Industrial Relations and the Welfare State in Italy: Assessing the Potential of Negotiated Change*

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The 1990s saw an important shift from long-term reform sclerosis in the Italian industrial relations and welfare state systems to important innovations, both in the mode of policy making (concertation via social pacts) and the content of reform (decentralization in the collective bargaining system and greater flexibilization of a highly-rigid labour market). After 1998, concertation weakened considerably once macro-economic convergence for EMU membership had been achieved, and contestation of the collective bargaining system and labour market regulation reappeared. This article seeks to explain the rise and demise of concertation over the past decade or so, and to assess the consequences of reform for wage bargaining and employment.

Introduction

Few West European countries have been subject to the continuous wave of reforms in industrial relations and welfare state institutions experienced by Italy in the last fifteen years or so. Italy stands out not only in terms of the number and scope of reforms, but also their transformative potential. After years of institutional stasis, Italy’s policy landscape was shaken in the 1990s by a series of negotiated reforms on collective bargaining, employment regulation and the pensions system that seemed to herald a new era for the Italian economy. Some even referred to a ‘Copernican revolution’ (Salvati 1997).

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Reform on this scale in a veto-ridden political system such as Italy’s raises several questions. The first concerns the conditions facilitating change. The critical role played by Economic and Monetary Union (EMU) as a catalyst for reform is widely acknowledged (Ferrera and Gualmini 2004). The macroeconomic challenges associated with Italy’s EMU accession were internalised through negotiations between employers, unions and the state that neutralised the vetoes that had hindered change in the past (Natali and Rhodes 2004). But after 1998, the impetus weakened. Fully-fledged, tripartite concertation was increasingly blamed for Italy’s lacklustre economic performance and was rejected outright by the second Berlusconi government. Our first task is to understand why social pacting faltered before its potential was fully exploited.

The second question concerns institutional outcomes. Has Italy really experienced a policy paradigm shift? The ‘transformative potential’ of the 1990s reforms remains unclear. It is widely agreed that concertation both facilitated change and increased the overall coordination of Italy’s socio-economic system (Perez 2002; Herrmann 2005). But the outcomes of negotiated reform reflect a specific balance of power, and those outcomes will be contested anew once that power balance shifts (Molina and Rhodes 2002; Molina 2006). This has been especially true of the institutional legacies of 1990s reform. Our second task is to understand the nature of that contestation and its consequences.

A third question concerns distributive outcomes. In Italy, the industrial relations/welfare state nexus is a complex one. Many labour market entitlements, notably extensive job protection, provide de facto compensation for Italy’s under-developed and fragmented welfare system. Collective bargaining has undergone substantial change in the last decade and a half, as has the regulation of the labour market, with greater pay and employment flexibility as the key objectives. A number of adjustments – though too few in the opinion of most observers - have also been made to the welfare system to complement
those innovations. But with what result? Our third task is to assess the equity and efficiency outcomes of the reforms.

We organize our analysis as follows. The first section presents the pattern of social pacting *all’italiana*, through the rise and demise of tripartite negotiations from the early 1990s to the present day. The second section presents an explanation for the changing dynamic of concertation, emphasizing the importance of economic context in creating ‘win-win’ opportunities for collaboration between otherwise antagonistic actors. The third section examines the ongoing tensions between unions, employers and the state over the key institutional innovations put in place. The consequences of policy reform for pay and productivity, wage dispersion, and the relationship between the labour market and welfare systems are analyzed, respectively, in the fourth, fifth and sixth sections. Section seven concludes.

**The ‘Storm after the Calm’: Concertation under EMU and its Aftermath**

The central focus of Regini and Regalia’s (1997) study of employers, unions and the state for the first special issue of *West European Politics* on Italy was the vitality of concertation in the 1990s and its critical contribution to Italy’s membership of EMU. Ferrera’s (1997) article on the Italian welfare state in the same issue was also guardedly optimistic about the country’s new-found capacity for reform. But their analyses were written near the peak of 1990s concertation – the *Patto di Natale* (Christmas pact) of 1998. The phase of industrial relations cooperation and concerted welfare reform that had characterized much of the decade encountered a major impasse shortly thereafter.

The tripartite agreements of the early 1990s inaugurated a new era of inter-confederal cooperation, previously abandoned after disagreements over an attempted social pact in 1984. The deterioration of political and economic conditions in 1992, and the prospect that EMU
membership would elude the Italians, created a perception of emergency among unions and employers, facilitating two important tripartite agreements: the first in 1992 abolished the *scala mobile* system of automatic wage indexation, a major impetus behind Italy’s high inflation rate\(^1\); the second in 1993 set out a new and stable architecture for incomes policies and collective bargaining (Regini 1996: 726).

The third ‘cornerstone’ of Italy’s recovery - the concerted 1995 Dini reform of the pensions system - followed Berlusconi’s failed unilateral reform of a year earlier. Although its long-term impact on pensions’ costs and liabilities was rather modest, the Dini reform (developed by union experts and Ministry of Labour advisors, and strongly reflecting the preferences of the former) effected an important shift from an earnings- to a more contributions-related pay-as-you-go (PAYG) system, standardized contributions across categories of employees (private, public and self-employed), and promoted the use of fully-funded supplementary pension schemes (Natali and Rhodes 2004; 2007).

Together, these pacts established the framework for economic adjustment in the 1990s. Initially a mechanism of emergency governance, the ultimate ambition was to make concertation a routine mode of policy making.

After a short return to conflict under the first Berlusconi government in 1994, concertation regained momentum under the centre-left government of Romano Prodi that followed. The trigger for labour market reform was the so-called ‘*emergenza occupazione*’ of the 1993-95 recession when the already low Italian employment rate fell from 53 to 50.6 per cent against a background of overall unemployment above 10 per cent, rising to as much as 26 per cent in the South. Unemployment among young workers (aged 15-24) remained at a staggering 30 per cent throughout the decade (Alacevich 2000; Bertola and Garibaldi 2003).

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\(^1\) The *scala mobile* granted absolute rather than proportional wage increases in the face of inflation, thereby guaranteeing purchasing power and favouring low paid workers (Devicienti 2003).
Tripartite negotiations in the mid-1990s produced the 1996 *Patto per il lavoro* and the 1997 reform of the labour market (Law 196/1997), also known as the *pacchetto Treu*. Building on the principles set out in 1993, these reforms introduced certain measures of labour market flexibility and established regional procedures for policy concertation (CESOS 2000: 346). The *pacchetto Treu* was a major departure from an Italian tradition of labour law heavily focused on limiting contract flexibility. In 1987 the use of temporary contracts was somewhat liberalized, but remained heavily restricted compared with most other European countries. The 1997 law was the first to extend the use of temporary contracts throughout the private and public sectors, and was all the more remarkable for its union support.

But this climate of cooperation did not preclude important tensions between the unions and the Prodi government. The principal issues at stake were the introduction of the 35 hour working week – a major Italian union priority at the time – that was set aside in the 1997 reform, and a 1998 regulation on over-time work that established a ‘normal’ working week of 40 hours, even if it also envisaged incentives – in the form of lower social contributions – for a bargained reduction of working hours below that threshold.

The zenith (but also, as it turned out, the grand finale) of this phase of concertation came with the 1998 *Patto di Natale* (Christmas Pact), originally expected to upgrade, improve and extend the innovations of the 1993 agreement. The centre-left government proposal included gaining a commitment from employers to boost investment in exchange for more labour market flexibility, a reduction in firms’ tax burdens and wage moderation. In spite of strong disagreements on collective bargaining reform, a Pact was signed in December 1998 (Molina 2005).

The Christmas pact ostensibly signalled a turning point in the meaning and practice of concertation: it sought to institutionalize concertation, extend it to regional and territorial levels and deploy it for the promotion of development and growth (Bertola and Garibaldi
2003). It also aimed to compartmentalize tripartite negotiations – dividing the issues at stake into different bargaining arenas - to enhance the procedural efficiency. But in reality the pact delivered little. Indeed, it was never implemented as such - not even under the Prodi government that signed it during the 18 months before Berlusconi returned to power in 2001. Far from consolidating concertation as a mode of policy making, the Christmas pact was largely symbolic (Hancké and Rhodes 2005; Colombo and Regini 2006).

In fact, national concertation had begun to show signs of exhaustion by the time of the pact’s negotiation. Its gradual abandonment was triggered by several concurrent developments. The end of the EMU emergency, as argued below, was critical. But also important were the re-configuration during the 1990s of party politics and union-party alignments, the increasingly critical position of Confindustria towards concertation, and growing differences among union confederations regarding the role of political action. If as Ferrera and Gualmini (2004: 169) argue, the deadlines and anticipated sanctions attached to EMU membership weakened traditional veto points, creating a new advocacy coalition for reform, the removal of the *vincolo esterno* released social and political actors to pursue their own interests and agendas.

Labour market flexibility figured at the centre of growing employer-union disagreement. This was fully revealed by the Milan Employment Pact (*Milano lavoro*) of February 2000. This pact, which enlarged the scope for flexible employment contracts for specified categories of workers, was signed by CISL (the *Confederazione italiana sindacati dei lavoratori*), UIL (the *Unione italiana del lavoro*) and the employers’ organization Confindustria, but was opposed by the more militant CGIL (Confederazione generale italiana del lavoro), thereby formally breaking trade union unity and opening the road to future separate agreements (Baccaro et al. 2003). The government of Silvio Berlusconi was therefore
also freed to follow its own political path: benefiting from union divisions, it could pursue a more liberal labour market policy with less fear of collective union opposition.

Some months later, the Berlusconi government prepared a ‘White Book on the Labour Market and Employment’ that contained an ambitious plan to enhance competitiveness and labour market flexibility and boost the role and efficiency of employment placement services, whose operations in Italy were hamstrung by legal regulation. The White Book also contained a declaration of intent regarding policy concertation, advocating a shift to a much vaguer and looser ‘social dialogue’ in relations between unions, employers and the government that could circumvent the veto of the militant CGIL, reduce the role of the social partners to one of consultation and avoid ensnaring the state in a complex web of commitments (Ugolini 2003).

The unions’ reactions to the White Book reflected their contrasting understandings of concertation. In response to the CGIL’s strong protests against the White Book, the Berlusconi government maintained negotiations with the other two union confederations to gain support from as much of the labour movement as possible and feed its internal divisions (Megale and Leonardi 2002). CISL and the UIL continued negotiations until the end of 2001, when discussions broke down due to the government’s proposal (unannounced in the White Book) to relax the protection for workers’ unfair dismissal under article 18 of the 1970 Statuto dei Lavoratori, or Workers’ Statute.

Even though all three unions attacked this proposal and called for a one-day general strike, negotiations between the government and CISL and the UIL resumed some weeks later, leading to the Patto per l’Italia in 2002. In this pact, CISL, the UIL, Confindustria and the government committed to a comprehensive plan to improve the fortunes of the Italian economy. One year later, two bills – discussed in greater detail below - were passed, containing measures aimed at greater labour market flexibility, diminishing the size of the
informal (i.e. illegal) labour market, modifying collective bargaining and enhancing the effectiveness of public employment placement services.

Shortly thereafter, deteriorating economic conditions helped restore unity of action on the union side: the three confederations jointly criticised the government’s social and labour market policies, and the CGIL called a general strike in February 2003. But bipartite social dialogue was again restored in June when all three unions and Confindustria signed a ‘pact for employment and competitiveness’. The CGIL had in fact split internally over its militancy and ‘politicalization’, the source of tensions not just with the CISL and UIL but also the political centre-left. In September that year, a 600-member reformist group within the CGIL approved a document calling for a change in the union’s direction.

A year later, a joint union assembly approved a document attacking the government and proposing innovations in economic and social policy, and a general strike was called in November to protest against Berlusconi’s financial and tax policies. This union rapprochement was quickly followed by similar criticism from the newly elected president of Confindustria - Luca Cordero di Montezemolo – who also called for a resumption of concertation. As in 1992-3, economic crisis acted as a catalyst in reconciling union and employer policy positions.

Nonetheless, critical differences remained between the unions, impeding a full return to unity and - by extension - cooperation with employers. Confindustria’s calls in 2004-5 to include collective bargaining reform in a new pact on competitiveness revived some of those tensions. The CGIL firmly rejects any re-negotiation of the collective bargaining system, arguing that it performs well and requires only minor adjustments. But both the CISL and UIL believe that important changes are necessary to keep the system operating effectively.

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2 The Pact for development, employment and competitiveness signed in June 2003 identifies research, training, the South of Italy (Mezzogiorno) and infrastructures as the four priority areas for the country’s economic and social development.
There have been some signs since then that peak union-employer negotiations could be revived. Between 2003 and 2005, the social partners signed a series of inter-confederal pacts\(^3\), suggesting that a new momentum was gathering behind bi-partite dialogue. It seemed that unions and employers might be developing autonomous bargaining arenas where agreements would be struck and presented to the government for endorsement. But in the absence of clear commitment from the state, that had sought to ‘de-institutionalise’ concertation under Berlusconi, and given ongoing tensions in the labour movement, such ‘pacts’ amount to little more than statements of intent or a form of lobbying, with no real influence on government policy making.

To reinforce the point, Berlusconi introduced a unilateral pensions’ reform in 2004 – the first successful one of its kind. His previous such attempt a decade earlier led to the collapse of his government. In contrast to the 1995 Dini reform (where unions were central to the reform writing process) neither the unions nor employers were co-decision makers in 2004. Despite two general strikes, and a series of large-scale protest marches in major cities, the unions were unable to block new rules on either the retirement age (a new limit of 65 was fixed for men and 60 for women) or an increased number of contribution years. Nor were they able to defend the public system by preventing the introduction of occupational and private individual pension schemes backed with tax incentives (Natali and Rhodes 2005).

Even if the victory of the centre-left in 2006 inaugurated a new process of dialogue and cooperation, there has been no return to 1990s-style concertation. Some argue that if concertation is revived it will require that all actors commit to increasing productivity in exchange for wage moderation (Acocella et al. 2006). Others (e.g. Ciccarone and Raitano 2006) argue that productivity, flexibility and human capital development must be considered

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\(^3\) The Pact for Employment, Competitiveness and Development (June 2003); Agreement to Relaunch the Development and Competitiveness of the South of Italy (November 2004); Manifesto for the Development of Italy’s Mezzogiorno (December 2005).
together to help shift Italy towards the ‘flexicurity’ model advocated by many social policy experts and the European Employment Strategy.

Regini and Regalia proposed something very similar in 1997, i.e., ‘a conception of national competitiveness which gives rise to a joint effort for the full development of human resources.’ But they also warned that ‘despite the importance of recent developments, relationships between employers, unions and the state are still a long way from accomplishing this goal’ (1997: 229). A decade later it is still not clear that they are closer to achieving it.

**Explanations: The Dynamics of Concertation and its Rise and Demise in Italy**

Explanations for the return of social pacts in Italy and elsewhere in Europe after the mid-1980s initially relied on the theoretical legacy of neo-corporatism. But it soon became clear that the new phenomenon was quite different from the old (Molina and Rhodes 2002). Italy was a case-in-point, due to its fragmentation of interest representation, a poorly coordinated collective bargaining system and conflict-ridden industrial relations.

In their assessment of the Italian case a decade ago, Regini and Regalia (1997: 226) argued that it was precisely the shared weakness of all three actors – the government, unions and employers organizations – that brought them together, providing the basis for economic recovery and membership of EMU, despite the country’s turbulent, post-‘tangentopoli, political transition (see also Baccaro et al. 2003). Enjoying only weak electoral support, and led by non-partisan prime ministers untainted by the scandals that brought down the party system in 1992, the success of these governments in meeting the Maastricht convergence criteria depended greatly on strengthening the corporatist arena of policy-making.

Elsewhere in Europe (notably Portugal, Ireland, Finland and The Netherlands) social pacts in the 1990s also focused on enhancing competitiveness, reducing inflation and correcting fiscal deficits. They also often developed in the absence of the unitary and
encompassing organisations of capital and labour that had underpinned traditional (e.g., post-war Scandinavian and Austrian) neo-corporatism (Rhodes 1998; Molina and Rhodes 2002). But as in Italy, these new, ‘lean’ forms of neo-corporatist intermediation have been subject to constant crisis and adaptation (Traxler 2004). In most countries (Ireland excepted) the rise of social pacts in the 1990s was followed by their equally sudden demise or reconfiguration on limited, sector-specific agreements thereafter.

Much recent work has been devoted to explaining these developments (e.g. Rhodes 2001; Avdagic et al. 2005; Molina 2006). Hancké and Rhodes (2005) argue that social pacts after the 1980s were primarily aimed at achieving EMU-compatible, non-inflationary wage bargaining and fiscal discipline (see also Perez 2002). As a result, only in those countries which failed to implement one or both of the two key components of wage moderation – i.e., nationally-set, productivity+inflation wage norms and the micro-foundations (company-level productivity bargaining) to implement them – do social pacts remain relevant. The key example is Ireland where firm-level bargaining is weak and coordination via centrally negotiated incomes policies essential. Elsewhere, the achievement of wage moderation and successful EMU entry has robbed national concertation (as opposed to more limited, ad hoc and policy-specific bargains) of its core *raison d’être*.

In the Italian case, the 1993 pact aimed to induce new forms of behaviour among local wage bargaining agents by modifying the institutional framework. And by contrast with Ireland it succeeded - despite ongoing contestation of the 1993 framework, and employers’ disappointment with the extent of productivity-linked wage setting, discussed below. The success of the Italian reforms in achieving disinflation and nominal stabilization makes much less surprising the conclusions drawn by Ferrera and Gualmini (2004: 146-147) that no truly shared goals have been defined and pursued by unions, employers and governments since EMU entry.
The success of concertation in the early-to-mid 1990s therefore goes a long way towards explaining its post-1998 crisis. Once the EMU emergency had passed, and the key mutually-shared objectives were achieved, the ties that bound these previously antagonistic actors together dissolved. Fiorito (2003) calls this the ‘paradox of concertation’ – its demise once the goals that call it into existence are achieved.

The 1993 agreement did in fact contain specific clauses which, had they been implemented, might have led to a deeper and more routine involvement of unions and employers’ organisations in macroeconomic management. Indicating a concern on the part of the unions to pursue that goal, in April 1998, some months before the Patto di Natale, they and Confindustria agreed to renew the rules of concertation which had occurred only sporadically ‘a fasi alterne’ until then (La Repubblica, 1 April 1998). The 1998 pact was intended to constitutionalize social pacting all’italiana and provide a new stimulus to the methods and policies set out in the 1993 agreement and the 1996 Patto per il lavoro (Ghera 1999).

The fact that the 1998 accord was never fully implemented can be explained by fundamental disagreements on policy options both between unions and employers and within the labour movement itself, as well as by government reluctance to enter into long-term commitments. That failure supports the argument that, without the EMU vincolo esterno, the political opportunity structure for concertation was considerably weakened. Ultimately, the Patto di Natale was largely symbolic, signed by social partners in order to re-affirm the principle of social concertation and used by the left coalition executive to legitimate its policies prior to an internal government crisis (Colombo and Regini 2006).

As a result, the institutional foundations for concertation remain fragile. Inter-confederal relations remain highly voluntaristic and subject to the easy ‘exit’ of actors (Alacevich 2000: 122). The July 2002 Patto per l’Italia between the two more moderate
union confederations and the Berlusconi government does not contradict that assessment. It did not represent a reversion to neo-corporatist policy making. It rather conformed to the centre-right government’s interpretation of concertation as a process for gaining support for objectives and priorities set by the executive and legitimized in parliament, not a system of power sharing with organized interests (Ferrera and Gualmini 2004: 157).

It has been argued that concertation might still be institutionalized via a set of formal and informal rules sustaining cooperation (Vatta 2001). Thus, rules establishing the status of ‘most representative’ organizations would not only limit the number of actors legally allowed to participate, but would also help reduce fragmentation in the union movement. Clear rules of representation might also reduce the gap between formal institutionalisation at the national level and the capacity of unions to develop their representative status and legitimacy at lower levels of the system (Fontana 2002: 3).

But the main obstacle to such formalisation comes precisely from the three trade union confederations which reject any such legal intervention. Biagi’s (2002) argument that an excessive formalization of the role of unions reduces their appeal to workers, as well as their strategic flexibility, is particularly apposite here. Given changing incentives and socio-economic conditions, excessive institutionalization threatens to constrain the strategic capacity of both employers and unions – not to mention the policy autonomy of the government.

However, it is important to note the contrast in Italy between the failure to institutionalize national concertation and its rapid expansion and vitality at regional and territorial levels. The decentralisation of tripartite social dialogue has been intense in Italy, with a multiplication of mechanisms in recent years, and a wide array of modes of intervention and objectives (Negrelli 2000). Use of the five instruments of ‘programmazione negoziata’, i.e., the mechanism for developing negotiated regional employment initiatives laid

Providing further support for the Hancké/Rhodes argument, Negrelli (2000) considers the strengthening of these instruments to be a natural evolution of national concertation. For the success of EMU convergence in the 1990s led to a logical shift thereafter from a focus on national macro-economic adjustment to a more territorially-focused development and employment strategy. Although proponents of national concertation (e.g. Treu 2001; CNEL 2001) argue for complementarity and functional specialization between all levels of the industrial relations system, the crisis of national concertation may well be connected precisely to the rise of its regional counterpart.

This is not to say that political variables – i.e., the ideology of the government, the links between social partners and political parties and changes in the party system - are unimportant. A longstanding characteristic of Italian industrial relations is their politicization by ideological divisions within the labour movement and the ‘cinghie di trasmissione’, or ‘transmission belts’ that link trade unions to political parties. Traditionally, concertation in Italy has been interpreted as a political exchange between parties in government and their allied trade unions (Pizzorno 1977).

This scenario was transformed in the early 1990s with the overhaul of the party and political system. The collapse of the ‘First Republic’ led to a re-alignment of political alliances, a process of de-linkage from friendly left-wing parties and an increase in the autonomy of the trade unions (Piazza 2001). Although recent developments suggest that politico-ideological variables still play a role in relations between unions, employers and governments, transition from a multi-party to a more bi-polar system has not only changed traditional alliances; it has also had an impact on earlier understandings of democracy and the role of concertation.
Thus, as might have been expected, the centre-left Ulivo victory in 1996 saw the resurgence of traditional union-party alliances and although tensions remained, they did not jeopardise the underlying climate of unity. But punctual disagreements turned into real breakdown under the second Berlusconi government, opening a new phase of so-called union ‘competitive unity’ in the late 1990s.

But the new bi-polar political configuration after the 2001 elections translated awkwardly into traditional party-union alignments: while the CGIL has linked up with the centre-left Ulivo (in a far from harmonious relationship), the positions of the CISL (traditionally Christian Democratic in orientation) and the more liberal UIL have proven harder to define. Moreover, as argued by Mariucci (2005), the political transition implies a change in the principle and practice of democracy: increasingly understood in terms of the majority principle, governments of both the centre-right and centre-left in Italy are tending to neglect or bypass other democratic inputs, including interest organisations.

Institutional Transformation in Industrial Relations and the Welfare State

More than ten years after the reforms negotiated in the early 1990s, the industrial relations and collective bargaining status quo remain fiercely contested. There are several sources of disagreement, the resolution of which are complicated by the specific nature of Italy’s welfare state-labour market nexus. The most visible source of disagreement stems from the structure of collective bargaining, and more specifically from demands by employers for further decentralization and a closer relationship between wages and productivity. Both come up against the acquired rights and entitlements of Italian workers.

Unions remain committed to preserving the strong rights and entitlements of their members (predominantly full-time workers), in large part because of the weakness in Italy of the so-called ‘social shock absorbers’ (ammortizzatori sociali) – in other words,
unemployment benefits and active employment policies such as training and job placement services. Job protection and the pension system act in Italy instead as a *de facto* welfare safety net in the absence of a more fully-developed alternative covering the risks of social exclusion and unemployment among mature workers. Restricting the level of wage dispersion in the system is also seen as a welfare enhancing measure (it plays a substantial role in supporting incomes in the South), given the incapacity for effective redistribution through the Italian tax and welfare systems (Ferrera 1997; Rostagno and Utili 1998).

The inability of government to shift resources from other areas (such as pensions) and provide more complete formal coverage of social risks, especially unemployment, contributes to – and indeed, has also been exacerbated by - the unions’ ongoing strident defence of core (permanent-contract) workers’ rights. This has a number of perverse consequences, including the emergence in recent years of a significant degree of labour market segmentation (see Section 5 below) and the perpetuation of a welfare state aimed prevalently at past or present members of the formal labour market. Public-sector employment and wages in the South have also acted as a functional equivalent to direct social transfers, and with massive labour-market distorting effect: it has been calculated that roughly half the wage bill in the South is effectively a subsidy (Alesina et al. 2001). Thus, issues that in other countries might be seen as purely industrial relations matters assume a quite different, and much larger, social-wage and welfare dimension in Italy (Ferrera 1997; Rostagno and Utili 1998), making reform all the more difficult to achieve.

Nevertheless, the social pacts of the 1990s did manage to forge a difficult compromise between the need for macro stability and systemic flexibility, balanced against union opposition to accentuated wage dispersion and a reduction in employment protection for their members (Rhodes 1998; Regini 2000). Negotiations led in 1992-93 to the abolition of the automatic wage indexation mechanism (the *scala mobile*), the creation of new structures of
union representation at firm level (*Rappresentanze sindacali unitarie* - RSU) and the creation of a two-tier (*doppio livello*) bargaining structure with clear roles assigned to actors at each level (Carrieri 1995; Ricciardi 1996; Alacevich 2000). There ensued a process of controlled or coordinated de-centralisation, whereby company-level bargaining was to be governed and constrained by a regulatory framework set by the CCNL - the *Contratti collettivi nazionali di lavoro*, or national labour contracts (Bordogna 1997; Molina 2005).

Although to some extent these reforms formalised pre-existing trends in Italian collective bargaining (Bellardi 1997; Regini 2000a), there is no denying their contribution to the shift from conflict to cooperation in industrial relations and to the delivery of disinflation (Megale et al. 2003). But despite their general efficacy, the consensus that accompanied the creation of the new system quickly fell apart.

Some of those tensions emerged as early as 1996, when employers criticised the reforms for reflecting union preferences too closely (CESOS 1997: 266). Confindustria fully endorsed the findings of the 1997 Giugni Commission, appointed by the Prodi government, which pointed to several flaws in the system: that company-level bargaining had failed to make a sufficiently close link between productivity and wages; that the RSUs had not been widely diffused, and where they did exist they acted autonomously from higher levels; and that overlapping functions between the system’s two levels were frustrating the achievement of wage flexibility (Carrieri 1995; Commissione Giugni 1998). The report proposed further decentralisation and greater functional specialisation between the two levels: industry-wide agreements would define minimum levels of regulation, and provide broad guidelines for lower levels; and company bargaining would focus on variable and performance-related changes to organizational flexibility, working hours and pay.

The critical issue for employers was the role of CCNL labour contracts, which in their view had to be subordinated to the lower - regional and company - levels of the system. The
most extreme view has been articulated by Federmecanica (the engineering employers’ association), which wants the end of national bargaining and its full devolution to company and sectoral levels. By contrast the CGIL argues that the system is already sufficiently flexible, and has argued for giving still greater regulatory power to the CCNLs to counter widening wage inequalities (Bellardi 1997; Treu 2004). The CISL, however, has long supported a revision of the 1993 system that would strengthen its lower levels (CISL 1997). These divisions explain the failure of the 1998 Christmas Pact to include a reform of collective bargaining.

The debate on collective bargaining was revived by the 2001 White Book on labour market reform. Prepared by Marco Biagi (a University of Bologna professor and labour market expert, later murdered in March 2002 by Red Brigades terrorists because of his role in advocating this new wave of reforms), the White Book recommended increasing the capacity of the lower (region and company) levels of the system in determining working conditions, including the possibility of opting out of the terms agreed in the CCNLs. Echoing the 1998 Giugni Report, it criticised the hierarchical relationship between levels and recommended a greater role for companies in introducing and regulating new forms of work flexibility. The CCNL should simply set wage minima to guide lower-level negotiations.

The White Book also recommended a territorialization of the system to allow for a better match between industrial relations, collective bargaining and regional economic conditions. Trade union (and especially CGIL) discontent with the White Book spilled over into open conflict in the autumn of 2001 after the Berlusconi government asked parliament for a broad delegation of powers for labour market reform, including a revision of Article 18 of the 1970s Workers Statute, the ‘constitutional’ basis of Italy’s high levels of dismissals
protection for workers in firms with more than 15 employees (Ferrera and Gualmini 2004: 157-158).  

Following discussions between unions, employers and the government, the *Patto per l’Italia* was signed in 2002, whereby Confindustria, the government, the CISL and UIL agreed to pass some of the White Book’s proposals into law. These included a reform of the ordinary unemployment benefit (increasing the replacement rate from 40 to 60 per cent of the previous wage and extending its duration from six to twelve months), and a diluted version of the Article 18 reform, to be suspended experimentally for three years in companies that moved above the 15-employee threshold by recruiting new permanent workers.

Even though the Biagi Law (no. 30/2003) and legislative decree 276/2003 permitted the pact did not challenge the basic structure of the 1993 system, they nonetheless did increase the regulatory autonomy of firms at lower levels, further de-centralising the system and increasing the flexibility of company employment practices. Specifically, firms could now lease workers or outsource work through specialized private placement agencies (whose activities the Biagi Law legalized) and recruit employees on a variety of part-time work contracts.

Confindustria re-opened the collective bargaining debate in 2005 but was less critical of the two-level system than hitherto (Coletto 2005). The employers expressed concern with the recent decrease in productivity and increases in unit labour costs and asked for new measures to correct this trend. Although they still want further decentralization, employers seem to be more concerned with improving compliance with the terms of national agreements.

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4 One of the reasons for the proliferation of firms under 15 workers, in 2002 Article 18 covered less than 10 million workers, as some 12.5 million were employed in firms below the 15-employee threshold. The government’s reform proposals were not especially radical. They would have involved Article 18’s experimental suspension for three years and only for those firms emerging from the shadow economy, increasing employment through new regular hires to more than 15 workers, and transforming temporary employees into permanent ones (Ferrera and Gualmini 2004: 157-158).
at lower levels. They would also like to see a reduction in conflict resulting from the re-negotiation of collective agreements by establishing a clear division of tasks across levels. Their aim is a system of industrial relations that creates incentives rather than impediments for firms that want to make competitiveness-enhancing innovations.

The changes envisaged in the 2003 Biagi Law moved Italy one step further in the direction of a more flexible wage and employment system (Zoli 2004; Del Conte and Tiraboschi 2005). Company bargaining is no longer limited to improving the conditions established by law or collective bargaining at higher levels. It is now able to ‘regulate’ in peius, i.e., to initiate a downward re-negotiation of those conditions through ‘opt-out clauses’. The emphasis of regulation is therefore no longer on stability but on flexibility; and individual rather than collective contracts is considered better suited to that task – a trend found more widely in European industrial relations governance (Visser 2005).

And yet the welfare and ‘security’ dimension of the labour market remains highly underdeveloped. Labour market reforms in Italy over the last decade have also set out to expand the rights and entitlements of the new, more flexible part of the workforce. But a comprehensive reform of the unemployment benefit system has still to be achieved, and Italy’s unemployment support system (i.e. active labour market policies, such as re-training and job placement) remains inadequately funded, and its efficacy regionally highly heterogeneous.

**Pay, Competitiveness and Macroeconomic Outcomes**

Since 2000, the Italian economy has experienced the worst period of economic stagnation in the post-war era and the lowest average growth rate in the Eurozone (De Cecco 2007). But the bright spot in an otherwise gloomy picture has been a significant improvement in the ratio of job growth to GDP which, increasing from 0.26 in 1981-1992 to 0.36 in 1993-2005, suggests
a structural shift in economic development. In addition to the positive impact of immigration, two factors have been critical: wage moderation and the introduction of greater labour market flexibility.

Figure 1: Nominal Compensation, Inflation and Productivity in Italy 1981-2005

The 1993 pact set out to establish a closer link between anticipated inflation, productivity and wage negotiations in the new two-level system. Figure 1 presents the outcomes. The remarkable slowdown in inflation was achieved by using anticipated inflation as a benchmark for wage bargaining at the national sector level (Fabiani et al. 1998; Casadio 2003). But the inflation overshoot of the early 2000s - a consequence of unexpected oil price hikes - raised concern about the disinflationary capacity of the system under sluggish economic growth. As can also be observed in Figure 1, nominal wages grew above the productivity+inflation guideline in 2001-2004 to compensate for previous losses in purchasing power. CCNL labour contracts have safeguarded the purchasing power of wages
in most years. But while trade unions therefore welcome the innovations of the 1993 reform, they remain concerned that Italian workers have nonetheless obtained significantly lower real wage increases than their counterparts elsewhere in Europe (see Table 1) (Megale et al. 2003).

Employers, naturally, remain concerned with competitiveness and flexibility. As discussed above, the 1993 pact aimed at a better match between productivity and wages through decentralized negotiations. The evolution of that relationship since 1993 is captured in Table 1 through the evolution of real unit labour costs, which have fallen further in Italy than in rest of the Eurozone. But in the recession years of 2001-2005, higher wage settlements coincided with a productivity slowdown to deliver higher real unit labour cost increases than elsewhere (Figure 1). Lower productivity growth has diminished the space for rent-sharing negotiations at lower levels, reducing the two-tier system, de facto, to a single national bargaining level. Thus the evolution of productivity poses a major challenge to the continuity and smooth operation of the 1993 system.

Table 1: Real Compensation and Real Unit Labour Costs 1993-2005

<table>
<thead>
<tr>
<th></th>
<th>Real Compensation per Employee</th>
<th>Real Unit Labour Costs</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Italy</td>
<td>EU-12</td>
</tr>
<tr>
<td>1981-1984</td>
<td>0.95</td>
<td>-0.18</td>
</tr>
<tr>
<td>1985-1992</td>
<td>1.79</td>
<td>1.50</td>
</tr>
<tr>
<td>1993-2000</td>
<td>-0.45</td>
<td>0.70</td>
</tr>
<tr>
<td>2001-2005</td>
<td>0.52</td>
<td>0.52</td>
</tr>
<tr>
<td>1993-2005</td>
<td>-0.08</td>
<td>0.63</td>
</tr>
</tbody>
</table>

Source: Eurostat
A key objective of the new bargaining system was the extension of flexible pay mechanisms to help match wages with company performance. Origo (2000) and Casadio (2003) report a consequent increase in the use of variable pay in Italian companies through wage discrimination, such as the salario d’ingresso or entry wage which can be reduced for new hires, and an extended use of the premio di risultato, or productivity-linked bonus payments.

But even though company-level negotiations have increased wages above the nationally-set contractual minimum, the variable (performance-related) part of the wage is still comparatively low. For while strong local unions have resisted increases in the variable share of earnings, productivity growth has also been sluggish in the recent recession (Origo 2003). Moreover, wage drift (the proportion of wages set at lower levels) seems to be explained mainly by firm size and employee category, not by the performance-related variables envisaged in the 1993 agreement (Devicienti and Maida 2004: 7).

As a result, nominal wage rigidity remains rather high (Devicienti 2003). In fact, Italy now has the highest degree of nominal downward wage rigidity (NDWR) in the EU (Knoppik and Beissinger 2005; Montuenga et al. 2006). In line with the Giugni report and employers’ criticisms, Casadio (2003) argues that the 1993 reform introduced insufficient elements of flexibility, blaming the CCNL for ongoing systemic rigidities.

The role of the CCNL in sustaining high relative levels of real downward wage rigidities (RDWR), at levels above NDWR, has also been singled out by Devicienti and Maida (2004), who show that the wage minima set in national sector agreements strongly inhibits nominal wage adjustment. Even if there is evidence of a re-establishment of the wage curve - i.e. the downward sloping relationship between unemployment and wage increases - (Maida et al. 2005), Pichelmann et al. (2004) confirm that there has been no statistically significant improvement in the relationship between wage and productivity growth.
Overall then, Italy has achieved nominal macro-economic stability without real microflexibility. This may well be a consequence of wage moderation in itself, for under low inflation, nominal downward wage rigidity may prevent real wage cuts that might have occurred under conditions of higher inflation (Holden 2004). The problem of high NDWR under low inflation is that in the event of demand shocks, firms will find it difficult to cut costs through wage adjustments and may resort to lay-offs instead.

**Distributive Outcomes: Between Differentiation and Solidarity**

Incomes policies can have significant distributional implications. Wage moderation can lead to a functional re-distribution of income from labour to capital, conditional on the dynamics of wages and productivity. Evidence of a strong re-distributive impact in Italy comes from the sharp decrease in the wage share of labour during the 1990s (Megale et al. 2003). Even though this trend has recently been reversed due to higher increases in real compensation per employee, employment growth and the productivity slowdown, as explained above, the wage-share level is still well below that recorded in the early 1980s.

But the key tension (and perhaps the most salient issue in the current Italian debate) is between solidarity and differentiation in collective bargaining, as revealed by the evolution of wage inequalities. In the late 1970s and 1980s, the *scala mobile* wage indexation system, the sectoral negotiation of wages at the national level and the solidaristic ideology of the union confederations, were responsible for what employers and many economists believed to be an excessive inter-sectoral and inter-regional compression of wages (Erickson and Ichino 1995; Bertola and Ichino 1995).

In principle, the 1992-3 agreements allowed for an increase in wage differentials following the abolition of the *scala mobile*, the de-centralization of collective bargaining and the introduction of productivity-linked wages in firms. However, greater wage dispersion was
restricted by two factors: the strengthened role of national sector bargaining, where Italian unions are strongest; and the role of the CCNL in reducing between-sector, -region and -firm wage inequality by setting the equivalent of a minimum wage rate that varies by sector and qualification but not by firm size (Checchi and Pagani 2005). By fixing occupational scales within each sector, national wage contracts could narrow wage differentials between blue- and white-collar workers.

Using data from the OECD Structural Analysis (STAN) database, in Figure 2 we compare inter-sectoral wage dispersion for selected European economies between 1992 and 2003. As can be observed, wage differences between sectors widened in most countries. The only exception is Italy where inter-sectoral wage differentials remain relatively low, suggesting that collective bargaining still exerts a powerful homogenizing effect.

Figure 2: Inter-Sectoral Wage Dispersion, 1992-2003

Source: OECD Stan Sectoral Database. Wage costs per employee. Average deviations from the mean, 45 economic sectors (including services and manufacturing)
How can this be explained? Checchi and Pagani (2005) reach the somewhat paradoxical conclusion that continued wage compression is due to the role of strong local unions. Their analysis reveals an increased dispersion of negotiated CCNL wages in the 1990s, alongside a decrease in the inter-sectoral dispersion of actual wages. Thus, union strength at company and local levels may have limited the dispersion effects of bargaining decentralization. Devicienti (2003) and Devicienti and Maida (2004) present evidence that the limited inter-personal earnings inequality that has occurred can be explained by traditional variables such as tenure and contractual category (e.g. by allowing occupational and seniority rates of return to widen) rather than innovations in pay-setting across all contracts.

A rather different and more intriguing argument suggests that restricted wage dispersion may actually be preferred by employers – or at least by certain types of firm in certain regions (Brunello 2002; Croce and Ghignoni 2004). Hancké and Herrmann (2007) argue that homogeneity in wages supports the high quality production (HQP) strategies of advanced Italian companies. The fact that wages cannot vary substantially across different skill levels creates a ‘productivity-whip’ that encourages both employers and employees to engage in sophisticated education and training programmes. If wage dispersion in such systems increases beyond a certain point, then firms risk losing the workers they train to poaching from their competitors, and will be reluctant to make the initial high investment. And many firms may not train at all if they can compete on pay and price alone.

At first glance, that conclusion sits awkwardly alongside Italy’s poor training record. According to Eurostat data, in 1999, only 26 per cent of Italian employees (and 8 per cent in small firms of between 10 and 19 workers) received training, compared with an EU-15 average of 40 per cent (19 per cent in small firms) and 50 per cent in the Nordic countries (regardless of firm-size). An Isfol (Istituto per la formazione dei lavoratori) survey in 2003 found that by 2001-2, only 30 per cent of workers in the private sector took part in any
training initiatives, and the proportion of white-collar employees and management involved (at 50 per cent) was twice that of blue-collar workers (Paparella and Rinolfi 2003; Ciccarone and Raitano 2006: 5).

Yet these figures conceal an important regional divide and a highly fragmented production structure; and both exert a strong influence on company behaviour and the broader political economy (Molina and Rhodes 2007). As demonstrated by Croce and Ghignoni (2004), the number of firms training workers is much higher in the North-East than in the South, except for firms over 500 workers, bringing the proportions of workers trained in the former regions to very high levels. They also show that both the unemployment rate and wage compression exert a strong influence on the incidence of training, and specifically on the number of workers a firm chooses to train. The fact that workers with more education receive more training and acquire more qualifications is to be expected since such workers typically also demand more training.

In line with the basic insights of Hancké and Hermann (2007), Croce and Ghignoni (2004) conclude that policies based on wage flexibility and widening wage dispersion could actually depress training investments, lower the skill requirements of the economy and reduce the quality of employment. This may have already occurred in a wide range of firms that have sought since the mid-1990s to compete increasingly on the basis of poorly-paid, irregular contract employment rather than invest in human capital (Tiraboschi 2005: 153-154).

Collective bargaining institutions therefore remain the key to explaining aggregate wage differentials. Inter-personal wage inequalities decreased until the mid-1980s, then grew moderately until the mid-1990s, since when Italy has experienced relative stability compared with other European countries (Brandolini et al. 2001; Devicienti and Maida 2004). While there has been an extension of performance and productivity-related wage clauses at company level - which, *ceteris paribus*, would in theory lead to greater wage differentials – wage
increases are still negotiated within similar bands for all categories of employees, due to the harmonising role played by the CCNL.

An intriguing possibility in light of the evidence is that although this would appear to be the price employers paid in the 1990s for the formal introduction of company-level, performance-related pay, as argued by Rossi and Sestito (2000) and Devicienti and Maida (2004), the fact that Confindustria has not pushed harder for further decentralization and flexibility in pay setting may also indicate that not all of its member firms are hostile to the status quo.

The (Limited) Transformation of Italy’s Welfare State-Labour Market Nexus

As discussed above, the relationship between the welfare state and the labour market is an intricate and often dysfunctional one, with compensation for long-standing inadequacies in social policy provision effected via narrowly applied entitlements (wage compression, a high level of employment protection, redundancy payments) for workers on open-ended contracts in the formal economy. Given that workers on fixed-term contracts of various kinds have increased massively in number (doubling between 1996 and 2004), but have not acquired equivalent access to those entitlements, labour market reform has refocused attention on the inadequacies of Italy’s social and employment policy systems.

The purported aim of labour market reform from the late 1990s onwards was to shift Italy in the direction of ‘flexicurity’ – in other words, a balanced combination of a flexible labour market and a supportive welfare system. But innovations to date have been heavily weighted towards the ‘flexi’ side of equation. Exit-rate (i.e. job severance) indicators confirm increasing flexibility from the early 1990s onwards, and unprecedented job destruction in the 1993-94 recession. External flexibility – i.e. the greater freedom to recruit on a variety of different contracts - introduced in the pacchetto Treu in 1997 and expanded by the 2003 Biagi
law, has increased substantially, one positive result being a decline in unemployment in the last few years and an increase in open-ended as well as fixed-term contracts.

But Italy remains a ‘pensioner’s welfare state’, with old age, disability and survivors’ pensions absorbing 68 per cent of social expenditure in 2004, and unemployment benefits only two, compared with an average of 53 and seven per cent respectively in the EU 15 (Ciccarone and Raitano 2006). Meanwhile, Italy has one of the lowest levels of active labour market expenditure in Europe, at 0.6 per cent of GDP compared with a 0.9 per cent average for the EU 15, rising to 1.4 per cent in The Netherlands and 1.7 per cent in Denmark. The training and job placement that does occur is also highly heterogeneous depending on location, and has become even more so since 2001 when responsibility for training was transferred to the regions.

The 2003 Biagi Law did in fact seek to address the increasing three-way segmentation of the Italian labour market - between (1) workers with open-ended contracts, high employment protection and adequate access to welfare state coverage of the risks unemployment and old age; (2) the increasing number of workers with flexible contracts, low employment protection and inadequate coverage of social risks (around 3,400,000 workers in 2005); and (3) workers in the irregular shadow economy, that accounts for around 10 per cent of employment in the North, 20 per cent in the Centre and a massive 30-35 per cent in the South (Tiraboschi 2005). The reform aimed to increase access to unemployment benefits and pensions for fixed-term workers, and to transform irregular workers into regular employees with flexible contracts, thus trading a reduction in the size of the informal economy for greater autonomy and experimentation with work contracts in the formal economy (Zoli 2004).

But the impact has been limited. In the case of fixed-term workers, the Biagi reform gradually increased social security contributions from 10, 14 and then 19 per cent of salary,
depending on the type of contract – but that is still low: it is projected that when these workers retire they will only be entitled to around 30 per cent of their last wage. Moreover, there has been little success in tackling the other inequalities between core ‘insider’ workers and their ‘outsider’ counterparts. Trade unions began trying to represent the flexible work force from 1998 onwards, with the creation that year of Nidil-CGIL (Nuove identità di lavoro), Alai-CISL (Associazione lavoratori atipici e interinale) and Cpo-Uil (Comitato per l’occupazione). The aim was to campaign for greater rights and social security entitlements, but there has been little success to date. Workers on fixed-term contracts tend to be much less unionised, have interrupted work careers and typically earn less (around 20 per cent) than similar workers on open-ended contracts (Ciccarone and Raitano 2006: 5-6). Such workers actually break down further: between ‘protected’ temporary workers, with access to a standard but diminished range of welfare entitlements (including unemployment and pensions benefits); and so-called co.co.co (coordinated collaborator) workers on continuous, project, or occasional contracts, whose eligibility for pension benefits is diminished by low pension contributions and who are ineligible for unemployment benefits, maternity leave or paid vacations (Franzini 2001).

Although it is commonly thought that the majority of young people finding work in Italy do so through co.co.co contracts, in 2004 the largest group (over a third) was aged 30 to 39, 25 per cent were over 50, and only 6 per cent were under 25. Young workers are more likely to be in apprenticeship contracts (many of which are subsidised but deliver little training) including the contrato di inserimento di lavoro introduced by the Biagi Law (Tiraboschi 2006). Nevertheless, the level of labour market access for young workers is appallingly low: in 2003, 30 per cent of this group was unemployed (with Greece the highest rate of youth unemployment in the OECD), and the majority of those had never held a job (the average age of access is a high 25), making them ineligible for unemployment benefits.
Apart from unequal access to social benefits, there is an extraordinary gulf between the two categories of workers in terms of employment protection. The unemployment regime for regular workers in large firms is based on the *Cassa integrazione guadagni ordinaria* (CIG) that pays 80 per cent of previous wages for temporary layoffs of industrial workers, up to a ceiling. Under the *Cassa integrazione guadagni straordinaria* (CIGS) the same replacement rate is available for several years for workers in industrial firms (with more than 15 employees) and retail and service-sector firms (more than 50) that are restructuring according to a government-approved plan (Bertola and Garibaldi 2003). Regular workers also receive the TFR (*trattamento fine di rapporto*), a severance payment funded from contributions that serves as a kind of *de facto* unemployment benefit, but which is not available to most people on irregular contracts.

As Franzini (2001) argues, if one has to identify the worst of all the flaws in the Italian welfare state-labour market nexus, it is the deficient system of unemployment benefits. It is neither equitable nor efficient. General unemployment and CIG/CIGs benefits discriminate between workers by economic sector, the size of the firm and sometimes location; there is no effective unemployment assistance for those with irregular work or no work histories and who are consequently ineligible for insurance benefits - an increasingly serious problem given the expansion in the number of such workers; and the benefits system is more or less completely divorced from active labour market policies, regardless of the latter’s recent reform and creation of a new public employment service to manage them.

**Conclusion**

Regardless of the frequently-evoked successes of the mid-1990s social pacts (notably in pensions and collective bargaining), the level of reform consensus within and across parties and interest organizations in Italy continues to be low, as does the broader legitimacy of
economic reform in Italian society. Policy change and institutional transformation is consequently sclerotic and limited – a state of affairs that even the Berlusconi government, in power between 2001 and 2006, was unable radically to depart from, apart from stimulating a growing segmentation of the labour market. As a result, the perverse set of relationships that link employment regulation with the welfare state has been reinforced rather than corrected over the last 20 years (Molina and Rhodes 2007).

Greater coordination in wage bargaining – even if still contested - has served the interests of both employers and trade unions. But there has been much less consensus in other areas of social protection and labour market reform – a reflection in part of the divisions between the preferences of large and small firms, which has been further complicated by the political developments of recent years. The large firms, more closely linked with Confindustria, have adopted a strategy of ‘equidistance’ from the centre-left and centre-right political blocs, and have been cautious in pursuing a strong liberalizing agenda. Meanwhile, small firms and younger entrepreneurs have more fully embraced such policies and closely allied themselves with the Northern League and Silvio Berlusconi’s Forza Italia to achieve them (Lanza and Lavdas 2000). Trade union unity has also been compromised by increasing bipolarity in the system, and the severing of the ‘transmission belts’ that linked unions and parties in the past.

Given long-standing political and legal ‘hyper-protection’ for the heavily-unionized core workforce, both firms and workers have sought flexibility via other channels, which recent reforms have encouraged. These include self-employment and exit from the regular labour market (covered by collective bargaining) at both ends of the skill distribution: highly-skilled workers leave to seek the higher returns to self-employment, while the less skilled have been forced into the more precarious underground economy. Firms have also increased flexibility by sub-contracting to smaller affiliates that operate below the Workers’ Statute’s
employment threshold. Since the 1990s they have expanded their use of ‘atypical’ temporary, fixed-term and part-time workers, as well as so-called co.co.co contracts, which have lower costs and dismissals protection, creating a growing segmentation of the labour market. Closing the divide between labour market ‘insiders’ and ‘outsiders’ will become all the more difficult as it becomes entrenched in both the legal system and organisation of firms.

There are currently two major impediments to a more thorough-going reform of the labour market and welfare state in Italy that would generalise equal levels of legal protection and social policy support to all workers: the fragmentation of the limited union-employer consensus put in place in the 1990s under the EMU convergence constraints; and the systemic incentives for preserving passive forms of state labour market intervention in the absence of a stronger social safety net. The two cassa integrazione regimes are a case in point. The extensive use of early retirement schemes and subsidised employment schemes is another. Flexibility, initially introduced at the margins of the system, is gaining ground, but the rigidities protecting the core ‘insider’ work force are proving highly resistant to reform. The over reliance of the Italian welfare state on social contributions to finance these and other social expenditures impacts heavily on production by increasing labour costs. The latter may reinforce other ‘productivity-whip’ incentives for the most advanced firms. But they exact a heavy toll on the country as a whole, especially the growing number of workers on poorly-protected, fixed-term contracts.

Ultimately Italy faces a double bind: the perverse incentives created by the existing labour market and welfare state regimes prevent both employers and unions from creating a cross-class, pro-reform coalition; and the stakes that both have in the current system heavily constrain governments in their attempts to change it. For a short time the EMU and employment ‘emergency periods’ created a common cause among these actors. But in the
absence of a similar crisis, it is unlikely that Italy’s veto-ridden polity will once again regain that capacity for reform.

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