Are flexible working hours really helpful in stabilizing unemployment?

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This paper challenges the conventional view that increasing flexibility of working time in Europe would limit the amplitude of business cycle fluctuations, and in particular help reduce swings in unemployment. Our argument is based on two empirical findings. The first one is that hours per worker in Europe are much less procyclical than in the US, and in some countries they even comove negatively with output. The second is based on the results from a VAR model for the euro area, in which working hours tend to increase after a contractionary monetary shock, exacerbating the upward pressure on unemployment. To understand these counterintuitive results, we next develop and estimate a structural search and matching macroeconomic model for the euro area, which features endogenous job separation and frictions in working hours adjustment. The model implies countercyclical hours per worker and qualitatively matches the VAR evidence on how the labor market adjusts to monetary shocks. We next use the model to simulate the effects of increasing flexibility of working time and find that, if anything, it amplifies the cyclical movements in unemployment.