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**Smuggling-in flexibility: Temporary work contracts and
the “implicit threat” mechanism**

Reflections on a new European path

Valerio De Stefano

International Labour Organization– Geneva

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Preface

Labour administration is currently challenged by the continuous changing nature of the employment relationship. Recent trends such as the fragmentation of work have been calling for the adoption and implementation of responsive and efficient labour policies, with a view to better coordinating and operating labour administration responses.

In this regard, the paper of Dr. Valerio De Stefano of the University of Bocconi of Milano is a timely one. It deals with the new structure of business organizations and their impact on the employment relationship, in looking at the diverse scenarios of the compliance with labour legislation. This topic has direct effect on the way employment protection functions in society characterized by a mixture of private and public initiatives.

What the author in the paper defines as “implicit threat” has repercussions on the functioning of a labour administration system which finds itself in between two scenarios: advancing in the modernisation of its own machinery and making sure that the compliance with labour legislation is an effective one.

Without advancing any personal conclusions, I invite the reader to go through De Stefano’s paper and to follow through the challenges and risks ahead in the labour administration area.

Giuseppe Casale
Director
Labour Administration
and Inspection Programme

Abstract

This paper describes some of the changes which have taken place in business and workforce practices in recent decades. In particular, it focuses on firms' increasing recourse to outsourcing and non-standard forms of employment in pursuit of business flexibility.

The author argues that, although, from a legal standpoint, the internalization of working activities and permanent employment provide a great deal more flexibility than such practices, business organizations are able to exploit them to obtain de facto flexibility, taking advantage of extra-legal mechanisms. This gives rise to what can be called "hierarchical market relationships".

The paper also adopts a "law and economics" approach, based on transaction costs theories and refers to some results of "relational contract theory", applied both to outsourcing and temporary work contracts.

With regard to the latter, it is argued that firms can increase flexibility unduly by means of extra-legal mechanisms, such as economic dependence and reputation. The temporary nature of the working relationship, it is argued, heightens such possibilities by means of what the author describes as the "implicit threat" mechanism.

Valerio De Stefano*

* PhD candidate, business and commercial law, Bocconi University
e-mail: valerio.destefano@unibocconi.it

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Needless to say, I remain solely responsible for the opinions, suggestions and conclusions expressed in this paper. In particular, they are not necessarily shared by the abovementioned institutions.

1. Introduction

This paper deals with business and workplace management practices under the Post-Fordist production system. In particular, it focuses on firms' ever-increasing search for flexibility – that is, ways of rapidly adjusting their activities to meet contingent business needs.

This kind of flexibility is paramount in a system in which demand for goods and services is uneven and increasing global competition is incessantly pushing firms to reduce production costs.

In these circumstances, firms have not only changed their production methods, but have also adopted new techniques of workforce management, significantly different from those which characterized the Fordist or Taylorist production systems. These techniques are challenging traditional categories of both employment law and industrial relations, which were constructed and construed with reference to the Fordist–Taylorist workplace.

The Post-Fordist system is also characterized by significant growth in recourse to outsourcing and non-standard forms of employment, in particular, temporary work contracts.¹ This might seem inconsistent with the abovementioned pursuit of flexibility, since – as I try to show – these practices should imply, in theory, the renunciation or at least a reduction of hierarchy in the business organization.

As I maintain, hierarchy is of the utmost significance in business organizations because it enables the rapid and effective issue and enforcement of production guidelines and directives. This also makes it possible to shape and adjust production in order to meet new business requirements quickly and, ultimately, significantly enhances flexibility.

However, as I try to show throughout the paper, recourse to both outsourcing and non-standard forms of employment is not necessarily inconsistent with the pursuit of flexibility through hierarchy, even if, in theory, the internalization of business activities and permanent employment relationships afford a higher degree of hierarchy from a legal standpoint.

Some scholars have argued, for instance, that firms are able to make use of outsourcing without renouncing hierarchy in the management of the relevant business relationships by means of extra-legal mechanisms.

I try to show that firms can use similar extra-legal mechanisms by resorting to non-standard forms of employment.

As I argue, with reference to Italian employment law, the permanent employment relationship theoretically affords the maximum degree of flexibility. I also try to justify this assertion on “law and economics” grounds. Accordingly, I explore the reasons behind the increasing recourse to temporary work contracts, despite their greater rigidity in comparison to open-ended employment contracts. In my view, an explanation can be provided in terms of extra-legal mechanisms.

¹ For a definition of “temporary work contract”, see below.

In Section 2, I describe the main features of Post-Fordist production and their consequences for both the employment relationship and the relevant legal categories. In Sections 3 and 4, I analyse both the employment relationship and firms' resort to the internalization or outsourcing of business activities, taking a "law and economics" approach based on the notion of a trade-off between transaction costs and what might be called "organization costs", namely the costs of conducting business on an internalized basis. In Section 5, I make reference to a number of studies – by lawyers, sociologists and economists – which show that, in some cases, firms manage to outsource parts of their business without surrendering too much hierarchy in relation to their counterparts, giving rise to what might be called "hierarchical market relationships". I also refer to "relational contract theory", as relational contracts are central in such business practices.

In the following sections, I apply some of the results of such studies to the employment relationship and to temporary working relationships, in particular.

In Section 6, I describe the main legal features of the open-ended employment contract, comparing them to those of temporary work contracts under Italian law (fixed-term employment contracts, agency work contracts and also project work contracts, a recently-enacted self-employment contract under Italian law). As already stated, I maintain that, at least under Italian law, the former is the most flexible working relationship, from a legal standpoint.

In Section 7, I propose an explanation of why firms – although pursuing flexibility – are increasingly resorting to temporary work contracts even though, in theory, they provide for less flexibility in comparison to permanent employment. In my view, such contracts enable firms to acquire flexibility unduly by means of extra-legal mechanisms, such as economic dependence and reputation. In particular, I hold that the temporary nature of the working relationship enhances such possibilities by means of what I label the "implicit threat" mechanism.

In Section 8, I draw some conclusions, arguing that, due to the generally low-skilled character of the activities usually performed under temporary work contracts in Italy, the relevant workers are easily replaceable, which only enhances the aforementioned "implicit threat" mechanism.

2. New forms of business organization and their impact on employment relationships

Business organizations have experienced the continuous mutation of manufacturing processes in recent decades. Such mutations have dramatically changed the production model on the basis of which much of workers' existing legal protection was shaped, namely the Fordist–Taylorist production model, whose hallmarks were strong vertical integration and significantly hierarchical production planning.

One of the main features of the relevant economic system was continuous – albeit cyclical – growth in the demand for goods and services. From the second half of the 1970s, however – also as a consequence of the oil crisis in 1973 – the economic system began to undergo a profound change. Firms had to deal with increasingly uneven demand, as well as growing international competition due to globalization of trade and production. Financial markets also grew dramatically and new business practices – also supported by influential "law and economics" theories – centred upon so-called "shareholder value" began to spread (see Dore,

2000; Reich, 2007; Stone, 1993). Accordingly, changes in the nature of demand and the globalization of markets and capital played a significant role in the transformation of firms' business practices (see ILO, 2006a; Dore, 2003; Prasad and Mishra 2004; Stone, 2005; Wedderburn, 2002).

Even the point at which product value was appraised changed. Under the Fordist system, it was the point at which the product was exchanged for money. Under the new system – which we shall term “Post-Fordism” or the “Post-Fordist system” – such appraisal can be carried out at any stage of production; any phase of the productive cycle is subject to analysis to assess its profitability. This has led to both a theoretical and a factual disintegration of the productive cycle, aimed at adjusting each segment of production to variations in demand. In order to achieve this, it is necessary to implement decentralized production planning: production levels must be decided on the basis of inputs from the bottom, rather than from the top, of the business organization.

Top management, however, retains both major tasks: that is, coordinating the different stages of production and supervising the development of so-called “performance rules”. The latter are the fundamental processing and manufacturing standards that have to be complied with by every line stage in view of the integration of production outputs. However, it is commonly held that, insofar as such standards are complied with, the different line stages have now acquired a much greater degree of executive autonomy in comparison to what they had under the Fordist system (Salento, 2003; Smith, 1997).²

This is an essential feature of so-called “just-in-time” production, one of the pillars of Post-Fordist business organization (see Gallino, 2007). The basic idea of just-in-time production is to avoid, as much as possible, any unsold stock, as variations in product demand could cause a significant reduction in utility and a related loss of value. Another non-negligible element characterizing Post-Fordist firms is the spread of new technologies, which has led to the fundamental “informatization” of businesses and to the urgent renewal of methods of production (see Blanpain and Colucci, 2002; F. Carinci, 1985).

These new features of production systems have also had a profound impact on both the working activities and the work organization of firms. With reference to the former, the increased autonomy of the different line stages has resulted in renewed consideration of the performance of worker teams, rather than that of single workers, which were the basic unit of Taylorist analysis. As a consequence, profound changes have been experienced also in teams' internal organization, as the strong hierarchy, standardization and routine, which were the major features of the Fordist system, have undergone significant diminution. Naturally, such developments have also effected change in the practices of human resources departments (see Schuler and Jackson, 2007).

The increasing importance of team performance, combined with teams' increasing executive autonomy, has also led to a loosening of the bureaucratic and hierarchical organization of the workplace. Fordist–Taylorist production was based upon a well-delineated division and parcelization of work, resulting in a precise definition of tasks and a related organization of jobs and positions within a precise,

² For a description of the new theories and practices of workplace management, see Stone (2004).

either flattened or hierarchical, structure.³ The Post-Fordist business organization is quite different. Above all, the distinction between those who plan the work and those who execute it is becoming increasingly blurred, as ever more individuals in the team are entrusted with both activities (cf. Cafaggi, 2004). Unsurprisingly, this has resulted in a broadening of team members' discretion (Powell, 2001). This development – in combination with another hallmark of Post-Fordism, the significant growth of the service sector – has had powerful effects, both practical and theoretical, on the employment relationship.

A major feature of the employment relationship, characteristic of all national and legal traditions, is the hierarchical power⁴ exercised by employers over employees. This hierarchical power consists, broadly speaking, of three related elements: (i) the power to assign tasks and to give orders and directives to employees (directional power); (ii) the power to monitor both the performance of such tasks and compliance with the orders and directives (control power); and (iii) the power to sanction both improper or negligent performance of the assigned tasks and disobedience with regard to orders and directives (disciplinary power).

Hierarchical power in work relationships has traditionally been established – by either statute or case law – as the distinctive feature of employment in contrast to self-employment and, accordingly, as the key to the wide range of regulations set out to protect employees in various jurisdictions.⁵ The reduction of hierarchy and the parcelization of work, which we have referred to, have substantially changed the way in which working activities are performed. Together with the spread of new activities in the service sector and the informatization of business, this challenges the traditional legal categories of working relationships, which were tailored to a model which, generally speaking, no longer exists, namely blue-collar employees working on an assembly line for a big, bureaucratic and vertically integrated firm.

Gradually, lawyers began to become aware of new working practices which could not be easily categorized as either employment or self-employment (see ILO, 2003: 27). In particular, such practices embodied new forms of work integration in business organizations, in terms of which the coordination applied by firms to the workers did not match all the elements of hierarchical power as construed by legal scholars and existing case law.

With regard to Italy, for instance, the 1942 Civil Code defined and described the main features of the employment relationship.

As in most other countries, this definition has been construed by scholars and courts predominantly in terms of legal-technical concepts rather than socio-

³ Stone (2004), p. 49, points out that the difference between Taylorism and Fordism was the former's stress on the hierarchical structure of the business organization in contrast to the latter's reliance on the flattened job structure characteristic of the assembly line.

⁴ With regard to the term "hierarchical power" see footnote 5.

⁵ The term "hierarchical power" is used in this paper in a technical sense to indicate the employer's equivalent of the employee's "subordination" or "dependency". The presence of subordination or dependency is an essential feature of employment relationships in most jurisdictions. See ILO (2006b), p. 20; Engels (2007), p. 324; and Perulli (forthcoming).

economic ones (see Engels, 2007: 329; Perulli, 2003: 13).⁶ The Italian Civil Code stresses, primarily, employers' directional power⁷ and hierarchy.⁸

Numerous classification problems emerged with reference to the growing number of working activities in which directional power and hierarchical organization were becoming loosened or, at least, exhibiting new features (Liebman, 1999: 1; Persiani, 2005: 3; Perulli, 2003: 16). One emerging risk was either the exclusion of certain working relationships from the legal protection afforded to workers by employment law or the inclusion of workers who did not merit such protection. Neither exclusion nor inclusion could be determined on the basis of written or oral declarations by the parties, since courts – as in the majority of other jurisdictions (ILO, 2006: 24; Engels, 2007: 329) – must rely principally on the factual circumstances and characteristics of the relevant relationship. Under Italian law, this primacy of fact principle or factual predominance rule is a general principle set out in the Civil Code and applying to any contractual relationship.⁹

In order to avoid the unlimited expansion of the scope of employment, Italian courts initially adopted a rigorous and narrow approach, in terms of which hierarchical power – and, accordingly, subordination – was deemed present only where the worker was subject to the directional, organizational and disciplinary power of the relevant employer. This could be established by the issue of specific orders and the assiduous monitoring and control of working activities.¹⁰ This approach risks excluding from the scope of the employment relationship and, thereby, from the relevant legal protection, a large number of working activities which – due to the abovementioned changes in the production system – do not display such clear-cut characteristics, but which nevertheless merit such legal protection on the basis of a systematic construction of labour regulations.

In order to address such problems, some judicial decisions took a more flexible approach to cases involving working activities which displayed forms of hierarchical power different from the traditional ones. According to these rulings, subordination, hierarchical power and, therefore, employment are also present when persons perform their working activities – on a continuous, loyal and diligent basis – following the general directives issued by a firm, in accordance with said firm's programmes and purposes.¹¹

However, new working activities are still challenging legal categories: in Italy, as in most European jurisdictions, a growing number of workers are finding

⁶ However, a situation of economic dependency, even if usually not sufficient in itself to entail the existence of an employment relationship, could nonetheless – especially in ambiguous cases – be taken into account, implicitly or explicitly, by courts as an indication of subordination: see ILO (2003), p. 23; Brooks and Engels (1992), p. 5; and with regard to Italy, Liebman (1999), p. 4.

⁷ Sections 2094 and 2104.

⁸ Sections 2086 and 2104.

⁹ Section 1362.

¹⁰ Corte di Cassazione, 26 October 1994, No. 8804, in *Rivista Italiana di Diritto del Lavoro*, 1995, 496; Corte di Cassazione, 14 July 1993, No. 7796, in *Notiziario di Giurisprudenza del Lavoro*, 1993, 638; more recently, Corte di Cassazione, 28 July 2008, No. 20532, in *Diritto e Giustizia*, 2008; Corte di Cassazione, 28 September 2006, No. 21028, in *Giustizia civile (Massimario)*, 2006, 9; Corte di Cassazione, 23 July 2004, No. 13884, in *Giustizia civile (Massimario)*, 2004, 7–8.

¹¹ Corte di Cassazione, 26 February 2002, No. 2842, in *Massimario di Giurisprudenza del Lavoro*, 2002, 423; Corte di Cassazione, 6 July 2001, No. 9167, in *Massimario di Giurisprudenza del Lavoro*, 2001, 1133; Corte di Cassazione, 28 July 1995, No. 8260, in *Giustizia Civile (Massimario)*, 1995, 1442; see also Liebman (1992), and Perulli (forthcoming).

themselves in a grey zone between employment and self-employment, as their working relationships only partly meet the requirements of employment under existing laws (ILO, 2006: 5; Muehlberger, 2007; Perulli, 2003; Sciarra, 2004: 22). The problem is more serious in countries such as Italy, in which no – or insignificant – protection is afforded to the self-employed and in which this empirical grey zone does not correspond to a legal one, as no “intermediate” legal category exists between employment and self-employment. I return to this below, after looking more closely at changes in work organization in the Post-Fordist firm.

3. Firms, business integration and transaction costs – Employment as a flexibility tool

So far, I have examined the different reasons for contracting out; I have also mentioned the profitability assessments firms carry out with regard to different production stages. As a consequence, firms find it easier to assess whether a single stage or part of production ought to be carried out on an internal or an outsourced basis in pursuit of the highest profitability. Accordingly, the number of production stages contracted out has grown considerably in recent years (see Collins, 1990; European Foundation for the Improvement of Living and Working Conditions, 2004; Ichino, 1999; M. Marchington, Grimshaw, Rubery and Willmott, 2005; Ratti, 2009).¹² This is leading not only to a quantitative change in outsourcing practices, but also to a qualitative one. The Fordist production system was characterized by the significant vertical integration of the business organization: firms carried out directly almost the whole of their production cycle, from top to bottom (Chandler, 1990; Hannah, 1976). This does not mean that no business activities were contracted out (Mazzotta, 1979): nevertheless, outsourced activities were mainly marginal and secondary in the business organization (such as catering, portering and security). In this sense, one might speak of “vertical” outsourcing as typical of Fordism. In contrast, under the Post-Fordist system, a substantial number of production stages are being contracted out, increasingly including tasks which are extremely important in the production cycle. Activities as important as accounting, marketing and client care have been entrusted to third parties (see De Luca Tamajo, 2002).¹³ This could be described as “horizontal” outsourcing.

There are many reasons for such business practices. On the one hand, firms can have recourse to third parties in search of a specialized supplier of precision and high-skilled services. This amounts to turning to a company which performs a particular business activity better than they can, with regard to both the quality of the relevant output and the cost, related, for instance, to the relevant experience curve effect. They may also seek to acquire a competitive advantage over their competitors (Vicari, 2002).

On the other hand, contracting out may also be part of a business strategy aimed merely at reducing labour costs. For example, firms could turn to suppliers whose overall labour costs are lower than theirs because the relevant workers are

¹² With specific regard to off shoring, see Auer, Besse and Meda (2006).

¹³ For an accurate application of legal and economic theories to the labour issues arising from outsourcing, see Corazza (2004).

non-unionized or just receive lower wages (see Stone, 2004: 79–80; Doellgast and Greer, 2007).

In countries such as Italy, in which collective bargaining takes place primarily at industry level, and the courts do not contest employers' choice of the collective bargaining agreement which is to be applied to their workforce, firms could also choose to outsource some business activities to suppliers applying a less "expensive" national collective agreement.

So far, I have examined the different reasons for contracting out; I have also mentioned the profitability assessments firms carry out with regard to different production stages.

At this point, it might be useful to highlight a common factor among all these reasons, namely reduction of costs. This is patently obvious in relation to outsourcing parts of the business to suppliers with lower costs. However, this factor also influences outsourcing to specialist suppliers able to provide high-skilled services. The cost of bringing such activities in-house, in terms of acquiring the necessary experience and know-how, would probably be higher.

Cost trade-offs in the activities of firms constitute one of the main topics of the field of "law and economics", since Nobel laureate R.H. Coase's famed essay "The nature of the firm" (Coase, 1937; see also Coase, 1960). The central point of Coase's analysis – which has been followed up by further eminent work, for example, by Professor O.E. Williamson (Williamson, 1981a; 1981b; 1985) – is that the main reason for the existence of firms is cost reduction, in particular the reduction of transaction costs. The latter include costs related to seeking and selecting a business partner, negotiating the terms and conditions of contracts and enforcing such contracts.

The existence of such costs, generally, makes it impossible to conduct business merely by having recourse to the market, that is, to external suppliers. As a consequence, firms are compelled to internalize at least some stages of their production in order to limit transaction costs.

Furthermore, firms continually face changing and unpredictable circumstances, to which they must adapt. In doing so, they require flexibility, most notably the ability to adjust their activities to contingent production needs. As a consequence, they cannot afford to bargain new conditions of production solely by recourse to the market. Internalization of activities renders firms' organizations more flexible to the extent that, in case of uncertain and evolving circumstances, firms do not need to bargain concerning changes both in the purpose and the terms of their production, as would be necessary if dealing with independent suppliers.

Moreover, in case of internal differentiation in the running of the business they can rely, to a considerable extent, on hierarchy. In this context, the contract of employment is one of the principal business instruments (see Deakin, 2006).

Employees accept and are obliged to follow orders and instructions given by the employer – or by any agent lawfully acting on the latter's behalf – in the performance of their duties. Moreover, they are also bound to adapt their work, based on the relevant business needs, to their employer's requests, provided that this does not result in demotion. This is a common feature of employment relationships in most jurisdictions and renders the employment contract extremely flexible. This is also true of employment relationships in any business environment, whether organized on a strong or a weak hierarchical basis. As already mentioned,

under the new patterns of business organization – even if characterized by a looser hierarchy in comparison to the Fordist model – the role of top management remains central in coordinating the different production phases and in supervising development of the principal business standards. Some scholars have argued that limiting *bureaucracy* and broadening the scope of individual and team working has not resulted in a reduction, let alone the elimination, of hierarchy (see Heckscher and Donnellon, 1994; Salento, 2003).¹⁴ In terms of this paper, it is sufficient to state that the broadening of the executive autonomy of individuals and teams has not – and could not have – resulted in unlimited discretion. Firms are business organizations and the very concept of organization entails a plurality of parts and a last-instance centre of decision-making power whose task is to solve the problems that may arise in generating different outcomes.

In firms, such decision-making power is in the hands of top management, whether in the form of corporate bodies or the person of the employer. As a consequence, some – even minimal – degree of hierarchy cannot be eliminated from firms.

From the standpoint of employment relationships, if “employment” is to exist at all, some degree of hierarchical power is required, however small. As already mentioned, hierarchical power makes it possible to shape and direct employees’ working activities, pursuant to the firm’s aims and requirements, without the need to obtain their consent, whereas the business partner’s consent is normally required in order to amend activities performed under other forms of contract. This legal feature of the contract of employment corresponds to its socio-economic function of providing employers with flexible working activities, ultimately bringing about a reduction in transaction costs (see Ichino, 2000: 265; 2004a: 180). This applies also to working relationships within the framework of which the employee is endowed with a substantial degree of executive autonomy and broadened discretion.

We have already discussed the problems which Italian courts have had to face in dealing with working activities in which hierarchical power has taken on forms different from the traditional ones. Even in such cases, as we have seen, the courts have maintained that hierarchical power is essential to the employment relationship, in the sense that no employment relationship can be said to exist in the absence of hierarchical power, the latter also being understood – taking into account the relevant circumstances – as the power to issue general directives, according to the programmes and purposes of the firm, to persons who perform their working activities on a continuous, loyal and diligent basis.

With regard to the duty of loyalty, it is worth noting that some scholars have construed it in a broad sense, namely as the duty to make oneself available to perform any activity the employer may require on the basis of its different business needs, as long as no demotion results (see Persiani, 1966). It could, therefore, be said that the aforementioned basic legal feature of the contract of employment, together with the relevant socio-economic function, recurs also when the employment relationship exists under more loosely hierarchical conditions and/or environments.

So far, in my account of hierarchical power and its flexibility, I have dealt principally with only one of its three main elements, namely the power to assign tasks and to give orders and directives to employees, known as “directional power”.

¹⁴ For a good account of this debate, see Smith (1997).

The other two elements are also instrumental in achieving flexibility and, ultimately, in reducing transaction costs, however. “Control power” grants employers the ability to monitor how working activities are performed, thereby allowing them also to adjust such activities, if necessary, also by having recourse to directional power. Under other forms of contract, the power to check how partners are performing their duties is usually exercised at the end of, not during, their activities.

This results in quicker and, sometimes, more flexible ways of coordinating the activities of different subjects in the firm. This is also the result of the third element of hierarchical power, namely disciplinary power, which is a mighty instrument of flexibility and the reduction of transaction costs.

As to the former, disciplinary power allows employers to sanction activities which deviate from their orders and directives. In this way, it is a powerful means of enforcement. Moreover, since it is exerted on a private basis – legal proceedings are not needed to exercise it – it is a rapid means of enforcement. Accordingly, disciplinary power is an important means of deterrence and of sanctioning non-compliance when firms are faced with rapidly adjusting their activities to contingent and unpredictable events.

With regard to the reduction of transaction costs, since compliance with the employer’s orders and directives is an employee’s contractual duty, sanctioning non-compliance is a matter of enforcing the contract of employment, with no need to resort to the courts. This substantially reduces the contract’s enforcement costs and, therefore, reduces transaction costs overall.

Furthermore, disciplinary power also fosters enterprise flexibility because it allows them to adjust sanctions to particular breaches. Most notably – and almost uniquely in connection with contracts – this makes it possible to lawfully sanction a breach of contract without terminating it. This allows for the enforcement of internal rules without the need to enter into a new relationship and, as a result, incur the relevant transaction costs.

4. Hierarchy and organization costs: Employment protection and outsourcing

We have looked at a number of features of the employment relationship which render it useful for business organizations, particularly with regard to flexibility. Accordingly, it should follow that the internalization of activities – in which the employment contract is a central tool – makes it possible both to run the business more flexibly and to take advantage of hierarchy as a way of reducing transaction costs. However, as I pointed out at the beginning, under the Post-Fordist system, while firms are certainly pursuing flexibility, the number of outsourced activities has increased in comparison with the Fordist era.

In light of what I have said so far, this might appear to be inconsistent. It would, therefore, be appropriate at this point to examine the second facet of the costs trade-off, namely what we shall call “organization costs”.

These are the costs faced by any organization in carrying out an activity on its own, such as outlay of resources, arrangement of methods and devices of coordination and hierarchy, as well as costs related to external limitations imposed on hierarchy within the organization. With regard to the latter, the employment

relationship has traditionally gone together with a – growing – set of regulations afforded by the law and by industrial relations mechanisms to protect one of the parties to the relationship, namely the employee. As we have seen, the definition of “employment” has traditionally had a legal–technical basis rather than a socio-economic one, the key element being hierarchical power rather than economic dependence on the employer

This has led to some classification problems in dealing with new forms of hierarchical power and also to a lack of protection of workers finding themselves in what I have called a “grey zone” between employment and self-employment.

As hierarchical power is the core of the employment relationship, the regulatory protection of employees has traditionally focused on trying to limit it. In this sense, it provided for measures such as reduction of working hours, regulation of overtime, limits on employers’ control power, preventing demotion and, most notably, possibilities for employees to organize and bargain collectively.

Collective organization not only makes it possible to reduce competition among workers, enabling them to bargain for better working conditions. It also entails a reduction of the hierarchical power of employers. Hierarchical power enables employers to organize their business. However, such organization is rarely conducted on an individual basis. Since organization implies the coordination of different parts and outputs, it is commonly exercised on a plural and collective basis. With regard to work organization, orders and directives are normally issued, not to individual workers, but to teams, line stages or establishments.

This gives rise to a discrepancy between the level at which hierarchical power is exercised – which is plural – and the individual worker, who is subject to hierarchical power. As already mentioned, collective organization enables employees to stand together on a plural basis and therefore at the same level as their employers (Liebman, 1993). This results in a limitation of hierarchical power as it sets against it another plural power. When, for instance, employees bargain collectively to regulate working time or output audits or working conditions at shop or plant level, they control and limit the employer’s hierarchical power.

This is also true of regulations governing individual employment relationships, such as statutory rules establishing disciplinary procedures, prohibiting demotion, regulating the transfer of workers or providing redress against unfair dismissal. Employment protection is usually perceived by employers as a gross impediment to flexibility, since it may – depending on the available remedies – hinder the ability of the firm to adjust the size of its workforce in accordance with the business situation.

In this light, employers see employment protection rights as limiting their hierarchical power and, ultimately, as reducing the flexibility of the business overall. This reduction is perceived as a cost for the firm (Pedrazzoli, 1998), notably as an organization cost. Such costs represent the other side of the coin with regard to internalizing working activities as a means of reducing transaction costs. Accordingly, in deciding whether to implement a particular production phase internally or to outsource it, firms will also take into account the trade-off between organization costs and transaction costs.¹⁵

¹⁵ On the trade-off between transaction and organization (or governance) costs, see Williamson (1985), 85.

However, a number of other circumstances must be taken into account in an analysis of why firms choose internal or outsourced production.

First, the employment contract is not monolithic: there is a wide range of forms of employment and working relationships.

Second, the employment contract is not the only means by which firms can acquire flexibility via a hierarchical relationship in which they can adjust features of performance to their business needs, while avoiding or limiting transaction costs.¹⁶

In Section 5, I deal with the second of these considerations since – as I will show – some of the relevant issues are also useful in dealing with the first.

5. Relational contracts and “hierarchical market organizations”

We shall now look at a variety of contractual relationship to which lawyers and economists have increasingly devoted their attention in recent decades, namely “relational contracts”.¹⁷ The main features of relational contracts are their incompleteness and their extension over time. In fact, the latter feature could be deemed to be the cause of the former. Given the impossibility for the parties to take into account every circumstance that might arise in the course of the relevant relationship – whether due to unpredictability, bounded rationality or prohibitive transaction costs – they allow a significant portion of the contract’s terms and conditions to remain unspecified, so as to be able to determine them as the relationship unfolds. As a consequence, they formally draft what could be called a framework agreement, setting out only the basic rules governing the business relationship, such as criteria determining compensation, the minimum or maximum unit of supply, and grounds or notice of termination. Other terms of the contract (for example, the quantity of supply or the number or frequency of orders) are therefore left to the parties’ future – often informal – determination. This makes it possible to adapt the parties’ performance to contingent business conditions and, therefore, affords a good deal of flexibility to the contractual relationship.

However, it is worth noting that not only is the quantity of supply usually not specified in advance in relational contracts, but also the means by which disputes between the parties are to be settled.

As the settlement of disputes occurs after the conclusion of the contract it might also take place by means of *extra-legal* mechanisms,¹⁸ notably reputation and the economic dependence of the parties (see, for example, *Corazza, 2004: 84*).

With regard to the latter, it is important to highlight the role of what have been defined as “idiosyncratic investments” (see *Corazza, 2004, 85*; *Kerschbamer, Maderner and Tournas, 2002*; see also *Williamson, 1981a*). These are investments

¹⁶ This consideration is already present in Coase (1937).

¹⁷ On relational contracts, see, first and foremost, Macneil (1978; 1980; 2000). See also the papers collected in *Northwestern University Law Review*, spring 2000, vol. 94, as well as Baker, Gibbons and Murphy (2001); Corazza (2004); Goetz and Scott (1981); Libecap and Smith (1998); and Ruiz (2001).

¹⁸ The importance of the incompleteness of long-lasting contracts for organizations and firms was already stressed by Llewellyn (1931) and Coase (1937).

which are very difficult to reallocate to other business relationships because of their specificity. Idiosyncratic investments can be either tangible (such as special machinery, special premises near to the business partner's location and so on) or intangible (such as specific training, skills and know-how).

Furthermore, idiosyncratic investments can be either symmetrical or asymmetrical among the parties: for example, in some relationships, only one of the parties incurs idiosyncratic investments or, at least, to a much greater degree than the other party. Being difficult to reallocate, idiosyncratic investments constitute an incentive to the party bearing them to prolong the relevant business relationship as long as possible. In a situation of asymmetrical idiosyncratic investments, only one party has this kind of incentive, while the other party has the option of seeking another partner. In such circumstances, the former party will be in a much weaker position, particularly if the latter is their sole customer. In this case, the latter might abuse their stronger position as the weaker party lacks business alternatives (Klein, Crawford and Alchian, 1978). While terminating the relationship is a neutral or almost neutral option for the second party, it might even lead to the bankruptcy of the first.

Accordingly, the stronger party may unilaterally lay down terms and conditions of the business relationship, particularly by specifying new performance criteria, left unspecified by the incompleteness of the contract. Moreover, the stronger party could also encroach on the other party's business organization by imposing and enforcing standards of production and supply which are more convenient and specific to its own business (which, incidentally, serves only to ratchet up even further the idiosyncrasy of the other party's investments).

In this way, the stronger party could furnish itself with a hierarchical relationship with the other party: most notably, it could establish a hierarchy by having recourse to the market instead of internal organization. If curbing transaction costs is a common effect of hierarchy, this kind of hierarchical relationship would also result in lower organization costs in comparison to the internalization of business activities.

If we look, for instance, at labour costs, the stronger party could impose a low-wages policy in order to reduce the cost of the relationship. If a demand crisis occurs, it will not have to deal with redundancies, as it does not have a legal relationship with the other party's employees (Morin, 2005).

Moreover, it could also encroach on the other business organization by unilaterally specifying the quantity and quality of outputs and, ultimately, dictating "performance rules" to the other party. This kind of action would be made easier in the Post-Fordist system, within the framework of which even internal production phases have greater executive autonomy, vertical integration no longer being an essential feature of business organizations.

Backer (2007) has observed, for instance, that, due also to government policies establishing obligations for companies to monitor and establish control systems for the enforcement of state-imposed standards, multinational corporations have adopted this approach in the construction of their purely internal private governance systems. Enforcement and monitoring can include a variety of mechanisms, from certifications, to participation in multinational corporation training contracts, to consent to audits (scheduled and unscheduled). Sanctions can include anything from agreements to suggested changes, to financial penalties, to

loss of the supplier arrangement with the multinational corporation. (Backer, 2007: 1753–54)

Backer states that such systems of private enforcement are usually intended to implement the relevant multinational corporation's ethical standards. However, they also show how corporations are able to establish an authority-based system of business relationships, which could be used to impose their business standards, besides their ethical ones.

By abusing its business position within the framework of a relational contract, a firm could provide itself with a level of hierarchy similar to one characteristic of an internalized production stage, but without the need for corresponding internal organization or cost bearing. This kind of business relationship might be called a "hierarchical market relationship".¹⁹

If the stronger party is a large firm, it might have a considerable number of hierarchical market relationships with different suppliers, independent contractors or franchisees, giving rise to what might be called "asymmetrical cluster firms".

The term "asymmetrical" is meant to distinguish this type of business organization from symmetrical cluster firms, namely a net of firms with genuine market rather than hierarchical market relationships, thus cooperating on a parity, not a hierarchical basis.

Asymmetrical cluster firms have recently been the subject of increasing attention from economists, sociologists and, of course, lawyers and legislators (Rugman and Verbeke, 2003; Muehlberger, 2005; Salento, 2003; 2006; Corazza, 2004; Orlandini, 2004).

Italian law started to deal with the problems arising from "hierarchical market relationships" in 1998, with Law 192/1998 (Sala Chiri, 2002; Iudica, 1998). This law provides a set of regulations governing subcontracting and outsourcing and takes special account of contractual relationships whereby a party undertakes to provide goods and services which are intended to be integrated within its counterpart's business organization, pursuant to executive projects, technical or technological know-how or models and prototypes made available by the latter.²⁰ The same law also sets out some rules intended to protect the weaker party, for example, with regard to payment schedules, providing sanctions in case the outsourcing party delays payment.²¹

In particular, the Law aims at avoiding excessive incompleteness in the drafting of contracts as a way of countering abusive business practices. Accordingly, it renders null and void clauses whereby one party can unilaterally amend the terms and conditions of the contract or terminate the contract without reasonable notice.²² It lays down that parties must determine or set criteria for determining their activities under the contract.²³ Most notably, it prohibits the

¹⁹Professor Corazza (2004), pp. 103–6, discusses "a 'hybrid' organization pattern, halfway between market and hierarchy", giving rise to "contractual integration", that is, to "organization patterns that make it possible to substitute production systems based on vertical integration for a network of contractual relations between different firms". See also Powell (1990).

²⁰ Section 1.

²¹ Section 3.

²² Section 6.

²³ Section 2.

abuse of the other party's economic dependence and lays down that economic dependence must be ascertained, also taking into account the other party's opportunities for finding business alternatives.²⁴

The rationale of such rules, therefore, is to reduce opportunities to misuse a stronger business position by means of incomplete contracts.

A similar rationale might be identified in a particular provision of Law 129/2004 regulating franchising (see Cian, 2004).²⁵ Section 3 of the same law provides that, where franchising is on an open-ended basis, the franchisor must grant a duration of franchising sufficient for the franchisee to recoup the relevant investment and, in any case, not less than three years. In this way, the law aims, ultimately, to protect the franchisee from idiosyncratic investments, which are very common in franchising.

The legislator has, therefore, endeavoured to prevent some of the abuses made possible by "hierarchical market relationships". However, it is important to note that all the possible abuses deriving from such relationships have by no means been eliminated.

This is because the abovementioned provisions on outsourcing are not easy to enforce, as it is impossible to effectively monitor the clauses of outsourcing contracts. Moreover, the nullity of incomplete or unfair clauses might be an insufficient remedy to protect weaker parties. Of course, such parties could be awarded the relevant damages, but they may be unable to survive until the end of a trial without going bankrupt, if they lack business alternatives; also, economic dependence is difficult to ascertain and requires court proceedings. Furthermore – and no less important – the abovementioned regulations do not take into account the effects of "hierarchical market relationships" upon the employees of the weaker party in such relationships. By means of its dominant business position, a firm outsourcing its production stages could impose on its counterpart poor working conditions, collective bargaining agreements which are "weaker" than its own, anti-union practices and so on. In addition, it could interfere with the other party's work organization, imposing rules, terms and standards of production.

None of the abovementioned laws deal with such issues and, moreover, in 2003, the legislature repealed a provision establishing equality of treatment between the outsourcing firm's employees and those of the contractor.²⁶

6. Relational contracts, permanent employment and temporary work contracts

Relational contracts are also relevant to working relationships. As already mentioned, employment relationships are extremely variegated, taking on a number of different forms. Besides the permanent, full-time employment relationship –

²⁴ Section 9.

²⁵ With regard to the relevant labour issues, see Razzolini (2006).

²⁶ Sections 29 and 85 of Decree No. 276/2003.

traditionally, the standard employment relationship – we find, for instance, fixed-term employment, part-time employment and agency work.²⁷

For the purposes of this paper, I will also deal with what has been defined as “dependent self-employment” (see Perulli, 2003; Muehlberger, 2007; see also Bologna and Fumagalli, 1997), since it is relevant to my analysis of “hierarchical market relationships”.

Recourse to non-standard forms of employment – including dependent self-employment – has been growing in recent years as a consequence of firms’ pursuit of flexibility, which is typical of Post-Fordism. The increase has been particularly significant with regard to forms of temporary work (see, for instance, EU Commission, 2006; Stone, 2005; Auer and Cazes, 2000: 395).²⁸

One distinctive feature of the Fordist system was lifelong employment, the main benefit of which, from the employer’s standpoint, was that it fostered the employees’ loyalty and commitment to the firm, as well as their self-identification with its aims.

Under the Post-Fordist system, however, this policy is increasingly being substituted by new patterns of work organization, with temporary work much more to the fore than previously.

It has been observed that, in place of lifelong employment, employers now tend to offer “employability”, in the sense of increased and continuous training, job experience in a wider range of production tasks and enhancement of skills and know-how, all of which, supposedly, improve employees’ chances of finding a new job with a different employer (see Stone, 2004; 2007). In this connection, it is worth noting that the Italian Supreme Court recently emphasized that employees have a fundamental right to work and not to be demoted, since demotion may result in a deterioration of their skills and stymie improvements in their capabilities, leading to lost employment or further earning opportunities.²⁹

Firms perceive non-standard forms of employment as more flexible than the standard variety. One of the main reasons for this is their temporariness. Although not all non-standard forms of employment are on a fixed-term basis (for example, part-time employment might be permanent), this is a common feature.

A temporary arrangement affords flexibility to the extent that it allows firms to adapt the duration of working relationships – and so the size of the workforce – to contingent business needs. On the other hand, temporary forms of work are, in some respects, more rigid than the standard employment relationship.

Before we briefly compare standard and non-standard forms of employment, we shall outline their main characteristics. We may then assess the extent to which a particular form of employment may provide for greater or lesser flexibility than others.

²⁷ See the – essential – Supiot (2001); see also Chahad (2004); Freedland (2007); and Sciarra (2004). Increasing recourse to non-standard forms of employment has also been addressed by the International Labour Office: see ILO (2003), p. 12; ILO (2006a), p. 53.

²⁸ With regard to Italy, see Barbieri and Sestito (2008). See also footnote 30.

²⁹ Corte di Cassazione, 24 March 2006, No. 6572, in *Orientamenti della Giurisprudenza del Lavoro*, 2006, 1, 86.

I will deal principally with Italian law, which has undergone a number of reforms in order to foster flexibility over the last fifteen years. Recourse to non-standard forms of employment has grown substantially over the same period.

Employment which is open-ended, full-time and within one firm is still the standard form in Italy, as in most other countries (see ILO, 2003: 18).³⁰

I have already highlighted the fact that the main legal feature of the contract of employment is hierarchical power, consisting of three principal elements: directional power, control power and disciplinary power. I have also stressed that such elements confer a great deal of flexibility on the employment contract. This is true, in particular, for directional power, namely the power to assign tasks and to issue orders and directives in order to adapt the employee's working activities to contingent business needs without the need for their specific consent, insofar as it does not entail a demotion. In this respect, it is worth noting that, pursuant to section 2103 of the Civil Code, employees can be entrusted with new job duties, provided that they are equivalent to their previous duties (see Liso, 1982). It is important to note that the Law speaks of equivalence and not of identity of job duties. In order to verify whether the new duties are equivalent to the previous ones, case law mentions a twofold assessment based on both an objective and a subjective judgement. With regard to the former, it is worth noting that collective bargaining agreements in Italy usually group different job duties under a classification structured on a multilevel basis. To be equivalent, the new duties must fall within the same classification level as those previously performed. Concerning the latter, the new working activities must allow employees to make use of the same set of skills and capabilities they had been developing up to that point.³¹ Case law has also stressed that employees have a duty to update and foster their skills in order to render them adaptable to changes in technologies and methods of production which firms must face in an advanced capitalist system. Refusal to comply with this duty might lead to disciplinary dismissal.³² This not only, ultimately, promotes the aforementioned "employability", but also makes it easier for employers to adapt their employees' performance to their changing business needs and, ultimately, to increase the flexibility of work organization.

Since I have underlined one of the most powerful forms of flexibility in relation to the employment contract, I will now deal with what is most commonly

³⁰ Auer and Cazes' 2000 study (Auer and Cazes, 2000) asserted the continuing "resilience" of the long-term employment relationship. Nonetheless, the authors also underlined the increasing recourse to temporary forms of work. It is, moreover, worth noting that, even if the proportion of temporary forms of work is still lower than that of open-ended employment, the percentage is increasing among young workers and women. In Italy, for instance, the average proportion of persons employed in temporary forms of employment overall was 9.57 per cent in 2006; the share among persons aged 15–29, however, was 24.66 per cent. The percentage among women was 13.13 (data reported in Mandrone, 2008). This could help to explain the profound differences in job tenure between young and adult/senior workers and between male and female workers reported in Auer and Cazes (2000). According to Barbieri and Sestito (2008), "the whole period from 1993 to 2003 saw a growth of 636,000 people in temporary work *vis-à-vis* a 761,000 rise in permanent employment" in Italy. With regard to Italy, see also Accornero (2006) and Gallino (2007), the latter also with regard to the different methods of calculation of the number of non-standard workers and the relevant inconsistencies.

³¹ Corte di Cassazione, 2 May 2006, No. 10091, in *Orientamenti della Giurisprudenza del Lavoro*, 2006, 2, 289; Corte di Cassazione, 11 April 2005, No. 7351, in *Diritto e pratica del lavoro*, 2005, 1422; Corte di Cassazione, 20 March 2004, No. 5651, in *Giustizia Civile (Massimario)*, 2004, 3.

³² See, for instance, Corte di Cassazione, 1 September 2000, No. 11457, in *Notiziario di Giurisprudenza del Lavoro*, 2001, 38.

associated with its alleged rigidity in Italy, namely statutory remedies against unfair dismissal.

In general, under Italian law, employers are permitted to terminate an open-ended employment contract by (a) dismissal without notice for just cause, that is, a cause which does not allow the employment relationship to continue, even on a provisional basis;³³ (b) dismissal with notice for a subjective justifiable reason, namely a serious breach of the employee's contractual duties and obligations, in particular, non-compliance with the employer's orders and directives or assignment of tasks;³⁴ (c) dismissal with notice for an objective justifiable reason, grounded in economic factors relating to production, work organization and the proper functioning of the business (including the liquidation of the firm).³⁵

Remedies against unfair dismissal vary significantly, depending on the size of the workforce.

If the employer has 60 or fewer employees in Italy, or 15 or fewer employees in a single work unit, the employer can be ordered to either re-engage the employee under a new contract, or pay an indemnity, varying between two-and-a-half and six months' salary (depending on the employer's size and the employee's status, length of service and behaviour such damages can rise to 10 and even, albeit unusually, to 14 months), at the employer's choice.³⁶

Above the abovementioned thresholds, the employer can be ordered to both reinstate the employee under the original contract (however, the employee can elect instead to receive an indemnity in lieu of reinstatement, equal to 15 months' salary) and to pay damages amounting to the employee's salary between the date of dismissal and the date of actual reinstatement (but with a minimum of five months' salary).³⁷

The latter set of remedies has long been the focus of the debate on the alleged rigidity of Italian employment legislation (see Ichino, 2004a: 495).³⁸ This is because both reinstatement and damages commensurate to the period between the unfair dismissal and reinstatement are said to burden the employer with undue uncertainty with regard to business decision-making. Since legal cases tend to be extremely long in Italy, such uncertainty would be excessively protracted. Moreover, since such remedies apply also when a dismissal for objective justifiable reasons (ultimately, dismissal for business reasons) is held to be unfair, this is alleged to hinder employers in taking business decisions, preventing them from adjusting their workforce to business needs and, ultimately, jeopardizing the whole economic system.

In this respect, it should be emphasized that courts follow specific criteria in verifying whether an objective justifiable reason exists in the relevant case. Pursuant to such criteria, the dismissal can be implemented only if directly caused by the relevant economic grounds.

³³ Section 2119 of the Civil Code.

³⁴ Section 2118 of the Civil Code and Section 3, Law No. 604/1966.

³⁵ Section 2118 of the Civil Code and Section 3, Law No. 604/1966.

³⁶ Section 8 of Law 604/1966.

³⁷ Section 18 of Law No. 300/1970. An English-language description of the Italian system of remedies against unfair dismissal can be found in Liebman (2003).

³⁸ See also the essays collected in Ballestrero (2007).

Moreover, the employer must prove that no alternatives to dismissal exist; for example, that no suitable positions will become available in the firm which adequately match the employee's skills and experiences and that it is therefore not feasible to employ them in other positions (the so-called "duty of *repêchage*") (see De Angelis, 2007).

This imposes a substantial burden of proof on employers who want to dismiss an employee for business reasons. This regime of legal proofs, together with the remedies against unfair dismissal afforded to the employees of larger firms, has long been criticized as the cause of excessive rigidity in business organizations, supposedly preventing employers from restructuring (Ichino, 2004a: 495; 2004b and 1996).

However, this alleged rigidity ought not to be overestimated. First of all, the abovementioned remedies apply only when a dismissal is held to be unfair. If the court finds that the employer, in the course of restructuring, has implemented a bona fide redundancy, this will not be deemed an unfair dismissal and the relevant remedies will not apply. Moreover, reinstatement and damages proportionate to the wages lost by the employee during the dismissal apply only to work units whose workforce is over 15 employees or to firms whose overall workforce exceeds 60 employees. Employers falling into this category are very much the minority among Italian firms, roughly 95 per cent of which employ fewer than 10 employees (Istat, 2008).

In the cases subject to stricter remedies against unfair dismissal, however, the statutory regulation governing collective redundancies applies. Under Italian law, a collective redundancy occurs when a firm employing 15 or more persons, as a result of a business downturn or reorganization, implements at least five dismissals within 120 days, in each production unit, or in several production units within the same province.

If an employer intends to carry out collective redundancies, they must notify the employees' representatives and the local Employment Offices in writing and follow a compulsory procedure, establishing the exact timing and engaging in compulsory information and consultation with the unions. No agreement with the unions is required to carry out the collective redundancy, however. The law provides for a maximum duration for the procedure, equal to 82 day plus the relevant notice period. Moreover, the timeframe is halved when fewer than 10 redundancies are involved.³⁹

It is worth noting that, in dealing with collective redundancies, courts do not check employers' motivations or the actual status of the relevant restructuring; their attention is limited to formal compliance with the procedure.⁴⁰ Moreover, as I have already mentioned, the procedure requires only information and consultation – not an agreement – with the unions for the implementation of collective dismissals.

This provides a good deal of flexibility in business reorganization, ultimately allowing firms to make reasonable predictions about the timeframe and costs of redundancies.

³⁹ Section 4 and 24 of Law No. 223/1991.

⁴⁰ On this aspect, see Zoli (2007); a general English-language overview of the Italian legislation governing collective dismissals can be found in Del Punta (1998).

In light of the above, the perceived excessive rigidity of Italian employment regulations – in particular, those governing the dismissal of permanent employees – should be reconsidered. Stricter remedies against unfair dismissals apply to only a minority of employers. Moreover, when non-negligible business reorganization occurs, employers can by all means resort to collective redundancies.

Terminating open-ended employment contracts is far easier than terminating temporary ones.

In particular, fixed-term employment contracts can be terminated only if just cause can be shown. Accordingly, neither breaches of contract which do not imply just cause for termination nor business reasons are grounds for the dismissal of a fixed-term employee. Moreover, collective redundancy regulations do not apply to fixed-term employees. Thus, business reasons are not grounds for terminating fixed-term employment contracts.

It is a general principle of Italian contract law that, unless the parties agree otherwise, only a substantial breach of contract can cause the end of a fixed-term contractual relationship before its agreed expiry.

With regard to an agency work contract – as specified below – one must distinguish between the labour supply contract between the firm and the agency and the employment contract between the agency and the worker. With regard to the former, in cases of misconduct on the part of agency workers, the user firm could ask for their substitution by other workers if the labour supply contract includes a clause to this effect (cf. Romei, 2006: 419). However, if the agency refuses to comply, legal action may ensue. With regard to business or economic reasons – such as a fall in demand or an unexpected need to restructure the business – this would not be considered grounds for the firm to terminate the contract unilaterally. Recourse to the courts is possible only to a very limited extent and is very time-consuming.

Concerning the employment contract between the agency and the worker, it can be on a permanent or a fixed-term basis. However, the latter constitute the great majority in Italy today. The employment relationship between the agency and the worker is, with some exceptions, a normal employment relationship.⁴¹ Therefore, if the employment contract is fixed-term, it can be terminated only when just cause can be shown.

In light of the above, it can be said that the law confers much greater flexibility on permanent employment contracts in comparison to temporary ones.

A permanent employment contract is also more flexible in terms of hierarchical power. Before we discuss this topic, we must briefly describe the main features of temporary work contracts under Italian law, including a preliminary clarification.

So far, I have referred to temporary work contracts, with principal reference to fixed-term employment contracts, agency work contracts and temporary self-employment. In particular with regard to the latter, I will refer to what in Italy are called “continuous coordinated collaborations”, which some scholars also label “dependant self-employment” (see Perulli, 2003; Muehlberger, 2007; see also Bologna and Fumagalli, 1997).

⁴¹ Section 22 of Decree No. 276/2003.

All these contractual relationships have very different legal features and regulations and cannot be carelessly lumped together: they cannot be classified under a common category, as their legal characteristics are different.

Nonetheless, I would like to highlight their common features in order to verify whether, their legal features notwithstanding, their use might be motivated by the same economic aim of providing firms with flexibility by means of extra-legal mechanisms.

I will clarify how this may happen below. First, we need to describe the legal features of these contracts, focusing in particular on the fact that, theoretically, they are characterized by less hierarchical power – or even by a lack of hierarchical power – in comparison to permanent employment contracts.

6.1. Fixed-term employment contracts

Italian regulations governing fixed-term employment contracts have undergone major reform through Legislative Decree No. 368/2001 (Ciucciovino, 2007; 2008; Maresca, 2008; Corazza, 2008). This decree was intended to implement Directive 1999/70/EC, which aimed at ensuring non-discrimination between permanent and fixed-term employees and at preventing abuses arising from the use of successive fixed-term employment relationships (see EU Commission, 2006; Caruso and Sciarra, 2007).

By means of Legislative Decree No. 368/2001, the Italian Government not only dealt with the aims of the Directive, but also reshaped fixed-term employment regulations under Italian law in general. The previous regulation provided for a close list of reasons authorizing recourse to fixed-term employment contracts. Accordingly, it was clear that this kind of contract was an exception to the standard form of permanent employment contract.⁴²

The new legislation establishes, instead, that fixed-term contracts are permitted for technical, production, organizational or substitutional reasons, if required by the ordinary business of the employer, which must be stated in writing in the contract.⁴³ It therefore sets out a general authorizing clause instead of the previous close list. On the basis of Legislative Decree No. 368/2001, it was, as a result, no longer clear whether fixed-term employment contracts were still an exception to the standard form of open-ended employment contract or were coming to be a common form of employment alongside the permanent kind. Case law and a significant number of scholars, however, continued to refer to it as an exception⁴⁴ and, eventually (in 2007), the legislator amended the decree and established that open-ended employment contracts remain the general rule.⁴⁵

⁴² Law No. 230/1962, repealed by Decree No. 368/2001, established that “*the contract of employment is held to be open-ended with the exception of*” the cases specified in the close list mentioned above.

⁴³ Section 1 of Decree No. 368/2001.

⁴⁴ See Corte di Cassazione, 17 May 2002, No. 7468, in *Il Foro Italiano*, 2002, I, 1956; Tribunale di Milano, 17 January 2008, in *Il Lavoro nella Giurisprudenza*, 2008, 736; Tribunale di Reggio Calabria, 20 July 2007, in *Foro italiano*, 2008, I, 294; Corte d’Appello di Milano, 9 January 2006, in *Il Lavoro nella Giurisprudenza*, 2006, 823; with regard to the doctrinal debate see, generally, Ciucciovino (2008) and the opinions collected in Vallebona (2006).

⁴⁵ Section 1 of Decree No. 368/2001, as amended by Section 1, Law No. 247/2007.

This principle has a significant practical impact. Pursuant to it, even before the above mentioned statutory amendment, courts have ruled that, where there is no technical, production, organizational or substitution-related grounds for a fixed-term employment relationship, the relevant contract shall be deemed to be a permanent one. Accordingly, courts have started to examine the reality underlying the contracts. Moreover, most have ruled that the reasons in question must be not only actual but also specific; in other words, parties cannot refer in general to an employer's business needs but must specify in writing the tasks to be carried out by the fixed-term employee in the course of the relevant employment relationship.⁴⁶

A significant number of rulings have held that the reasons must also be temporary; that is, no fixed-term contract can be entered into for the performance of activities related to a permanent business need of the employer.⁴⁷

All this also affects hierarchical power. Pursuant to Directive 1999/70/EC, the Decree establishes that fixed-term employees have economic and normative entitlements equal to those of comparable permanent employees in the company.

This also means that the employer can exercise hierarchical power over them. It can issue orders and directives to them, as well as monitor their working activities and discipline breaches of contract (however, as highlighted above, dismissal of fixed-term employees for subjective justifiable reasons is not permitted). It might seem that the law allows employers to exercise hierarchical power over fixed-term employees to the same extent as over permanent employees, but that is not the case.

As we have already seen, one of the most important features of directional power – and therefore of hierarchical power – with regard to permanent employees is the possibility to change their job duties in order to adjust their working activities to contingent and unpredictable business needs. This possibility is not afforded in fixed-term employment contracts, since the parties must indicate in writing the specific job duties the employee will discharge during the fixed-term relationship (cf. Ciucciiovino, 2007: 461).

This reduces hierarchical power and, therefore, the degree of flexibility enjoyed by the employer. Furthermore, it is not compensated by substantially lower

⁴⁶ See Corte d' Appello di Genova, 12 September 2005, in *Guida al Lavoro*, 2006, 8, 41; Tribunale di Milano, 17 April 2008, in *Orientamenti della Giurisprudenza del Lavoro*, 2008; Tribunale di Milano 25 November 2005, in *Rivista Critica di Diritto del Lavoro*, 2005, 152; Tribunale di Firenze, 5 February 2004, in *Diritto e Lavoro*, 2004, 325; Tribunale di Milano, 8 June 2004, in *Diritto delle Relazioni Industriali*, 2006, I, 146; Tribunale di Ravenna, 7 October 2003, in *Il Lavoro nella Giurisprudenza*, 2004, 1285

⁴⁷ Corte d' Appello di Milano, 9 January 2006, quoted in note 44; Corte d' Appello di Bari, 20 July 2005, in *Il Foro Italiano*, 2006, 1540; Corte d' Appello di Firenze, 30 May 2005, in *Rivista Italiana di Diritto del Lavoro*, 2006, 111. It is worth noting, however, that other judgments and some scholars have held that, under Decree No. 368/2001 the temporary nature of business needs is not a requirement of having recourse to fixed-term contracts: see, for instance, Tribunale di Pavia, 12 April 2005, in *Argomenti di diritto del lavoro (ADL)*, 2006, 1, 260 and Ciucciiovino (2007), p. 458. Recently (Law No. 133/2008), the legislator once more amended Section 1 of Decree No. 368/2001, with the intention of permitting fixed-term employment also on non-temporary grounds by establishing that the recourse to a fixed-term contract may also be related to “the ordinary business of the employer”. Nonetheless, some scholars have argued that the “temporariness requirement” is still in force in the amendment, which refers to the “ordinariness” and not to the “temporariness” of the reasons in question, as well as because the notion of temporariness is a means of preventing the abuse of fixed-term employment relationships, which is one of the main objectives of EU Directive 1999/70/EC. See Corazza (2008), p. 521.

direct costs because, as I have already stated, the Decree implements the non-discrimination principle established by Directive 1999/70/EC.⁴⁸

Moreover, since the second main aim of the Directive is to limit abuses arising from a succession of fixed-term contracts, the Decree regulates the prorogation and renewal of such contracts by setting out the maximum duration of the overall fixed-term relationship (normally 36 months, including prorogations and renewals) and minimum periods between the end of a fixed-term contract and the commencement of a new one with the same employer.⁴⁹ This also results in reduced flexibility in managing the workforce and, together with the abovementioned limitation of hierarchical power and the impossibility of terminating the contract before expiry, apart from when there is just cause, ultimately renders fixed-term employment contracts far less flexible than permanent ones in legal terms.

6.2. Agency work contracts

With regard to agency work contracts, it is important to note that, in Italy, as in the vast majority of other European countries, agency workers are employees of the agency (see European Foundation for the Improvement of Living and Working Conditions, 2006; Ratti, 2009).⁵⁰ They can be hired by the agency on either a fixed-term or a permanent basis. As already mentioned, most agency workers in Italy are employed on a fixed-term employment contract.⁵¹ Their economic and normative entitlements may not be lower than those of the user firm's employees.⁵² This makes the overall cost of labour supplied by agencies higher than the cost of directly hiring the worker: on top of the agency fees, the user firm must pay the agency at least as much as it pays its own employees. Nonetheless, since agency work was first permitted under Italian law, in 1997, recourse to it has grown significantly. It is important to note that the contract of labour supply – that is, the contract between the agency and the user firm – can only be a fixed-term one. The possibility of entering into an open-ended labour supply contract was repealed in 2007, having been introduced in 2003. However, recourse to labour supply contracts on an open-ended basis was always negligible in Italy.

One of the main advantages of using fixed-term labour is that, for a short period, it is more convenient to use a worker already selected and trained by an agency.⁵³ Moreover, the agency can undertake to provide substitute workers if the workers they have supplied become ill or go on maternity leave, or even if they are negligent or unable to carry out the assigned tasks.

⁴⁸ Section 6 of Decree No. 368/2001.

⁴⁹ Sections 4, 4-bis, 5 of Decree No. 368/2001.

⁵⁰ With specific regard to Italy, see M. T. Carinci (2008) and Del Conte (2006).

⁵¹ No precise data exist on the number of agency workers hired under open-ended contracts, as the statistics usually do not distinguish between fixed-term and open-ended agency workers (this is true even of statistics compiled by public bodies. See, for instance, Ministero del Lavoro, della Salute e delle Politiche Sociali, 2008). Most notably, some statistics consider agency work as such as involving a temporary contract (Accornero, 2006: 42; Mandrone, 2008: 4).

⁵² Section 23 of Decree No. 276/2003.

⁵³ In this respect, agency work could be said to cut some of the costs that, according to the literature, render labour a “quasi-fixed factor” (see Oi, 1962).

In the long run, however, this competitive advantage over direct hiring is reduced as the gap between a direct employee and a trained agency worker narrows until the higher cost of labour is no longer justified.

Moreover, open-ended contracts of labour supply are permitted only with regard to specific activities.⁵⁴ These activities – including cleaning, portering, call centres, marketing and library management – are the most commonly outsourced activities and, as already mentioned, equality of treatment of the employees of the outsourcing firm and of the contractor is no longer compulsory. In contrast, also within the framework of open-ended labour supply, agency workers are entitled to working conditions which are not inferior to those of comparable user firm employees.

In the short term, recourse to agency workers instead of direct employment can be convenient, also because there are no limits on prorogations and renewals of contracts with regard to labour supply.⁵⁵ This makes it possible to enter into temporary working contracts on a more regular basis, since there is no need for a gap between employment relationships for the user firm.

In light of the above, it is clear that labour supply through an agency can provide firms with significant flexibility. At the same time, it is important to note its rigidities in comparison to direct, permanent employment.

First, as we have seen, the termination of a labour supply contract before expiry – also because only fixed-term contracts are currently permitted in this regard – is far more difficult than implementing individual or collective dismissals, as legal action and solid grounds are required. This results in rigidity with regard to the management of the business organization.

Second, fixed-term labour supply is permitted under a general authorizing clause, similar to the one provided for fixed-term employment contracts, namely for technical, production, organisational or substitution-related reasons, if required by the ordinary business of the user firm. Case law does not require that the relevant business need be temporary, as it commonly does for fixed-term employment contracts. Nonetheless, a significant number of courts have ruled that the reasons must be specific,⁵⁶ and there is a statutory requirement to set down the duties of agency workers in writing in the labour supply contract.⁵⁷

This results in the limitation of directional and hierarchical power, similar to that which affects fixed-term employment contracts. Once the permissible reasons are specified and the job duties identified, it is not possible to change agency workers' duties in order to meet the contingent business needs of the user firm.

Another limitation of hierarchical power affecting agency work is related to disciplinary power. While directional and control power are exercised directly by the user firm, disciplinary power can be exercised only by the agency, albeit at the request of the user firm.⁵⁸ This results in slower enforcement of the latter's orders

⁵⁴ Section 20 of Decree No. 276/2003.

⁵⁵ Section 22 of Decree No. 276/2003.

⁵⁶ See Tribunale di Firenze, 26 January 2008; Tribunale di Milano, 10 April 2007, in *Diritto e Pratica del Lavoro*, 34, 2007, 2091; Tribunale di Milano, 9 December 2006, in *Rivista Critica di Diritto del Lavoro*, 2007, 126.

⁵⁷ Section 21 of Decree No. 276/2003.

⁵⁸ Section 23 of Decree No. 276/2003.

and directives and can, ultimately, lead to stoppages, for example, because the agency might refuse to apply disciplinary power if it does not acknowledge a particular action as negligence or misconduct on the part of the agency worker.

Even in agency work, therefore, there are limitations on flexibility in comparison to direct permanent employment.

6.3. “Dependant self-employment”, “*collaborazioni coordinate e continuative*” and project work contracts

The type of self-employment relevant to this paper is what in Italy is defined as “*collaborazioni coordinate e continuative*” or “continuous coordinated collaborations” (“*collaborazioni*”), carried out mainly on a personal and self-employed basis.

These can be identified as self-employment relationships in which the worker undertakes to carry out an activity in the interests of a principal, mainly on a personal and continuous basis, coordinating with the latter how the activity is performed. The Italian legislator started to take note of such “*collaborazioni*” as distinct relationships in comparison to agency work and sales representation in 1973, when it reformed employment law. On that occasion, employment procedural law was also extended to “*collaborazioni*”.⁵⁹

It is worth noting that, apart from a minor exception, only procedural rules were extended to them. Nonetheless, the mere fact that the legislator mentioned them as self-employment relationships on a continuous and coordinated basis, distinct from traditional relationships of that kind, was interpreted by firms as the legislator’s consent to firm-integrated working activities not covered by the legal and collective protections of the employment relationship. In 1973, the first elements and practices of Post-Fordism were already starting to gain ground.

This resulted in the ever-increasing use of “*collaborazioni*” as a cheaper alternative to permanent employment relationships, both because of their lack of protection and the fact that no social security contributions had to be paid. Accordingly, besides genuine self-employment relationships, a large number of disguised employment relationships were – increasingly – being entered into.

When, in 1995, modest social security contributions and employment tax were extended to “*collaborazioni*”, this, far from constituting a disincentive, fostered the idea that they were a low-cost substitute for employment, in consequence of which they became more popular than ever.

Courts, pursuant to the previously mentioned factual predominance rule, reclassified sham “*collaborazioni*” as employment relationships, but this resulted in uncertainty and, moreover, in a huge increase in the number of court cases.

At the end of the 1990s, it was clear that statutory regulation of “*collaborazioni*” was needed in order both to provide them with some legal protection and to distinguish genuine from sham self-employment relationships.

⁵⁹ Section 409 of the Procedural Civil Code; for an English-language account of *collaborazioni coordinate e continuative*, see Liebman (1999) and Perulli (forthcoming); see also Pedrazzoli (2004).

A progressive increase in the social security contributions levied on “*collaborazioni*” was also deemed expedient, to discourage their improper use.

A number of bills were presented in Parliament with a view to drafting a new regulation on “*collaborazioni*”. The need was particularly urgent due to the fact that, under Italian law, self-employment is not protected by any special regulations and, therefore, an increasingly alarming number of “*collaborazioni*” workers were finding themselves in a socio-economic “grey-zone”, to which no intermediate legal classification corresponded.

A significant new regulation on “*collaborazioni*” was enacted by means of Legislative Decree No. 276 of 2003. This decree was presented by both its detractors and its supporters as a major deregulation of Italian labour law (De Luca Tamajo, 2005). It became clear a number of years after enactment, that such forecast had overestimated its effects. However, that part of the Decree dealing with “*collaborazioni*” was one of the most significant, namely the sections introducing and regulating so-called project work.⁶⁰

In fact, pursuant to Decree 276/2003, apart from a few exceptions, all private sector “*collaborazioni*” must have a number of specific features.⁶¹ In particular, the working activities to be carried out by the “*collaborazioni*” worker in the course of the employment relationship must pertain to the performance of either a project, a work programme or a phase thereof. These must be defined in writing in the contract, together with both the duration of the relationship – which means that, apart from some minor exceptions, no more open-ended “*collaborazioni*” can be entered into in the private sector – and the methods of coordination to be applied to the “*collaborazioni*” worker’s (hereafter also “project worker”) activities in relation to the principal’s business activity.⁶²

The main rationale of the reform is to identify sham “*collaborazioni*” by clearly differentiating the coordination applied to them from the directional power typical of permanent employment.⁶³

Once they are defined and fixed in writing in the contract, the principal cannot amend such activities unilaterally. This means that the principal will not be able to shape them in line with changing business needs.

Of course, a new project, work programme or phase thereof could be agreed, but the project worker’s consent would be needed. Moreover, case law has ruled that projects, work programmes and their phases must be specific; in other words, they cannot merely generically describe the project worker’s activities nor provide for too wide a range of activities.⁶⁴ This would negate the rationale of the reform,

⁶⁰ For an English-language account of project work, see Perulli (forthcoming); see also Ghera (2005), Persiani (2005) and Santoro Passarelli (2005).

⁶¹ It is worth noting that Decree No. 276/2003, with some exceptions, does not apply to public bodies. Accordingly, public bodies can continue to engage workers on a “*collaborazioni*” basis without identifying a particular project, work programme or phase thereof. According to the Italian social security administration, the number of workers engaged by public bodies on a “*collaborazioni*” basis was, roughly, 75,000 in 2006 (Di Nicola, Mingo, Bassetti and Sabato, 2008).

⁶² Sections 61 and 62 of Decree No. 276/2003.

⁶³ See, in this connection, Circular Letter No. 1/2004, issued by the Italian Ministry of Welfare.

⁶⁴ See Tribunale di Milano, 12 October 2007, in *Diritto e Lavoro*, 2008, 145; Tribunale di Piacenza, 15 February 2006, in *Il Lavoro nella Giurisprudenza*, 2006, 885; Tribunale di Torino, 5 April 2005, in *Orientamenti della Giurisprudenza del Lavoro*, 2005, 235.

since it would blur the difference between coordination and directional – not to mention hierarchical – power.⁶⁵

Establishing and carrying out a generic project, work programme or phase thereof would make it possible for the project worker to be reclassified as an employee. If the parties do not specify any project, work programme or phase thereof, the project worker could also claim reclassification. Whether the principal is able to furnish evidence that the worker's activities are being carried out on a self-employment basis is a matter of dispute among scholars and in case law.⁶⁶ In any case, it would be very difficult for a principal to avoid such reclassification.

As already stated, the reform aims at identifying employment being conducted in the guise of “*collaborazioni*” and, therefore, behind a façade of self-employment. Differentiating coordination from hierarchical power by means of predetermining working activities is one of the backbones of the reform.

Other ways of setting “*collaborazioni*” apart include the raising of social security contributions to a similar level to those applying to permanent employment (currently, roughly equal to 25 per cent for “*collaborazioni*” as against 33 per cent for permanent employment) and the provision of some legal protection for project workers, in particular with regard to maternity, illness and injury.

However, it cannot be said that the problems arising from “*collaborazioni*” have been eliminated by the project work reform. Legal protections afforded to project workers remain very small in comparison to the protections established with regard to the employment relationship. Moreover, the gap between the two social security contribution levels is still wide.

Furthermore, the differentiation of employment from self-employment by means of the prior specification of tasks and methods of coordination of working activities risks being too formal and awkward. Legal proceedings would be necessary in order to challenge the classification asserted by the parties. Setting out a project, work programme or phase thereof in relation to a project work contract should, in theory, result in less flexibility in comparison to regular employment. The principal is not able to adjust the relevant working activity to its contingent business needs.

On the other hand, some flexibility can be recouped due to the lack of statutory protections afforded to project workers. Rather unusually for fixed-term contractual relationships, they can provide either party with the option of terminating the contract simply by giving notice.⁶⁷ Needless to say, project workers have no protection against unfair dismissal, since they are not employees.

⁶⁵ See, on this point, Tribunale di Milano 21 June 2008, in *Il Lavoro nella Giurisprudenza*, 2008, 1027.

⁶⁶ For the possibility of bringing contrary evidence, see Tribunale di Ravenna, 25 October 2005, in *Giustizia Civile*, 2006, 1605; Tribunale di Torino, 5 April 2005, quoted in footnote 64; Circular Letter No. 1/2004, quoted in note 63; *contra*, Corte d'Appello di Firenze, 29 January 2008, in *Diritto e pratica del lavoro*, 2008, 2107; Tribunale di Milano, 5 February 2007, in *Rivista Italiana di Diritto del Lavoro*, 2007, 809; see also Santoro Passarelli (2005).

⁶⁷ Section 67 of Decree No. 276/2003; see Tribunale di Ravenna, 25 October 2005, quoted in note 66.

Moreover, the parties to a project work contract may also agree on clauses likely to strengthen the principal's strong contractual position. For instance, they could prevent the project worker from being engaged by other principals.⁶⁸

Lack of business alternatives in a labour market characterized by unemployment, underemployment and high rates of informal work (see Isfol, 2008), combined with sole-customer clauses, could easily lead to the economic dependence of the project worker on the principal.

The payment they receive for project work may represent the sole source of income for project workers, which, moreover, may not easily be replaced.⁶⁹ Lack of – or inadequate – unemployment benefits, which are also characteristic of the Italian labour market,⁷⁰ would foster such economic dependence.

Sole-customer clauses and labour market conditions are considered to lead to the dependency of project workers also by Muehlberger and Bertolini (Muehlberger and Bertolini, 2008). They also refer to the fact that self-employed workers are usually highly educated and offer specialized skills, since their contracts are often related to specific projects. Accordingly, each project should increase their firm-specific know-how.

In this case, the principal would also have an incentive to prolong its relationship with the project worker.

In my view, the high-skilled and specialized character of project work should not be overestimated. The fact that project workers are usually highly educated does not automatically imply that they perform high-skilled activities, especially because – as Muehlberger and Bertolini correctly observe – “many firms in the business sector offer jobs to young professionals only on the basis of dependant self-employment”.

Moreover, most legal rulings on project work contracts focus on the specificity of projects rather than on the specialized nature of the relevant working activity. For instance, one judgment by the Tribunale di Genova stated, notably, that: a “project work contract does not necessarily require highly specialized or professional activities”.⁷¹

⁶⁸ Section 64 of Decree No. 276/2003. According to Di Nicola, Mingo, Bassetti and Sabato (2008), 89 per cent of project workers were working for a sole principal in 2007. According to Mandrone (2008), in 2006, 78 per cent of project workers were working for a sole principal. The differences between the data probably stem, in addition to the different reference years, from the different research approaches. The first research was based on social security administration data; the latter was carried out by means of interviews.

⁶⁹ According to the social security administration, payment received for project work was the sole source of income for 84 per cent of project workers in 2007; see Di Nicola, Mingo, Bassetti and Sabato (2008).

⁷⁰ For an English-language overview of the Italian unemployment benefit system, see Liebman and Del Conte (1999).

⁷¹ Tribunale di Genova, 7 April 2006. Available at: <http://www.fmb.unimore.it>

7. Economic dependence and the temporary nature of the working relationship: The “implicit threat” mechanism

In a situation in which the activities performed within the framework of project work are not high-skilled or specialized, replacing project workers does not constitute an insurmountable problem for the principal.

For the project worker, on the other hand, due to the abovementioned economic dependence, it is extremely important to prolong their relationship with the principal as long as possible. Since project work is, by definition, carried out on a fixed-term basis, such prolongation may be obtained principally by means of prorogations or renewals. No limits on these exist, on the proviso that a need can be shown either for a prolongation or a new project, work programme or phase thereof.

In this case, the temporary nature of the contractual relationship is likely to bolster the principal’s business position in relation to the project worker, as the latter’s main and not easily replaceable source of income depends on prorogations or renewals of the project work by the principal.

In such a situation, principals may abuse their stronger position, providing themselves with the flexibility they require, only notionally impeded by the existence of a project, work programme or phase thereof.

The temporary nature of the relationship – potentially combined with a clause permitting termination of the project work simply by giving notice –enhances the implicit threat of not consenting to a prorogation or a renewal of the contractual relationship, should the project worker refuse to adjust their working activities, pursuant to a request from the principal, either by agreeing to a new project, work programme or phase thereof or by an unofficial modification of such activities.

It is true that such practices might expose the principal to the risk of judicial reclassification of the project worker as an employee. But such a risk lies in the future and depends on the worker challenging the project work contract.

In that case, the principal could also offer the worker employment in return for a general innovative settlement regarding the project work. This would, however, result in a saving on social security contributions or other employment-related costs for the period of the project work.

A number of savings on employment-related costs could be identified: for instance, the elimination – or maximal reduction – of sick leave, no unionization and avoidance of maternity, as well as lower payments in terms of both lower wages and no payments for overtime, obtained by means of the aforementioned implicit threat not to prolong the contractual relationship.

The project worker has no incentive either to assert or demand such rights as they do have, given their need for the prolongation of the contract or an offer of employment from the principal. Whether the project work is genuine or a sham does not necessarily make any difference. Only if the project worker has a realistic alternative will the mechanism of the implicit threat misfire. However, due to the above mentioned features of the Italian labour market and unemployment benefit system, this is likely to be the exception.

Moreover, quite apart from the major hindrance posed by the lack of a business alternative in the course of a long legal case, project workers can also be

prevented from challenging either the project work or their working conditions before a court by another extra-legal mechanism, namely reputation.

It has recently been argued that, in particular with reference to project workers in the service sector – where most of them work – networking and acquaintances play an important role in the search for new employment (Muehlberger and Bertolini, 2008). Pending legal proceedings with the principal would not be easy to conceal and this might hinder the search for new employment.

As a consequence, the main risk of reclassification would be from the social security administration, which is allowed to challenge in court the legal classifications applied by parties to their working relationships, since they can result in the evasion of social security contributions. In such cases, although the principal is obliged to pay the difference between the relevant social security contribution amounts, if the judgment goes against them, they still benefit from a working relationship which is as flexible as the employment relationship and far less costly in term of workers' rights.

Accordingly, firms might have an incentive to have recourse to project work contracts as a means of providing themselves with flexibility similar or equal to that afforded by a permanent employment relationship, but without the same costs.

We have seen that economic dependence and reputation play an important role in relational contracts, providing leverage with which to abuse the incompleteness of the terms and conditions and to exploit the stronger business position of one of the parties. By means of such abuse, the stronger party can be said to provide itself with a so-called “hierarchical market relationship”. This kind of relationship has been found to be a valid alternative to the internalization of production stages, since it cuts organization costs, but also makes it possible to reduce transaction costs by means of an extra-legal hierarchy.

In light of what has been said above with regard to project work contracts, a similar mechanism can be said to operate here. Extra-legal elements, such as reputation and, most notably, economic dependence – boosted by the temporary nature of the contractual relationship and the related “implicit threat” – can provide the principal with a great deal of flexibility, together with savings on social security and employment-related costs.

In this respect, the temporary nature of the project work contract is central, since it sustains the “implicit threat”. Even when a clause allowing unilateral termination with notice is provided for, it may not play a decisive role in the employment relationship, because – especially when the duration of the project work contract is not long – the principal may prefer to wait for the expiry of the contract than terminate it. No explanation has to be given for refusing either a prorogation or a renewal of a project work contract, whereas its termination may, in theory, be subject to a good faith assessment, as a duty of good faith in the execution of contracts is a general principle of Italian contract law.⁷²

As a consequence, it could be said that temporary contracts provide firms with flexibility, not only because they allow them to plan the duration of working relationships as a way of adjusting workforce size in accordance with contingent business needs, but also because they provide extra-legal means of exercising hierarchical power, even when it is theoretically limited or excluded in legal terms.

⁷² Section 1375 of the Civil Code.

As already stated, one of the main functions of hierarchy is to provide flexibility in terms of the possibility to issue orders, control their implementation and enforce them with disciplinary sanctions. This leads, ultimately, to a reduction in transaction costs.

It has often been said that in the hierarchical relationship par excellence – namely the permanent employment relationship, in which employers enjoy the maximum degree of hierarchical power – employees are provided with a wide range of statutory and collective protection, which is intended to counterbalance that hierarchical power. This could lead to organization costs. Accordingly, firms have an incentive to resort to alternative means in order to avoid such costs, without renouncing hierarchy.

With regard to project work contracts, as we have seen, the temporary nature of the relationship can substitute an extra-legal for a legal hierarchy.

The same can be true also for other temporary work contracts, such as fixed-term contracts and agency work. In this case, temporariness can both increase the hierarchical power afforded to employers and user firms and, most notably, reduce organization costs in terms of savings on employment-related costs.

Even if fixed-term contracts and agency work are very different, both from one another and from project work, temporariness is a common feature. This is also because the number of permanent employment contracts between agency workers and agencies is negligible in Italy.

Looking first at fixed-term contracts, it could be said that fixed-term employees also have an incentive to prolong their relationship with the employer because of the abovementioned features of the Italian labour market, namely inadequate unemployment benefits and high rates of informal work, unemployment and underemployment.

Such a prolongation can be obtained either through a prorogation or a renewal of the contract. This can result in what, with regard to project work, I have called the “implicit threat” mechanism: the fixed-term employee could renounce, de facto, most of the rights to which they are entitled.

Therefore, even if the law theoretically provides for sick pay, maternity leave, working time regulations, union rights and collective action rights, the fixed-term employee may waive such rights, simply by not exercising them, in order not to displease the employer and to try to obtain either a prorogation or a renewal of the contract.⁷³ They may also accept a lower level in terms of collective bargaining classifications.

This is likely to result in lower employment-related costs for the employer and, therefore, in reduced organization costs, without the need to give up hierarchical power.

On the contrary, due to the “implicit threat”, the fixed-term employee is likely to accept duties different from those specified in the contract and even demotion.

⁷³ See, for instance, Chicchi (2003), p. 121, who reports on interviews conducted with fixed-term or former fixed-term employees, who declare that they would not become – or would not have become – members of trade unions until they become – or became – permanent employees. Other employees stated that, in their experience, temporary workers strike less often than permanent employees or go to work even when they are ill, in order to have their employment prolonged on the expiry of their contract.

This provides the employer with de facto hierarchical power similar to or even greater than the power afforded by a permanent employment contract.

There are many indications that awareness is increasing concerning what I have called the “implicit threat” with regard to fixed-term contracts. It is sufficient to quote Directive 1999/70/EC, which sets out as its aim: “to establish a framework to prevent abuse arising from the use of successive fixed-term employment contracts or relationships”.

The use of successive fixed-term contracts can result in abuses also because of the “implicit threat” not to prolong the relationship, with the possible consequences highlighted above. With regard to Italy, the legislator recently established a maximum duration for fixed-term relationships, normally 36 months, including prorogations and renewals. One other fixed-term contract can be entered into, above this threshold, by notifying the Employment Office or the trade union. Nonetheless, 36 months is quite sufficient for the operation of the “implicit threat” mechanism.

During a period of this length, the employer can acquire unduly extended, de facto hierarchical power and a reduction in employment costs.

Of course, the employee could take legal action against their employer and, if successful, would probably be reclassified on a permanent basis. However, this is unlikely as long as the employee has hopes of a permanent job offer. Moreover, the possible length of the proceedings and reputation issues could discourage the employee from taking their employer to court. And even if the employee is reclassified on a permanent basis, the employer will still have enjoyed the abovementioned benefits arising from the “implicit threat” mechanism for the period of the fixed contract.

As a consequence, it could be said that employers have an incentive to hire fixed-term employees and to use the “implicit threat” to strengthen their contractual position and to reduce costs without renouncing their hierarchical work organization. This applies in particular to employers subject to reinstatement in case of unfair dismissal. Even if termination of a fixed-term employment contract is more difficult during the duration of the contract, when it expires the decision not to prolong it cannot be challenged, unless an abuse is proved. In contrast, the dismissal of a permanent employee can always be challenged, at the risk of reinstatement, where it applies.

With regard to project work contracts, I have maintained that the possibility of terminating the contract is far less important for principals than its temporariness. The same could be said with regard to the possibility of dismissing a fixed-term employee, when the temporary nature of the relationship is taken into account.

Similar considerations apply with regard to agency workers. As I have stated, the vast bulk of agency workers are employed by the agency on a fixed-term basis. Moreover, no limits on the renewal of such contracts apply in this case.

An agency work contract can be seen as an opportunity to obtain a permanent position within the user firm.

Moreover, it may be that the duration of the employment contract with the agency is linked to the duration of the labour supply contract between the agency and the user firm (as already mentioned, since 2007 such contracts can only be entered into on a fixed-term basis). As a consequence, the end of the labour supply contract would directly affect the agency worker as it would cause them to lose

their job. In such a situation, they would have the incentive to try to obtain permanent employment within the user firm.

Therefore, due to the temporariness of the contracts, the “implicit threat” mechanism could operate also in this case. In the relationship between the agency worker and the user firm, the “implicit threat” would be that of not being offered employment by the user firm at the end of the labour supply contract, or on the expiry of their employment with the agency. As a consequence, the agency worker could be induced to waive some of their rights, such as sick pay, maternity leave and union and collective action rights in an endeavour to obtain permanent employment at the user firm.

The imposition of changes in duties or demotions are less probable, in comparison to fixed-term employment, as duties and tasks must be specified in the labour supply contract and are likely to be monitored by the agency, since abuses of agency work can entail criminal liability and may be proved more easily.

Nonetheless, employers can still benefit from minor reductions in employment-related costs in term of the agency worker’s renunciation of fundamental rights, ultimately leading to a reduction of organization costs, again without any need to renounce hierarchy and related reductions in transaction costs.

Moreover, the limits on hierarchical power and flexibility imposed by the user firm’s inability to exercise disciplinary power directly over agency workers lose importance when the agency worker has an incentive not to displease the user firm. As a result, the user firm may also benefit from its ability to enforce orders and directives.

In addition to the one operating between the user firm and the agency worker, the “implicit threat” mechanism operates also between the worker and the agency. This is because the agency worker cannot be sure of obtaining permanent employment with the user firm. As a consequence, the worker has to maintain the possibility of prolonging their employment contract with the agency. For the agency, this is likely to result in more committed agency workers and, therefore, better service for its customers.

In the case of agency work, too, then, the temporary nature of the relationship may reduce both transaction costs and organization costs, ultimately reducing the abovementioned trade-off to a considerable extent.

Since the circumvention or reduction of this trade-off is also one of the main effects of “hierarchical market relationships” between firms, a number of observations can be made in this connection.

First, “hierarchical market relationships” are often based on the use of relational contracts, especially when asymmetrical idiosyncratic investments and sole-customer suppliers are involved. The incompleteness of the contract is essential in these cases, since it allows the stronger party in the relationship to “fill in the blanks” and specify terms and conditions almost unilaterally, without the need to negotiate with the weaker party. This provides hierarchy and flexibility and, at the same time, makes it possible to avoid the internalization of business activities and the related organization costs.

To some extent, recourse to temporary work contracts could also be said to give rise to “hierarchical market relationships”, since it makes possible a reduction or circumvention of the organization costs arising from employment. This happens without the need to renounce hierarchy, thanks to the “implicit threat” mechanism.

Furthermore, temporary work contracts may also enable the internalization of working activities without the need to internalize the relevant workers, as the temporary nature of the relationship makes it possible to end the relationship easily, simply by awaiting its expiry.

Moreover, temporariness could be said to be a special kind of incompleteness, as it allows one of the parties – through prorogations or renewals of the relationship – to specify, from time to time, the quantity of the other party’s supply: in this case, the supply of working activities. In this sense, it may be asserted that temporary work contracts are a type of relational contract. Moreover, extra-legal mechanisms, such as economic dependence and reputation, operate in a similar manner to other relational contracts.

8. Conclusions

I started by declaring that, under the Post-Fordist system, firms look for flexibility: mainly the possibility to adapt production rapidly to contingent business needs. I have maintained that the internalization of activities and permanent direct employment affords flexibility through hierarchy, as the latter leads to a reduction of transaction costs. However, I have also shown that, under the Post-Fordist system, firms resort to a much greater extent to outsourcing and to working relationships which differ significantly from direct, permanent employment. One possible reason for this is related to organization costs.

Together with transaction costs, such costs form a trade-off. We have suggested that firms try to find an alternative both to the market and the internalization of activities – and, therefore, that they try to obtain flexibility through reduced organization costs – by means of what we have called “hierarchical market relationships”.

Therefore, the growing emphasis on flexibility and the increasing recourse to outsourcing, typical of Post-Fordism, can be reconciled in terms of “hierarchical market relationships”.

One of the most important characteristics of “hierarchical market relationships” is the fact that they are governed mainly through extra-legal mechanisms, such as reputation and, most notably, economic dependence.

Such extra-legal mechanisms have been found to operate also with regard to relationships between individuals and firms. For the purposes of this paper, we have analysed them in connection with temporary work contracts in Italy: fixed-term employment, agency work and project work contracts.

I have suggested that the abovementioned extra-legal mechanisms have found good leverage in the temporary nature of the contractual relationship by means of an “implicit threat”, wielded by the employer (including labour supply agencies), the user firm or the principal.

This “implicit threat” consists, ultimately, of a refusal to prolong the contractual relationship or to offer permanent employment. In a country such as Italy, characterized by both inadequate unemployment benefits and high rates of informal work, unemployment and underemployment, both economic dependence and lack of working alternatives are very significant, rendering the “implicit threat” particularly menacing and effective.

The brief outline of the permanent employment relationship in Italy presented here has shown that the law affords it a high degree of flexibility, notably in terms of greatly extended hierarchical power. The law provides considerable protection to employees as a counterbalance to such power. Firms perceive this protection in terms of organization costs.

This ultimately results in a trade-off between the flexibility afforded by hierarchy and the related organization costs. As a consequence, firms have the incentive to try to cut such organization costs without renouncing hierarchy and flexibility.

Since the largest degree of legal hierarchy is provided by the permanent employment contract – as I have maintained – firms have to seek out extra-legal mechanisms which favour hierarchy and flexibility.

Such extra-legal mechanisms can be found, for example, in reputation and economic dependence. The temporary nature of working relationships tends to strengthen them by means of the “implicit threat” mechanism.

Exposed to such an “implicit threat”, workers engaged under temporary work contracts are induced to renounce a number of fundamental rights. This ultimately allows firms both to obtain *de facto* extra-legal hierarchical power, similar to or, in some cases, greater than the power characteristic of a permanent employment contract and to benefit from employment-related costs which, globally, are far lower than those characteristic of permanent contracts.

It is also not the case that employers, in general, have an incentive to hire workers engaged under a temporary work contract on a permanent basis, once they have acquired sufficient skills and expertise, so as not to lose their services. This applies only to high-skilled jobs.

New research shows that, instead, the proportion of low-skilled jobs – which have a high replacement rate – has been increasing in Italy (Cavallaro and Palma, 2008).

Moreover, some statistics with regard to fixed-term employees in the most developed Italian region, Lombardy, show that the bulk (roughly 70 per cent) of them are employed in low-skilled or routine work (Accornero, 2006: 74–75).

A survey by the Italian Ministry of Labour on demand for agency workers on the part of user firms reports that only 23 per cent of such a demand is for skilled workers (European Foundation for the Improvement of Living and Working Conditions, 2006).

The replaceability of these workers renders the “implicit threat” easier to effect. Firms have no reason to give up temporary work contracts if they are not fully satisfied with the low-skilled and unspecific character of such activities, since they benefit so much from such worker’s implicit waiver of their employment rights.

The same applies also to project work contracts, not only sham ones but also genuine ones, since – as we have shown – project work does not necessarily involve high-skilled or specialized activities.

Firms might, on the contrary, have more of an incentive to engage high-skilled workers on a permanent basis in order to ensure their loyalty. On this basis, there would seem to be little point in improving their “employability”, which would serve, among other things, to bolster their likelihood of finding a new job with a

competitor. That being the case, the stress on “employability” is likely to shift: it could be argued that employer practices which result in the enhancement of “employability” are rather the outcome of just-in-time production and related, less bureaucratized work organization rather than deliberate business policy.

It goes without saying that the abovementioned considerations are, by no means, intended to provide a comprehensive description of reality. Not every recourse to a temporary work contract is malignly motivated. However, the incentives and disincentives described do offer a possible explanation of the increasing use of non-standard forms of employment and, in particular, of temporary work contracts by Post-Fordist business organizations.

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