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Arbeidsconferentie

The Hague
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Earnings profiles, EPL, labour market older workers

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Labour market for older workers?

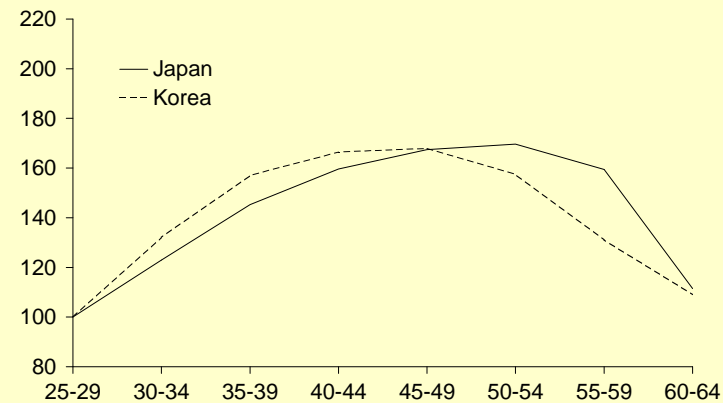
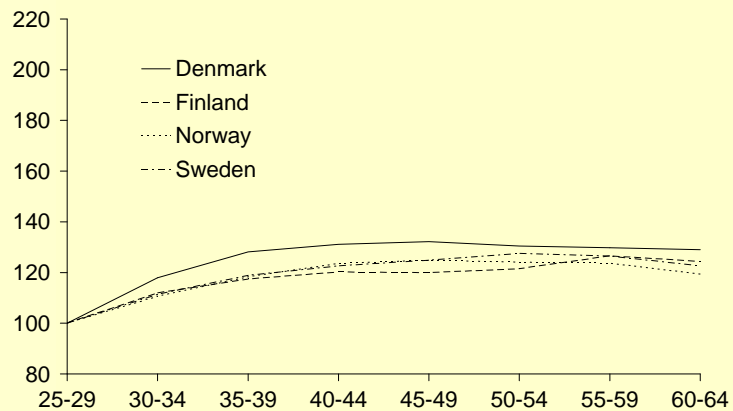
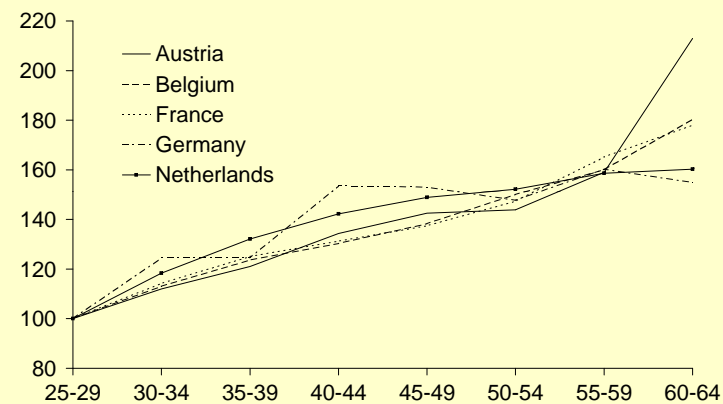
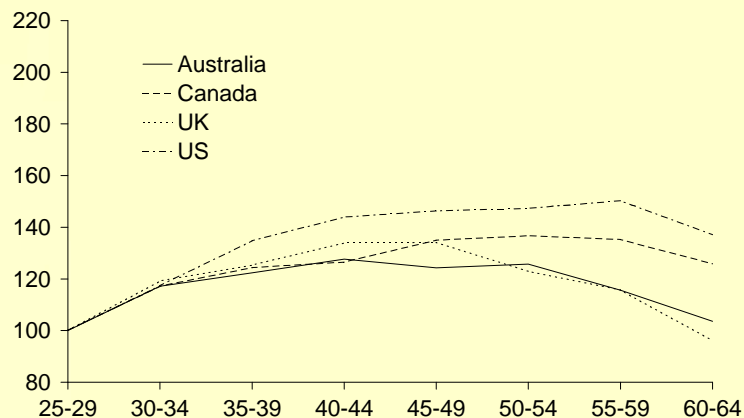


Menu of the day

1. Empirical evidence
2. Theories for experience profiles
3. Effect of EPL & UI
4. If EPL & UI are bad, why are they so popular?
5. Principles for reform

1. Empirical evidence

Experience profiles in wages for men



1. Empirical evidence

Experience profiles in wages

Conclusions

- Extensive EPL & UI → steep profiles
- Profiles flatter for women
- US stands out: no EPL – rather steep profile

1. Empirical evidence

Tenure distribution for men (%)

	15 to 24		55 to 64	
	< 1 year	> 10 years	< 1 year	> 10 years
France	51	0,1	4	76
Netherlands	34	0,2	3	75
Portugal	39	0,6	4	70
Denmark	53	0	11	58
UK	45	0	9	50
US	56	0	9	54

- Extensive EPL & UI → lower mobility
- ... in particular for older workers
- Here: US fits the pattern
- The Netherlands stands out

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2. Theories of experience profiles Specific human capital (SHC)



2. Theories of experience profiles

Two Principles

- SHC = only valuable in current relation
 - ▶ Wedge: productivity > outside wage (quasi-rents)
 - ▶ Wage somewhere in between

- **Two Principles**
 1. Share cost and quasi-rents in same proportions
 2. Insurance = assign quasi-rents to the firm

- Hence
 - ▶ Firm should pay SHC
 - ▶ SHC *per se* no rationale for return to tenure

- **Denmark fits this ideal type best !**

2. Theories of experience profiles Incentives

- Incentives between jobs: search
 - ▶ Tenure profiles as no-quit premiums
 - ▶ Tenure profiles due to bid wars against outside offers

- Incentives within jobs: providing effort
 - ▶ Tournament models

- Common feature
 - ▶ Incentives problems are everywhere
 - ▶ Popular among economist, but:
 - ▶ Cannot explain cross country differences
 - ▶ Bargaining theories offer better prospect

2. Theories of experience profiles Bargaining

- Distribution of quasi-rents
 - ▶ Either: if firm cannot pay SHC
 - ▶ Or: if worker cannot **commit** not to bargain

- *Grand Conflict*: labour versus capital
 - ▶ Why leave quasi-rents to the firm?
 - ▶ Why should labour give up bargaining power?

- Because
 - ▶ Hold up problem: lower job creation
 - ▶ Increases output price wedge hiring–firing bound
 - ▶ Inconsistency *ex ante* and *ex post* incentives
 - ▶ Outsiders (*ex ante*) versus Insiders (*ex post*)

3. Effect of EPL & UI Fixed EPL

- Transfer of firm to worker in case of lay off
- Direct effect: less firing
- Indirect effect: higher wages → more firing
- Efficient bargaining: both effects cancel
- But: direct + indirect effect → less hiring
- Greater wedge hiring-firing bound
- Less mobility, lower investment in SHC
- **Fits the data !**

3. Effect of EPL & UI Variable EPL

- EPL related to tenure
- Effect on wages increase with tenure
- Lower job mobility elderly
- **Fits the data !**

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4. If EPL & UI are bad, why are they so popular?



4. If EPL & UI are so bad, why are they so popular?

- Inconsistency *ex ante* and *ex post* incentives
 - ▶ Benefits EPL & UI immediate, cost later on
 - ▶ Hence: cost not transparent
 - ▶ Moreover: cost partly shifted to future generations
 - ▶ They do not vote!

- Self-reinforcing effect
 - ▶ EPL & UI lead to steep experience profiles
 - ▶ ... and low job creation
 - ▶ Strong interest insiders in keeping/insuring jobs
 - ▶ Hence: more EPL & UI

- **Trapped in a bad equilibrium !**

5. Principles for reform

1. Explain hold-up / insider-outsider mechanism
2. Compensate current generation of elderly
 - General tax deduction to offset effect on wages
 - Specific tax deduction for job movers to offset EPL
 - Paid for by:
 - Firms, since wages go down
 - State debt, to compensate wealth transfer to future generations
3. No compensation needed for youngsters
 - Tax deduction should be phased out
4. Involve unions in flattening experience profiles