



REPORT ON THE

COEURE WORKSHOP ON “LABOUR MARKETS”

## “EU Dual Labour Markets: Consequences and Potential Reforms”

Organizers: **Ramon Marimon** | European University Institute  
**Juan Dolado** | European University Institute

Université libre de Bruxelles | 42, avenue Roosevelt | 1050 Brussels  
Building SBS-EM | Solvay Brussels School of Economics  
Room R42.2.103

8 June 2015

Rapporteur: **Pablo Forero** | European University Institute

- Workshop programme
- Rapporteur’s report
- Workshop participants

10 September 2015



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### Background on COEURE:

The **COEURE Coordination Action** (which stands for COoperation for EUropean Research in Economics) brings together the key stakeholders in the European economic research space – funders, policy-makers and researchers – in a process of stocktaking, consultation and stakeholder collaboration. The aim of this process is to identify the knowledge gaps on key EU economic policy issues and assess the current challenges and opportunities facing European-based researchers, with the ultimate goal to inform the European agenda for research funding. COEURE is funded by the FP7 SSH research programme and it is coordinated by the European Economic Association.

## ■ PROGRAMME

### Monday, 8 June

**9.00 – 9.05** Presentation of the COEURE project **Ramon Marimon** | EUI and UPF –  
Barcelona GSE



This project has received funding from the European Union’s Seventh Framework Programme for research, technological development and demonstration under the grant agreement no 320300.

09:05-11:00

**Session 1**

*Overview and ongoing research agenda on the interaction of Employment Protection Legislation (EPL) with technology adoption and human capital accumulation*

Chair: **Antonella Trigari** | Bocconi University

**Juan Dolado** | European University Institute  
brief presentation of survey draft

Discussion by invited speakers:

**Jan Eeckhout** | Universitat Pompeu Fabra

**Juan F. Jimeno** | Bank of Spain

**Fabien Postel-Vinay** | UCL

Debate with audience

11:00-11:30 Coffee break | Cafeteria (1st floor)

11.30-13:00

**Session 2**

*Overview and ongoing research agenda on the effects of EPL (dual and unified) on labour productivity and TFP growth*

Chair: **Stefano Scarpetta** | OECD

Discussion by invited speakers:

**Gilles Saint-Paul** | Toulouse School of Economics

**Marco Leonardi** | University of Milan

**Pietro Garibaldi** | Collegio Carlo Alberto

Debate with audience

13:00-14:00 Lunch | Cafeteria (1st floor)

14.00-15:30

**Session 3**

*Overview and ongoing research agenda on the pros and cons of introducing a Single Contract*

Chair: **Georg Fischer** | European Commission

Discussion by invited speakers:

**Mario Centeno** | Bank of Portugal

**Andrea Bassanini** | OECD

**Catherine Saget** | ILO

Debate with audience

15:30-16:00 Coffee break | Cafeteria (1st floor)



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16.00-18:00

**Session 4**

*An Agenda for European research on Labour Markets: youth misallocation and human capital: theoretical, policy and empirical challenges*

Chair: **Richard Blundell** | UCL

Discussion by invited speakers:  
**Michele Pellizzari** | University of Geneva  
**Glenda Quintini** | OECD  
**Etienne Wasmer** | Sciences Po

Debate with audience

**19.30 Dinner by invitation only**

**Workshop Organizers:**

**Juan Dolado**

Professor of Economics  
European University Institute  
and Universidad Carlos III  
P.I. of COEURE's Labour Survey

**Ramon Marimon**

Professor of Economics  
European University Institute  
and UPF – Barcelona GSE  
Exec. Comm. of COEURE

**Contact and registration information:**

**Julia Valerio**

Department of Economics  
European University Institute  
Julia.Valerio@EUI.eu

**Rapporteur**

**Pablo Forero**

PhD Researcher  
European University Institute



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# COEURE Workshop on EU Dual Labour Markets: Consequences and Potential Reforms

8<sup>th</sup> June 2015

## Rapporteur's Report

### Executive Summary

This event was the third of those organized by the COEURE Coordination Action as a series of eleven workshops organized to evaluate European research in economics. The workshop focused on EU Dual Labour markets and was divided in four sections focusing on, (i) Employment Protection Legislation (EPL) and its effects on technology adoption and human capital accumulation, (ii) Effects of EPL on labour productivity and TFP growth, (iii) Discussion on the single contract, and (iv) Youth misallocation and human capital. The discussions in each panel were lively supported with contributions from a wide range of participants. The purpose of this report is to summarise the main points made during the COEURE workshop.

### Summary of the opening remarks

The workshop was opened by a keynote address from the survey's principal investigator, Professor Dolado, who reviewed some of the history, characteristics and challenges presented by dual labour markets in the EU. He argued that dual labour markets are in the agenda since the great recession, because high levels of temporary employment strongly correlates with unemployment. He explained that dual labour markets have two possible origins. In Southern-EU and France, strict EPLs in the past meant that they had to make their labour market more flexible by making them two tier. Other dual labour markets created non-regular contracts to facilitate certain jobs.

The great majority of European countries have seen a reduction of EPL stringency prior to the Great Recession, but most of this reduction has been achieved by widening the EPL gap between temporary and permanent jobs. This has led to the current situation where many European countries have two tier labour markets. During the Great Recession the gap of protection between

temporary and permanent has decreased. But greater job destruction of temporary contracts during recessions reduced this measure by itself.

The main issue with dual labour markets occur when conversion rates between temporary and permanent contracts are low, as this leads to two tier labour markets, and its consequent effects.

He argued that an increase in protection gap also increases the wage gap, as trade unions, who protect permanent workers, negotiate higher wages at the cost of temporary workers. It also leads to more human capital investment in permanent workers, and less in temporary workers, school dropout rates, job security and fertility.

During the boom, countries with dual labour markets saw an over investment in low-skilled industries, as these countries had a comparative advantage given by temporary contracts. This led to an increase in high school dropout rates and immigration. It also affected negatively TFP, competitiveness and the college premium, causing a long term impact on mismatch.

Professor Dolado discussed some of the possible steps necessary to dismantle dual employment protection legislation. Among them, he considered collective bargaining decentralization, which could lead to more flexible wages, more protection to temporary contracts (without changes in permanent contracts), reducing overly restrictive employment protection legislation for permanent contracts (without changes in temporary contracts), long entry phases or just adopting a single open ended contract. Some other possibilities could be a unified contract (such as the one currently being proposed in the Jobs Act in Italy), or a combination of severance payment and a contribution to a mutual fund or an experience rating.

Some considerations were also offered on the effects of dual labour markets on youth unemployment. The effects of entering permanent contracts are persistent. This leads to high youth unemployment and NEET rates. In this aspect dual vocation training has been useful to reduce youth unemployment, while other active programs have not proven to be as useful.Summary of the principal observations made during the four sessions

The workshop was divided in four different sessions, in which the following subjects were included:

1. Overview and ongoing agenda on the interaction of Employment Protection Legislation (EPL) with technology adoption and human capital accumulation.
2. Overview and ongoing agenda on the effects of EPL (dual and unified) on labour productivity and TFP growth.
3. Overview and ongoing agenda on the pros and cons of introducing a Single Contract.
4. An Agenda for European Research on Labour Markets: youth misallocation and human capital: theoretical, policy and empirical changes.

Each one was started by three invited speakers and then followed by lively discussions with the audience through a Q&A format led by a chair.

***i) Overview and ongoing agenda on the interaction of Employment Protection Legislation (EPL) with technology adoption and human capital accumulation.***

Chair: Antonella Trigari – Bocconi University

Discussion by Invited Speakers:

Jan Eeckhout – Universitat Pompeu Fabra

Juan F. Jimeno – Bank of Spain

Fabien Postel-Vinay – UCL

The debate differed on how EPL affected the economy, arguing if it is through job creation and distraction or not. However, everyone agreed that it did influence technology adoption and human capital investment, leading mostly to mismatch and other adverse effects.

Jan Eeckhout argued that EPL exists under the intention of making jobs more secure and unemployment lower. The idea is that a decrease of job outflows, while job inflows staying the same, will decrease unemployment. However a cross-country shows that a low probability of losing a job means a low probability of finding a job. Therefore, lowering the probability of losing a job

affects the probability of finding it, and what matters is the mechanism that links them.

EPL will also affect mismatch, as it creates less job movement, and under investment from firms in human capital. It can also have some effects on job security, especially unemployment which is the only risk that firms cannot insure against. It can also compensate for under saving from workers for unemployment insurance.

Employment Protection Legislation also has redistribution effects, and especially under dual labour markets, which can be inefficient and increase inequality. This was the view presented by Juan Jimeno, who argued that EPL is about how it affects different groups in a different manner. For example, in non-dual labour markets the probability of losing a job depend on gender and education. But only in countries with dual labour markets it depends mostly on the age of the worker. This is because the EPL is different for each group, creating more uneven/even job creation and job destruction. Dual labour markets was seen as a consequence of bad labour market regulation.

Independent from the mechanism, the effects of EPL on technology adoption and human capital were many. Fabian Postel-Vinay explained that by focusing just on severance payments, it was enough to find how it can affect it. For starters it has a negative effect on productivity, as it only affects the least productive jobs, and temporary contracts has adverse effects on job training.

Yet, this effect is in the short-run. In the long run it depends on human capital an innovation. EPL affects the duration of a job, and therefore the expected return on human capital. High EPL economies invest more in specific human capital than specific human capital. It affects positively innovation on things that do not affect the workforce, but not radical innovation.

***ii) Overview and ongoing agenda on the effects of EPL (dual and unified) on labour productivity and TFP growth.***

Chair: Steffano Scarpetta – OECD

Discussion by Invited Speakers:



Gilles Saint-Paul – Paris School of Economics

Marco Leonardi – University of Milan

Pietro Garibaldi – Collegio Carlo Alberto

The effects of EPL and TFP were heavily discussed. Some caution was drawn on the theoretical links between EPL and TFP growth, as what linked them was indirect and needed other assumptions. On the other hand, much empirical evidence was shown on the effects of high EPL and dual labour markets on TFP and labour productivity, showing that some negative effects seem to be occurring.

Gilles Saint-Paul warned for caution when linking EPL with TFP growth and labour productivity. He explained that the effects of EPL were on i) contract duration, ii) reallocation and iii) risk. The effects on contract duration could be counteracted with efficient market prices for wages. Therefore they shouldn't have an effect. On reallocation it would seem it had a larger effect, as growth comes from creative destruction. It is necessary for unproductive firms to shed workers in order to reallocate them towards more productive jobs. But EPL does not apply to obsolete technologies, and for these closing costs are more important.

Risk could be more decisive. Riskier sectors (those with more fluctuations) are more likely to need to fire workers, and are more affected by EPL. Therefore countries with high EPL will have a comparative advantage on low risk sectors, and vice versa. This is not necessarily a bad thing, as for a more risk averse country this could be a positive effect, allowing it to specialize on low risk sectors. Innovation is high risk, therefore it would skew towards low EPL countries, while low risk countries will take over production as goods mature. But even this is not necessarily a negative effect, as R&D is expensive, and the welfare effects of not innovating can be even positive. For this he concluded all links between EPL and TFP must be taken with a pinch of salt, as they will require further assumptions.

Marco Leonardi on the other hand, brought some empirical evidence on some of the effects EPL seems to have on the economy. He drew on the specific case of Italy, especially the 1990 labour reform. Before 1990 firms with less than 15 employees could fire at will. After the reform, large firms were left untouched,

but the EPL for small firms grew. He used the effects of this reform to see how EPL can affect firms.

He found that after introducing EPL, the entry level wage of small firms was reduced. Also, these invested more in capital than labour, which could affect TFP as this may not be the optimal K/L ratio. It also reduced turnover and increased the share of senior workers, generating an incentive to invest in complementary physical capital. At the end, the reform of fixed term contracts reduced TFP in Italy.

Pietro Garibaldi focused more on dualism and seniority on EPL. He started by numbering a series of facts. i) Dualism is stronger in countries with stricter protection on regular contracts. ii) There is lower TFP growth in countries with more dualism. iii) Low training in Temporary contracts is a standard feature across countries. iv) Links between tenure and severance payments exist in most countries. Dualism has a honey-moon effect, increasing at first employment, and reducing fluctuations. However, these disappear after a while, which explains the better labour market of dual countries before the Great Recession, and the increase of job losses during it.

He then justified that EPL increases with tenure. Firms, in order to provide incentives for investing in job specific training, use wages that increase with tenure. Firms can commit on wages, but not on employment. This means that firms have an ex-post incentive to fire senior workers. If marginal cost of training increases with tenure, severance payment increasing with tenure is optimal.

Dualism and productivity growth is a concern both micro and macro. Low human capital investment is an intergenerational concern that is too often overlooked. But reducing temporary contracts now would not make sense. Initiatives, as equal opportunity contracts at entry, are no longer discussed in labour economics, but it is something it would seem necessary.

Towards the end of Pietro Garibaldi's discussion, he explained some of the features of Italy's Jobs Act of 2015. One of the reforms it undertook was to terminate judge's ability to reinstate workers who have been fired, and substitute it with a monetary compensation with a cap. The effect of judges on EPL drew a large discussion from the audience. There seems to be an agency problem with judges and law makers. If judicial costs are too high, low severance payments may not achieve the wanted effect. In fact one of the

advantages of temporary contracts is that one does not “fire” the worker when the contract terminates. Some solutions, like the maximum severance payment in Italy, could be unconstitutional in countries like France, as it limits the judge’s power. As Italy tries to limit the power of the judges, Spain’s labour reform is being undermined by the judges. It seems judges can affect the optimal policy, and it would be best to leave the judges discretion out of it, as the problem may not be the severance payment, but the judicial uncertainty and risk beyond the severance payment.

***iii) Overview and ongoing agenda on the pros and cons of introducing a Single Contract.***

Chair: Georg Fischer – European Commission

Discussion by Invited Speakers:

Mario Centeno – Bank of Portugal

Andrea Bassanini – OECD

Catherine Saget – ILO

The session brought the most vivid discussion of the day. Most views exposed were in favour of the Single Contract to combat dual labour markets. However some cautions were expressed, while others questioned directly the need for severance payment.

For Mario Centeno the Single Contract is a good tool to tackle many of the problems of segmented labour markets. These have high structural unemployment, wage flexibility, high worker rotation and very high wage inequality. They are a feature of labour markets with dual contract arrangement, low education and weak/extractive institutions.

The Single Contract would address the segmentation of the market, long-term unemployment and poor social protection. Among the benefits of the Single Contract are a reduction of the job rotation and improvement of the distribution of the costs of protection, eliminating the problem with temporary jobs. Temporary jobs are the port-of-entry jobs, making them a barrier to permanent positions.

For Mario Centeno, the cons of the Single Contract are small compared to the pros, but are still important to be aware of them. First it requires a large cost

of transition from multiple contracts to a unique contract. Also, possible issues on how to deal with the legacy market, and how to accommodate those countries idiosyncrasies. Finally, how to relate reforms with unemployment insurance and pensions.

Andrea Bassanini agreed with the positive effects of the Single Contract. For him other possible solutions are just not enough. The problem is not the level of protection of temporary and permanent workers, but the gap between them. A reduction in costs has started to be applied, but these leave many losers which require expensive policies to compensate them. Also restrictions of access to temporary contracts does not seem to determine the share of labour under temporary contracts. In addition, a legal limit on the duration of temporary contracts only reduces tenure and increases job insecurity.

The Single Contract would seem to solve these problems. However, it would be hard to predict the final outcome, as many other things matter and there are many temporary contracts. These contracts could be absorbed by temporary workers agencies, meaning this would just move the problem, and making it harder for low demand jobs.

The most important thing of a unified contract, is that the costs of dismissal are the same for everybody. Not just the severance payment, but it also affects fair and unfair dismissals, and collective dismissals. Some rules must be created to adjust for this, as including temporary workers in collective dismissals, and that an unfair dismissal must never be more expensive than the full wage until the end of the contract. Also the definition of “fair” dismissal must be broaden. At the end most examples of unified contracts (anglo-saxon countries) are characterized by a lack of regulation.

Catherine Saget as representative of the ILO explained that any reform must follow the ILO convention, including the Single Contract. This means that any employment conditions require: i) justification of termination, ii) procedure, iii) a period of notice, iv) severance allowance or other income protection, v) consultation of workers representatives and notification to the competent authority in case of collective dismissal and vi) exclusion. Some audience members pointed out that in some countries 81% of contracts (temporary contracts) are not covered by the ILO convention anyway.

At the end, the conversion rate and the length of jobs depend on the type of contract. Many countries have tried to regulate non-standard forms of

employment with varying degrees of success. And before any reform to a unified contract can be applied, it is necessary to address how many people would lose their jobs, or are at least more likely.

This session was characterized by a lively debate on the Single Contract and reform. Some called for caution when trying to apply the single contract, while others believed it may not be enough to solve the problems of dual labour markets. It could be possible that after introducing a single contract, if no further changes are applied, we end up with the same thing but with a different name. If you have low initial firing costs, under Single Contract you can still achieve the same result as the current dual market. Some argued that if this is the worst case scenario, then it shouldn't be too worrying to try, but others were sceptic on using political capital on a reform that may not be efficient.

Many practical issues were also found with the single contract. With fixed-term contracts, during the length of the contract workers are subject to the same EPL as permanent contracts. On the other hand, in open-ended contracts an employer can terminate a contract at any time, claiming the project for which the other worker was hired to do, has been completed. Also a single contract may be too rigid for economies with high cyclical labour, where a more flexible contract would be necessary. In addition, temporary contracts can be needed not just for cyclical jobs. A lesson learned during the implementation of the Jobs Act 2015 in Italy is that it is not good to talk about a Single Contract, as there is always an argument for temporary contracts.

For others, talking about the single contract is not enough, and it is more important to talk about the insider-outsider problem caused by representatives of workers, and not the contracts per se. While there is too much protection, it is obvious insiders want to protect themselves, but it should be Labour Economists that warn against this. On the other hand, some argue that while Fixed-term contracts are used to subsidise groups, it will not work forever, as industries are restructuring and those who benefit from the current contract have an advantage.

At the end, it seemed that considering other tools and types of contracts could be a more important tool for reform. For some, the protection of labour is already too high, and that talking about the single contract without lowering the cost may not be worth it. Some other ideas were mentioned, such as paying severance payments in the form of firm shares. Also, having the

severance payment not being linked to tenure, like it is the UK, which could be more efficient. Even some other tools, as flexicurity, could be better used to compensate for the asymmetry.

***iv) An Agenda for European Research on Labour Markets: youth misallocation and human capital: theoretical, policy and empirical changes.***

Chair: Richard Blundell – UCL

Discussion by Invited Speakers:

Michele Pellizzari – University of Geneva

Glenda Quintini – OECD

Etienne Wasmer – Sciences Po

Michelle Pellizzari covered the theoretical changes and challenges found when studying mismatch. He believes that when talking about mismatch, the literature is in dire need of more theory, as currently it has the fallacy of the composition of labour.

The broad definition of mismatch is the difference between the skills needed by the market and what is offered by the market. There is geographical mismatch, qualification skill mismatch and if the skills of a specific worker is appropriate for the specific job. He differentiates between what he called Macro-mismatch and Micro-mismatch. The former is a feature of the joint distribution of workers skills and firm's technologies, which takes into account the heterogeneity in terms of geographical location, industry and skills. There is no sense in which any single job-worker pair can be a good or bad match. The latter on the other hand is when the skills of a specific worker match or do not match those needed to carry out her job. It is a feature of the individual job-worker pair. Macro-mismatch has a solid theoretical foundations but is less influential in policy. Micro is the other way round.

This lack of theory has led to a variety of different measures. This makes it hard to compare without a clear definition of what they are meant to measure. The OECD tried to create a theory grounded definition, but it still has some problems. More needs to be done in order to improve theory and measurement.

Finally, he heeded some warning for policies trying to tackle mismatch. For some it seems that we need to predict better future needs of skills, but that is to be a fallacy, as the demand is endogenous to the supply and vice versa. Policies in the short run should try to bring those unemployed, with the skills needed, back to employment.

Policy was then further discussed by Glenda Quintini, especially for those needed to tackle the problem of youth misallocation. There is a large concern for the currently high levels of youth unemployment. During the Great Recession youth employment has gone down by 23% in the euro area. However, youth unemployment is not a perfect measure of youth difficulty. It is important to see if they are inactive or unemployed, and for this it is important to talk about the NEETs (Not in Education, Employment or Training).

About 80% of NEETs do not have a higher education. The skill level of NEETs' parents are lower than those of non-NEETs' parents. A third of NEETs do not leave with their parents. And single parents over represent NEETs.

Policy focused to help them can be divided in two, early intervention and youth guarantee. The first help on improving cognitive skills, personality traits and motivation. These impact education attainment, labour market performance, life-long health, crime and benefit dependency, but not without its challenges. It is hard to identify youth at risk, training professionals, problems with remote places and specially the coordination and involvement of families. Youth guarantee focuses on getting young people back to work. For this implementation is challenging, especially when unemployment is high. It must allow local areas with flexibility in design and execution, in order to strengthen local partnerships. However, they must also ensure financing and share results.

Some issues were raised by the audience. NEETs in Europe are not socially marginal as in the US, where early intervention programs have proven there worth. Therefore policies for them may not be the same as those in the US. Also Europeans move less in and out of inactivity and unemployment that in the US.

Etienne Wasmer presented an empirical and policy analysis of youth unemployment in France. To tackle the growing unemployment of 15-24 year olds in France there have been many programs creating up to 300,000 jobs a

year for young workers. Yet these policies have not seem to have solved the problem. In studies it seems as apprenticeships are a more useful tool.

When looking at youth unemployment geographical restrictions do not seem to matter much, as young workers are seem as very mobile. But there exists a high dispersion of geographical youth unemployment. Youth have poor access to social housing, especially in large cities. This can be an obstacle to mobility.

The current policy for youth unemployment is to give them jobs where there are no current private jobs, forcing them to stay where they shouldn't be. There are too many old people in big cities, which causes for housing prices there to rise, and creates a barrier for youth to move in areas where they have higher employment demand. At the end subsidised jobs will only encourage young people to stay in areas where there is low demand for their employment. A more efficient policy would be to offer them housing help.

The audience raised some issues, as the idea that housing prices may be inefficient, instead of just showing preferences. In addition, small cities may not want to encourage young people to go the city, as they benefit from having them there.



## Workshop on Labour Markets - Bruxelles 8 June 2015

Name	Surname	Affiliation
Ramon	Marimon	EUI
Juan	Dolado	EUI
Pablo	Forero	EUI
Jan	Eeckhout	Univ. Pompeu Fabra
Juan F.	Jimeno	Bank of Spain
Fabien	Postel-Vinay	UCL
Stefano	Scarpetta	OECD
Gilles	Saint-Paul	TSE
Marco	Leonardi	Milan
Pietro	Garibaldi	Collegio Carlo Alberto
Etienne	Wasmer	Sci-Po
Mario	Centeno	Bank of Portugal
Andrea	Bassanini	OECD
Richard	Blundell	UCL
Michele	Pellizzari	Univ. Geneva
Glenda	Quintini	OECD
Catherine	Saget	ILO
Eunate	Mayor	Toulouse School of Economics
Antonella	Trigari	Bocconi
Brigitte	Preissl	Intereconomics
Dasa	Farcnik	University of Ljubljana
Polona	Domadenik	University of Ljubljana
Xi	Chen	STATEC
Luca P.	Merlino	Université libre de Bruxelles
Bodo	Aretz	German Council of Economic Experts
Patrick	Legros	Université libre de Bruxelles
Piotr	Lewandowski	Institute for Structural Research (IBS)
Alfonso	Arpaia	European Commission
Cyrille	Schwellnus	OECD
Blanca	Sanchez-Robles	Spanish Embassy in London & University of Cantabria
Bart	Cockx	Ghent University
Alkistis	Zavakou	European Commission
Simone	Rosini	European Commission
Federico	Pancaldi	European Commission
Monika	Kiss	European Parliament
Julien	De Beys	European Commission
Fabiana	Pierini	European Commission
Georgios	PAPANAGNOU	DG Research & Innovation