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DOES LABOUR LAW ACTUALLY PRODUCE EQUALITY AMONG WORKERS?

*A tentative law and economics approach to the question of coherence
between the protective rule's egalitarian ratio and its effective consequences*

Report to the International Seminar on The effectiveness of social law: under what conditions?

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Summary: 1. The protective rule's reasons for existence and its practical effects. - 2. An interesting test-bench of labour law effectiveness: the commitment to building equality among workers. The employment contract as an insurance policy. - 3. Equality vs. parity of treatment. The commensuration principle and the question of the incentive for individual effort. The possible paradoxical effects of antidiscrimination rules. - 4. A crucial test for the equalization principle: is it fair to dismiss an inefficient worker? - 5. A mechanism that actually makes the most rigid courts' orientation to prevail – 6. Protection against dismissal as a factor of inequality. - 7. The crisis of the old egalitarian mechanism. - 8. A mechanism actually hostile to the less fortunate workers. - 9. How a “Rawlsian” option can be pursued in the western market system of the XXI century.

1. The protective rule's reasons for existence and its practical effects.

The most radical attack against labour law, in the last quarter century, has been moved by theories of the conflict of interests between insiders and outsiders ⁽¹⁾. The deadly insidiousness of those theories lies in their capacity of highlighting the contrast between the universal character of the protection that workers are formally offered by the juridical rule and the real effects that it can cause, of protection of one part of the workers – the insiders – against the competition of another part: that of those who are outside the fortified citadel of regular work. Real effects that it actually can cause, if the theoretical insider/outsider model

⁽¹⁾ A. LINDBECK, D.J. SNOWER, 1988.

corresponds to the effective labour market's functioning in a certain place and a certain time. But we can no more exclude this possibility on the basis of an ideological option: the question whether in fact this actually happens or not is open.

Another menace, this one specifically directed against the continental European labour law, has appeared at the horizon during the last decade as a consequence of the communitarian law tendencies towards the protection of competition in the services market. In the labour intensive sectors the workers' protection can exert an effect of limitation of competition between enterprises. Hence, in the context of the communitarian law, the workers' protection is no longer a value in itself, unquestionably good: it is an option that the communitarian law requires us in some measure to justify; and the justification passes also through the verification of its effective consequences ⁽²⁾.

It is by these menaces that labour law scholars have been forced to open up to the economists' contribution: because it is only by the economic analysis of the labour law effects that a persuasive answer can come to those who consider labour law as a means of protection of unearned incomes for some workers and a cause of exclusion for some others, as well as to those who support its subordination to the need for competition enhancement. And it must be observed that the question arises not only at the level of the *ius condendum* or of labour policies, but also at the strictly juridical level of the interpretation and application of the *ius conditum*: because the verification of the coherence between the *ratio* and the practical effects of the rule becomes an indispensable passage for the control of compliance of the ordinary law with the rules of higher rank, be they constitutional or communitarian rules.

So it happens that labour law scholars are forced to familiarize themselves with old and new economic concepts and models, in order to draw from them the arguments - indispensable also from the strictly juridical point of view - for the defence of labour law as an *effective* means of social justice, of *effective* guarantee for the weakest workers, of correction of major labour market failures. I recall only the most important and well-known concepts and models that are commonly opposed to the insider/outsider theories ⁽³⁾:

⁽²⁾ Hence the question, with which the Court of Justice has had to deal several times in the last few years, of the balance between the citizens' protection need in the labour market and that of protection of competition in the services market: see on this subject Court of Justice *****.

⁽³⁾ For a fuller exposition of these concepts and models, may I refer to my essay *The labour market: a lawyer's view of economic arguments*, in *International Labour Review*, 1998, pp. 299-311.

- models based on the idea of a *common interest shared by insiders and outsiders* in the increase of treatment standards, even at the cost of a reduction of regular employment opportunities;
- the *structural monopsony* model, which shows the characteristic distortion of the original labour market, in the still underdeveloped countries, with its depressive effect on wages and employment levels; as far as this model corresponds to the effective labour market structure, minimum mandatory standards of treatment can be justified as a means for correcting that distortion: enhancing standards of treatment without causing unemployment;
- the concepts of *dynamic monopsony* and of *economic dependence*, as mechanisms (mainly produced by information asymmetries and idiosyncratic personal investments in human capital) that cause an analogous distortion in mature labour markets, characterized by a great plurality of employers in competition in the labour market; here too minimum mandatory standards of treatment can enhance standards of treatment without causing unemployment;
- the analysis of possible further effects of *informative asymmetries*, most of which are not eliminable in the labour market, and in particular of those that hinder an optimum risk distribution between employer and employee, so justifying the mandatory limitation of the employer's dismissal power as a second best, in a situation in which the first best (the free and efficient negotiation of the risk distribution between employers and employees) is in fact unattainable ⁽⁴⁾.

The last mentioned line of reasoning is of great importance today in general, and in particular for the considerations that will be proposed in the following pages: any restriction of the employer's freedom to dismiss turns the employment contract into an insurance contract, with a trade-off taking place between stability of employment and level of earnings (because of the "insurance premium" that the workers pay their employers, in terms of lower wages). The imposition of regular employment stability, in order to guarantee workers' security against adverse contingencies, therefore, implies a cost not only for outsiders (in that it becomes more difficult for them to gain access to the protected sphere), but also for those it protects, since it can reduce their earnings. This may go some way towards explaining the deliberate "flight" of the best endowed workers out of employer-employee relationships and into self-employment, or even out of countries where stability is

⁽⁴⁾ P. AGHION, B. HERMALIN, 1990.

most rigidly imposed; and we will see how this can jeopardize one of the fundamental labour law commitments.

Each of the above models proposes an extreme simplification of the social and economic reality; each of them captures an aspect, none entirely describes it. None, therefore, provides a universally decisive argument, over which the correspondence can be demonstrated, once and for all, of the protective rule practical effects to its constitutional *ratio*, or of the protective rule compatibility with the communitarian antitrust law: it is always necessary – not only for economic policy purposes, but also for a strictly juridical purpose: that of correct application of communitarian or constitutional rules - to control at the empirical level which one is the model that in each situation effectively captures the most relevant aspect of the labour market functioning.

2. An interesting test-bench of labour law effectiveness: the commitment to building equality among workers. The employment contract as an insurance policy

To the rational explanations of the usefulness of mandatory minimum standards as a second best with respect to a – in fact unfeasible - perfectly competitive labour market, we can add one that leverages on the modern concept of justice: the labour law as a means for guaranteeing – or rather: for building – the substantive equality among unequals. On this idea it is possible to build a theoretical model that captures a very interesting and often neglected aspect of the labour law function. But this too is a model whose effective correspondence to the labour market functioning must be carefully verified. And we will see that just from this verification a paradoxical result can emerge: the labour law in its traditional configuration can effectively make inequalities increase.

Some labour law institutions - and particularly the ~~Italian-European~~ ones of the Sixties and Seventies, part of which are still in force - seem to be created with the principal aim of producing an equality effect among workers: when the individual relationship is negotiated, they assure that the initial determination of the worker's treatment ~~when the individual relationship is negotiated~~, ignores as far as possible his/her effective productivity; and they protect, as far as possible, the weakest ones against subsequent reductions in the same treatment, caused by the emergence of a lack of productivity. In particular, these institutions as a whole take advantage of the ~~informative~~ asymmetry in information, which

causes the employer, at the moment of hiring the worker, scarcely to know his/her capacity (especially - but not only - when the latter is a young person in his/her first job). We can see the protective mechanism as aimed - so to speak - at cultivating that informative on asymmetry, hindering what can reduce it, in the phase of constitutioning and first experimentation of the work relationship constitution (with the effect that the contractual treatment must be fixed *ex ante*, on the basis of the average expected productivity of the professional category); and at preventing the subsequent adjustment of the stabilized relationship.

If ~~considered~~ in this light, the work contract functions as a sort of insurance policy is particularly evident: the contract, making the employer responsible for the risk of the future worker's lack of efficiency (not caused by observable fault), ~~and in~~ this way it producing an effect of equalization among workers.

The function-role of preventing the predictability of worker's productive qualities is exerted, to greater or lesser extent:

- by the *pre entry* or the *labour pool* closed shop rule, or by the *collocamento numerico* mechanism - in force in Italy until 1991 as a general rule, except for professional employees, and still in force in this country for the special placing procedure of disabled persons - that allows only the public employment service (and not the employer) to select the workers to be hired, on the basis of the number of dependents and the length of unemployment;

- the mandatory limitation of the probation period;

- ~~la~~ the mandatory limitation of the *fixed term contract* and of the *temporary help service agencies* activity, which prevents utilizing the temporary work contract as a substitute for the probation period;

- the prohibition of the employer's inquiries about worker's opinions and private life, his criminal and health record;

~~—the career and compensation mechanisms related only to the seniority commonly foreseen by collective contracts.~~

The function-role of preventing the *ex post* adjustment of the worker's treatment to his productive qualities, the knowledge of which the employer acquired in the course of the relationship, is exerted by:

- the *mechanisms of automatic compensation increase* related to the worker's seniority, these too broadly foreseen by collective contracts;
- in general, all the *rules that attribute predominant weight to the seniority* in the choice of workers to be laid off in case of redundancy (and in particular the "last in first out" rule): these are the rules that have the greatest diffusion on a world scale;
- the legal or contractual *limitation of the workers' dismissal*, insofar as it prevents the employer from replacing the worker who shows himself to be less able to adjust his performance to the technological shocks, or from ~~substituting-replacing~~ the one who in whatever other way shows herself to be or becomes less productive for owing to causes deriving pending on from her person, ~~as happens to the unfortunate chambermaid in the case from which we started.~~

This ~~way of~~ interpretation of labour law shows some remarkable similarity with to the theory of justice based on the "*a priori* preference for equality", proposed by John RAWLS at the beginning of the Seventies ⁽⁵⁾. The American philosopher moves from the idea of a basic situation in which ~~the~~ individuals ("under the veil of ignorance") can't see and foresee their position, *i.e.* do not know the endowment and the social position reserved to each of them by the natural and the social lottery, but ~~they~~ know well their aversion to the risk of finding themselves among the poorest and the socially excluded: in such a situation they will be induced - by their own egoistical interest, apart from ethical considerations - to make the contractual choice of a social order inspired by a principle of equalization. The concrete expression of this principle is that of the most even distribution of fundamental rights and opportunities; it permits or even imposes possible inequalities in the distribution of rights and resources only when these favour the disadvantaged, *i.e.* effectively operate for the reduction of their handicap. The legal and social order founded on this principle pursues ~~the~~ equality notwithstanding the differences of in endowment and social positions which show up day by day, in fact ~~contrasting-countering~~ such diversity at its origin, or countering ~~contrasting~~ its effects of differentiation of wealth and welfare.

We can conceive the labour law, in its traditional configuration, as a juridical mechanism that - by means of the institutions and the rules that we have considered above - tends to create a system where the terms and conditions of the work relationship are

⁽⁵⁾ J. RAWLS, 1971.

negotiated, with stable effects, in a situation of ignorance or ~~constrained forced~~ indifference ~~about to~~ the endowment and quality of each worker: something like the situation that RAWLS, in his paradigm, assumes as the “original” one, characterized by the “veil of ignorance”. Assimilating, for this aspect, the above outlined old protective mechanism to the Rawlsian paradigm leads us to single out the *a priori* preference for workers’ equality as a rational justification of the part of labour law that we are here considering, in addition to the other rational justifications singled out by modern labour economics mentioned above⁶. This *a priori* preference derives from the risk aversion that characterizes the generality of mankind; and it manifests itself in human beings’ tendency - when they are under the “veil of ignorance” about their (present or future) position and endowment - to deal with uncertainty problems by means of solutions modeled on an insurance pattern.

It must be immediately stressed that the assimilation of the above juridical mechanism to the Rawlsian paradigm is possible only at the price of a trivialisation or even obliteration of some important aspects of the theory of justice proposed by the American philosopher. First of all, he ~~builds a theory~~ ~~theorizes of~~ a system that can guarantee, ~~rather than an~~ equality in individual positions and ~~in the distribution of material resources, —rather than a parity in the distribution of material resources—~~ an equitable parity in opportunity distribution, that is ~~a~~ parity of the expectations that each individual can reasonably and actively cultivate. Moreover, an essential part of that theory is the “difference principle” by which he justifies a differentiation of treatments aimed to reward the difference of productivity of the better endowed individuals, when this greater productivity consistently redounds to the advantage of the less endowed ones (⁷). In other words, the Rawlsian option for equality cannot be understood in a static sense: it must be viewed in a dynamic way, taking into account the mechanisms that bring about the counterthrust of the economic system to the rules that we try to impose on it. In the original situation to which RAWLS

⁽⁶⁾ See § 1.

⁽⁷⁾ “The difference principle ... requires that the higher expectations of the more advantaged contribute to the prospects of the least advantaged” (RAWLS, 1971, p. 95). “It does not require society to try to even up handicaps as if all were expected to compete on a fair basis in the same race. But the difference principle would allocate resources in education, say, so as to improve the long-term expectation of the least favored. If this end is attained by giving more attention to the better endowed, it is permissible; otherwise not ... the difference principle represents, in effect, an agreement to regard the distribution of natural talents as a common asset and to share in the benefits of this distribution whatever it turns out to be. Those who have been favored by nature, whoever they are, may gain from their good fortune only on terms that improve the situation of those who have lost out. The naturally advantaged are not to gain merely because they are more gifted, but only to cover the costs of training and education and for using their endowments in ways that help the less fortunate as well” (pp. 101-102).

refers, the “veil of ignorance” covers only the results of the natural and social lottery, not the general mechanisms that determine the functioning of the economic system ⁽⁸⁾. We will return to this point in the last part of this report; in this initial part the assimilation of the labour law mechanism to the Rawlsian paradigm – however imprecise and censurable it can be from the point of view of the [correct reading of the](#) American philosopher ~~’s correct reading~~ – is useful in order to single out and underline a fundamental *ratio* of the continental European labour law, in its peculiar configuration that has prevailed through the second half of the XXth century.

3. Equality vs. parity of treatment. The commensuration principle and the question of the incentive for individual effort. The possible paradoxical effects of antidiscrimination rules.

In fact, the principle of equalization that can be seen to be implied in the above described labour law mechanism is only one of the fundamental principles to which the labour law has intended to give application in the last half century. Quite another and quite different is the parity of treatment principle, which has been assimilated by the international law, by the European Community and by all the modern national legal systems, and that is comprehended in the expression “equal treatment for work of comparable worth”. While the equalization principle pursues the equality among persons as such, independently of their productivity, the parity of treatment principle pursues, on the contrary, the precise commensuration of treatment to ~~the~~ performance: in the Italian Constitution this principle is laid down by Sect. 36, in the part in which it precisely foresees the proportioning of worker’s wages to the quantity and the quality of his/her work.

In other words, the principle of equal treatment for work of comparable worth generates *inequalities*: an effect that conflicts with the one pursued by the traditional labour law mechanism. This inequality is not consistent with the Rawlsian “difference principle”, as it is pursued even if no beneficial effects derive from it for the disadvantaged.

The issue becomes more complicated if we consider that these inequalities, in large part, are certainly caused by each worker’s original endowment, but for the remaining part are caused by his/her personal effort. The boundary line between the two parts is often not

⁽⁸⁾ “I shall suppose that the parties possess all general informations” (op. cit., p. 142). The “ignorance” of which RAWLS speaks is an ignorance enlightened by the knowledge supplied by the social sciences.

easily determinable; and it is even less easily provable in a court of law. The principle of commensuration, therefore, through the inequalities that it produces, exerts also an effective function of stimulating individual effort which is in some measure irreplaceable.

The issue is further complicated when antidiscrimination rules are implied. Those rules often don't specify if they must be interpreted and applied as an expression of the parity of treatment (in the sense of commensuration) principle, as the labour economists would suggest, or of the equalization principle, which implies that members of two groups must be equally treated even when their performances are unequal; and the latter is more often the interpretation that jurists prefer of antidiscrimination rules, especially when it comes to applying the prohibition of indirect discrimination. When this is the juridical content that is attributed to the antidiscrimination rule, it happens that empirical economic research finds out the evidence of a negative impact of its application for those who should benefit from the protection; economists' explanation is that this rule causes the employer to bear equal costs for performances of different value ⁽⁹⁾. Hence a conflict between the equalization and the commensuration principles in the field of the juridical struggle against discriminations.

The fact is that all the national labour law systems adopt both principles – equalization and commensuration -, though contrasting with each other, and postulate a balance between them. Each law system combines them in a different way, favouring in different measures one or the other, according to choices that often have a pendular trend; but the trade-off between them is always there and easily observable. It is easy to see in the same trade-off the sense of the debate between the left and right wing tendency of labour law scholars: the left wing tendency – be it inspired by ideals arousing from a marxist matrix, or from a [Catholic](#) one, or from a different one – has traditionally lined up in defence of mechanisms producing an *a priori* equality, therefore limiting the competition between workers on the level of productivity and the individual incentive to effort; the right wing tendency has traditionally lined up in defence of the commensuration of treatment to the quantity and quality of the performance, as well as of the management prerogatives in this field.

⁽⁹⁾ See, in the American literature, D. ACEMOGLU, J. ANGRIST, 1998, in reference to the effects of the prohibition of discriminations against disabled persons set by the *American with Disabilities Act* of 1991; and P. OYER, S. SHAEFER, 2002, in reference to the effects of the prohibition of gender or race discriminations set by the *Civil Rights Act* of 1991.

Now let's see how effectively the worker's protection mechanism functions, inspired to these two fundamental principles. We'll consider one of its most important devices: the limitation of the employer's dismissal power.

4. A crucial test for the equalization principle: is it fair to dismiss an inefficient worker?

A decision of the Italian Court of Cassation was recently published, about dismissal for economic reasons, which lends itself as a starting point for a discussion about the role effectively played by the equalization principle in the labour law and in particular for a *law and economics* approach to the notion of "good economic reasons for dismissal", which plays a crucial role in the work protection system ⁽¹⁰⁾. The case can be summarized as follows: the chambermaids of a large hotel are normally able to tidy up 30 rooms each, every day; one of them, through no fault of her own, for some time has been (and still is today ~~is~~) able to tidy up only 15 rooms; for this reason she is dismissed. Can the dismissal be considered fair, in the light of the principle of justification of dismissals established by all the European national laws (and now by the new E. U. Constitution as well)?

In order to facilitate the reasoning, it can be useful to utilize the elementary formalization of the problem proposed in figure 1, by means of algebraic symbols. We will then call

θ_i the number of rooms daily tidied up by the *inefficient* chambermaid whose dismissal is discussed,

θ_n the number of rooms *normally* tidied up every day by the chambermaids of the hotel, *i.e.* their normal output;

θ_g the number of daily tidied up rooms below which, according to the court, the chambermaid can be dismissed.

Once we can exclude the dismissal for unlawful causes (discrimination, retaliation, or caprice), which in most countries is specifically forbidden by ~~at~~the law ⁽¹¹⁾, and the

⁽¹⁰⁾ Italian Court of Cassation March 5th, 2003. n. 3250, which can be read in *Rivista italiana di diritto del lavoro*, 2003, II, p. 689. See the principle stated by this decision in the footnote 13.

⁽¹¹⁾ In Italy the dismissal for such causes is null and void by virtue of sect. 4 of the Statute n. 604/1966 about individual dismissals.

dismissal for misconduct – if the employer fires an employee, he *always* does so because he judges that the balance of the relationship continuation would be at a loss. This happens when the manpower need in the firm actually decreases and/or keeping on duty the worker causes the employer an *opportunity-cost*, because it is easy to replace her with a more efficient one. This is the case from which we started: when

$$\theta_i < \theta_n$$

the employer *always* suffers a loss, consisting in an opportunity cost. Keeping on the payroll the chambermaid whose performance went down below the normal output always generates an opportunity cost equal to $\theta_n - \theta_i$. Is this *per se* sufficient for dismissing the inefficient chambermaid? Of course not, because, if *whatever* loss, even one of the most trivial amount, ~~was-were~~ sufficient for the justification of the dismissal, this would remove all juridical meaning from the rule that limits the employer's dismissal power. We must therefore admit that the dismissal cannot be justified by an expected loss of *whatever* amount ⁽¹²⁾. In this line of reasoning, what justifies the dismissal is that the opportunity cost exceeds a threshold T (the amount of the expected loss that the employer is not obliged to bear):

$$\theta_n - \theta_i > T$$

Where exactly the threshold T is placed, we still don't know; but we know that the loss of only one room tidied daily, and probably also the loss of two or three rooms, couldn't be sufficient for justifying the chambermaid's dismissal. We can therefore, at least, affirm that the threshold is higher than zero:

$$T > 0$$

This means that the principle of commensuration (§ 3) can't be the sole criterion for the decision.

But we can also observe that no court would consider unfair the dismissal of our chambermaid if the number of rooms she is able to tidy up every day were close to zero. In

⁽¹²⁾ A more extended argumentation in support of this thesis is developed in my *Lezioni di diritto del lavoro. Un approccio di labour law and economics*, Milano, Giuffr , 2004. There (chapt. X) I criticise the recurrent court decisions in the field of economic justification for dismissals, stressing their lack of logical foundation, and I propose a new interpretation of the juridical notion of good economic reason for dismissal, founded on the economic notion of expected loss (inclusive of opportunity costs) consequent ~~to-upon~~ the continuation of the individual work relationship. The legal or contractual rule of justification for dismissal makes sense only if it is interpreted as forcing the employer to bear - without dismissing the worker - the expected loss, within a reasonable limit. The limit of the expected loss that must be borne by the employer coincides with the insurance content of the work relationship: the bearable expected loss is the mishap, the accident to which the "insurance policy" typically contained in the work contract refers. The determination of such a limit can be ~~committed-entrusted~~ to the courts; but it can also be ~~also~~-indirectly fixed by imposing on the employer a severance payment, or a firing cost of a different nature. The firing cost is an implicit automatic filter of the economic justification for dismissal.

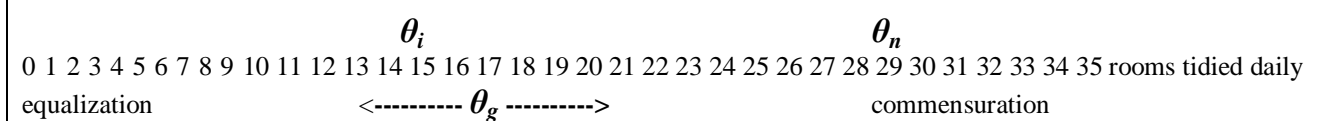
other words, the courts always accept as a good reason for dismissal a *total* or nearly total loss of productivity:

$$0 < T < \theta_n$$

This means that the equalization principle too can't be the sole criterion for the decision.

If we search for a rule that precisely allows us to determine T , we can find it neither in theoretical treatises, nor in case-law books. In case-law books we find several different theoretical maxims, each one closer to the commensuration principle, or to the freedom of enterprise principle (¹³), or to the equalization principle (¹⁴), but rarely do we find a maxim that indicates the logical itinerary really followed by the court in its decision. In fact, if we look at the substance of each judicial decision, without focusing only on the theoretical part of its grounds, it is easy to observe that the court never applies one only of those principles, but always tries to find an equilibrium without obliterating any of them (¹⁵). Each court perceives, more or less consciously, that none of those constitutional principles involved can assume an absolute value; and that none of them, in any case, can be totally ignored. In other words, the threshold T of expected loss that can constitute a good economic reason for dismissal, foreseen by the "law in action" (in the sense of the law as it is effectively interpreted and applied by the courts), is the result of a balance between those two fundamental principles.

Figure 1



(¹³) In particular, we can single out three maxims - corresponding to a theoretical orientation that totally obliterates the equalization principle - according to which:

- a) the dismissal is always justified when *the company as a whole* is working at a loss, is not producing profits;
- b) the dismissal is always justified when *the single work relationship* is at a loss, and that's all that matters;
- c) the dismissal is *always* justified when there is a drop in a worker's performance: θ_n is the due performance, below which it is always possible to recognise a breach of contract, even if it is not through the worker's fault.

(¹⁴) In particular, we can single out two maxims - corresponding to a theoretical orientation that gives absolute predominance to the equalization principle over commensuration - according to which

- d) output reductions without worker's fault *never* justify dismissal, because this risk is borne by the employer (this is the principle that has been enunciated by the Italian Court of Cassation in the decision n. 3250/2003 cited in the footnote 9;

- e) the dismissal is *always* justified if the employer eliminates the job, inside the organization; *never* justified if he replaces the worker with another.

(¹⁵) This is particularly evident, for example, in the decision of Bundesarbeitsgericht June 3^d, 2004 (in *Neue Zeitschrift für Arbeitsrecht*, 2004, p. 1380), where the court stated that a drop in performance can justify the worker's dismissal only if it is foreseeable that it will cause "a heavy dysfunction in the contractual equilibria for a long time".

high insurance content of the contract
maxims d and e in footnote 13

low insurance content of the contract
maxims b and c in footnote 12

θ_n = normal output

θ_i = inefficient chambermaid's output

$\theta_n - \theta_g$ = opportunity cost that, according to the court, can justify dismissal

Where that threshold T of expected loss (that in figure 1 consists in the opportunity cost represented by the difference $\theta_n - \theta_g$) is set, in the present Italian law system as well as in most European national law systems, it depends on the weight that, in the view of the court, must be attributed to the equalization principle, ~~with respect~~compared to the other two principles. The higher the threshold T (hence $\theta_n - \theta_g$) is, the higher ~~is~~ the level is at which the workers' equalization is guaranteed; and correspondingly:

- the higher ~~is~~ the insurance content is of the work relationship;
- the more serious ~~is~~ the sacrifice is of the commensuration principle;
- the more serious ~~is~~ the sacrifice is of the entrepreneur's freedom in the choice and management of human resources inside the firm.

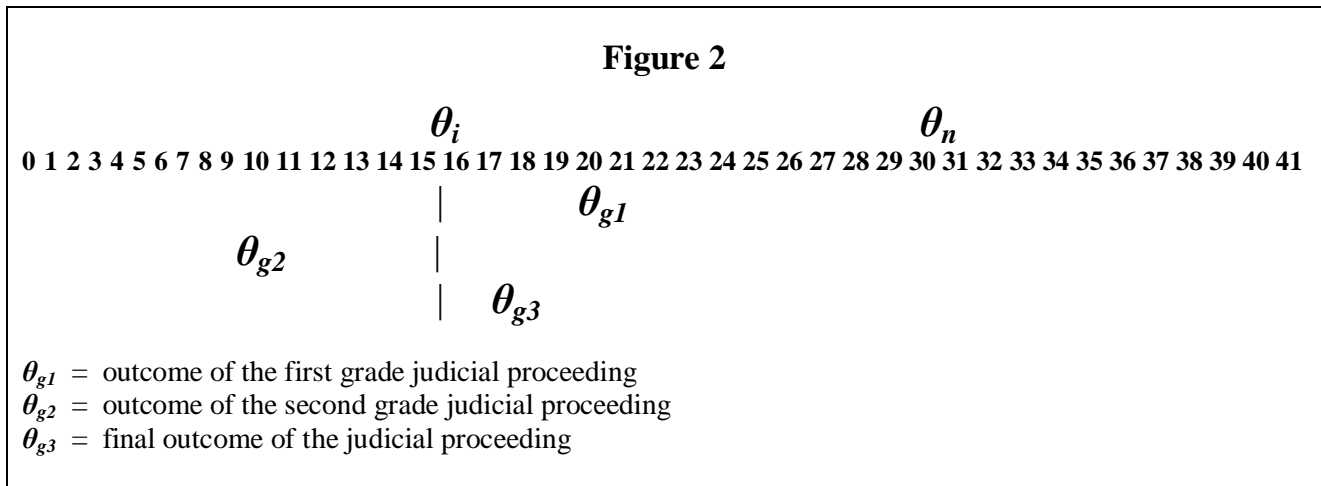
In the case of the chambermaid that we have assumed as a test-bed for our reasoning, in conclusion, the existence of a minimum number of rooms that must be tidied up by the worker, if she wants to avoid ~~the~~ the contract termination, cannot be denied. We can therefore affirm that the prohibition of replacing the chambermaid by a more efficient one cannot be an *absolute* prohibition: the legitimacy of the substitution depends on the productivity difference between the two workers ($\theta_n - \theta_i$), *i.e.* on the opportunity cost that can be foreseen as incurred by the hotel keeper as a consequence of the continuation of the work relationship. And it depends on the court's opinion about where θ_g is placed on the scale; which means on the way in which in the specific case the court balances the equalization principle with the commensuration principle.

Hence also a new juridical notion of good economic reason for dismissal, founded on the economic notion of expected loss consequent upon the continuation of the individual work relationship (expected loss, of course, inclusive of opportunity costs)¹⁶. The legal or contractual rule of justification for dismissal makes sense only if it is interpreted as forcing the employer to bear – without dismissing the worker – the expected loss within a reasonable limit.

⁽¹⁶⁾ *****footnote on the notion of opportunity cost*****

5. A mechanism that actually makes the most rigid courts' orientation prevail

Now, let's imagine a plausible judicial proceeding promoted by the dismissed worker, according to what commonly happens in the Italian system (but something similar, as far as I know, happens also in the German system). Let's suppose, for example, that in the decision that concludes the first phase of the proceeding the threshold T is set by the court as equal to one third of the worker's productive capacity, so that terminating the work relationship can be justified by the reduction of output to 20 rooms tidied up daily (θ_{g1}): in our case the dismissal is therefore justified. The second phase ends up with a different decision, according to which T is equal to two thirds of the worker's productive capacity, so that dismissal can be justified only by the reduction of output to 10 rooms tidied up daily (θ_{g2}); the chambermaid is then paid all the lost salaries and is reinstated in her workplace. The work relationship restarts, with the corresponding loss for the hotel keeper, increased by the fact that in the meanwhile another (normally efficient) chambermaid has been hired in order to replace the inefficient one, so that the performance of this one is now totally superfluous. Let's suppose, further, that – as a result of the Cassation proceeding and of a new trial - the second decision be reversed and in the final one the drop in performance of our chambermaid be again considered sufficient for the justification of contract termination (θ_{g3}).



According to a jurisprudence orientation that has prevailed in Italy for the last two decades – and that only in the last few years has begun to be disregarded – salaries and welfare contributions that have been paid by the employer during the period between the

provisional worker's reinstatement and the final opposite decision cannot be recovered, even if during all that period the chambermaid has been left totally inactive.

Things, obviously, go worse for the employer if it is the decision θ_{g2} that comes as the final one: in this case, he will derive no benefit from having had the favourable decision θ_{g1} halfway through the proceeding, because in the end, in addition to the reinstatement of the chambermaid in her work-place, he will have to pay her all the lost salaries from the day of dismissal and to pay the corresponding welfare contributions and the sanctions for the delay in the payment.

In other words: the effect of the provisional reinstatement sanction, in the litigation about dismissal, is that the employer suffers a substantial loss also if he/she finds the severest court only once, halfway through the proceeding, winning the case at the end of it. This has the result that he/she actually makes his/her choices, in this field, taking into account not the medium courts' orientation, but that of the most severe ones (in our case θ_{g2}), *i.e.* of those that attribute the highest weight to the equalization principle, in comparison with the commensuration one and with the employer's freedom in the choice of employees.

6. Job protection as an inequality factor

Precisely in reference ~~with-to~~ the equalization principle, however, the old egalitarian labour law mechanism, which hinged – as we have seen – on the notion of good economic reason for dismissal, shows some immediately ~~evident-obvious~~ defects:

- firstly, ~~that-the~~ mechanism operates in different ways from one zone to another, due to the discretionary power left to the courts in the determination of the threshold T , *i.e.* of the limit of the expected loss that can justify the dismissal (in the case of our chambermaid: the maximum amount of the opportunity cost that can be imposed on the employer, identified by θ_g);

- secondly, even when the decision is taken by the most egalitarian court, as we have seen, it can always happen that the threshold θ_g may be exceeded (because the prohibition to ~~substitute-replace~~ the inefficient worker cannot be absolute) so that the ~~inculpable-blameless~~ worker may be therefore dismissed; and according to many national laws, in particular to

the Italian one, this happens without any indemnification ⁽¹⁷⁾. Coming back to the case of the chambermaid: for one more or one less completed room, the worker can save everything or lose everything. From the standpoint of the “*ex ante* preference for equality”, by which that mechanism should fundamentally be inspired, here clearly is something that doesn’t work properly: the most unfortunate chambermaid, the one who loses most badly in the lottery of life, is just the one who is abandoned to her own devices. The cost accruing to her from the loss of the job is by no way internalized in the company ~~balance~~finances.

Again from the point of view of the equalization principle, the old labour law mechanism shows some other failures, which are less immediately evident, but in fact not less serious than those above singled out:

- economists’ opinions differ about the effects of job protection on the unemployment rate, but all of them agree on the point that the steadier ~~is the~~ employment is, the more difficult it is for the unemployed, the irregular or the temporary worker to ~~come out of~~leave his/her position; in other words, job protection risks generating the phenomenon of a dual labour market, divided into compartments with insufficient communication, if any, between each other;

- furthermore, the less efficient worker who, notwithstanding the job protection offered by the law system, loses his/her job, finds him/herself in the labour market negotiating ~~in the labour market~~ a performance of which at this point it is easy to know the defective quality (θ_i): thus negotiating a performance that places itself in the lower part of the category; in this case the minimum mandatory standard, which has been established with reference to the category average productivity (θ_n), turns against the worker, exposing him/her to the risk of long-term unemployment; ~~in~~ other words, the old equalization mechanism turns into a trap, into an exclusion mechanism;

- a last remark, with reference to the above described general ~~informative~~information asymmetry about the quality of offered work performances (§§ 1 and 2): in a market mainly characterized by such asymmetry, if workers (who know that they are) more efficient are allowed to place themselves outside ~~of~~ the area within which the protection is applied, they tend to do so, because they have a strong incentive to escape the egalitarian mechanism.÷

⁽¹⁷⁾ In Germany a recent statute – the s.c. Hartz Act of December 2003 -, which came into force at the beginning of the last year, foresees and favours an indemnification for every case of dismissal based on economic reasons; but it doesn’t oblige the employer to offer this treatment to the dismissed worker. Better, from this point of view, is the situation in France, where a firing cost is always borne by the employer in the case of dismissal for economic cause, be it in the form of the *convention de conversion* or of a severance payment negotiated with the worker.

This phenomenon can show itself in the form of a worker's transfer from the subordination area to the self-employment area (¹⁸), or in the form of workers' transfer from the country with a higher job protection rigidity rate to the one with a lower j.p.r. rate (this is what happens, to some extent, in the university labour market between continental Europe and U.S.); when this happens, the egalitarian mechanism reduces itself to a solidarity mechanism inside the poorest workers' segment, while the inequalities between this segment and the professionally stronger one tend to increase (¹⁹).

The conclusion is that in a market in which the legalaw system is not able to offer an absolute guarantee against the risk of unemployment or irregular employment, and to prevent the flight of the strongest workers from the protected area, the old job protection pattern can produce effects that match-correspond very badly to with the egalitarian ideal. How wide this phenomenon can prove, it is not in the scope-purpose of this report to investigate; but it is, yet-however, quite important to recognize that the phenomenon exists and that it can show-assume not negligible dimensions.

7. The crisis of egalitarian labour law

The fact is that in the most developed countries in the last fifteen years we have witnessed a general tendency to the more or less marked weakening of the egalitarian labour law institutions. As far as the Italian legal system is concerned, this tendency has characterized the labour law evolution for a quarter of a century, though without involving the dismissal discipline, that, on the contrary, during the same period has been, if anything, strengthened:

- from the first half of the '80s the rule of quotas in placing procedures (*s.c. collocamento su richiesta numerica*) began to be gradually abolished, until the total abrogation in 1991;
- since the end of the '70s the limitative discipline of fixed-term contracts has begun to be gradually made more flexible; in 2001 a reform of the matter with strong liberalising intentions was promulgated;
- since 1997 the temporary work supply by specialized agencies has been allowed; since 2003 this has been allowed in all the cases in which the fixed-term contract is allowed; in

(¹⁸) A strong correlation between the employment protection rigidity rate and the self-employment rate is in fact observed: see OECD, 1999, chap. 2.

(¹⁹) This is the phenomenon that has been described by G.A. AKERLOF, 1970.

fact the temporary work through an agency is widely utilized as a substitute for the trial period;

- since the beginning of the '80s the Italian law has foreseen a fixed-term contract – be it called apprenticeship, work and training contract, or ~~with-by~~ other ~~expressions-names~~ – as the normal form of access of young people to the labour market;

- since 1997 the Italian law has recognized fixed-term internships without remuneration as a normal form of access of undergraduate or graduate students to the labour market.

At the end of the phase of worker's quality examination through temporary contracts, only the worker who turns out to be more efficient succeeds in entering the citadel of stable jobs; the weaker one risks to remain confined in the swamp of precarious jobs. It is easy to foresee that, as a result of the above trend of liberalization of temporary work, if the dismissal discipline remains rigid, the dual character of the labour market will be accentuated. This means that we will witness an increase of inequality between workers. And this is what is visibly happening in the Italian labour market.

8. A mechanism actually hostile to the less fortunates

Under the “veil of ignorance” about his/her own personal endowments and effective position in the market, but not about the general mechanisms of the market functioning ⁽²⁰⁾, what protection system can be preferred by the western XXIst century worker, who fears to lose in the lottery of life and wants to reduce his/her risk to the minimum, in a productive system that is continuously moving and is exposed to ~~the most various~~ upheavals of every kind?

He/she could perhaps prefer a system which offers the weakest workers a guarantee of absolute permanence of the job, even at the cost of a very high “insurance premium”, provided that the most successful ones are not allowed to escape mutual insurance and that for the least successful ones the risk of unemployment and of irregular work is made negligible. The problem is that nowadays we are not able to build a system with these characteristics, but without the other less desirable effective characteristics of the collectivistic systems that have been experienced during the XXth century in eastern Europe. And it must be observed that these other characteristics – among which a drastic compression of the possibilities of economic development and of consequent improvement

⁽²⁰⁾ See § 2 and there the footnote 8.

of conditions and expectations of disadvantaged people – make this system quite different from the Rawlsian ideal: in the pattern inspired by that ideal an important role is played by the incentives to effort, in particular by that of the most productive persons, when the wealth that is produced by them can be utilized for the improvement of the most disadvantaged people's conditions and opportunities ⁽²¹⁾.

What doesn't appear questionable is that our Rawlsian worker cannot prefer a system of the kind today in force in Italy and in most other south-European countries, which offers, doubtless, to the majority of stable workers in the sector of the medium-sized and large enterprises a sort of insurance policy with a very high maximum coverage, but is not able to effectively prevent a large unemployment and irregular work area, from which it is difficult to ~~get out~~escape (because the steadier regular work is, the steadier the unemployed worker's and ~~the~~ irregular worker's positions is-are, too): this is today in Italy the position of almost one quarter of the labour force, not to speak of the millions of potential workers – women, young or elderly people – who don't even ~~show~~present themselves in the labour market because they have given up hope of finding a really effective work opportunity (the Italian employment rate, for these categories, is markedly below the European average). Neither can our Rawlsian worker prefer a system that, notwithstanding the above insurance mechanism, in ~~anyway~~ case exposes the weakest worker to the risk of losing the protected job without any indemnification and of visibly placing him/herself, at this point, in the lower half of his/her category, so falling into the trap of ~~the~~ long-term unemployment (see § 7). A system in which, what's more, the probability of this occurrence is higher or lower depending on the personal orientation of the local court.

9. How an egalitarian “Rawlsian” option can take concrete form in the western XXIst century market system

From the point of view of the Rawlsian paradigm, it must be admitted that

- the most unfortunate person is actually in a better position if it is the law, rather than the local court, which establishes and differentiates the maximum coverage given to the worker by the insurance policy implicit in the work contract, according to general criteria: in other words he/she is in a better position if – without prejudice to ~~the~~ judicial control over the disciplinary or discriminatory dismissal ~~–and–against–the–discriminatory–control–one–~~ the

⁽²¹⁾ About the “difference principle” see § 2 and there footnote 7.

filter of dismissals for economic reasons consists in an adequate compensation (firing cost for the employer) due *in any case* and not in a judicial evaluation of the dismissal ground, to which the loss of the job, without any worker's fault, can follow without any compensation;

- the most unfortunate person is in a better position if the mandatory insurance mechanism offered by the law has a rigorously universal character, bringing together weak and strong workers in a unitary mutual insurance system, without the possibility for the stronger ones of avoiding it and without the exclusion of the weakest ones: under the veil of ignorance about his/her own personal endowments and effective position in the market, he/she can therefore be interested ~~to in~~ forgoing a part of the insurance coverage, if this is necessary in order to enlarge the group of insured people upwards, but also downwards, in particular (but not only) by means of a strict discipline of temporary work.

- the best effective guarantee of welfare for the worker who turns out to be the loser in the natural or social lottery is obviously given, in any way case, by a system of education, professional training, information and assistance in the labour market, capable of reducing as much as possible, or even eliminating, his/her deficit of initial endowment or handicap, either pre-existing or acquired.

In the global economic context in which we ~~are placed~~ find ourselves today, a good ~~perspective-prospect~~ for the losers could be guaranteed by a system that, first of all, offers a universal security net consisting of an organisation of educational services, training services oriented to ~~the~~ effective occupational opportunities, information and guidance services, assistance to ~~the~~ geographic mobility and intensive placing assistance for those who suffer from a social or physical handicap, as well as income support during unemployment periods. The weaker the position is of the person affected, the more active and intensive the assistance must be; which means an organisation able to act in order to neutralize his/her natural competitiveness deficit, even at the cost of a huge drawing from the gross national product, for the necessary funding of such services. As for the individual work relationship, the legal system should offer everybody who receives most of his/her income from one employer, whatever the juridical type of the relationship, a contract with a smaller insurance content ~~in comparison with~~ than the one which is today offered by the South European job protection systems, but in a really universal mutual insurance system, capable of being applied at the same time to the stronger section of workers, which today is able to avoid it,

as well as to the weaker section of them, which today is often cut out of it. Such a system would be able to guarantee to the totality of workers in a position of substantial dependence on the employer an alternation of relatively long spells of work in a condition of reasonable protection, and relatively short unemployment spells, with intense assistance, preceded by a non—traumatic separation from the employer: that is, a separation accompanied by an adequate compensation, paid in every case and proportioned to the seniority, for the damage ~~intrinsically intrinsic~~ inherent in the loss of the job, partly convertible into a notice period, the length of which, within a certain limit, could be left to the choice of the worker. In such a protection system the employer's decision to terminate the work relationship for economic reasons would be automatically filtered by the firing cost, consisting in the above indemnity and in the cost of an unemployment benefit system funded by an employers' contribution which increases with the number of workers dismissed by the company, without involving lawyers and courts ⁽²²⁾.

In the case from which we began, if such a job protection system were in force, the lower ~~was~~ the chambermaid's seniority had been, the lower would have been the severance payment and the higher would have been the expected loss deriving from the continuation of the work relationship. Hence, a higher probability of losing the job for the chambermaid who became inefficient at the beginning of her work-life, a lower one in the opposite case. But in every case, if the employer decides that the expected loss exceeds the firing cost, the chambermaid would automatically be paid – without the necessity of involving lawyers and judges – an adequate severance payment (something that in the Italian system and in ~~the~~ many other European continental systems doesn't happen today as an automatic consequence of dismissal for economic reasons), and would be left the choice between collecting the indemnification immediately or converting it in current ~~retribution~~ remuneration, with the corresponding delay of the work relationship termination, the cost being equal for the employer; she would have the possibility of being enrolled by a

⁽²²⁾ The most interesting reference, ~~about to~~ this approach to our problem, is the recent proposal for a reform of job protection formulated by O. BLANCHARD and J. TIROLE, 2003, in reference to the French legal system, which essentially consists in burdening the company with: *i*) the compensation of the worker for the job loss by an adequate severance payment; *ii*) the indemnification of the worker for the damage of remaining unemployed, by means of an insurance mechanism, funded by insurance premiums paid by the employers, varying with the number of dismissals. It must be stressed that the proposed job protection system is not *per se* less protective than other systems – even the most rigid ones – today in force for regular workers in continental Europe: the protection level – *i.e.* the amount of insurance coverage implicit in the work contract – essentially depends on the firing cost (which corresponds to the threshold under which the expected loss deriving from the relationship continuation falls within the risk that must be borne by the company). The higher ~~is~~ the firing cost imposed on the company, the higher ~~is~~ the job protection level.

manpower services system capable of retraining her in conformity with a new job, in which her disability would be of less importance or of none (switchboard operator, receptionist, doorkeeper, etc.), without a significant income loss during the transition period; it would be much easier for her to find a new job compatible with her disability, in a more fluid labour market.

This is the pattern which has been experienced with success (even if with high costs for the tax-payers: up to 3% of gross national product in periods of recession) in the last half century in the Northern European Countries, and particularly in the Scandinavian ones: the Countries where the least fortunate are better off, in comparison with any other Country in the world; and where labour law is more effective. Furthermore, this is probably today the sole way we can follow in order to build a job protection system capable of reconciling the fundamental principles of equalization and commensuration. Provided that such an option is on the agenda.

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