Foreword

In the real world, labor markets are always segregated in a number of ways. For instance, as a result of various types of turnover costs for workers, those who already have permanent jobs, the 'insiders' in the labor market, are privileged as compared to others. This is the case, in particular, when comparing with workers with temporary jobs, unemployed workers and new entrants in the labor market, hence the 'outsiders' for short.

The turnover costs come in several different forms. It is costly for firms to search and scrutinize new hires as well as training them for firm-specific tasks. There is also considerable uncertainty about the abilities of newly hired workers. Moreover, insiders can protect their positions from wage competition from outsiders by threatening not to cooperate with entrants who get jobs by underbidding existing wages, and possibly also by threatening to harass them at the workplace or during leisure time. These various types of labor turnover costs create market power for insiders, and this power can be used to push up wages above the wages at which outsiders would be happy to get job offers (outsiders' reservation wages). Unions are also able to accentuate these market powers of insiders.

In most countries the government has further raised the market power of insiders by various types of employment protection legislation. The purpose has usually been to stabilize employment and income for labor-market insiders – as a complement to social insurance such as unemployment insurance and early retirement pensions. While most observers agree that such legislation does increase employment security and income security for insiders in the short run, there is considerable controversy about various types of side effects of the legislation.

In this book, Per Skedinger gives an excellent and balanced survey and evaluation of both the theoretical prediction and the empirical research about the consequences of legislated employment protection. His empirical exposition relies on three different types of studies – cross-country studies based on aggregate data; cross-country studies using disaggregate data; and within-country studies mostly based on disaggregate data. He finds the last type of studies more reliable than the cross-country studies based on aggregate data.

Since employment protection tends to reduce both the firing and the hiring of labor, it is natural that theoretical predictions of the effects on aggregate employment and unemployment are ambiguous. However theoretical studies also predict that job-security legislation tends to increase the duration of both spells of employment and spells of unemployment, and that aggregate short term fluctuations in employment are reduced. By and

large, Skedinger finds that these predictions are consistent with the empirical evidence. However he also suggests that there are strong distributional consequences of job-security legislation in the sense that individuals with permanent employment are favored relative to groups such as immigrants, the young, the long-term unemployed and disabled individuals. Unfortunately, there are hardly any studies about the long term effects on aggregate unemployment when new generations of youngsters and immigrants find it difficult to enter the labor market.

I would add that the aggregate effects on employment and unemployment differ depending on the actual macroeconomic situation. During periods of high employment, with modest and regular business cycles, we would expect that strict employment protection tends to stabilize aggregate employment. By contrast, in the case of a deep and long recession, with great uncertainty about the timing of the subsequent recovery, a strict employment protection legislation would rather stabilize high unemployment. Hence, legislation that may be favorable for aggregate employment in 'normal' times may be problematic during deep and prolonged recessions with large uncertainty about the future macroeconomic path.

On the basis of the empirical studies surveyed, Skedinger also argues that the dynamics in the economic system, on balance, suffer from strict employment protection, presumably because re-

allocation of labor becomes more costly for firms. There is also some evidence that, on balance, productivity growth suffers.

We should be grateful for Skedinger's comprehensive survey and evaluation of the literature in the important field of employment protection.

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