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The perverse effects of partial employment protection reform: The case of French older workers ☆

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Abstract

French firms laying off workers aged 50 and above have to pay a tax to the unemployment insurance system, known as the Delalande tax. We evaluate the impact of this tax on layoffs as well as on hiring, taking advantage of several changes in the measure since its introduction in 1987.

A legislative change in 1992 exempted firms from the tax for workers who were *hired* after age 50. Following this change, the transition rate from unemployment to employment increased significantly for workers over 50 compared to workers under 50. The difference is sizeable: between one third and one half of the initial transition rate.

Evidence on the effect on layoffs is less clear cut. The impact is sizeable only for the most stringent tax schedule, after 1998.

JEL classification: J23; J63; J65
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1. Introduction

Confronted with persistently high unemployment rates, most countries in Continental Europe have reformed their employment protection over the past two decades. These reforms have however generally been partial, as governments developed exceptions to the main employment contract while leaving the latter largely untouched. A well-studied example is the development of fixed-duration contracts and its coexistence with indefinite duration contracts. Such partial employment protection reforms have unintended perverse effects. In the case of France, for instance, Blanchard and Landier (2002) and Cahuc and Postel-Vinay (2002) show how fixed-duration contracts increased the segmentation of the labor market.

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In the case of fixed-duration contracts, segmentation occurs because firms and workers select one type of contract depending on their characteristics and their negotiation power; the law in itself does not make a distinction between workers based on such characteristics as age, gender, disability status or experience. In this paper, we study employment protection reform in a case where the law explicitly treats workers differently depending on their age. Specifically, we study the impact of the Delalande tax, a measure introduced in 1987 in France to discourage firms from laying off older workers.[1] Firms have to pay a tax to the UI system each time they lay off a worker aged above 50.[2] The amount of the tax is proportional to the worker's gross wage at the time of layoff; it has varied over time but can be as high as twelve months of gross wages. Moreover, in 1992, a major reform occurs that exempts workers who are hired after the age of 50.

Studying the impact of the Delalande tax is interesting for two reasons. First, the tax provides a good illustration of the potential benefits and drawbacks of targeting employment protection on specific groups of workers. On the one hand, the benefits of having the firms internalize the cost of laying off older workers are likely to be high. Indeed, the probability that an unemployed older worker finds a job is very low in France. Jointly with high layoff rates and the widespread use of early retirement schemes, this explains the low employment rate of older workers in France: for male workers aged 55 to 59, it has fallen dramatically in the early eighties and stabilized below 60% since then. The social cost of this low employment rate is probably high, but firms do not seem to internalize it; they rather tend to view the early exit of older workers as a painless way to adjust their workforce (Behaghel and Gautié, in press). The question is therefore whether the tax has been effective in modifying firms' and workers' behavior. On the other hand, standard theory predicts that firms will refrain from hiring heavily protected workers, as they expect higher total labor costs. This negative effect of employment protection on hiring may be particularly acute in the case of the Delalande tax. Indeed, firms may easily substitute younger (less protected) workers to older (more protected) ones. Moreover, as the Delalande tax is paid to the UI system, its negative effect cannot be undone by private transfer, as opposed to severance payments in Lazear's (1990) argument. Overall, the Delalande tax appears as a case where the desired as well as the undesired effects of employment protection may both be particularly strong: it therefore appears as an interesting measure to study.

The second interest of the Delalande tax is that it has undergone several major legislative changes that provide useful sources of identification. Building on these changes, we are able to separately analyze the effects of the tax on the probability that a worker is hired or laid off.

The approach and the key results can be summarized as follows. We start by studying the adverse impact of the tax on hiring. We take advantage of a change that occurred in 1992 and exempts firms from the tax for workers *hired* after the age of 50, if they are laid off later on. If there was any adverse impact of the tax on unemployed workers aged above 50, it disappeared in 1992; it should therefore be evidenced *ex post* by an increase in the hiring rates for this particular age group. Indeed, we find that the chances of finding a job increased for unemployed workers aged just above 50 relative to those just below 50. The difference-in-difference estimate is sizeable (around one third or one half of the initial transition rates), pointing toward a large adverse effect of the tax on hiring. Then, we study the desired effect of the tax on layoffs. We use three changes in the tax schedule (in 1987, 1992 and 1998) to infer consequences on layoff rates, using workers in the unprotected age group (below 50) as a control group. Our results show that the tax reduced layoffs for older men; however, the estimates are imprecise and rather small, except for the most stringent tax schedule in 1998. Results for women are sensitive to the specification. We view the negative impact of the tax on the hiring rates of workers older than 50 as an example of 'perverse effect' of a partial reform: by targeting employment protection on a limited age group, the legislator has induced substitution from these workers toward younger ones. It is unclear whether the reduction in layoffs is sufficient to compensate for this unfavorable effect.

Our paper relates to a handful of recent papers that use variation in labor legislation across groups of workers in a given country as a way to provide micro evidence on the impact of employment protection. Acemoglu and Angrist (2001) look at the effect of the American with Disabilities Act: they find that it reduced the employment rate of the protected group, the disabled workers, most likely through lower hiring rates — but they do not find significant effects on layoffs. Autor, Donohue and Schwab (2002) find that employment of protected groups is ultimately reduced by the adoption of wrongful-discharge laws by various States in the U.S. In Colombia, Kugler (2004) finds that a reduction in dismissal costs increased separations and accessions for formal workers relative to informal workers, and more so in

[1] Temporary layoffs do not exist as such in France. Throughout the rest of this paper, we use the word "layoff" for permanent layoffs.
[2] The age threshold was 55 in 1987 but was lowered to 50 after 1992.