Employment protection legislation and skill mismatch: evidence from a reform[1]

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Abstract. Economic theories dating back to the late eighties suggest that more flexible labor markets improve employment and growth by enhancing efficiency, and namely through a better worker allocation on jobs. Related empirical evidence nonetheless mostly focused on the "reduced form" of the model, i.e. on trying to assess directly the impact of labor market deregulation on employment and unemployment, paying little attention on how employment protection legislation affects the quality of job-worker matches. The reason has been fourfold. First, knowing about the consequences of labor market institutions on employment performance was (and probably still is) of much higher policy relevance. Second, the relationship between employment protection and the quality of job-worker matches is more micro in nature and raises issues of data availability. Third, the causality of this relationship is circular and its identification requires the emergence of quasi-experimental conditions. Fourth, measuring the quality of a match is not trivial and requires information that is not commonly collected in labor market databases. Today a renewed interest for knowledge-based economy, human capital accumulation and active ageing has circumvented the first limitation, in particular inasmuch as job match quality is assessed in terms of skills. Our seminar aims at giving a contribution with respect to the other three. Indeed, we will propose and describe complementary – rather than alternative – methods to measure skill mismatch, suggesting that LMEED-type data contains underexploited information in this perspective. Moreover, we take advantage of a recent labor market reform – the so-called "Fornero Law" – that created in Italy the ideal conditions to identify the impact of employment protection upon skill mismatch. Our estimates show that the EPL reduction that followed the Fornero reform is responsible for an increase of around ten percentage points in the probability of a good match. Consistently with the idea that it takes a while for turnover to affect job-match quality, most of the impact emerges one year after the implementation of the reform. Moreover, we also show that match quality improved mainly through a reduction of under-education that resulted from the dismissal of old-age workers and their substitution with younger and more educated ones.

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