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Severance Pay Mandates: Firing Costs, Hiring Costs, and Firm Avoidance Behaviors
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Abstract:
The potentially adverse labor market effects of severance pay mandates are a continuing source of policy concern. In a ser study, Lazear (1990) found that contract avoidance of severance pay firing costs was theoretically simple – a bonding sche would do – but that empirically the labor market distortions were large. Subsequent empirical work resolved the apparent paradox – firing cost effects are modest even without firm avoidance activities. To explore why that should be so, formal measures of severance-induced firing costs and hiring costs are derived. Firing costs are, it turns out, systematically less t benefit generosity alone would imply. Moreover their interrelationship with hiring costs, often employed in empirical studies substitute measure, is complex, with co-movements varying in sign and magnitude across policy parameters and the econ environment. Although the analysis assumes a fixed benefit mandate, the cost measures are easily extended to assess th impact of service-linked severance benefits on age-specific employment levels. The model permits design of a cohort-neutra severance mandate – which is not a flat rate structure.

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