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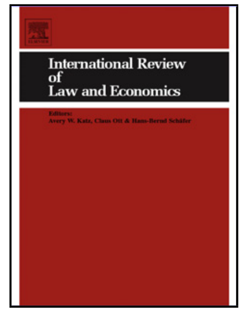

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Bankruptcy and the difficulty of firing

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Highlights

- Layoffs may be an *ex ante* mechanism to avoid bankruptcy.
- An important amount of firing restrictions leads to more bankruptcies.
- The employer's legal obligation to notify a third party prior the dismissal of one employee encourages the use of bankruptcy.
- Labor codes that apply priority rules in case of reemployment tend to increase the number of bankruptcies.

Abstract Firms may use layoffs as an *ex ante* mechanism to avoid filing for bankruptcy. However, the national labor law may impose some restrictions that delay or hamper the firing decision of the employer. This study proposes a different legal pathway for policymakers whose goal is to reduce the use of bankruptcy without acting on the design of the bankruptcy law. Using a sample of 33 countries from 2007 to 2015, we show that the total amount of firing restrictions leads to more bankruptcies. The employer's legal obligation to notify a third party prior the dismissal of one employee tends to increase the number of bankruptcies. It is very likely that the employer's rescue strategy endures an intense *ex post* monitoring of the employment contracts and/or a strong legal opposition to the layoff decision from such third party. In addition, labor codes that apply priority rules in case of reemployment can increase the use of bankruptcy.

Keywords Bankruptcy, Layoff, Labor
JEL Classification G33 G38 J63 K31