Lecture 4: Italy and European integration: the 1990s (2)

Structural Factors of Decline

- Low productivity growth
- High public debt
- Inefficient bureaucracy
- Limited innovation and R&D investment
- Dual economy: North-South divide

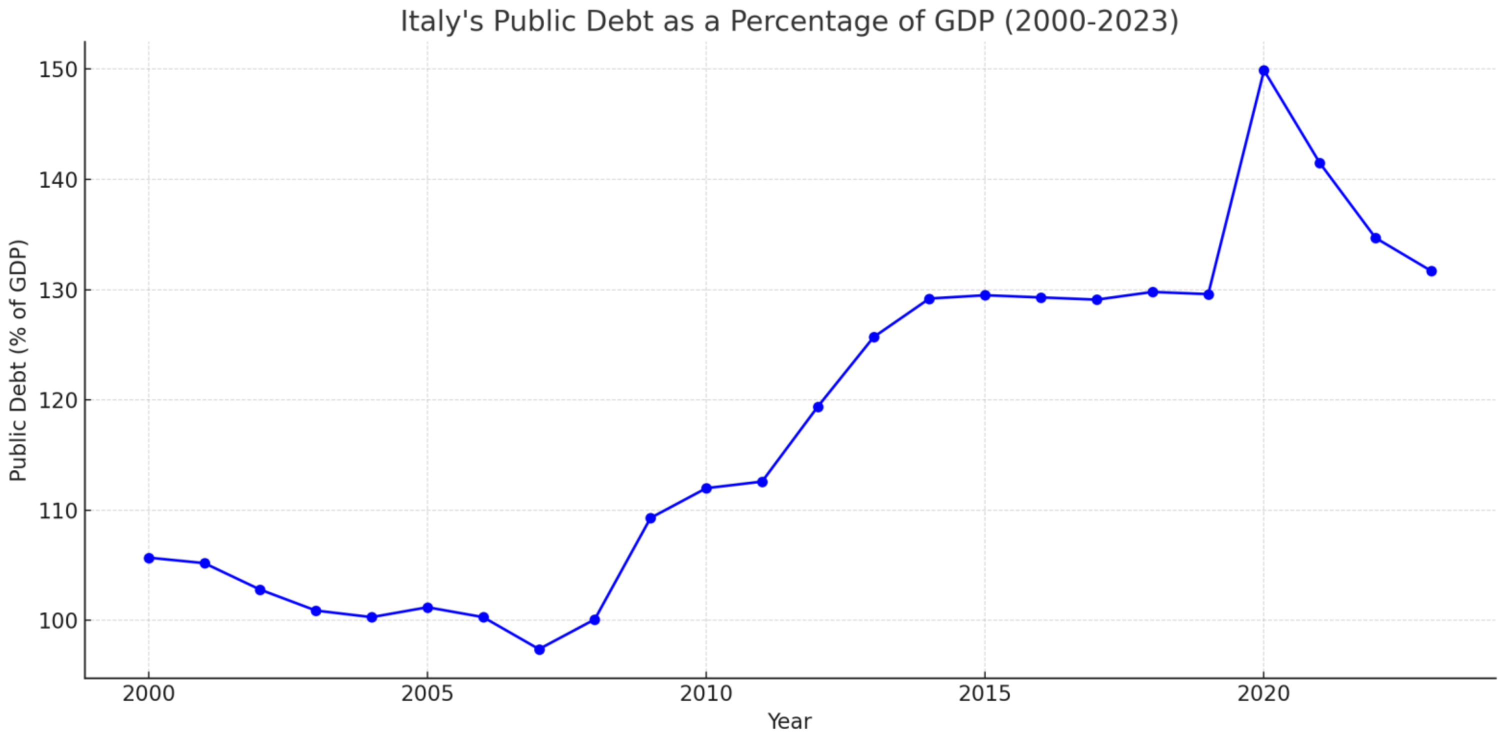
Low Productivity Growth

- Definition: Slow increase in output per unit of input
- Causes:
- - Small average firm size
- - Low investment in new technologies
- - Limited competition in some sectors
- Consequences:
- - Reduced competitiveness
- - Slower wage growth

High Public Debt

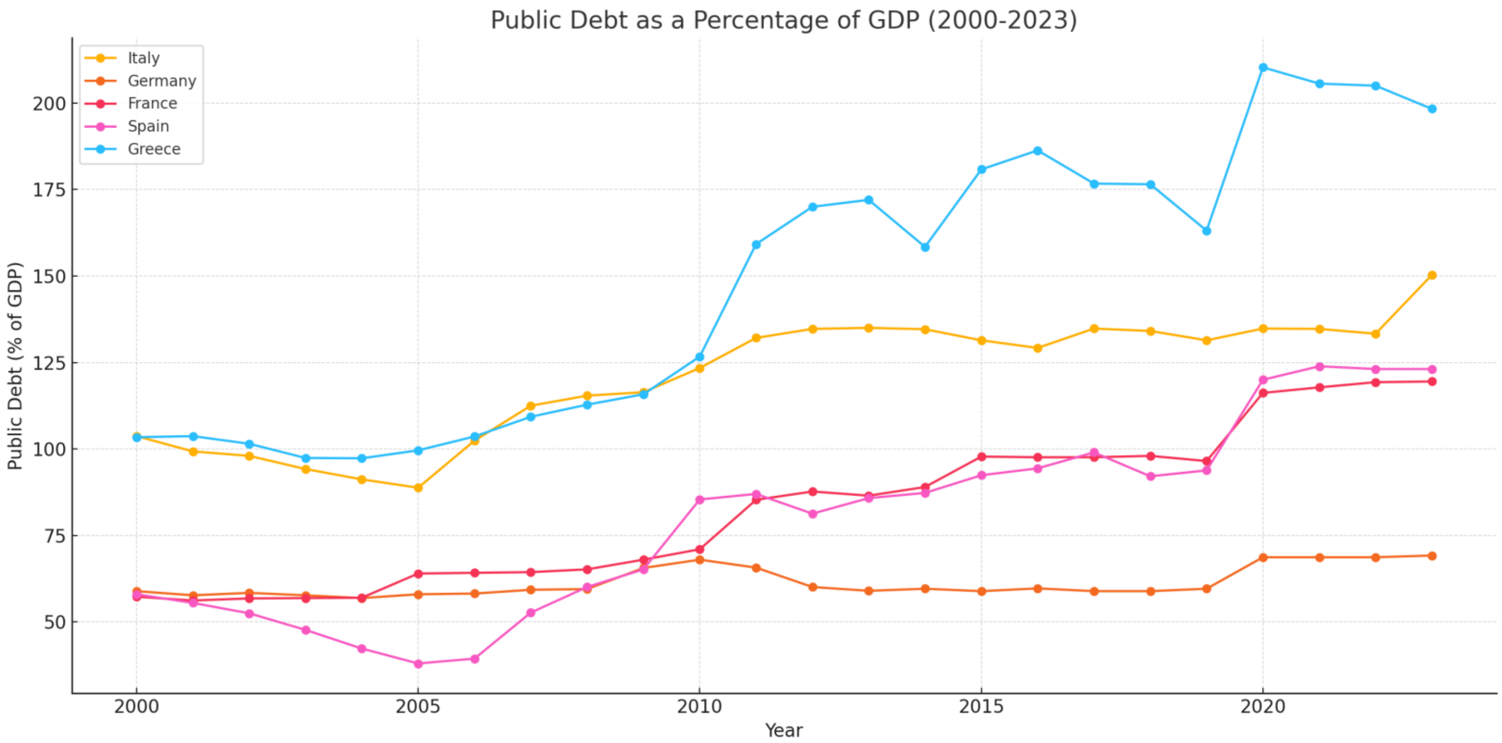
- Historical trend: Rapid increase since the 1980s
- Causes:
-   - Expansionary fiscal policies
-   - High interest rates in the 1980s and early 1990s
- Consequences:
-   - Limited fiscal space for investments
-   - Vulnerability to financial market pressures

High Public Debt



Source: Eurostat - Public Debt as a Percentage of GDP

High Public Debt



Source: Eurostat - Public Debt as a Percentage of GDP

Inefficient Bureaucracy

- Complex regulatory environment
- Slow judicial system
- High costs of doing business
- Impact on economic performance:
-   - Discourages foreign investment
-   - Hampers business growth and innovation

Limited Innovation and R&D Investment

- Low R&D spending compared to other advanced economies
- Causes:
- - Prevalence of traditional, low-tech industries
- - Limited public funding for research
- Consequences:
- - Reduced competitiveness in high-tech sectors
- - Difficulty in adapting to technological changes

Dual Economy: North-South Divide

- Persistent economic gap between North and South
- Characteristics:
-   - Higher unemployment in the South
-   - Lower productivity in Southern regions
-   - Different industrial structures
- Impact on overall economic performance

Explaining Economic Decline since the Early 1990s

Many theories proposed to explain the origins and the long-term nature of Italy's economic decline

Some of them fully economy-centred
Other combine economic and political factors

Theories (1)

1. **Decline in Total Factor Productivity (TFP)Problem:**

Since the 1990s, Italy has experienced a sharp decline in TFP, reflecting systemic failures to innovate and compete.

Key Factors: Loss of competitiveness in R&D-intensive industries (e.g., automotive), with a shift toward low-value-added sectors (e.g., fashion, furniture) facing declining global demand.

Lack of adoption of advanced technologies and diminished capacity for both incremental and radical innovation.

Theories (2)

2. Hybridization of the Capitalist Model

Theory of Hybridization: Reforms in the 1990s dismantled existing institutional complementarities, creating a "hybrid" economic model incapable of supporting either strategic coordination (typical of Coordinated Market Economies) or free-market mechanisms (typical of Liberal Market Economies)1.

Examples:

Incomplete privatizations led to private monopolies instead of competitive markets.

Failure to incentivize long-term innovation and investment.

3. Lack of Effective Aggregate Demand

Keynesian Theory: Italy’s decline is linked to a drop in aggregate demand caused by stagnant wages and weak domestic consumption growth.

Critiques of Policy:

Real wage stagnation not offset by household debt (as in the UK) or export growth (as in Germany).

Dependence on domestic consumption without external drivers exacerbated the issue.

Theories (3)

4. Failed Liberalizations and Privatizations

- Market Reforms: In the 1990s, Italy undertook the largest privatization program in the OECD, equivalent to 12% of GDP.
- Despite increased market flexibility, the economic impact was modest or negative.
- Privatizations often resulted in private monopolies, reducing competition.

5. Institutional Decline and Poor Governance

Institutional Weakness: Italian institutions have struggled with inefficiency and an inability to enforce the rule of law.

Consequences:

- Systemic corruption and tax evasion.
- Lack of financial transparency discouraging investment.
- Poor reform management and elite selection based on loyalty over merit

Theories (4)

6. “Bad Equilibrium” Theory

Definition: Italy is trapped in a negative economic equilibrium characterized by endemic corruption, inefficiency, and inequitable resource distribution.

Dynamics:

- Beneficiaries of the current system lack incentives to push for change.
- Clientelistic policies and welfare-for-votes exchanges stabilized the system but stifled productivity until the 1990s.

7. Labor Market Reforms and Flexibility

Flexibility Without Security:

- Reforms like the “Treu Package” (1997) and "Biagi Law" (2003) introduced precarious and temporary work without adequate social protections.
- Increased labor flexibility led to job insecurity without corresponding gains in productivity or stable employment.

Theories (5)

8. Austerity and Eurozone Constraints

Fiscal Austerity:
Eurozone membership imposed fiscal discipline (e.g., Maastricht criteria), reducing public spending and welfare, which further suppressed domestic consumption.

Impact of the Euro:
An overvalued currency for Italy reduced export competitiveness, worsening internal economic imbalances.