ITALY: FROM ECONOMIC DECLINE TO THE CURRENT CRISIS. A COMPARISON WITH FRANCE AND GERMANY

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OBJECTIVE AND MOTIVATION OF THE PAPER: THE ITALIAN DECLINE

GDP per capita in PPS: EU27=100

EU (27 countries)  Italy
HYPOTHESES

- the current global economic crisis, in which also Italy fell in 2008, represents just the last step of a long declining path for the Italian economy which began in the nineties.

- reasons explaining decline, and also deeper recession: past reforms of the labour market and institutional change.

1. labour flexibility + other policies: \( \rightarrow \) inequality, low consumption, low aggregate demand, decline of wage share, declining labour productivity and stagnant GDP dynamics.

2. lower productivity dynamics, since Italian firms implemented mainly labour intensive investments, trying to get advantages from cheaper (and flexible) labour and to reduce costs, without innovative investments.
<table>
<thead>
<tr>
<th>Country</th>
<th>GDP– in $</th>
<th>GDP 1950=100</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>1950</td>
<td>1989</td>
</tr>
<tr>
<td>Czechoslovakia</td>
<td>3501</td>
<td>8768</td>
</tr>
<tr>
<td>USSR</td>
<td>2841</td>
<td>7098</td>
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<tr>
<td>Poland</td>
<td>2447</td>
<td>5684</td>
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<tr>
<td>Hungary</td>
<td>2480</td>
<td>6903</td>
</tr>
<tr>
<td><strong>Average</strong></td>
<td>2819</td>
<td>7013</td>
</tr>
<tr>
<td>Socialist</td>
<td><strong>countries (4)</strong></td>
<td><strong>2819</strong></td>
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<tr>
<td>Austria</td>
<td>3706</td>
<td>16369</td>
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<tr>
<td>Belgium</td>
<td>5462</td>
<td>16744</td>
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<td>Denmark</td>
<td>6943</td>
<td>18261</td>
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<td>Finland</td>
<td>4253</td>
<td>16946</td>
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<tr>
<td>France</td>
<td>5271</td>
<td>17730</td>
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<tr>
<td>Ireland</td>
<td>3453</td>
<td>10880</td>
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<tr>
<td><strong>Italy</strong></td>
<td><strong>3502</strong></td>
<td><strong>15969</strong></td>
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<tr>
<td>Netherland</td>
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<td>16695</td>
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<tr>
<td>Sweden</td>
<td>6739</td>
<td>17593</td>
</tr>
<tr>
<td>United</td>
<td>6939</td>
<td>16414</td>
</tr>
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</table>
PERIODIZATION OF POLITICAL ECONOMY IN ITALY SINCE THE 1990S

- After 1992 recession (and “Mani Pulite”): de-regulation process, less involvement of the State in the economy. Partial and inefficient liberalization coupled with privatization → creation of private monopolies (CNEL, 2007).

- Inflation was considered a major problem: July 1993, Tripartite agreement for wage moderation. The “pact of exchange” was never actually respected, and investments in innovation did not fully take place (Tronti, 2005). Profits increased. Income distribution worsened.

- Privatization process (1990s): caused a further squeeze of the economy and the reduction of the industrial sector, where large State owned companies were very active Gallino (2003).

- Maastricht (1993) → reduction of public expenditure to cut public debt → reducing indirect wage. Conflicting objectives between Maastricht and the July agreement. (Fitoussi, 2005)

LABOUR MARKET REFORMS

- The labour market reforms in the 1990s, with an uncompleted and unfair liberalization and privatization process, favoured both the increase of rents and the worsening of income distribution.
- In fact privatization was introduced without a full liberalization of the goods market.
- Therefore, in the sectors where former public assets operated (such as: telecommunication, energy, infrastructures, public utilities, railways etc) mark-up and rents increased and private monopoly firms were created. Those reforms, caused
  1. a strong pressure on wages and labour,
  2. lower productivity performance
FROM WHASINGTON CONSENSUS TO INSTITUTIONAL CHANGE: A NEW ECONOMIC MODEL

- The 90s policies, tried to introduce a very market-oriented economic model, following the (Washington Consensus and Maastricht) → negative consequences on economic performances and social problems such as:

1. high income inequality, job precariousness, declining wage share over GDP, low wage and low consumption levels and a strong profit soar;
2. Plus: lower human capital, lower education and training on the job place, low competitiveness and low labour productivity, low innovation and low R&D (Sylos Labini approach).
FROM POLICIES TO DECLINE

- the July Agreement of 1993 in the end contributed to the stagnation of wage at national level. After that, labour flexibility, increased consistently, temporary work, unstable jobs and all the atypical forms of job surged.

- Hence, I claim, on the basis of the deteriorating income distribution, and more in general on the basis of the Italian economic decline, that there is a negative effect of the institutional change introduced mainly by law.
THE MODEL: FROM LABOUR FLEXIBILITY TO ECONOMIC DECLINE

↑LF → ↑IJ → ↓W → ↑Ineq → ↓WS
(+↓IW) → ↓C → ↓AD → ↓GDP
LABOUR FLEXIBILITY (1)

Protection for regular employment - EPL component
LABOUR FLEXIBILITY (2)

Temporary work, in % of total employment
Italian stagnant wages

Annual wages, in 2011 US$ at PPP constant prices

- France
- Germany
- Italy
- OECD old members
The declining of wage shares in the economy

Wage share, in %, on total income

- France
- Germany
- Italy

Labour and Capital in Italy 1990-2005

Income distribution, wages and profits in Italy (% on tot. income)

- Dependent work remuneration
- Capital remuneration
Public Expenditure, % of GDP

<table>
<thead>
<tr>
<th></th>
<th>1990</th>
<th>2001</th>
<th>2009</th>
</tr>
</thead>
<tbody>
<tr>
<td>France</td>
<td>50</td>
<td>53</td>
<td>56</td>
</tr>
<tr>
<td>Germany</td>
<td>48</td>
<td>50</td>
<td>52</td>
</tr>
<tr>
<td>Italy</td>
<td>51</td>
<td>54</td>
<td>57</td>
</tr>
<tr>
<td>EU15</td>
<td>50</td>
<td>53</td>
<td>56</td>
</tr>
</tbody>
</table>
Indirect wage, social expenditure

Social Expenditure as % of GDP and % of Gov expenditure, 2009

- France
- Germany
- Italy
- EU15

% of GDP
% of Gov exp.
Labour Policies and unemployment subsidies

Active and passive policies, % of GDP, 2008

- Denmark
- Belgium
- Netherlands
- Finland
- Germany
- Sweden
- France
- Spain
- Austria
- Ireland
- Italy
- Canada
- Australia
- New Zealand
- Japan
- United Kingdom
- S. Korea
- USA
- EU15

active passive
The decline in the consumption level

Consumption Share of GDP Per Capita (2005 prices)

- France
- Germany
- Italy
The decline in the investment level

Investment Share of GDP Per Capita (2005 prices, in %)

France

Germany

Italy
The Italian decline
AD (C+I+G)↓ → GDP ↓ (*)

GDP per capita in PPS: EU27=100
\[ PI (g+n-u) = a+b1EPL-b2TW-b3Ineq+e \]

### OLS Model

**Dep Var. : PI (2007-12)**

<table>
<thead>
<tr>
<th>Variable</th>
<th>Coefficient (standard errors)</th>
<th>P-values</th>
</tr>
</thead>
<tbody>
<tr>
<td>EPL_2008</td>
<td>8.147022 (1.95968)</td>
<td>* 1%</td>
</tr>
<tr>
<td>Temporary work 2008</td>
<td>-.1638903 (.1295744)</td>
<td>** 5%</td>
</tr>
<tr>
<td>Inequality 2008</td>
<td>-.696365 (.2433367)</td>
<td>*** 10%</td>
</tr>
<tr>
<td>Constant</td>
<td>-4.865248 (9.95968)</td>
<td></td>
</tr>
</tbody>
</table>

**R-squared = 0.6413**

**Adj R-squared = 0.5945**

**Prob > F = 0.0000**

**Number of obs = 27**
GLS Model.

Random effects: Hausman Test (RE vs FE):

Dep Var. : Performance Index (PI)

<table>
<thead>
<tr>
<th>Variable</th>
<th>Coeff. (stand errors)</th>
<th>P-values</th>
</tr>
</thead>
<tbody>
<tr>
<td>EPL</td>
<td>1.615307 (.7324882)</td>
<td>*</td>
</tr>
<tr>
<td>Temporary work</td>
<td>-.1578564 (.0694321)</td>
<td>**</td>
</tr>
<tr>
<td>Inequality</td>
<td>-.2716993 (.107862)</td>
<td>*</td>
</tr>
<tr>
<td>Constant</td>
<td>4.225772 (3.638554)</td>
<td></td>
</tr>
<tr>
<td>Year 2006</td>
<td>-.5277289 (.9971861)</td>
<td></td>
</tr>
<tr>
<td>Year 2008</td>
<td>-3.037997 (.9973313)</td>
<td>*</td>
</tr>
<tr>
<td>Year 2009</td>
<td>-10.86284 (.9978834)</td>
<td>*</td>
</tr>
<tr>
<td>Year 2010</td>
<td>-4.382909 (.9970402)</td>
<td>*</td>
</tr>
<tr>
<td>Year 2011</td>
<td>-6.065116 (.9974051)</td>
<td>*</td>
</tr>
</tbody>
</table>

Year 2007 dropped because of collinearity

R-sq: within = 0.5610; between= 0.2293; overall = 0.4880

Wald chi2(8) =170.93; Prob > chi2=0.0000

Number of obs = 162. Number of groups = 27
From lack of competition to productivity decline following the Sylos Labini approach

- Besides: the other problem in Italy is the strong rigidity, and a lack of competition and protection in the goods market.
- This seems to be the main cause of low productivity dynamics:
  - firms prefer a labour intensive investment strategy rather than a strategy of technological innovation and investments expansions, because of
    1. relatively cheaper real wages (guaranteed by the downward pressure of labour flexibility),
    2. protections firms enjoy in the goods market, scarcely competitive (inefficient liberalization).
The decline in investment changes

Gross fixed capital formation, annual growth in %

- Italy
- France
- Germany

<table>
<thead>
<tr>
<th>Year</th>
<th>Italy</th>
<th>France</th>
<th>Germany</th>
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<tr>
<td>2000</td>
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<td>2005</td>
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<tr>
<td>2008</td>
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<td>-2</td>
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<tr>
<td>2009</td>
<td>10</td>
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<tr>
<td>2010</td>
<td>3</td>
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</tr>
<tr>
<td>2011</td>
<td>0</td>
<td>3</td>
<td>6</td>
</tr>
<tr>
<td>Avg 2000-10</td>
<td>2</td>
<td>4</td>
<td>5</td>
</tr>
</tbody>
</table>
The industrial decline

Real Value Added in Industry, % annual growth

- Italy
- France
- Germany

Cumulative 2000-10
The gap in R&D

R&D expenditure as % of GDP

Italy
Germany
France
UE28
USA
Labour Productivity

Labour Productivity Growth 1990-2010

<table>
<thead>
<tr>
<th>Country</th>
<th>Average 1990-2000</th>
<th>Average 2001-10</th>
<th>Average 1990-2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>France</td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Germany</td>
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<tr>
<td>Italy</td>
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<td></td>
<td></td>
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<tr>
<td>United States</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Eu15 / Euro area</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>OECD Total</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Labour Productivity Decline

- following the Sylos Labini approach:

\[ \Delta \pi = a + b\Delta Y + c(CLUP - P) + d(W - P_{MA}) + e\Delta I \]

- if we come back to the equation (*) above, we can add to it another component, the productivity, and we will observe easily that following the Sylos Labini approach, the contraction of the aggregate demand not only reduce the GDP but does not allow for productivity gains with further negative effects on the GDP, as follows:

\[ \text{AD (C+I+G)↓ } \Rightarrow \text{GDP ↓ } \Rightarrow \text{productivity ↓ } \Rightarrow \text{GDP} \]
Why Italy is not growing

Because our economy is like a coffee bar’s economy....
ITALY’S LACK OF GROWTH

- Italy’s lack of growth over the past 20 years
- Put simply, Italian firms have a problem with productivity and competitiveness.
- Example: TODAY: picture the Italian economy as a café, one of those places selling cappuccinos, espressos, sandwiches and freshly squeezed orange juice....
- this café is more representative of Italy’s economy than firms like Fiat or Zanussi in the past. NO LONGER!
The making and drinking of delicious coffee took a leap forward in the period after the second world war when Italy rebuilt itself. Through the 1950s and 1960s Italy grew like a developing country rather than a rich-world one. Among countries now considered developed, only Japan and South Korea performed better. Growth just shy of 10% a year became the norm.
Great innovation before...like Gaggia, Olivetti

One reason for this growth was the application of new technologies to the workplace both in café as in the factories of Milan and Turin.

Before the war coffee had often been ruined by machines burning it on the way and producing a dark, bitter liquid.

In the late 1940s a company founded by Achille Gaggia produced an espresso-maker ...that you find everywhere today

There were many thousands of such innovations, and they made Italy success and boom. Think about Olivetti, IBM, technology applied to food industry, textile, shoes, etc..

No longer!
VERY GOOD COFFEE...BUT JUST COFFEE

- THE MADE IN ITALY story cannot support and lead productivity growth today as it did in the past
- Breathing shoes, fiat 500, fashion accezzories...
Good things only if they are accompanied by other leading industries like in the past...
TWO NEGATIVE FORCES AGAINST GDP GROWTH

Therefore, the pressure on wages and the labour flexibility ended up to be detrimental twice for the GDP growth:

1) via the reduction of the aggregate demand
2) via the negative effect on the productivity growth.
1997-2007: JOBS WITHOUT GROWTH

This picture is a good example of what happened in Italy since 1993 (Tronti, 2005; Sylos Labini 2003; Tridico, 2009; Lucidi, 2006), in which beside a modest employment growth and strong wage moderation, there was a negative trend and stagnant productivity. In fact, by definition we have:

\[ \text{GDP } = Y = L \Pi \]  
\( L = \text{labour employment and } \Pi = \text{average productivity} \)  
\[ \Delta y = \Delta l + \Delta \pi \]
Employment levels: back to previous lower levels

Employment rates, %, 1992-2012

- EU27
- Germany
- France
- Italy

Legend:
- EU27
- Germany
- France
- Italy
The return of mass unemployment
**Before the crisis**

- Until 2007-08, there was an increase of employment in the tertiary sector, fragmented and disorganized, poorly motivated and low paid. The result was the lower productivity of the Italian economy.

- In the end, the only factor partially positive is the modest increase of employment which was negatively offset by the negative labour productivity and by the reduction of the wage share in the GDP.

- This brought about the reduction of the purchasing power of workers and the lack of a positive dynamic in the aggregate demand and therefore in the GDP.
Most new jobs in Italy, were low paid jobs, with real wages lower than those needed to maintain purchasing power adequate to price levels. Semi-employment contributed to the increase of employment.

Since capital intensive investments were lacking, industrial production was stagnant or declining, advanced technological sector was almost inexistent and therefore the Italian economy lost competitiveness in comparison with the EU partners.
Labour market Decline before crisis

- Low wages, accompanied by insecurity, poor incentives and awards for employees, decreased the efforts and thus the efficiency of workers on the job places. The lower real wages, did not lead to an increase in the productivity of the system. It led, on the contrary, to an increase in profits, which often are not converted into new investments, but on the contrary, increased dominant positions of some rent-seeking firms, and increased portfolio movements of speculators and investors.

- This allowed for accumulation of extra profits by firms, and worsened income distribution.
During the crisis

- The current crisis has only worsened the situation of the labour market and it is the final outcome of an economic decline that originated much earlier at least fifteen years ago, as we originally claimed.
- The lack of sustained economic growth and the current economic crisis resulted in lower levels of employment which contributed to the increase in the unemployment.
- The first jobs lost: flexible & temporary (unemployment back to 12% and layoffs (“cassa integrazione”): 1 billion working hours lost at the end of 2012),
- Further decline in income, with consumption levels down to those of 30 years ago.
TRIPLE PLAGUE

In conclusion, the country seems plagued today by a triple negative combination:

1. low productivity,
2. low employment,
3. low dynamics of the GDP.
GDP performance during the crisis

% Gdp growth during the crisis, and cumulative 2007-13

EU27  Germany  France  Italy

Cumulative 2007-13
Italy Great depression

Cumulative GDP growth 2007-13, %

EU27: 2.9
Germany: 8.1
France: 3.1
Italy: -5.6
The current crisis: a final step of a longer decline (since 1992-93)

Following Washington Consensus and Maastricht criteria → institutional changes, policies and institutions (labour market reforms coupled with a partial privatization process, and an uncompleted and inefficient liberalization process):

1. Instable jobs, income inequality, lower consumption, industrial decline, lower wage share and weaker aggregate demand.
2. Lower productivity dynamics, since Italian firms implemented mainly labour intensive investments, trying to get advantages from cheaper (and flexible) labour and to reduce costs, without innovative investments.

These two forces → economic decline, with a loss for the Italian GDP of more than 20% (respect to EU).

Moreover, they cause today deeper recession and slower recovery in the current crisis.