Reforming Labor Market Institutions to Promote Elderly Employment

Handout

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Research Institute of Economy, Trade and Industry (RIETI)
What/How Dismissal Regulation Affects the Elderly Employment and Youth Employment

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Warning

The opinions and analyses in this presentation are the responsibility of the author and, therefore, do not necessarily coincide with those of the Banco de España or the Eurosystem.
Outline

- Facts
  - Demographics
  - Employment/unemployment rates of older and young workers
  - Worker flows by age in the EU during the Great Recession

- Determinants of older workers employment/non-employment
  - Flows from employment to non-employment
  - Flows from non-employment to employment

- Policy responses (focus on older workers)
  - Labour market reforms
    - Make Employment Protection Legislation more neutral
    - Reduce soft-landing schemes towards retirement
    - Get wages closer to productivity (reduce seniority-based pay systems)
    - Avoid measures inspired by the “lump of labour fallacy”
    - Reduce reservation wages of older workers
  - Investment in skills
  - Pension reforms

- Concluding remarks
Demographics: Youth Population/Total Population
Demographics:
Prime-Age Population/Total Population
Demographics: Older Population (I) / Total Population
Demographics: Older Population (II) / Total Population

The graph illustrates the percentage of the population aged 65 and over for different regions and countries over the years from 1995 to 2013. The data shows an increasing trend in the proportion of the elderly population across various regions, with notable differences between men and women. The regions and countries included in the graph are EU-28 Men65+, EU-28 Women65+, Japan Men65+, Japan Women65+, US Men65+, and US Women65+.
Demographics: Looking ahead - Older Workers as % Total Pop
Demographics: Looking ahead- Older Workers as % Total Pop
Youth unemployment rate
Employment rate (older workers)
Participation rates in the EU during two crisis

Chart 14: Activity rate (15–64) compared to 1990 and 2007 levels, for selected countries, in pps

Source: OECD.

Source: Eurostat, EU-LFS and OECD data for the US.
Recent trends in participation rates in the EU

Chart 15: Activity rate by group (age and sex), EU-28, 2002–13 (in %)

Source: Eurostat, EU-LFS, [lfsi_agan].
Employment rate (65+)
Changes (pp) in the (annual) flows from Employment to Unemployment (2006-2012)
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Labor Market Institutions and Changes in the (annual) flows (2006-2012)

From Employment to Unemployment

\[ heu_{ct} = \alpha_0 + \alpha_c + \alpha_1 gdp_{ct} + \alpha_2 Inst_{ct} + \varepsilon_{ct} \]

**Employment protection legislation on temporary contracts**

**Employment protection legislation on permanent contracts and collective agreements**
Labor Market Institutions and Changes in the (annual) flows (2006-2012)

From Employment to Unemployment

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Initial net replacement ratio

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Expenditure in ALMP per unemployed
Labor Market Institutions and Changes in the (annual) flows (2006-2012)

From Employment to Unemployment
Labor Market Institutions and Changes in the (annual) flows (2006-2012)

From Unemployment to Employment

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Expenditure in ALMP per unemployed
Labor Market Institutions and Changes in the (annual) flows (2006-2012)

From Unemployment to Employment
Why are firms reluctant to retain older workers?

Flows from employment to non-employment: Driving factors

1. **Labour costs: Wages increase with age**
   - Seniority-based pay systems
   - Cohort size effects
   - Bargaining power increases with age

**Policy responses:**
- Reform wage determination
- Get wages closer to productivity
Why are firms reluctant to retain older workers?

Flows from employment to non-employment: Driving factors

2. Productivity: Does it decline with age?
   • Physiological fact – Age bias
   • Negative externalities?
   • Worsening of employment conditions

Policy responses:

➢ Improve employment conditions
➢ Lifelong learning
➢ More flexible work arrangements for older workers
Why are firms reluctant to retain older workers?

Flows from employment to non-employment: Driving factors

3. Employment Protection Legislation

- Different provisions by age
  - Alternatives available for older workers but not for younger workers (Soft-landing schemes towards retirement)

Policy responses:
- EPL: Make firing costs more neutral
- Firing costs should not depend on seniority
- Protect workers, not jobs
- Use unemployment benefits, rather than severance payments, as a compensation for loosing jobs
- Introduce some “experience-rating” in unemployment benefits, like in the US
Why are firms reluctant to retain older workers?

**Flows from employment to non-employment: Driving factors**

4. **“Social acceptance”**
   - Less “stigma effects”
   - Lump of labour fallacy: “Restricting the supply of older workers increases the employment opportunities of younger workers”
     - Logically unsound
     - None empirical support whatsoever
   - Age discrimination: Stereotypes?
     - Evidence of positive effects of anti-discrimination laws in the US (David Neumark)

**Policy responses:**
- Banish any idea inspired by the “lump of labour fallacy”
- Forbid age discrimination (specially, collective bargaining agreements ruling on hiring and firing age-related practices)
Why are firms reluctant to hire older workers?

Flows from non-employment to employment: Driving factors

1. **Skills and the arrival of job offers**
   - Many dimensions of “skills”:
     - Education, “General” human capital
     - Experience, “Specific” human capital
     - New organization of work: Versatility, multi-tasking, team work, adaptability…
     - Labour demand is demand for composition of skills embodied in workers
   - Older workers have a different composition of skills…
     - Less general human capital
     - More specific human capital (Experience, EPL creates incentives for investment in specific skills)
     - Technological changes bring about changes in the demand of skills (skill-biased technological change)
   - …and less incentives to invest in training
     - Less time to extract returns from the investment
Why are firms reluctant to hire older workers?

Flows from non-employment to employment: Driving factors

2. Non-employed older workers have high reservation wages

- Less mobile (across sectors, occupations, regions…)
- Earn non-wage income (benefits)
  - Soft-landing schemes towards retirement
  - “Generosity” of pension systems
- In some cases, return to work imply loosing benefits

Policy responses:

- Get creative at designing programs to make compatible retirement and (part-time) employment
- Do not use pension systems to substitute for unemployment protection at later working ages
- Use pensions for their purpose not to facilitate labour force adjustment
Why are firms reluctant to hire older workers?

Flows from non-employment to employment: Driving factors

3. *Imperfect substitution between old and younger workers*

- Changes in the sectoral composition of employment towards activities in which younger workers have a competitive advantage
- Changes in the occupational composition of employment towards activities in which younger workers have a competitive advantage
- But also, shortage of experienced workers in some industries

**Policy responses:**
- Be aware
- Get retirees involved in the training of younger workers
Why are firms reluctant to hire older workers?

Flows from non-employment to employment: Driving factors

4. Age discrimination: Stereotypes?

- Evidence of positive effects of anti-discrimination laws in the US (David Neumark)
Concluding remarks

- In the EU, better performance of older workers participation/employment rates during the Great Recession than in previous recessions

- However, higher employment rates of older workers are absolutely necessary for...
  - Maintaining economic growth
  - Achieving high overall employment rates
  - Sustaining the “Welfare State”

- Low employment rates of older workers is the combination of labour demand and labour supply factors...
  - EPL, wage costs, and soft-landing schemes raise the flow of older workers from employment to non-employment
  - Soft-landing schemes and “generous” pension systems restrict the labour supply of older workers, shutting off the flows of older workers from non-employment to employment