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Labor Market Institutions and Flexibility in Italy:  
A Critical Evaluation and Some International Comparisons

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Abstract

The paper surveys three broad categories of labor market institutions in Italy: employment protection legislation, unemployment benefit systems, and wage bargaining arrangements. In each case, the recent evolution and current state of Italian institutions are evaluated and compared with those in other major European countries.

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	<u>Page</u>
1. Introduction	1
2. Employment protection legislation	1
a. Hiring rules	2
b. Rules on dismissals	4
c. Employment arrangements	5
3. Unemployment benefits	9
4. The wage determination system	14
a. The evolution of the wage bargaining system in the 1970s and 1980s	16
b. The July 1993 agreement between the social partners	19
5. Conclusions	22
<u>References</u>	36
<u>Tables:</u>	
1. Hiring Restrictions	23
2. Distribution of Employment by Firm Size, 1986	24
3. Regulations on Individual Dismissals	25
4. Fixed-Term Labor Contracts	26
5. Share of Temporary Workers to Total Employment, Selected Sectors, 1983 and 1991	27
6. Part-Time Employment, 1983 and 1991	28
7. Training Contracts	29
8. Unemployment Insurance Schemes	30
9. Unemployment Benefits: Maximum Duration and Replacement Rates	31
10. Public Expenditure on Active Labor Market Programs	32
11. Structure of Annual Compensation	33
12. Components of the Monthly Wage as a Percentage of Total, 1991	34
13. Gross Compensation Per Employee, 1980-91	35
<u>Charts:</u>	
1. Wage Supplementation Fund (CIG)	12a
2. Unemployment Insurance System: Entry, Duration, and Exit	12b
3. Unemployment Insurance Schemes, 1993 (estimated)	14a
4. Union Strength and Militancy	18a
5. Wage Drift	18b
6. Wage Differentials	18c

### Summary

This paper surveys labor market institutions in Italy in three broad categories: employment protection legislation (including hiring and dismissal rules, employment contracts, and regulation of working time); unemployment benefit systems; and the wage bargaining system. Research and debate on this topic has recently intensified, prompted by the impact of the recent recession on the labor market, and has informed to a great extent the changes--some of them fundamental--that have been taking place in this area during the last few years.

The main conclusions are that Italian labor market institutions have, until very recently, been restrictive and often ill-suited for the tasks they were supposed to perform. Employment protection legislation was among the most restrictive in the OECD; the unemployment insurance schemes in place were not equipped to deal with Italy's current unemployment problem; and the wage setting process, including automatic indexation, was inflexible (although a gradual shift away from the rigidities of the 1970s took place during the 1980s). Since the turn of this decade, a number of far-reaching changes have been introduced, generally in the right direction. The most extreme restrictions in employment protection legislation (notably in the area of hiring rules) were abolished; a new unemployment insurance scheme (the mobility list) was introduced to deal with collective redundancies; and, in July 1993, the wage bargaining system was fundamentally overhauled.

These changes have been conceived and introduced not as part of a comprehensive plan to reform the labor market, but rather in a piecemeal fashion, and--aside from the new wage bargaining system--have generally not gone as far as they should. Significant restrictions and distortions remain in dismissal rules, placement services, and employment contracts, making Italy an outlier among major EU countries. Moreover, these apply only to part of the market, aggravating the distortions of the Italian labor market. The unemployment benefits system is generous to those who are entitled for benefits, but inequitable and--perhaps more important--does not motivate skill-building and active job search. Spending on active labor market programs is not optimally allocated, and public employment services need improvement. As regards the new wage bargaining system, although the abolition of indexation has already contributed to wage moderation and is expected to continue doing so, a full evaluation of the system will have to wait until new agreements are concluded according to its guidelines.



## 1. Introduction

In the 1980s, the level and persistence of unemployment in Italy, as well as in most OECD countries, started shifting attention towards the "structural" or "equilibrium" component of unemployment, i.e., that part which could not be influenced directly by macroeconomic policies as it was independent of the cycle, as well as the speed with which the labor market could adjust to shocks. In this context, research started focussing more on labor market institutions as critical determinants of these aspects of labor market performance.

Labor market institutions fall into three major categories: institutions that regulate the transactions taking place in the labor market, such as hiring and dismissal rules, regulations on working time, types of employment contracts; institutions that take care of those seeking work, namely unemployment insurance and what has recently come to be known as "active" labor market policies (training, placement services, etc.); and institutions that govern the price-setting process in this market, namely-- in the case of Europe--wage bargaining systems.

This paper surveys these labor market institutions in Italy. Research and debate on this topic has recently intensified, prompted by the impact of the 1992-93 recession on the labor market, and has informed to a great extent the changes--some of them fundamental--that have been taking place in this area during the last few years. The following three sections focus on each of these three categories, beginning with a review of the literature in each area, and then proceeding to examine and evaluate the Italian institutions, comparing them with those elsewhere in Europe whenever possible. The main conclusions of the paper are summarized in the final section.

Since Italian labor market institutions apply uniformly throughout the national territory (with a few exceptions), this paper has little to say on the issue of the North-South segmentation of the Italian labor market. The broader issue of how the existing institutions may have caused the emergence of this segmentation lies outside the scope of this survey.

## 2. Employment protection legislation

This section discusses the rules governing the contractual basis of the employment relationship (namely hiring, firing, and regulation of working time, as well as the various forms of employment contracts), and compares the situation in Italy with that in other European countries.

Restrictions on hiring, firing, and working time may be seen as increasing the fixed cost of labor. This would result in smoother and less pronounced employment fluctuations than otherwise. However, there is no consensus in the literature on the overall effects of these restrictions on the average level of employment or unemployment over the cycle. On the one hand, they need not have any effect at all if wage earners are willing to

accept (and minimum wages do not prevent) wages such that the market clears; indeed, it may be argued that standardization of the contractual rules across firms may reduce information and transaction costs, thus rendering the market more efficient. On the other hand, such restrictions may have indirect effects on the level of unemployment by increasing the incidence of long-term unemployment through reduced labor turnover, thus speeding up skill loss among the unemployed and reducing the downward pressure of the unemployed on wage demands.

Models assuming symmetric costs of adjusting the level of employment would predict effects only on the size of fluctuations and not on the average level of unemployment; there is some empirical evidence to support this view (Bertola 1990). However, there is also some evidence to the contrary (Lazear 1990; Heylen 1993; OECD 1993a), as well as a number of models with non-linear or asymmetric adjustment costs that are capable of generating--at least under certain conditions--effects on the level of unemployment (for a discussion, see Bean 1992).

In contrast to restrictions on hiring, firing, and working time, limitations on the permissible types of employment contracts (e.g., temporary or part-time work) would tend to reduce employment and potential output directly. In addition, they also raise adjustment costs, since atypical or flexible contracts usually have lower fixed costs. Again, however, positive effects could arise from standardization and reduction of information costs.

Employment protection legislation in all its forms may also have allocational effects. To the extent that it does not apply uniformly to all firms (or enforcement varies according to firm size), it may distort labor allocation and firm size. Also, from a dynamic point of view, employment protection legislation may reduce the ability of a sector or the economy as a whole to adjust to a changing environment or to new production technologies.

a. Hiring rules

Rules determining how the recruitment is made or imposing quotas for the recruitment of workers from certain groups, notably the disabled, exist in most European countries. They represent virtually the only hiring restriction on employers, who are otherwise free to decide whom they hire.

Italy is the only European country that has attempted to regulate precisely whom the employer could hire. Companies in the nonagricultural sectors were for many years required to hire workers from a list of those seeking work at the public employment agency, following a rank order of candidates determined by the agency. The rank order was determined on the basis of a number of criteria, such as whether the person seeking work was employed or unemployed; the duration of unemployment; and "social" factors (number of dependents, etc.). This so-called "numerical" system (*chiamata numerativa*) was widely criticized by employers and, over the years, was

limited in various ways: for instance, it did not apply to companies with less than 10 employees, and it excluded jobs requiring special skills. In 1984, a proportional numerical system was introduced, allowing firms to hire workers of their choice from the list without regard to their rank ordering ("nominative" system - *chiamata nominativa*), as long as hiring in this way was kept in a certain small proportion to hiring under the "numerical" system. The proportional system, however, was not respected: in 1986, for example, 96,188 workers were hired under the "nominative" system, and 34,781 under the "numerical" system (CER 1993).

In 1991, the "numerical" system was finally abolished (law 223/1991). Currently, there are two quantitative hiring restrictions in Italy: a 15 percent quota for the disabled for firms with more than 35 employees; and a 12 percent quota for "disadvantaged" workers, i.e., long-term unemployed, workers on the mobility list (see below), etc. for firms with more than 10 employees. The former are among the most severe in Europe. First, the 15 percent quota is very high. Second, there is no graduated system of penalties for under-fulfillment as in other countries: the quota is simply a regulatory requirement. Finally, the disabled workers hired against the quota are mostly still determined by the state employment agency. <sup>1/</sup> The quota for "disadvantaged" workers, on the other hand, is a particular feature of the Italian labor market, introduced with law 223/1991 as an "emergency" measure. Moreover, according to this law, this quota may be increased to a maximum of 20 percent by the regional employment agencies, with the approval of the Ministry of Labor.

In addition to the quotas, Italian legislation requires firms to give preference in hiring to temporary workers or workers dismissed by the firm during the previous 12 months.

Finally, aside from the quotas and the preferences, Italy is the only major European country where job placement is a state monopoly and private employment agencies are banned. This, compounded by the inefficiency of the state employment service (Bank of Italy 1993b), is one of the most crippling obstacles to efficient job search and hiring. A government proposal to allow the operation of such agencies in early 1993--albeit with stringent regulations on remuneration of workers hired through these--was rejected by Parliament. More recently, however, the government announced its intention to allow such agencies under license to intermediate temporary fixed-term contracts, albeit not for jobs of "low professional content".

In summary, Italian hiring regulations appear restrictive when compared to those in other major European countries (Table 1). Moreover, the fact that both the quantitative restrictions and the mandatory preference system apply to large firms only (the threshold for disabled quotas is higher in

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<sup>1/</sup> Individual hiring against the quota is allowed in certain cases.

Italy than in other major EC countries) has probably influenced the industrial structure in Italy relative to the rest of Europe. 1/

b. Rules on dismissals

Rules on dismissals in most countries have been influenced by a legal tradition that considers that the worker has a sort of "right" to and property in the job (Casavola 1993), and that, being the "weaker" party, he deserves protection by the state. European legal systems, in particular, protect the worker against arbitrary action by the employer, by providing a list of acceptable causes for dismissal, a notification requirement, an appeal mechanism in case the worker decides to contest the dismissal decision, protection for more vulnerable workers, severance pay, and penalties for the employer for "unfair" dismissals. At the same time, most systems allow summary dismissals for a "just cause", typically in case of grave misconduct or criminal behavior. In addition, most systems place more stringent conditions on the employer for mass dismissals.

In most of these areas of individual dismissal regulations, the Italian system has traditionally been more restrictive than that of other major EC countries. Table 3 presents a summary comparison of the main aspects of regulations governing individual dismissals in France, Germany, the U.K., and Italy. The severance pay and notification requirement in Italy are high relative to those in the other countries; the acceptable causes are somewhat loosely worded in the law (redundancy is not mentioned explicitly), making dismissal decisions by firms more easily contestable; and the stipulated "just cause" for summary dismissals is more stringent, rendering it less usable for firms. Perhaps the most important restriction, however, is the heavy penalties on the employer in case the dismissal is judged to be "unfair", particularly the re-hiring requirement, which is in addition to the mandatory compensation. 2/ This, together with the favorable rulings traditionally handed down by the Italian courts to workers appealing against dismissals, has made dismissal practically impossible (Emerson 1988a and 1988b).

Rules for collective dismissals typically stipulate longer notification periods and--often--consultations with union representatives and the government. At the same time, however, the need for large-scale restructuring of the work force (including through firm closure) is acknowledged as a prerogative of the employer. In Italy, the law requires consultations lasting up to 75 days. If agreement is not reached during this period, the dismissals may take place (subject to payment of

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1/ Although the industrial structure in Italy is attributable to a number of factors, labor market institutions may also help explain the prevalence of small enterprises in Italy compared with the rest of the EC. Table 2 illustrates the importance of small enterprises for employment.

2/ The re-hiring requirement is in place only for a limited number of cases in Germany, Greece, and Portugal (Casavola 1993).

termination benefits), but the dismissed workers can appeal to the courts. The Italian courts have always considered that an individual fired following a decision to reduce the work force is entitled to appeal to the court as if his dismissal was an individual dismissal (Treu et al. 1993). Thus, given that redundancy is not mentioned explicitly as a justified cause for dismissal, collective dismissals are at least as difficult to justify in court as individual ones.

The government has taken steps to mitigate the impact of stringent firing regulations. First, exemptions from the most onerous regulations have been granted to small firms: firms employing less than 15 employees (6 for agricultural firms) are not subject to the re-hiring requirement, although they, too, are subject to heavy penalties for "unfair" dismissals; for firms with less than 35 employees, the courts may order the payment of compensation only if the employer refuses to re-hire the dismissed worker. Just as in the case of hiring restrictions, this has probably had an effect on industrial structure. Secondly, the Italian state has undertaken responsibility for collective redundancies through the Wage Supplementation Fund (*Cassa Integrazione Guadagni* - CIG), the mobility list, early retirement, and work-sharing arrangements. Of these, the first two are discussed in the next section as part of the unemployment insurance system, and the last--which has been used only marginally thus far--is discussed in the context of alternative employment arrangements. While this solution has suited both employers and workers, it has arguably slowed down the re-allocation of labor resources (see next section).

Surveys of employers support the view that dismissal regulations in Italy constitute a serious restriction in the efficient functioning of the labor market. According to these, employers consider employment protection legislation in Italy the most severe among all EC countries (Commission of the European Communities 1993). Moreover, Italy reported the highest share of employers among all EC countries (88 percent), who believe that shorter notice periods, simpler legal procedures, and lower penalties would have a positive employment impact (Emerson 1988a). Recent empirical research also showed that, at least for large Italian firms during the period 1958-88, firing costs have been a statistically significant factor (and more important than hiring costs) in slowing down the adjustment of the work force to optimal levels (Jaramillo et al. 1992).

### c. Employment arrangements

An important aspect of the flexibility of the labor market is the menu of available employment arrangements. While the contract of unlimited or indefinite duration has historically been the norm in most European countries, during the 1980s a number of more flexible contractual forms was

developed, such as fixed-term or part-time work, temporary work, overtime, and work-sharing. 1/

Italy has been slower in moving in this direction than most other EC countries. Law 230/1962, in force still today, constrains the freedom to enter into "flexible" work arrangements (Casavola 1993). Moreover, during the 1970s, the unions were successful in limiting recourse to such arrangements, as well as to overtime work. In the 1980s, partly due to the reduction in union power, piece-meal liberalizations were promulgated as regards fixed-term and part-time contracts and work-sharing (although the latter, so-called "solidarity" contracts, are only marginally used); and limits to use of overtime were relaxed.

Fixed-term and temporary work regulations were liberalized with law 56/1987. Despite this, however, they remain restrictive relative to other major EC countries (Table 4). The most important restrictions pertain to the maximum allowed duration of contract; the limitation in the law of the cases in which fixed-term work is allowed; and the heavy penalty imposed on firms that are found violating these norms (typically requiring the firm to convert the fixed-term contract into one of indefinite duration). Furthermore, as discussed above, private employment/placement agencies--a very common way to arrange temporary fixed-term work--are not (so far) allowed to operate in Italy. Partly as a result of these restrictions, the share of temporary to total employment in Italy is by far among the lowest in Europe, consisting mainly of seasonal work in agriculture (Table 5).

Part-time work is currently regulated by law 863/1984, which partly liberalized previous regulations in this area. However, important restrictions still remain, and the share of part-time to total employment in Italy is by far the lowest in Europe (Table 6). Part-time workers cannot work overtime (Delsen 1991), and the hours of work have to be fixed precisely in advance. Employers argue that the current regulation of part-time work makes the employment of two half-time workers more costly than that of one full-time worker (Confindustria 1993).

The low share of fixed-term and part-time employment may also be explained by the flexibility introduced in the labor market by other means, notably subsidized training contracts; increased use of overtime; and the prevalence of small firms, which are largely able to evade labor market regulations.

There are two basic kinds of training contracts. Apprenticeship contracts (*contratti di apprendistato*) for youths under 20 years of age were first introduced in the 1950s. They last up to a maximum of 5 years and

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1/ The latter, which has appeared relatively recently, could also be considered an alternative to unemployment; indeed, it is often advocated as such. Here, however, it is discussed as part of the universe of alternative employment arrangements.

offer social security rebates to employers who hire apprentices. Apprentices, however, are expected to follow for part of the time a training course organized by the regional authorities. This requirement has made the alternative 2-year trainee contracts (*contratti di formazione e lavoro*), introduced in 1984 for youths under 30 years of age, more popular in recent years. Under these contracts, all training is supposed to take place at the firm. Like apprenticeships, trainee contracts offer employers substantial (but frequently modified) social security rebates. Trainee hirings peaked at well over half a million in 1989, although the cyclical downturn reduced the pace thereafter (Table 7). Currently, trainee contracts may be offered to youth under 32 years in the South or in high-unemployment areas, and the rate of social security rebates is higher there. A draft law presented to Parliament in late 1993 relaxes further the restrictions on training contracts.

In addition to these two basic types of training contracts, two new types of employment arrangements with some training content were recently introduced. First, law 236/1993 regulated internship arrangements (*stage*). Such arrangements already existed to a limited extent on an informal basis. The new rules require coordination between an educational institution (university, public school) and a private employer, and place limits on the duration of the internship. Second, decree-law 462/1993 introduced experimentally (initially for 1994 and 1995) the possibility of part-time "professional insertion" arrangements (*inserimento professionale*) of up to one year for unemployed youth (19-32 years), in programs coordinated by the Ministry of Labor. Both schemes are too recent to have a track record.

Regulations on working time were gradually relaxed during the last decade and the use of overtime increased significantly, partly reflecting the decline of the power of the unions. As a result, more flexibility was introduced both in terms of the distribution of the regular working time within the week and in terms of overtime. <sup>1/</sup> Thus, the percentage weight of overtime in total hours worked in manufacturing firms with over 500 workers, after declining to 2.5 percent in 1982, increased steadily to 5.5 percent in 1989 (Treu et al. 1993).

Aside from the relaxation of the restrictions on overtime, this increase in the use of overtime reflected the willingness of workers to work more and the preference of firms for use of overtime rather than additional employment. In general, the choice of firms is determined by a number of factors, notably efficiency considerations (e.g., the costs of building firm-specific human capital in newcomers, the costs of supervision, uncertainty about skill level, etc.). In the case of Italy, however, the firms' strong preference for overtime was probably also due to the stringency of current regulations on hiring, firing (including severance pay

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<sup>1/</sup> In Italy, overtime falls into two categories: supplementary work (40 to 48 hours weekly) and extraordinary work (over 48 hours weekly), with different rules for each.

requirements), and permissible employment arrangements, as well as other fixed costs (e.g., the required end-year bonus or "13th salary"). This is an illustration of how such regulations may have a direct effect on the creation of job positions.

While the use of overtime allows firms to respond quickly to an increase in demand for output, in Italy there are two instruments that allow a reduction in working time in the opposite case: one is recourse to the Wage Supplementation Fund (*Cassa integrazione guadagni* - CIG), essentially an unemployment compensation scheme; a second is work-sharing arrangements, (called "solidarity contracts"), which were first introduced in 1984 for firms with over 1,000 employees. The rationale behind work-sharing was to spread the costs of reduced labor demand over a larger number of workers. Two types of solidarity contracts were envisaged: "internal" or "defensive", where the current employees of a firm accept fewer working hours and a correspondingly lower salary; and "external" or "expansive", where the firm's total work force is increased through new hiring. 1/

In practice, solidarity contracts were very little used: in 1991, for example, only 29 such contracts were finalized, affecting a total of 2,269 employees (CER 1993). This was due primarily to the fact that both employers and employees preferred recourse to the Wage Supplementation Fund (CIG) (see next section): employers because it was virtually free for them, 2/ and employees because they could get more (the CIG replacement rate is set at 80 percent of the wage) for less or no work. To address this, the government "re-launched" solidarity contracts in mid-1993, providing increased social security rebates in line with the reduction in working time (and, therefore, with the number of jobs "saved"). As usual, the rebates are higher in EC "target zones" 1 and 2; 3/ they are significantly lower, however, for firms which are not eligible for CIG.

The experience with solidarity contracts highlights two important aspects of institutional reform in the Italian labor market in recent years. First, reforms and liberalizations have been introduced in a fragmentary and piece-meal manner, with an eye to the increasing burden of unemployment, but with little coordination and without an overall policy framework. Second, more often than not, labor market liberalization has been "bought" by the

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1/ In certain cases of "internal" solidarity contracts, the Wage Supplementation Fund (CIG) would supplement up to half of the lost remuneration for up to 24 months.

2/ At least until 1988, when employers were obliged to contribute 4.5 percent of the CIG benefits of workers towards social security.

3/ As of 1994, the Italian regional policy is to be aligned with that of the EC. As a result, whereas in the past preferential tax treatment, rebates, and other incentives were provided by the government to the South, from now on they are supposed to be provided to areas characterized as disadvantaged (according to certain criteria) throughout the country, and called "target zones" 1 or 2. In practice, these are mostly in the South.

government with larger fiscal incentives, notably social security rebates. These elements were recognized by the social partners in the July 1993 agreement, and the government undertook to prepare a comprehensive framework law for the labor market, covering all aspects of employment, bargaining, and unemployment protection, within the limits imposed by fiscal constraints.

### 3. Unemployment benefits

This section describes the system of unemployment benefits in Italy, including recent changes, and compares certain key aspects of it--notably level and duration of benefits--to those in other European countries.

Aside from equity considerations, there are efficiency arguments for providing some income support during unemployment. The lack of complete insurance markets means that the availability of a certain income during (unexpected) spells of unemployment, by minimizing disruption of the unemployed individual's life, facilitates job search. Seen as a subsidy on job search, unemployment benefits could improve job matches and increase productivity. Moreover, the provision of unemployment benefits, by increasing the mean and reducing the variance of expected permanent income, should encourage labor force participation (Layard et al. 1991; OECD 1991).

At the same time, however, it is clear that unemployment benefits, just like any other non-labor income, tend to increase the reservation wage and thus weaken the incentive for job search and the willingness to accept job offers. 1/ Also, in the aggregate, the existence of a "safety net" of this kind would tend to increase the bargaining power of unions over wages. These two factors would unambiguously lead to downward wage rigidity and a higher equilibrium unemployment rate. 2/ Moreover, the availability and financing of benefits may affect the sectoral composition of employment and the structure of unemployment (OECD 1993b).

Empirical studies with panel data have generally confirmed that unemployment benefits, on balance, have negative but small effects on the individual's willingness to leave unemployment and accept a job; these effects have been found to be higher in the U.S. and Canada and very low or insignificant in continental Europe; no correlation has been found between the level of benefits and the incentive to quit voluntarily from a job. 3/ Empirical studies with cross-country data, on the other hand, have tended to

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1/ Although they would have the opposite effect on workers not entitled to benefits or nearing the end of their entitlement.

2/ It has been shown, however, that in the absence of efficient labor contracts, some downward wage rigidity--notably through an unemployment insurance scheme--is Pareto-superior to full wage flexibility (Drèze & Gollier 1993).

3/ A wide survey of empirical studies is provided in Atkinson & Micklewright (1991).

come up with substantially higher estimates of (positive) effects of benefits on unemployment (Bean et al. 1986; Burda 1988; Nickell 1990; Layard et al. 1991). This is probably due to a great extent to the fact that cross-country data capture the effects that benefits have on unemployment through increasing the bargaining power of unions and leading to higher average wages, which are not likely to be captured in panel data.

On this basis, the emphasis in many countries since the late 1980s has shifted from general "passive" income support for the unemployed to "active" labor market policies, such as training, especially for the young and the long-term unemployed; improving employment services, including through more systematic contact with the unemployed; hiring and employment subsidies; and support for job initiatives. These policies, though costly, can have positive effects by facilitating matching, reducing long-term or low-skill unemployment, and increasing skills and productivity. At the same time, the traditional unemployment benefit systems have tended to become less generous and to be shaped so as to reinforce the active measures, e.g., through a reduction in the duration of benefits, a level of benefits that declines over time, and the linking of the payment of benefits to accepting training or a job (OECD 1993a).

In Italy, there are three main vehicles for providing income support during unemployment: the ordinary unemployment benefits (*trattamenti di disoccupazione*); the Wage Supplementation Fund (*Cassa integrazione guadagni* - CIG); and the mobility benefits (*indennità di mobilità*). The first, although it is the older of the three, it is not very important from the policy point of view and offers the lowest benefits. The CIG is a system originally designed to finance temporary layoffs, but has become by far the most important instrument of unemployment protection. Finally, the mobility list was introduced in 1991 to deal with collective redundancies. The main characteristics of the three systems are summarized in Table 8.

Ordinary unemployment benefits are available only to workers laid off (except those fired for a "just cause"--see previous section--or those eligible for mobility benefits). Thus, they are not available to first-time job seekers or to those who quit. The level of benefits has historically been very low (originally less than 10 percent of the average wage), but was recently increased to 25 percent of the last wage and, in July 1993, the government announced its intention to raise it to 40 percent of the last wage. The benefit is paid for up to 3 months. Aside from the ordinary benefit, there is also a special benefit paid to construction workers for up to 18 months, equal to 80 percent of the last wage.

The Wage Supplementation Fund (CIG) is an institution peculiar to Italy, and has been extensively studied (see Cucchiarelli & Tronti (1993) for a brief overview). It was first introduced during the war and took its present form in the early post-war years. It was designed to finance temporary redundancies in industry: firms that faced a reduction in demand could place some of their workers either full-time or part-time on CIG, where they would receive benefits very close to their actual wage. These

workers were not considered unemployed (and even today are not categorized as unemployed in the labor force surveys), and were expected to return to full employment in the same firm. 1/ The CIG has been reformed and extended numerous times, and has been split into two: the "ordinary" CIG (CIG-O) and the "special" CIG (CIG-S), which offers benefits for longer. Use of the CIG has fluctuated substantially during the last two decades, rising sharply in 1973-75 and 1980-84 after the oil shocks and, in the latter case, the large scale restructuring of Italian industry, and again registering a concomitant increase again in 1993 (Chart 1).

As at end-1993, ordinary CIG (CIG-O) benefits are available to workers (including white-collar) in industrial firms that experience "temporary difficulties". They last up to 12 consecutive months or 12 non-consecutive months in any two-year period (until end-1994, 24 months for firms in EC target zones 1 & 2). The replacement rate is 80 percent of the wage (after the first six months, a maximum of Lit 1,248,021 applies, which is roughly equivalent to 60-65 percent of the average industrial wage). 2/ Firms apply for CIG-O at the local social security office, and approval procedures are usually quick. Special CIG (CIG-S) benefits are available to workers of industrial firms with more than 15 employees and commercial firms with more than 200 employees (until end-1994, they are also available to commercial firms with more than 50 employees). In cases of "crisis", they last up to 12 months (renewable once); up to end-1994, this can be extended to 18 months if less than 100 employees are involved. In cases of "restructuring", they last up to 24 months (also renewable once, for a maximum of 48 months). The replacement rate is 80 percent of the wage, subject to a maximum of Lit 1,248,021. Procedures for CIG-S benefits are more complex, and Ministerial approval is required.

Although the CIG is still theoretically a system for financing temporary redundancies, in practice it is an unemployment insurance scheme. This was recognized explicitly in 1991, when it became possible for CIG-S beneficiaries to move on to the mobility list after the CIG-S benefits run out.

The mobility list was introduced with law 223/1991 for workers who are victims of mass layoffs. These are considered "disadvantaged" workers and have automatic priority for hiring (see section 2). In addition, those among them who come from industrial firms with more than 15 employees or commercial firms with more than 200 employees (extended in 1993 to

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1/ The exclusion of workers on CIG from the unemployment figures partly reflects a technical problem: data on CIG activity are reported in terms of "hours authorized", since many beneficiaries are paid by the CIG for only part of the time; a conversion into "worker-equivalent" is necessarily approximate.

2/ In terms of net salary the replacement rate is higher, because workers on CIG benefits pay minimum social security contributions (equal to those paid by an apprentice).

commercial firms with more than 50 employees), as well as those who have "graduated" from CIG-S, receive a benefit (*indennità di mobilità*) generally equal to that offered by CIG (80 percent of last wage). The duration of the benefit varies depending on the age of the worker and the area of origin: workers up to 40 years old receive the benefit for up to 12 months (24 months in EC target zones 1 & 2); workers between 40 and 50 years receive the full benefit for up to 12 months and 80 percent of the benefit (about 75 percent of the last wage) for an additional 12 months (24 months in EC target zones 1 & 2); and workers over 50 years receive the full benefit for 12 months and 80 percent of the benefit for an additional 24 months (36 months in EC target zones 1 & 2).

The mobility benefits have also been temporarily linked to the possibility of early retirement in some areas and sectors. Workers already on mobility before end-1993, who are 5 years short of early retirement age (55 years) and have at least 15 years of contributions (or 10 years short with 28 years of contributions) may continue to receive 80 percent of the mobility benefit until retirement.

This brief review of the main elements of the Italian unemployment benefits system is summarized in a simplified form in Chart 2. Three important general observations are in order. First, the duration of benefits and the replacement rate are very generous: even aside from the possibility of receiving benefits until early retirement for certain groups of unemployed, it is feasible for prime age workers who start in the CIG-S to combine CIG-S and mobility benefits equal to 80 percent of their last wage for a maximum of five years (four in the CIG-S and another one on mobility). In certain areas (notably in the South), the maximum combined duration can reach six years. Older workers can continue to receive slightly reduced benefits for another two years. These benefits are far more generous than those in other EC countries (Table 9).

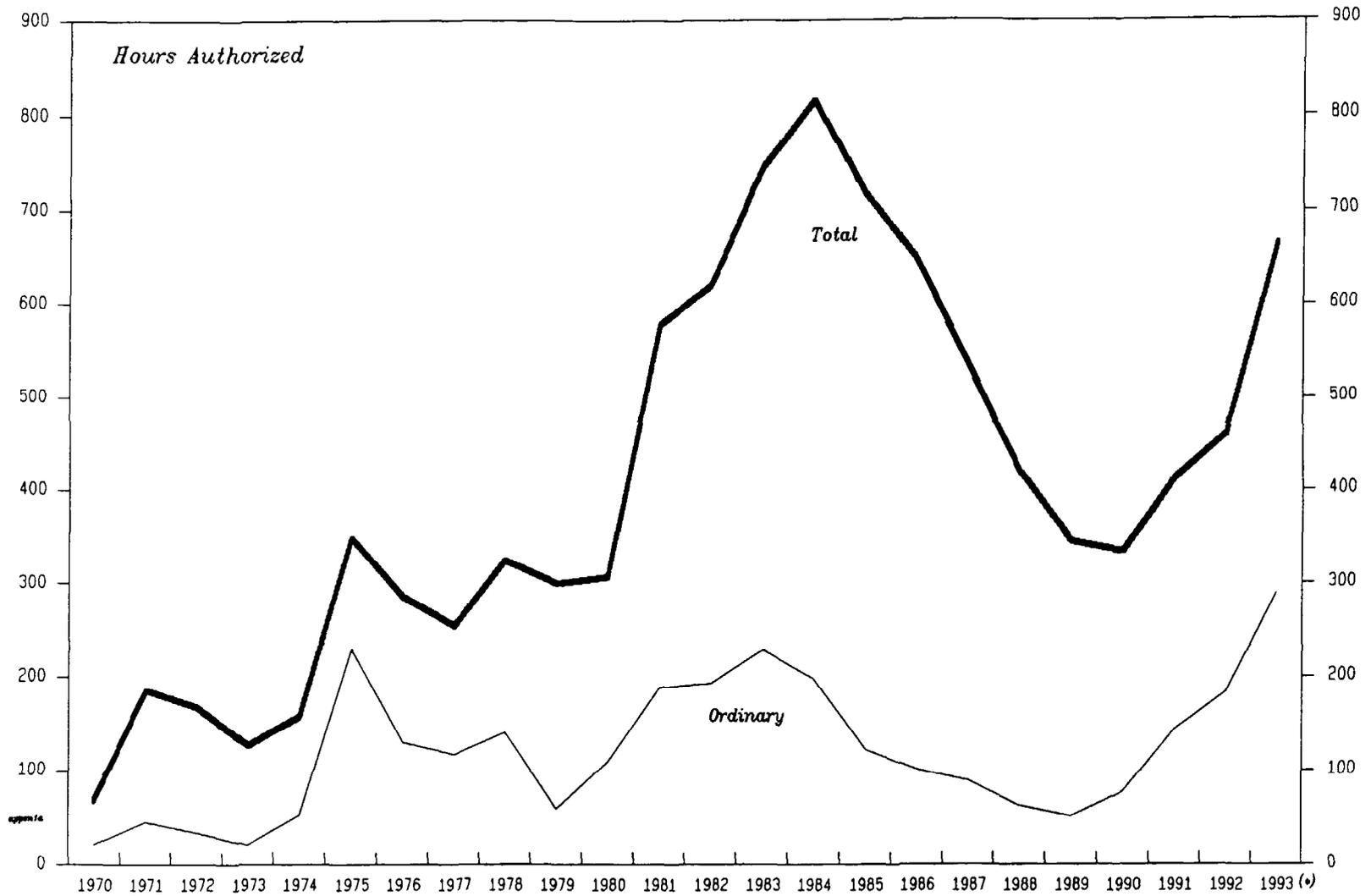
Second, the benefits are inequitable. Generous benefits are available to some segments of the labor force, particularly dependent workers in medium or large industrial and service firms, while workers in small firms or in small and medium-size firms in the service sector are eligible only for the much less generous ordinary unemployment benefits. Workers with no job experience and self-employed are not eligible for any kind of benefits at all.

Third, payment of the benefits is not linked to any re-training or active job search requirement. This is a major drawback that creates significant moral hazard. Partly to deal with this problem, the government announced in November 1993 the introduction of a social work scheme (*lavori socialmente utili*). <sup>1/</sup> According to this scheme, public administrations, public enterprises, or other entities authorized by the Ministry of Labor

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<sup>1/</sup> The decree-law that introduced the scheme was reproduced in the *Sole 24 Ore* of November 17, 1993; see also Confindustria (1993).

CHART 1  
 ITALY  
 Wage Supplementation Fund (CIG)  
 (In millions of manhours)

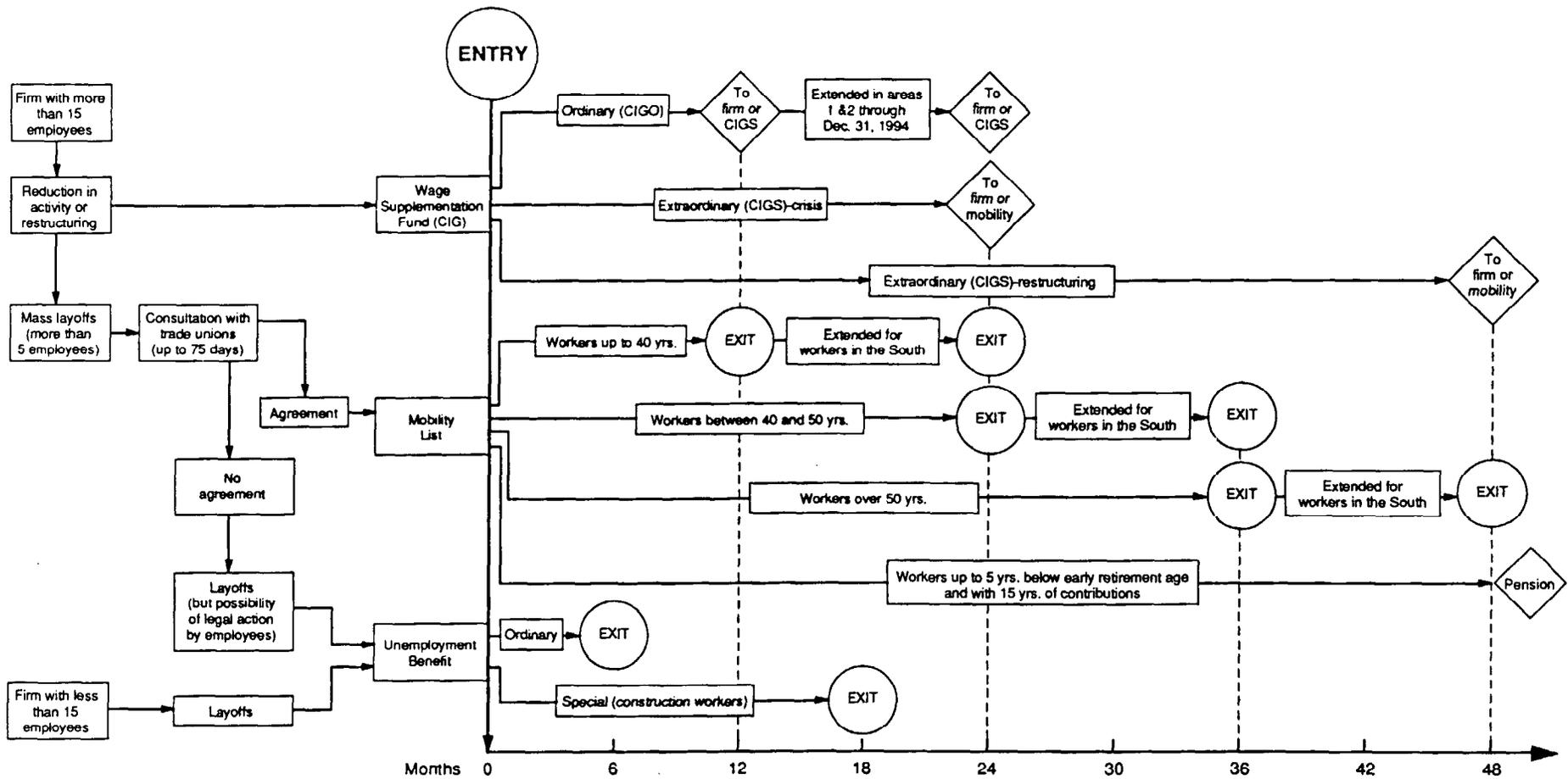


Sources: INPS (1993); and Cuchiarelli & Tronti (1993).

(\*) Estimate based on data for the first ten months.



Chart 2: Unemployment Insurance System: Entry, Duration, and Exit





may organize social work schemes, employing workers who have been unemployed for at least two years, who are enrolled on the mobility list, who receive CIG-S benefits, or unemployed youths in the South. Workers on this scheme continue to receive the mobility or CIG-S benefit plus a premium of at least 10 percent of that benefit; if they were not eligible for any benefit prior to their enrollment in the scheme, they receive an hourly wage of Lit 7,500. Workers who without justification refuse to participate lose their mobility or CIG-S benefit for the duration of the project. Although the social work scheme can play a useful role as a "screening device" for benefit recipients, it is not clear whether it will improve skills and facilitate job search. Moreover, it risks creating pressure for permanent jobs in the wider public sector.

These shortcomings of the Italian unemployment benefits system flow directly from the fundamental concept underlying its most important component, the CIG. The CIG was designed to deal with short-term, temporary, and reversible reductions in labor demand, affecting primarily the industrial sector, and not with longer-term, structural unemployment. The changes in the structure of the economy and the labor market during the last decade have created a situation that the system has been unable to tackle successfully, notably a large incidence of long-term unemployment and unemployment among first time job-seekers. Recent changes in the system, particularly the introduction of the mobility list in 1991, have generally been in the right direction, but have not yet changed the balance. The CIG still absorbs the bulk of financial resources devoted to income support for the unemployed, although it covers only about one-third of total unemployed manhours that are compensated (Chart 3).

Although a thorough discussion of active labor market policies lies outside the scope of this paper, Table 10 gives an important perspective. <sup>1/</sup> In contrast to the relative generosity of the Italian unemployment insurance scheme, Italy spends a relatively low percentage of GDP on active programs. Moreover, the bulk of it is spent in the form of social security rebates for training contracts, while nothing is spent on supporting job creation, and very little is allocated to the public employment services. The latter, in particular, highlights an important problem: although Italy spends one of the lowest shares of GDP in the EC on public employment services, these public agencies are about the only formal means of job search, since private agencies have thus far been prohibited by law (Casavola & Sestito 1993).

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<sup>1/</sup> Active labor market programs can be very varied; a large body of literature on this topic is already available (see OECD 1993a), and the OECD publishes annually cross-country comparisons of expenditures on active programs.

#### 4. The wage determination system

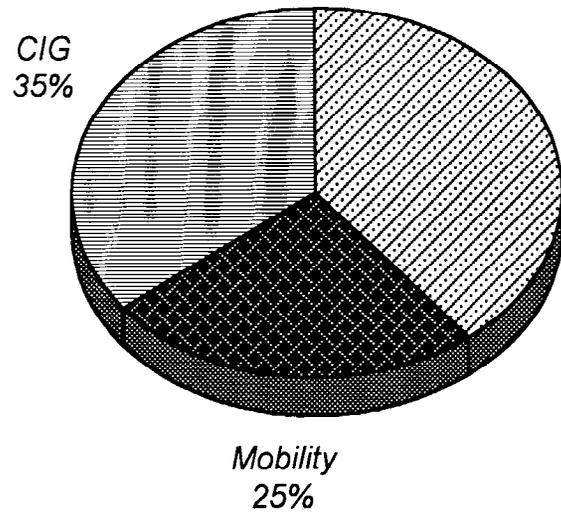
One of the most important institutional aspects of the labor market is the wage determination process. The experience in the OECD in the 1970s and 1980s, first with the two oil shocks and then with the slowdown in productivity growth and increase in unemployment, attracted attention to the effects of this system on the extent and the speed of labor market adjustment to terms-of-trade or productivity shocks. In perfect competition with full information agents would adjust real wages so as to ensure continuous full employment. Institutional arrangements for wage setting, however, differ greatly between countries, varying from very centralized systems (e.g., Austria) to very decentralized ones (e.g., the U.S.). The work of Bruno & Sachs (1984) challenged the conventional view that more decentralized systems are better: they constructed an index of the degree of centralization of the wage bargaining system, or "corporatism" index, and showed that more corporatist countries (notably small non-EC European countries) performed better in response to the first oil shock.

Calmfors & Driffil (1988) pursued this argument further. They ranked countries according to the degree of centralization of the wage bargaining system by constructing a "centralization index", and found that "extremes work best", i.e., that both centralized and decentralized systems are associated with better macroeconomic performance than intermediate ones. Freeman (1988) pursued a similar line (although using wage dispersion and union density as proxies for centralization), and found the same hump-shaped relation between centralization and performance. Calmfors (1993) provided some microeconomic foundations for this "hump-shaped" relation between centralization and performance, arguing that centralization in wage bargaining--defined as inter-union and inter-employer cooperation at the national level--helps internalize a number of negative externalities that arise in situations of imperfectly decentralized wage setting, where workers and employers negotiate wages at the firm level. Perhaps the most important among these are: (i) the consumer price externality, which arises because firm-based wage setting disregards the effect of higher wages on the aggregate price level; (ii) the input price externality, namely the effect of higher wages in one firm on input prices of another firm; (iii) the unemployment externality, or the effect of a reduction in employment in one firm on the job prospects of all the unemployed; and (iv) the relative wage externality, which captures the effects of wage increases in one firm on wage demands in others.

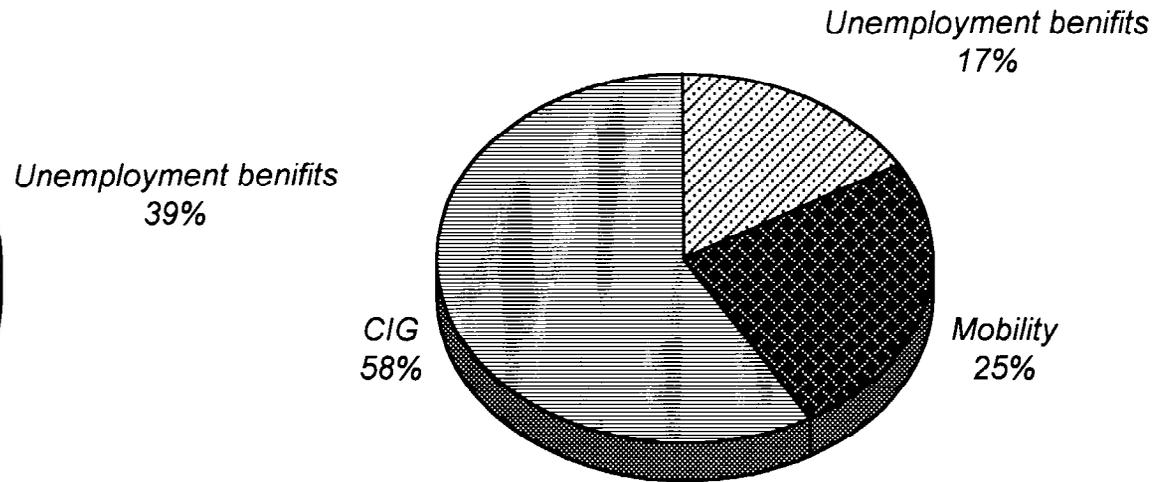
Several criticisms may be leveled against this model. First, as Calmfors & Driffil themselves pointed out, the simple hump-shape model may not hold in cases of imperfect markets or economies that are substantially open to foreign competition; in the latter case, in particular, the more open the economy, the smaller the consumer price externality and thus the gain from centralization. Second, a centralized system may involve bargaining in several overlaid levels (e.g., provincial, regional, and national); in that case, the resulting wage drift may impart an inflationary bias to the system and offset the benefits of centralization. Third, it may

Chart 3  
Italy  
Unemployment Insurance Schemes, 1993 (estimated)

Shares in Total Manhours Covered



Shares in Total Expenditure



Source: Cuchiarelli & Tronti (1993).



be argued that what matters for macroeconomic performance is not the degree of centralization *per se*, but the degree of social consensus and enforceability of agreements; McCallum (1983) has found that the degree of consensus, as proxied by strike levels, was a superior indicator of economic performance in the 1970s. In such a case, the amplitude of union coverage is a crucial determinant of the extent to which firm-based wage setting externalities can be internalized by higher centralization. Fourth, the benefits of centralized systems may decline quickly as the economy moves towards a "post-Fordist" production environment, since developments in production technology and work organization may increase the proportion of firms that find decentralized bargaining more profitable (Ramaswamy & Rowthorn 1993).

Another important criticism of Calmfors' hump-shaped model is that it disregards the negative effects of centralization on relative wages. That centralization would tend to reduce wage dispersion and render wage differentials more rigid can be argued in different ways. The decision-making process in centralized unions would tend to favor the "median voter"; thus, if union members are risk averse and uncertain about their position in the post-negotiation relative wage distribution, unions would demand a compression of wage differentials irrespective of the conditions in the labor market. Also, centralized unions may prefer a "solidaristic" wage policy, i.e., tying wage increases to average productivity, rather than individual (firm) productivity. Rigid wage differentials, in turn, slow down employment adjustment and increase unemployment persistence (Pissarides 1990), thus leading to a worse macroeconomic performance under centralization. 1/

Finally, aside from the possible theoretical problems of the model, a practical shortcoming of the hump-shaped hypothesis is that it does not always give a clear direction for policy. Starting from any given intermediate degree of centralization, whether the system should move to more or less centralization depends, aside from everything else, on its precise position on the curve, which is very difficult to establish.

Against this background, it is hardly surprising that there is little consensus on the desirable degree of centralization in a country's wage bargaining system. While the empirical basis of the hump-shaped relation between centralization and performance seems sound, evaluating changes in existing wage bargaining systems that move them in one or the other direction along the curve must depend on a host of country-specific factors, including the history and influence of unions, the degree of wage dispersion at the starting point, and the extent of openness of the economy.

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1/ On the other hand, it has been shown that under decentralized wage bargaining and asymmetrical relative wage preferences, different expectations about aggregate wage behavior may result in multiple equilibria (Bhaskar 1990).

a. The evolution of the wage bargaining system in the 1970s and 1980s

The wage bargaining procedures in Italy evolved over a number of years into a multi-tiered system. From an institutional point of view, the system changed little during the last two decades, although the emphasis shifted between tiers. The system was fundamentally overhauled in 1993 with the July agreement between the social partners. This sub-section traces the evolution of the system over the 1970s and 1980s, and the changes introduced with the July 1993 agreement are presented in the next one.

Bargaining in Italy historically took place at a number of different levels--national, industry, provincial, and firm--which could overlap and cover the same ground. The importance of the various levels varied considerably over time, with national inter-confederal bargaining very important during the post-war reconstruction and again in the late 1970s. It has been argued (Treu et al. 1993) that national bargaining gained importance during crisis periods, when its role spilled over into forms of political bargaining with the government. In contrast, bargaining by profession has been virtually nonexistent (except in some cases in the public sector).

Since the early post-war years, the main actors in the negotiations have been, on the part of labor, three main national union confederations with strong political affiliation, and on the part of employers, Confindustria, which groups together well over 100,000 companies in industry, construction, and some service sectors. 1/

Collective bargaining in the private sector is generally regulated by private law. Thus, in principle, unions and employer organizations do not have a "monopoly" in representation, and the agreements only apply to members of the participating organizations. However, the development of unionization during the 1960s and 1970s, as well as the privileges awarded to members of the three major union confederations (the only established unions at that time) by law 300/1970, such as the right to hold meetings at the workplace, time off work for union officials, etc., have ensured that, in practice, collective agreements signed by these three confederations have

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1/ The three trade union confederations are the *Confederazione Generale Italiana del Lavoro* (CGIL), of socialist and communist origin; the *Confederazione Italiana Sindacati dei Lavoratori* (CSIL), the catholic trade union; and the *Unione Italiana Lavoratori* (UIL), with republican and socialist affiliation. The two employer confederations in the wider public sector, Intersind (which covered IRI and EFIM, the two largest state holding companies) and ASAP (which covered ENI, the public energy company), are now in the process of joining Confindustria.

general validity, at least as far as compensation is concerned. <sup>1/</sup> Collective bargaining in the public sector, on the other hand, is less regulated, and independent unions more common. Thus, government guidelines on pay have often been overridden as a result of strong union pressure in some sectors.

The so-called national sectoral agreements, the mainstay of the Italian system, are negotiated at the national level between employer and union confederations, and determine a number of parameters on an industry-by-industry basis, notably wages, working hours, working conditions, etc. White- and blue-collar workers in each industry are distributed according to a rank-ordering system with a fixed number of ranks (typically ten or twelve), called *inquadramento*, and these parameters are specified for each of them. Until 1993, subsequent agreements at the regional or firm-level could re-open discussion on any of the aspects of the national sectoral agreements, and bargain wages and working conditions above the standards laid down in national agreements.

As regards wages, in particular, in addition to the rates agreed through bargaining, workers received backward-looking indexation payments through the *scala mobile* system. The wage indexation system was changed in the mid-1970s, with the introduction of flat-amount indexation irrespective of the worker's actual wage, and again in 1985-86, when the flat-amount system was abolished, but remained perhaps the single most important distortion in the Italian wage bargaining system throughout the period. <sup>2/</sup> Table 11 presents the structure of the worker's annual compensation, and the level at which each component is, in principle, determined. It is noteworthy that by far the largest proportion of monthly compensation is determined by agreements at the national sectoral level, and that this share is greater the lower the skill level (and thus rank) of the employee (Table 12).

Trade union power changed considerably during the last two decades, affecting the way the wage bargaining system worked. Unions gained power during the late 1960s and 1970s, especially after the "hot autumn" of 1969, which resulted, inter alia, in the Charter of Workers' Rights (*Statuto dei Lavoratori*) that was the basis for most of the restrictive employment protection legislation reviewed in the previous sections. During the 1970s, unions pushed--with some success--for restrictions on overtime and a more egalitarian distribution of income, and--unsuccessfully--for a unification of the rank-ordering system for white- and blue-collar workers to reflect

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<sup>1/</sup> In recent years, however, the decline in the power of the unions and the emergence of independent unions may have led to a decline in the coverage of national sectoral agreements, although this still remains quite high. Treu et al. (1993) report that the coverage ranges between 70-80 percent in the major industrial sectors.

<sup>2/</sup> For a description of the *scala mobile* and its evolution, see Bank of Italy (1986) and the references therein.

the equivalence of manual and intellectual work. Coverage and militancy of the three large union confederations, however, started declining quickly in the early 1980s (Chart 4) while, at the same time, the importance of small independent unions increased, especially in the public sector. 1/

The changes in union power affected profoundly the balance of power in bargaining and the outcomes of the negotiations. In the 1980s, the importance of firm-based agreements increased: although the share of contractual compensation awarded at the firm-level remained small, wage drift (which is also largely determined at the firm level) increased, especially for white-collar workers (Chart 5). At the same time, while the 1970s saw a substantial narrowing of wage differentials, the trend was partly reversed in the 1980s, when differentials both across ranks and within each rank started to increase (Chart 6). This was the result of a number of factors, including greater differentiation of contractual compensation, greater wage drift, and the abolition of the flat-amount indexation. This increase, however, did not fully compensate for the compression of the 1970s, while there is some evidence that suggests that compression of differentials may have started again in the late 1980s. 2/ Inter-sectoral wage differentials also tended to increase (Table 13); the explanation for this, however, probably also reflects the impact of relative goods price changes. Finally, aside from wage settlements, contractual agreements during the 1980s tended to relax gradually some of the most restrictive elements of earlier agreements, notably on overtime.

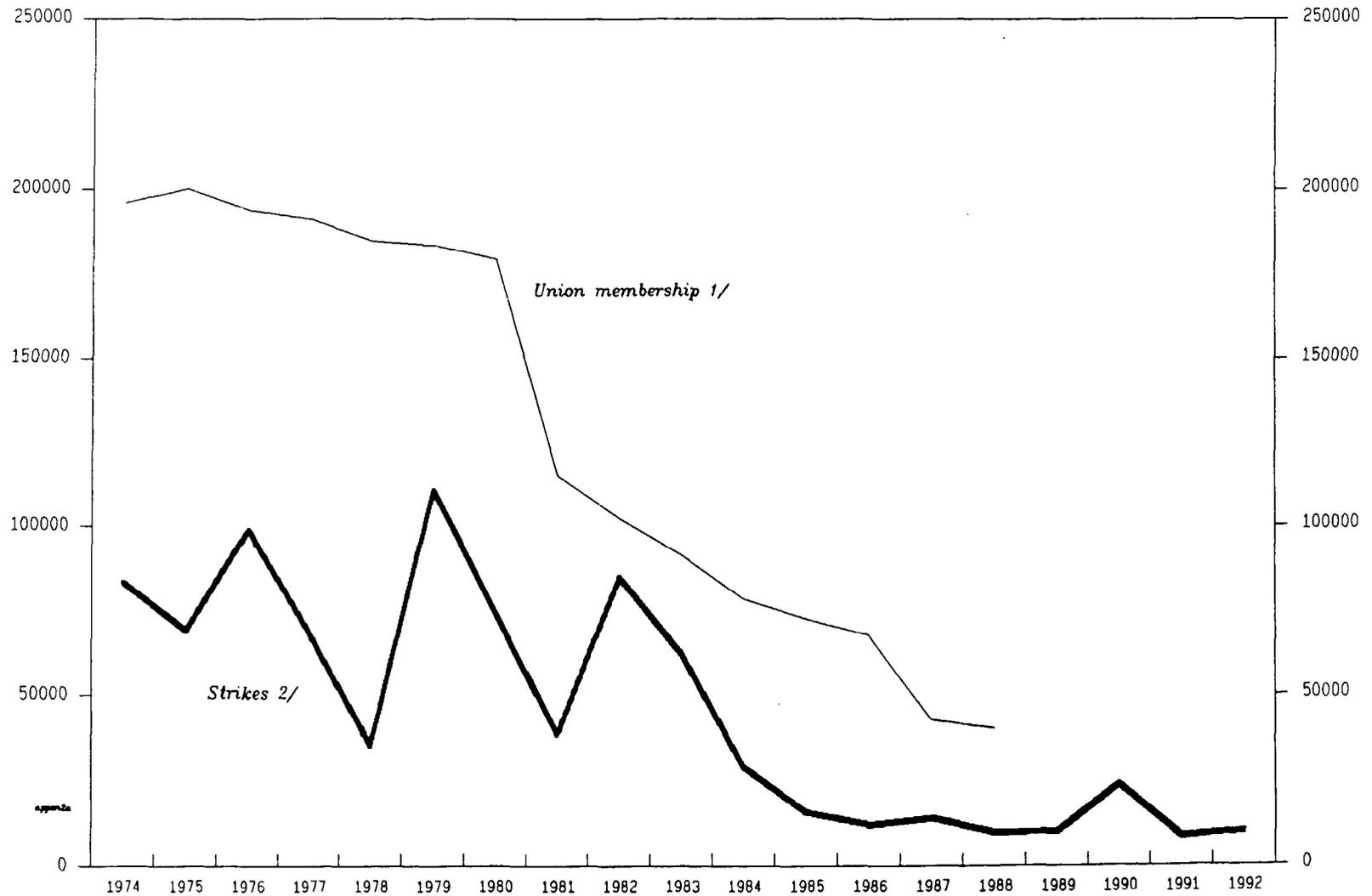
In summary, until the early 1980s the Italian wage bargaining system was very centralized: the share of the wage determined at the national level was high, unions were strong and coordinated at the national level, and wage dispersion was low and declining. During the 1980s, the Italian wage bargaining system moved towards greater decentralization and flexibility. Although the share of the wage determined at the national level remained high, the importance of firm-based bargaining increased, the power of national union confederations declined, and wage differentials caught up some of the ground lost during the previous decade. This shift came about gradually, primarily reflecting changes in the underlying economic structure and the political influence of the unions, while the institutional aspects of the bargaining system remained essentially

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1/ For international comparisons of union power during the 1970s and 1980s, see OECD (1991).

2/ Ericson & Ichino (1992) examine the development of wage differentials and conclude that some compression that cannot be explained by market forces still persists in Italy. Sestito (1992) presents evidence on the compression of differentials in the late 1980s.

CHART 4  
 ITALY  
 Union Strength and Militancy

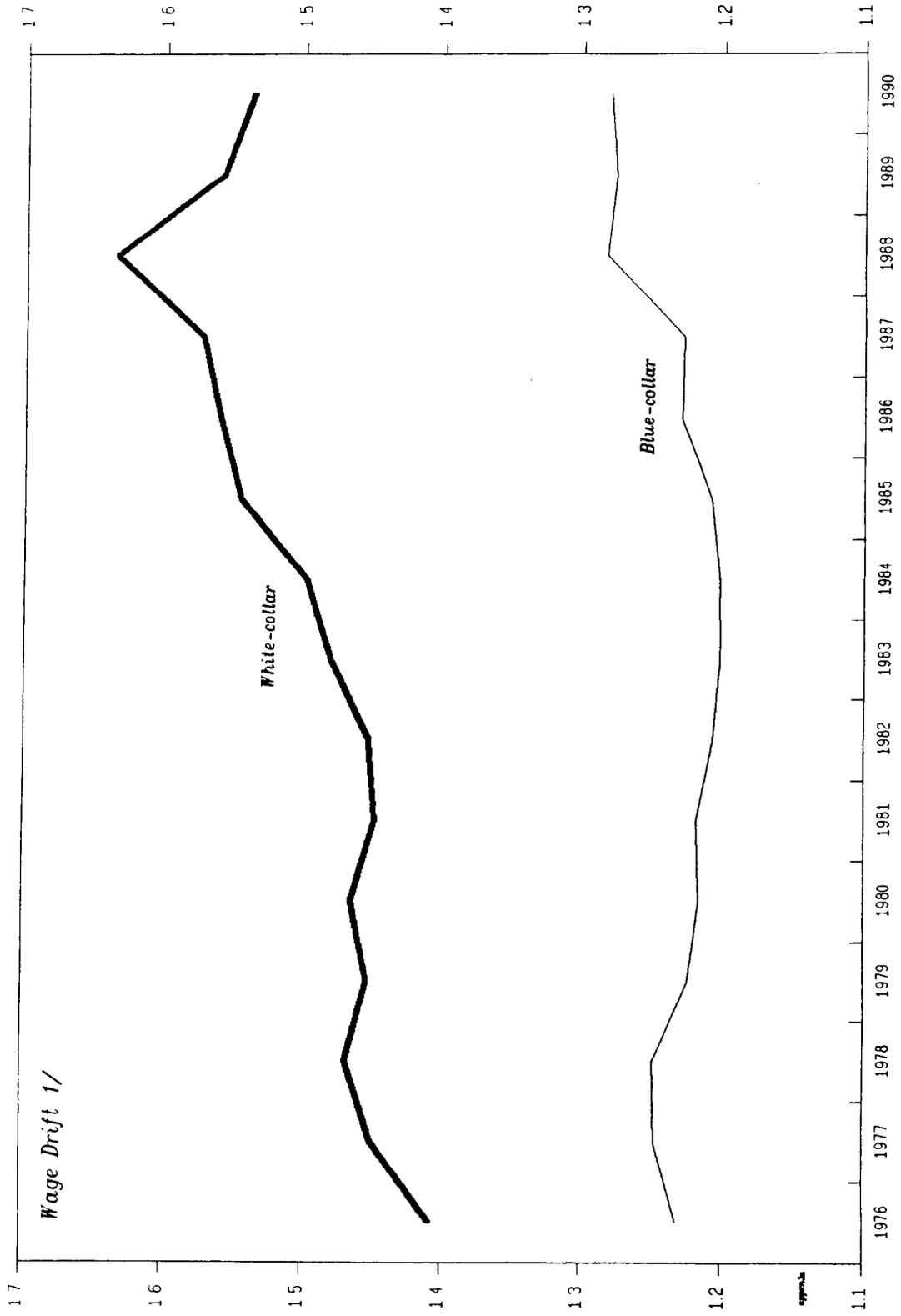


Sources: ISTAT; and Ericson & Ichino (1992).

- 1/ CGIL, CISL, and UIL members, metal-manufacturing, Milan area.
- 2/ Thousands of hours lost to strikes, manufacturing sector.



CHART 5  
ITALY  
Wage Drift



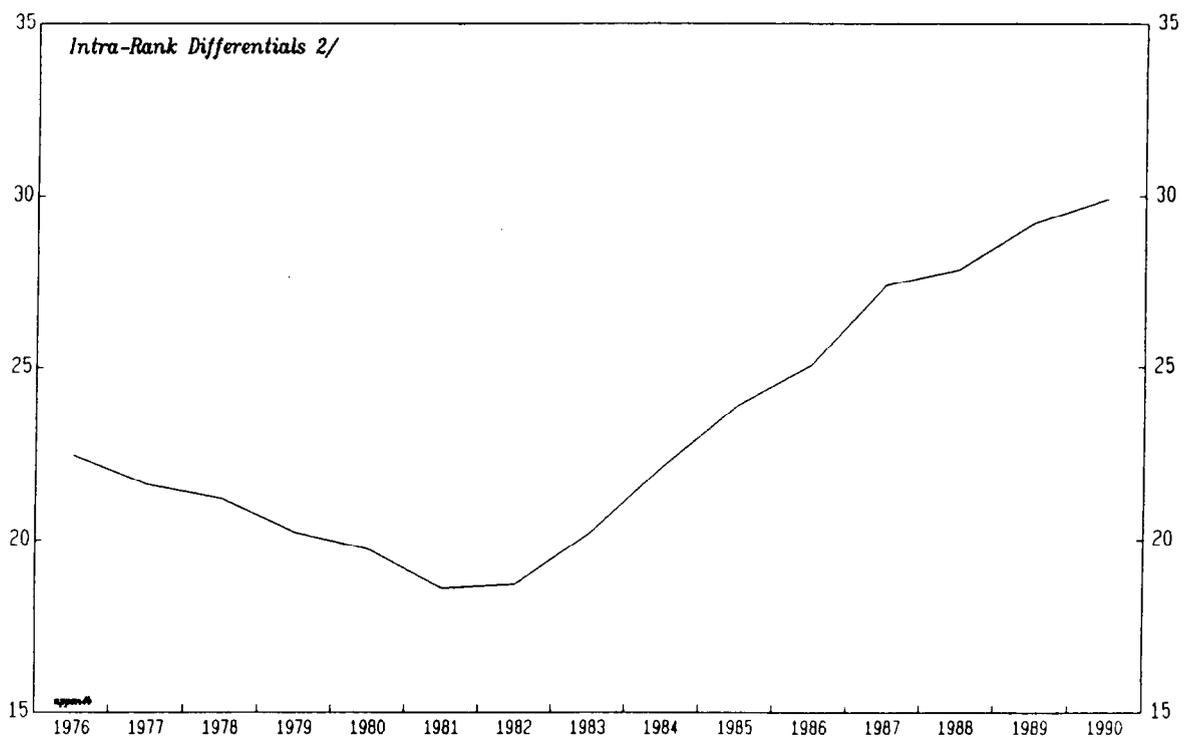
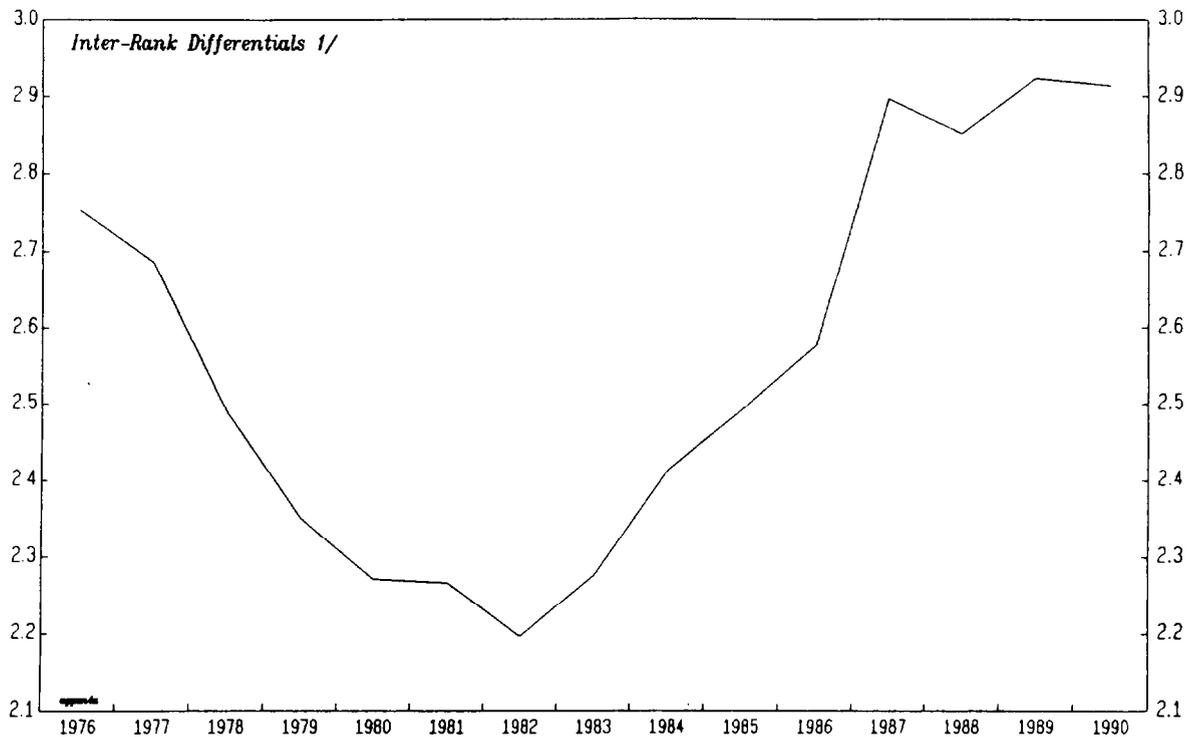
Source: ASAP (1993).

1/ Ratio of actual to contractual wages, metal manufacturing industry.



CHART 6  
ITALY

### Wage Differentials



Source: ASAP (1993).

1/ Ratio of higher to lowest rank salary, metal manufacturing industry.

2/ Weighted coefficient of variation of salaries in the inquadramento, metal manufacturing industry.



unchanged. 1/ The system was fundamentally changed in 1992-93, first with the abolition of indexation in December 1992, and then with the agreement of July 1993.

b. The July 1993 agreement between the social partners

On July 3, 1993, representatives of the trade unions, employer confederations, and the government, after a 2-year old negotiation, finalized a framework agreement on a wide range of labor market issues, notably incomes and employment policy and the bargaining system (*protocollo sulla politica dei redditi e dell' occupazione, sugli assetti contrattuali, sulle politiche del lavoro, e sul sostegno al sistema produttivo*). 2/ This agreement includes specific measures, such as changes in wage bargaining and other labor market institutions, the level of unemployment benefits, etc.; as well as more general policy commitments on issues such as public infrastructure investment, industrial policy, policies to encourage research and development, public sector procurement practices, etc. As the latter have been discussed in sections 2 and 3, this sub-section summarizes the changes introduced to the wage bargaining system.

By far the most important aspect of the July agreement was the definitive abolition of backward-looking automatic indexation (*scala mobile*). 3/ In addition, the agreement introduced the following changes in the process of wage bargaining system: (i) the demarcation of the content of the existing levels of wage bargaining (national sectoral-- *contrattazione nazionale di categoria*; and regional or firm-based-- *contrattazione territoriale o aziendale*), which up to that point could overlap (effectively creating a multi-tier bargaining system), and the introduction of specific timetable and procedures for bargaining and conflict resolution; and (ii) the introduction, for the first time, of benchmarks that the social partners agree to take into account in their negotiations (notably targeted inflation at the national level).

Under the new system, the national sectoral contract is to last four years; the minimum wage rates agreed for each sector and rank of worker, however, are to be reviewed after the first two years. To minimize the disruption from possible industrial action at the time of this review, the

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1/ It has been argued (Ministry of Labor 1993) that membership in the ERM and the resulting effect on inflationary expectations also had an effect on the evolution of the wage bargaining system. While the link between ERM membership and expectation formation has been noted by others as well (e.g., Giavazzi & Giovannini 1989), the one between expectations and the wage bargaining system is more difficult to establish empirically.

2/ The agreement was ratified by the members of the confederations on July 23. Its contents are described in Bank of Italy (1993a) and (1993b), and analyzed in Brunetta et al. (1994). For the actual text of the agreement, see *Sole 24 Ore*, July 4, 1993.

3/ The *scala mobile* was first suspended in December 1991.

new system provides for a "cooling-off" period starting three months before the expiration of the wage contract, during which the parties shall not take "unilateral measures" or "direct action". Specific penalties are provided for violating the "cooling-off" period. At the same time, if a new contract is not agreed within three months after the expiration of the old one, then wages are automatically increased by 30 percent of targeted inflation; and after another three months without a contract, this is increased to 50 percent of targeted inflation.

Wage negotiations and settlements at the national sectoral level are supposed to be "consistent" with the targeted inflation rate. The July agreement does not provide a precise formula for linking the two, but lists a number of factors to be taken into account to ensure consistency: the current incomes and employment policies, the objective of safeguarding the real income of workers, and the general state and competitiveness of the economy, as well as that of the specific sector to which the wage settlements apply.

The July agreement provides a concrete framework for continuous dialogue between the social partners at the national level. In the spring of each year, the government, in the context of the preparation of its Economic and Financial 3-year Program (*Documento di programmazione economico-finanziaria*), is supposed to discuss with the representatives of employers and employees its broad economic policy objectives, with a view to reaching agreement on targets or projections for growth, inflation, employment, and public spending. In September of each year, in the context of the preparation of next year's budget, the Government is supposed to convene the social partners again to present the specific targets for the following year. In addition, the government has undertaken the responsibility to create a price monitoring office (*Osservatorio dei prezzi*), in order to follow the mechanics of price formation, as well as to compile every spring an annual report on employment, which would form the basis of employment and incomes policies.

Firm-based or regional contracts are to take place within the framework of and according to a timetable laid down by the national sectoral contracts; they are to cover areas not covered by the latter, and last four years. Wage settlements at this level are to be directly linked to developments in productivity and profitability, e.g, through profit-sharing schemes; again, however, the agreement does not include a precise formula. To encourage such schemes, the government has agreed to consider the possibility of differentiation of social security contribution rates for the

part of wages contracted at the firm level. 1/ Moreover, the government has been committed to promulgating legislation that would extend the coverage of firm-based contracts to other firms or sectors, if that is necessary to ensure "fair" competition among firms.

Finally, to ensure a connection between the national and the firm-based contracts, the July agreement stipulates that two-thirds of the workers' representatives at the firm level will be directly elected by the workers, with the remaining one-third appointed or elected by the unions that sign the national contracts.

The definitive abolition of indexation--one of the main achievements of the July agreement--is expected to contribute to wage moderation and improve labor market conditions. Aside from that, it is difficult to evaluate whether the institutional changes in the wage bargaining system will lead to a higher or lower degree of centralization, and whether they will tend to improve or deteriorate labor market performance. Until negotiations at both tiers are concluded under the new system, it is impossible to know whether the share of the wage determined at the national level (including the forward looking indexation component) will increase or decline relative to the past. From this point of view, the effects of the new system are impossible to predict. Other indicators of centralization are likely to move in different directions. On the one hand, wage dispersion will probably increase, especially if profit-sharing schemes can be extensively used, thus continuing the trend towards more decentralized and flexible wage setting. On the other hand, however, the July agreement reinforces the position of the three union confederations by institutionalizing their role in the consultations and negotiations, and by ensuring their *de jure* participation in all firm-based bargaining, whether the local union is a confederation member or not. This may have adverse effects, especially as labor market conditions firm up and unemployment declines in the medium-term.

## 5. Conclusions

This paper examined labor market institutions in Italy in three major groups: employment protection legislation, unemployment benefits, and the framework for wage negotiations. The purpose was to catalog the main aspects of these institutions as they currently stand, describe their recent evolution, compare them with those in other major European countries, and

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1/ This was one of the most controversial aspects of the July agreement, with the employers' confederations initially demanding an across-the-board reduction of social security contributions for firm-based wage settlements. As the final form of the compromise formula is yet to be made specific, its fiscal implications are unknown. In order to protect the budget, the government is considering introducing a 3 percent cap on the share of income from profit-sharing schemes to the total compensation package.

derive some conclusions about their likely impact on labor market performance.

The main conclusions are that Italian labor market institutions have, until very recently, been restrictive and often ill-suited for the tasks they were supposed to perform. Employment protection legislation was among the most restrictive in the OECD; the unemployment insurance schemes in place were not equipped to deal with Italy's current unemployment problem; and the wage setting process, including automatic indexation, was inflexible (although a gradual shift away from the rigidities of the 1970s took place during the 1980s). Since the turn of this decade, a number of far reaching changes have been introduced, generally in the right direction. The most extreme restrictions in employment protection legislation (notably in the area of hiring rules) were abolished; a new unemployment insurance scheme (the mobility list) was introduced to deal with collective redundancies; and, in July 1993, the wage bargaining system was fundamentally overhauled.

These changes have not been conceived and implemented as part of a comprehensive plan to reform the labor market, but were often introduced in a piece-meal and inconsistent fashion (an example is the introduction of the work-sharing arrangements, or solidarity contracts, which were little used). Furthermore, aside from the new wage bargaining system, it is clear that these changes have generally not gone as far as they should. Significant restrictions and distortions remain in dismissal rules, placement services, and employment contracts, making Italy an outlier among major EC countries. Moreover, these apply only on part of the market, aggravating the distortions of the Italian labor market. The unemployment benefits system is generous to those who are entitled to receive benefits, but remains inequitable and not well targeted, and--perhaps more importantly--does not motivate skill-building and active job search. Spending on active labor market programs is not optimally allocated, and public employment services need improvement. As regards the new wage bargaining system, although the abolition of indexation has already contributed significantly to wage moderation and is expected to continue doing so, a full evaluation of the system will have to wait until new agreements are concluded according to its guidelines. Finally, it will be important, as the government has acknowledged in the July 1993 accord, that any new systemic measures in the labor market be introduced as part of a coherent overall strategy.

Table 1. Hiring Restrictions

	France	Germany	United Kingdom	Italy
Quotas for handicapped persons	10 percent quota for firms with over 10 employees; fines for underfulfillment, subsidies for overfulfillment	6 percent quota for firms with over 16 employees; fines for underfulfillment, subsidies for overfulfillment	3 percent quota for firms with over 20 employees; limitations on freedom to hire for underfulfillment and restrictions on dismissal of handicapped persons	15 percent quota for firms over 35 employees is a regulatory requirement (no provisions for under/overfulfillment). In addition, in most cases, the handicapped to be hired against the quota is chosen by the state placement agency.
Other hiring restrictions/affirmative action programs	No other restrictions	No other restrictions	No other restrictions	12-20 percent quota (depending on the region) for firms with over 10 employees for disadvantaged workers (long-term unemployed, workers on mobility list, etc.); in addition, in case of new hiring, preference is reserved for temporary workers already employed by the firm, or workers laid off by the firm in the previous 12 months.
Employment/placement agencies	ANPE, the public employment agency, has a monopoly on non-temporary placements. This, however, is not always strictly enforced.	Private non-profit employment agencies allowed under license.	Private employment agencies allowed under license.	State registry of job-seekers open to all applicants (even if employed); no training offered; private employment agencies to be allowed soon, but only for professionals.

Sources: Emerson (1988a); Confindustria (1993).

Table 2. Distribution of Employment by Firm Size, 1986

(In percent)

	France	Germany	United Kingdom	EC12	Italy
<b>Manufacturing</b>					
1-9 employees	7.3	6.2	6.9	11.1	21.0
10-99 employees	23.8	19.2	13.4	46.0	35.3
100-499 employees	22.5	22.0	25.4		16.9
500- employees	46.4	52.6	54.3	42.9	26.8
<b>Services</b>					
1-9 employees	30.3	27.1	30.3	34.8	46.1
10-99 employees	25.2	30.1	30.0	43.4	32.2
100-499 employees	10.9	16.5	22.4		6.5
500- employees	33.6	26.3	17.6	21.8	15.2

Source: CER (1993).

Table 3. Regulations on Individual Dismissals

	France	Germany	United Kingdom	Italy
Applicability of the regulations	Limited applicability to firms with less than 11 employees, and for workers with less than 2 years of service	Not applicable to firms with less than 6 employees; limited applicability for workers with "special" employment contracts (e.g., fixed-term)	Not applicable for workers with less than 2 years of continuous service	Not applicable for fixed-term workers
Acceptable causes	Ineptitude; redundancy (but the firm is obliged to offer 5 months retraining)	Ineptitude; redundancy (but the firm is obliged to take into account "social" criteria in choosing redundant workers); firm is also obliged to offer, if possible, alternative employment	Ineptitude; redundancy	Serious ineptitude; economic motives (no specific mention of redundancy)
Notification requirement <sup>1/</sup>	One to two months for workers with at least 2 years of service	4 weeks to 7 months, depending on length of service and type of contract	1 week per year of service, up to 3 months	2 weeks to 4 months
Protected workers	Union representatives; pregnant workers or workers on maternity leave; workers on military service	Workers' Council members; pregnant workers and workers in military service	Trade union members; pregnant workers or workers on maternity leave	Union representatives; pregnant workers, nursing mothers; workers on military service
Burden of proof	Employer	Employer	Employer in case of redundancy; otherwise worker	Employer
Summary dismissal (no notification requirement)	Grave misconduct	Grave misconduct	Absenteeism, insubordination, violation of professional secrecy	Interruption of relation of "trust" (e.g., criminal act)
Severance pay	Equal to one-tenth of a months' pay for each year of service for workers with at least 2 years of service (except in cases of summary dismissal) for companies with more than 10 employees; additional pay in lieu of notification available	No legislated severance pay, but the firm is obliged to pay to the worker its contributions to his or her retirement plan	One-half to 1 1/2 weeks pay for each year of service for workers with at least 2 years of service (for redundant workers only); additional pay in lieu of notification available	Equal to 12 months' pay divided by 13.5 for each year of service, payable in all cases of individual dismissal
Penalty for unfair dismissal	Rehiring, with payment of due wages, <u>or</u> at least 6 months pay; applies to companies with more than 11 employees	Rehiring, with payment of due wages <u>or</u> compensation equal to 12 months' pay in firms with more than 5 employees.	Rehiring (payment of due wages??), <u>or</u> compensation equal to regular redundancy payment	Firms with more than 15 employees: rehiring <u>and</u> compensation equal to at least 5 months' pay; firms with up to 15 employees: rehiring <u>or</u> compensation equal to 2.5-14 months' pay (depending on length of service)

Source: Emerson (1988a); Casavola (1993); OECD (1993a); Confindustria (1993).

1/ In all countries, the notification requirement may be modified by collective agreements.

Table 4. Fixed-Term Labor Contracts

	France	Germany	United Kingdom	Italy
Restrictions on work content	For specific tasks that are peripheral to the firm's activity	None	None	For seasonal or irregular work, or for replacing temporarily absent workers only; these requirements, however, may be relaxed for younger workers (16-32 years)
Maximum duration	24 months (renewable twice)	No maximum	No maximum	6 months (not renewable); 12 months in special cases (young workers in the South or in high unemployment areas)
Termination benefits	Yes	No	No	Yes
Remuneration and conditions	Similar to those of regular workers	Similar to those of regular workers	Similar to those of regular workers	Similar to those of regular workers
Dismissal protection	Yes	Yes	Yes	Yes

Sources: OECD (1993a); Casavola (1993); CER (1993).

Table 5. Share of Temporary Workers to Total Employment, Selected Sectors, 1983 and 1991 <sup>1/</sup>

(In percent)

	France		Germany		United Kingdom		Italy		Denmark		Portugal		Spain		Ireland	
	1983	1991	1983	1991	1983	1991	1983	1991	1983	1991	1983	1991	1983	1991	1983	1991
Total	3.3	10.2	10.0	9.5	5.5	5.3	6.6	5.4	12.5	11.9	14.7	16.5	15.6	32.2	6.2	8.2
Of which:																
Agriculture	5.1	13.9	22.9	16.5	11.8	6.8	35.9	24.4	21.7	14.9	31.5	29.1	39.4	54.4	7.6	10.6
Manufacturing	3.7	8.5	8.1	7.1	2.7	2.7	2.2	2.9	9.5	8.5	15.0	16.5	12.3	28.5	3.4	3.8
Construction	5.2	10.1	10.1	7.9	6.9	3.6	11.9	7.5	16.3	18.2	25.5	23.5	29.5	55.7	8.0	10.5
Trade	6.0	10.2	12.6	10.7	9.0	7.8	7.0	6.3	15.3	15.0	16.6	21.5	18.3	38.9	7.2	9.4
Transport and communications	1.1	6.1	5.2	5.8	2.2	2.6	1.5	2.0	7.8	7.1	4.8	10.8	7.8	19.3	4.1	3.5
Banking and finance	3.8	7.5	8.5	8.7	3.7	4.3	1.9	3.3	6.7	6.4	6.3	15.1	8.5	26.3	6.6	7.2
Public administration	0.7	10.0	10.7	13.5	4.0	4.0	2.3	2.2	14.6	12.0	7.3	8.5	7.7	15.7	3.1	6.4

Source: OECD (1993a).

<sup>1/</sup> Temporary employment in the EC is defined as employment whose termination is understood by the employer and the employee to depend on objective conditions, such as reaching a certain date, completion of assignment, or return of an employee who has been temporarily replaced. These conditions are typically mentioned in the work contract. Included in their group are: (i) seasonal workers; (ii) persons hired through an employment or placement agency for a fixed time term; and (iii) workers with specific training contracts.

Table 6. Part-time Employment, 1983 and 1991

	Share of part-time employment to total employment (In percent)	Percentage of part-time workers	
		Permanent employment	Temporary employment <sup>1/</sup>
France 1983	9.7	95.7	4.3
1991	12.0	78.9	21.1
Germany 1983	12.6	87.7	12.3
1991	15.5	90.6	9.4
United Kingdom 1983	19.4	84.8	15.2
1991	22.2	85.0	15.0
Italy 1983	4.6	45.4	54.1
1991	5.5	50.0	50.0
Denmark 1983	23.8	86.6	13.4
1991	23.1	86.6	13.4
Portugal 1983	...	64.7	35.3
1991	6.8	63.6	36.4
Spain 1983	...	56.1	43.9
1991	5.9	42.8	57.2
Ireland 1983	6.5	50.8	49.2
1991	8.4	54.9	45.1

Source: OECD (1993a).

<sup>1/</sup> Temporary employment in the EC is defined as employment whose termination is understood by the employer and the employee to depend on objective conditions, such as reaching a certain date, completion of assignment, or return of an employee who has been temporarily replaced. These conditions are typically mentioned in the work contract. Included in their group are: (i) seasonal workers; (ii) persons hired through an employment or placement agency for a fixed time term; and (iii) workers with specific training contracts.

Table 7. Training Contracts  
(Contratti di Formazione e Lavoro), 1985-92

	Total hirings under training contracts	<u>Percent of training contracts in</u>		
		Agriculture	Industry	Services
1985	108,434	0.42	60.68	38.90
1986	229,126	0.46	61.24	38.30
1987	402,856	0.66	58.20	41.14
1988	493,643	0.64	58.67	40.69
1989	529,297	0.44	59.35	40.21
1990	469,050	0.43	57.05	42.52
1991	316,343	0.51	54.67	44.82
1992	236,000	...	...	...

Source: Casavola (1993).

Table 8. Unemployment Insurance Schemes <sup>1/</sup>

	Eligibility	Benefits	Maximum Duration
Unemployment insurance - Ordinary benefits (trattamento ordinario)	Workers dismissed individually or collectively (but not eligible for mobility benefits)	25 percent of last wage <sup>2/</sup>	6 months
- Special benefits (trattamento speciale)	Workers dismissed by construction firms	80 percent of last wage	18 months
Mobility benefits (indennità di mobilità)	Redundant workers either dismissed from industrial firms with more than 15 employees or commercial firms with more than 200 employees, or "graduated" from CIG-S (see below)	80 percent of last wage up to a maximum of Lit 1.2 million per month (currently equal to about 60 percent of average wage in industry) <sup>3/</sup>	12 months; renewable once for workers over 40 years old and twice for workers over 50 years old, at a level 20 percent lower
Wage supplementation fund (Cassa Integrazione Guadagni-CIG) - Ordinary (CIG-O)	Workers or employees temporarily laid-off by industrial firms	80 percent of last wage without a maximum for the first 6 months	12 months <sup>4/</sup>
- Special (CIG-S)	Workers and employees laid-off by industrial and construction firms with more than 15 workers and commercial firms with more than 200 employees, due to restructuring, reorganization, or "crisis"; <sup>5/</sup>	80 percent of last wage, up to a maximum equal to that for mobility benefits	24 months; renewable twice (12 months each time) in cases of restructuring or reorganization, or once in cases of "crisis"

Sources: Bank of Italy (1991); Bank of Italy (1993a); Confindustria (1993).

<sup>1/</sup> A draft law submitted to Parliament in late 1993 proposes modification to certain aspects of the current unemployment protection schemes.

<sup>2/</sup> The government has indicated its intention to raise this to 40 percent of last wage.

<sup>3/</sup> The nominal ceiling is less-than-fully indexed to the consumer price index, implying a decreasing replacement rate over time.

<sup>4/</sup> Up to December 31, 1994, 24 months in areas characterized as target zone 1 or 2 by the EC.

<sup>5/</sup> Up to December 31, 1994, available also to commercial firms with more than 50 employees.

Table 9. Unemployment Benefits: Maximum Duration  
and Replacement Rates 1/

	Maximum duration	Replacement rate <u>2/</u>
France	50 months <u>3/</u>	0.57-0.75 <u>4/</u>
Germany	32 months	0.60-0.67 <u>5/</u>
United Kingdom	12 months	0.16
Denmark	30 months	0.47
Spain	24 months	0.40
Ireland	15 months	0.35

Source: OECD (1993a).

1/ For prime age workers; rules for young or old workers may differ.

2/ Calculated as the ratio of actual payments of benefits to the total number of unemployed with respect to the average wage of production workers, unless otherwise indicated.

3/ 27 months with full benefits, and 23 months with reduced benefits for workers aged 55 and over with at least 27 months of contributions in the last 3 years.

4/ Range of gross replacement rates; Fund staff estimate.

5/ The higher figure applies to unemployed workers with children.

Table 10. Public Expenditure on Active Labor Market Programs

(In percent of GDP)

	France (1991)	Germany (1992)	United Kingdom (1992-93)	Italy (1988)	Denmark (1992)	Portugal (1992)	Spain (1992)	Ireland (1991)
1. Public employment services <sup>1/</sup>	0.13	0.24	0.17	0.08	0.11	0.09	0.11	0.14
2. Training <sup>2/</sup>	0.35	0.59	0.18	0.03	0.40	0.30	0.08	0.49
For employed adults	(0.06)	(0.03)	(0.02)	(--)	(0.13)	(0.25)	(0.03)	(0.17)
For unemployed	(0.29)	(0.56)	(0.16)	(0.03)	(0.27)	(0.05)	(0.06)	(0.32)
3. Youth measures <sup>3/</sup>	0.23	0.06	0.18	0.69	0.26	0.38	0.06	0.44
Of which: apprenticeship programs	(0.14)	(0.01)	(0.18)	(0.43)	(--)	(0.29)	(--)	(0.15)
4. Subsidized employment <sup>4/</sup>	0.11	0.52	0.02	--	0.39	0.04	0.32	0.29
Of which: support of job creation in the private sector	(0.05)	(0.07)	(--)	(--)	(0.28)	(0.01)	(0.13)	(0.01)
Support for job initiatives of the unemployed	(0.02)	(--)	(0.02)	(--)	(0.11)	(0.02)	(0.12)	(0.26)
5. Measures for the disabled <sup>5/</sup>	0.06	0.24	0.03	--	0.40	0.05	--	0.14
Vocational rehabilitation	(--)	(0.15)	(--)	(--)	(0.27)	(0.05)	(--)	(0.14)
Work for the disabled	(0.06)	(0.09)	(0.03)	(--)	(0.13)	(--)	(--)	(--)
Total expenditure on active programs	<u>0.88</u>	<u>1.64</u>	<u>0.59</u>	<u>0.80</u>	<u>1.56</u>	<u>0.86</u>	<u>0.57</u>	<u>1.51</u>

Sources: OECD (1993a); for Italy, OECD (1992).

<sup>1/</sup> The following services are included: placement, counselling and vocational guidance; job-search courses and related forms of intensified counselling for persons with difficulties in finding employment; support of geographic mobility and similar costs in connection with job-search and placement. In addition, all administration costs of labor market agencies (at central and decentralized levels), including unemployment benefit agencies (even if these are separate institutions), as well as administrative costs of other labor market programs are included.

<sup>2/</sup> Training measures undertaken for reasons of labor market policy, other than special programs for youth and the disabled. Expenditures include both course costs and subsistence allowances to trainees, when these are paid. Subsidies to employers for enterprise training are also included, but not employers' own expenses.

<sup>3/</sup> Includes only special programs for youth in transition from school to work. Thus it does not cover young people's participation in programs that are open to adults as well.

<sup>4/</sup> Targeted measures to promote or provide employment for unemployed persons and groups (other than youth or the disabled) specified as labor market policy priorities.

<sup>5/</sup> Only special programs for the disabled are included. The category does not cover the total policy effort in support of the disabled.

Table 11. Structure of Annual Compensation

Component	Determined by
Contractual minimum	National sectoral agreement
+ Indexation	National sectoral agreement
= Contractual wage	
+ Collective superminimum	Firm-based negotiations
+ Individual superminimum	Management
+ Other (seniority increases, other premia, etc.)	Law, other agreements
= Base monthly compensation	
+ Overtime payments	National sectoral agreement
= Monthly compensation	
* 12	
+ "13 salary"	National sectoral agreement
+ Other bonuses	Agreements; management
= Annual compensation	

Source: Ericson & Ichino (1992).

Table 12. Components of the Monthly Wage as a Percentage of Total, 1991 1/

(In percent)

Rank	Contractual Minimum	Indexation	Individual Super- Minimum	Collective Super- Minimum	Other
Blue-collar 1	31.47	58.38	0.51	2.67	6.96
Blue-collar 2	31.62	53.12	1.30	2.95	11.01
Blue-collar 3	31.76	49.91	3.27	4.01	11.05
Blue-collar 4	32.35	45.62	3.54	3.96	14.53
Blue-collar 5	31.19	49.06	6.75	2.60	10.40
White-collar 2	30.35	42.80	12.10	4.54	10.20
White-collar 3	31.54	53.00	3.04	4.44	7.97
White-collar 4	31.22	49.08	4.83	5.86	9.01
White-collar 5	31.53	44.47	9.92	5.18	8.90
White-collar 5s	30.28	39.56	14.37	4.15	11.63
White-collar 6	30.18	35.57	21.48	5.16	7.62
White-collar 7	29.47	27.91	30.06	4.22	8.34
Managerial 7	26.15	23.11	38.59	4.16	7.98

Source: Ericson & Ichino (1992).

1/ Metal manufacturing sector.

Table 13. Gross Compensation Per Employee, 1980-91

(Indices (1980=100))

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	Manufacturing	Market Services	Market Goods and Services	General Government
1980	100.0	100.0	100.0	100.0
1981	123.0	119.5	122.0	129.6
1982	140.3	130.7	133.9	148.3
1983	163.5	150.9	155.1	168.3
1984	187.0	167.6	174.7	188.3
1985	206.9	183.3	192.6	203.8
1986	220.0	194.5	205.0	216.7
1987	238.9	210.6	222.2	238.3
1988	256.7	226.6	239.2	264.4
1989	275.1	243.5	256.8	280.8
1990	294.8	262.0	276.1	325.1
1991	321.8	285.2	301.0	355.9

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Source: Ministry of Labor (1993).

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