

Self-confidence and optimal design of employment protection policies*

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Abstract

This paper characterizes for optimal employment protection policies in a simple static model in which a worker has the belief about own ability and feels fulfilled if he builds his confidence about own ability. The confidence is updated when the firm decides whether to keep the worker or eliminate the job, his confidence goes down if he is fired and goes up if he continues to be employed. The first best policies are that the government imposes higher firing tax on firms which try to fire low ability workers than firms which try to fire high ability workers, but it is difficult to achieve this policy. If the entry cost of firms is low, the second best policies are combination of the unitary firing tax and to prohibit the nominative for fired worker.

JEL classification: J32; J63; J65; J68

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