Addressing Labor Market Duality in Croatia: A Single Employment Contract?

Policy Note

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1. Most of the newly created jobs in Croatia are temporary jobs. This contributes to labor market duality: the growing divide between employees with secure, permanent jobs (referred to as insiders) and those with precarious, temporary jobs (referred to as outsiders). Dual labor market is inefficient from both the social and economic perspective. It contributes to inequality, and potentially slows down productivity growth. This Note considers policy measures to address labor market duality. It focuses on the proposal of a Single Employment Contract. By design, the single employment contract eliminates the divide between permanent and temporary contracts. All employment contracts are open-ended with employment protection increasing with seniority. Single Employment Contract is more flexible than existing permanent contracts, but provides workers with more protection than temporary contracts. As such this is an attempt to balance flexibility with fairness in the labor market. The adoption of the Single Employment Contract proposal requires a compromise between social partners. Trade Unions need to recognize employers need for flexibility. Employers need to acknowledge employees need for job security. The compromise will serve the interest of the growing numbers of outsiders – workers with precarious jobs – and will promote equality and efficiency.

The rise of temporary employment

2. Temporary employment is high and on the rise in Croatia. One out of five employees has a temporary contract, more than in most EU countries (Figure 1). The incidence of temporary employment is much higher among the newly employed workers: 7 out of 10 workers are presently hired on a temporary basis (Figure 2). This represents a marked shift in hiring practices: the share of temporary employment is currently twice as high as in 2002 (Figure 3). The increase in the share of temporary employment is not specific to Croatia, it happened in most EU countries over the last decade or so (Eichhorst et al. 2016). What is worrying is the fast pace of growth in temporary employment, and as a result, the high incidence, a couple percentage points higher than the EU average.

Figure 1. The incidence of temporary employment is above the EU average in Croatia

![Bar chart showing the incidence of temporary employment as % of total number of employees in Croatia compared to other EU countries (2014).](chart.png)

Source: Eurostat; Bank staff calculations.
3. **Employment increase in Croatia in recent years was achieved mostly on the back of growth in temporary jobs.** According to different estimates, the increase in temporary employment represent from 65 to 100 percent of the total increase in employment during the period of 2002 – 2014. Almost all newly created jobs in the last 12 years were temporary jobs. Probably if employers were not able to use temporary employment contracts, then the increase in employment would be significantly smaller.

4. **Temporary contracts facilitate labor market entry and exit from unemployment.** Data from the Croatia Employment Service show that the bulk of the unemployed who found jobs are hired using temporary contracts (Figure 4).\(^1\) To some extent temporary contracts are substituted for permanent contracts. But the high and rising – also during the global crisis – hiring rate suggests that temporary contracts improve the chances of the unemployed to escape unemployment, and as such might have contributed to keeping the unemployment rate in check.

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\(^1\) Close to 200 thousand unemployed were hired using temporary contracts in 2014, up from slightly above 100 thousand in 2007, before the global crisis. In comparison, less than 12 thousand unemployed were hired using permanent contract in 2014, down from the peak of 26 thousand in 2007. Clearly it is temporary contract that are the main vehicle facilitating the transition from unemployment to jobs.
5. **Temporary employment in Croatia is involuntary.** Virtual all temporary Croatian workers would prefer to have a permanent jobs. This is in contrast to most EU countries, where a non-negligible proportion of temporary employees are voluntary. For example, one-third of temporary employee in Austria and one-fourth in the neighboring Slovenia are voluntary. (In Croatia only 2% of temporary employees are voluntary). This suggests that the extent to which temporary contracts are abused by employers in Croatia is probably greater than in other EU countries.

**Precarious jobs and vulnerable workers**

6. **Temporary employment is most prevalent in small private firms.** Large and public firms and institutions predominantly rely on permanent employment. The incidence of temporary employment in the public sector exceeds 20 percent, and is twice as high as in the public sector. In small firms (up to 10 employees) one quarter of all workers have temporary contracts, twice as many as in large firms (250+). This is an expected pattern, since small private firms tend to be subject to strong competitive pressures and thus need to be flexible (i.e. quickly respond to changes in product demand), and cost conscious.

7. **Incidence of temporary employment is highest in the construction, and market services sector.** The share of temporary employment among construction workers is 25 percent, compared with 19 percent among market services workers, and 15 percent among industry workers. But given the large size of the services sector, half of all temporary jobs are located there. Again, these are expected results given the seasonal and temporary nature of construction work, and the high labor turnover in the service sector.

8. **Less-skilled workers are most likely to hold temporary jobs.** About one-third of workers in elementary (unskilled) occupations, and one-fourth in service and sales occupations have temporary jobs. In comparison, skilled blue-collar workers (such as craftsmen or machine operators) the share of temporary employment is about 15 percent. This pattern reflects the fact that the cost to employer of labor turnover is higher for skilled workers than for unskilled ones. It may cost a lot to replace a highly qualified professional with firm specific skills, while it usually costs little to find a replacement for a laborer.

**Figure 4. Exit from unemployment is increasingly through temporary employment**

![Graph showing trend of unemployment exit through temporary employment over time.](image-url)
9. **However, the incidence of temporary employment among highly educated professionals is relatively high, too.** The share of temporary workers among persons with tertiary education is 15 percent, and among professionals it is 12 percent. This means that the use of temporary contracts has become widespread in Croatia, no longer limited to intrinsically seasonal, temporary jobs or low-skilled jobs. As discussed later, this may have a negative impact on productivity growth, to the extent that employers invest less in human capital of temporary than in that of permanent workers.

10. **Temporary employment is particularly high among young workers.** In the age group 20 – 29 the proportion of those with temporary contracts approaches 40 percent, and among new hires it reaches 75 percent (Figure 5). Vast majority of young people are hired on temporary contracts. Surprisingly, temporary employment is most frequent among young persons with university education than among those with secondary education. Almost 50 percent of university educated young workers (20-29) have temporary contracts, which is about 10 percentage points more than among workers with secondary technical or basic vocational education. More analysis is necessary to understand why highly educated workers are more often offered temporary employment than less educated worker. But insofar as temporary employment is harmful for skill utilization and accumulation, this pattern is worrisome. It may imply that the human capital of highly educated workers is not utilized to its full potential.

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**Figure 5. Incidence of temporary employment is highest among young workers**

![Bar chart showing the incidence of temporary employment by age group.](chart.png)

*Source: Labor Force Survey; Bank staff calculations.*

**Dual labor market is inefficient from both social and economic perspective**

11. Temporary contracts were introduced to provide employers with more flexibility in adjusting the size of their workforce to the changing needs. They made the labor market more flexible, however at a high price. First, they gave rise to the development of a dual labor market and as such contributed to labor market inequality. Second, by making the employment relationship more precarious and uncertain, they might have adversely affected human capital investments, and labor productivity. A consensus emerged among economists that partial labor market reforms— that liberalize the use of temporary contracts, while maintaining strict regulation of permanent contracts— are an inefficient way of enhancing labor market flexibility and improving employment outcomes.

12. **Croatia, as many other countries in Europe, liberalized the use of temporary contracts in order to address problems resulting from the strict employment protection legislation.** In particular the objective was to facilitate labor market entry, lower youth unemployment, facilitate movements from unemployment to jobs, and reduce long-term unemployment. While the regulation on temporary contracts was liberalized, the regulation on permanent contracts remains strict (Kunovac 2014). Such an
approach is known as partial (or asymmetric) labor market reforms. It is now widely recognized that partial labor market reforms are inefficient.

13. **While partial labor market reforms improve labor market outcomes in the short-term, they bring about negative long-term consequences, both social and economic.** Employment increase following the liberalization of the use of temporary contracts tends to be transient, a phenomenon referred to as a “honeymoon effect”. For many workers temporary jobs are a bridge to regular employment, as intended. However, there is also a large number of workers who trapped in temporary jobs, with little prospects of moving to permanent jobs (Eichhorst 2016). Evidence for European countries shows that less than 50% of the workers that were on temporary contracts in a given year were employed with full time permanent contracts three years later (OECD 2014). Temporary contracts are prone to abuse by employers. They are often used for jobs that are permanent rather than temporary, as a means of lowering labor cost.

14. **The key issue resulting from the liberalization of temporary contracts is labor market duality.** The labor market becomes divided into two separate sub-markets with limited cross-over capability. In the primary labor market workers – referred to as *insiders* -- hold permanent contracts and jobs are stable and secure. In the secondary market workers – referred to as *outsiders* -- hold temporary contracts and jobs are precarious and insecure. The bargaining power of insiders is naturally much stronger than that of outsiders. They can secure higher wages and benefits. Given that temporary workers cost employers less than permanent workers, the chances of moving from temporary to permanent employment are limited. Such a dual labor market is inefficient both from the social and economic point of view. It gives rise to social tensions, and impedes productivity growth.

15. **A dual labor market is inefficient from a social perspective because it contributes to economic inequality and gives rise to social tensions.** Similar workers doing same jobs enjoy different rights and benefits. While the jobs of insiders are decent, those of outsiders are precarious. During economic downturns the burden of employment adjustment falls almost entirely on temporary workers. They are first to lose their jobs. Temporary workers face significant uncertainty regarding their jobs and incomes, with a negative effect on their well-being, including a negative effect on family formation in the case of young workers. As the numbers of temporary workers are swelling, the scale of the problem becomes more severe. In his famous book Guy Standing coins the term “precariat” and calls it a new dangerous class (Standing 2014).

16. **A dual labor market is inefficient from an economic perspective because of a potentially negative effect on productivity growth.** Temporary workers have a weaker attachment to their jobs and thus are less likely to invest in firm-specific skills. Also employers are less likely to invest in the skills of temporary workers because they risk the loss of their investment. As a result temporary employment hampers human capital formation, which in turn translates into slower growth in labor productivity. This effect is particularly deleterious in aging societies (such as Croatia), where economic growth hinges entirely on the growth in productivity. The magnitude of this effect is the greater, the more frequently temporary contracts are used for skilled jobs, whose productivity depends on human capital development.

*Employers have strong incentives to use temporary rather than permanent contracts*

17. **Why are employers switching from permanent to temporary contracts?** The answer is simple. The cause of the growth in temporary employment (in Croatia as elsewhere) is the lower cost of temporary relative to permanent employment. The greater the cost difference, the stronger the incentive to use temporary contracts, because savings outweigh possible loses (e.g. due to higher labor turnover). This particularly refers to dismissal costs. As mentioned, in Croatia the difference in dismissal costs
between permanent and temporary contracts is substantial (Kunovac 2014). The cost of terminating permanent workers is high, while that of terminating temporary employment is negligible. Restrictions on the use of temporary employment are de facto few in Croatia, including liberal regulations of Temporary Work Agencies. Employers have thus strong incentives to substitute temporary contracts for permanent ones.

18. **The spread of temporary employment reflects a demonstration effect and competitive pressures.** Employers learn from each other ways to reduce costs, including labor cost. And competition means that once some employers start to lower labor cost by using temporary rather than permanent employment, others have to follow in order to stay competitive. The fast growing share of temporary employment in Croatia is the results of the working of these forces.

**Balancing flexibility with fairness**

19. **Labor market duality and the spread of precarious employment are problems faced by many European countries.** Given the high social and economic costs of duality, a number of European countries undertook reforms aimed at reducing duality and balancing flexibility with fairness in the labor market. There were two approaches to addressing duality: reformist and a radical one. The reformist approach consists of narrowing the cost gap between permanent and temporary contracts. The radical approach consists of introducing a single employment contract, and thereby abolishing the division into permanent and temporary employment. The reformist approach is politically easier than the radical one and therefore was used more widely. The radical approach was considered in a number of European countries, but only Italy has so far implemented a variant of it. Below we present the key features of both approaches in a reverse order.

**Single Employment Contract**

20. The idea of a single employment contract (also referred to as the *equal opportunity contract*) emerged as a reaction to the spread of temporary employment, and is meant to address labor market duality. It was developed in countries coping with inefficiencies and inequities resulting from labor market duality (France, Italy, and Spain), and was recently partly implemented in Italy (see Annex 1). In essence, the Single Employment contract provides employees with more job security than the temporary contracts, while it provides employers with more flexibility (by making dismissals easier) than the traditional permanent contract.

21. **There are three defining elements of the Single Employment Contract:**

   - All employment contracts are open-ended.
   - Employment protection and benefits increase gradually with job tenure (with given employer).
   - Protection against dismissal has the form of monetary compensation (severance pay increasing with job tenure), while recourse to courts is limited (to the cases of discrimination or violation of worker rights).

22. **There are two variants of the single employment contracts proposal.** According to the *radical* variant, the single contract is to replace all existing forms of employment contracts. Temporary contracts are altogether abolished, and short-term tasks and relationships are handled through Temporary Work

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2 These are general principles governing the design of the single employment contract. Specific design features are to be negotiated and agreed upon by social partners.
Agencies (with employees of TWAs having regular employment contracts). According to the moderate variant, the single contract is a dominant type of contracts, replacing permanent and fixed-term contracts. Irregular contracts are still permissible, but their use is strictly limited to genuinely temporary or atypical tasks (e.g. specific task or interim contract). Naturally, if the moderate approach is adopted, there is a question of compliance and enforcement. Employers will still have an option to use temporary contracts and there is no guarantee that this option will not be abused, given that enforcement is costly, and the enforcement capacity may be limited.

23. **Single Employment Contract proposal comes in two forms.** One is a contract with progressive seniority rights. The underlying principle is a gradual increase in the cost of dismissal based on seniority (job tenure). The other form is a contract with long probation period (a dual-phase approach). The contract is divided into two periods: a three year entry period, and a stability period. During the entry period there is only a monetary compensation for dismissal. The stability period provides full employment protection subject to existing labor regulations governing permanent contracts. The dual phase approach entails discontinuity (a discrete change) in the level of employment protection, since the cost of dismissal sharply increases once the probation period ends. This creates the risk that employers will dismiss workers before entering the stability period.

24. **The rate at which employment protection increases with job tenure is a matter than should be solved through tripartite negotiations involving the government, trade unions, and employers.** The increased protection involves a longer advanced notice of dismissal, and higher severance pay for workers with longer job tenure. It is important that the severance pay increases in a continuous way (e.g. 20 days of salary for each year of employment), and is capped at a certain level (e.g. at 12 monthly salaries). Discrete increases in the severance pay are to be avoided because they create a strong incentive for employers to terminate employment before the new higher level of the severance pay is reached.

25. **Open-ended single employment contract is more flexible than the traditional permanent contract because dismissals are made easier, and their cost is made predictable.** Dismissals are easier because all dismissals for economic or organizational reasons are valid by definition, and not subject to judicial review. The monetary cost of dismissals are made predictable because the amount of monetary compensation for dismissal (severance pay) is defined and known in advance. This removes the uncertainty associated with court adjudication. This uncertainty is particularly high in Croatia, where if the court rules that the dismissal was invalid, it may order monetary compensation and, in addition, oblige the employer to pay the wrongfully dismissed worker all forgone earnings. Given that court procedures tend to be lengthy, the expected cost of dismissal may be prohibitively high, and thus may act as an effective deterrent against dismissals.

26. **The idea behind the single employment contract is to limit costly recourse to courts, and to substitute monetary compensation for the judicial review of the validity of dismissal.** Employees may still have the right to court appeal if the dismissal was done for discriminatory reasons. However, if they

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3 For repetitive, short-term tasks the firm and the worker could write a so-called discontinuous open-ended contract. The contract allows for interruptions and the worker would be accumulating rights in proportion to the accumulated time in which he or she is effectively rendering services to the firm. The severance payment would thus only be due at the end of the contract if the firm decides to discharge the worker.

4 Higher amounts can be agreed upon at firm level collective agreements.

5 Judicial review of the validity of dismissal is restricted to cases of discrimination or disciplinary dismissals without compensation.

6 As it was put in the Italian proposal, “... the best way to protect the worker from illegitimate dismissal appears to be not judicial review of the reasons for the termination of employment, but rather the imposition of a monetary cost to the entrepreneur ...” (quoted after Casale and Peruli 2014).
decide to go to courts, they forego the severance pay. In other words, an employee who was dismissed has a choice of either accepting the severance pay in which case the dismissal becomes a fait accompli, or to refuse the severance pay and appeal to court. An employer also has a choice of paying the severance pay, or proving in court that the employee was dismissed for misbehavior (if the employee decides to appeal dismissal for disciplinary reason).

**Narrowing the gap between permanent and temporary contracts**

27. Below is an illustrative list of the measures taken by different governments to reduce labor market duality by making permanent contracts more flexible, and by restricting the use of temporary contracts. A good example of such an approach is the labor market reform recently implemented in Slovenia (Vodopivec, Laporšek, Vodopivec 2016).

(i) **Measures to reduce the cost of permanent employment**
- Employers no longer have to reinstate workers dismissed for invalid economic reasons (Italy).
- Simplification of employment protection legislation by clarifying the cases in which courts decide upon the validity of dismissals (the Netherlands).
- Shorter advanced notice, lower severance pay, and lower unemployment insurance contributions for permanent contracts (Slovenia).

(ii) **Measures to raise the cost of temporary employment**
- Higher unemployment insurance contributions for temporary jobs (France, Slovenia).
- Higher severance pay for temporary contracts (Spain).
- Shorter maximum cumulative duration of temporary contracts (the Netherlands, Poland, Slovenia).
- “Insecurity bonus” to be paid by employers to the worker if the employment relationship is not continued after the contract has expired (France).

**European Commission supports the Single Employment Contract proposal**

28. The idea of a single employment contract was tentatively endorsed by the EC. The EC called for an exit strategy from segmentation: “A possible “exit” strategy from the regulatory asymmetry between permanent and temporary contracts could be the so-called “single contract”, advocated by a number of prominent labour economists, i.e. open-ended but providing for a gradual build-up of employment protection rights.”

29. To our knowledge the ILO has no official position on the single employment contract, however Giuseppe Casale and Adalberto Peruli, two prominent ILO officials, in a book published by the ILO with under a suggestive title *Towards a Single Employment Contract*, write as follows: “The segmentation and casualization of labour that are typical of many European labour markets require a rationalization of flexibility instruments, which in some systems appear to be out of control. From this perspective, the employment contract itself needs to be re-thought, and the introduction of a new provision that reduces the multiplicity of types of contracts is most welcome. The single employment contract is (...) supported by economic theory, introducing into employment arrangements the element of flexibility that is...”

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7 European Commission (2010), and European Commission (2011).
9 Casale and Peruli (2014).
10 Giuseppe Casale is director of the Labour Administration and Inspection Programme at the International Labor Office in Geneva. Adalberto Perulli is professor of labor law at Cà Foscari University of Venice.
considered necessary in order to render labour markets more dynamic, creating new jobs, increasing
turnover and hence presenting more entry points for ‘outsiders.’” (p. 77)

30. **One potential obstacle to the adoption of the single employment contract is the ILO Convention No. 158.** It states that:
  
  - The employment of a worker shall not be terminated unless there is a valid reason.
  - A worker who considers that his employment has been unjustifiably terminated shall be entitled to appeal against that termination to an impartial body, such as a court, or arbitrator.
  - A court (arbitrator) shall be empowered to examine the reasons given for the termination and to render a decision on whether the termination was justified.
  - The burden of proving the existence of a valid reason for the termination shall rest on the employer.

31. **How to design the single employment contract so as not to violate the Convention is a legal issue.** One way to solve the issue is to maintain the right of a dismissed worker to appeal against the termination to court, subject to his/her relinquishing the right to the severance pay.

**Need for compromise**

32. **The introduction of the Single Employment Contract requires both employers and trade unions make some concessions and reach a compromise.** Employers need to acknowledge the employee’s need for job security, whereas trade unions need to acknowledge the employer’s need for flexibility. If introduced, the Single Employment Contract would be used only for new hires, while workers with permanent contracts would keep all the existing rights. The reform would benefit the growing numbers of outsiders, predominantly young employees with temporary, precarious jobs, and as such would render the Croatian labor market more inclusive. Table one shows who would be the winners and losers from the reform.

**Table 1. Summary of gains and losses from the introduction of a single employment contract**

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33. **Experience from countries that attempted to implement the Single Employment Contract proposal shows that it may be difficult to secure the necessary support for the reform.** Trade unions tend to oppose the reform because their base is workers with permanent contracts, and they want to protect all the existing rights associated with these contracts (Lepage et al. 2013). Employers tend to oppose the reform because they don’t want to lose the flexibility provided by temporary contracts, which are significantly cheaper than the single contract. However, without insiders giving up some of their privileges, and without employers accepting workers’ need job security the problem of the spread of temporary employment will be hardly possible to solve. And unless the problem is solved, the precariat – the new dangerous class -- will grow in numbers and in power, giving rise to political and social tensions.
Annex 1: Labor Law Reform in Italy

1. In Italy, the overhaul of labor regulations carried out by the Renzi Government is aimed at curbing labor market segmentation and fostering employment, competitiveness and productivity. This comprehensive reform is better known as the Jobs Act. The introduction of a new open-ended contract with rising levels of protection, accompanied by a significant reduction of civil law temporary contracts and the revision of dismissal schemes, constitutes the most prominent measures taken to encourage permanent employment relationships. The implementation of the reform has been underpinned by the application of substantial fiscal and tax incentives as well as the establishment of new enforcement and inspective procedures. Social partners have reacted differently towards the labor law reform as a whole. Whereas employers’ associations have openly endorsed the more flexible approach adopted by the legislator, trade unions have raised concerns over the lower level of protection now attributed to employees, who continue facing no real perspective of job security. Based on available empirical evidence, the impact of the Jobs Act into the labor market is quite ambiguous. Some studies display positive results in terms of the increase of permanent contracts over temporary ones, but the reform appears not to have succeeded to achieve its major goals of job creation and employment security.

A comprehensive and wide-ranging labor law reform was needed to confront high unemployment rates, labor market duality and slow economic growth

2. In the frame of the global financial crisis prevailing crisis, Italy witnessed a steep fall of real GDP and a substantial decline in terms of productivity and external competitiveness. Between 2007 and 2013, the employment rate plummeted by 3 percentage points from 62.7 % to 59.7 %, whilst unemployment rate almost reached the pick of 13 % in November 2014. Young people, women and the southern-regions population were the labor force segments who suffered the most from the dearth of employment opportunities: youth unemployment rate reached the unprecedented rate of 40%. All these factors set the ground for an exceptionally fragmented and inefficient labor system. The proliferation of fixed-term and atypical contacts together with the lack of employment growth has eventually produced a conspicuous labor market duality.

The introduction of a wide range of temporary and flexible contracts led to the abuse of atypical employment relationships and marked labor market duality

3. At the EU level, Italy is one of the most prominent examples of labor market dualism. In the last 15 years, labor law reforms just produced timid – if not ‘failed’ – attempts to enhance flexibility while securing employment protection. Over time, the legislative reform process brought to a gradual deregulation of the use of temporary contracts while maintaining stringent dismissal schemes and benefits for permanent contracts – the latter regime was established under the Labor Code in 1970. As a result, a highly segmented labor market took hold: a significant share of temporary and less protected contracts began to coexist alongside with a limited volume of more secure open-ended contracts. This labor law reform process has been described as marginal – since it was applicable only to newly-created jobs - and asymmetric\(^\text{11}\), with an impact just on a limited fraction of the overall labor force.

4. This reform development was successfully carried out, because it was rendered politically viable. Older generation of employees were almost unaffected by legislative changes and the standard open-ended contract (with strong employment protection under the Labor Code of 1970) remained unaltered.

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\(^{11}\) Garibaldi e Taddei (2013)
Concurrently, the new flexible labor contracts created a variety of new jobs in the short-run, thus offering younger generation the possibility of entering labor market.

5. The initial success of flexible and atypical employment relationships was soon called into question, due to what has been defined as the **honeymoon effect** of marginal reforms\(^\text{12}\). In a dual labor system, employers highly benefit from the opportunity to hire workers through more convenient and flexible temporary contracts. However, this scheme proves to work well in times of economic expansion, thus boosting employment especially among young generations. With the advent of economic downturns, numerous jobs are doomed to be wiped out, because temporary contracts are not renewed and workers are consequently dismissed from their job placement. Therefore, the widespread use of temporary contracts in countries with large differentials in the labor law protection increases the volatility of employment to economic fluctuations.

6. Moreover, the domestic labor market also experienced a extensive **abuse of bogus self-employment**. In Italy, self-employed acquire a VAT registration number (Partita IVA) in order to issue invoices to their clients. These are usually independent consultants who perform a variety of tasks with full flexibility in work organization, but subject to very limited labor law protection. However, free-lance were very often hired by their employers to deliver services under conditions similar to open-ended employees, but with no benefits or job security as generally recognized under permanent contract regime.

**The Jobs Act: a comprehensive reform to encourage labor market flexibility, foster job creation and boost competitiveness and productivity**

7. Once in office in 2014, the Renzi Government immediately launched an ambitious wide-ranging reform plan in the attempt to boost economic recovery, foster investment opportunities, enhance competitiveness, strengthen social cohesion and improve public sector efficiency. The trend of **Flexicurity**\(^\text{13}\), as envisioned by the EC, was eagerly embraced by experts and institutions which explored integrated strategies to reconcile employers’ need for a flexible labor force with employees’ need for a well-defined path to employment stability and security. The Jobs Act (Law n. 183/2014) represents the most comprehensive labor market reform since the introduction of the Labor Code (Statuto dei Lavoratori) in 1970. Its core objective consists in the creation of a more inclusive, resilient and flexible labor market. As such, the reform encompasses a broad range of structural reforms of the labor regulatory framework as transposed in detail in several implementing decrees enacted in 2015. The new law addresses a broad array of subjects as follows:

8. **The principle Hetero-organization delimits the scope of labor law application.** The new principle regulating the scope of labor law application is related to the concept of “hetero-organization”. Labor law now applies to employment relationships if the ensuing identifying elements recur: a) the assigned work task relate to an activity and not a specific result, b) functions are carried out personally by the worker, without any other support or collaboration, and c) the employer has the power to determine the place and the time of the performance.\(^\text{14}\)

9. **Reduction of the number of existing atypical contracts not protected under labor law.** The majority of civil law contracts have been abolished to confront labor market duality. The outlawed contracts are the following: project-related contract (contratto a progetto), an individual joint venture between worker and company, where just labor is contributed to the company (associazione in

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\(^{12}\) Boeri e Garibaldi (2007)  
\(^{13}\) Communication on the common principles of flexicurity (June 2007), Council conclusions on common principles of flexicurity (November 2007).  
\(^{14}\) Ichino 2016
partecipazione con apporto di lavoro) and “job sharing”. The only exception in the domain of atypical temporary contracts concerns a contractual agreement well-defined in terms of duration and tasks under strict requirements and precise circumstances (so-called collaborazione coordinata continuativa).

10. The new Open-Ended contract with increasing levels of protection (“Contratto a Tutele Crescenti”). The Decree no. 81/2015 rewrites the entire regulation concerning contractual agreements. The key novelty of the reform is the introduction of a permanent contract offering “rising levels of protection”, proportional to job tenure (“Contratto a Tutele Crescenti”). This open-ended contract does not acquire the status of the envisioned “single-contract”; instead, it serves as the default form of employment for new-recruits. Employee’s protection is meant to increase alongside with the length of time worked, building on a concept of growing confidence and trust between employer and employee. In the attempt to encourage employers to adopt this new permanent contractual agreement, the Italian government adopted two fundamental policy measures: 1) a set of generous hiring incentives applicable in open-ended employment relationships, and 2) a drastic reduction of firing costs for newly established permanent contracts (see below).

11. Fiscal Incentives as a Powerful Tool to Boost Permanent Employment. In the attempt to boost permanent employment, the Italian government has introduced a generous temporary rebate of non-wage labor costs. These ‘hiring’ incentives cover all new permanent workers who were not employed on permanent basis in the semester prior to the recruitment. An equivalent advantageous treatment has been granted in cases of conversion from a fixed-term to an open-ended contract. More in detail, under the 2015 Finance Act (the so-called “Legge di Stabilità”), employers resorting to the new permanent contract - from January 1st to December 31st 2015 - could benefit from an exemption on social contributions, for which they would normally be liable, for three full years (36 months) up to an annual maximum of €8,060 per contract\(^\text{15}\). In 2016, the economic incentives have been The 2016 Finance Act has reduced to 40 percent of the amount of social security contributions. It has allowed for a social contributions exemption applicable only for 24 months from the signature of the contract, but with a maximum amount a year of €3,250 per employee. This measure applies to all permanent contracts signed from January 1\(^\text{st}\) to December 31\(^\text{st}\) 2016.

12. Reshaping of Dismissal Schemes: Reduction of Uncertainty, Firing Costs and Litigation Burden. The Italian government clearly intended to reduce the uncertainty on average expected costs related to permanent employees’ lay-offs. Prior to the Jobs Act, if a judge ruled in favor of an employee on unfair dismissal cases, overall costs upon the employers could potentially be very high. Over time, this stringent dismissal scheme induced employers to prefer temporary contracts over permanent ones. The issue of removing the risk of high firing costs has been at the roots of a contentious debate in Italy for over 20 years. Trade unions strenuously shielded the rigid system of labor rights protection, as laid out under Article 18 of the Labor Code (Statuto dei Lavoratori, Law 300/1970). However, with the Jobs Act the government resolved to circumvent trade unions’ approval. The reform has significantly restrained the possibility of employees’ reinstatement, limiting it only to discriminatory dismissals and few cases of disciplinary dismissals. The general rule now establishes that unfair dismissals are compensated with monetary indemnification. The amount to be disbursed by the employer is predetermined by the law as it increases with job tenure (from a minimum of 4 times the monthly pay to a maximum of 24 times, i.e. 2 monthly pay every year of seniority).

\(^{15}\) Such tax exemption expressly refers to contributions due by the employers to the National Institute of Social Welfare (INPS). The contribution is calculated as a percentage over the gross salary of employees and it usually amounts up to 32,70%.
13. **Fixed-term Contracts and ‘De-Skilling’ Revised Regulation.** The use of fixed-term contracts has been significantly liberalized. The reform removes the obligation upon employer to indicate the specific (technical, productive, organizational or substitutive) reason (the so-called causale) for which fixed-term employment has been stipulated. By eliminating any reference to reasons, the legislator has shaped a system based on the increased employer’s discretion to make use of fixed-term contracts. This system is limited by three external elements: 1) a maximum duration of 36 months for fixed-term employment relationships; 2) a maximum of five contract extensions; 3) the possibility for the employer (companies with more than 5 employees) to hire temporary workers up to a maximum of 20% of the total number of employees. Additionally, another effect of the reform was the increased flexibility in setting and re-organizing worker duties upon the employer. An eased regulation now consents the transfer of employees from one duty to another, a phenomenon better known as “de-skilling”: when a company’s “organizational structure” undergoes a change, employees can be assigned to perform duties at levels below those for which they were originally hired.

14. **Work vouchers to pay ‘casual’ and ‘extra’ work taking place (Mini-Jobs).** Introduced in 2003 but implemented only since 2008, vouchers are hourly tickets introduced by the legislator to regulate “casual jobs”. Generally speaking, vouchers allow for paying individual workers per hour, with no need to sign any formal contractual agreement. The current nominal value of the voucher is of 10 Euros per hour worked, which includes a social contribution of 25% to fiscal institutions. The recent Jobs Act reform of 2015 has raised the maximum cap of up to 7,000 EUR to extend labor protection to otherwise hard-to-regulate employment relationships. Nevertheless, employees resorting to vouchers do not have any social security rights, continue to be classified as unemployed, pay no income tax and receive no workplace rights or benefits.

**Enforcement and Inspection System under New Labor Law Regulations**

15. **Establishment of a New Inspection Agency to foster coordination and secure enforcement.** The implementing Decree no. 149/2015 of the Jobs Act brought to the establishment of a new National Labor Inspectorate, aimed at strengthening inspection and surveillance activities over employment. The Inspectorate gathers in a single authority all monitoring and control activities covering employment relationships, undeclared work, health and safety, obligatory insurance, fiscal and social contribution obligations. The core function of the New Labor Inspectorate consists in the general coordination of inspection activities, entailing the planning and development of inspection procedures, tools, guidelines and operational directives for all the personnel involved; the definition of qualitative and quantitative targets, and monitoring their achievement; the planning of training activities for inspectors; the set-up of a monitoring and risk-mapping system targeting all forms of undeclared and irregular employment.

16. **Revision of the Sanctions under the Jobs Act, the “Maxi-Sanction” for Undeclared Work.** A comprehensive revision of the system of sanctions in cases of non-compliance with labor law obligations has been introduced by Legislative Decree. n. 151/2015. Article 22 of the decree calibrates certain penalties for undeclared or informal work proportionally to violations. Among relevant provisions, the rule concerning the so-called max-penalty (“maxi-sanzione”), applicable in cases of breach of undeclared work prohibitions, stands out. As an effect of the Jobs Act, the new administrative sanction applicable to employers, who resort to informal employment, is not computed on the basis of single work days - as occurred under the previous regime; instead, the amount of applicable penalty is proportional to different ranks of misconduct, depending on the duration of the ascertained breach.

17. **New System of Electronic Distance Control of Employees as a Powerful Monitoring Tool.** Up until the enactment of the Jobs Act, Italian labor law fiercely forbade the use of any audio-visual system or other similar equipment as a way of controlling employees’ working performance at a distance. This ban
has witnessed a remarkable adjustment under the newly established-rules on monitoring and inspection system of the labor force. The norm now into force maintains that audiovisual equipment and other remote control tools can be installed exclusively on the grounds of organizational and productivity needs for job security and the protection of company assets. Employers are also required to either sign an agreement with trade union representatives or obtain an express authorization from a public authority to install any equipment, through which they may monitor employees’ activities.

Social Partners Reactions to the Jobs Act Reform

18. Trade Unions show Widespread Criticism and Skepticism on the Jobs Act Reform. The Renzi Government resolved to adopt and implement the Jobs Act reform in spite of the widespread criticism and opposition shown by Trade Unions. Unions loudly denounce the fact that longstanding employees’ rights are now at stake, due to the new regulation on illegitimate and collective dismissal. Despite their acknowledgment on the government’s efforts to curb labor market segmentation, a bolder intervention on the reduction of precarious employment was expected. Unions claim more decision-making on their side power through tools collective bargaining and negotiation. On the contrary, the Jobs Act is perceived to have deprived Unions of their well-established role in two crucial phases of a firm life-cycle: collective dismissals and firm’s internal re-organization. Being reinstatement confined to very limited cases, the negotiation between the employers and relevant unions has lost its inner significance. In the majority of lay-off cases, employers now merely risk bearing the costs of an administrative indemnification. Therefore, no settled compromise or agreement with the Unions might secure a job placement.

19. Secondly, Unions have strongly criticized the fixed-term contracts reform. The relevant norm abolishing the requirement of causality in connection with contracts and extensions - will allow the employer to hire employees under fixed-term contracts to satisfy even long-term business needs. In the frame of the current regime, fixed-term employees could be kept in a condition of job insecurity not only for a 36-month period – the maximum length allowed by the rules – but also for a further 36 months by simply modifying workers’ job tasks – due to the increased discretionary power attributed to the employer in this direction. This factor could determine a scenario of semi-permanent job insecurity, where fixed-term contracts become the new general form of employment relationships.

20. Employers’ Associations demonstrate a favorable approach to the new labor regulations. Employers’ organizations have openly welcomed the simplification of labor law regulation, the flexibility of open-ended contracts as well as the reformed dismissals regime. Despite the reduction of temporary and more convenient civil law contracts, employers’ associations have supported the government’s efforts towards the promotion of permanent employment in response to the abuse of precarious contracts. Positive reactions also relate to the increase of discretionary power employers may exercise on the setting, re-organizing and de-skilling of employees’ duties. Employers expect that all these measures may contribute to improve the business climate and make the country more attractive for foreign investors. Notwithstanding, the Jobs Act is not considered sufficient to trigger long-term employment and economic growth in the country. What employers explicitly request to the government is the adoption of broader set of policies capable of enhancing a solid structural change in the internal economic system. High labor costs and stringent fiscal requirements are still perceived as the most prominent barrier to employment creation.

Impact Assessment of the Jobs Act: Empirical Evidence and First Results

21. Evidence on the first effects of the Jobs Act into the labor market leads to ambiguous and not univocal results. Some studies demonstrate a considerable increase of new permanent employment relationship, mostly as a consequence of the significant reduction of social welfare contributions granted under the new open-ended employment contracts with raising levels of protection. The current outlook
of the labor market in Veneto - a large and productive region in the North-eastern part of Italy - is a case in point. Empirical data display very positive results both in terms of increase of permanent employment rates and job creation. Notwithstanding, other studies have shown opposing outcomes. Some data reveal that the increase of new permanent contracts is, in fact, limited to a very modest percentage of the total amount of contractual agreements stipulated during 2015. Moreover, the decrease of unemployment rate does not seem to be a direct result of job creation and internal economic growth; instead the inactivity rate of the labor force is currently experiencing a steep raise in the country as a whole.
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