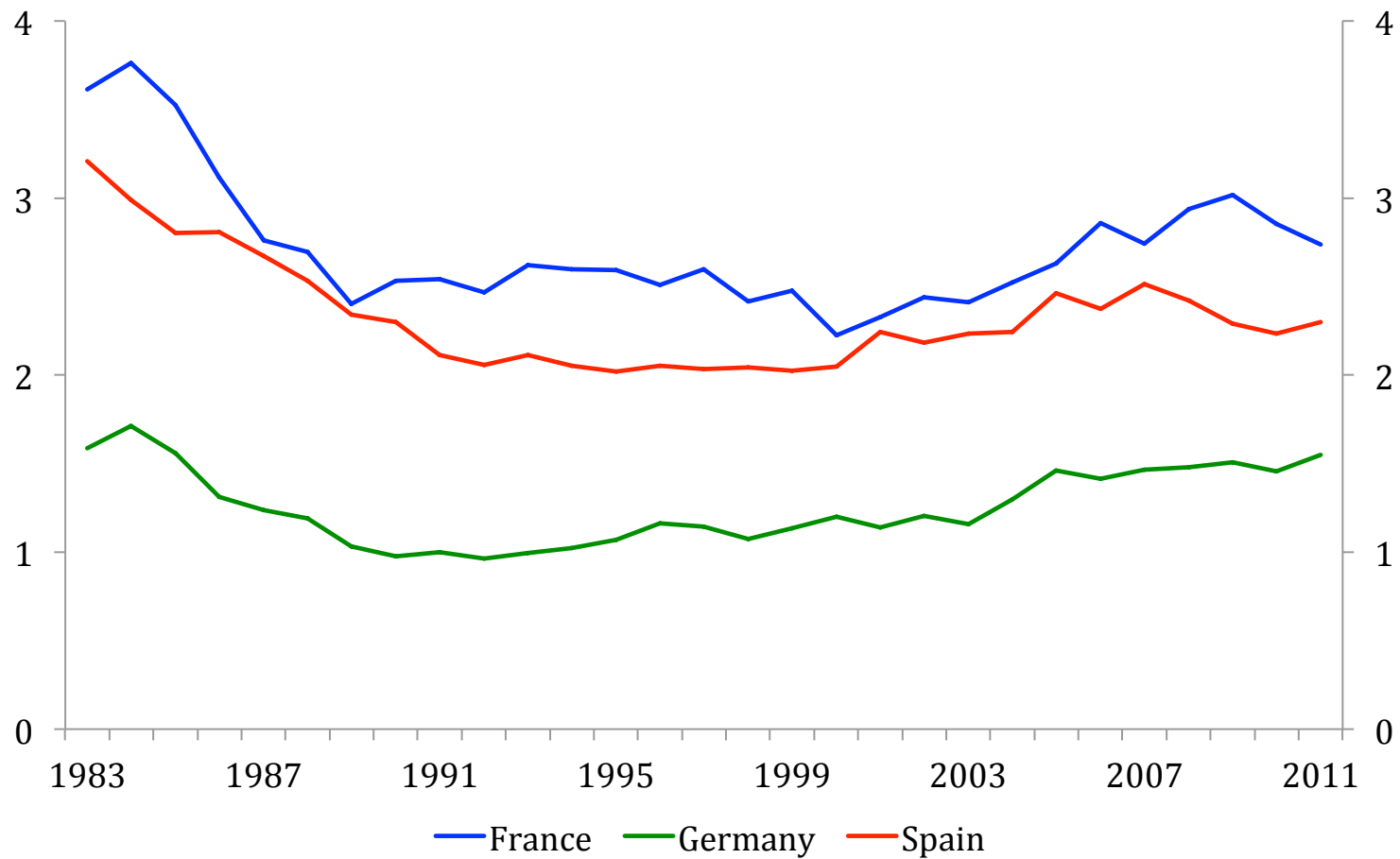
They contribute to:

- **Flexibility:** employers are less afraid to create vacancies, as attested by huge turnover
- **Youth find jobs more easily:** youth-to-adult unemployment ratio no worse than, e.g., France (Figure)
- Not particularly bad performance in term of **long-term unemployment** (Figure) (*data?*)

→ So, why such a bad unemployment performance?

## Youth to adult unemployment no worse than in France

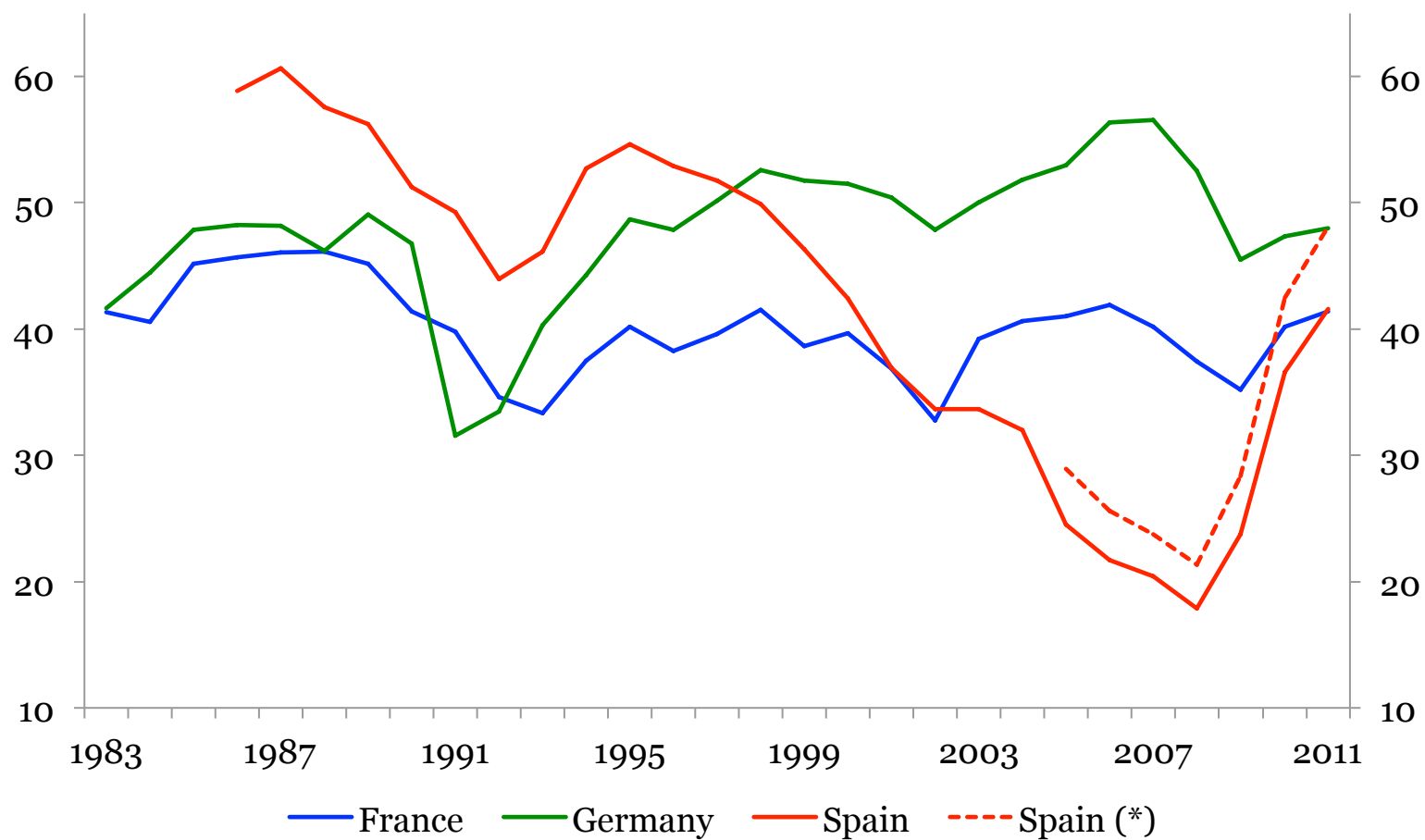
Relative unemployment rate: 15-24 y. o. / 25-54 y. o.



Source: Online OECD Employment database.

## Long-term unemployment ratio

Unemployed for 1 year or more as a share of unemployed (%)



Source: Online OECD Employment database and INE for Spain, 2005-2011 (\*).

## Interactions between institutions and unemployment (1)

- Enforcement of eligibility for temporary contracts matters (Bentolila, Cahuc, Dolado, and Le Barbanchon, 2012)

*What would Spanish unemployment have been in the GR had it had French labor market institutions?*

- Mortensen-Pissarides model calibrated to 2005-2009 (housing bubble burst as a mismatch shock in Spain)
- Distinguish permanent-temporary firing cost gap  $v$ .  
regulation of temporary jobs

→ 45% of the unemployment rate increase would have been avoided, 60% of which due to lax regulation of temp jobs

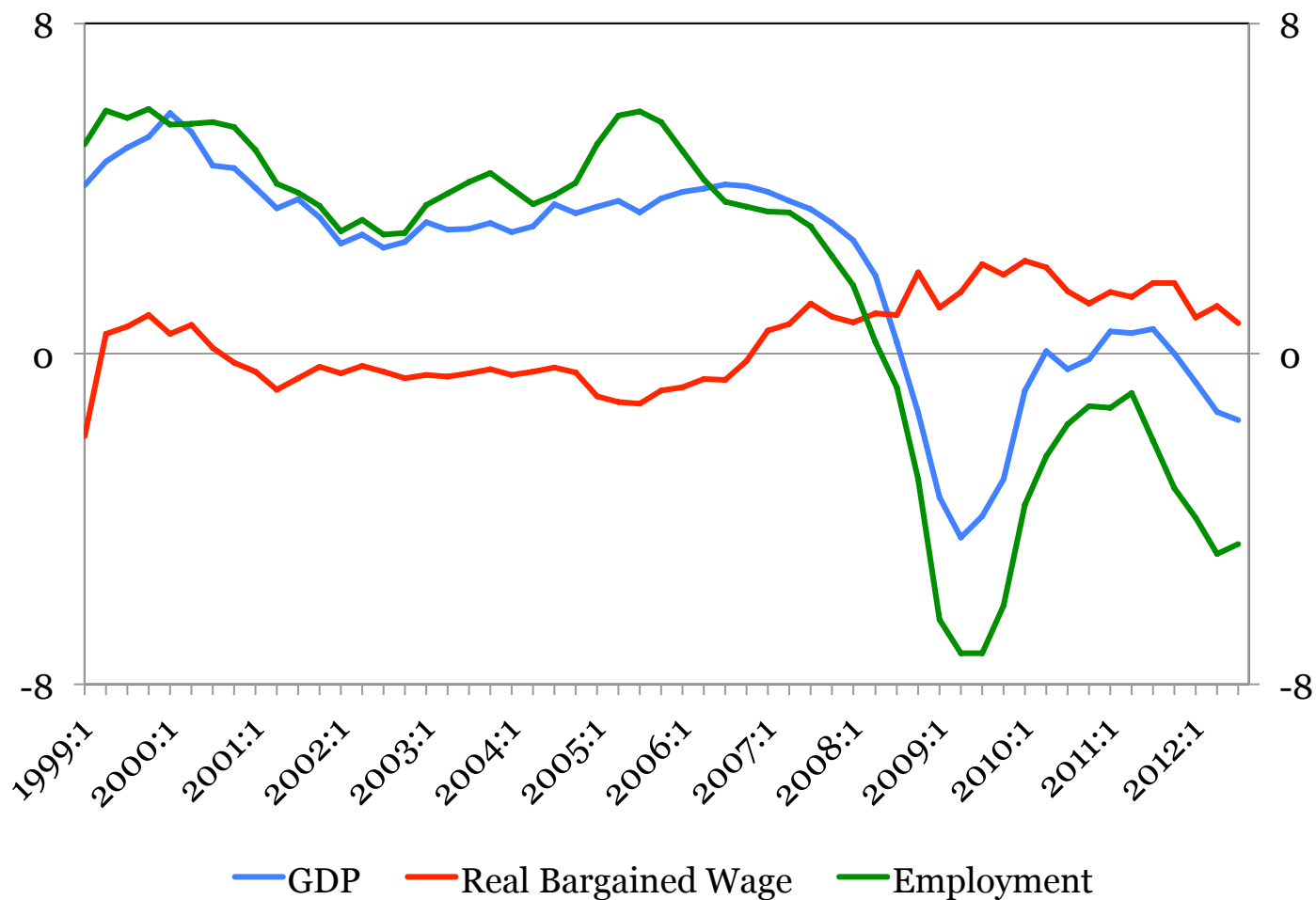
## Interactions between institutions and unemployment (2)

- **Collective bargaining: a case of insiders-outsiders**
  - Insider permanent workers disregard interests of outsider temporary workers (Bentolila and Dolado, 1994)
  - Predominantly industry-wide bargaining with mostly large firms' interests represented (SMEs as outsiders)
- **Unemployment benefits:** no check for job search effort
- **Active labor market policies:** small, wasteful, and never evaluated (managed by employers' association and labor unions)



## Evidence of insider wage setting?

GDP, employment, and real bargained wage (annual change, %)



Source: INE and Bank of Spain. Bargained wage deflated by GDP deflator.

## Interactions between institutions and unemployment (3)

→ Two-tier market is different from single-contract market

Costain, Jimeno, and Thomas (2010):

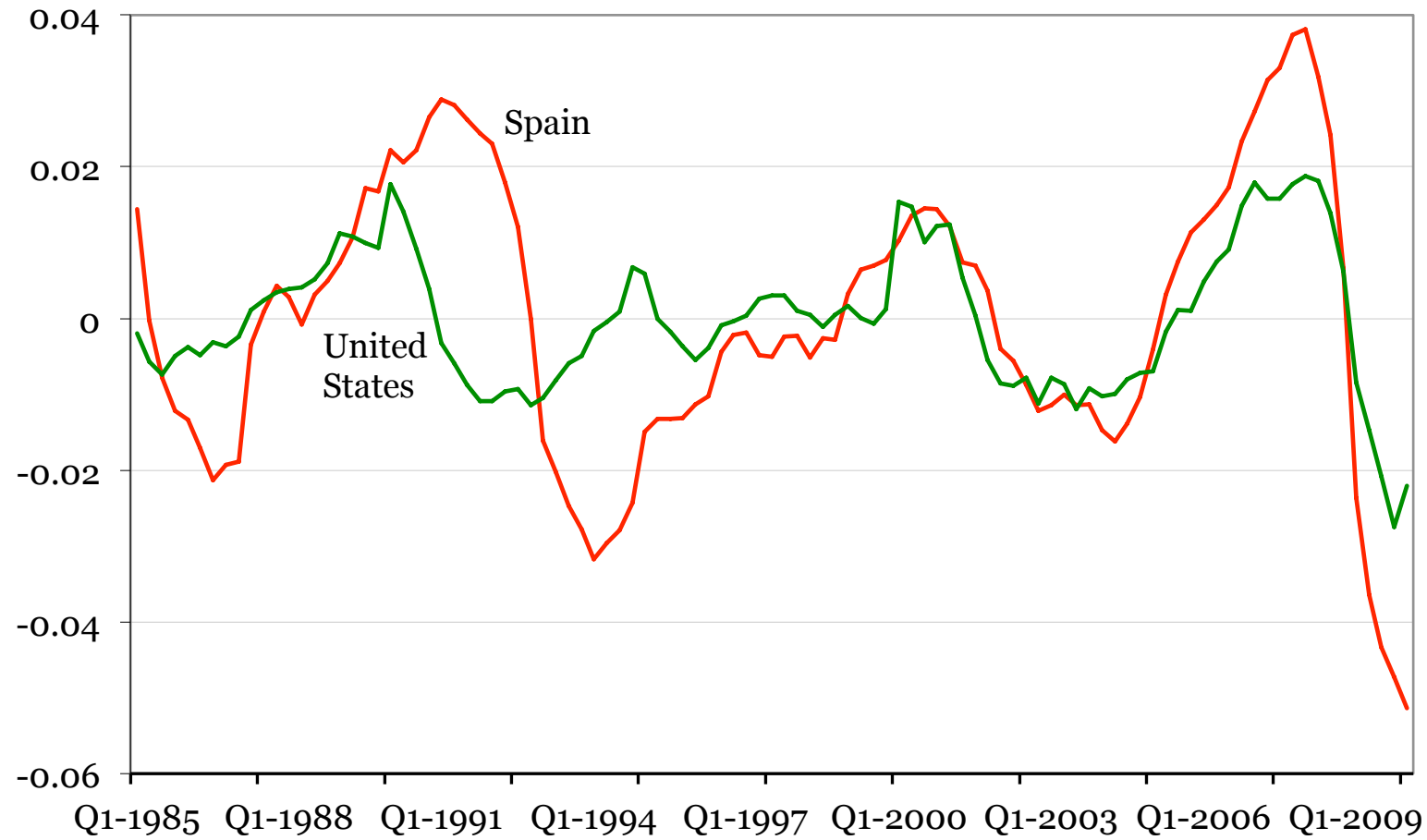
- Mortensen-Pissarides model calibrated to Spain
- In dual market unemployment rate fluctuates:
  - 21% more with same average firing cost
  - 33% more with same average unemployment rate

Why? Temporary jobs are fragile

- Unemployment benefits and wage rigidity enhance the impact of duality on labor market volatility

# Employment volatility doubles that of the US

Cyclical component of employment (H-P filtered)



(\*)  $\sigma_{US}=0.09$ ,  $\sigma_{Spain}=0.18$



# The political economy trap

## Single contract proposals

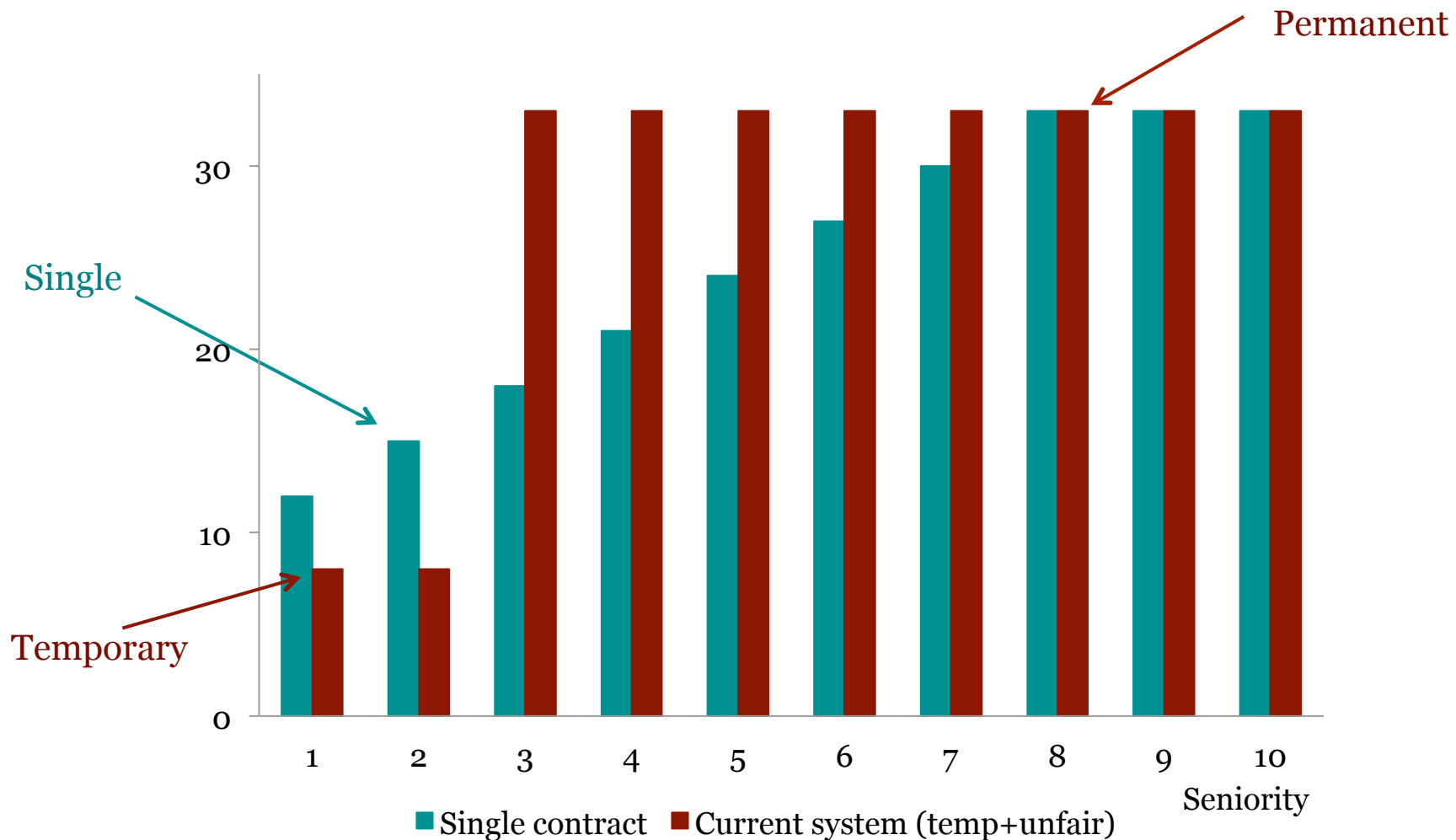
### Proposals for several countries

- **France:** Blanchard and Tirole (2003), Cahuc and Kramarz (2003)
- **Italy:** Boeri and Garibaldi (2007), P. Ichino (2009)
- **Spain:** “Manifesto of the 100 Economists” (2009)

The proposals vary, but all agree in promoting permanent contracts that imply a smooth increase in firing costs (as opposed to discontinuous)

## Single contract (100 academic economists, 2009) (example)

Severance: Days of wages per year of service



## Potential effects of single contract

García-Pérez and Osuna (2013):

- Mortensen-Pissarides model calibrated to Spain (1997-2007, i.e. boom)
- Compare steady state comparing 2012 labor market reform with single contract
- Unemployment rate could fall by a tenth, job destruction rate by 19%, especially for first three years of tenure (50%)

## Recent labor market reforms in Spain (2010, 2011, 2012)

- Lower firing costs, decentralization of collective bargaining, and lower unemployment benefits
- Active labor market policies unchanged (and no *effective* link to benefits)
- Temporary contract regulation essentially unchanged: severance pay progressively increased from 8 to 12 days' wages per year of service over 2012-2015
- All reforms undertaken due to pressure from financial markets and European institutions (against extreme unpopularity)



## Why are temporary contracts not reformed?

Bentolila, Dolado, and Jimeno (2012): Political economy

- Temp contracts liberalized for all jobs in 1984, due to inability to reduce very high firing costs inherited from Franco's dictatorship in the face of labor unions' opposition. Reforms to restrict their use failed

Standard reform: suppress temporary contracts in exchange for lower severance pay for permanent contracts. But:

- Temporary contracts supported by employers (flexibility) and unions (insiders enjoy shock-absorber and higher wages)
- Governments faced with a reform opposed by both employers and labor unions and that would benefit mostly the young, who are not median voters

## Who supports increased flexibility?

Share agreeing with the statement:

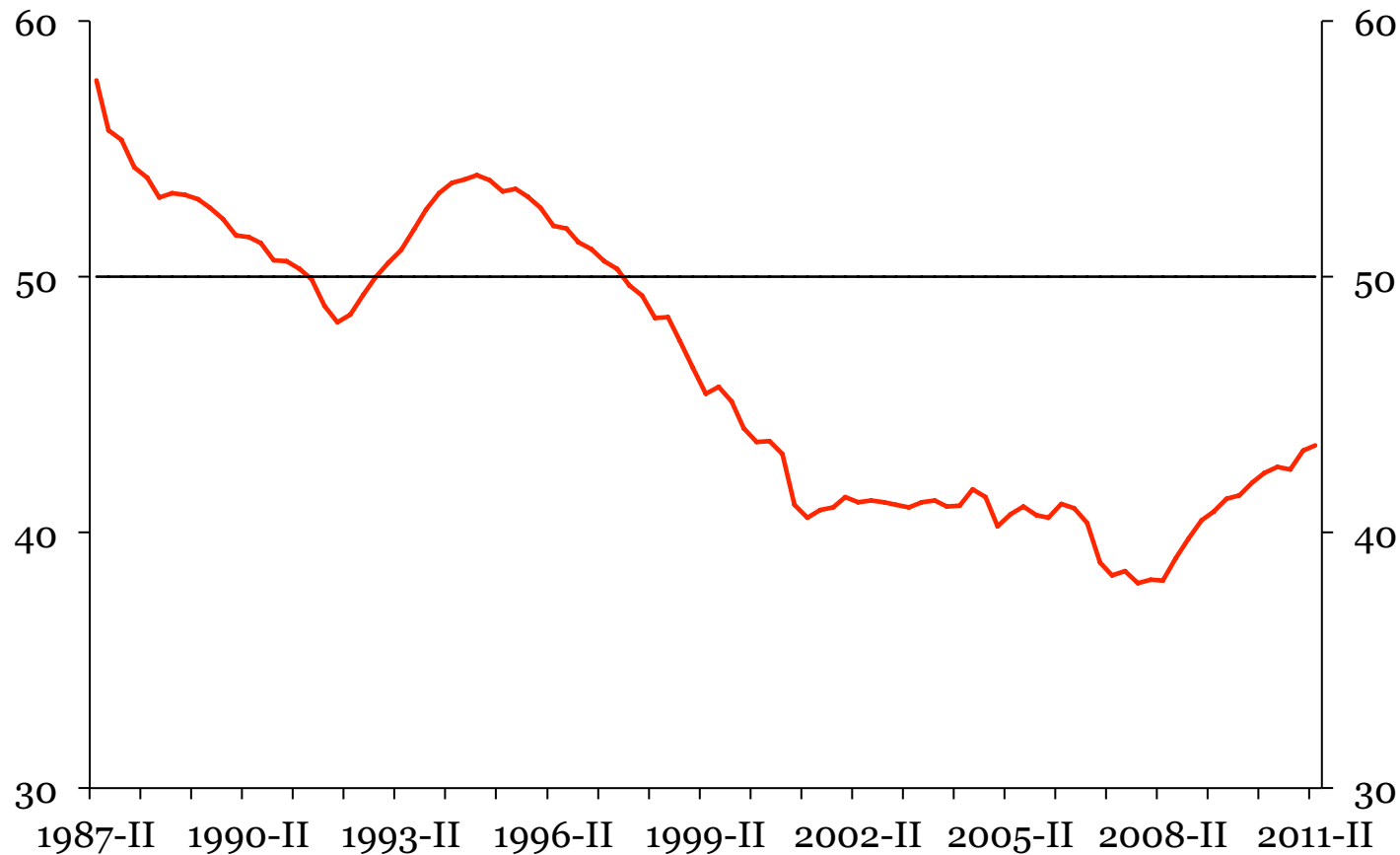
“Contracts should be more flexible to incentivize job creation” (%)

	Spain	EU-15
Population 16 years old and over	61.2	71.2
16-24 years old	64.9	71.2
45-54 years old	58.8	68.6
Lost their jobs during the crisis	70.3	73.5
Did not lose their jobs during the crisis	60.0	70.5
Self employed/Entrepreneurs	67.2	77.4
Managers	62.2	68.5
Professionals (employees)	65.3	73.6
Other skilled employees	51.0	67.3
Low-skill employees	69.3	71.2
Unemployed	69.6	72.6

Source: Eurobarometer, May-June 2009, from Dolado, J. , F. Felgueroso, and M. Jansen (2010): “El conflicto entre la demanda de flexibilidad laboral y la resistencia a la reforma del mercado de trabajo en Español”.

## Potential support for reform

Outsiders (temp plus unemployed) as share of employees plus unemployed (%)



Source: Dolado, J., C. García-Serrano, and J. F. Jimeno (2002): “Drawing Lessons from the Boom of Temporary Jobs in Spain”.



“Die Entrüsteten” occupy the Puerta del Sol (2011)







# Recap

## Conclusion

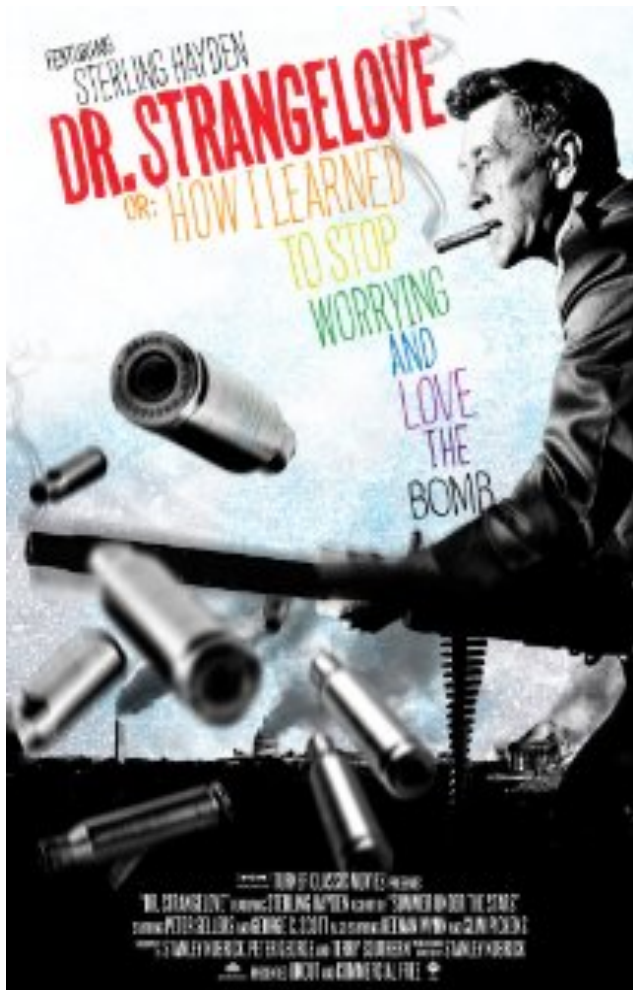
### Temporary contracts have deleterious economic effects

- They create very high volatility that is unequally shared, especially falling on youth, with potentially permanent scarring effects (e.g. 24% aged 15-29 NEETs in Spain)
- They foster a model with low productivity growth, which hampers sustainability of the Welfare State in the face of globalization and skill-biased technological progress
- Their effects depend on the nature of other labor market institutions

### Dual labor markets become political-economy equilibria

- We don't know where the critical threshold is (it depends on other institutions), but 15% (FR, GE) seems dangerously high (+minijobs?)

I had another title...



OR:

*HOW I DIDN'T LEARN  
TO STOP  
WORRYING  
ABOUT THE GREAT RECESSION  
NOR  
LOVE THE  
DUAL LABOR MARKET*



Thank you for your  
attention!