The Effects of Partial Employment Protection Reforms: Evidence from Italy

Abstract:

We combine matched employer-employee data with firm financial records to study a 2001 Italian reform that lifted constraints on the employment of temporary contract workers while maintaining rigid employment protection regulations for employees hired under permanent employment contracts. Exploiting the staggered implementation of the law across different collective bargaining agreements, we find that the reform led to an increase in the incidence of temporary contracts but failed to raise employment significantly and lowered the earnings of new entrants. By contrast, the reform was successful in decreasing firms' labor costs, leading to higher profitability, some gains in managerial pay, and a rise in within-firm earnings inequality. Our findings suggest that the main beneficiaries of this ``partial reform'' to employment protection were firms, managers, and older incumbent workers. Rent-sharing estimates show that workers on a temporary contract receive only 66% of the rents shared by firms with workers hired under a permanent contract.