

Labour market regulations and capital labour substitution

Gilbert Cette^a, Jimmy Lopez^b and Jacques Mairesse^c

On the basis of a country*industry unbalanced panel data sample for 14 OECD countries and 18 industries covering the years 1988 to 2007, this study proposes an econometric investigation of the effects of the OECD Employment Protection Legislation (EPL) indicator on four components of total capital and for two skill components of total labor. Relying on a difference-in-difference econometric approach, we find that an increase in EPL has (i) positive and significant effects on the non-ICT capital - labor ratio and the share of high-skill labor; (ii) non-significant effects on the ICT capital – labor ratio; (iii) negative and significant effects for R&D capital – labor ratio and the share of low-skilled labor. These results suggest that firms consider that the strengthening of Employment Protection Legislation is equivalent to a rise in the cost of labour, resulting in capital-to-labour substitution in favour of non-ICT capital and working at the disadvantage of low-skill relatively to high-skill workers. They indicate to the contrary that structural reforms for more labour flexibility weakening this legislation could have a favourable impact on firms' R&D investment and their hiring of low-skill workers.

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a: Banque de France and Aix-Marseille School of Economics, CNRS & EHESS

b: Banque de France and Université de Bourgogne (LEDI), CNRS

c: CREST-ENSAE, Maastricht University (UNU-MERIT), Banque de France and NBER