

Employment protection

Policymakers need to find the right balance between protecting workers and promoting efficient resource allocation and productivity growth

Keywords: regulations on hirings and firings, employment protection legislation (EPL), labor mobility, reallocation of resources, productivity growth

ELEVATOR PITCH

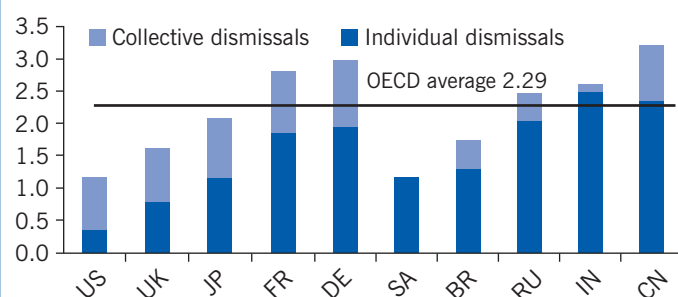
Laws on hiring and firing are intended to protect workers from unfair behavior by employers, to counter imperfections in financial markets that limit workers' ability to insure themselves against job loss, and to preserve firm-specific human capital. But by imposing costs on firms' adaptation to changes in demand and technology, employment protection legislation may reduce not only job destruction but also job creation, hindering the efficient allocation of labor and productivity growth.

KEY FINDINGS

Pros

- ⊕ Employment protection legislation can be justified by the need to protect workers from arbitrary actions by employers.
- ⊕ Imperfections in financial markets limit the possibilities for workers to insure themselves against dismissal. Employment protection legislation provides such insurance.
- ⊕ Employment protection legislation can promote long-lasting work relationships that encourage workers' commitment to a firm and the firm's investment in human capital.
- ⊕ In countries lacking unemployment benefits, severance pay can sustain job search by dismissed workers and improve job matching.

Protection of permanent workers against dismissals, 2013



Note: Scale 0–6: 0=least stringent; 6=most stringent.

Source: Based on Figure 1.

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World of Labor

Cons

- ⊖ By raising labor adjustment costs, stringent employment protection reduces job creation as well as job destruction and weakens firms' ability to exploit new technologies and markets.
- ⊖ Stringent employment protection reduces the ability of economies to redirect labor resources to the most productive uses.
- ⊖ Liberalizing temporary contracts while retaining stringent regulation of permanent contracts contributes to labor market segmentation.
- ⊖ In many developing and emerging economies, stringent employment protection is weakly enforced, and many workers in the informal sector are unprotected.

AUTHOR'S MAIN MESSAGE

Studies suggest that stringent employment protection legislation hinders the effectiveness of labor market flows and the allocation of labor to the most productive jobs, harming productivity and growth. In general, workers benefit from a more efficient allocation of labor, through higher real wages and better career progression, but some displaced workers may suffer longer unemployment spells and lower real wages in their new jobs. Employment protection reform should be part of a comprehensive package that promotes better allocation of labor and adaptability in the labor market but also provides safety nets for the unemployed and effective re-employment services.