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Labor Law and Innovation Revisited

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Abstract

This paper examines the impact of changes in job security on corporate innovation in 20 non-U.S. OECD countries. Using a difference-in-differences approach, we provide firm-level evidence that the enhancement of labor protection has a negative impact on innovation. We then discuss possible channels and find that employee-friendly labor reforms induce inventor shirking and a distortion in labor flow. Further investigation reveals that the negative relation is more pronounced in 1) firms that heavily rely on external financing, 2) firms that have high R&D intensity, 3) manufacturing industries, and 4) civil-law countries. Our micro-level evidence indicates that enhanced employment protection impedes corporate innovation.

JEL classification: F30, J5, J8, K31, O31

Keywords: Employment protection laws; Labor law reform; Corporate innovation; Inventor turnover

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