

Cappellari, Lorenzo; Dell'Aringa, Carlo; Leonardi, Marco

## Article

# Temporary Employment in Italy

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## TEMPORARY EMPLOYMENT IN ITALY

LORENZO CAPPELLARI\*,  
CARLO DELL'ARINGA\* AND  
MARCO LEONARDI\*\*

### Introduction

Similarly to many European countries, Italy introduced labour market flexibility at the margin, by liberalizing the use of so-called flexible or temporary employment, without changing the employment protection legislation for standard regular workers. A large body of literature has claimed that a positive relationship exists between the growth of temporary workers and two-tier labour market reforms (e.g. Boeri, 2011). The European Commission (2010) reports that such a positive, albeit statistically weak, relationship exists. The OECD indicators for Employment Protection Legislation (EPL) group Italy with the countries which have largely reduced the EPL index for temporary workers (Venn, 2009), although Italy still exhibits an EPL index both for regular and temporary workers that is in line with the average EPL for the OECD area.

This paper offers an overview of the features of temporary employment in Italy. We start by briefly describing the institutional framework for temporary employment in Italy, and report some stylised facts on the diffusion of temporary workers over the last 15 years, with a special focus on the youth labour market. Next we look at transitions from temporary to permanent employment (i.e. the so-called stepping stone hypothesis), discuss the evidence on wage gaps between different types of employment contracts, and report some recent findings regarding the impact of temporary employment on firm productivity. We conclude by reviewing the current debate and policy proposals on temporary contracts and employment protection.

\* Università Cattolica Milano.

\*\* Università di Milano.

### Institutional framework

Italian employers may choose to utilize labour inputs under a variety of employment contracts. The most typical form of contract is the permanent one, which has no termination date and features the highest wedge between workers take-home gross pay and labour costs, caused by taxes and social security contributions. Depending upon firms' characteristics (mainly upon their size) these contracts are characterised by relatively stringent EPL and, consequently, high firing costs. A second type of contract is represented by fixed-term contracts. The only difference between these and their permanent counterparts is the presence of a fixed term, i.e. they can be renewed only once and can last altogether no more than three years in the same firm. All other working conditions such as wages, working times, pension rights and probationary period are identical to those of permanent contracts. Apprenticeships represent another form of temporary employment contract. Unlike fixed-term contracts, firms can use these contracts only for younger workers, for whom they must provide certified training and pay lower social security contributions. Workers under these three contracts are employees of the firm.

There exist other contractual arrangements through which firms can use the labour services of external workers. As in many other countries, there are temporary help agencies which supply labour services upon the payment of an agency fee. Additionally, and this is mostly an Italian peculiarity, firms can use collaboration contracts. These contractual arrangements have been in place since the early 1970s and were regulated again in 1997 and 2003. They provide a contractual framework for individuals who are not formally employed by the firm. Formally, these workers are self-employed, but often they are utilized by firms as normal employees. Thanks to a reduced regime of compulsory pension contributions and to lower labour costs compared to regular employees, many firms use them extensively. Finally, with the same intent of saving on labour costs, firms may simply outsource tasks to single individuals who act formally as external suppliers to the firm but actually have an exclusive relationship with the firm, thus being in all effects economically dependent on it.



Over the past 15 years the legislation on temporary employment has changed several times. The most important reforms of the legislation were:

1. Law no. 196/1997 (the so called “Treu-Package”, named after the minister of labour at that time), which legalised temporary work agencies, regulated collaboration contracts and liberalised both apprenticeship and fixed-term contracts;
2. Law no. 30/2003 (the so called “Biagi Law”, named after the professor of labour law and government consultant killed by terrorists), which introduced a number of new contracts into the national legislation, further regulated collaboration contracts and reformed apprenticeship contracts.

These institutional changes have greatly contributed to the spread of temporary employment in Italy, as we show in the next Section.

### Stylised facts

In Figure 1 we plot the stock of temporary workers aged 15 to 24 since the mid-1990s. We use the definition of temporary workers adopted by the international institutions, which includes only those who are formally employed by firms. Vertical lines mark the two labour reforms of 1997 and 2003. In line with these reforms one can notice an increase in the stock of temporary contracts. As of 2010 the total number of temporary contracts is about 500,000 among those aged 15 to 24 (2.2 million in the whole labour force), and the vast majority of them are fixed-term contracts.

The widespread use of temporary contracts has a marked age profile, and is especially concentrated among the youngest segment of the labour market. As of 2010 temporary contracts have accounted for around 50 percent of the employed population aged 15-24. However, both the share of temporary employees in the employed population aged 15-24 (Figure 2) and in the employed population aged 15-64 (13 per-

cent of the total in 2010) is similar to the European average, and it is actually lower than in other countries such as Germany and France. Looking at historical trends in Figure 2, Italy appears to be the country with the steepest increase of temporary contracts among young people in the EU.

The peculiarity of the Italian labour market concerns the possible inclusion of part of the formally self-employed workers (i.e. collaborators and external suppliers) in the group of temporary employees. In Italy 10 percent of those aged 15 to 24 are self-employed, compared to 4 percent on average in the EU (OECD 2010). Understanding how many of these are not really self-employed but “economically dependent” on a single firm is not an easy task and depends on the interpretation and the definition of “economically dependent”. In a representative sur-

Figure 1

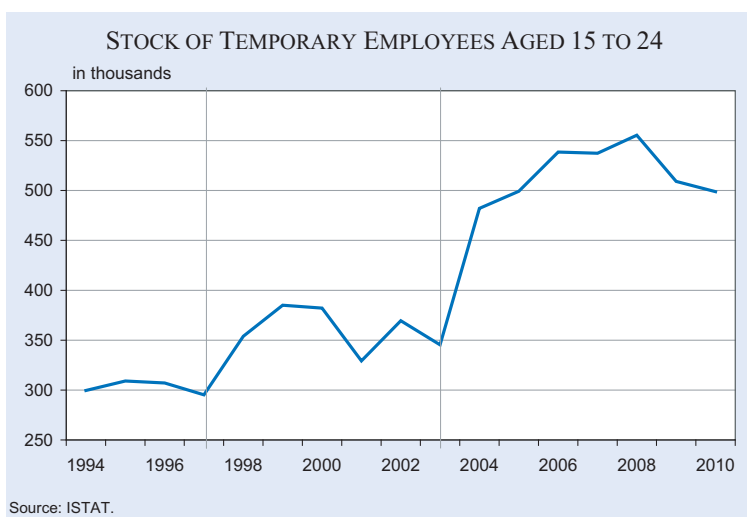
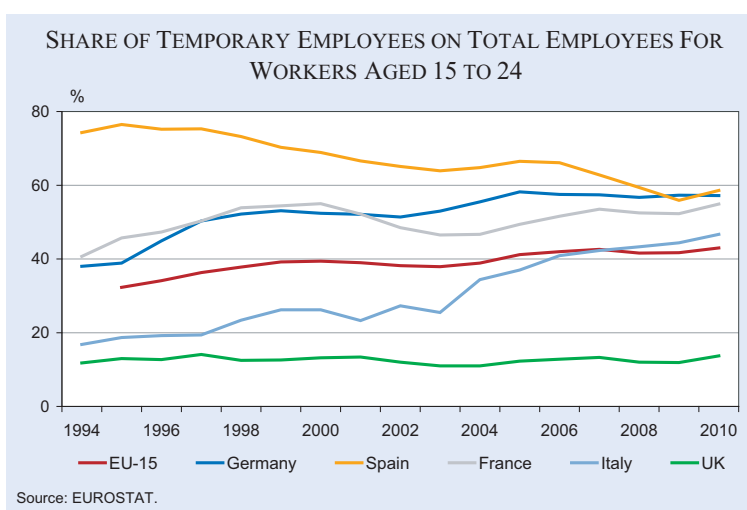


Figure 2



vey run by ISFOL, a research institute of the Ministry of Labour, self-employed workers were asked: 1) whether they had one single principal; 2) whether they worked exclusively at the principal office; and 3) whether they had a fixed working time imposed by their principal. Anastasia (2012) reports that those who responded affirmatively to all three questions were only one hundred thousand, but those who replied “yes” to at least one of those questions were 2 million. The best estimate of “economically dependent” self-employment is probably around 1 million workers, i.e. those who work exclusively at the principal office. In this sense, the inclusion of this type of workers in the category of temporary employees makes their incidence substantially higher in the Italian labour market than in other European countries, and increases the share of temporary contracts from 13 to 19 percent of the employed population aged 15-64 and from 50 to 70 percent of the employed population aged 15-24.

To understand this phenomenon, which circumvents the rules attached to the use of temporary contracts, we need to know why firms decide to use contracts of limited duration of any kind. The same ISFOL survey cited above also investigated this issue in order to better disentangle the motivations that drive demand for flexible work arrangements. The main results seem to indicate that temporary workers are used as a tool to rapidly adjust workforce to demand shocks (given their lower firing costs). Alternatively, firms can use temporary contracts as a screening device or a sort of extension of the probationary period or – and this is the case of the “economically dependent” self-employed – to reduce labour costs and social security contributions. It seems likely that in the presence of such labour cost-saving opportunities and of various types of temporary contracts and “economically dependent” self-employment opportunities, firms will continue to use temporary rather than permanent work.

### Stepping stones?

Are temporary employment contracts really a temporary experience in one’s career and act as springboards into stable employment, or do they represent a trap from which it is difficult to escape? While common to many debates around Europe, this question has become increasingly relevant in Italy due to the increasing diffusion of flexible employment – particularly youth employment, as documented in the previous section.

One way of quantifying the trap is to estimate individual transitions across types of employment contracts. Cross-country evidence for the youth labour force (15-24) is provided by the OECD (2010; Figure 5.8), using the European Survey of Living Conditions (EU-SILC, 2005-2006). It is shown that the one year transition rate from permanent to temporary employment is 50 percentage points (p.p.), a level that is much higher than the Spanish one (which is just above 20 p.p.) and not too far from the UK one (which is approximately 56 p.p.). One remarkable Italian peculiarity is that transition rates are lower among youths with tertiary education than among all youths, whereas the opposite occurs in all the countries considered. Another striking fact is the difference in transition rates into permanent work between temporary workers and the unemployed, which is almost 45 p.p. in the overall population of Italian youths, and only 20 (15) p.p. in the UK and Spain. This evidence seems to support the stepping stone hypothesis, at least for very young workers. However, if one considers the whole labour force aged 16-64, the impression is rather different. The European Commission (2010; Chart 29) based on data from the EU-SILC between 2005 and 2007 ranks Italy amongst the countries with the lowest year to year exits from temporary employment into permanent one. In Italy, the probability of moving to a permanent contract from one year to the next is about half of the probability of remaining on a temporary contract over the same period (an odd ratio of 0.6). This ratio is very similar in countries like Spain, and much lower of 1.8, the level reached in the United Kingdom.

Moving on to country-specific evidence, more detailed information on labour market transitions can be obtained from the Labour Force Survey. Panel A of Table 1 is derived from the annual reports on the state of the labour market published in 2009 and 2011 by the National Labour Council (Consiglio Nazionale Economia e Lavoro - CNEL) using the longitudinal component of the Labour Force Survey between 2007 and 2008. Considering the youth sample first, the table shows that the one year transition rate from temporary employment into permanent one is about 32 p.p., much lower than the one derived from the EU-SILC discussed above, even though in that case the selected sample was much younger, which may partly explain the difference. On the other hand, temporary workers face a non-negligible probability of becoming unemployed or inactive after one year, approximately 7 and 8 p.p.. The

risks of unemployment and inactivity are much lower among permanent workers. Recent work for Spain (Bentolila et al. 2011) points to the possibility that the diffusion of temporary employment increases unemployment volatility, and the differential churning between employment and unemployment for workers on permanent and temporary contracts singled out in Table 1 is in line with this interpretation. The positive side of the coin is that temporary employment may act (better than permanent one) as a bridge into employment for the unemployed: in fact the destination of those youth leaving unemployment is twice as likely to be a temporary rather than permanent contract (18 versus 10 p.p.). In addition the transition from unemployment into permanent contracts is one third of the transition from temporary to permanent employment.

Considering the broader (16-64) sample, Panel A shows a lower transition rate from temporary contracts to permanent ones, and larger transitions into both unemployment and inactivity. While the latter may reflect retirement, the increase in the transition to unemployment, and especially the larger differential with permanent contracts, suggests that for older workers there are higher risks of labour market segmentation attached to temporary employment. This impression is reinforced if one notes that, in this

sample, exits rates from unemployment are the same whatever the destination, permanent or transitory employment contracts.

Due to its rotating panel design, the Labour Force Survey enables following individual trajectories over one year windows only, i.e. it allows identifying the persistence of temporary employment just in the short run. Longer term insights can be gained using alternative data sources. For example, long term persistence of temporary employment can be analysed using administrative data from the archive of the National Social Security Institute (INPS). Relative to the LFS, this archive provides larger samples and can track individuals in principle throughout their entire career.

The larger sample size makes it possible to distinguish between workers on fixed-term contracts and workers on collaboration contracts within the large group of workers in temporary employment, the latter being often considered the more problematic form of temporary employment, as explained in the previous section. Making such a distinction in a meaningful way is not possible with survey data due to limited sample sizes. One shortcoming of the administrative archive concerns the absence of information on those individuals whose social security

Table 1

## Transition rates across labour market states

Panel A: Labour Force Survey 2007-2008						
Transition from	Permanent	Temporary	Transition to Self-Employed	Unemployed	Inactive	
			Age 16-30			
Permanent	85.6	6.5	2.5	2.6	2.7	
Temporary	31.6	49.8	3.9	6.8	7.9	
Unemployed	10.2	18.0	8.5	31.1	32.2	
			Age 16-64			
Permanent	90.8	2.1	1.5	1.5	4.0	
Temporary	26.5	49.9	4.7	7.3	11.5	
Unemployed	11.7	12.6	6.3	32.6	36.7	
Panel B: National Social Security Institute 1998-2004, age 16-40						
Transition from	Permanent	Fixed term	Transition to Self-Employed	Collaboration	Training	Not cov.
			2-year transition			
Fixed term	34.7	25.2	2.2	1.9	10.9	25.3
Collaboration	17.3	6.7	9.6	19.6	8.2	38.6
			4-year transition			
Fixed term	49.4	15.5	4.2	1.3	7.0	22.7
Collaboration	30.3	6.8	13.3	10.0	4.2	35.4
			6-year transition			
Fixed term	55.5	10.4	6.5	1.7	5.1	20.9
Collaboration	35.1	8.4	13.6	5.1	1.9	36.0

Notes. Row sums equal 100.0.

Sources: Panel A, CNEL (2009; 2011); Panel B: Berton et al. (2011).

contributions are not managed by the INPS, and this is the case of public sector employees. In addition, the unemployed and the inactive are also simply categorised as “Not covered”. Berton et al. (2011) use INPS data to compute transition rates across contract types between 1998 and 2004 for a sample of workers aged between 16 and 40. Their results are summarised in Panel B of Table 1. Starting with fixed-term employees, they report figures for two and four year transitions from temporary to permanent employment of 34 and 49 p.p. respectively. Over six years they find that 55.5 percent of temporary employees on fixed-term contracts become permanent ones, 10 percent remain temporary and 20 percent are no longer observed in the administrative archive, while only minor proportions end up in self-employment, collaborations or training and apprenticeships. Different patterns of transition characterise collaborators. The degree of persistence in this state is much lower compared with fixed-term employees, while the transition into permanent employment is lower. On the other hand, four out of ten of these workers are no longer observed in the administrative archive two years later, an outcome that may suggest a state of unemployment or inactivity, confirming that there is more instability attached to these contracts than to temporary employment as a whole.

Taken together, the transition rates reported in Table 1 help draw up a picture of temporary employment which shows that, in the medium-term, over half of temporary employees manage to escape to the primary segment of the labour market; for these individuals temporary jobs are really stepping stones

into better ones. More problematic is the situation for the remaining half, the majority of whom is either trapped into a sequence of temporary contracts, becomes unemployed or exits into inactivity.

### Wage gaps

While the transformation of temporary contract into permanent ones has received much attention in academic and policy debates, other aspects play important roles in determining the overall quality of temporary jobs and their viability as stepping stones into the labour market. Wage differentials with permanent workers are certainly one of these. If temporary contracts are screening devices, then theory of adverse selection would predict lower wages for workers during their trial period. However, temporary workers bear more economic risks than permanent ones, and efficient risksharing would result in a wage compensation for temporary workers. In any case, temporary and permanent jobs may be very different in productivity to start with, so that it is crucial that estimated wage differentials are generated from regression analyses that control for workers and jobs characteristics as much as possible.

Among the few studies that have attempted estimating the temporary/permanent wage gap in Italy, Picchio (2006) uses data from the Survey on Households Income and Wealth (SHIW) on net hourly wages and reports a wage gap against temporary workers of 12 percent. To provide further evidence on wage gaps, we use data from the INPS archive, which provides information on gross weekly wages, see Table 2. The longitudinal structure of the

**Table 2**

#### Differences in wage levels and wage instability between temporary and permanent workers

	Men	Women
	Panel A: Log-Wages	
Whole sample	-0.074 ***	-0.042 ***
Age≤30	-0.057 ***	-0.028 ***
Age>30	-0.086 ***	-0.062 ***
	Panel B: Wageinstability	
Whole sample	0.025 ***	0.009 ***
Age≤30	0.005 ***	-0.003 °
Age>30	0.049 ***	0.025 ***

Notes: Reported are coefficients associated with temporary employment from fixed effects regressions that control for age, occupation, industry, region and firm size. \*\*\* and ° denote statistical significance at the 1 and 30 percent level respectively. Wage instability is defined as the absolute deviation of individual log-wages from individual specific five period averages.

Source: Own elaborations on gross weekly earnings data drawn from the INPS archive 1985-2003.



administrative archive allows us to use fixed effects specifications, which is crucial in this context since the temporary/permanent divide may entail a lot of unobserved heterogeneity. Using specifications that include flexible controls for age, occupation, industry, region and firm size, in Panel A we estimate a temporary/permanent wage gap of 7 percent among men and 4 percent among women. Interestingly, the gap grows with age: it is 5 percent for men younger than 30 (3 percent for women) and 8 (6) percent for older men (women). Being a temporary worker at older ages appears to be a serious problem, possibly reflecting the fact that the bulk of wage growth occurs in permanent contracts after the age of 30, while there is no wage growth in temporary contracts.

The long panel structure of the administrative data allows not only an investigation of wage gaps net of individual unobserved heterogeneity but also a consideration of the wage instability associated with temporary employment. Recently, the OECD (2011) has placed much emphasis on the concept of wage or earnings instability, i.e. the volatility of one's earnings around long-term earnings trajectories, as a measure of the extent of uncertainty surrounding labour incomes, with potentially deep welfare-diminishing consequences. Using an approach similar in spirit to Gottschalk and Moffitt (1994), we compute wage instability as the individual specific absolute deviation of log wages from 5-year averages, and use fixed-effects regressions to estimate the impact of temporary employment on instability, while flexibly controlling for age, occupation, industry, region and firm size. Results in Panel B of Table 2 clearly indicate that temporary workers experience more wage instability than permanent ones. For example, men on temporary contracts experience a wage deviation from the period average that is 2.5 p.p. larger with respect to permanent ones to (the average deviation in this sample is 10 p.p.); the effect for women of 0.9 p.p. is smaller. Again, we find evidence that this gap widens with age. For men younger than 30 the instability differential is only 0.04 p.p., while for women in the same age group we did not find any statistically significant difference. On the other hand the gap is 4.9 p.p. and 2.4 p.p. for men and women older than 30. Overall, the investigation of wage differences between temporary and permanent workers shows that the former experience a disadvantage that comes in two forms. Firstly, they are paid less on average, and this penalty hardly squares with a screening interpretation considering that the gap is

larger at older ages. Secondly, they are subject to higher wage fluctuations, which, combined with the larger employment instability that is inherent with this type of employment contract, depicts a scenario of great uncertainty for temporary workers.

### Effects on productivity

Depending upon the reasons for the use of temporary contracts, there may be some relevant productivity differential between permanent and temporary workers measured at the firm level. On one hand, one can think of multiple mechanisms why a relaxation of the rules about the use of temporary contracts (which corresponds to a lower EPL for temporary contracts) may induce a negative effect on firms' productivity. Firstly, permanent contracts provide insurance and promote specific investments; secondly, when facing high EPL firms become more selective with workers and less productive matches are not realised or less productive firms do not survive altogether. According to both these mechanisms a lower EPL for temporary workers should lower productivity. On the other hand, high EPL hampers the reallocation of workers and jobs across industries and firms by inducing substitution of specific for general skills, reduces workers effort, reduces the undertaking of highly productive, but risky activities. Through these channels we should observe that regulations that lower EPL for temporary workers should increase firms' productivity.

In Cappellari et al. (2011) we use panel data on Italian firms to investigate the effects on temporary employment of the "Biagi Law" and of a Decree Law (no. 368) issued in 2001. The Biagi reform relaxed the regulations on apprenticeships, while the Decree eased the applicability of fixed-term contracts. We exploit variation in the implementation across regions (for apprenticeships) and sectors (for fixed-term contracts) for identification purposes. We find that the reform of apprenticeship increased job turnover and induced the substitution of external staff (mainly collaborators and agency workers) with firms apprentices, with an overall productivity-enhancing effect. The reform of fixed-term contracts instead did not produce the intended results: it induced a substitution of temporary employees in favour of permanent ones and reduced capital intensity, generating productivity losses. We interpret this result as an effect of unclear regulations, which induced entrepreneurs to shun fixed-term contracts (at least in the early period of the new law) for fear

of having to face court suits for unfair use of fixed-term contracts. In an environment where employers can choose among different types of temporary contracts, a new law designed to favour the use of the fixed-contract resulted in a diversion into other types of temporary contracts or into permanent contracts. We estimate high substitution elasticities across different types of temporary contracts that are consistent with this interpretation.

### Conclusion and future policies

There is widespread consensus that the introduction of temporary contracts has favoured the reduction of youth unemployment (see Figure 3) and has contributed to the positive performance of total job creation in the past decade. However policy makers are also worried of the low quality of many of those jobs and of the uncertain prospects of those that happen to be trapped for a long time in those jobs. Particularly worrying is the phenomenon of the “economically dependent” self-employment, whose large number, if included in the range of temporary jobs would increase the share of youth in temporary jobs to a very high level compared to most European countries.

There is also general agreement among Italian economists that the segmentation of the labour market could be reduced by closing the existing gap in labour costs between permanent workers and temporary workers. In the current legal framework, one main reason makes temporary contracts more attractive to the employer: in firms above 15 employees the definition of individual dismissals for economic reasons implies that whenever it is judged in a

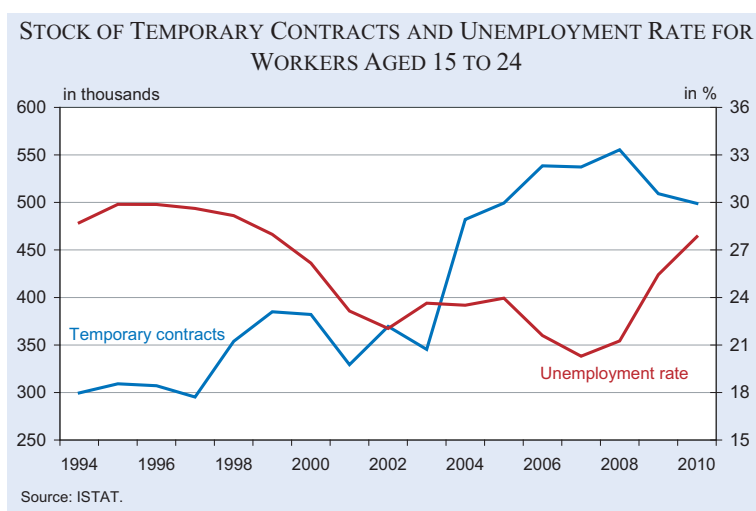
court case that a dismissal occurred for “unjust cause” (i.e. in absence of the conditions contemplated in the Labour Code), the employer will have to compensate the worker for the foregone wages and the worker can choose between reinstatement and 15 months of severance pay. In light of the long duration of trials and of the ensuing high costs of uncertainty, the above elements hinder the creation of permanent jobs.

If one wants to reduce the marginal cost faced by employers when deciding whether to upgrade expiring temporary contracts into permanent ones, two measures should be taken: firstly social contributions of “economically dependent” self-employed should be increased and, secondly, the firing costs of permanent workers should be reduced.

There are basically three proposals for reducing these firing costs, which we discuss in decreasing order of complexity. The first would abolish the possibility of resorting to courts for cases of individual dismissal for economic cause, on the grounds that judges are not apt to discuss the financial situation of firms and the entrepreneurial choices involved. According to this proposal firms can fire for economic reasons with a severance payment. This would make EPL similar to the American case. Proponents suggest completing the reform by building an experience rated system whereby firms pay contributions to a fund (managed by firms and unions together), which sustain laid-off workers until they find a new job. This is the most radical proposal and probably the hardest to implement politically, as reinstatement via courts is often viewed as a guarantee of workers’ rights. The second proposal would substitute most types of temporary

contracts with a “single contract” which delays the application of the current regulations against individual dismissal for economic reasons to the third year of seniority and beyond (currently it is three months) and would introduce a severance payment for the first three years. This is a compromise that moves forward the reinstatement guarantee, but maintains some difference in firing costs between permanent and temporary contracts. Finally, the third proposal would introduce a new option at the moment of

Figure 3





individual dismissal for economic cause: the worker would be offered a severance payment which rises with seniority. If the worker accepts the payment s/he renounces the right to a court case, but upon refusal s/he retains the right to sue the employer for unfair dismissal for discriminatory reasons. This last proposal creates an incentive to avoid resorting to the courts and eliminates the uncertainty attached to court rulings. These are the main policy options available to the Italian Government at the time of writing.

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