In a Time of Crisis: Some Notes on the Italian Labour Market and Beyond

Luca Nunziata*

Introduction

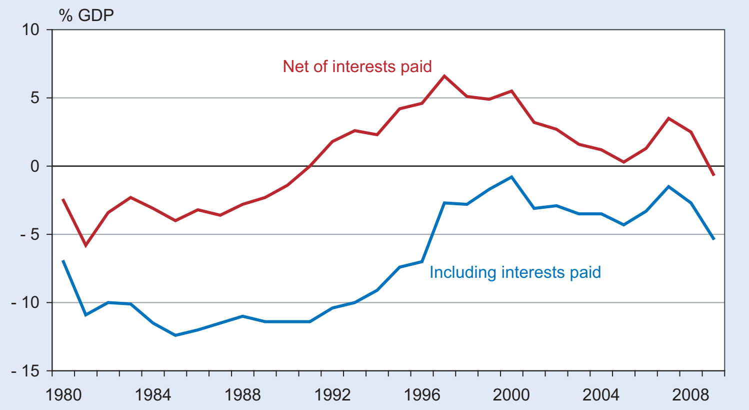
150 years after its foundation as a unitary state, Italy is living another founding moment of its history. The unfolding of the sovereign debt crisis has contributed to reveal the contradictions that still affect Italian society, while focusing attention on the status of the Italian economy and its prospects for the future. In this short article, I will concentrate on the main issues regarding contemporary Italy, the problems plaguing its economy and the dimensions of it that direly need to be reformed.

The Italian economy was characterized by a relatively long period of stagnation and possibly one of the poorest performances in terms of real GDP growth among OECD countries over the last decade. According to the OECD data depicted in Table 1, Italy grew by only four percentage points in the period 2000-2010. These numbers originate from the inability to define new economic strategies in a world where traditional competitive devaluations are no longer an option and fiscal policy is constrained by the burden of a large debt to GDP ratio.

Since the mid-1990s substantial efforts were put into reducing the debt to GDP ratio in order to meet the Maastricht treaty criteria. These efforts resulted in almost a 15 percent reduction in just eight years during the period of 1996–2004. However, the fiscal consolidation process did not advance at the same pace in subsequent years, and the emergence of the global financial crisis did the rest. After a prolonged accumulation of government surpluses net of interests paid since the early 1990s (Figure 1), the finan-

Figure 1

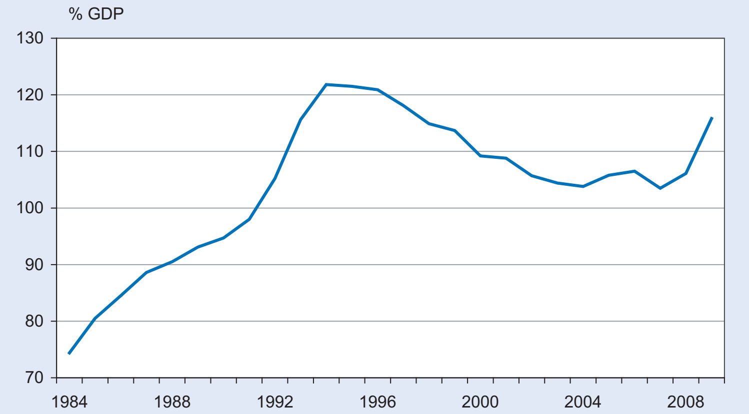
Italian Government Deficit/Surplus, 1980–2009



Source: ISTAT.

Figure 2

Italian Government Debt, 1984–2009



Source: ISTAT.

* University of Padua, IZA

cial situation worsened; and in recent years the debt to GDP ratio reversed its course, returning to the level of the late 1990s (Figure 2) once again. Since then Italy has become one of the main players on the stage of the subsequent sovereign debt crisis.

Much needs to be said about the path that brought the country and Europe to this point. However, this would go far beyond the scope of this article. Leaving our focus on contemporary Italy, the impossibility to intervene at a national level through traditional monetary policy since the introduction of the Euro and the constraints on fiscal policy have shifted the focus of policy makers and commentators to the structural factors and bad institutions that contribute to such poor economic performance. Over a decade of political ineptitude has nevertheless left its mark by preventing action in the critical areas that most urgently need to be addressed.

One aspect of the Italian disease that always attracts much attention is the labour market. This is not surprising since labour markets are at the basis of an efficient allocation of resources, they contribute to define the productivity standards of an economy and determine the welfare of a society. In addition, the crucial dynamics of social mobility and income distribution stem from the way labour markets are regulated. This article briefly discusses the fundamentals of Italian labour markets. It mainly concentrates on the actual state of labour in Italy, the open questions, the problems and possible solutions. It claims

Table 1

Real GDP growth rates in selected OECD countries, between 2000 and 2010

Country	2010/2000	2010/2005	2005/2000
Australia	1.36	1.14	1.19
Austria	1.17	1.07	1.09
Belgium	1.15	1.06	1.08
Canada	1.20	1.06	1.13
Denmark	1.06	0.99	1.06
Finland	1.19	1.05	1.14
France	1.12	1.03	1.08
Germany	1.10	1.06	1.03
Greece	1.23	1.01	1.22
Ireland	1.24	1.01	1.23
Iceland	1.27	1.00	1.27
Italy	1.04	0.99	1.05
Japan	1.07	1.01	1.07
Netherlands	1.15	1.07	1.07
New Zealand	1.29	1.07	1.21
Norway	1.16	1.04	1.11
Portugal	1.07	1.02	1.04
Spain	1.23	1.05	1.17
Sweden	1.23	1.08	1.14
Switzerland	1.18	1.11	1.07
United Kingdom	1.18	1.02	1.15
United States	1.17	1.04	1.13
Euro area (17 countries)	1.12	1.04	1.08
European Union (27 countries)	1.15	1.04	1.10
China	2.70	1.70	1.59
Russia	1.59	1.18	1.35

Real GDP end year/ Real GDP start year. Source: Author’s calculation using OECD data.

that the reform of Italian labour market institutions is a crucial step towards improving Italy's economic prospects. However, the article also stresses that this is only one aspect, albeit crucial, of what lies ahead. Other major corrections are badly needed in order to put Italy back on track and need to be addressed with comparable urgency. In addition, the success of a reform of Italian labour market institutions is strongly tied to a parallel intervention in other crucial areas of the economy. One set of policies intrinsically needs the other.

Labour market outcomes in Italy

Table 2 displays the latest data on employment, unemployment and activity rates in Italy in the first quarter of 2012. The picture is of a country with a large variation in performance across the three dimensions of geography, gender and age. As regards activity, the total activity rate goes from 70 percent in the North to 52 percent in the South, with the Centre in between at 67.2 percent. The relative difference increases when we consider females only. In this case, the activity rate goes from 62.6 percent in the North to only 39.1 percent in the South. Not only is the activity rate for females on average very low if compared to other European countries, but the relative discrepancy between North and South is even larger in this respect. Similar patterns are found when we consider employment and unemployment rates across regions and gender. In addition, what is striking is the amount of young individuals aged 15 to 24 who are unemployed. The average unemploy-

Table 2

Labour market indicators by sex and geographical area, 1st quarter 2012

Geographical area	Levels (%)			Absolute changes on previous year (percentage points)		
	Total	Males	Females	Total	Males	Females
			Activity rate 15-64 years			
Italy	63.6	73.8	53.4	1.4	0.7	2
North	70.4	78.2	62.6	0.9	0.4	1.5
Centre	67.2	76.1	58.4	1	0.4	1.6
South and the Islands	52.7	66.7	39.1	2.1	1.3	2.9
			Employment rate 15-64 years			
Italy	56.5	66.2	46.9	-0.2	-0.9	0.5
North	65	73	57	-0.3	-0.7	0.2
Centre	60.6	69.8	51.7	-0.4	-0.7	-0.2
South and the Islands	43.3	55.4	31.4	-0.1	-1.4	1.1
			Unemployment rate 15 years or more			
Italy	10.9	10	12.2	2.3	2.1	2.6
North	7.6	6.6	8.9	1.6	1.4	1.9
Centre	9.6	8.1	11.4	2.1	1.4	2.9
South and the Islands	17.7	16.6	19.6	3.7	3.7	3.5
			Unemployment rate 15-24 years			
Italy	35.9	33.6	39.3	6.3	5.9	6.8
North	27.3	25.9	29.4	5.4	6.4	3.9
Centre	34.7	28.6	43.3	5.3	-1.2	14.5
South and the Islands	48.3	46.1	51.8	7.7	8.7	5.8
			Inactivity rate 15-24 years			
Italy	36.4	26.2	46.6	-1.4	-0.7	-2
North	29.6	21.8	37.4	-0.9	-0.4	-1.5
Centre	32.8	23.9	41.6	-1	-0.4	-1.6
South and the Islands	47.3	33.3	60.9	-2.1	-1.3	-2.9

Source: ISTAT, Employment and Unemployment Quarterly Release, June 2012.

Figure 3

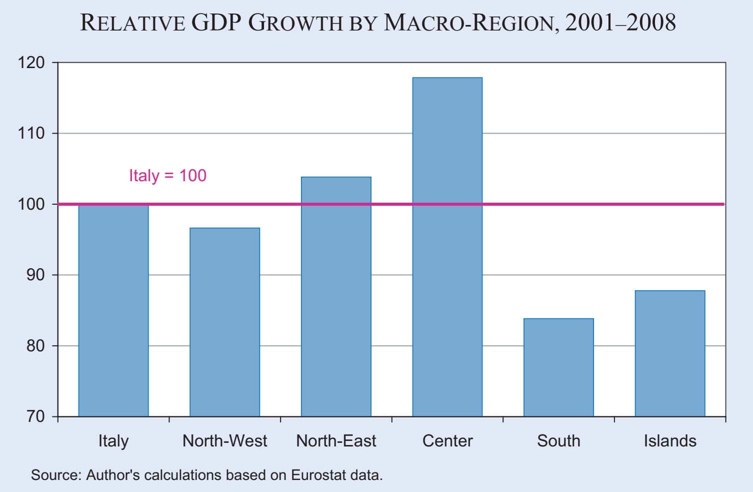


Table 3
Long-term unemployed (12 months or more) as % of total unemployed

	1995-1999	2000-2004	2005-2009
European Community (12 countries)	48.3	43.5	39.5
Italy	58	58.3	47.4
France	39.8	37.1	39.2
Germany	50.2	50.3	52.8
Spain	51.1	35.8	21.6
United Kingdom	36.7	24.4	23.1

Source: Eurostat.

ment rate in Italy is 10.9 percent. It totals 35.9 percent for the young (48.3 percent in the South) and a striking 51.8 percent for young females who live in the South. These figures actually underestimate the actual unemployment level because they do not account for those employees who are out of work, but are covered by the Cassa Integrazione Guadagni benefit system. In addition, the geographical patterns are persistent and the South is not catching up. If we look at Figure 3, we notice how in the period 2001–2008 the South and the Islands grew just little more than 80 percent of the country average growth rate, while the rich North-East and Centre were above average.

Another important feature of the Italian labour market is the duration of unemployment. Table 3 reports the percentage of long-term unemployed (12 months or more) over the total in a number of European countries. Almost half of unemployed Italians are out of work on a long-term basis, one of the largest shares in Europe, more than twice the percentage in the UK. However, the incidence of long term unemployment has substantially declined since the early 2000s, possibly because of the diffusion of atypical contracts.

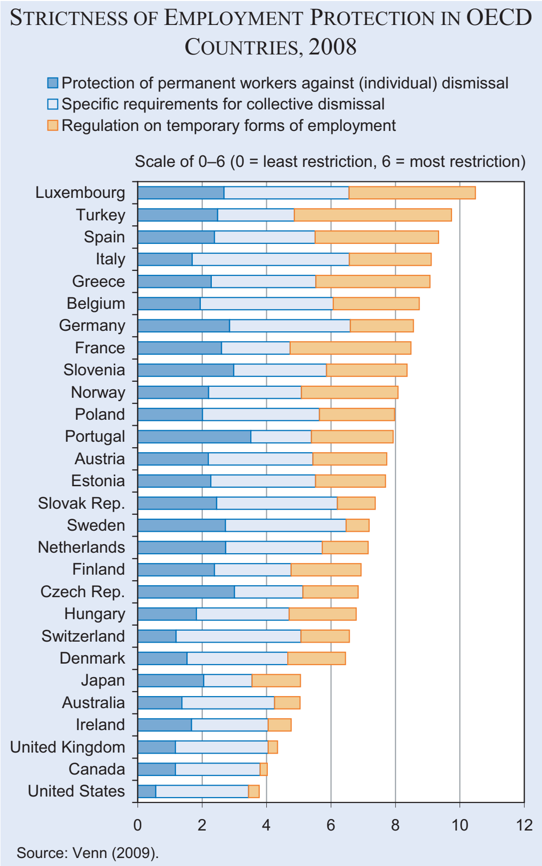
These numbers from the Labour Force Survey only partially account for the jobs that originated in the black economy. According to the recent estimates in Schneider, Buehn, and Montenegro (2010), the share of the Italian black economy amounts to around 27 percent of GDP, i.e. one of the largest among OECD countries. Not only are the jobs that originated in the hidden economy not covered by any form of social protection or regulation, but the wealth that originated through these jobs does not contribute to improve Italian public finances.

The most pressing labour-related issues that need to be addressed by Italian policy makers are therefore how to reduce geographical imbalances, increase female participation and opportunities, increase the chances of young new entrants, reduce the duration of unemployment and crack down on the black economy. In order to intervene in these areas, one first needs to identify the institutional factors that contributed to the status quo.

Labour market institutions in Italy

How can we explain the poor outcomes outlined above and how did policy makers respond to this? The Italian labour market is traditionally considered as one of the most rigid in the Euro area. However, the actual picture is not as clear-cut as many imagine. Figure 4 displays how Italy stands among other OECD countries as regards the latest OECD measure of the Employment Legislation (EPL) indicator. This indicator is a useful summary of what is going on, as it represents a synthesis of complex bodies of laws and regulations across countries. It is composed of three dimensions, i.e. protection for regular workers, requirements for collective dismissals and

Figure 4



Source: Venn (2009).

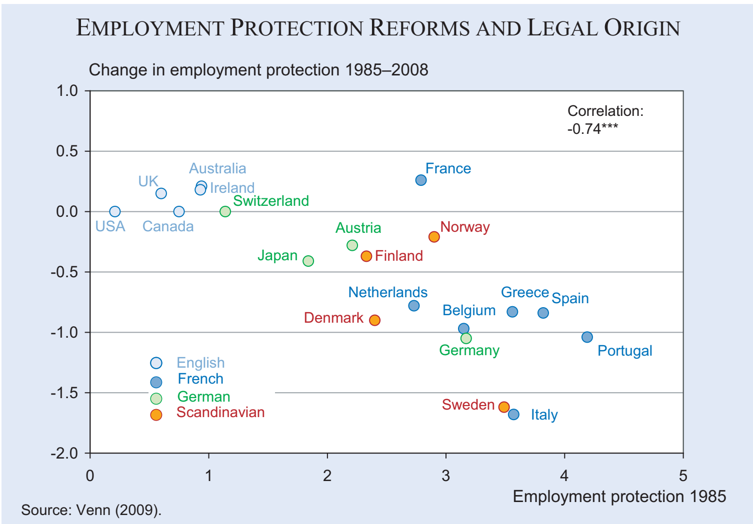
regulation of temporary workers. It increases with the rigidity of regulations. Looking at the 2008 numbers, employment protection in Italy is rigid, but not stricter than Germany. Overall, regulations are less tight than in France and Spain. Indeed, Italy was the country where the EPL indicator decreased the most between 1985 and 2008 as we can see in Figure 5. However, the reforms that took place in the 1990s and 2000s mostly intervened in the regulation of atypical contracts, rather than reassessing the regulations of permanent jobs.

As a result, the share of temporary contracts, especially among young workers, has steadily increased in recent decades and unemployment among the young has decreased (Figure 6). However, a dual labour market has emerged. As of today, some jobs are characterized by very high protection, while others, especially among the young, are sometimes locked in a precariousness trap. In these cases, the chances of having a temporary contract converted into a permanent job are small, as are the resulting training and productivity levels.

The reason why it was decided to intervene in the regulation of temporary contracts only, like in most European countries, has mostly to do with the median voter, who was largely left untouched by these policies. On the contrary, young workers, less likely to be unionized, were affected the most. This may partly explain why this strategy somehow did not face major opposition from the unions, at least initially. According to Visser (2006), around half of Italian union members are retired from the labour market. This striking figure is likely to affect the objective function of the main unions in Italy with important consequences in terms of collective bargaining dynamics and the public role of unionism in Italy. As a result, the instances mostly represented in the public debate by unions have been those of pensioners and permanent employees, rather than the young new entrants under atypical contracts and the new professions.

What are the consequences of this duality in employment protection? High EPL on permanent contracts is likely to depress productivity and flexible temporary work regulations are not going to reverse this negative effect (Bassanini, Nunziata and Venn 2009). The effects of EPL on the employment level are debated. Nevertheless, high EPL is likely to increase the duration of unemployment and reduce the speed of adjustment to negative shocks. This, in turn, contributes to the duality of the labour market

Figure 5



Source: Venn (2009).

and reduces the employment opportunities of young new entrants.

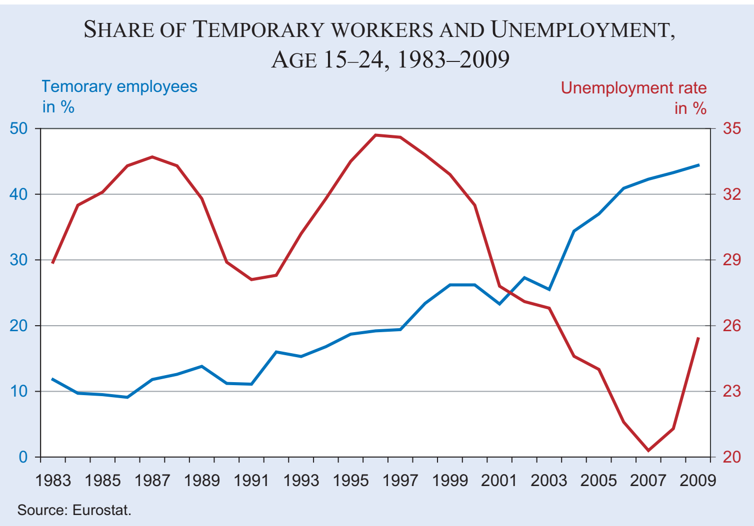
One dimension around which the regulation of individual dismissals is administered is firm size, with some EPL restrictions applying only to firms with over 15 employees. One then may wonder whether stricter EPL may prevent firms growing beyond that threshold in order to avoid EPL. Schivardi and Torrini (2008) show that this effect is limited and not likely to bind. However, as shown by Klueger and Pica (2008) and Leonardi and Pica (2010), Italian EPL decreases accessions in addition to separations and is likely to reduce insiders' wages. Jappelli and Pistaferri (2010), also suggest that the labour market reforms of the 1990s and 2000s may have contributed to an increase in earning instability in Italy, after a historical phase of declining income inequality in the 1970s and 1980s (see also Brandolini and Vecchi 2011). This is in line with the findings in Koeniger, Leonardi and Nunziata (2007) that suggest that an increase in flexibility may be associated with an increase in inequality.

As regards unemployment benefits, these are provided on the basis of a number of different arrangements. On the one hand the Liste di Mobilità (Mobility Lists) provide a hybrid system characterized by incentives to employment. On the other hand, the Cassa Integrazione Guadagni (CIG) scheme is a form of benefit provision for employees who work reduced or zero hours (with the latter being excluded by the official statistics of unemployment). The provision of the CIG can take place in different forms, some of which rely on policy-makers and unions playing an active role. It is therefore no surprise that the introduction of a universal and automatic system of unemployment benefits has not been so strongly advocated by both in the public debate. For example, in the case of Cassa Integrazione in Deroga the provision of the benefit is actually the result of an intervention by decree by the policy-maker who is likely to extract a political rent from it. A universal and automatic system may prevent the extraction of such rent.

As regards taxation, Table 4 from OECD (2012) shows the extent of the tax wedge in Italy as compared to other OECD countries. Here the tax wedge is intended in the somehow restrictive sense of the difference between labour costs and take-home pay (i.e. excluding taxes on consumption), and in the case of a single worker without children at the average wage level. Taxation on labour in Italy is at the very high level of 47.6 percent, which is only slightly lower than that of France and Germany. It is substantially higher than the tax wedge in Scandinavian countries, where the welfare state provision paid with those taxes is well known to be much more generous than in Italy. This high level of taxation is clearly distorting the incentive structure in the Italian economy with negative consequences in terms of performance (Nickell, Nunziata and Ochel, 2005)

According to the World Bank Doing Business Project (World Bank 2012), in 2012 Italy ranks 87th over 183 economies around the world in terms of ease of doing business. Compared to other European countries (the UK ranks 7th, Sweden 14th, Germany 19th, France 29th, and Spain 44th), this is an astonishingly poor performance. Along the dimensions upon which the index is constructed (ease of starting a business, dealing with construction permits, getting electricity, registering property, getting credit, protecting investors, paying taxes, trading across borders, enforcing contracts and resolving insolvency) Italy is doing particularly badly as regards paying taxes and enforcing contracts. Complying to tax rules is much more cumbersome than the OECD average (285 hours per year versus 186) and taxation is very high (the total tax rate on

Figure 6



profits is 68.5 percent versus an OECD average of 42.7 percent). Contract performance is particularly inefficient. Italy is ranked 158th out of a total of 183 countries. In order to resolve a commercial dispute an average of 1210 days are required, versus the OECD average of 518. The cost is 29.9 percent of the claim (the largest part being represented by attorney cost) versus an OECD average of 19.7 percent.

Table 4

Tax wedge in Italy and other OECD countries (total and components)

Income tax plus employee and employer social security contributions as % of labour costs, 2011[1]					
Country[2]	Total tax wedge[3] (1)	Income tax (2)	Social security contributions employee (3)	Social security contributions employer (4)	Labour costs[4] (5)
Belgium	55.5	21.7	10.8	23.1	64 169
Germany	49.8	15.9	17.4	16.5	65 788
Hungary	49.4	13.6	13.6	22.2	25 960
France	49.4	10.0	9.6	29.7	58 862
Austria	48.4	11.9	14.0	22.6	59 671
Italy	47.6	16.1	7.2	24.3	48 025
Sweden	42.8	13.6	5.3	23.9	55 351
Finland	42.7	18.5	5.8	18.4	53 652
Slovenia	42.6	9.7	19.0	13.9	32 018
Czech Republic	42.5	8.9	8.2	25.4	27 963
Estonia	40.1	12.5	2.1	25.6	25 051
Spain	39.9	12.0	4.9	23.0	46 151
Portugal	39.0	10.9	8.9	19.2	34 446
Slovak Republic	38.9	7.5	10.6	20.8	23 460
Denmark	38.7	28.0	10.7	0.0	48 994
Greece	38.0	3.0	12.8	22.2	28 579
Netherlands	37.8	14.5	14.0	9.2	60 765
Turkey	37.7	10.7	12.9	14.2	25 323
Norway	37.5	19.0	6.9	11.6	57 278
Luxembourg	36.0	13.3	11.7	11.0	60 063
Poland	34.3	5.9	15.5	12.9	23 607
Iceland	34.0	25.6	0.5	8.0	44 011
United Kingdom	32.5	14.1	8.5	9.9	57 711
Canada	30.8	13.9	6.5	10.5	41 939
Japan	30.8	6.6	11.7	12.4	51 089
United States	29.5	15.7	5.2	8.7	51 255
Ireland	26.8	13.5	3.6	9.7	43 442
Australia	26.7	21.0	0.0	5.6	47 530
Switzerland	21.0	9.4	5.8	5.8	54 919
Korea	20.3	3.9	7.3	9.2	48 370
Israel	19.8	8.0	7.4	4.5	33 594
Mexico	16.2	4.4	1.2	10.5	12 337
New Zealand	15.9	15.9	0.0	0.0	32 426
Chile	7.0	0.0	7.0	0.0	14 530

1. Single individual without children at the income level of the average worker.
2. Countries ranked by decreasing tax wedge.
3. Due to rounding total may differ one percentage point from aggregate of columns for income tax and social security contributions.
4. Includes payroll taxes where applicable.
5. Dollars with equal purchasing power.

Source: modified version of table 0.2 in OECD (2012).

Other dimensions are possibly not fully captured by the World Bank Indicators. The implicit taxation on economic activity induced by corruption is a serious limit to the competitiveness and the efficiency of both private and public sectors (according to Transparency International, the corruption perception in Italy is one of the highest in the OECD). Organized crime constitutes a grave constraint on the economic development of Southern regions, and its ties are increasingly connected to the rest of the country.

Such a burden on business constitutes a crucial restraint on economic growth and an obvious major obstacle to any positive consequences arising from a reform of the labour market. In other words, increasing the dynamics of the Italian labour market when the economy is crushed by such constraints is simply not going to deliver the results we expect.

A sketchbook of possible directions for reforms

One possible direction for reforming the regulation of the Italian labour market is to shift the emphasis from job protection to the protection of the worker. This is the so-called flexicurity framework that has received much attention in the European political debate in the last few years. A flexicurity strategy would require loosening EPL on permanent contracts (especially when seniority is low) in order to reduce dualism and improve the efficiency of the allocation of productive resources, while at the same time improving the earning protection of dismissed workers by introducing an automatic system of unemployment benefit provision. In other words, the logic is to reduce the duration of unemployment spells by increasing the chance of finding a job when unemployed, increase the earning stability across labour market states, and on the job training when a job match is realized. Many authors (for example, Bentolila, Boeri and Cahuc 2010) have argued in favour of substituting the complex variety of labour contracts available in the market with a single contract characterized by a certain level of EPL increasing with seniority. This would also contribute to simplify the suffocating bureaucracy to which Italian firms and workers have to comply.

At the time of writing the Italian Parliament is debating a set of measures aimed at reforming Italian EPL. These measures are still to be finalized and therefore it is not yet possible to provide detailed comments. The overall philosophy seems to be to marginally increase the strictness of the regulations regarding temporary contracts and the flexibility of permanent contracts. However, from what we can infer at the moment we are still far from providing an overall new design of Italian labour market institutions. In addition, it is not clear whether some of the proposed measures may actually have perverse effects especially if the degree of EPL enforcement is supposed to be increasingly defined by labour court rulings.

The question then becomes whether a global reform of Italian labour market institutions is politically feasible; and whether such reform can put the country back on track. Italy is definitively in dire need of a change of pace as regards its economic performance. And policy-makers should design new rules and regulations aimed at tackling the new challenges posed by the global economy. The reform of the labour market is an important step in this direction, but it cannot be considered by any means the one and only step. There are other dimensions of the Italian economy and society that need to be changed. And one cannot provide good enough arguments in favour of a change in labour market regulations when other markets are left untouched. In addition, the political feasibility and the economic success of a reform of Italian labour market institutions is strictly tied to how policy-makers are going to intervene in other aspects of the Italian economy. The Italian productive system is now strangled by bad regulations and policies that favour rents and do not provide enough room for competitiveness and innovation.

In the past the country had many opportunities to show its ability to face tough challenges, but today more than ever Italy needs a change of paradigm. Italy needs to liberalize its markets, introduce efficiency into its public administration including the judicial system, redesign public spending and reduce taxation on productive activities, reduce its asphyxiating level of bureaucracy that constitutes a burden on all sectors of activities, eliminate its intolerable level of corruption and free resources from a convincing fight against tax evasion. The latter is not only a burden on public finances and a constraint on the basic principles of equity, but also one of the distortionary mechanisms that incapacitate the Italian economy. In order to help the South to catch-up with the rest of the country, the plague of organized crime should be definitively eliminated and the efficiency of the judicial system improved. Economic activity needs the rule of law and certainty about a reasonable duration of trials. Last but not least, improving access to credit for young and innovative economic ventures and creating the conditions for profitable investments from abroad are fundamental steps in the direction of a more dynamic economic system.

This is a rough and incomplete agenda for the future, but the punch-line is that Italy needs to shift power from rentiers to innovators increasing efficiency, productivity and competitiveness. The reform of the labour market is part of this process. But it will never be feasible or successful if other sectors of the Italian economy and society are not equally improved. For example, the introduction of a universal system of unemployment benefits is doomed to fail if corruption, the extent of the shadow economy and tax evasion are not dealt with (Algan and Cahuc 2009). The political support for a reform of EPL on permanent contracts will never be reached if product markets are not liberalized too. More flexibility in the labour market is not of much help if the economic system as a whole is inefficient and unproductive.

Is this a story with a happy ending? We cannot be sure. We are, however, left with a sense of being at a crossroads. In one direction, we see the road of immobility and guilty conservatism, something Italy can no longer afford. On the other side, the historic opportunity to change the course of events by exploiting the great potential of a country that has stood still for too long. It is time for a new generation of policy makers, not compromised with the mistakes of the past, to take the lead and make the right choices.

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