Do firms obey the law when they fire workers? – Social criteria and severance payments in Germany –

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Abstract

Employment protection legislation defines social criteria according to which firms can dismiss workers. If firms evade the law, then negotiation about compensations begins. To reduce legal and financial uncertainty often associated with ex-post bargaining, the German government stipulated severance payments in the case of mutual agreements into the law in 2004. The paper shows that workers protected by law have the lowest probability of being dismissed. The expected severance payment and firm size increase the probability of receiving compensation while the amount of severance payment depends significantly on the way the employment relationship is dissolved. Contrary to the intention of the legislator, the reform increased the level of compensation.