

Reforming labor market institutions: Unemployment insurance and employment protection

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Introduction

What labor market institutions should countries put in place?

- A discussion dominated by slogans: “Getting rid of labor market rigidities.”
- Slogans will not do. The labor market is full of what economists call “imperfections”, from asymmetric information, to distributional issues.
- Need to take a step back. Identify the imperfections, think about whether the state can do better, and, if so, how.
- Shall limit to unemployment insurance and employment protection (Among other issues: minimum wage versus negative income tax, role of labor laws versus contracts, rules on collective bargaining)

Five points

- Growth: Creative destruction (increasingly so). Comes with the loss of jobs, and unemployment
- Private markets do a poor job of providing unemployment insurance
- Potential role for the state. Twofold: Unemployment insurance (pain)/Employment protection(incidence)
- Europe has done poorly.
- Can design better institutions, providing insurance more efficiently: different for rich countries (with institutional capability) and for middle income/poor countries

Growth and Creative Destruction

- Dates back to Schumpeter, but very much confirmed by newly available micro data sets.
- Knew about the fall in employment in agriculture. Now in industry in OECD countries
- Knew about trade. Opening to trade good for output, ambiguous initially for aggregate employment, unambiguous increase in reallocation.
- Micro data sets: True within sectors as well. A striking example.
90% of (very large) productivity growth in distribution sector in the United States in the 1990s due to entry/exit of establishments
- For consumers: good news. For many workers: Job loss, unemployment.

Why markets fail in providing insurance

- Self insurance by workers can only play a limited role.
- Firms. Natural insurers.
But risk averse/credit constraints.
Difficult to monitor unemployment status/search behavior.
- Third parties (Insurance companies.)
More likely to be risk neutral.
But not equipped to monitor both firms and workers for abuse.
- What happens in the absence of state provided insurance? (based on historical and cross country evidence)
Severance payments. Avoid need to monitor search effort but provides no insurance against duration uncertainty

The mistakes of Europe

- Employment protection: Protecting existing jobs, not workers
Done through judicial and administrative controls. Large randomness/uncertainty in outcomes.
Effects. Increase in unemployment duration.
- Unemployment insurance. Protecting the unemployed
Increase in benefit duration (social insurance and social assistance) in answer to increase in unemployment duration
Effects: Few incentives to search. Further increase in duration.
- Reforms at the margin.
Temporary contracts. The emergence of a dual labor market.
More flexibility for firms. Worse life cycle for workers.

Designing a system from scratch. Unemployment insurance

- Why would the state be better than third party insurers?
Large, single, insurer. Risk neutrality, or close.
Better (administratively/legally) at checking status/search; at taking sanctions.
Still faces two problems:
- Making sure the unemployed have incentives to take jobs, if available.
Declining benefits, or conditioning on job acceptance (provides better insurance and better incentives)

Unemployment insurance, continued

- Making firms take into account the cost of insurance provided by the state.

Basic solution. Layoff tax: equal to unemployment benefits paid to the unemployed laid off by firms. (paid ex-post. send the bills to the firms)

If firms risk averse/shallow pockets:

- Lower layoff taxes.
- Separate the timing of payment of benefits and firms' contributions. Bonus/malus. (Experience rating)

Designing a system from scratch. Employment protection

- A layoff tax: Natural counterpart to state-provided unemployment insurance.
- Scope for additional direct severance payments?
Financial costs, from tilted wage profiles.
(Psychic costs, from losing friends, networks, workplace?)
Can be paid by firms directly. No obvious reason to involve the state.
Left to individual or collective contracts. State minima.

Reforms in rich countries (i.e. Europe +)

- Unemployment insurance: Condition payments on acceptance of “acceptable jobs” .
Technically difficult. Definition of “Acceptable jobs” .
Provides both better insurance/stronger incentives.
- Employment protection: Decrease uncertainty.
Replace (at least partially) payroll taxes (used to finance unemployment benefits) by layoff taxes
Reduce role of judges/controls.

Reforms in middle income countries (Latin America,...)

- Currently: High severance and high administrative/judicial protection. Typically, no state provided insurance.
Inefficient, and no protection against uncertainty duration.
High risk of non payment by firms.
- Introducing state-provided unemployment insurance cum layoff tax.
Declining benefits with unemployment duration.
In exchange for insurance, decrease severance payments.
- Effects on informal/formal split?
- Individual unemployment accounts?
If pure accumulation/decumulation, very limited insurance. Not enough.

Conclusions

- Different challenges in rich and middle-income/poor countries.
- Rich: Moving from existing to better institutions.
Increase incentives to take jobs. Simplify employment protection.
- Middle income: Putting in place the right institutions
Put in place state-provided insurance. In exchange, decrease severance payments.
- Can it work? Efficient creation/destruction, and high insurance:
Tentative yes: Scandinavian countries, the Netherlands.