

Dual Labor Markets and the Equilibrium Distribution of Firms

by J. Pijoan-Mas and P. Roldan-Blanco

Discussion by Edouard Schaal

CREI, ICREA, UPF and BSE

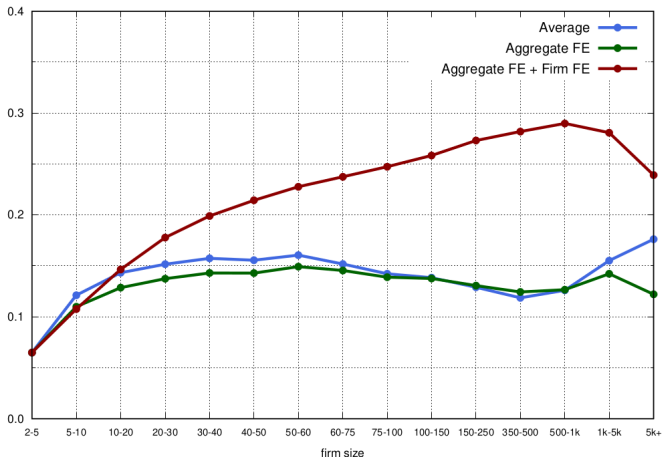
ECB-CEPR Labour Market Workshop 2022

- Coexistence of **open-ended** (OE) and **fixed-term** (FT) contracts is pervasive in Europe (“**duality**”)
 - ▶ FT contracts provide needed flexibility to firms in a “rigid” market
 - ▶ But they create important inequalities (income, housing market, financial services, human capital, intergenerational...)
 - ▶ Many calls to abolish two-tier system in favor of a unique contract (Tirole, 2016)
- Large literature that studies worker-side implications, less on firm side
- **Pijoan-Mas and Roldan-Blanco (2022):**
 - ▶ How does duality affect firm dynamics and the equilibrium firm distribution?
 - ▶ Implications for unemployment, welfare, productivity?

Empirics

Three main facts:

- Fact #1: share of temporary workers is highly **heterogeneous**
- Fact #2: tiny fraction explained by aggregate/sectoral, most by **firm FE**
- Fact #3: share of temporary workers increases in **firm size**



- **Directed search** framework with multiworker firms
 - ▶ Kaas and Kircher (2015), Schaal (2017), Roldan-Blanco and Gilbukh (2021)
 - ▶ Efficient benchmark with complete dynamic contracts
- Two types of contracts $i = OE, FT$ that differ in:
 - ▶ Matching efficiency A_i
 - ▶ Firing costs $C^F(\delta_i) = \chi_i \delta_i^{\psi_i}$
 - ▶ Exogenous separations s_i^W
 - ▶ Promotions $FT \rightarrow OE$
 - ▶ Enter differently in production

$$Y(\vec{\pi}, z) = \exp(z) (\omega n_{OE}^\alpha + (1 - \omega) n_{FT}^\alpha)^{\frac{1}{\alpha}}$$

Quantitative Results

- Model is calibrated to match various moments
 - ▶ **Key:** UE & EU rates for OE vs. FT contracts; temporary share by size
- Key trade-off:
 - ▶ FT contracts have higher **matching efficiency** $A_{FT}(1.53) > A_{OE}(0.42)$
 - ▶ But higher **exogenous separation** $s_{FT}^W(0.52) > s_{OE}^W(0.05)$
 - ⇒ FT workers are cheap but face high turnover
- The model can rationalize why large firms use more FT workers :
 - ▶ **Productive firms prefer OE** because high opportunity cost of not filling vacancies
 - ▶ Large firms with low marginal product (DRS) **prefer FT workers**
- **Policy counterfactuals:** reduce duration of FT contracts (higher s_{FT}^W)
 - ▶ temporary share ↘, unemployment ↘
 - ▶ **BUT:** productivity ↘, output ↘ because a key input becomes more expensive!

In Praise of the Paper _____

- Super important topic that deserves more study
 - ▶ Possibly important policy impact
 - ▶ Huge demand from politicians/general public
- Extremely well executed paper:
 - ▶ Clean state-of-the-art model with lots of features
 - ▶ Super transparent, clear desire to understand and explain
- Kudos to the authors!

- It would like to see more on **Spanish institutional background**
 - ▶ How many times can an FT contract be renewed? Do firms have an obligation to promote workers after a while?
 - ▶ Limits on the number of FT contract at the same time?
 - ▶ More on the legal framework: social security, payroll taxes, firing costs?
- By focusing on firms, the authors seem to avoid **worker-side** characteristics
 - ▶ Obvious data limitations...but it matters to understand firm incentives
 - ▶ Which types of jobs are given to FT workers (**tasks/occupations**,...)?
 - ▶ Who are the workers employed in FT jobs (**young, low educated**,...)?
- In the data, why focus specifically on firm size?
 - ▶ What about **age, volatility** of demand, **growth rate**?
 - "hockey stick" graph with decomposition of hires and separations b/w OE vs FT
 - ▶ **Occupation composition** (production/admin, skilled/unskilled)?

- Why model FT workers as a **separate input**?
 - ▶ Unclear why two legal contracts enter production differently
 - ▶ Maybe justifiable in a model of tasks and worker heterogeneity...
 - ▶ But hardwires the need for both types of workers
 - ▶ Also matters a lot for misallocation and productivity results...
- Why should **matching efficiency** be higher for FT contracts?
 - ▶ Required here to make FT contracts desirable
 - ▶ Data: $UE_{FT} > UE_{OE}$, but is it also true for job filling rate?
 - ▶ In practice, this must be an **endogenous** outcome:
 - Firms understand that OE workers will stay long, so tougher screening process → lower acceptance probability, higher recruiting costs
 - On the other hand, FT workers may be assigned to task that require less talent or specific knowledge → easier to recruit
 - Selection on worker side: large pool of FT workers with lower outside options
 - ▶ Modeling all this is hard, but is exogenous matching efficiency a good proxy?

Comments: Are these the right trade-offs? _____

- FT is usually perceived as the **most flexible** contract
 - ▶ Businesses like to hire cheap, expendable FT workers to compensate for excess rigidity of OE workers
 - At the cost of getting lower skilled workers with weak attachment
 - ▶ A big part comes from large severance payments for OE workers
 - But severance payments **DO NOT** matter here
 - Is the choice of contracting model wise (complete and efficient)?
- Here instead, FT contracts are quite bad for firms:
 - ▶ Were it not for a higher matching efficiency or for entering as a separate input...
 - ▶ **Least flexible**: high exogenous separations (10x) and endogenous not allowed
 - ▶ Only way to escape this fate is by promoting worker...
 - ...but the workers then shows up as OE in production
 - ▶ Bottom line: FT workers are essentially a **costly essential input**
- Interpretation of policy counterfactual:
 - ▶ Shortening duration of FT contracts basically make that input **even more costly**...
 - ▶ But does NOT capture the fact that FT contracts fulfill flexibility needs of businesses

Comments: Temporary Share by Size

- Intuition why large firms have more FT workers seems **ambiguous**
 - ▶ Productive firms, who are usually large, prefer OE...
 - ▶ So this must come from large unproductive firms

- Who are the **large firms**?

- ▶ Productivity process is very volatile and not super persistent:

$$d \log(z_t) = -0.2053 \log z_t dt + 0.1700 dB_t$$

- ▶ Here: frictions+lack of persistence

- large firms are those with history of positive shocks
- growth rate of large firms in this model is likely **negative on average**

- Is this a good model of **large firms**?

- ▶ Perhaps not, but this is common to this literature
- ▶ This type of models usually do not match well the firm size distribution:
 - Fail to deliver Pareto tail, Gibrat's law...
 - To fix it typically requires persistent fat-tailed shocks or random walk
- ▶ But they usually do well in matching job flow dynamics

- Perhaps forget about role of size to concentrate on **firm growth**?

- ▶ OE/FT hires and separations for growing vs. contracting firms?

Conclusions ---

- Great topic
- A beautiful paper by extremely skilled authors
 - ▶ A great display of modeling skills and how to conduct serious quantitative work!
- My main suggestions:
 - ▶ Expand empirics to other observables and go beyond firm size
 - ▶ Concentrate on getting the mechanism right