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Public Employment Policies and Regional Unemployment Differences

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Abstract

This paper contributes to the existing literature on public employment showing that the wage setting policy of the public sector is an important determinant of private employment and unemployment. I look at the case of geographically homogeneous wages across regions with different productivity, and show that public employment generates a crowding out effect against private employment. This effect is larger the larger is the public sector share of total employment. However, when the government pays wages according to local productivity the crowding out effect vanishes. I present a two region two sector model based on Pissarides (2000) heterogeneous search and matching model where vacancies are posted by the private and the public sector as in Quadrini and Trigari (2007), Gomes (2014) and Boeing-Reicher and Caponi (2016). I calibrate the model to the Italian labor market and show that the uniform wage setting policy adopted by the central government, in the presence of productivity unbalance across regions, is responsible for up to 33% of the unemployment gap between the North and South. Moreover, I show that the geographical homogeneous wage setting is responsible for a stronger and geographically highly asymmetric response of unemployment to aggregate productivity shocks. I also allow for migration from one region to the other and find that it has only a very limited mitigating role in reducing this gap. Policy experiments suggest that reducing the size of public employment reduces unemployment in lower productive regions while allowing for regional wage setting in the public sector almost eliminates the unemployment differential.

JEL Classification: E24, J6, R1

Keywords: Italy, European Unemployment, Regional Unemployment, Public Employment

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