Moving towards a single labour contract: pros, cons and mixed feelings

Juliette Schleich Nicolas Lepage-Saucier Etienne Wasmer

Sciences Po UQAM and Sciences Po Sciences Po

Organisation of the talk

1. General discussion on pros and cons of the single employment contract
2. Description of the contractual arrangements and recent reforms in Europe
3. Theoretical framework to discuss the coexistence of several types of contracts
4. Empirical illustration
5. Conclusion
The ‘single employment contract’

- Has been discussed for many years as a way to eliminate dualism in the labor market
- Idea: convergence between different types of contracts, several possibilities
  - Eliminate all non-standard forms of contracts
  - Eliminate only fixed-duration contracts
  - Create a new labor contract progressively replacing existing contracts (trialism?)
  - Create a new labor contract immediately replacing permanent contracts with progressive rights
    - most elaborate version, cf vox column by Bertola, Boeri and Cahuc in July 2010
The ‘single employment contract’

- General idea behind the proposal: there are costs associated with dualism in contracts.
  - Convergence of contracts is therefore needed.

- Tree hiding the forest? The forest is that there are social costs associated with employment protection (EPL)
  - The emergence of non-standard forms of contracts is the response of the business sector to EPL
  - Reform of the permanent contract is therefore needed, and this should be the primary focus of the discussion.
    - Otherwise: qui pro quo.
  - NB: EPL has positive aspects too. A reform should keep the good aspects.
Costs and benefits of EPL

Negative side

- Misallocation of workers in less productive units
- Underinvestment in physical capital (low capital/labour ratios at least for high levels of EPL)
- Reduces labour turnover
  - Mismatch of workers (stress and job insatisfaction)

Positive side

- Favors investment in specific skills
- Protects (to some extent) workers under permanent contracts
What are the costs of dualism?

- Higher inequality: reduced access to stable jobs, recurrent spells of temporary jobs
- Workers under temp. contracts may not have access to credit, housing
- High employment volatility
- Abuse (too many non-standard forms of employment)
- Too low training of workers under temporary contracts
- Stigma effect from being trapped into temp jobs
Would a single contract with progressive rights eliminate these costs of dualism?

- Key discussion is whether employees under “low seniority rights” will be treated differently from temporary workers
  - Higher inequality: no more protection
  - Access to credit, housing: may not change; need to be improved by specific policies
  - High employment volatility: “low seniority” may still be screened.
  - Abuse (too many non-standard forms of employment): comes from too high EPL, hence need to reduce EPL (political economy!)
  - Too low training of workers under temporary contracts: can be corrected by bonus-malus on fraction of the workforce trained.
  - Stigma effect from being trapped into temp jobs: what about being terminated during probation period?
France: is it the solution?

- Most recent report (Louis Gallois) on competitiveness (Nov. 5, 2012). Mostly about labor costs and R&D.
- However: there is a section on employment, but
  - No reference to a single contract
  - Explicit reference to Sécurisation des Parcours Professionnels, convergence of training and Pôle Emploi
  - Mostly about the complexity and duration of layoffs procedures, that is, about EPL for regular contracts, and legal insecurity
  - Suggest however to further limit the recourse to temporary employment
    - So, some partial and careful convergence.
Interesting interactions between $EPL_{reg}$ and $EPL_{temp}$

- $EPL_{reg}$ itself has two components: complexity and costs of individual layoffs; and complexity and cost of collective layoffs.

- $EPL_{temp}$ also has two components:
  - Valid cases for use of fixed-term contracts*0.5 + Types of work for which is legal *0.5
  - Max. num. of successive FTC*0.25 + Max. cum. duration FTC*0.25 + same for TWA
Lepage-Saucier and Wasmer (2012) Does employment protection raise stress? A cross-country and cross-province analysis

Table 1: Effect of EPL on workplace stress: cross-sector/country identification (EWCS 2000, 2001, 2005 and Eurobarometer 1996)

<table>
<thead>
<tr>
<th>Main variable</th>
<th>Main spec.: DDD</th>
<th>Linear probability model (2-Step GLS estimation)</th>
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<tr>
<td></td>
<td>1</td>
<td>2</td>
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<tr>
<td>EPL_{ct}\times JD_s</td>
<td>4.51***</td>
<td>4.77***</td>
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<tr>
<td></td>
<td>(1.58)</td>
<td>(0.89)</td>
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<td>EPL_{ct}</td>
<td></td>
<td></td>
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<td></td>
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<tr>
<td>dEPL_{ct}\times JD_s</td>
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<tr>
<td>mean EPLc</td>
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<td>Indiv. Controls</td>
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<td>Y</td>
</tr>
<tr>
<td>Country Controls</td>
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<td>Y</td>
</tr>
<tr>
<td>Time dum.</td>
<td>Y</td>
<td>Y</td>
</tr>
<tr>
<td>Sector dum.</td>
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<td>Y</td>
</tr>
<tr>
<td>Country dum.</td>
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<tr>
<td>Country\times Year dum.</td>
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<tr>
<td>Sector\times Year dum.</td>
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<td></td>
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<tr>
<td>Country\times Sector dum.</td>
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<td>Y</td>
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<td>22,732</td>
</tr>
<tr>
<td>Num. of clus.</td>
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<tr>
<td>Adjusted R²</td>
<td>0.782</td>
<td>0.747</td>
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</tbody>
</table>
Lepage-Saucier and Wasmer (2012) Does employment protection raise stress? A cross-country and cross-province analysis

Table 4: Effect on workplace stress of EPL components, interaction between EPL components (EWCS 2000, 2001, 2005 and Eurobarometer 1996)

<table>
<thead>
<tr>
<th>Main variable</th>
<th>3 components individually</th>
<th>Product of 3 comp.</th>
<th>Product of EPL components 2x2</th>
</tr>
</thead>
<tbody>
<tr>
<td>EPL_ind(c_t)×JD(_s)</td>
<td>-5.23 (-4.36 - 6.50)</td>
<td>-5.39 (-4.36 - 6.50)</td>
<td>13.4 (12.6 - 14.2)</td>
</tr>
<tr>
<td>EPL_coll(c_t)×JD(_s)</td>
<td>38.3*** (36.7*** - 40.1*** )</td>
<td>43.8*** (42.2*** - 45.4*** )</td>
<td>12.6 (9.03 - 16.2)</td>
</tr>
<tr>
<td>EPL_temp(c_t)×JD(_s)</td>
<td>3.40*** (2.83*** - 4.28*** )</td>
<td>4.63*** (3.89*** - 5.37*** )</td>
<td>5.21** (4.26*** - 6.05)</td>
</tr>
<tr>
<td>EPL_temp_valid(c_t)×JD(_s)</td>
<td>0.425 (0.066)</td>
<td>0.425 (0.066)</td>
<td>1.83** (0.66)</td>
</tr>
<tr>
<td>EPL_temp_limit(c_t)×JD(_s)</td>
<td>1.83** (0.66)</td>
<td>1.83** (0.66)</td>
<td>1.83** (0.66)</td>
</tr>
<tr>
<td>EPL_pro(c_t)×JD(_s)</td>
<td>8.57*** (2.88)</td>
<td>8.93*** (1.28)</td>
<td>8.93*** (1.28)</td>
</tr>
<tr>
<td>EPL_ind×EPL_coll</td>
<td>13.4 (12.6 - 14.2)</td>
<td>12.6 (9.03 - 16.2)</td>
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</tr>
<tr>
<td>EPL_temp×EPL_ind</td>
<td>5.21** (4.26*** - 6.05)</td>
<td>6.40*** (4.87*** - 8.93)</td>
<td>5.38*** (4.87*** - 6.88)</td>
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<td>5.38*** (4.87*** - 6.88)</td>
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Indiv. Controls: Y = Yes, N = No
Comm.xYear dum.: Y = Yes, N = No
Sector x Year dum.: Y = Yes, N = No
Comm.xSect. dum.: Y = Yes, N = No
Num. of obs.: 22,732
Num. of clusters: 21
Lesson

These tables say that:

- Overall EPL raises stress
- This is due to costs of collective layoffs (goes in the direction of rapport Gallois is right here) and restrictions for temp, and their product (complementarity).
- Interpretation: temporary contracts undo EPL for regular contracts: rapport Gallois ignores this dimension.
  - As a matter of fact, as single contract acts as reducing the margin of adjustment offered by temporary contracts (increase in $EPL_{temp}$).
Overview of the single employment contract
European Countries dominated by Dualism

Figure: Proportion of employees with a contract of limited duration (% of total employees aged 15 to 64) in 2010

Source: Eurostat (online data code: #s.a.etpga)
The UK, Italy and Denmark have the lowest EPL of the group (respectively 1.64, 1.77 and 1.90)

- Denmark’s low EPL stems from it’s flexicurity system:
  - flexible contractual arrangements
  - high social protection including strong income support
  - strong active labour market policies

- Example of Denmark suggests that low EPL is still associated with 9 to 10% of limited duration contracts!
Diversity of EPL for Temporary Contracts among European countries

- In the Netherlands and in the UK: no limitation to the use of Fixed Term Contracts $\rightarrow$ low EPL
- In France: CDD can only be used in 9 specific cases + limitation in the duration of FTC $\rightarrow$ high EPL
Eliminating dualism in theory

1. Keep only the existing ‘open-ended contracts’ (and dismiss all the forms of temporary contracts)

2. Replace all existing contracts by a single contract

   - **the ‘pure’ single employment proposal**: single employment contract should replace all existing forms of employment contracts

   - **the ‘extended’ single employment contract proposal**: smaller and more specific employment contracts such as agency or interim contracts remain (Andres, 2009)
     
     - **extented trial period**: the single employment contract would have two periods: a probationary period and a normal permanent period
     
     - **reduced dismissal requirements**: extend the number of motives for termination of the regular employment contract (Céline Gleize 2011 & Cahuc and Kramarz 2004)
Limiting dualism in practice

- The February 2012 reform in Italy:
  - rationalization of the different types of contracts (40 different legal types of contracts brought down to 8)
  - implementation of a new open-ended contract (in replacement of traditionnal permanent contract) with a 3 year trial period, after which the worker would be permanently employed (fits Ichino’s view of the world: no absenteism under probation!)

- The March 2012 reform in Spain:
  - creation of a new open-ended contract (for small and medium companies: less than 50 workers, and independent workers): 1 year probationary period, provides tax breaks for employers who hire specific workers
  - restriction of the use of fixed term contracts: max duration of 24 months
Convention 158 of the ILO: a legal obstacle?

- **little relevance to the situations covered by Article 2** (grants exceptions for workers employed for a specified period of time or a specified task, workers serving a period of probation or a qualifying period of employment determined in advance and of a reasonable duration and workers engaged on a casual basis for a short period).
- **significantly departed from the workers’ protections’ requirements of article 4** (establishes the need to base termination of employment on a ‘valid’ reason. The reason given must be connected with either the capacity of the worker, the conduct of the worker or the operational requirements of the undertaking establishment or service)
- July First, 2008: Cour de Cassation rendered the CNE reform illegal.
Is it really worth the trouble?
Dualism may survive even with a single labour contract: The example of the United States

- United States’ ‘at-will’ employment system, much like a ‘would-be’ single labour contract, applies to all workers
  - An employer can terminate an employee at any time for any reason (except an illegal one), or for no reason, without incurring legal liability
  - Yet persistent divisions among American workers remain
    - there are wage differentials among workers (which cannot be explained by productivity differences)
    - there is heterogeneity in the labour market turnover rate.
Is it really worth the trouble?

- Dualism may survive even with a single contract and lengthy trial periods or low dismissal requirements
- Progressive severance payments can be implemented independently of a single contract
- Dualism may take different forms: the risk of a surge in agency contracts or training contracts, unless fully eliminated at a huge economic cost.
- Implementation of a single labour contract: some major labour market issues would remain:
  - the uncertainty and length of layoff procedures for employers
  - the distortive effects on capital accumulation and misallocation of productive units
  - the fear of layoff for workers and the job insecurity triggered by it
  - the stress of workers
What is the demand for temporary work?

- Illustrative: reduced form of a more microfunded model
- Bottom line: there is a positive demand for temporary contracts
- The demand is higher in recessions, under volatile demand and under workers’ heterogeneity
Firm’s value functions
A trade-off between temporary contracts and permanent contracts

- Initial value of workers: $V_0$. Workers differ by their perceived risk of unprofitability next period, $\epsilon$.
- Trade-off between contracts:
  - Permanent contracts have low quit rate $q_P$, but layoffs cost $F$.
  - Temporary contracts can be allowed to expire at no cost, but have higher chance of quits/non transformation $q_T$ or lower productivity $(1 - q_T)$ due to lower training or h.c. investment.
- Expected value of giving a temporary or permanent contract:

\[
V_P(\epsilon) = V_0 + (1 - q_P) \int_y^{\hat{y}} \max(\hat{y} - w; -F) dG_\epsilon(\hat{y})
\]

\[
V_T(\epsilon) = V_0 + (1 - q_T) \int_y^{\hat{y}} \max(\hat{y} - w; 0) dG_\epsilon(\hat{y})
\]
Hiring decision

\[ y = 1, \ w = 0.5, \ q_P = 0, \ q_T = 0.2, \ F = 0.05 \]

Figure 5: Expected value of worker and expected % of workers kept according to \( \epsilon \) and the type of contract
Fraction of workers hired and fired as function of layoff costs
Dualism increases with firing costs

Figure 6: Impact of layoff costs $F$ on contracts ratios, ($F \in [0.03, 0.2]$)
Fraction of workers hired and fired as function of layoff costs as a function of the non-transformation rate
Dualism decreases with restrictions on temporary contracts

Figure 7: Impact of parameter $q_T$ (quit rate or non-transformation rate of temp. contracts) on contracts ratios ($q_T \in [0.05, 0.33]$)
Fraction of temporary contracts
Incidence (new hires) and stocks

Figure 8: Stocks and inflows/incidence of temporary contracts as a function of layoff costs $F$ and restrictions $q_T$ to temporary contracts.
Fraction of temporary contracts as function of aggregate productivity. Dualism increase and then decreases with productivity

Figure 9: Impact of aggregate productivity $y$ on contracts ratios ($y \in [0.8, 1.2]$)
Introduction
Overview of the single employment contract
A model of workers’ heterogeneity and temporary contracts
Empirical illustration and concluding comments

Setup
Positive effect of EPL on temporary contracts demand
Ambiguous effect the business cycle on temporary contracts
Possibility of multiple equilibria

Fraction of temporary contracts as function of aggregate productivity
it has an ambiguous effect on dualism

Figure 10: Stocks (blue curve) and inflows/incidence (red curve) of temporary contracts as a function of aggregate productivity ($y \in [0.8, 1.2]$)
Business cycle volatility increases dualism

Figure 12: Impact of the volatility of the business cycle (variance of $y$) on contracts ratios ($\delta \in [0, 0.3]$)
Fraction of temporary contracts as function of business cycle volatility: dualism increases with volatility

Figure 13: Stocks (blue curve) and inflows/incidence (red curve) of temporary contracts as a function of aggregate uncertainty $\delta$: in good times, $y + \delta$, in bad times, $y - \delta$ ($\delta \in [0, 0.3]$)
Optimal choice of temporary contracts
if temporary contracts influence firing costs

- The structure of firing costs may not be linear (Abowd and Kramarz, 2003, Kramarz and Michaud, 2010).

- Laying off permanent workers while keeping a fraction of temporary workers may be costly
  - break down the implicit contract with permanent workers (a last in, first out clause)
  - may reduce their level of effort

- But: Firms want to keep their “good workers” regardless of the contract under which they were hired.
  - Example: Proposal by ANDRH: Suppress temporary contracts, without changing permanent contracts.

- If $F$ is lower in the absence of temporary contracts: possibility of multiple equilibria.
Optimal choice of temporary contracts
if presence of temporary workers influence firing costs of permanent workers

Figure 14: Firm profits and total worker’s wage as function of choice of temporary contracts
Concluding comments
The share of temporary contracts depends on

1. Long-run growth (<0)
2. Short-run growth (business cycle) (>0 then <0)
3. Business cycle volatility (>0)
4. (Perceived) heterogeneity in skills hence risk (>0)
5. Protection of regular contracts (>0)
6. Restrictions to temporary contracts (<0)

Additional costs to dualism.
Overview of the single employment contract
A model of workers' heterogeneity and temporary contracts
Empirical illustration and concluding comments

### Empirical Illustration

#### Table 2: Determinants of the incidence of temporary contracts

<table>
<thead>
<tr>
<th>Dep var: Portion of temporary employment in new jobs</th>
<th>Between</th>
<th>Within</th>
<th>Within+country trend</th>
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</thead>
<tbody>
<tr>
<td></td>
<td>1</td>
<td>2</td>
<td>3</td>
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<tr>
<td>Restrictions to temporary contracts</td>
<td>1.97</td>
<td>1.71</td>
<td>0.72</td>
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<tr>
<td></td>
<td>(1.66)</td>
<td>(1.58)</td>
<td>(1.65)</td>
</tr>
<tr>
<td>Employment protection of regular contracts</td>
<td>6.69**</td>
<td>6.90**</td>
<td>7.59*</td>
</tr>
<tr>
<td></td>
<td>(2.91)</td>
<td>(2.90)</td>
<td>(4.36)</td>
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<tr>
<td>Growth rate</td>
<td>-1.31***</td>
<td>-1.49</td>
<td>-0.45***</td>
</tr>
<tr>
<td></td>
<td>(0.49)</td>
<td>(1.45)</td>
<td>(0.16)</td>
</tr>
<tr>
<td>Restrictions to temporary contracts × growth</td>
<td>0.31</td>
<td></td>
<td>-0.01</td>
</tr>
<tr>
<td></td>
<td>(0.19)</td>
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<td>(0.05)</td>
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<td>Protection of reg. contracts × growth</td>
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<td>0.01</td>
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<td>(0.58)</td>
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<td>(0.21)</td>
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<td>Country dummies</td>
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<td>Nb. of observations</td>
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<tr>
<td>Nb of clusters</td>
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<tr>
<td>Adjusted $R^2$</td>
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<td>0.220</td>
<td>0.222</td>
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Least squares regressions, cluster-robust standard errors in parentheses, *** p<0.01, ** p<0.05, * p<0.1

Employment protection and growth rates are lagged one year

### Empirical Illustration

Table 3: Determinants of the incidence of temporary contracts

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<tr>
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<td></td>
<td>(1.91)</td>
<td>(1.89)</td>
<td>(2.13)</td>
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<tr>
<td>Employment protection of regular contracts</td>
<td>12.84***</td>
<td>12.71***</td>
<td>17.83***</td>
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<td></td>
<td>(3.44)</td>
<td>(3.40)</td>
<td>(5.50)</td>
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<tr>
<td>Growth rate</td>
<td>-0.63</td>
<td>2.52</td>
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<td></td>
<td>(0.80)</td>
<td>(2.08)</td>
<td>(0.17)</td>
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<td>Restrictions to temporary contracts×growth</td>
<td>0.12</td>
<td>-0.04</td>
<td>-0.02</td>
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<td>(0.30)</td>
<td>(0.06)</td>
<td>(0.08)</td>
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<tr>
<td>Protection of reg. contracts×growth</td>
<td>-1.58*</td>
<td>-0.29</td>
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<td>(0.92)</td>
<td>(0.30)</td>
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<td>Adjusted $R^2$</td>
<td>0.521</td>
<td>0.524</td>
<td>0.535</td>
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GLS estimation, weighted by country’s average total declared workers over the period
Cluster-robust standard errors in parentheses, *** p<0.01, ** p<0.05, * p<0.1
Employment protection and growth rates are lagged one year
Concluding comments

- Starting point: some consensus in favor of a single contract. After a discussion of the costs and benefits, mixed feelings.
  - Clear costs and benefits associated with employment protection
  - Less clear costs of dualism and most can be eliminated by alternative policies (training, housing, credit) or would remain if EPL is maintained.

- Political economy is complex: single contract is a quid pro quo. Should not be a quiproquo.
  - Disappearance of temporary contracts in exchange for an extended probation period: Would unions easily accept it?
  - Severance payment increasing with seniority in the current job. But strongly reduces incentives to professional mobility.
Concluding comment

- Flexicurity is a more appealing trade-off:
  - Lower employment protection but higher unemployment benefits combined with incentives to accept job offers, and supplemented with active labour market policies and efficient training.
  - Clear trade-off.
Impact of aggregate productivity on hiring choices

Expected value of a worker
Change after increase in expected productivity $y'$

Hiring cost: $H$
Perceived risk of low productivity: $\varepsilon$

Firm offers a permanent contract
Firm offers a temporary contract
Firm rejects the application: no hire

$V_p$
$V_t$

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