

Temporary contracts as a screening device in the frictional labour market

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Abstract

In this paper, we develop a matching model with both permanent and temporary contracts to address the situation in which the quality of a match formed by a worker-firm pair is not observable to both economic agents. The screening and cost-saving aspects of temporary employment contracts are two primary reasons that firms use them, but screening has not received much attention in the study of employment protection. We examine how a change in the degree of employment protection affects the hiring policies of employers and the equilibrium value of other labour market variables. When dismissal costs are reduced, job creation increases and the difference in hiring thresholds between permanent and temporary contracts becomes smaller. The latter result implies that employers will be less selective in hiring a worker by a permanent contract. From a different perspective, temporary contracts are more likely to be used as the screening device in the countries with stringent employment protection.

Keywords: temporary contracts, screening, dismissal costs, hiring policies.

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