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Monthly Brief on the Italian Economy

December 2023

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Every month, our Monthly Brief on the Italian Economy provides a bullet-point recap of the month's main events, followed by reasoned deep dives and/or interesting graphs and commentaries on topics of significance for economic policymaking in Italy.

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[1] We thank Stefano Chiappo for his excellent research assistance.

LAST MONTH IN BRIEF

05/12 The parties of the governing majority reject, with a vote in Parliament, the opposition's proposal to introduce a €9-euro **minimum wage (see deep dive 1)**.

20/12 Finance ministers of EU countries agree on the reform of the **European Stability and Growth Pact** (SGP), with a compromise that will require countries with public debt/GDP ratios over 90%, like Italy, to reduce it by 1 percent per year (see the **graph of the month** for how Italy's public finance developed since the Euro's launch and under the SGP constraints).

21/12 With a parliamentary vote, Italy is the first and only country to reject the ratification of the reform of the **European Stability Mechanism**, causing uncertainty about the future of the instrument **(see deep dive 2)**.

28/12 The decree containing the implementation of the **Global Minimum Tax** and the reform of **fiscal incentives** for the attraction of human capital (back) to Italy is published and becomes effective (see primary source in Italian).

28/12 Italy receives the **fourth tranche of the RRF**, worth €16.5bn (see primary Government source in Italian).

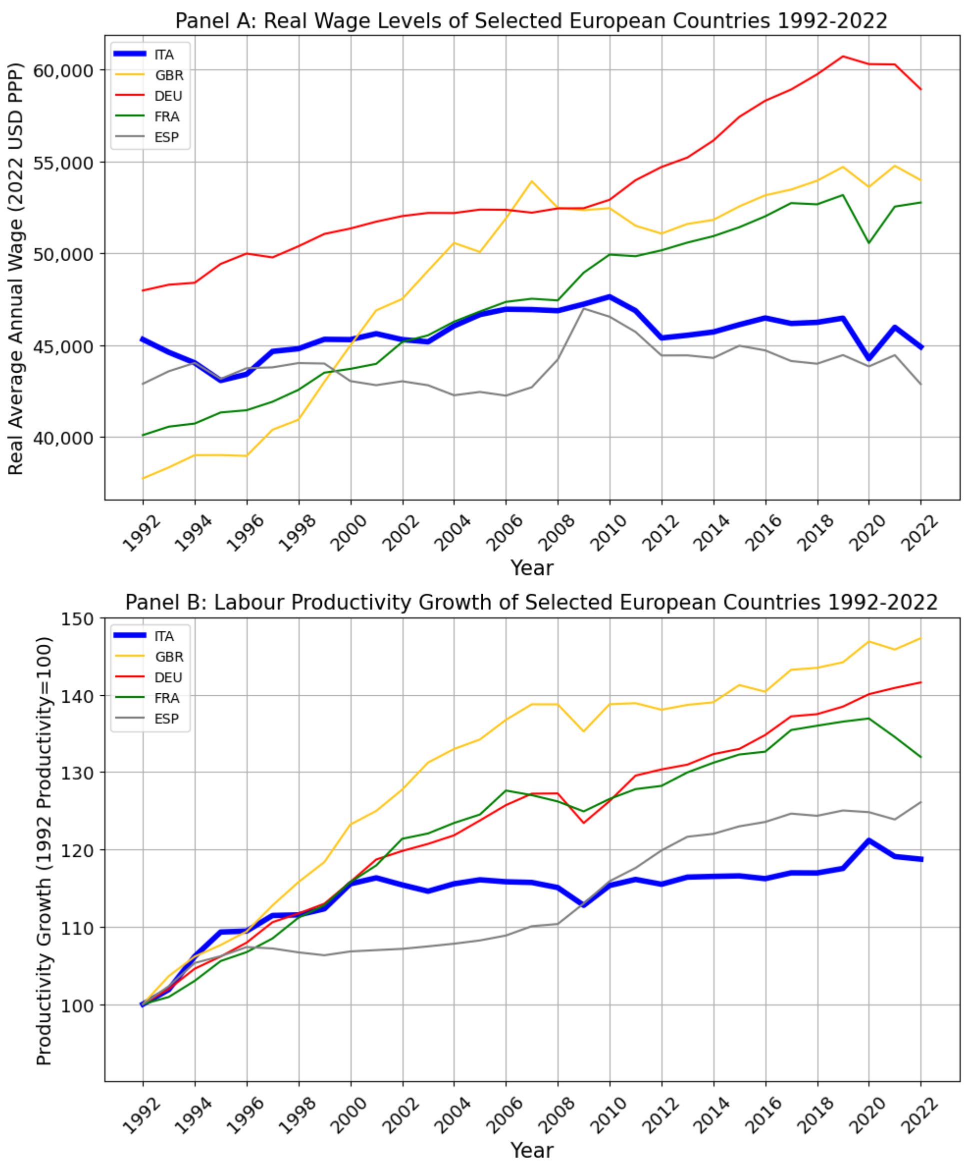
29/12 Parliament approves the 2024 **budget law**, with no major amendments from the government's original draft, confirming the majority's cohesion (see primary source in Italian) (for a deep dive on the budget law, see our November 2023 Monthly Brief)

DEEP DIVE 1

Parliament rejects the proposal to Introduce a minimum wage

On December 5, Italy's parliament examined the possibility to introduce a 9-euro minimum wage, a proposal tabled by the opposition. In line with the position expressed by the Government, the majority coalition parties voted against the law proposal, amending the text by replacing the 9-euro floor with a general mandate for the government to address the issue of fair compensation. Currently, Italy is one of the few European countries without a statutory minimum wage. Historically, this has been thought to be compensated by Italy's high collective bargaining coverage – similar to countries such as Denmark and Sweden. However, a 20-year trend of real wage stagnation (see figure 1), compounded by the recent inflationary shocks, has led to 2.7 million "working poor", or 11.5% of the workforce.

Figure 1: Real Wage and Labour Productivity Growth of European Countries



Source: OECD real wage data and OECD GDP per hour of work data.

Commentary

The Italian government's decision to forgo a €9 minimum wage resonated in Italy's public debate. The law proposal, widely supported by the public, was the first cohesive move of the opposition parties, which coalesced around one of the country's key labour market problems. Currently, in several industries, including cleaning and tourism, the gross hourly wage is lower than the level proposed by the law: 2.5 million people are earning less than €9 per hour.

Minimum wage as a policy tool has been gaining support in policy circles. As growing academic evidence suggests, minimum wage policies may have less detrimental effects than it was hitherto believed. However, a statutory minimum wage in Italy would likely address only one part of the more structural problems which characterise Italy's labour market. First, Italy has a broader problem of relatively low wages compared to its European peers. Italy's average wages (in purchasing power parities) are 25% lower than in Germany (figure 1, Panel A) and have been stagnating, together with labour productivity (figure 1, Panel B), for the past 30 years. At the macro level, it is hard for an economy to guarantee steady wage growth without productivity growth. Italy's "working poor" phenomenon is the extreme and most unfortunate symptom of this complex problem: currently, 18% of full-time workers and 29% of part-time workers earn less than €9 per hour. Second, this condition is driven not only by low hourly wages but also by involuntary part-time work, which in 2022 affected 10.3% of Italy's workforce – 16.7% among women and 13.9% among younger workers (aged 15-34).

Therefore, the proposed minimum wage could have been the first important step in confronting Italy's intricate labour market issues. However, even more ambitious reforms are needed to fix the underlying problems that relate to the wage-productivity nexus and Italy's three-decade old issue of stagnant productivity. Unfortunately, its causes are multifaceted, as the literature has widely explored.

DEEP DIVE 2

Italy's rejection of the European Stability Mechanism reform

On December 21, Italy's Chamber of Deputies rejected the ratification of the reform of the European Stability Mechanism (ESM) Treaty. The ESM is the inter-governmental organisation set up in 2012 to provide a backstop for euro-area countries in case they are in such financial distress that they are unable to fund themselves on the financial markets. In January 2021, ESM member states' governments signed a reform to reinforce the institution. Together with specific financial assistance instruments to be assigned to the ESM, the major change proposed related to the introduction of a common backstop for the Single Resolution Fund (SRF), the fund established by the EU to assist failing banks within the Banking Union. The common backstop would have transformed the ESM into a revolving credit line in case the SRF were to be depleted. Since 2021, Italy has been the only eurozone country that has not ratified the reform. With Italy's rejection, the ESM reform will not be operational starting from January 1, as agreed by EU leaders in 2021, since the transitional period ended with 2023. Now governments can try to find an agreement for a new transitional period or leave the reform temporarily unapplied. The possibility of the Italian Parliament voting again on the ratification would take at least six months, and there are no indications that the result could be different. The issue had become particularly contentious in Italian politics, despite this vote being about ratifying the ESM reform, not requesting funds from it.

The final vote showed different positions within both the majority and the opposition. Among the main parties in parliament, Brothers of Italy, the League and the 5-Star Movement voted against the ratification, while the Democratic Party voted in favour, and Forza Italia abstained.

Commentary

Italy's rejection of the ESM reform will likely have domestic and external consequences.

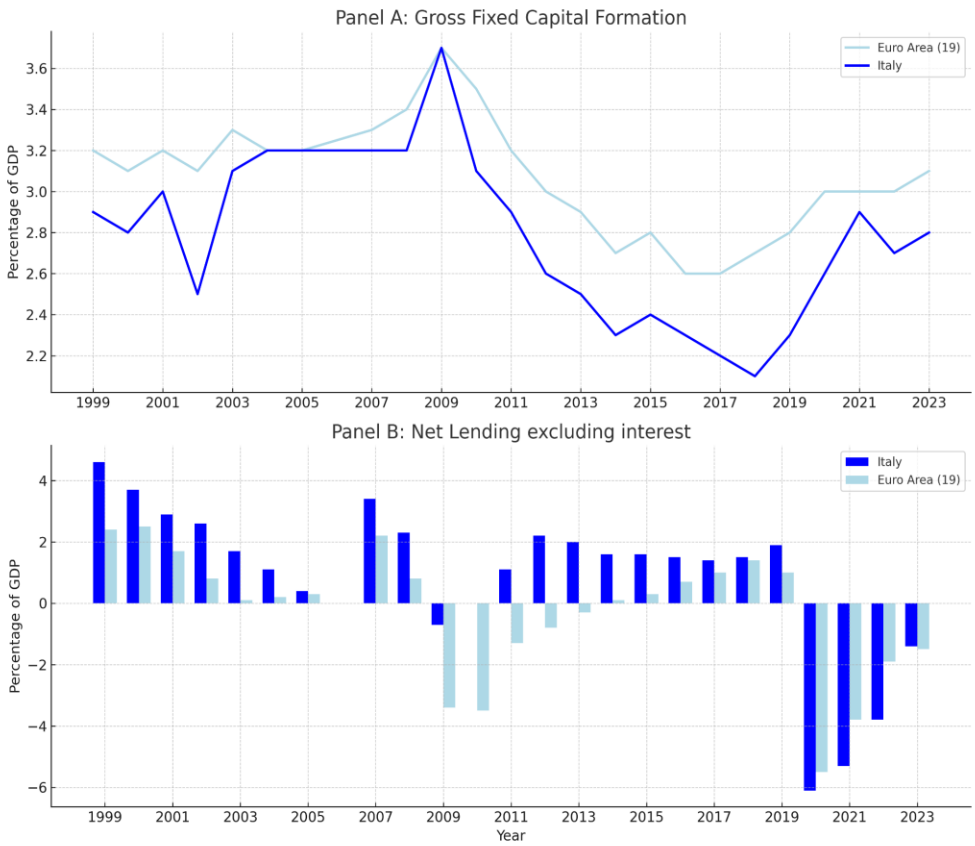
First, this was the first important parliamentary split vote in the governing majority. Forza Italia's abstention avoided a fully-fledged governmental crisis, but the division that emerged signals the broad spectrum of views within the majority of European institutions and integration. For one, Finance Minister Giorgetti himself was contradicted by the vote as he had previously expressed partial support for the reform. These differences will likely become clearer as parties start campaigning and competing for votes in the upcoming 2024 EU elections.

Second, it should be noted that the opposition did not appear cohesive either. It can be argued that it missed an opportunity to expose the government's divisions. If the 5-Star Movement and the minor Green-Left Alliance party had voted together with PD, the negative votes would have been a minority. However, it is possible that a cohesive pro-ESM vote by the opposition would have played in the League and Brothers of Italy's favour. These parties justified the vote against the ESM as a vote for Italian national interests against European imposition. Therefore, in this context, opposition parties probably also paid attention to the potential implications of this vote for their positioning in the upcoming European elections.

Finally, this vote can be an inflection point in Italy's relationship with EU institutions. The government's strategy had always explicitly been to use the ESM ratification as a bargaining chip in the discussions on the Stability and Growth Pact (SGP). The outcome, namely an SGP agreement that falls short of Italy's expectations and the non-ratification of the ESM, signals that Italy's strategy did not fully work out as hoped. For a commentary on the proposed economic governance reform, see our colleague Carlo Bastasin's Brief. Whether Italy's ESM rejection will also have other repercussions will become clear from its EU partners' behaviour at the next key negotiation tables.

GRAPH OF THE MONTH

Italy's general government's public investment over time (Panel A) and primary balances (Panel B)



Source: our elaboration from AMECO Database, European Commission.

In the past 20 years, the constraints of the Stability and Growth Pact (SGP) have induced Italy to follow a path of fiscal rectitude. What has this looked like in practice? Two insights emerge from the graph.

First, Panel B shows that, before the Covid-19 pandemic, Italy ran primary surpluses almost every year since the launch of the EMU. In other words, over the past 20 years Italy's deficits have mostly been driven by its annual debt repayment costs, not by runaway public spending. Every year Italy's fiscal stance was also more conservative than the average of the Eurozone countries (19-member composition), including in 2009 during the Great Recession, when Italy ran only a modest primary deficit compared to the EMU19 average.

Second, Panel A shows that Italy's public investments have been sacrificed on the altar of permanent austerity. One of the ways in which Italy has achieved these primary surpluses has been by greatly reducing public investment. Panel A indicates that the general government's public investment spending fell significantly since the Great Recession, from 3.2% to 2.1% of GDP. It started to recover towards levels comparable to the average EU19 only since Italy began implementing its post-pandemic recovery plan.

The story of fiscal discipline translating into lower public investment is not only an Italian phenomenon. Public investment was historically low across the Eurozone in the past decade – see for example our work on Germany's collapsing public investment. The pandemic years were the exception. But now that the new SGP rules were agreed, will eurozone countries be able to reconcile fiscal rectitude with growth-enhancing investments and the need to finance the twin transition? This will be the most fundamental question for European and Italian industrial policy in the years to come.