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Temporary jobs, employment protection and labor market performance☆

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Abstract

The simultaneous use of strong employment protection and temporary jobs observed in many European countries seems contradictory since the former aims at limiting job destruction while the latter intensifies it. We analyze the combined impact of those two instruments using a matching model. We find that it may be the willingness of a majority of workers to support the *combination* of two instruments with opposite effects on job destruction and job creation that increases unemployment and reduces efficiency. Moreover, while inefficient, this combination may be supported by a majority of workers, depending on firm ownership concentration. *Laissez faire* is the preferred point of a majority of workers when firm ownership is dispersed, whereas a combination of job protection and temporary jobs is preferred by workers when it is concentrated. © 2002 Elsevier Science B.V. All rights reserved.

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1. Introduction

In response to the dramatic rise in unemployment faced since the end of the 1970s, many European governments made a simultaneous use of two apparently diverging policy

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instruments. The first one clearly pushed in the direction of a more stringent labor market regulation: It consisted of maintaining or even sometimes reinforcing generally already strong legislation on employment protection, with the idea of slowing down job destruction. Meanwhile, the second one was a definite step toward more flexibility: It consisted of introducing the possibility of hiring workers on flexible, fixed-duration contracts, aiming at fostering job creation. At the end of the 1970s, labor market regulations required that temporary jobs were directed to specific tasks, characterized by large variations in productivity, due to important seasonal variations in demand for instance. But those regulations have changed somewhat since the 1980s, and it is now possible in a number of European countries to hire workers on a temporary basis even on jobs that are not subject to large variations in productivity. For instance, in Spain (Cabrales and Hopenhayn, 1997), in Germany (Rogowski and Schöman, 1996) and in France (Barthelemy and Jaulent, 1997), the use of temporary jobs is authorized quasi-unconditionally for certain groups of workers (such as youths, seniors, long-term unemployed), and restrictions on the use of such contracts for other categories of labor have been slackened. As a result, in some of those countries, the bulk of recent hires have been on temporary jobs (about 80% in France and over 90% in Spain), even though it is hard to believe that the share of newly created jobs for which the use of a worker for a short period only is 'objectively' justified is that high. As Bentolila and Dolado (1994), Saint-Paul (1996) and Cabrales and Hopenhayn (1997) emphasized, this evolution toward a more flexible labor market has started to bring down unemployment without harming the so-called 'insiders' who are protected by high job security.

Does introducing flexibility in this particular way actually help increase employment? The literature on job security provisions delivers no clear-cut answer. The impact of firing costs on employment and labor market flows has been thoroughly analyzed in a number of important contributions, which generally show that a more stringent employment protection has an ambiguous impact on the level of overall employment, but reduces labor flows (Bentolila and Bertola, 1990; Bertola, 1990; Bentolila and Saint-Paul, 1992; Bentolila and Dolado, 1994; Garibaldi, 1998; Hopenhayn and Rogerson, 1993; Ljungqvist, 1998; Millard and Mortensen, 1997; Mortensen and Pissarides, 1994, 1999a,b). The impact of fixed-duration contracts on unemployment also seems to be unclear. Empirical papers of Goux and Maurin (2000) for France, and Güell (2000a) for Spain, find that the spread of temporary contracts increases inflows and outflows from unemployment to employment. It is generally concluded that the introduction of fixed-duration contracts is equivalent to a reduction in firing costs and that its impact on unemployment is therefore ambiguous (Bentolila and Saint-Paul, 1992; Bentolila and Dolado, 1994; Saint-Paul, 1996; Cabrales and Hopenhayn, 1997; Aguirregabiria and Alonso-Borrego, 1999; Boeri, 1999; Wasmer, 1999; Garibaldi and Violante, 1999; Blanchard and Landier, 2000; Güell, 2000a,b).

In this paper, we focus on two common features shared by many European labor markets: (1) firms can create *both* permanent and temporary jobs and (2) firms *convert* a certain share of the latter to permanent contract at their expiration (the rest being terminated at no cost). Our paper explicitly analyzes the consequences of this specific combination of temporary and permanent jobs. This is, as far as we are aware, a novelty, as it is generally assumed either that firms can create both permanent and temporary jobs, the

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