

**Referee Report on: Reducing severance costs or subsidizing permanent job creation: which policy is more effective to reduce duality? (MS 1441)**

In this paper the authors present a search and matching model in a labour market with permanent and temporary contracts and job tenure distribution. They use the model to analyse the effects of reducing the gap in firing costs vs subsidising job creation in a set of labour markets variables (unemployment rate, job destruction and job tenure distribution). These policy exercises go in line with the labour market reforms introduced in Spain in 2006 and 2012.

**Comments**

Although this a very interesting and well written paper that analyses the labour market reforms introduced in Spain during recent years, I think it needs to be improved in two ways. First, some of the model assumptions are not clear and need to be justified or modified. Second, the authors should incorporate others key labour market variables in their simulated results.

1. With respect to the model assumptions:
  - a. Is not clear why the productivity of permanent contracts increase with job experience while it doesn't happen in temporary contracts. Since there is also job tenure in temporary contracts (with a maximum duration of three years), it should also affect the labour productivity of this type of contracts.
  - b. It is difficult to understand why temporary and new permanent contracts receive the same subsidy,  $\zeta$ , (see equations 2 and 3). If I understand well, there is a permanent employment promotion subsidy. Thus, only new permanent contracts should receive it. Is that right?
  - c. I do not understand why firms do not have the possibility to provide on-the-job training to temporary workers. Although this is true that the empirical evidence shows that workers with temporary contracts receive higher on-the-job training than workers with permanent job positions, however, this can be explained by the presence of a gap in firing costs between these two types of contracts. Thus, if you want to introduce on-the-job training in your model, you should endogenize it, especially if the model results are sensitive to the presence of training costs.
  - d. Moreover, the labour productivity should also be affected by the level of training provided by the firms. Why higher training costs have not effect on labour market productivity? Maybe it should be better to eliminate the training costs parameter from your model and just assume the presence of a productivity gap between temporary and permanent contracts.
2. In your simulated scenarios, you only present the results of few labour market variables (unemployment rate, the job destruction rate, and the job tenure distribution). I encourage you to include other variables such as the job creation rate, job conversation rate as well as the share of temporary contracts. It is difficult to understand your results without presenting the simulated results of these variables. How can I see if a reform has reduced the duality in the labour market if you don't show the simulated results for the share of temporary contracts?