

## Behind the Job Miracle

Tito Boeri

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There is a sea change with respect to the labour market conditions investigated in the 1994 OECD Jobs Study. Over the last few years several European countries, and notably most Mediterranean countries (the so called Olive belt countries) experienced protracted employment growth despite moderate output growth. This performance stands in sharp contrast with the "jobless growth" of the eighties and mid nineties. In a nutshell, we moved from "jobless growth" to "growthless job creation".

While the determinants of jobless growth were deeply investigated by the 1994 OECD Jobs Study, this "job miracle" is only partly addressed in the current reassessment of the OECD Jobs Strategy.

In my presentation I stress that the "job miracle" is an indication of both the effectiveness and the limitation of the reforms of labour market institutions carried out in the interim period, notably the reforms of employment protection legislation, which are reviewed in the OECD reassessment. Such reforms introduced two-tier systems, as the increase labour market flexibility took place mainly through a series of marginal reforms that liberalized the use of fixed-term contracts, while leaving largely untouched the legislation applying to the stock of workers employed under open-ended contracts. After the reforms, the use of fixed term contracts for new hires, which had been largely restricted up to the early eighties in Spain and the early nineties elsewhere, became more and more flexible over time. These marginal labour market reforms offered a viable mechanism to win the political opposition of insider workers.

While the effects of EPL on labour demand have been thoroughly investigated theoretically and empirically, the literature has devoted much less attention to the transitional dynamics of such two-tier reform strategies. The traditional analysis predicts no sizeable permanent employment effect associated to (radical) EPL reforms. The reduction in EPL is indeed bound to increase employment volatility over the business cycle, but should not have any obvious effect on average labour demand. This is because

EPL affects both the incentives to hire and to dismiss workers, and there is no reason to believe a-priori that one effect could dominate the other. However, a move from a fully rigid to a two-tier regime may be associated with a temporary increase in employment, and a fall in average productivity, as firms adjust fully employment upwards when product demand conditions improve and only partly when they are hit by negative demand shocks. This induces the increase in average employment levels and decline in labour productivity, which has been observed not only at the macro level, but also drawing on microeconomic data on firms.

If this explanation of the “job miracle” is convincing, then there are reasons to think that it may be a temporary, honeymoon, phenomenon. In order to make the progress in labour market conditions sustainable, the reforms should now be completed. A politically viable option avoiding an intergenerational conflict that would, almost unavoidably, favour the older insider workers, is to define a tenure track to the labour market, increasing gradually employment protection together with the investment in job specific human capital.

Currently, workers in the new contracts are often segregated in a secondary labour market, and face much higher unemployment and longevity risks than their counterparts with permanent (or regular) contracts. Indeed, this strong job creation is not paying off the Governments that carried out the reforms and there are mounting requests to reverse the trend, phasing out the reforms that introduced labour market flexibility at the margin. This way of reacting to the problem would be a step in a wrong and dangerous direction. A sensible and credible long term reform plan should instead offer a clear “tenure track” prospect to young workers. Currently, there is no long term prospect after the expiration of a temporary contract. A more sensible policy should aim at promoting permanent entrance in the permanent labour market in stages, introducing employment protection with gradualism and avoiding the formation of a long term dual market. Job security provisions, in the form of mandated severance payments, should increase smoothly as workers acquire tenure without large discontinuities. Young workers would likely accept the idea of a “tenure track” in the labour market. Unions may like it less, but if they oppose it, it would be clear for everybody that they do it to protect the insiders and in opposition of the aspirations of the young generations.