THE POLITICAL ECONOMY OF FLEXICURITY

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Abstract
We document the presence of a trade-off in the labor market between the protection of jobs and the support offered to unemployed people. Different countries’ locations along this trade-off represent stable politico-economic equilibria. We develop a model in which individuals determine the mix of job protection and support to the unemployed in a political environment. Agents are heterogeneous along two dimensions: employment status (insiders and outsiders) and skills (low and high). Unlike previous work on the political economy of labor market institutions, we emphasize the role of job protection and unemployment benefits in the wage setting process. A key implication of the model is that flexicurity configurations with low job protection and high support to the unemployed should emerge in presence of a highly educated workforce. Panel regressions of countries’ locations along this institutional tradeoff are consistent with the implications of our model. (JEL: J68, J65, D72)

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