Discrimination and employment protection

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Can discrimination of a group of workers persist if there are profit maximising employers with no "taste for discrimination"? In Becker's model, if there exist employers with prejudices that push the wage down for one group of workers, other employers without prejudices will benefit from hiring this group at lower wages. In long run equilibrium, entry of employers without prejudices will increase demand for the disadvantaged group, implying that the wage gap disappears. However, subsequent work by among other Arrow (1973), Lundberg and Startz (1983) and Coate and Loury (1993) has shown that discrimination may exist even in a long run equilibrium with profit-maximising employers with no "taste for discrimination". The key idea in this papers is that if there is discrimination against one group of workers, this will reduce these workers' incentive to invest in human capital, which potentially may make the employers' initial perception of productive differences self fulfilling.

We argue that discrimination may exist in a steady state equilibrium even if there are no productive differences between groups of workers at the time of hiring by the firm. A crucial requirement is that there exists some costs for the firm of laying off the workers. The most important example of such costs are legal restrictions, in the form of Employment Protection Legislation which in many countries involve tight restrictions on firms' possibility of laying off workers.

The results build on two key assumptions. First, we assume that at the time of hiring, there is uncertainty as to the quality of a match between a specific employee and employer. The quality of the match may be low if the worker does not satisfy the job requirements, or if the worker does not get along with the colleagues. Second, we assume that the employer and the employee share the benefits from the match being of high quality. In the model, this is captured by the assumption that the wage is increasing in the output in the job.

Consider an economy with two types of workers, Natives and Immigrants. Assume that firms only hire Immigrants if their observable match-specific productivity is considerably higher than the corresponding threshold for Natives. After hiring a worker, irrespective of the type of the worker, the match may turn out to be of low quality, as the worker does not fit the job. In this situation a Native worker is likely to find a better job somewhere else, and thus quit, to the benefit of both the worker and the firm. However, an Immigrant in a low quality match is less likely to find a new job, as firms are less inclined to hire Immigrants. Thus, as Immigrants are less likely to find a new job, the risk that a firm is stuck with a worker with a low quality match is much higher if the worker is an Immigrant. This difference makes it less attractive for the firms to hire Immigrants in the first place, consistent with our initial assumption. The prediction of the model that Employment Protection Legislation may lead to discrimination of Immigrants is consistent with the finding in OECD (2007) that many immigrants have severe difficulties with finding a job in the regulated Swedish labor market.