

Job tenure Jigsaw: Why Is Employment Protection Bad for Labor Market Fluidity?*

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Abstract

This paper investigates how employment protection legislation (EPL) affects labor market fluidity by changing the wage premium for employer tenure. I construct a structural model where workers optimally choose the type of human capital accumulation (firm-specific or general) and move across employers in the face of deterioration in matching quality. The quantitative analysis using the Japanese household-level microdata indicates that (i) stringent EPL increases the wage premium for employer tenure because workers optimally shift their human capital accumulation from general to firm-specific, and (ii) the large wage premium for employer tenure due to EPL raises an opportunity cost to move across employers, thus leading to stagnated labor market fluidity measured by job-to-job transitions. It also indicates that the welfare effect of eliminating EPL is negative but not large, as it reduces firm-specific human capital but increases general human capital and improves matching quality through more active job-to-job transitions.

Keywords: Labor market fluidity; Human capital; Employment protection; Job tenure.

JEL Classification codes: E24, J24, J62

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