

Too bad to be true

—The Impact of the EPL Reform on the Firm Performance in China

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Abstract: We study the causal relationship between EPL reform and the firm performance based on a quasi-experiment—The New Labor Contract Law reform, especially the strengthening of concluding a written labor contract. Depending on the firm size and capability evidences, we use a DID method to identify the real effects. We found robust evidence that the EPL reform increase the economic performance for the small private enterprises in China. We also found the firms which concluded more individual contracts tend to invest more in training.

Keywords: EPL, New Labor Contract Law, Firm Performance, Private Enterprises

Employment Legislation Protection (EPL for short) is one of the most important institutions in the labor markets which plays critical roles in the games among the government, employers and employees. In 1920s, the EPL was established in most developed countries. (Schwenning,1932) while only at the beginning of the 21th century, the developing countries started their modern EPL schedules. As latecomers, the effects of EPL are much more ambiguous in specific environments in developing countries. Generally, a tighter EPL means the increase of contract coverage rate, wage, social insurance, and severance payments expenditure. (Banker et al,2013) It also weaken the firms' motivations for hiring, reduce the flexibilities (Bassanini & Garnero, 2013), even reduce the workers' efforts. (Ichino & Riphahn, 2001; Riphahn, 2004; Olsson, 2009) It seems like EPL is too bad to be true. In this paper, we study the causal relationship between EPL reform and the firm performance based on a quasi-experiment—The New Labor Contract Law reform, especially the strengthening of concluding a written labor contract. The rationale is that if the reform improves the written contract coverage without hurting the firms' economic performance. Then, socially it will be a Pareto improvement. If the firms' performances are significantly influenced, it will be better to loosen the EPL due to the job allocation effects, or share the cost with employees and the government.

Empirically, a large literature uses Difference in Difference approach to study the casual effects of severance payment exemption on employment (Boeria et al,2005; Bauer et al,2007; Kugler&Pica,2008; Boockmann et al,2008; Behaghel et al,2008; Bauernschuster,2013;) and wage rate (Wiel, 2010; Leonardi & Pica,2013). While few literatures are related to the EPL reform on the firm performance. Some researchers make use of country-level data and use EPL index to explain the firm performances among different countries. Laporsek and Stubelj (2012) found tighter EPL do harm to the firms' capital returns while Griffith & Macartney (2014) found positive evidences for the quantities of the invented patents in the multinational enterprises, but negative for the radical inventions. The biggest drawback of this branch is that it's not easy to

make distinctions among different labor market institutions, such as product market regulations, union and collective bargaining, minimum wage etc. (Addison & Teixeira,2003; Boeria & Jimeno,2005; Garibaldi & Violante,2005; Koeniger & Prat,2007; Lommerud et al,2012) The measure error problems of the EPL index are also not easy to overcome. The other branch is based on the policy divergence within a country. Based on the dismissal exemptions in Portugal, Martins (2009) found the exemptions increase the sales and surplus per worker. The second branch is a good way to solve the identification problem.

In 2008, The Chinese government published the New Labor Contract Law in which significantly change the rules of concluding individual contracts. Firstly, the new law puts time limits to concluding written contracts and setting probation periods. “When industrial relations have been established without written labor contracts simultaneously, they shall be concluded within one month since the recruiting.” “In case that the employer fails to conclude a written labor contract with the employee within one year since recruiting, it will consider that a non-fixed term contract had been concluded between the employer and the employee”. As it concerns to the probation period, the new law also makes specific time limits according to the length of the contracts. “For a labor contract which lasts above three months but less than one year, the probation period should not exceed one month; for a labor contract which lasts above one year but less than three years, the probation period should not exceed two months; and for a more than three years or non-fixed term contract, the probation period should not exceed six months.” All these time limits make it harder to hire employees without legal contracts.

Secondly, the new law makes the wage rates indifferent between concluding and not concluding the written contracts. “In case that the employer fails to conclude a written labor contract with an employee upon recruitment, or the wage issue has not been clearly specified with the employee, the wage of the concerned employee shall be defined according to the rate specified in the collective agreement; where there is no collective agreement or the wage issue has not been defined in the collective agreement, equal pay shall be provided for equal work.” Even for the employers who didn’t sign the contracts with employees, they still need to pay the same wage rates which provide less motivations to evade contracts conclusion.

Finally, the new law adds new contents to the stereotype of the labor contracts which are working hours, rest and leave as well as social insurance terms. They are critical to the employers’ motivations to offer labor contracts because the employers have to afford more social insurance costs compared with the old law. It also makes it clear that the specific duties to supervise and monitor the implementation of the new system for the labor administration authorities, especially the conclusion and termination of the labor contracts, minimum wage standards and various social insurance schemes.

What have changed in the new law pose strong motivations to different employers in different directions. For the employers who didn’t offer any contracts, they may conclude nothing because of the higher cost of one more contract. Only through enforcements can make them comply with the new law. While for the employers who

have concluded labor contracts with not all the employees, they have to stick to the new rules and spend more on the senior staffs as well as signing more contracts with the rest of the employees. There are two forces that may push them to do this. One is the model effect which will stimulate inequality if the employers refuse to offer labor contracts to the rest. The other one is the possibility that once they signed the labor contracts, they are more likely to be supervised by the labor administration authorities. All in all, the employers' capability of concluding labor contracts matters. Firms which have the capability of signing individual contracts are more vulnerable to the new EPL reform. Practically, we also observed positive relationship between firm size and the probability of signing individual contracts which support our argument.

Following these logics, we use a difference in difference method to identify the causal relationships. We use the firms which didn't sign individual contracts with employees as the control group, while using the firms whose contract signing rates are below 100% as the treatment group. We also use a good strategy to eliminate interference caused by the economic crisis.

The data used in this research derived from a national representative private enterprises survey in China, which was conducted by the United Front Work Department of the Central Committee of the Communist Party of China, the All China Industry and Commerce Federation, and the China Society of Private Economy at the Chinese Academy of Social Sciences. We use three waves. Private enterprises are preferred because of their special natures, for example lower coverage rate of trade unions which means low bargaining power that will confound the real effects of the EPL. Compared with state owned enterprises(SOE) and collective enterprises(COE), the divergence of the capability and the contract concluding rates is another reason we choose private enterprises.

We found the interesting evidence that the EPL reform increase the sales per capita for the small private enterprises in China. We also tested some channels which were hiring temporary workers as well as training. We didn't find the evidence that private enterprises hire more temporary workers while they increased the training when facing stricter EPL.

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