

Probationary Contracts, Worker Moral Hazard and Firms' Hiring Decision in the Frictional Labour Market

Makoto Masui ^{*†}

Faculty of Economics
Soka University

Abstract

We develop a Pries-Rogerson type matching model to address situations in which the quality of worker-firm pairs is not observable to both workers and firms and workers' effort choices are their private information. In this paper, the productivity of each job match is stochastically determined, and there are different types of jobs for which workers on probation cannot receive severance payments, while workers in other jobs do receive these payments when they are dismissed. Using this framework, this study examines how changes in the lengths of probationary periods affect work incentives and job creation. Then, major results are summarised as follows. First, a policy of shortening probationary periods increases the creation of new jobs. Second, this policy decreases incentives of workers in a regular contract for putting in greater work effort. Finally, shorter probationary periods reduce the equilibrium unemployment, provided that the hiring threshold for probationary jobs is reduced.

Keywords: probationary jobs, screening, severance payments, hiring policies.

JEL Classification Numbers: J41, J64, J65

^{*}Correspondence: Makoto Masui, Soka University, Faculty of Economics, 1-236, Tangi-cho, Hachioji City, Tokyo 192 – 8577, Japan.

[†]Email: mmasui@soka.ac.jp