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**Research Report**

## Understanding Italy's stagnation

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## Understanding Italy's Stagnation

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### Executive Summary

Italy's economic stagnation is a matter of fiscal, national, and European concern. Since a good remedy requires an accurate diagnosis, this paper summarises, compares, and evaluates the main explanations for this stagnation. After describing Italy's recent economic record, the paper reviews three families of explanations: "unwillingness to reform" accounts, monetary integration accounts, and accounts that prioritise the firm-level perspective.

Concluding that, taken by themselves, none of these explanations provide a fully convincing account, a synthesis of their most promising elements follows. In this synthesis, the paper argues that Italy's recent stagnation can be traced back to two key moments: first, a failed attempt during the 1990s and early 2000s to overcome the growth slowdown of the 1970s and 1980s. Guided by the ideas of their time and the desire to meet the Maastricht convergence criteria, policy-makers chose a mix of market-liberalising reforms and demand suppression. Though well-intentioned, this mix proved counterproductive, lowering investment- and human capital growth and deepening the growth slowdown it was meant to remedy.

The second key moment was the retention of this policy mix in the late 2000s and early 2010s. In the wake of 2008, once investors realised that the ECB would not be a conventional lender of last resort, spreads on Italian government bonds increased, and although the macro-financial architecture of the Eurozone was reformed, these reforms militated towards a doubling-down on Italy's pre-crisis policy mix. Subject to these pressures, policy-makers retained the broad strokes of the earlier policy mix, even after its ineffectiveness had become apparent.

While this paper does not develop proposals for a new reform mix, its diagnosis implies that any credible reform package must tackle the deep roots of Italy's stagnation without repeating the investment-suppressing mistakes of the last 30 years. In light of this, positive conditionality – i.e. conditions that unlock additional resources, as with NextGenEU – with a focus on companies, institutions and investment, may be a promising way forward.

#ITALY

#PRODUCTIVITY

#DEBT SUSTAINABILITY

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## Outline

<b>1. Introduction .....</b>	<b>3</b>
<b>2. Taking stock .....</b>	<b>5</b>
<b>3. The slowdown in growth: descriptive analysis .....</b>	<b>10</b>
<b>4. Reviewing existing explanations .....</b>	<b>16</b>
4.1 “Unwillingness to reform” .....	16
4.2 Italy’s integration into the Euro.....	24
4.3 The firm-level perspective .....	29
<b>5. An attempt at synthesis .....</b>	<b>40</b>
<b>6. Conclusion .....</b>	<b>44</b>
<b>Bibliography.....</b>	<b>46</b>

## 1. Introduction

In the 1980s, Italy's per-hour productivity was among the highest in the world. Today, Italy remains Europe's second-ranking manufacturing nation. In recent decades, however, it has seen economic stagnation, high unemployment, low investment, and waning confidence.

Overcoming this stagnation is a matter of importance not just for Italy itself, but for the future of Europe as a whole.<sup>3</sup> On the country's current growth path, the sustainability of its public finances depends on low long-term interest rates and low spreads. The former may not always be economically appropriate; the latter may become politically contentious.

A successful remedy requires an accurate diagnosis. Summarising, comparing, and evaluating existing explanations of Italy's economic stagnation is this paper's main goal.

The paper starts by providing a description of Italy's recent economic record relative to its European peers. The decline in both nominal and real GDP growth since 2000 (Section 2), driven by a decline in productivity growth and, to a lesser extent, the growth in hours worked (Section 3), emerges as the main phenomenon in need of explanation.

Next, the paper reviews three families of explanations, concluding that, taken by themselves, none of them provide a fully convincing account. These are: "unwillingness to reform" accounts, monetary integration accounts, and accounts that prioritise the firm-level perspective (Section 4).

In the next section (Section 5), the paper presents a synthesis of the most promising explanatory elements. This synthesis argues that Italy's stagnation can be traced back to two key moments: first, a failed attempt from the early 1990s to the mid-2000s to overcome the growth slowdown of the 1970s and 1980s. That slowdown had deep, structural roots and the expansive fiscal policy of the mid-1980s did not prove an effective remedy. In light of this, and shaped by the ideas of its time as well as the desire to meet the Maastricht convergence criteria, the reform mix chosen was a combination of market-liberalising reforms – primarily concerning the labour market, industrial policy, the financial sector, and state-ownership – and intense demand suppression through fiscal tightening. This mix proved counterproductive, however, lowering investment- and human capital growth. Whatever growth was achieved in the early 2000s was largely extensive, driven by additional labour input, not intensive, i.e. propelled by productivity gains.

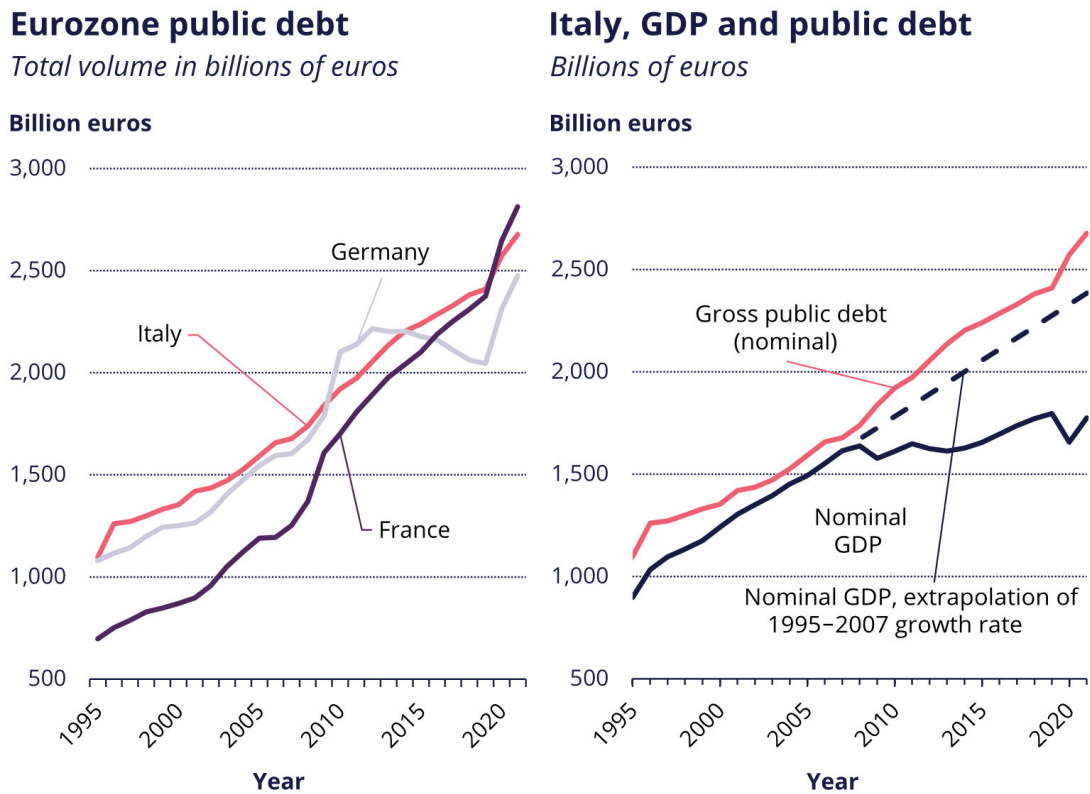
The second key moment was the retention of this counterproductive policy mix in the late 2000s and early 2010s. In the wake of the 2008 financial crisis, once investors realised that the ECB would not function as a conventional lender of last resort to Eurozone governments, interest rates on Italian government bonds increased, putting policy-makers under pressure. Although the much-debated macro-financial architecture of the Eurozone was reformed because of the crisis, these reforms militated towards a doubling-down on Italy's pre-crisis policy mix. Subject to these pressures, policy-makers retained the broad strokes of the earlier policy mix, even after its ineffectiveness had become apparent.

<sup>3</sup> Indeed, some analysts have already concluded that the "economic models of Germany, France and Italy differ to such an extent that it is impossible to pursue a sustainable convergence path" and called for a "focus on how to stabilise the single currency under conditions of limited convergence" (Tokarski 2019, p. 6).

While this paper does not develop proposals for a new reform mix, its diagnosis implies that any credible reform package must tackle the deep roots of Italy's stagnation without repeating the investment-suppressing mistakes of the last 30 years. In light of this, positive conditionality – i.e. conditions that unlock additional resources, as with NextGenEU – with a focus on companies, institutions, and investment, may be a promising approach.

## 2. Taking stock

In a European and particularly in a German context, the main economic challenge associated with Italy is high public debt. For most, though not all of the last 20 or so years, Italy had the largest stock of public debt among all Eurozone countries (Figure 1, left panel). This stock of debt has become a challenge given the development of Italian GDP over the last 20 years (Figure 1, right panel).



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**Figure 1:** Eurozone public debt & Italy, GDP and public debt; Source: Eurostat, Government consolidated gross debt (left panel) and AMECO (right panel)

What explains this elevated debt level? From the late 1980s on, i.e. after the expansive budgets of the mid-1980s, Italian fiscal policy can be divided into three phases (Figure 2, left panel): a long decade of consolidation (1985–1997), when the fiscal stance was tightened by approximately 10% of GDP; then a gradual loosening from 1998 to 2005, which brought the primary surplus close to, but above, zero; followed by the settling into a structural primary surplus of around 2% of GDP, with primary deficits occurring only in the crisis years of 2009 and 2020–1. During the Great Financial Crisis, Italy followed a “Northern path” (Merler in Chang et al. 2019, p. 186), opting for a comparatively small stimulus and quickly returning to a positive primary balance.

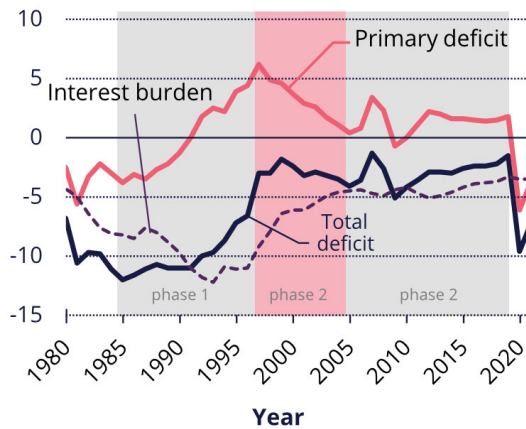
Desynchronised from these three phases, the interest burden of Italy’s outstanding debt has varied significantly in recent years. Driven by high interest rates and a rapidly rising debt stock, this cost peaked at over 12% of GDP in 1993. This explains why the turnaround in the primary stance (from a deficit of 3.8% in 1985 to a surplus of 2.5% in 1993) was only reflected in the total deficit with a significant lag: from a deficit of 12% in 1985, this had barely moved by 1993, with the total deficit remaining at 10%. Since coming down from its 1993 peak, with and because of the introduction of the Euro, Italy’s interest cost has remained below 5% of GDP, despite recent increases in its debt level.

As a result of this fiscal profile, increases in the debt-to-GDP ratio have clustered around the economic crises of 2008–9, 2012–13 and 2020–1 (Figure 2, right panel). Outside these years, the debt-to-GDP ratio has remained stable or declined gently. However, given fast increases during crises and slower declines thereafter, Italian debt stood at 151% of GDP in 2021, significantly above the Eurozone average of 97%.

## Italian general government deficits

% of GDP

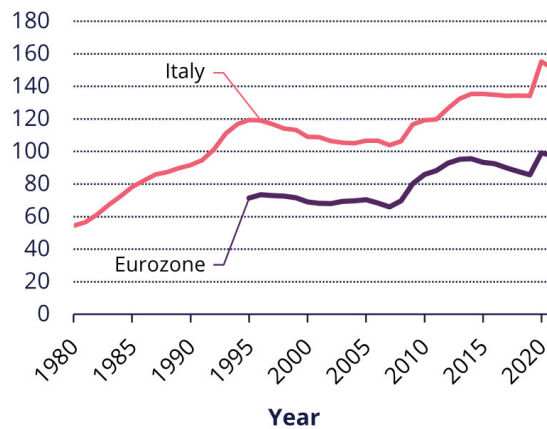
Percent



## Gross public debt

% of GDP

Percent



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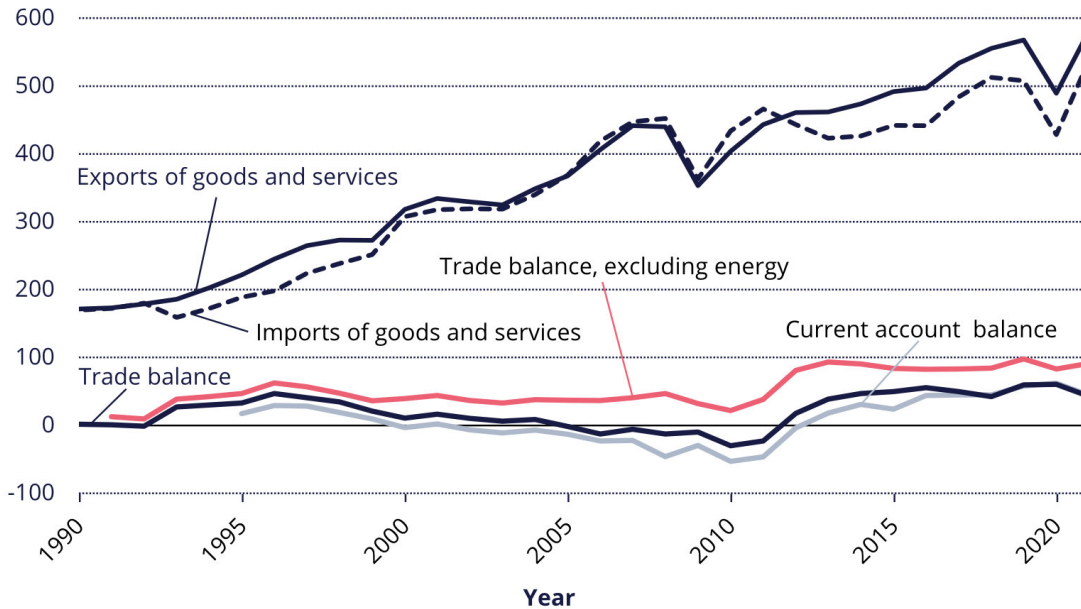
Figure 2: Italian general government deficits & Gross public debt; Source: Banca d'Italia and AMECO

Considering the economy as a whole, Italy has been living within its means during the last 30 years, as reflected by its generally balanced current account (Figure 3). Both the intense budget consolidation of the 1990s and the early return towards primary surpluses after the Great Financial Crisis are visible in the trade data: imports markedly declined both times. The impact of energy on Italy's international economic position is equally visible: from 2000 to 2011, it was largely the high costs of energy imports that pushed an otherwise stable trade balance into deficit. Since then, due to an increase in exports and a decrease in imports, the trade balance as well as the current account returned to a structural surplus of around 3% of GDP. However, as in the period 2000–2011, this surplus may now be threatened again by high energy prices.

## Exports, imports, and the trade and current account balance

Billions of euro in current prices

Billion euros



**Note:** The discrepancy between the trade balance and the current account balance is largely explained by remittance flows, Italy's EU contributions, and international dividend flows, interest flows and capital return flows.

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**Figure 3:** Exports, imports, and the trade and current account balance; **Source:** AMECO and Coeweb (Istat's foreign trade database)

Counterfactual modelling suggests that the main driver of Italy's elevated debt level is a lack of growth: had Italy's nominal GDP grown in line with Germany's since 2008, Italy's debt-to-GDP ratio would be 34 percentage points lower, at 117% instead of 151% (Figure 4, left panel). Elevated interest rates, too, have left their mark: had Italy paid German interest rates<sup>4</sup> on its debts after 2008, its debt in 2021 would have been 18 percentage points lower (Figure 4, left panel). With both German growth and interest rates, it would have been 52 percentage points lower.<sup>5</sup>

<sup>4</sup> A counterfactual in which Italy pays German interest rates could be construed as a scenario in which financial markets never altered their beliefs about all Eurozone sovereign debt being fundamentally safe, as largely the case (visible in the near-absence of spreads) pre-2008, or a scenario in which a change in Eurozone macro-financial policy eliminated spreads after they appeared, for example by declaring that, in the context of the Transmission Protection Instrument and reformed EU fiscal rules, the ECB sees no fundamental justification for significant spreads between those Eurozone countries that are in compliance with the rules.

<sup>5</sup> To calculate these counterfactual figures, we altered only the specific variable of interest and the variables directly dependent on it: in the first case, nominal GDP growth and hence the denominator of the debt-to-GDP ratio; in the second case, the contribution of interest payments to the national debt, and hence the numerator of the debt-to-GDP ratio. This is a conservative approach: it excludes, for example, the likely effect of higher growth leading to a bigger primary surplus and, potentially, lower borrowing costs (in the first counterfactual), and the likely effect from lower interest rates to higher investment and hence higher growth (in the second counterfactual).

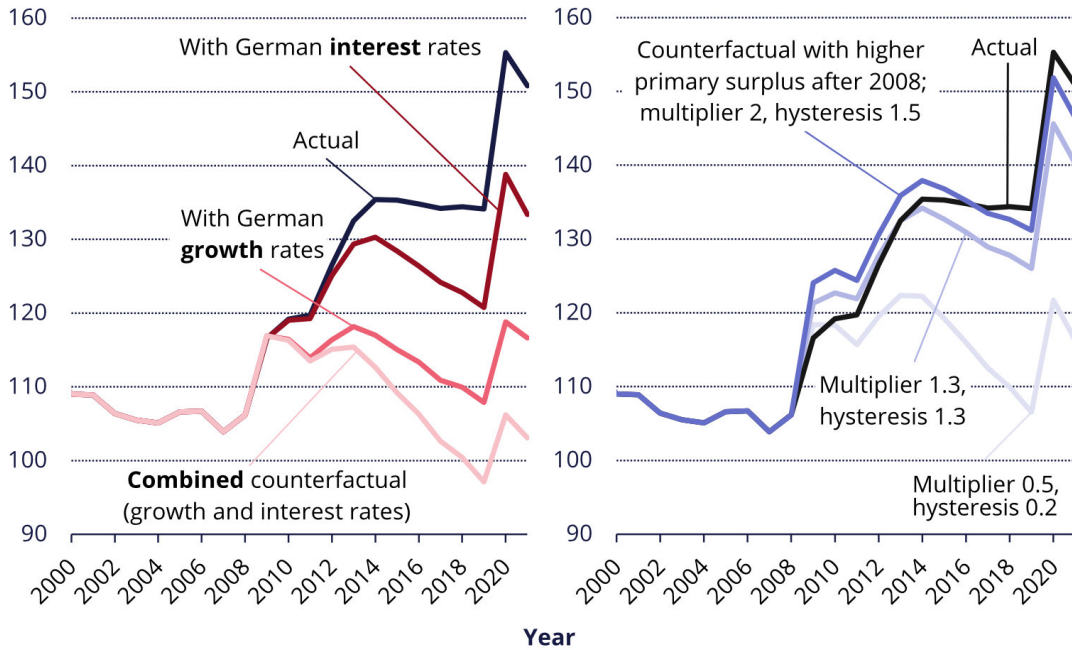


Improvements to the primary balance have significant but smaller effects on the debt level:<sup>6</sup> we model a fiscal consolidation of (ex-ante) 3% of GDP.<sup>7</sup>

## Italy's public debt under counterfactual scenarios from 2008 on

In % of GDP

Percent



**Note:** Left panel: growth and interest rate counterfactual. Right panel: primary deficit with fiscal multiplier and hysteresis effects.

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**Figure 4:** Italy's public debt under counterfactual scenarios from 2008 on; **Sources:** author's calculations, based on AMECO data

<sup>6</sup> Here, too, our approach is conservative: we have excluded any effect that a higher primary balance might have on the yields of Italian public debt, modelling only the direct impact of the primary balance on the stock of debt (and through this, on annual interest payments) as well as fiscal multiplier and hysteresis effects (see footnote 8 below).

<sup>7</sup> Italy's SGP deficit in 2009 was 5.1% of GDP, so an improvement in the fiscal balance of 2.1% of GDP would have been deemed necessary for compliance with the 3% Maastricht limit on deficits. Using a multiplier of 0.5 (as commonly used at the time) and a tax take of 46% of GDP, a consolidation of around 2.7% of GDP (ex-ante) would have been calculated as necessary for this 2.1% improvement in the fiscal balance ex-post. With a margin of safety, we have modelled a consolidation of 3% of GDP, implying an expected improvement in the fiscal balance of 2.3%.

Depending on the growth impacts of this change to the primary balance, i.e. the fiscal multiplier and the extent of hysteresis,<sup>8</sup> this tightening of the primary balance would have reduced the debt-to-GDP ratio by around four to 11 percentage points by 2021 (Figure 4, right panel), or, given optimistic assumptions, by up to 35 percentage points.<sup>9</sup> The wide range of the potential debt impact illustrates how context- and growth-dependent a process of primary balance-led debt consolidation is.

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<sup>8</sup> We define the fiscal multiplier as the impact of a 1% of GDP (ex-ante) change in the fiscal balance on GDP in the next year. A value of 1 would imply that a 1% of GDP tightening (loosening) of the fiscal stance leads to a 1% loss (gain) of GDP the next year. Reasonable values in the literature range from 0.5 to above 2, with high values particularly likely when monetary policy is at the Effective Lower Bound (Gechert 2020). Our hysteresis parameter is defined as the permanent impact of the same consolidation. A value of 0.2 would imply that a 1% of GDP tightening (loosening) of the fiscal stance leads to a 0.2% permanent negative (positive) level effect on GDP. We transition from the fiscal multiplier impact to the hysteresis impact linearly over three years. Concerning the magnitude of long run hysteresis effects, values in the literature range from 0.1 (for the US), 0.2 (for Italy), or 0.3 (for the Eurozone) from Rawdanowicz et al. (2014, table 1, p. 9), to 1.4 (for Europe) or 1.5 (for the Eurozone) from Fatás and Summers (2018, table 8, p. 246). The three scenarios we model correspond to the most optimistic relevant assumptions for both parameters (a 0.5 multiplier and a 0.2 hysteresis parameter), to mid-range levels of 1.3 and 1.3 (drawing on Gechert et al. 2018, p. 11 and 18) and to high levels of 2 and 1.5. Note that the optimistic scenario is not consistent with most empirical studies of the period under investigation.

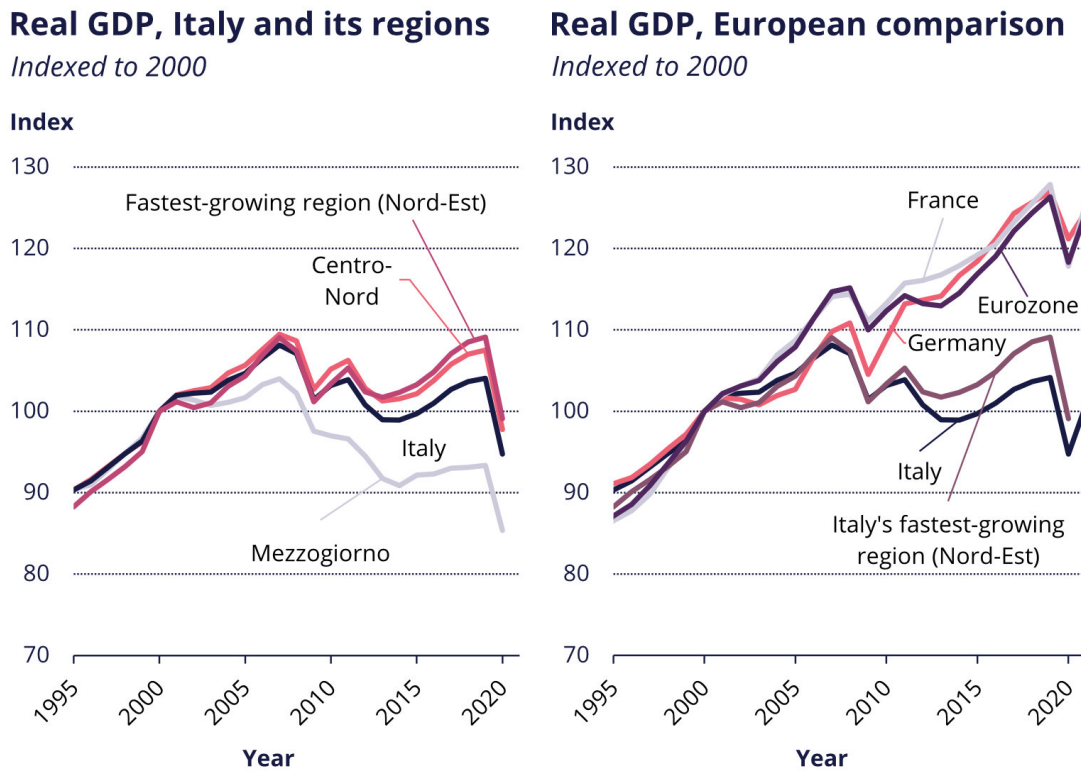
<sup>9</sup> Note also that our projections differ significantly from a recent set of IMF projections (Arnold et al. 2022, p. 6), largely because the IMF ignores hysteresis effects (Arnold et al. 2022, p. 24, Annex 1, footnote 4). Given that the most recent survey paper on the question observes “a wide agreement that shocks are indeed very persistent” (ibid, p. 13; see also Nelson and Plosser 1982, Ball 2014, Blanchard et al. 2015, Fatás and Summers 2018, or Aikman et al. 2022) and that Fatás and Summers (2018, p. 245) argue that by now “persistence of fiscal policy shocks should not be a surprise to the academic literature”, we have chosen to include hysteresis effects in our modelling.

### 3. The slowdown in growth: descriptive analysis

Given that Italy's growth record is at the heart of its fiscal challenges, a more detailed analysis of the country's recent growth is called for.

Starting with a geographic perspective, some argue that while Southern Italy has deep, structural problems, the North Italian economy is developing in line with the Eurozone's core. In this analysis, the central challenge would be to bring Italy's southern regions up to speed with its northern ones.

Figure 5 shows, however, that while GDP in the Mezzogiorno region has indeed fallen further below the national average (left panel), declining by over 10% since 2000, low growth is a national feature: even Italy's fastest-growing region, the Northeast, grew by only 9% between 2000 and 2019, i.e. much more slowly than Germany, France, and the Eurozone average during the same period (right panel).<sup>10</sup>



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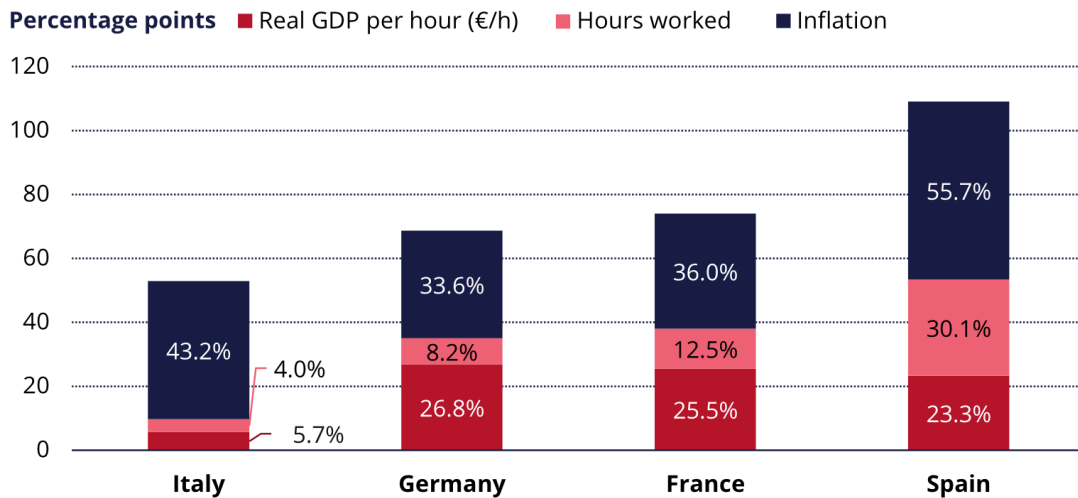
**Figure 5:** Real GDP, Italy and its regions & Real GDP, European comparison; **Sources:** AMECO and Istat

<sup>10</sup> This is consistent with Calligaris et al. (2016), who find that capital misallocation has increased significantly in one of the core areas of Italian industry, large firms in the Northwest, as well as with IMF (2022b) analysis showing that all regions have seen a decline in gross value added per worker since 2000, with the largest decline, around 10 percentage points, in the Central region, the smallest, around 2pp, in the Northwest, and the Mezzogiorno in between with a 6pp decline (p. 3). For evidence to the contrary, see Bugamelli et al. (2018, figure 9), who find that for the top 10% of firms in Italian manufacturing, productivity has been steadily increasing between 2005 and 2014, and Haltiwanger et al. (2018), who challenge the methodological basis of Calligaris et al. (2016).

Zooming in further, Italy's nominal growth can be decomposed into three factors: real productivity per hour, total hours worked, and inflation. Their respective contribution is shown in Figure 6.<sup>11</sup> A first visual inspection shows that Italy lagged Germany and France, its closest European peers, in both the growth of hours worked and productivity growth.<sup>12</sup> It also lagged behind Spain, again in both productivity growth and especially hours worked.

## Decomposition of nominal GDP growth, 1999–2019

Contributions to nGDP growth, in percentage points



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Figure 6: Decomposition of nominal GDP growth, 1990-2019; Sources: AMECO and Istat

Considering the three factors in turn, Italian inflation has been unremarkable since the introduction of the Euro. Italy averaged an annual rate of 1.7% between 1999 and 2019, below Spain's 1.9%, well in line with the ECB's inflation target, and halfway between the Eurozone average of 1.6% and the EU average of 1.8%. Although higher than the 1.3–1.4% annual average for France and Germany in the same period, as is visible in the higher contribution it made to Italy's nominal GDP growth, it was neither exceptionally low, so that it could explain the decline in nominal growth, nor above the inflation target or exceptionally high, so as to be responsible for undermining Italy's competitiveness.

With respect to total hours worked, a structural break is visible around 2008. From 1999 (42.2 million hours per year) to 2008 (45.8 million), they increased by 8.5%. From 2008 to 2019 (43.6 million), however, they fell by 4.8%.<sup>13</sup> This decline was partly driven by demographic change, with the total population aged 15–64 decreasing by 0.7%, but mostly by a decline in hours worked per

<sup>11</sup> Note that, due to interaction effects between the three, the contributions to total nominal growth do not equal their individual growth rates over the same period.

<sup>12</sup> Throughout this paper, productivity is defined as real GDP per hour worked, unless explicitly indicated otherwise. As Bugamelli et al. (2018, p. 15) show, "in the case of Italy ... the assessment on productivity does not change much with the measure used". Given this, as well as the challenges associated with accurately measuring the capital stock (see e.g. Bobbio et al. 2014, Mistretta and Zollino 2018 or Mattevi and Modugno 2022) and with interpreting the precise meaning of TFP, I prefer real GDP per hour worked over TFP as the main measure of productivity.

<sup>13</sup> Taking 2019 as the cut-off point in order to exclude COVID's impact on hours worked.

person of this age range, which decreased by 4.1%. This decline in hours worked across the entire working-age population, in turn, was driven by a decline in hours worked per person employed, which fell by 5.3%, from 1807 hours to 1710 hours worked per person per year. It was not driven by a decline in the number of people employed, which decreased only marginally from 25.0 million people in 2008 to 24.9 million people in 2019.

Two things are notable about this decline in hours worked per person employed. First, it is a decline from a high level: the annual number of hours worked per employed person in 2019 stood at 1382 in Germany and at 1518 in France. Both are considerably below Italy's 1710 (and below Spain's 1686). Second, the decline results from a composition effect: as Hoffmann et al. (2021, figure A.9) show, both for full-time and for part-time jobs, average hours worked per week remained constant. The decline in average hours worked per person employed was driven by an increase in part-time and intermittent employment and the mirroring decrease in full-time, year-round employment, not by a reduction in the weekly hours of either typical full-time or part-time employment.

Further, even though an increasing participation rate overcame demographic headwinds so that Italy's labour force grew from 26.7 million people in 2008 to 27.5 million in 2019, rising unemployment prevented this from translating into more hours worked. With the number of unemployed increasing from 1.7 million people in 2008 to 2.5 million in 2019, practically the entire growth in the labour force was absorbed into higher unemployment, rather than additional hours worked.<sup>14</sup>

Despite the 2008–2019 increase in the participation rate, Italy's employment rate (the ratio of people working to the total working-age population) of around 60% is still among the lowest among G7 countries. Among the 38 OECD countries, it ranks 6th from the bottom, above Colombia, Greece, Costa Rica, Turkey, and South Africa, and nearly 10 percentage points below the OECD's average of 69.4%.<sup>15</sup>

A significant part of this is due to the generational gap in Italy's labour market: in 2019, 23.5% of young people between 15 and 29 were neither in employment, education nor training (NEET), more than 10 percentage points above the OECD average of 12.9%. This gap worsened during COVID: by 2021, the proportion of NEET young people had grown to 26%, with the gap to the OECD average widening to 11.5 percentage points.<sup>16</sup>

Another major contributor is the poor integration of Italian women into the labour force:<sup>17</sup> the employment rate among Italian working-age women was 50% in 2019, compared to an OECD average of 61%, 58% in Spain, 64% in France, and 72% in Germany.<sup>18</sup>

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<sup>14</sup> Employment and unemployment data from AMECO, discrepancies due to rounding.

<sup>15</sup> Data from the OECD (2023a), Employment rate (indicator). doi: 10.1787/1de68a9b-en.

<sup>16</sup> Data from the OECD (2023b), Youth not in employment, education or training (NEET) (indicator). doi: 10.1787/72d1033a-en.

<sup>17</sup> For an excellent economic history of female labour force participation in Italy since 1861, see Mancini (2018).

<sup>18</sup> Data from the OECD (2023a), Employment rate (indicator). doi: 10.1787/1de68a9b-en.

As with overall growth, there is a combination of large regional inequality and a lag even between Italy's North and the rest of Europe regarding female labour force participation: in the Mezzogiorno, the female 15–64 participation rate stood at 42% in 2019, more than 20 percentage points below the North's 65%. However, even the North was four percentage points below the Eurozone average, nine below Germany and 15 below Sweden in 2019.<sup>19</sup>

Nevertheless, while Italy's low female labour force participation represents a significant pool of untapped potential,<sup>20</sup> it explains neither the absolute nor the relative decline in growth since 2000. Until COVID, the gap in the female labour force participation rate between Italy and other European countries was slowly reducing, narrowing (against the EU average) by around one percentage point between 2009 and 2019.<sup>21</sup> And while the female labour force temporarily had stopped growing from 2002 to 2007, it resumed its growth thereafter, with no discernible decline in trend growth.<sup>22</sup>

Italy's main challenge lies in the third factor under investigation: productivity. Whereas in Germany, France, and Spain, real GDP per hour increased by 22%, 21% and 17% respectively between 1999 and 2019, the increase in Italy stood at only 5% (Figure 7, left panel).<sup>23</sup> At their average 1999–2019 growth rates, German and French productivity would double approximately every 70 years, Spain's every 90 years, but Italy's only roughly every 300 years.<sup>24</sup> Factoring out the growth in the capital stock, total factor productivity has in fact *fallen* by 13.5% between 2000 and 2019 (IMF 2022a, p. 30; though see footnote 12 above for a note of caution on TFP). And while productivity growth has been noticeably stronger in manufacturing than in the (private) service sector, over the last 20 years Italy has lagged its European peers in both (Figure 7, right panel).

Moreover, unlike with total hours worked, there was no trend break around 2008. Productivity growth was low both before and after the financial crisis, proceeding at an average annual rate of 0.3% from 1999 to 2008 and 0.2% from 2008 to 2021. This stands in stark contrast to the decade before the introduction of the Euro: from 1989 to 1999, annual productivity growth was 1.4%.<sup>25</sup>

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<sup>19</sup> Data from IStat and Eurostat.

<sup>20</sup> The Spanish case shows how quickly this potential can be tapped: between 1999 and 2008, Spain increased its female labour force participation rate from 50% to 63.6%, an increase of 1.5 percentage points per year (Eurostat Data, LFPR aged 15–64). For an analysis of how Spain achieved this and the corresponding lessons for Italy, see Campanella and Federico (2021, p. 6), though the authors caution: “While the Spanish experience is a reminder to Italy that significantly boosting female participation is possible in a reasonable amount of time, it does not provide an example of a clear set of policy measures for getting there.”

<sup>21</sup> Data from Eurostat.

<sup>22</sup> Average annual growth in female labour force participation was 0.8% for each of the periods 1990 to 2000, 2000 to 2019, and 2008 to 2019. From 2002 to 2007, annual growth fell to 0.1% but this was compensated for by 1.5% annual growth between 2007 and 2012 (data from IStat).

<sup>23</sup> Author's calculations, based on AMECO data.

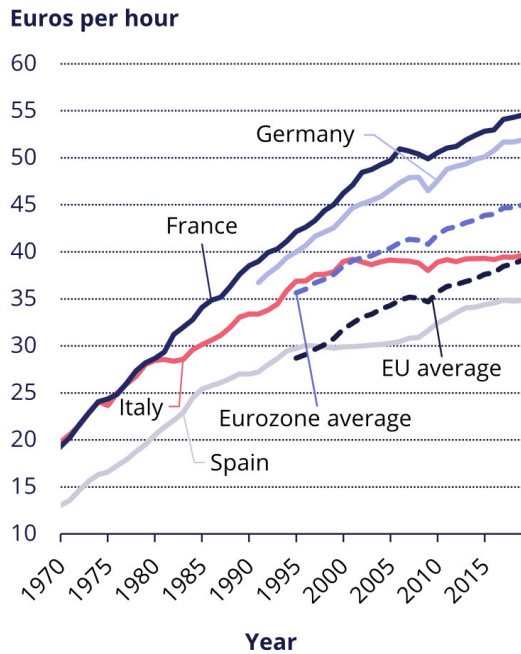
<sup>24</sup> Author's calculations, based on AMECO data.

<sup>25</sup> Author's calculations, based on AMECO data. The contrast becomes even starker if we use the period 1986–1996 (when Italy's exchange rate stabilised again and remained within a narrow band against the DM, effectively pre-empting its irrevocable fixing on the 31<sup>st</sup> of December 1998): Over this decade, Italy's average productivity growth was 1.9% per year.



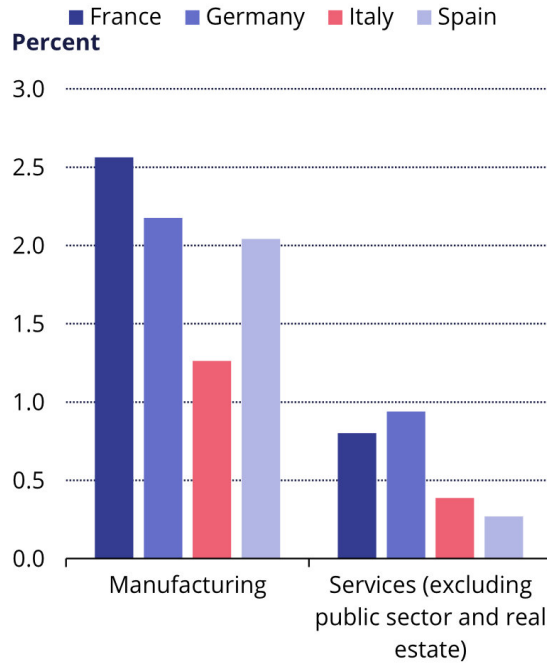
## Productivity in Italy, France, Germany, and Spain

Real GDP (2015 €) per hour



## Productivity growth by sector

Average annual growth in value added per hour, 1999–2019



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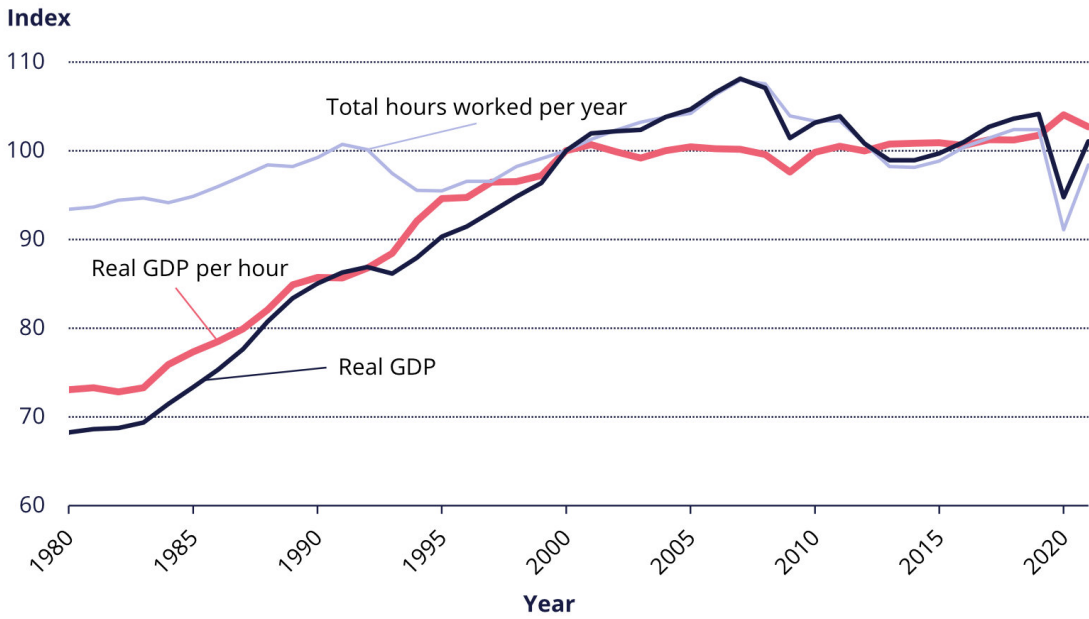
**Figure 7:** Productivity in Italy, France, Germany, and Spain & Productivity growth by sector; **Sources:** AMECO (left panel) and OECD (right panel)

Taking the three factors together, the following picture emerges: until 1980, Italian productivity growth was in line with other European advanced economies. Between 1980 and 2000, Italy lost contact with the European productivity frontier but continued improving its productivity at a reasonable clip. From 2000 on, however, productivity growth largely flatlined. In the period from 2000 to 2008, this was compensated for by a significant increase in total hours worked, which constituted the near-exclusive driver of real GDP growth in this period.<sup>26</sup> After 2008, total hours worked started flatlining too, caught between the cross-cutting forces of a rising labour force participation rate, increasing unemployment, and falling hours worked per person employed (itself driven by the rising proportion of part-time and temporary work). As a result, real growth largely came to a halt (Figure 8).

<sup>26</sup> Following Dario Guarascio and Francesco Zezza, this might also be called the period of “poor tertiarization” (author’s correspondence with Guarascio and Zezza).

## Real GDP, real GDP per hour, and hours worked in Italy, 1980–2021

Indexed, 2000 = 100



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**Figure 8:** Real GDP, real GDP per hour, and hours worked in Italy, 1980-2021; **Source:** AMECO



## 4. Reviewing existing explanations

The previous section has shown that Italy's stagnation is largely driven by two phenomena: untapped labour force potential and low productivity growth. What are these phenomena caused by? This section summarises three broad families of explanations. They are:

1. the “weak reform effort” account, which holds that Italy has not implemented sufficient structural reforms, particularly in the labour market, to enable the economy to adapt effectively to changing circumstances;
2. the “Euro-integration” account, which sees the causes of stagnation in adverse interactions between Italy's political economy and the process of qualifying for – and then maintaining membership in – the Economic and Monetary Union (EMU) and especially the single currency; and
3. the firm-level perspective, which focuses on the nature and behaviour of Italian firms, particularly their investment choices, management structures and size distribution, and seeks to explain why these might be dysfunctional and how these dysfunctions have come about.

These three families are neither completely exhaustive<sup>27</sup> nor neatly exclusive of one another. For example: certain contributions placed in the “Euro-integration” camp below, e.g. those drawing on the Varieties of Capitalism framework, include firms as crucial actors in their explanations and thus involve a firm-level perspective, too. Certain firm-level perspectives, in turn, point towards insufficient reform efforts or EMU interactions as explanations for why Italian firms behave in the way they do, and so on.

This is unsurprising: Italy's stagnation has long been recognised as an important problem (e.g. De Cecco 2007). If there were a consensus on a set of simple, separable causes, these would have been identified and remedied one by one. This has not been the case: disagreement remains endemic, and while there have been significant reforms to particular components of Italy's political economy (see Section 4.1), these have not yet succeeded at durably lifting productivity growth. This suggests that there are multiple, interlocking causes at work, so that different plausible explanations, even if they set off from different starting points, eventually shade into each other.

### 4.1 “Unwillingness to reform”

A widespread narrative sees insufficient liberalisation and a general lack of reform as the leading cause of Italy's stagnation. Excessively strict employment protection, strong trade unions, an expensive welfare state, overgenerous pensions, and anti-competitive product market regulation mean that capital and labour are inefficiently allocated in Italy (e.g. Daveri and Tabellini 2000; Alesina and Giavazzi 2006, Alesina et al. 2008, Gurría 2012, OECD 2012, Kangur 2018, Tokarski 2019), this explanation goes.

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<sup>27</sup> Two other explanations are addressed in Box 1 below, in particular “Zombie firms / excessively low interest rates” and “Political instability” accounts. On the role of China, see footnote 79 below.

This account is popular, especially in Germany.<sup>28</sup> Upon closer inspection, however, it is both incomplete and misleading. It is incomplete because Italy has undertaken major reforms in the last 30 years, as summarised below. A generic “unwillingness to reform” is not a convincing explanation of Italy’s malaise. More importantly, however, this narrative is misleading because, as we suggest further below, it is the *nature* of the many reforms undertaken that provides useful hints towards the deeper causes of Italy’s malaise. A simple denial of Italy’s reform efforts obscures this.

Over the last 30 years, successive Italian governments have undertaken reforms in the areas of (1) fiscal policy, (2) labour markets, (3) competition, and (4) the political process itself.<sup>29</sup> Many of these reforms resulted, directly or indirectly, from two crises of the early 1990s: the *Mani Pulite* corruption scandal starting in February 1992 (Rhodes 2015);<sup>30</sup> and the Lira crisis of September 1992.<sup>31</sup> Together, they persuaded significant parts of Italy’s political, administrative and business elites that deep reforms were urgently needed, lest Italy should miss out on Europe’s Economic and Monetary Union. The common thrust of these reforms was liberalisation and fiscal discipline (Armingeon et al. 2019, Baccaro and D’Antoni 2020, p. 5). The results, however, have been mixed.

First, concerning **political reform**, the feeling that deep reforms were needed led to changes to the electoral system and to party financing rules, as well as to a deliberate form of self-binding.<sup>32</sup> Deep European integration was intended as a commitment device (a *vincolo esterno*, or external constraint) to facilitate difficult reforms down the road, so that “Italian vices” could be “overcome by importing European virtues” (Crafts and Magnani 2013 in Toniolo ed, p. 100, Della Sala 2015 in Jones and Pasquino, p. 700–1; see also Dyson and Featherstone 1999, Talani 2017 and Frankel and Rose 1998).<sup>33</sup>

More than any of the specific economic reforms, these overarching political reforms show an earnest commitment among important parts of the Italian elite to modernising and reforming their country, as well as an awareness of some of the deep social and political impediments to doing so.

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28 A recent example, among many others, is Commerzbank’s chief economist stating that “Italy’s longstanding unwillingness to reform is coming back to haunt it” (Manager Magazin, 15.6.2022, <https://www.manager-magazin.de/politik/ezb-rat-trifft-sich-zur-sondersitzung-a-eb30c24a-69a9-493f-95b9-d8328f94df02>). This analysis was endorsed by Lars Feld (Twitter, 15.6.2022, [https://twitter.com/Lars\\_Feld/status/1537099519229407232](https://twitter.com/Lars_Feld/status/1537099519229407232)), a senior adviser to the German minister of finance.

29 This wave of reforms itself stands in continuity with certain reforms from the preceding decade, the 1980s. Perhaps the most important of those preceding reforms was the “divorce” between the Banca d’Italia and the Italian Treasury in 1981, which – comparable to the 1951 Treasury-Fed Accord – removed the Banca d’Italia’s obligation to finance any deficits not financed through taxes or bonds sold to private investors.

30 The consequences of this scandal, also known as Tangentopoli, are difficult to exaggerate. As Rhodes (2015, p. 309) summarises: “Within two years, the political class was decapitated, the parties that had dominated the country either collapsed and disappeared or broke into smaller successor organizations, and the electoral and party financing systems were radically reformed via popular referendum.” It is generally acknowledged that this scandal divides the history of post-war Italy, constituting the breakpoint between a “First” and a “Second” Republic.

31 This crisis, too, left deep traces: currency traders forced the Lira (along with Pound Sterling) out of the European Exchange Rate Mechanism (ERM, a precursor to the Euro). This was seen as a fundamental challenge to Italy’s place in European economic and political integration, calling into question whether the country was still a core member of the process.

32 Concerning electoral and party financing reform, a more majoritarian electoral system (the *Mattarellum*) was introduced, replacing the previously prevailing proportional representation system (Regalia 2015), to achieve more stable majorities and governments more capable of pushing through controversial reforms. Election funding was changed from annual public subsidies to a system nominally centred on reimbursing election expenses, though in fact parties (if they crossed a relevant threshold) received a lump sum in proportion to their votes rather than a reimbursement of actual costs (Piccio 2014, p. 142).

33 Not insignificantly, the quote is from Guido Carli, governor of the Banca d’Italia (1960–1975), president of Confindustria (1976–1980), President of LUISS University (1978–1993), senator (1983–1992), finance minister (1989–1992), author of the 1990 Carli Report on economic and monetary union and one of the architects of Italy’s European integration.

As with the economic reforms covered below, the results were mixed: Italy's electoral system remains contested to this day, with major changes implemented in 2005 (*Porcellum*), 2015 (*Italicum*) and 2017 (*Rosatellum*). Party financing, too, remains controversial, with the 1993 financing system amended seven times between 1993 and 2011 before its abolition and replacement in 2012 (Piccio 2014).

Against this backdrop of ongoing political controversy, however, elements of progress are visible. Concerning corruption, while new waves of scandals did follow (e.g. in 2012; Donadio and Povoledo 2012; see also Vannucci 2009), Italy has steadily improved its rating in Transparency International's Corruption Perception Index over the last decade, rising from rank 72 out of 180 in 2012 to rank 42 in 2021 (Figure 9, left panel).<sup>34</sup> The problems with perception-based indicators are well known, but considering that the World Bank Group's Control of Corruption indicator<sup>35</sup> shows a parallel upwards trend from 2014 on (Figure 9, also left panel), we may read these indicators as plausible signs of improvement. Beside this positive *trend*, however, it is also worth observing that Italy (with a score of 0.54) remains at a *level* significantly below the EU average (0.97).

Concerning **tax evasion**, the VAT gap,<sup>36</sup> too – a useful proxy for administrative quality and general compliance with the rule of law – follows a similar pattern. Its level, historically around 25%, is more than twice as high as that of France and Germany (Figure 9, right panel). Its trend, however, is encouraging: after showing worsening VAT collection from 2000 to 2009, with the gap peaking at 32% that year, it has steadily decreased to 21% since then (European Commission, VAT Gap Reports 2009–2022).

The estimated size of the shadow economy follows a similar trend, although, here too, data availability and quality are an issue. Official estimates are available from 2011 onwards and show a slight decrease from initially 11.3% of GDP (2011) via a peak of 12% (2014) to recent values of 10.2% (2019) and 9.5% (2020).<sup>37</sup> Further progress appears possible with the ongoing implementation of a new anti-corruption law passed in 2019 (IMF 2022a, p. 75), the successful launch of an electronic register of beneficial owners in June 2022, as well as a new National Anti-Corruption Plan currently being drafted by the National Anti-Corruption Authority (ANAC) (IMF 2022a, p. 31).

While both perception-based indicators of corruption and those based on tax collection show Italy lagging its European peers, it appears that a trend reversal may have been achieved in this area. However, whether this trend reversal will stabilise is an open question: historically, the deliberate underenforcement of tax collection has been used as an industrial policy tool in favour of small firms and the self-employed (Dewey and Di Carlo 2021),<sup>38</sup> and the new Italian government is

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<sup>34</sup> A higher rank means a lower perception of corruption. Denmark, Finland and New Zealand shared the first place in both 2012 and 2021.

<sup>35</sup> This indicator is part of the World Bank's Worldwide Governance Indicators dataset.

<sup>36</sup> The VAT gap is the difference between expected VAT revenues and the amount collected (European Commission 2020).

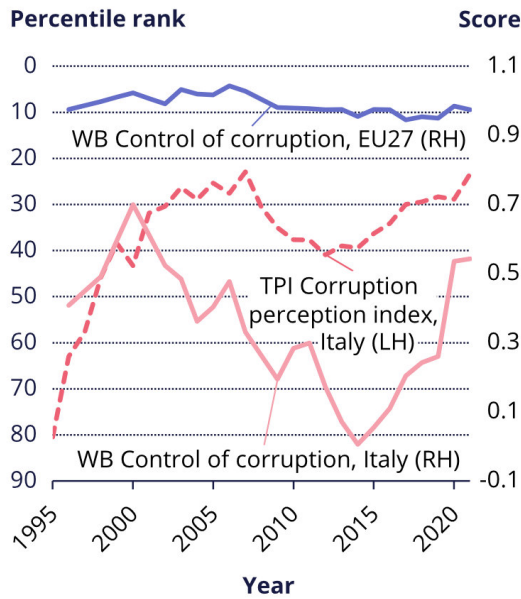
<sup>37</sup> Data from ISTAT, *Economia non osservata nei conti nazionali*, October 2022, <https://www.istat.it/it/archivio/275914>.

<sup>38</sup> Note that this is not unique to Italy. As Dewey and Di Carlo show, "the non-enforcement of tax regulations" via deliberate understaffing is also "the preferred mechanism used by the German states to chase national investments and improve local attractiveness" (p. 937).

considering weaker anti-tax-evasion measures in this vein.<sup>39</sup> Equally concerning is the decrease in the number of employees in Italy's tax administration, which has fallen by around 10% from 2007 to 2017 (Dewey and Di Carlo 2021, p. 944), though this mirrors a similar decrease in Germany from 2002 to 2013 (ibid., p. 939).

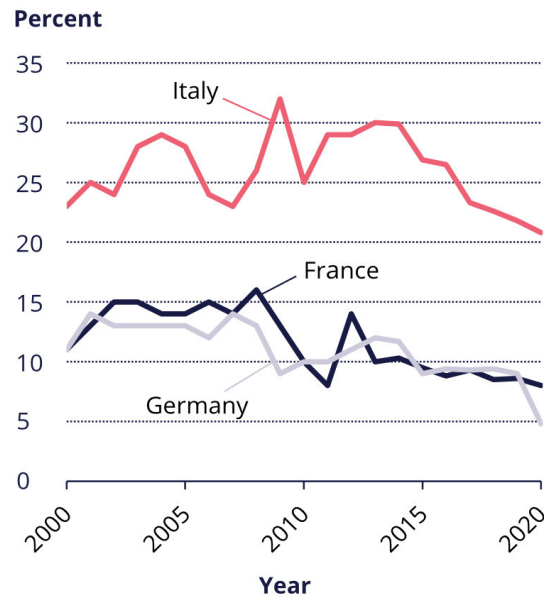
## Perception-based corruption indicators

TPI's corruption perception index (LH, percentile rank) and the World Bank's control of corruption indicator (RH, score)



## VAT Gap

Percentage of expected VAT Total Tax Liability



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Figure 9: Perception-based corruption indicators & VAT; Sources: Transparency International, European Commission

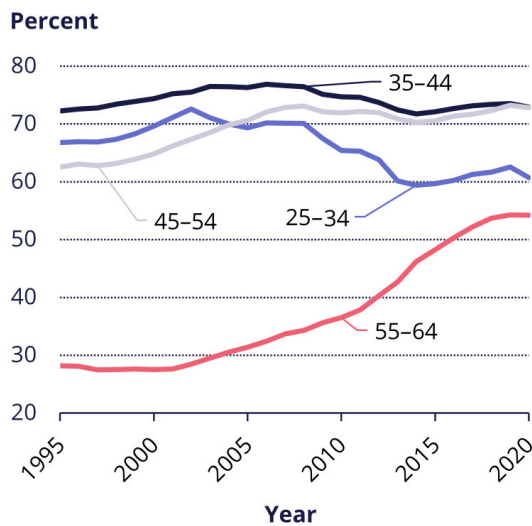
<sup>39</sup> "Reducing cash circulation is generally known to be one among the most effective measures to reduce the size of the underground economy and counteract evasion" (Dewey and Di Carlo 2021, p. 943), yet the Meloni government proposed lifting the legal limit for cash transactions from 1000 euros to 5000 euros (Kazmin 2022). This follows a well-established pattern: in the 1990s, the Prodi government reduced the limit to 1000 euros. Under Berlusconi, the limit was raised again to 12,500 euros in 2008, the Monti government lowered it again to 1000 euros in 2012, before the Renzi government raised it to 3000 euros in 2016 and Draghi brought it back down to 1000 euros (effective 1.1.2023). For context, in France, this limit is 1000 euros. Germany has no limit, but for cash payments of more than 10,000 euros, buyers must show their ID card, and sellers must document the buyer's name, place and date of birth, home address and nationality (European Consumer Centre France 2022). It is unclear to what extent this provision is enforced in practice.

Second, concerning **fiscal policy**, between 1992 and 2009, Italy implemented more discretionary fiscal consolidation measures than any other major OECD country (Devries et al. 2011), for a total cumulative retrenchment of around 24% of GDP. Around 56% of this consolidation occurred via spending cuts and 44% via tax increases. This consolidation (see also Figure 2 above) was in pursuit of joining the Euro at creation, i.e. meeting the Maastricht convergence criteria. Given that “many suspected [the criteria] had been selected by the Bundesbank precisely to keep Italy out of the future Euro-zone” (Sbragia 2001 in Cowles et al. eds, p. 80), this necessitated an extraordinary fiscal effort on the part of successive Italian governments. Following the negotiation of the European Fiscal Compact, Italy added a balanced budget amendment to its constitution (Article 81) in 2012, resulting in an unbroken string of primary surpluses until COVID, with an average primary surplus of 1.7% of GDP from 2012 to 2019. From 1991 to 2019, Italy had the highest average primary surplus of any G7 country.

Concerning **pensions** – the single largest item of Italian public expenditure – it is notable that while Italy’s pension expenditure is higher (as % of GDP) than in any other OECD country, reforms in 1992, 1995, 2005, and 2011 slowed and reversed the rise in pension spending. This had increased from 11.3% of GDP (1990) to 16.2% (2013), before falling back down to 15.4% in 2019 (Eurostat 2022, total pension expenditure).<sup>40</sup> Since 2012, the pension age is automatically updated to account for changes in life expectancy (Nadalet 2020). The employment ratio among the population aged 55–64 has increased from below 30% in 2000 to 54% in 2019 (Figure 10, left panel).<sup>41</sup> Italy’s effective labour market exit age is now the highest in the EU (European Commission 2021, Cross Country Tables, Table III.1.46).

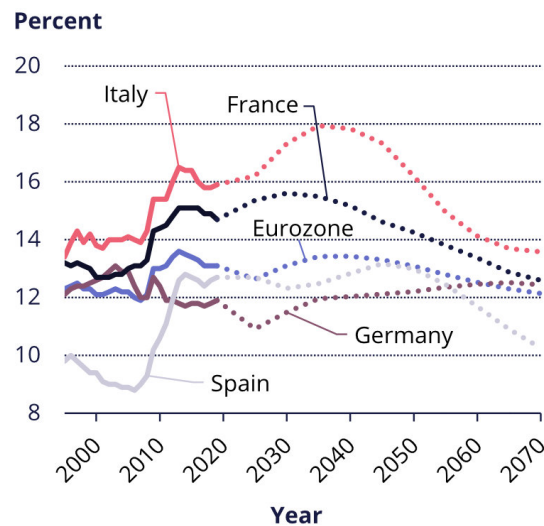
### Italian employment ratios by age

% of total population in age group



### Pensions expenditure, historic and forecast

% of GDP



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**Figure 10:** Italian employment ratios by age & Pensions expenditure, historic and forecast; **Sources:** Istat and OECD (left panel) and Eurostat and European Commission (right panel)

<sup>40</sup> Total pension spending includes public spending on disability pensions, early retirement due to reduced ability to work, old-age pensions, anticipated old-age pensions, partial pensions, survivors' pensions and early retirement benefits for labour market reasons.

<sup>41</sup> Note also, however, that the employment ratio has fallen by 10 percentage points among young people during the double-dip recession of 2008–2013 and has not yet recovered to its pre-crisis level.



Successive reforms also transformed Italy's public pension system from a defined benefit system to a notional defined contribution (NDC) system. This means that, besides raising and then indexing the pension *age*, the size of pension *benefits*, too, is now indexed to changes in life expectancy and GDP. As a result, while the European Commission's long-range projections see Italy's public pension expenditure increase, driven by the rapid ageing of the Italian population in the years to come, to 18% of GDP by 2040, over the long run they are projected to decline to below 14%.<sup>42</sup>

Third, **labour market reforms**.<sup>43</sup> In this area, major reforms took place in 1992–3, 1997, 2001, 2003, 2012, 2015, 2018, and 2019.<sup>44</sup> In a first wave (1992–2003), the automatic indexing of wages to inflation (the *scala mobile*) and the public monopoly on job placement services were abolished.<sup>45</sup> While permanent employment contracts were left untouched, temporary and cheaper labour contracts (involving lower pension claims and contributions, no paid maternity or sick leave, and no access to unemployment benefits) were introduced. The result of this first wave was **flex-insecurity** (Berton et al. 2012) – a significant increase in atypical employment, skewed towards the young, without an expansion of unemployment insurance to cover those in atypical employment – and **bifurcation**, with newly liberalised atypical contracts contrasting with an unreformed core of permanent contracts.

Subsequent reforms (2012–2019) strengthened active labour market policies, unemployment insurance coverage, and labour protection for atypical contracts, while reducing dismissal protection for new (but not existing) permanent contracts. In particular, the right to reinstatement in case of unfair dismissal was abolished and replaced with monetary compensation of up to 24 months of salary (Tassinari 2022).

The results are reflected in the OECD's index of employment protection:<sup>46</sup> for regular contracts, Italy's score moved from 3.02 in the 1990s and early 2000s, marginally stricter than Germany and France, to 2.56 by 2019, in line with France (2.56) and marginally looser than Germany (2.6). For temporary contracts, Italy's index indicated a dramatic loosening, from 4.88 in 1990 to a low of 1.63 in 2015, before re-regulation, especially via the "Dignity Decree" of 2018, brought it back to 3.13, marginally stricter than France (at 3.0) and considerably stricter than Germany (at 1.38).

The results of these labour market reforms are reflected in macroeconomic as well as microeconomic outcomes. Macroeconomically, while hours worked increased up to 2008, and while the labour force has continued growing even after 2008 (see Section 3 above), the labour share in Italy's GDP has declined significantly since 1990, falling from above 58% of GDP to just below 53% (Figure 11, left panel). Rising quantity at falling prices is consistent with an expansion in labour supply. Microeconomically, researchers at the Banca d'Italia have demonstrated how the

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<sup>42</sup> The IMF similarly forecasts a rising pension burden over the medium term, followed by a decline in the long run, although with a slightly more pessimistic profile. Pension expenditure is forecast to peak between 18% and 19% of GDP around 2040, before declining towards 15% as we near the 2070s (IMF 2022a, p. 19).

<sup>43</sup> For general overviews, see Sacchi and Vesan (2015) or Afonso et al. (2022).

<sup>44</sup> 1992: suspension of the *scala mobile*. 1993: the Ciampi Protocoll. 1997: the Treu Package. 2001: Decree 368/2001. 2003: the Biagi Law. 2012: the Fornero Reform. 2015: the Jobs Act. 2018: the Dignity Decree. 2019: introduction of universal unemployment insurance ("Citizenship Income").

<sup>45</sup> Introduced in 1945–6, the *scala mobile* was universalised in 1975, reformed and weakened in 1983–4 (approved by a referendum in June 1985), and suspended in 1992, before being finally abolished in 1993. For an overview, see e.g. Locke (1995).

<sup>46</sup> The index ranges from 0 (maximally deregulated) to 6 (maximally regulated). For methodological details, see OECD (2020, ch. 3).

2001 reform in particular shifted rents from (new, younger) workers to firms while failing to increase employment (Darulich et al. 2022). This is consistent with the view that this reform mainly redistributed bargaining power in the labour market without facilitating better worker-job matching.

The structure of the labour market, too, has changed significantly (Figure 11, right panel), from permanent to temporary contracts (pink lines) and from full-time to part-time contracts (blue lines). Temporary contracts have become especially prevalent among the young, where they increased from around 10% to more than 60% of all contracts (pink dotted line), part-time contracts especially among women, from around 10% to more than 30% (blue dotted line). In this context, it is worth highlighting that temporary employment contracts rarely serve as stepping stones into permanent, high-quality jobs (Booth et al. 2002, Autor and Houseman 2010, García-Pérez et al. 2019, Darulich et al. 2022). Instead, the relevant reforms “appear to mainly foster the creation of highly precarious and fragile temporary jobs” (Darulich et al. 2022, p. 8).

### Wage share (adjusted)

% of GDP

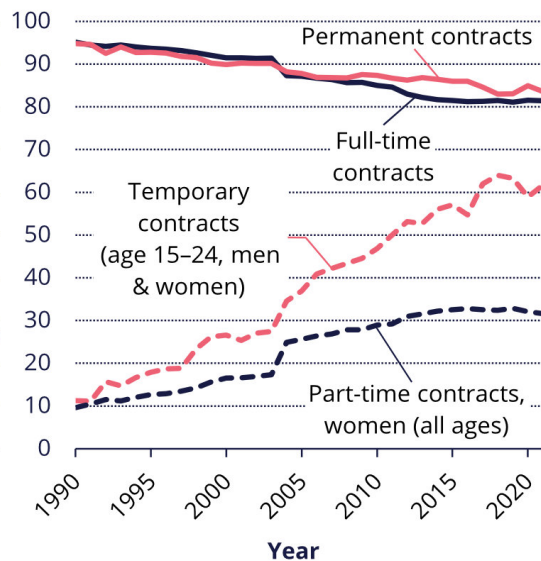
Percent



### Temporary and part-time employment

% of all labour contracts in the relevant demographic

Percent



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Figure 11: Wage share (adjusted) & Temporary and part-time employment; Sources: AMECO (left panel) and OECD LFS (right panel)

Finally, **competition reform**: The main reforms in this area consisted in a series of privatisations and competition law reforms. State-owned enterprises were privatised fully or by majority stakes in the areas of industry and banking,<sup>47</sup> insurance (INA, 1994), petrochemicals (ENI, 1995), telecoms (Telecom Italia, 1999) and electricity (ENEL, 1999). “In terms of proceeds, [Italy] was second only to the United Kingdom during the period 1979–1999” (Toniolo ed 2013, p. 97). However, the Italian state retains minority stakes and certain veto powers in a subset of strategically important firms, including ENI and ENEL, through so-called “golden power” provisions. In line with German and French practice, the Italian state also possesses a national promotional bank, the Cassa di Risparmio di Roma e di Credito per le Imprese (CDP). With a balance sheet of approximately 500 billion euros, it is comparable in size to Germany’s KfW (around 550 billion euros) and France’s Caisse des dépôts et consignations (around 1100 billion euros). While the CDP is not comparable to the former IRI – neither in size nor in scope – it is an important state holding company, has operated as a lender of last resort for government bonds, and provides significant liquidity to the treasury via private savings collected through the national postal system.

Paralleling these privatisations, markets for electricity, communications and transport were deregulated, and a modern competition law was legislated in 1990, then successively reformed. The two Bersani Laws of 2006 and 2007 started an ongoing liberalisation process in a number of service professions (e.g. pharmacies, architecture, law, accounting, and insurance brokerage) and streamlined certain legal requirements for the transfer of mobile property, eliminating the need for notarial authentication. Since 2009, annual competition law updates have been required (OECD 2021, p. 51). These have proceeded, but sometimes with significant delays.<sup>48</sup>

As a result of these reforms, Italy’s score in the OECD’s Product Market Regulation (PMR) Index fell from 2.36 in 1998 to 1.29 in 2013 (with low scores indicating lower barriers to entry and competition; see also Lanau and Topalova 2016, figure 3, for PMR scores by sector). In the latest version of the Index, Italy’s score is not only more liberal than the OECD average but also than that of France, the United States and Switzerland. While Italy still has comparatively high barriers in professional services and retail (OECD 2021, p. 50–1), the administrative burdens on start-ups are now among the lowest in the OECD and below those in Israel, the UK and the US (OECD 2022, Product Market Regulation Database).

In sum, Italy has seen profound changes in fiscal policy, labour market regulation, competition and the political process itself over the last 30 years. But while these reforms succeeded not only in driving down inflation, the strictness of labour and product market regulation as well as the labour share of GDP, but also in entrenching a permanent primary surplus, the growth record has remained subdued, with labour supply growth outpacing labour demand growth, and productivity growth remaining secularly weak.

As this overview shows, the question is not: did Italy reform or not reform? Instead, the question must be: why did those reforms that were undertaken and implemented not succeed in improving productivity growth? A tentative answer to this is formulated in the synthesis section below (Section 5). But beforehand, the paper turns to two more families of explanations: Euro-integration accounts and the firm-level perspective.

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<sup>47</sup> Credito Italiano was privatised in 1993, the Istituto per la Ricostruzione Industriale, known as IRI, largely between 1997 and 2000. This amounted to a near-complete privatisation of the banking sector, which had been in virtually complete state ownership before 1992 (Barucci and Pierobon 2007, p. 354).

<sup>48</sup> The 2015 draft, for example, was not passed until 2017 (European Commission 2017, p. 4).



## 4.2 Italy's integration into the Euro

If the “weak reform effort” narrative is the most widespread in Germany, the “Euro integration” account has attracted significant attention in Italy and other Eurozone member states. There are several different versions of this account. Their unifying features are

- identifying and focusing on various interactions between pre-existing features of Italy's political economy and the process of qualifying for (and then attempting to thrive within) the Economic and Monetary Union; and
- arguing that these interactions have reduced Italy's (productivity) growth.<sup>49</sup>

A first version identifies the interaction between Italy's labour market institutions and the process of monetary unification as a major cause of Italy's stagnation (e.g. Hancké 2013). Because of historical differences in wage bargaining regimes (Hancké 2013, Höpner and Lutter 2018) as well as deliberate wage repression in Germany (Bofinger 2015), inflation in Italy was higher than in Germany and other historically low-inflation Eurozone states, largely driven by wages in the public sector and non-traded services.<sup>50</sup> Given a fixed exchange rate, the competitiveness of Italian firms suffered, depressing Italian long-run growth (Wyplosz 2013, Hassel 2014, Hall 2014).<sup>51</sup>

Accounts from the Varieties of Capitalism literature (e.g. Hassel 2014) add that, in Mediterranean (or mixed) market economies like Italy's, the state plays a major role in the coordination of training, wages and investment (Molina and Rhodes 2007, Di Carlo 2022),<sup>52</sup> becoming a gatekeeper to significant resource allocation. Firms and unions then invest heavily in political capital to secure access to these resources (Molina and Rhodes 2007). The result tends to be compensation-oriented labour market and social policy, leading to excessive debt, delayed adjustment processes, further loss of competitiveness within EMU, and therefore low growth (Hassel 2014, p. 9–10).

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<sup>49</sup> For a useful summary of the basic logic of these accounts, though for Southern Europe as a whole as opposed to Italian specifically, see Bürgisser and Di Carlo 2023, esp. pp. 3–4 and 8–10.

<sup>50</sup> For detailed comparative data on wage inflation in France, Germany, and Italy, with the public sector and manufacturing considered separately from the evolution of economy-wide wages, see Di Carlo (2022, figures 1, 2, and 3).

<sup>51</sup> This mechanism was reinforced by the so-called Walters effects: given a single monetary policy but differential inflation rates, real interest rates were too low for Italy (and for Spain, Portugal, and Greece), too high for Germany, leading to further overheating and hence cost increases in the South, further competitiveness gains in the North (Walters 1986, Scharpf 2011, Wyplosz 2013).

<sup>52</sup> The reason being that, unlike in coordinated market economies like Germany or Japan and because industrialisation happened late, rapidly, and in conflictual circumstances, unions and employers were unable to create strong autonomous and cooperative forms of coordination to deliver the collective goods of wage moderation and skills formation.

These explanations are a significant advance over the no-reform accounts. They highlight the importance of understanding both the political and economic processes internal to Italy and their interaction with EMU. However, there are two causal loops that follow from this account, one implying lower,<sup>53</sup> one implying higher growth in the periphery.<sup>54</sup> While this family of accounts foregrounds the first loop, it is not obvious why that mechanism should be dominant over the second one.

Second, this explanation predicts a major current account deficit in those countries with excessively high wages and excessively low real interest rates, since both consumption and investment are stimulated. This is born out in Spain, Greece, Portugal and, to a lesser extent, Ireland, with current account deficits of up to 15% of GDP in the first decade of the Euro.

Italy, however, conforms weakly, if at all, with the prediction: it averaged a current account deficit of merely 0.8% of GDP between 1999 and 2008, and its highest deficit ever since the introduction of the Euro was 3.3% in 2010, largely explained by expensive energy imports (Figure 3 above).<sup>55</sup> Excess demand was hardly evident at the level of the economy as a whole (see also Baccaro and Bulfone 2022 in Baccaro et al. eds 2022).

Third, this version of the Euro-integration account can be overly focused on the supply side. Competitiveness effects, wage setting, skills and education, and labour market flexibility are foregrounded, while the different sources of demand – such as private credit creation, public credit creation, wages, and exports – can be downplayed.

Another version of the monetary unification account remedies this by placing greater emphasis on the demand side. Grounded in the growth-model literature (Baccaro and Pontusson 2016, 2020, Baccaro et al. eds 2022), it highlights how key sources of demand have dried up because of monetary integration (Storm 2019): public sector demand has been squeezed by tight fiscal policy, particularly after the 2008 Great Financial Crisis; domestic consumption demand has been depressed by low wage growth (Pontusson and Baccaro 2020, Johnston 2021 in Hassel and Palier eds 2021), again especially after 2008 and in the service sector; and export demand has failed to take up the slack because EMU blocks nominal exchange rate depreciation (Bagnai 2016; also Faini and Sapir 2005, linking it to Chinese competition).

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53 This is the “competitiveness loop” that is generally foregrounded in these accounts. It runs from low (public and sheltered sector) wages to lower inflation, from lower inflation to higher real interest rates, from there to increased competitiveness and to higher long-run growth. This loop is argued to operate positively in the core countries, boosting their competitiveness, negatively in the periphery, undermining it.

54 This is a “demand loop”, running from high wages to higher inflation, higher inflation to lower real interest rates, lower interest rates to higher short-run growth, and from higher short-run growth – via (positive) hysteresis effects, e.g. clustering effects, human capital accumulation or high-skill immigration – to higher long-run growth. Higher wages also have a direct demand and short-run growth-boosting effect. This loop would operate negatively in the core countries, where low demand would hit short-run growth, positively in the periphery countries. There is ample literature documenting the negative version of this cycle, running from low demand to low investment to low productivity (Kleinknecht 1996, Edler and Georghiou 2007, Janeway 2012, Crespi and Guarascio 2019), and generally identifying strong hysteresis effects (Adler et al. 2017).

55 Data from AMECO.

This variant, too, adds to our understanding of Italy's stagnation. Together with recent contributions from mainstream macroeconomics (e.g. Fatás and Summers, 2018, Cerra et al. 2020 or, for the US case, Furlanetto et al. 2021), it identifies excessively tight fiscal policy during recessions as harmful to growth and to fiscal long-run sustainability. However, it leaves several questions unresolved: given a significant loosening of the fiscal stance from 1998 to 2005 (see Figure 2 above), how come growth (and especially productivity growth) remained subdued at that time, too? Further, how can wages simultaneously be too high, undermining competitiveness and preventing exports from providing sufficient demand, and too low, preventing domestic demand from providing it? Even if we grant that internal devaluation is generally a more painful and slower process than nominal devaluation, why is it *particularly slow*, to the point of hardly occurring at all, for Italy?<sup>56</sup> An explanation for this, it would seem, must focus less on fixed exchange rates or unitary monetary policy, and more on nationally specific institutions and policies.

Most importantly, however, it remains unclear what the explanation's implicit counterfactual – an Italy outside of the Eurozone – would have looked like in practice. Besides higher borrowing costs for public and private borrowers, the benefits of a weaker currency in terms of additional exports and growth may well have been small. This conclusion is supported by two different bodies of literature. On the one hand, recent papers show that, under conditions of highly integrated global supply chains, a currency depreciation does not necessarily lead to stronger manufacturing output (e.g. Ahmed et al. 2017). On the other hand, core-periphery analyses of Eurozone imbalances (e.g. Simonazzi et al. 2013, Celi et al. 2018) highlight the structural reorientation of German trade away from the southern periphery and towards an eastern periphery – for the import of intermediate goods, forming the Central European Manufacturing Core – and China – for the export of capital goods and the import of cheap consumer goods. Given the logistical advantages of Eastern Europe for German industry as well as the lower wages then prevailing in Eastern Europe and China, it is unlikely that even a significantly weaker Lira (with its adverse side effects for the affordability of essential imports, esp. energy) could have countered this reorientation.

A fourth version of monetary unification accounts, finally, zooms in on specific actions undertaken by successive Italian governments in order to qualify for and succeed within EMU. This account highlights that, despite the governments' best intentions, these reforms had harmful effects in the long run.<sup>57</sup>

Italy's privatisations are a case in point (Baccaro and D'Antoni 2022, p. 15–18): “[M]ainly aimed at reducing public debt” (Crafts and Magnani 2013 in Toniolo ed 2013, p. 97), they were pursued to realise quick sales at high valuations. Given that high expected future profits support high sales prices today, it is unsurprising that many privatisations “took place before a proper regulatory framework had been set up, leaving room for substantial private economic rent and poorly designed incentives” (Baccaro and D'Antoni 2022, p. 17). Indeed, following privatisation, there was “a sharp increase in dividends”, with “the increase in payout [...] due at least in part to a cutback in investment” (Barucci and Pierobon 2007, p. 357–8).

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<sup>56</sup> While Italy was still 4% below its 2007 peak in real GDP in 2019, Spain, despite a nadir of similar depth around 2013–14, had reached a level 8% higher than its 2007 peak in 2019 (AMECO). However, see Baccaro and Bulfone (2022) for an explanation of precisely this difference between Spain and Italy.

<sup>57</sup> For a version of this explanation that locates itself in the Varieties of Capitalism framework and stresses the incoherence between the various reforms undertaken, see Simoni (2020), also covered in Section 5 below.

Besides a legacy of extractive firms, particularly in the sheltered sector,<sup>58</sup> the revenue-oriented, investment-decreasing nature of Italy's privatisations also reduced the number of large firms in advanced sectors. This was a niche that had historically been filled by state-owned companies and especially the *Istituto per la Ricostruzione Industriale* (Shonfield 1965, Rossi and Toniolo 1996 in [Crafts and Toniolo eds](#), Baccaro and D'Antoni 2022, p. 15), so that after the rapid privatisations of the 1990s, few private players were ready to take their place. Today, the absence of large, technologically advanced firms is frequently cited as a contributing factor to Italy's low productivity growth (e.g. Amatori et al. 2013 in Toniolo ed [2013](#)).

A further well-intentioned but arguably counterproductive reform effort triggered by monetary unification were the labour market reforms covered above. With nominal exchange rate devaluations ruled out, wage repression in Germany made labour market reform in pursuit of wage reduction, i.e. internal devaluation, a *prima facie* necessity. In theory, these labour market reforms should have enabled cost competitiveness and a reallocation of labour from less to more productive firms and activities, not just to preserve cost competitiveness within the Eurozone, but also to cope with intensifying competition from China and other emerging economies.

In practice, however, while reforms delivered both greater wage inequality and flexibility (Hoffmann et al. [2021](#)), arguably creating the incentives that reformers were hoping would facilitate labour reallocation, they also dismantled "beneficial constraints" (Streeck 1997),<sup>59</sup> harmed innovation (Cetrulo et al. [2019](#)), and reduced human capital formation (Lucidi and Kneinknecht [2010](#), Pinelli et al. [2017](#), Kleinknecht [2020](#), Hoffmann et al. [2021](#)). With temporary contracts, intermittent work, and job switching becoming more prevalent, particularly among the young (Hoffmann et al. [2021](#), p. 7, p. 29; see also [Figure 11](#) above), and with temporary employment contracts not functioning as stepping stones into permanent positions (Darulich et al. [2022](#), p. 8), human capital, especially of the firm-specific kind, has been accumulated at lower rates in recent labour market cohorts, with a decline of about 13% between cohorts entering the labour market in 1995 and 2005 ([Figure 12](#), see also Rosolia and Torrini [2007](#), Hoffmann et al. [2021](#), p. 30–31 and [figure 17](#)).<sup>60</sup> By lowering productivity growth alongside wage growth, these reforms thus failed to reduce productivity-adjusted wages, i.e. unit labour costs. Moreover, it remains unclear to what extent, if at all, they have raised employment growth above pre-reform trends (Cirillo et al. [2016](#), Darulich et al. [2022](#)).

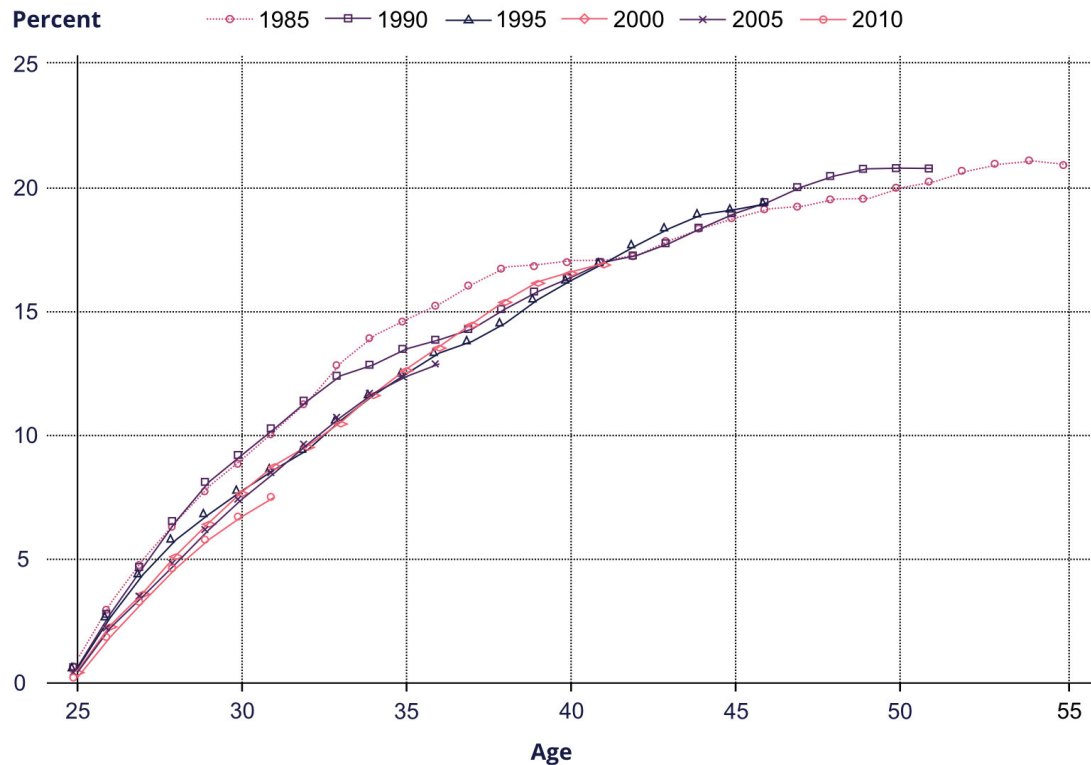
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<sup>58</sup> The sheltered sector includes energy companies, municipal utilities, airport management companies, Autostrade (the motorway toll company), and Telecom Italia (today: TIM). The increase in dividends and the cutback in investments were particularly concentrated in banking and the sheltered sector (Barucci and Pierobon [2007](#), p. 355–6).

<sup>59</sup> Beneficial constraints are constraints on the profit-maximising behaviour of firms that can benefit productivity in the long run. The canonical example is the German system of codetermination. It constrains employers and was fiercely resisted when first introduced (Streeck 1997, p. 204), but encouraged the development of a long-term cooperative relationship between employers and their employees, forcing firms into competing via high value-added production. Other examples of potentially beneficial constraints are minimum wage laws, safety and privacy standards, employment protection legislation, and union recognition requirements.

<sup>60</sup> Since this analysis only covers experience-related human capital accumulated after the age of 25, i.e. once most education is completed, the decline in human capital accumulation from cohort to cohort is not explained by an increase in schooling. In fact, as Hoffmann et al. ([2021](#)) point out, the "stagnation of labor productivity is especially puzzling given the gradual, albeit slow, improvements in educational attainment in Italy", with average years of schooling in the 15–64 population having increased from 8.3 in 1990 to 11 in 2015 (author's calculations, based on Barro & Lee database v3.0 [2021](#)).

## Human capital *explained by experience*



**Note:** Adapted from figure 17 in Hoffmann et al. (2021).

**Figure 12:** Human capital; **Source:** Hoffman et al. 2021

Finally, by worsening early-career employment conditions, the labour market reforms may have boosted emigration, particularly among young and highly skilled workers (“brain drain”). While migration data is notoriously imprecise (Tintori and Romei 2016), both private research (Merler et al. 2019) and official ISTAT data is consistent with this.<sup>61</sup> the out-migration of Italian citizens has more than doubled from around 40,000 or 50,000 Italians prior to 2008 to more than 120,000 in 2019 and 2020, a rising share of which are young and hold university degrees.<sup>62</sup> Corroborating the narrative of high-skill emigration, emigration from the North has also more than doubled from around 24,000 to more than 55,000 people per year (Istat 2022, table 9) over the same period. However, the economic consequences of this are difficult to estimate, in part because micro-level evidence suggests that the human capital distribution of emigrants might follow a bipolar distribution, with both high- and low-skill workers overrepresented among emigrants (Cattaneo et al. 2019).

To summarise, this second family of explanations adds significant insights, pointing out how the interaction of economic and monetary union with Italy’s domestic political economy created challenges for growth. Besides identifying specific policy errors that arose from this interaction, this group of explanations shows the difficulty of generating growth in an economic and monetary union in which the largest member state persistently undershoots the inflation target and in which fiscal rules encouraged excessive tightness during downturns.

<sup>61</sup> See also Kaplan (2019) for a recent journalistic article on the topic.

<sup>62</sup> The number of tertiary-educated Italians emigrating per year has increased from below 8000 (around 5000 of which aged 25–39) in 2011, constituting around 18% of all emigrants, to around 30,000 in 2019 and 2020 (more than 20,000 of which aged 25–39), constituting around 25% of all emigrants (Istat 2022, tables 9 and 10).

However, this family of explanations, too, suffers from certain internal tensions, especially concerning whether wages were too high, undermining Italy's competitiveness, or too low, restricting domestic demand. It also lacks a more granular account of how the various problems it identifies translate into a slowdown in productivity growth, which remains the main phenomenon in need of explanation. Moreover, it remains far from clear what its implicit counterfactual – an Italy outside of the Eurozone – would have looked like in reality.

Insofar as the translation of low demand to low productivity is argued to occur via negative hysteresis, a lack of Kaldor-Verdoorn learning by doing and capital updating, or an overhang of non-performing loans, there is also tension with data from the 1999–2007 period. Here, Italy underwent a degree of fiscal loosening, “excessively loose” monetary policy, and private credit growth; yet no burst of productivity growth occurred. It is to this more granular level of analysis that a final family of explanations turns: those taking the firm-level perspective.

### 4.3 The firm-level perspective

The firm-level perspective has received somewhat less attention in public discussion than the other two families just covered. Within empirical economics, however, it is the dominant approach. As a result, there is a significant literature that identifies Italian firm-level characteristics and behaviour as important drivers of low productivity growth and seeks to explain why firms engage in this behaviour or exhibit these characteristics.<sup>63</sup>

A first characteristic that has received widespread attention is the small size of Italian firms (Amatori et al. 2013 in Toniolo ed 2013): “the negative [productivity] gap reflects underinvestment by a great majority of firms, especially those of a micro and small size” (Bugamelli et al. 2018, p. 12).

Campanella and Federico (2020) find that productivity in Italian manufacturing firms is just as good as in German firms of the same size; but because of a composition effect – i.e. because there are more small firms in Italy than in Germany, and because small German and small Italian firms have a lower average productivity than large German and large Italian firms respectively – average productivity across the universe of manufacturing firms is considerably worse in Italy (Campanella and Federico 2020, figure 3, p. 3; see also Bugamelli et al. 2018, p. 16 and figure 7). Bugamelli et al. (2018, figure 7) analyse the productivity of manufacturing and private non-financial services firms and find that, while Italian firms with more than 10 employees are just as productive as German and French firms of a similar size,<sup>64</sup> Italian micro-firms (with one to nine workers) are almost 50% less productive than their French and German counterparts.

Since Italian micro-enterprises employ more than 40% of all Italian workers (Figure 13, left panel) – in contrast to Germany or France, where they employ around 20% of workers – this is a major drag on productivity. Moreover, while the proportion of the Italian workforce employed in large companies has grown, it has grown both more slowly and from a lower base than in France, Germany, and Spain (Figure 13, right panel).

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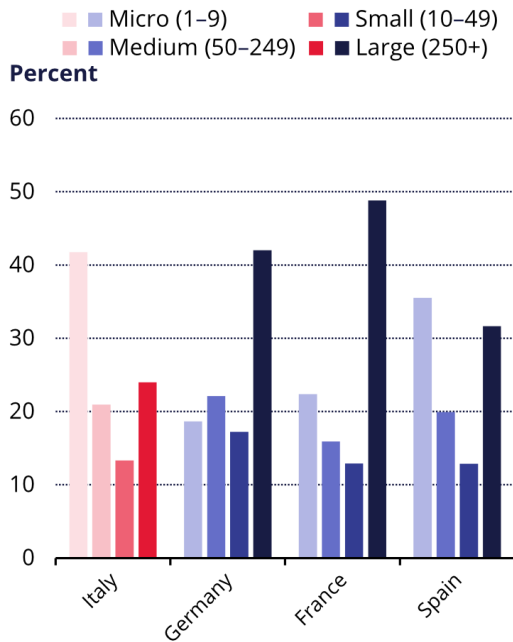
<sup>63</sup> Pellegrino and Zingales (2017) and Bugamelli et al. (2018) offer useful surveys of much of this literature. This section draws on both.

<sup>64</sup> French firms with 10–49 workers emerge as considerably more productive than German and Italian firms, adding around 50,000 euros as opposed to 40–44,000 euros per worker.



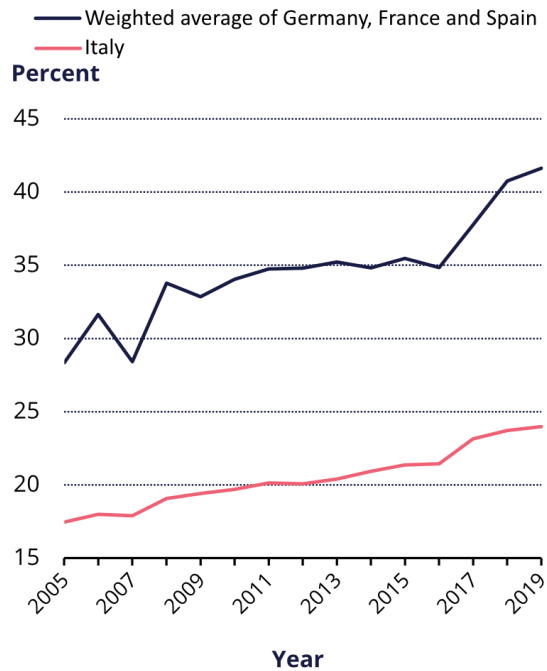
## Distribution of firm size, 2019

% of total employment by firms in respective size class



## Weight of large firms, 2005–2019

% of total employment accounted for by firms with 250+ employees



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**Figure 13:** Distribution of firm size, 2019 & Weight of large firms, 2005-2019; **Sources:** OECD, SDBS Structural Business Statistics

Why are firms smaller in Italy? Part of the answer is historical: as Amatori et al. (2013 in Toniolo ed 2013) show, between 1870 and 1970, both private entrepreneurship and the publicly owned Istituto per la Ricostruzione Industriale (IRI) had created a landscape of large and often globally competitive firms.<sup>65</sup> However, during the 1970s and 1980s, many of these firms started to weaken, partly driven by general factors like the oil shocks of 1973 and 1979 and the Hot Autumn of labour unrest of 1969, partly driven by firm-specific factors like mismanagement (Montecatini), botched successions (Olivetti), destructive competition (the petrochemical industry, see De Cecco 2007, pp. 774–5), or corruption scandals and political interference (ENI).<sup>66</sup> According to some analysts, a deeper cause lay in “the inability of industrial and financial post-war elites to maintain their long-term coordination capacity over time” (Simoni 2020, p. 387). Regardless of the precise causes, in the 1980s and 1990s, Italy saw a shift in emphasis from large industrial firms to small and medium enterprises, concentrated in so-called industrial districts (Locke 1995).

Reinforcing these historical trends, labour market regulation may have created incentives for firms to remain below the threshold of 15 employees at which enhanced employment protection kicks in (Lenzu and Maresi 2019). However, Bugamelli et al. (2018) find that “Italian firms enter the market with a smaller size, and grow less and for a smaller number of years with respect to their

<sup>65</sup> The role of IRI was particularly important in the first two post-war decades: “During this period, public enterprises under excellent middle managers were an engine of investment and technical progress. IRI produced at internationally competitive prices intermediate goods, such as iron and steel, in which the private sector had historically been uncompetitive and in need of protection from 1887 onward” (Toniolo 2013 in Toniolo ed, p. 22).

<sup>66</sup> For sectoral histories of the loss of Italian large and globally competitive firms in this period, see Gallino (2003).

U.S. counterparts” (p. 21). In other words, the relevant problems seem to apply, at least partly, even before the threshold is reached. Bobbio (2016) argues that uneven tax enforcement may reduce average firm size. His pivotal assumption is that smaller firms are less at risk of tax audits, so that tax evasion has a higher expected return for them, while growth raises the risk of detection. Developing this intuition into a model, and calibrating it on Italian firm-level data, Bobbio estimates that, relative to perfect tax enforcement, the current enforcement structure reduces average firm size by 25% (Bobbio 2016, p. 24). This is consistent with the argument made by Dewey and Di Carlo (2021), who identify the deliberate and asymmetrical underenforcement of tax collection as an industrial policy tool in favour of small firms.

Another firm-level feature that is uniquely prevalent in Italy is family management. This is different from family ownership, widespread in Italy but also in Germany and, to a lesser extent, in France and the UK.<sup>67</sup> It is also different from having a CEO from the family of owners, which is also widespread among family-owned firms in Europe.<sup>68</sup> Family management refers to a situation in which the entire management is from the family of owners. This is the exception in Spain, France, Germany, and the UK, where it applies to only around a third, a quarter and 10% respectively of family-owned manufacturing firms (looking only at firms with more than 10 employees to exclude micro-businesses). In Italy, it is the rule: more than two-thirds of family-owned firms with more than 10 employees (Bugamelli et al. 2018, p. 31) draw their entire management structure from the owner-family.

Family management reduces firm productivity (Bandiera et al. 2015; Lippi and Schivardi 2014).<sup>69</sup> While this finding applies internationally, not just in Italy (Bloom and Van Reenen 2007, Bloom et al. 2012), it is particularly problematic given the higher proportion of family-managed firms there.

Moreover, the costs in terms of foregone productivity gains may have increased significantly in recent decades. Pellegrino and Zingales (2017) study the link between productivity, the firm-level adoption of information technology (IT), and management structures, and find that this link may explain up to two-thirds of the shortfall in productivity growth in Italy vis-à-vis other advanced economies between 1996 and 2006 (p. 23). Their mechanism is that meritocracy drives IT adoption, IT adoption drives recent productivity gains, but – due to family management – Italian firms are less meritocratic than elsewhere and hence under-utilize the productivity-enhancing possibilities of IT.<sup>70</sup>

Insofar as the importance of IT has increased dramatically since the mid-1990s (Bloom et al. 2012), this explanation establishes an elegant link between a long-standing feature of Italy’s political economy (family management) and a time-varying factor (the IT revolution) that aligns well with

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<sup>67</sup> Among manufacturing firms with more than 10 employees, for example, family-owned firms account for 86% of the total in Italy, 90% in Germany, 83% in Spain, 81% in the UK, and 80% in France (Bugamelli et al. 2018, p. 31).

<sup>68</sup> Among family-owned firms in the sample, more than 80% have a CEO from the family of owners in Germany and Italy. In the UK, it is around 70%, in France slightly more than 60% (Bugamelli et al. 2018, figure 13).

<sup>69</sup> Theoretically, combined family ownership and management has both advantages and disadvantages. The main advantages are an elimination or reduction of information asymmetries and principal-agent problems between owners and managers. The main disadvantages are that it can stifle the market for corporate control (due to higher frictions in screening potential take-over targets, higher reservation prices among sellers, and higher costs of post-purchase integration), cause excessive management risk-aversion (due to the owner-managers’ undiversified wealth portfolio), and lower the average level of management skills (due to the narrow recruitment pool).

<sup>70</sup> Note: This is not about the volume of IT investment (in fact, “Italy does not appear to under-invest significantly in ICT capital”, Pellegrino and Zingales 2017, p. 34), but about the extent to which business practices are reorganised and adapted in order to maximise the productivity gains from this investment.



the timing of Italy's productivity slowdown.<sup>71</sup> Interestingly, Pellegrino and Zingales also find that, once one accounts for the link between meritocracy, IT investments, and productivity, other explanations for Italy's productivity slowdown like labour market regulation, intensifying global and Chinese competition, or Eurozone integration (Pellegrino and Zingales 2017, p. 26–30) lose most of their explanatory power. Given their focus on TFP<sup>72</sup> and the relatively short timeframe covered in their research (1996–2006), however, this result should be treated with caution.

Moving from factors and characteristics internal to firms, researchers working with the firm-level perspective have also studied the links between firm performance and the social, administrative and legal environment they are embedded in. Three findings merit highlighting here.

First, organised crime represents a significant obstacle to firm efficiency in Italy, though this effect is difficult to quantify. Productivity growth is harmed partly through rendering banks less willing to lend (Bonaccorsi di Patti 2009), reducing the funds available for investment;<sup>73</sup> partly through direct rent extraction from firms; and partly through the indirect costs of unsettling the rule of law, distorting competition, and reducing incentives to invest (Mirenda et al. 2022).

With regards to quantification, Mirenda et al. find that 0.7% of all Italian firms in the northern and central regions are infiltrated by 'Ndrangheta. Because these tend to be larger-than-average firms, they account for almost 2% or 42 billion euros of the total revenue of all firms in these regions (p. 2754). Infiltrated firms cluster in construction, real estate, retail and wholesale trade, as well as utilities (p. 2756–7). They exhibit higher revenues and lower productivity (table 2), and are around 30% more likely to have won at least one public procurement contract (p. 2770). Macroeconomically, the impact of organised crime appears to be particularly harmful in the South: Pinotti (2015) estimates that the settlement of organised crime in Puglia and Basilicata from the 1970s on caused a loss of around 15% in GDP per capita over 30 years. Given the nature of the phenomenon, these numbers must be taken as rough approximations; nevertheless, they would represent a decrease in the annual growth rate of 0.5% per year in the South, i.e. a significant fraction of total growth.

Second, Italy's legal system appears to be a challenge to productivity growth. International comparisons highlight the slow nature of Italian court proceedings (Esposito et al. 2014). The average length of first-instance proceedings over commercial disputes, for example, is 1120 days in Italy, versus 645 days in the EU (World Bank 2022) or 553 days in the OECD (Bugamelli et al. 2018, p. 59, see also Figure 14). For the enforcement of real estate collateral, the average time (as of 2017) was 4.25 years, for insolvency cases 7.5 years (IMF 2017, p. 18). Moreover, the gap across regions is significant, with up to six-fold differences between the fastest and slowest Italian regions (IMF 2017, p. 18).

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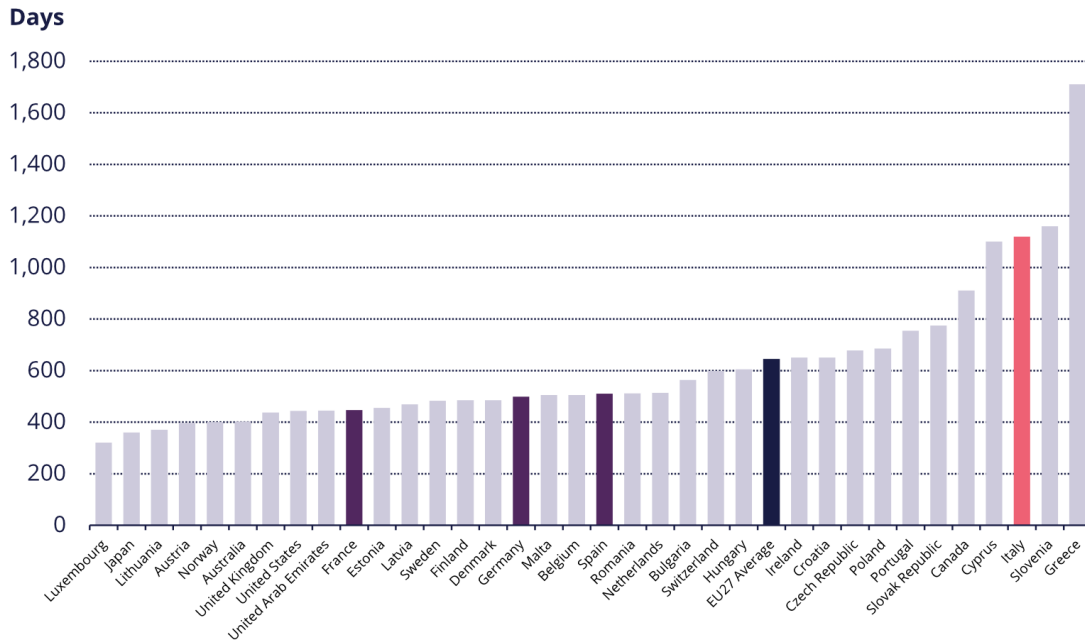
71 On “missing the IT revolution” as a driver of Italy's stagnation, see also Ottaviano and Hassan (2013), Milana and Zeli (2004), Bugamelli and Pagano (2004).

72 They only analyse the impact of the relevant events on TFP, i.e. a specific part of the intensive margin, ignoring the impacts that the same events may have on the volume of production (GDP), i.e. the extensive margin, as well as on capital and human capital investment, i.e. other parts of the intensive margin.

73 “[W]here the crime rate is higher, borrowers pay higher interest rates, pledge more collateral, and resort less to asset-backed loans and more to revolving credit lines than borrowers in low-crime areas. ... The offences that affect the loan market are those that exogenously increase firm fragility (extortion, organized crime) and raise expected loss, given the likelihood of default (fraud, fraudulent bankruptcy).” (Bonaccorsi di Patti 2009, p. 3)

These long delays in judicial proceedings have not gone unnoticed by private parties. Until a recent change in EU regulation, they gave rise to a legal tactic known as “the Italian Torpedo”: bringing a case before an Italian court in order to strategically delay its resolution by courts in other jurisdictions.<sup>74</sup>

## Time to enforce a contract in court



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Figure 14: Time to enforce a contract in court; Sources: World Bank, Doing Business Data Set, 2020

What are the implications for productivity? Drawing on over 4500 cases of judicial reforms across 74 countries, Chemin finds that for firms in relationship-dependent sectors<sup>75</sup> comprehensive legal reforms can improve productivity by around 20% (Chemin 2020, p. 63). This result should be interpreted with caution because the underlying data comes from reforms in developing countries with a major foreign aid component. It remains unclear to what extent it applies to Italy specifically. Nevertheless, it provides a first orientation for the magnitude of possible productivity impacts.

<sup>74</sup> A good description and (fictional) example of the Italian Torpedo is given by Bogdan (2007, p. 92–3): “Assume that a Swedish enterprise (the buyer) has purchased some goods from an Italian company (the seller). After delivery, which, pursuant to the contract, took place in Stockholm, the buyer finds that the quality of the goods is inferior to that specified in the contract. He demands damages from the seller, who refuses to pay. ... the Italian seller, anticipating that he will be sued in Sweden, rushes to an Italian court and applies for a declaratory judgment confirming that he is not guilty of a breach of contract. The Italian court lacks jurisdiction ... The seller is, of course, aware of this, but the main purpose of his action in Italy or a third Member State is not to obtain a favorable judgment there on the merits of the dispute. Instead, he wishes to benefit from the fact that the courts in some Member States are notoriously slow and it may take them years to finally dismiss the case due to lack of jurisdiction ... The seller hopes that the long delay, together with the potential costs and inconveniences of taking part in court proceedings abroad, will make the Swedish buyer give up his claim or accept a settlement favorable to the seller.”

<sup>75</sup> This is operationalised as sectors in which buyers cannot easily substitute from one seller to another. Non-substitutability creates the risk that, once a good is produced, a seller renegotiates the price up, knowing that the buyer cannot turn to an alternative supplier. This creates a heightened need for the reliable enforcement of contracts (Chemin 2020, p. 56). The main sector with particularly low substitutability, i.e. high relationship dependence, is specialised manufacturing. Examples of specific products with the lowest score for substitutability include actuators for plane seats, injection pumps, locking systems for cars, and machines to produce envelopes (Chemin 2020, Annex D).

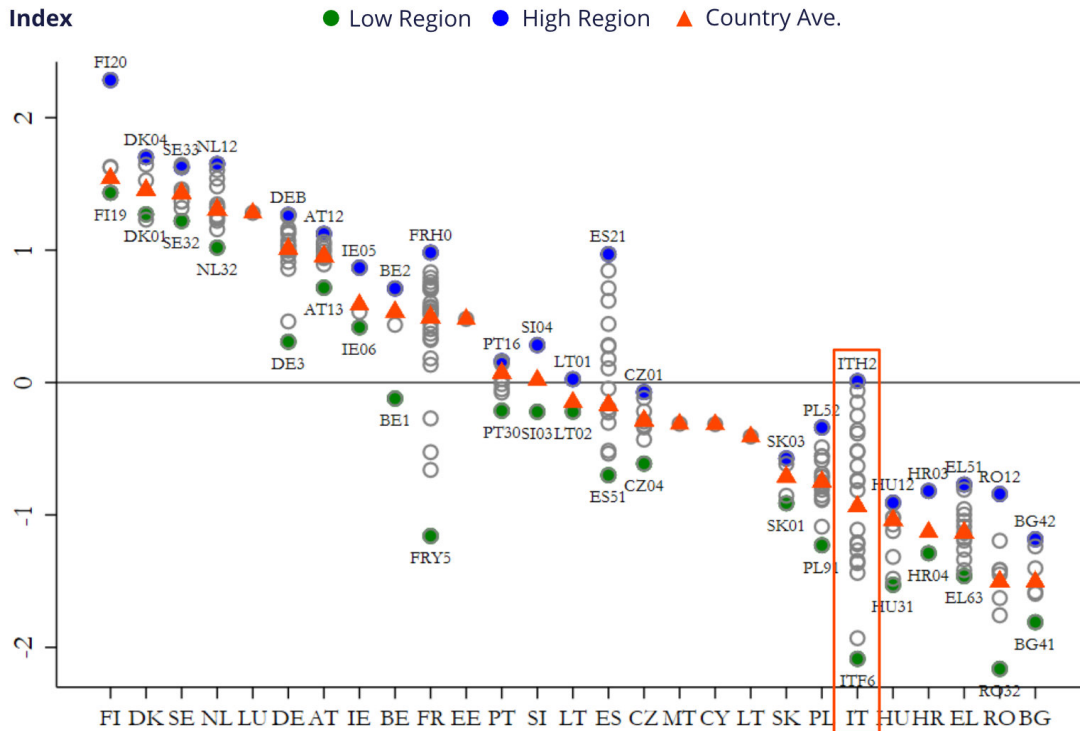
The slowness of Italy's legal system appears to reinforce two of the other firm-level problems in Italy: firm size and inefficient management structures. Giacomelli and Menon (2017) use regional differences in average court proceeding durations to estimate their impact on firm size. They find that a 10% reduction in the number of days it takes to enforce a contract leads to a 2% increase in the average size of manufacturing firms (p. 1252). Assuming a linear effect, bringing the speed of Italian courts in line with the EU or OECD average would lead to an increase in average firm size of approximately 10%, closing a quarter of the 40% gap between the average size of Italian firms and those of the other EU15 countries (Giacomelli and Menon 2017, p. 1253).

Linking court inefficiency to management structures, Bloom et al. (2012) provide evidence that ineffective legal protection, as proxied by a low "rule of law" indicator, induces firms to adopt higher centralisation and less efficient management structures. Note, however, that this result is obtained from a large-sample analysis, within which Italy obtains good scores for trust and decentralisation in firm management (e.g. figures 2, 3, and 4), so that any adverse effect would be visible only against a counterfactual of even higher trust and decentralised management in Italy.

Further, while the still-excessive duration of contract enforcement signals a need for further legal reforms, there have been improvements recently. From 2014 to 2019, the time to complete civil cases at trial has been reduced from 13 to 11 months. Over the same period, the number of pending proceedings at civil courts has been reduced by 24% and backlogs in the court of appeals and tribunals have fallen by 50% and 43% respectively (OECD 2021, p. 55). In addition, Italy's National Recovery & Resilience Plan has budgeted 2.3 billion euros for temporary staff over two 2.5-year cycles (around 8% of the justice system's regular annual total personnel budget, OECD 2021, p. 55), in order to clear more of the backlog. The bankruptcy regime, too, has been reformed in 2019, though it remains too early to evaluate the effects of this reform.

Third and finally, public administration affects firm behaviour and efficiency. Here, too, international comparison suggests that public administration in Italy creates costs and frictions for firms (Campanella and Federico 2020, p. 5). The European Quality of Governance Index (Charron et al. 2021), for example, shows Italy in the lowest quartile, with very high internal heterogeneity by region (Figure 15).

## National and regional scores in the European Quality of Government Index



**Note:** Figure 3 from Charron et al. (2019), minor graphic changes and highlight by the author.

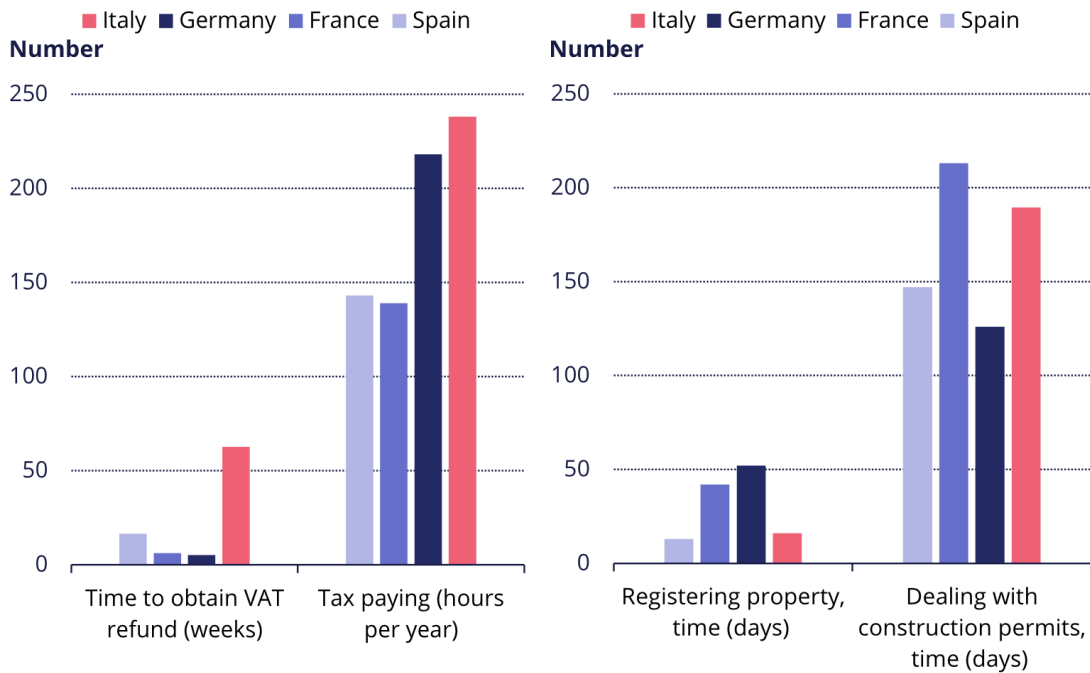
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**Figure 15:** National and regional scores in the European Quality of Government Index; **Source:** Charron et al. 2021

As Figure 16 shows, however, Italian public administration is by no means universally slow or inefficient. While it takes over a year to receive VAT refunds, and while the time burden for corporate tax filings is relatively high (left panel), registering property and dealing with construction permits is as fast as or faster than in comparable European countries (right panel).

## Time required for certain administrative procedures in Italy, Germany, France, and Spain

Weeks, days or hours per year



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**Figure 16:** Time required for certain administrative procedures in Italy, Germany, France, and Spain; **Source:** World Bank Doing Business Survey (2020)

The precise impact of public administration on overall productivity is difficult to measure. Giordano et al. (2020) use within-country differences in Italian regional and provincial administrations to investigate this effect. They find that productivity could be increased by 9% if all Italian provinces had the same level of public sector efficiency as the most efficient ones (Giordano et al. 2020, p. 1019). Here, too, the finding must be interpreted with caution: the quality of public administration may well be a proxy for other regionally specific features, which may either render administrative reform difficult or reduce its productivity-boosting effect (see Section 5 below).

The challenges faced by firms operating in Italy are also reflected in the volume and the characteristics of foreign direct investment (FDI). Although the stock of inwards FDI in Italy has approximately doubled since 2005, at just over 20% of GDP it remains below the levels in Germany (26% of GDP) and France (32%) as well as significantly below EU (63%) and OECD (56%) averages (Figure 17, left panel). Indeed, whereas the Italian economy constitutes 3.5% of total OECD GDP, its stock of inwards FDI accounts for only 2% of all inwards FDI across the OECD (OECD 2017, p. 2–3).

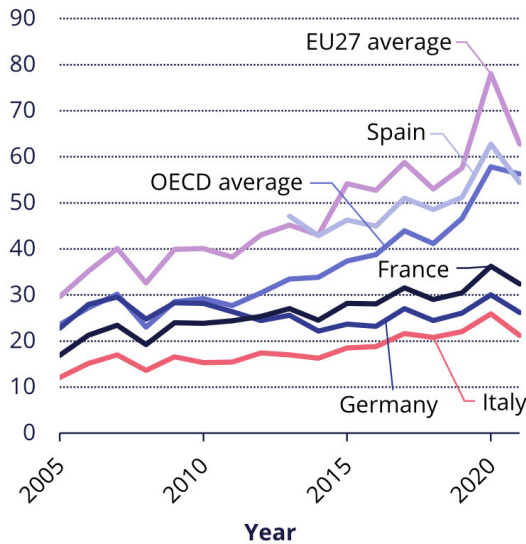
Concerning the characteristics of FDI, foreign-owned firms in Italy are more import-intense (i.e. have a higher share of imports in purchases) than the average foreign-owned firm in an OECD country, despite Italy being a comparatively large OECD economy. This suggests that foreign-owned firms in Italy may prefer to import goods and services as much as possible, rather than buy them locally (OECD 2017, p. 3). Compared to the OECD average, foreign-owned firms in Italy are also less export-intense (i.e. have a lower share of exports in turnover, OECD 2017, p. 3). While one might think that this is a natural consequence of Italy being a relatively large OECD economy, Italian domestic-owned firms are more export-intense than the average domestic-owned OECD firm (ibid). The fact that foreign-owned firms are less export-intense than both foreign-owned firms

in other OECD economies *and* than domestic-owned Italian firms may speak to the existence of specific challenges for these firms in Italy.<sup>76</sup> Potentially reflecting similar underlying factors, at 3.1% the average returns on FDI investments in Italy over the last five years are significantly below the OECD average of 4.2% (Figure 17, right panel).

### Stock of inwards FDI

% of GDP

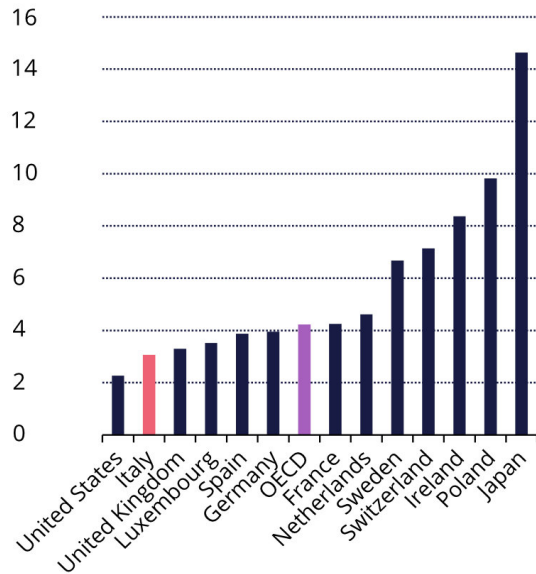
Percent



### Average return on FDI investment, 2017–22

Income on inward FDI as % of total stock of inward FDI

Percent



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Figure 17: Stock of inwards FDI & Average return on FDI investment 2017–22; Source: OECD

To summarise, the firm-level perspective adds important granular details overlooked or insufficiently substantiated by the other two families of explanations. In particular, it can account for the *prima facie* puzzling claim from the Euro-integration literature that wages are at once too high and too low. If management in many firms is low-quality and risk-averse, low wages will not encourage investment, so low wages may appear as (one of) the drivers of underinvestment and insufficient demand. At the same time, insofar as low investment and rent-extractive management depress productivity, unit labour costs (i.e. productivity-adjusted wages) may at the same time appear too high to be competitive in export markets.

However, in its emphasis on supply-side factors, the firm-level perspective can underemphasise the role of demand.<sup>77</sup> Pozzi and Schivardi (2016), for example, find that productivity and demand heterogeneity are equally important in shaping firm growth. Moreover, this perspective has generally little to say as to why, if these problems have been identified, they have not been remedied yet. For this, closer attention to Italian politics, history, and sociology is essential.

<sup>76</sup> In its 2020 Investment Climate Statement, the US State Department stated that “[t]he government’s efforts to implement new investment promotion policies to position Italy as a desirable investment destination have been undermined in part by Italy’s slow economic growth, unpredictable tax regime, multi-layered bureaucracy, and time-consuming and often inconsistent legal and regulatory procedures” (US State Department, 2020).

<sup>77</sup> As indeed some of the main researchers working in this framework acknowledge themselves. E.g. Bugamelli et al. (2018): “the focus of this paper is on structural and supply-side issues. This does not mean that demand is not important for productivity developments ... in particular, demand issues (both levels and uncertainty) have determined a prolonged weakness in investment by private firms” (p. 10).



**Box 1: Two other explanations**

Beyond the explanations covered in the main text, two others have received sufficient public attention to merit brief discussion.

First, some argue that **excessively low interest rates** have facilitated the survival of **zombie firms**, blocking the reallocation of their capital and labour inputs to more productive uses (Andrews et al. 2017, Gopinath et al. 2017). However, Schivardi et al. (2020) show that the zombie-firms literature suffers from an identification problem: it mistakes a correlation effect – in a recession, the share of zombie firms increases and the performance of non-zombie firms deteriorates – for causation. The true cause of poorer firm performance is the recessionary context, not the rising share of zombie firms (see also Bugamelli et al. 2018, footnote 13, for further methodological critique of this literature). Concerning the influential Gopinath paper from this literature, its causal mechanism is specifically contradicted by Calligaris et al. (2016, p. 37): whereas Gopinath et al. argue that low real interest rates decrease productivity by channelling too much capital to larger, credit-unconstrained, and allegedly lower-marginal-productivity firms, Calligaris et al. (2016, p. 37) find that being credit-unconstrained is correlated to *higher*, not lower total factor productivity. An increase in lending that skews towards non-credit-constrained firms should therefore raise rather than decrease productivity.

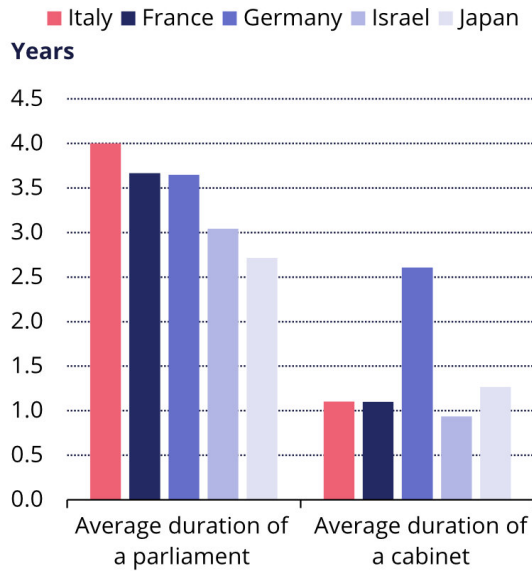
Second, **political instability**: some argue that “in Italy, political instability – reflected in frequent changes of government – is a major obstacle to coherent economic policies” (Tokarski 2019, p. 11). This explanation fails to convince for two reasons. First, the classification of Italy as a uniquely unstable country is contestable. While Italy has had 72 cabinets in the 77 years since WWII, i.e. a cabinet, on average, served for just over one year (Figure 18, left panel), there have only been 31 different prime ministers. Until 1981, all prime ministers came from the Christian Democratic party, so that a new cabinet was often just a way to reflect shifting balances of power between the party’s different wings. Moreover, while cabinets have been comparatively short-lived, parliaments are highly stable and usually serve their terms to completion.<sup>78</sup>

Having said this, political instability has arguably increased since the 1990s. While cabinets have become more long-lived, the rise and fall of political parties has accelerated and there have been four out-of-cycle elections (1994, 1996, 2008 and 2022). This coincided with the slowdown in productivity growth.

Second, however, even if Italy were to be classified as a particularly unstable country, the link from political instability to low growth is questionable: Israel, France and Japan all exhibit similar political instability, when measured by the (imperfect) proxy of average cabinet duration (Figure 18, left panel). Yet none of them saw a comparable productivity slowdown (Figure 18, right panel). The case of France is particularly telling: its period of maximum political instability in the 20th century – the turbulent 4th Republic (1946–1958) with 21 governments over 12 years – coincided with the first decade of its post-WWII economic miracle.

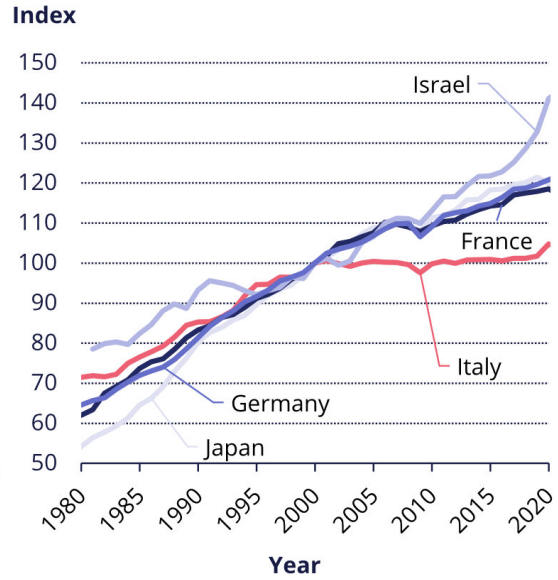
<sup>78</sup> Since 1945, Italy has had 19 parliamentary elections, the same number as Switzerland, compared to 20 in Germany, 21 in France and the UK, 25 in Canada, 26 in New Zealand, 28 in Japan, and 30 in Australia.

## Parliament and cabinet durations since WWII



## Productivity in Italy, France, Germany, Japan & Israel

Real GDP per hour (PPP), indexed to 2000



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**Figure 18:** Parliament and cabinet durations since WWII & Productivity in Italy, France, Germany, Japan & Israel; **Sources:** Döring et al. (2022), left panel, OECD, right panel



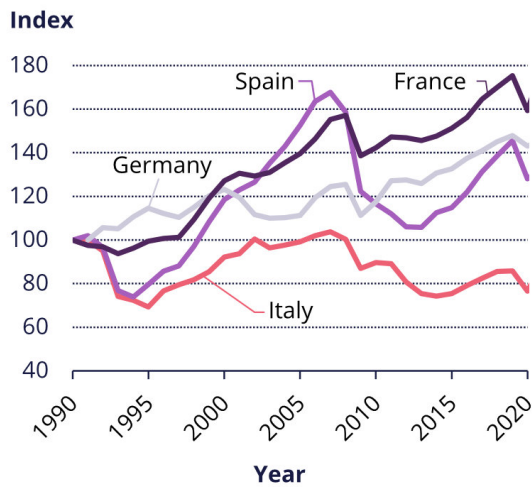
## 5. An attempt at synthesis

Uniquely among advanced economies, Italy's productivity – the amount of GDP produced per hour worked – stopped growing around the year 2000. GDP growth, both nominal and real, continued until 2007 and resumed weakly from 2013 to 2019, but was driven almost exclusively by additional labour input (Figure 8). This, as well as the growth-inhibiting nature of Italy's political economy, has long been recognised (De Cecco 2007). Despite this recognition, however, and despite repeated reform efforts over the last 30 years, productivity growth has not resumed. Why?

Surveying the various explanations canvassed above, a first answer seems to be that the various components of the reform mix were contradictory, and thereby ultimately counterproductive. The chosen combination of external constraint, severe demand compression, and liberalising structural reforms, which characterised the reform efforts of both the 1990s and the 2010s, is now understood to be counterproductive (e.g. Gehrke and Weber 2017 for labour market reforms, Bordon et al. 2016 for both labour and product market reforms). Public investment suffered directly (Figure 19, right panel); the general uncertainty created by this reform mix, together with weak demand and long-standing problems with corruption, the courts, and public administration, harmed private investment (Figure 19, left panel). Against such a backdrop, the dualising and part-liberalising labour market reforms boosted insecure and temporary employment, shifted rents from workers to firms, and reduced human capital formation.

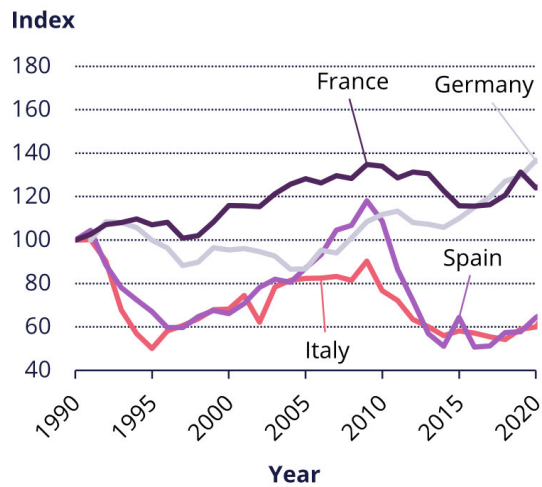
### Private investment, 1990–2020

Indexed to 1990, for Germany 1991



### Public investment, 1990–2020

Indexed to 1990, for Germany 1991



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**Figure 19:** Private investment, 1990–2020 & Public investment, 1990–2020; **Source:** AMECO; investment defined as gross fixed capital formation in constant euros

With public, private, and human capital investment all weak, and with the landscape of firms dominated by small and medium enterprises, often badly managed, Italy was in a poor position to tap the single market and the possibilities of the unfolding ICT revolution, and to respond to intensifying Chinese competition (Faini and Sapir 2005).<sup>79</sup>

Besides creating an inauspicious macroeconomic context, the reforms also undermined effective coordination on the supply side (Simoni 2020): in the labour market, the stronger centralisation of wage bargaining implemented in the early 1990s would have allowed for longer-term, cooperative strategies between firms, unions, and workers, roughly on the German model. But the simultaneous erosion of employment protection militated against this, instead encouraging noncommittal, more short-term oriented strategies. In corporate governance and finance, the reforms of 1998 and 2003 increased the protection of minority shareholders. Coupled with the privatisation of the banking system, this could have boosted market-based finance, leading to stronger monitoring of firms' managements via a market for corporate control.<sup>80</sup> This would have constituted an Anglo-American route towards rooting out poor management. But lifting the prohibition for banks to own shares in non-financial firms and continuing to tolerate networks of pyramidal and cross-ownership had the opposite effect. These measures worked towards the older model of bank-based monitoring of firms' managers, often associated with Cold War West Germany.

The result of these contradictory reforms, both at the macro and the micro level and on the demand as well as the supply side, was an equilibrium of low expectations, low investment, and intensifying hysteresis: a stagnation trap (Benigno and Fornaro 2018, Storm 2019). This was particularly problematic given that the ICT revolution, the rise of China, and the integration of Eastern Europe after 2004 created a situation in which both investment and a reallocation of production factors were essential. Germany, Austria, and other north-central European states seized the relevant opportunities, benefitting from the integration of high-skill, low-wage Eastern European workforces into their value chains, while Italy, along with most of Southern Europe, missed out. A core-periphery dynamic developed, leading to a polarisation between a successful Central European Manufacturing Core and a lagging Southern European Periphery (Celi et al. 2018).

But this only raises the next set of questions: Why was *this* mix of reforms adopted? Why did both the reforms and the productivity slowdown happen *when* they did? And why was there *no* (fundamental) *change* of direction once the reform mix's problematic nature became apparent?

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79 The role of Chinese competition in explaining Italy's stagnation remains contested: on the one hand, Bugemelli et al. (2017) find that, given its specialisation in mid-technology manufacturing, Italy was indeed particularly exposed to a "China Shock". The productivity numbers shown above are consistent with this explanation: Italian manufacturing productivity growth, while faster than in the service sector, was significantly slower than in Germany, France, and – most tellingly – Spain (see Figure 7 above). On the other hand, Pellegrino and Zingales (2017, p. 26–8) find that countries more exposed to Chinese competition tended to have higher, not lower total factor productivity growth. However, they only study the intensive margin, i.e. the productivity of operative firms, and ignore the extensive margin, i.e. firms leaving the market entirely. Their finding is therefore consistent with a negative effect of Chinese competition on Italian GDP growth through Italian firms going out of business. Through the Kaldor-Verdoorn effect and reduced learning by doing, this may then have reduced productivity growth. At the firm level, finally, Mion and Zhu (2013) find that increased Chinese competition leads to skill upgrading in low-tech manufacturing industries and has no or even a positive impact on firm survivability (through the offshoring of production). However, this finding is based exclusively on data from Belgian SMEs, and it remains unclear to what extent it would apply to Italian firms, given the significant challenges at the firm level identified in section 4.3 above.

80 i.e. the threat of hostile takeovers whenever a firm's share price drops too low.

I am no expert on Italy's political and economic history; the answers sketched to these deeper questions are hence tentative and cautious. It seems, however, that a convincing explanation must start from the developments of the 1970s and 1980s. At this time, the ebbing of growth brought a number of structural challenges to the surface: civil and administrative courts started to clog up, with average proceeding times nearly doubling (Bianco and Napolitano 2013 in [Toniolo ed](#), Figure 19.3, p. 540); wage bargaining, already more aggressive in the 1960s, started to become dysfunctional and inflationary; inflation settled at levels above Italy's main trading partners, the UK excepted; and large Italian manufacturing firms lost contact with the global productivity frontier. While the civil violence of these years died down after 1982 (Judt 2005, p. 475–6), the continued management of the macroeconomy through large public deficits contributed to high inflation, constant devaluations, an accumulating debt burden, and increasing tensions vis-à-vis the process of European integration. The culmination of this process was the 1992 ERM crisis.

The deeper lesson of these years among reform-oriented citizens and elites may well have been that the regionally concentrated lack of social capital and civicness (Putnam et al. 1993), well-known from the second half of the 19th century and Italy's incomplete unification, had not disappeared with the post-war economic miracle (Capussela 2018). In an echo of Eastern Bloc economic history, it seems plausible that the economic consequences of this social structure became costlier, the more the sources of growth shifted from extensive investment and technological catch-up to the redeployment of factors of production and innovation. As deindustrialization picked up pace and the ICT revolution beckoned, Italy lost touch with the global productivity frontier (Amatori et al. 2013 in [Toniolo ed](#), p. 462).

Economically, given the ideas prevalent at the time, austerity and market liberalisation seemed like good solutions to this slowdown (OECD 1994, Daveri and Tabellini 2000, IMF 2003). Politically, Euro integration seemed like a uniquely effective framework to ensure these reforms could and would be implemented, despite the resistance they would face (Dyson and Featherstone 1999). But, as outlined above, the reform mix produced by this conjuncture of ideas and circumstances was counterproductive. It dismantled existing structures but failed to build effective new institutions and processes for strategic coordination or for the recreation of large firms. It also starved those small and medium enterprises that had carried the remaining productivity growth of the 1980s and 1990s of demand, credit, and competitiveness. From the mid-1990s on, the ICT revolution was missed (Pellegrino and Zingales 2017), and stagnationist tendencies were reinforced by the austerity the *vincolo esterno* brought.

These problems started to become apparent in the mid- to late 2000s (e.g. Gallino 2003, De Cecco 2007). Yet the reform mix was not fundamentally changed. On the contrary: after 2008, successive governments continued pursuing austerity and structural reforms, particularly to the labour market, despite these policies having failed to boost growth in the past. Fully determining why policymakers doubled down on this approach may only be possible once the relevant archives in Rome, Berlin, Brussels and elsewhere are opened. However, as Moschella (2017) and others have argued, it seems plausible that a new mechanism was at work here: whereas the reform mix was originally adopted because of domestic dynamics, including the *vincolo esterno* strategy,<sup>81</sup> the continuation of this reform agenda in the 2010s may have been mostly due to a fear of market punishment, particularly after the 2011 peak in interest rates on Italian government bonds.

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<sup>81</sup> I.e. the deliberate (self-)imposition of an external constraint on Italy's future governments by a minority of politicians and civil servants in order to achieve reforms that this group deemed beneficial and necessary but unviable if debated purely in the domestic arena.

This fear of market punishment was rational, given the architecture of the Eurozone (De Grauwe 2013). But since this architecture is of human creation, this only leads to further questions: why was such an architecture constructed in the first place? And why was it not fundamentally rebuilt, even as its weak spots revealed themselves? These questions show how deeply Italy's economic fate is intertwined with that of the European Union and especially the Eurozone. Answering them, however, would take us too far afield for the purposes of this paper.

As a preliminary conclusion, then, it may be that the cause of Italy's stagnation is two-fold: first, in the 1990s and 2000s, and despite their best efforts, collective-interest-oriented politicians, bureaucrats, judges and prosecutors failed to overcome long-existing, path-dependent clientelistic legacies and structures. Reforming elites imposed the *vincolo esterno*; an emboldened judiciary went after endemic corruption; the rule of law confronted the extractive side of political capitalism (Milanovic 2019). But instead of overcoming stagnation, the resulting reforms deepened it. Partly, this was due to the economic ideas that guided these reforms, which turned out to be counterproductive, particularly regarding labour market reforms, privatisations, and the abandonment of industrial policy. Partly, this may have been because modernizing elites never achieved a "hegemony of reformers", so that their reforms relied on ad-hoc coalitions and favourable circumstances (see also Merler 2019 in Chang et al. 2019).<sup>82</sup> The result: the contradictory set of reforms described above.

Second, even as the counterproductive nature of this reform mix became clear, fear of financial market punishment (underpinned by a European macro-financial architecture that made these fears reasonable) may have deterred later governments from fundamentally revising the mix. To what extent this is truly the main mechanism that kept the dysfunctional reform mix in place – as opposed to, for example, a continued belief in its efficacy among key players in the Italian administration – must await future historical research.

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<sup>82</sup> The absence of a "hegemony of reformers" showed itself clearly in ongoing struggles over the rule of law. In the person of Berlusconi, and particularly between 2001 and 2011, the defenders and beneficiaries of extractive political capitalism achieved a significant weakening of the rule of law. Relevant examples include Law n. 367/2001, which restricts the admissibility in criminal proceedings of evidence gathered abroad, essential to the prosecution of white collar (and esp. tax- and accounting-related) crime; Law n. 61/2002, which effectively decriminalised fraudulent accounting; Law n. 251/2005 (also called ex-Cirielli, because Edmondo Cirielli, who originally introduced the draft law to parliament, voted against the law at final passage due to subsequent amendments and demanded it no longer be associated with his name), which reduced the statute of limitations for many crimes, including corruption; and Law n. 46/2006 (Legge Pecorella), which made it impossible for public prosecutors to appeal against acquittals in corruption-related and other cases. All of these laws were passed under Berlusconi governments. For a comprehensive list, see Vannucci (2009, p. 254–55, table 1).

## 6. Conclusion

To summarise, this paper covered three families of explanations for Italy's long stagnation: "unwillingness to reform" accounts, European monetary integration accounts, and firm-level perspectives. A first result is that no single factor explains the timing, depth, and persistence of Italy's lack of productivity growth. The demand compression, core-periphery restructuring, and competitiveness effects of Euro integration played a role, as did long-standing problems with firm size and management, the judicial system, corruption, and weaknesses in public administration.

If there is one factor that merits singling out, it is perhaps the contradictory and sticky nature of the reforms undertaken since 1992. These were driven by the desire to meet the Maastricht convergence criteria and by a recognition that change was needed, but were shaped by the economic ideas prevailing at the time and contorted by the absence of a hegemonic reform consensus. As such, they failed to produce a viable new growth regime, while dismantling the worn-out remnants of the old. Once their ineffectiveness had become apparent from the late 2000s on, instead of replacing them with a new reform paradigm, successive Italian governments, under pressure from financial markets and the macro-financial architecture of the Eurozone, doubled down on them.

However, while the *vincolo esterno* strategy of the 1990s and the Eurozone constraints of the later 2000s and 2010s were macroeconomically destructive, institutionally they have supported some promising reforms in the last five to 10 years. Italy's tax administration, for example, has made dramatic strides since the turn of the millennium by being one of the first to digitise its practices (Döpking 2023). In some areas, it now operates more efficiently than Germany's or France's (Murphy and Guter-Sandru 2018, p. 41). Both the World Bank's and Transparency International's perception-based indices of corruption indicate significant improvements since then, too. Non-performing loans, which had burdened the Italian banking system during the 2010s, have fallen from around 350 billion euros (with a coverage ratio of below 45%) to around 100 billion (with a coverage ratio of more than 50%) by 2020 (IMF 2022a, figure 5, p. 38), signalling significant improvements in the banking sector as well.

This positive trend is reinforced by the actions and reforms contained in Italy's National Recovery and Resilience Plan, *Italia Domani* (Government of Italy 2021). There have been improvements to public administration: a single national website for all recruitment by the national administration, for example, has been launched in July 2022 and the hiring process itself has been reformed (European Commission 2022a, p. 8–11). The tax administration, too, is being upgraded: for a pilot group of 2.3 million taxpayers, pre-populated VAT returns are now available on Italy's online tax platform, speeding up VAT refunds. A 'big data' analytics system has been set up to reduce tax evasion (European Commission 2022a, p. 19–21). The functioning of the courts is a further priority in the plan: 2.3 billion euros of fresh funds, around 10% of the judiciary's ordinary personnel budget, have been earmarked for hiring temporary staff to reduce the case backlog (European Commission 2022a, p. 4–6).

Besides these improvements to public administration, tax collection and the courts, the plan also provides for public investment in several key areas. 70,000 additional teachers are to be recruited by the end of 2024 (European Commission 2022a, p. 71). For this, and for other measures to improve vocational training as well as women's and young people's labour market participation, the Plan has budgeted 26 billion euros. Complementing the investment in staff, 40,000 school buildings, 40% of which must be in Southern Italy, are to be wired for digitalisation (European Commission 2022a, p. 73). Contracts for the expansion of 5G networks and 1 Gbit/s broadband,

including to 9000 schools, 12,300 public healthcare facilities, 8.5 million residential units and 15,000 square kilometres of so-called market failure areas (where 5G would not be installed without subsidy) have all also been awarded as part of the plan. These are to be built by Q2 2026 and will be funded with a budget of 6.7 billion euros (ibid, p. 23). Nearly 25 billion euros of investments are planned for Italy's railroad network, covering both the construction of new high-speed railways and the upgrading of existing infrastructure (Government of Italy 2021, p. 161). Finally, in light of the COVID pandemic, the plan foresees 7700 additional intensive and semi-intensive care units to be added by the second quarter of 2026 (European Commission 2022a, p. 105).<sup>83</sup> And while it is still early days for Italy's National Recovery and Resilience Plan, in an intermediary assessment in September 2022 the European Commission judged the investments and reforms outlined above to be on track (European Commission 2022b).

These green shoots should not obscure the difficult challenges that remain, however. The National Recovery and Resilience Plan does not include an industrial strategy to counteract the core-periphery dynamic that has unfolded across the European Union over the last 20 years. While helpful – and potentially significantly so – it therefore remains an open question whether the plan will suffice to bring Italian productivity back in line with the Central European Manufacturing Core. Nor does it address some of the root causes of poor management at Italian firms: their small size, the prevalence of family management, and the absence of effective external disciplining. Even if the positive macroeconomic turn associated with the NextGenEU programme were to continue, e.g. through an effective reform of EU fiscal rules, further action would therefore be needed to address Italy's corporate and industrial structure.

Apart from these economic challenges, politics remains pivotal. Any economic programme must be embedded in a deeper understanding of Italian politics and society than I have been able to develop here. As a closing reflection, consider the following. In its 2022 Article IV consultations, the IMF conducted a Principal Component Analysis (PCA) of 56 structural indicators – e.g. the average duration of civil proceedings in different regions, the share of the labour force with elementary, secondary or tertiary education, or the proportion of households with broadband access – across 21 Italian regions (IMF 2022b, p. 4–5; see box 1, p. 5, for an explanation of the method). This analysis shows that

- nearly 60% of the total variance was accounted for by the first Principal Component, indicating an extremely high correlation among the 56 different structural indicators; and
- regional labour productivity is tightly correlated with this first Principal Component.

One way to summarise these findings is that, beneath the various individual factors that inhibit productivity growth, there may be a single common pattern, a deeper economic, social, and political structure that explains much, perhaps even most of the weak productivity growth. This is consistent with but extends beyond the synthesis attempted above. It suggests that the deepest challenge already faced by reformers of the 1990s remains: to break up not just individual instances of inefficiency or particular structures of rent-seeking, but to transform the nature of Italy's capitalism from an extractive-selfish kind to a cooperative-inclusive one.

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<sup>83</sup> However, while this increase is significant, it does not close the gap in intensive care units between Italy and other European countries. In Germany, for example, there are approximately 330 intensive care beds per million inhabitants. Currently, there are around 80 per million inhabitants in Italy (Bramucci et al. 2020, figure 7, and author's calculation), which will increase to around 210 with this investment, closing just over half of the gap to Germany.



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