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# Are judges biased by labor market conditions?

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## Abstract

When a firing litigation is taken to court, only the characteristics of the employee's misconduct should be relevant for the judge's decision. Using detailed data from an Italian bank and aggregate macro data, this paper shows that, instead, local labor market conditions influence the court's decision: The same misconduct episode may be considered sufficient for firing in a tight labor market but insufficient otherwise. We reach this conclusion after taking carefully into consideration the non-random selection of firing litigations for trial. Although these results refer to the specific situation considered, they raise more general issues. For macroeconomists they suggest that higher unemployment rates may increase firing costs via the effect on courts' decision criteria; thus, the real extent of firing rigidities cannot be assessed without considering the role of courts. For labor law scholars, these findings are important because, following traditional principles, the law should be applied in the same way for all citizens and over the entire national territory.

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## 1. Introduction

The nature and relevance of firing regulations in the labor market differ sharply across countries, as recent surveys show (OECD, 1999). The first ground to evaluate these rigidities lies in the laws which specify the rights, duties and constraints that the

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employer and the employee must respect when dealing with a firing decision. However, the law is only one important component in the whole story, because, when a fired worker files the case in a court, the effective judicial enforcement of such rules plays a crucial role as well. From this viewpoint, it is important whether the statements of the law define a narrow grid of prescriptions which call for an almost automatic and mechanical decision by the judge, or if they are very general, leaving room for a wide range of possible interpretations. The role of judicial enforcement is much more relevant in this latter case, since the headings under which a firing decision can be taken must be filled with the interpretation prevailing in the jurisprudence and with the discretion left to the judge, who can confirm or overrule the firm's decision. The degree of effective labor market rigidity can therefore be assessed only when enforcement is considered together with the legal framework.

Assessing judges' decision criteria seems particularly relevant, from a macroeconomic point of view, if the legal standard applied is in turn influenced by labor market conditions. The fact that higher unemployment rates may induce judges to be more favorable to workers in case of a firing litigation creates the conditions for a potential reversed channel of causation between unemployment and firing costs. It is well known that higher firing costs generate longer unemployment spells and may also increase unemployment levels if they reduce hiring more than they prevent firing, given wage rigidity.<sup>1</sup> But if at the same time higher unemployment rates increase firing costs via the effect on courts' decisions, multiple equilibria may arise: On the one hand, equilibria with low unemployment and low firing costs, because courts tend to decide in favor of firms; on the other hand, equilibria with high unemployment and high firing costs, because courts tend to decide in favor of employees.

In this paper we investigate whether judges are biased by labor market conditions and we reach the conclusion that such a bias exists. Using detailed micro data from a large Italian bank, we show that in regions where unemployment is high the gravity of the cases of misconduct going to trial tends to be higher than in the other regions. Therefore, if judges decided only on the basis of the gravity of misconduct, the probability of a pro-firm decision should be larger where the unemployment rate is higher. We find, instead, the opposite result: judges are less likely to decide in favor of firms where unemployment is high, despite the fact that more serious misconduct cases are brought in front of them. Therefore, we conclude that worse labor market conditions induce judges to be more favorable to workers.

Our empirical analysis is a good case study to address the question we are interested in because Italy is a perfect example of a very rigid legislation that leaves wide scope for judicial discretion in the enforcement phase. Moreover, our company data allows us to reconstruct the entire selection process that generates a trial from a misconduct case and this is of crucial importance to derive conclusions on the criteria followed by judges in deciding the cases brought to court. If a worker files a firing decision before the judge, the latter will compare the specific nature of the case with some legal

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<sup>1</sup> The classic references are Lazear (1990), Bentolila and Bertola (1990), Bertola (1990). More recently, Acemoglu and Angrist (2001) and Oyer and Schaefer (2000) provide econometric evidence suggesting that employment protection laws can backfire against the group that the legislator would like to protect.

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