Labour Supply and Incentives to Work in Europe

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DISCUSSION

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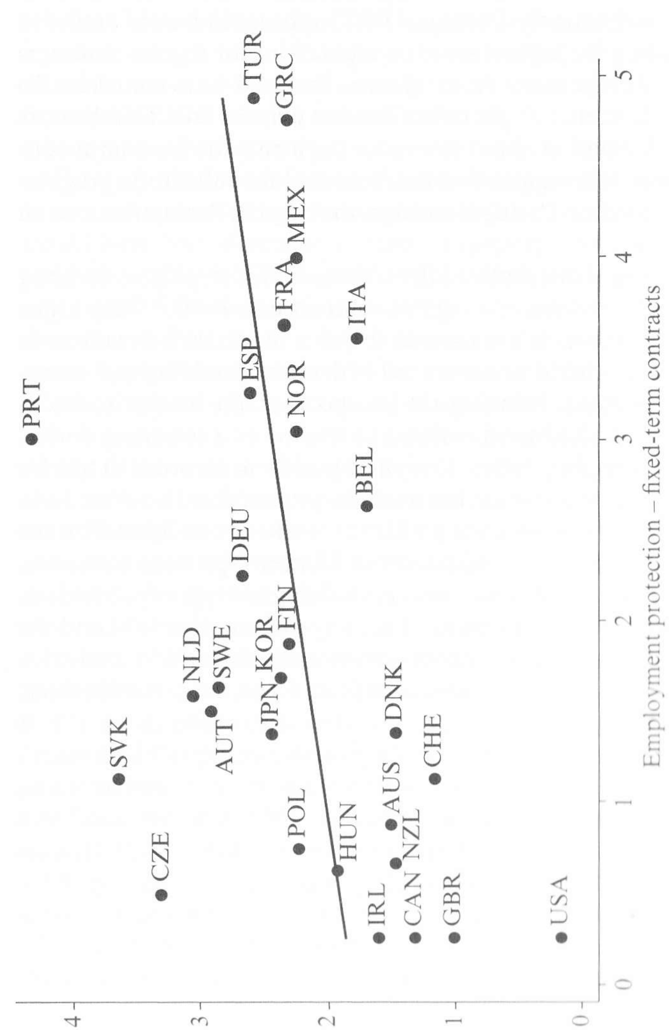
In this chapter José Varejão and Pedro Portugal study the consequences of employers' use of fixed-term contracts for workers' employment and wage dynamics in the Portuguese economy. The analysis relies on data from a representative household survey spanning from the first quarter of 1998 to the third quarter of 2000.

The topic is of major relevance in the current European policy debate, which is characterized by the opposing views of those who consider fixed-term contracts as 'stepping stones' to more stable employment relationships, and those who view fixed-term contracts as synonyms of low quality jobs or 'dead-ends', characterized by high insecurity and little training.

The chapter is well written and focused and the analysis is well executed. My discussion will be divided into three parts. First I will briefly put into an international context the Portuguese situation regarding the regulation of fixed-term and open-ended contracts. Second I will describe the characteristics of the analysis performed by the authors and discuss their main findings. Finally I will discuss their empirical strategy and suggest a number of directions in which the analysis could be extended and possibly improved.

Fixed-term contracts might be used by employers for a variety of reasons: to engage workers in seasonal or casual work duties, as a buffer stock to economic fluctuations or as a screening device. The first type of jobs may not easily lend themselves to permanent contracts, while in principle the second and third set of motivations could be achieved either with fixed-term or permanent workers. In the latter cases, the set of rules and regulations, together with the social norms governing the labour market, will determine the employers' choice of a specific type of contract. The rules and regulations governing the termination of contracts in Portugal are very restrictive when compared with other OECD countries. According to the OECD (2004), Portugal ranked second regarding the stringency of employment protection regulations during the period of analysis considered by the authors, only surpassed by Turkey. However, it is probably not the overall stringency of employment protection that matters for employers at the time of deciding whether to hire a new worker on a fixed-term versus a regular contract, but instead the relative stringency of regulation of dismissals for fixed-term versus open-ended contracts.

The OECD indicators allow distinguishing between regulations governing both contractual figures. These cardinal measures assess the overall stringency of regular and fixed-term contracts on a scale from 0 to 6 according to



Note: Abbreviations: AUS Australia, AUT Austria, BEL Belgium, CAN Canada, CZE Czech Republic, DNK Denmark, FIN Finland, FRA France, DEU Germany, GRC Greece, HUN Hungary, IRL Ireland, ITA Italy, JPN Japan, KOR Korea, MEX Mexico, NLD Netherlands, NZL New Zealand, NOR Norway, POL Poland, PRT Portugal, SVK Slovakia, ESP Spain, SWE Sweden, CHE Switzerland, TUR Turkey, GBR United Kingdom, USA United States.

Figure 8D.1 The regulation of fixed-term and open-ended contracts in OECD countries the increasing strictness of regulatory provisions. Figure 8D.1 presents a cross-plot of the regulation of fixed-term and regular contracts in OECD countries. It clearly shows a positive association between both measures, suggesting complementarities between regulations of fixed-term and open-ended contracts. Interestingly, Portugal (PRT) appears as a clear outlier in the graph, presenting the highest score on regulations for regular contracts and a just above average score on regulations for fixed-term contracts. To some extent, this difference might reflect the fact that the OECD indicators do not include information about severance payments for fixed-term contracts. Nevertheless, this suggest that the incentives for substituting regular for fixed-term contracts in Portugal are high, making the Portuguese case an interesting case study.

Varejão and Portugal discuss the different reasons for employers deciding whether to offer a fixed-term or a regular contract to a worker. They argue that, if fixed-term contracts are used as a buffer stock to fluctuations in labour demand, they should be associated with more instability and uncertainty and lower training, harming the prospects of the worker to find a better job. Instead, if fixed-term contracts are used as a screening device, they might act as 'stepping stones' to regular positions. In order to test for these two conflicting hypotheses, the analysis proceeds in two directions. First the authors examine the wage profiles of workers, conditional on the type of contract, following the estimation of Mincer-type wage equations. Second they study the transitions of workers holding any type of job to three labour market states (unemployment, inactivity and another job) and the transition of workers holding a temporary contract to three additional exits: another fixed-term contract, an open-ended contract and non-employment.

The analysis of wage profiles suggests a clear distinction in the effects of holding a temporary contract depending on the timing of the worker's career. Young workers at early stages of their career have similar wages irrespective of the type of contract. However, older workers holding a fixed-term contract suffer from important wage penalties, which increase from 10 per cent at the age of 30 to 20 per cent for workers aged 50. Unfortunately the short span of the data does not allow for properly identifying long-run wage effects of holding temporary contracts, but the cross-sectional evidence suggests important differences for different types of workers.

As expected, the analysis of workers' transitions shows that workers holding temporary contracts have a higher unconditional probability of changing labour market status. Interestingly, the duration analysis shows that the transitions of fixed-term contracts to open-ended contracts increase with tenure. This is interpreted as evidence of employers and workers' use of temporary contracts as a screening device. While bad matches are quickly destroyed, those workers surviving longer periods with temporary contracts are more likely to obtain a fixed-term contract. This is one possible interpretation of the result. Alternatively, it might be argued that individuals holding contracts for longer periods might signal themselves as high ability individuals, having a higher probability of obtaining a permanent job outside the firm. Unfortunately, the authors cannot distinguish between workers obtaining a permanent contract within the same firm and workers moving to another firm with a permanent contract after a fixed-term contract spell.

There are a number of issues that could complement the current analysis. In general, a more detailed discussion of the characteristics of the sample would have been desirable. I found surprising some choices in the set of control variables included, and I suppose that some simply reflect the characteristics of the data set. An important control variable that is missing is the size of the firm, since it is well known (and the authors discuss this point in the chapter) that firms with different sizes have different attitudes towards flexible forms of employment. Also, since the analysis cannot distinguish between seasonal and short-term jobs, it would have been important to clarify if the sample includes workers in the agricultural sector, which is characterized by the employment of a high number of seasonal workers.

At first sight it is surprising that the authors pool all types of workers in their analysis, making no distinctions across genders. One would expect that the consequences of holding a fixed-term contract are different for male and female workers, given different labour market attachment and human capital decisions (see for instance Booth et al., 2002). However, the high participation of female workers in the Portuguese labour market might justify this choice.

Finally, the analysis would greatly benefit from the expansion of the period of study. As the authors point out, the short period of analysis represents an overall expansion. Not having a full cycle will affect the estimated transitions between labour market states and might also affect the conclusions obtained from the analysis. During a period of expansion we are expected to observe more transitions from fixed-term to open-ended contracts and fewer transitions from the former to unemployment, reducing the estimated costs of these flexible working arrangements.

References

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