(Missing) productivity and the growth challenge

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1. The relation between GDP growth, wages, labour market reforms and productivity
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1. Growth and productivity

- Between 2000 and 2023, Italy's output growth has lagged behind the euro area and accumulated a growth gap of over 20 points with France and Germany, and over 30 with Spain.
- Economic stagnation, labour markets reforms and wage policy have compressed aggregate demand and reduced incomes.
- **“Productivity hysteresis”**. Crises , superimposed on a trend of austerity and stagnant demand, led to persistent productivity losses: balance sheet vulnerabilities, protracted weak demand and high uncertainty triggered an adverse feedback loop of weak investment, weak productivity and bleak income prospects (Adler et al 2017).
- **Levels matter**. Output losses from crises were not temporary, resulting in permanent downward level GDP shifts. Although the growth rate of GDP somewhat recovered, the levels ended up permanently below the pre-crisis trend. In the long run, capacity will adapt to demand, hiding the traces of the loss of productive capacity (Garegnani 1983).
- In this context, the persistent weakness of domestic demand and the loss of productive base in manufacturing have contributed to depress gross fixed in physical and human capital, innovation and productivity (Istat 2024, 57).

GDP growth rates

Period	Italy	Euro Area	USA
1995-2007	1,6%	2,5%	3,2%
2000-2007	0,9%	2,3%	2,5%
2008-2023	0,4%	1,4%	2,0%
2000-2023	0,7%	1,4%	2,1%

Low wages: cause or effect?

- Between 1990 and 2018 the OECD Employment Protection Legislation (EPL) Index for Italy fell from 3.02 to 2.56 for permanent contracts, and from 4.88 to 1.13 for fixed-term contracts.
- Between 2008 and 2023, real wages in Italy decreased by 8.7%, the worst figure among the G20 countries. The impact was particularly strong in low-skilled sectors and for workers with precarious contracts. More than 50% of wage inequality occurs within industry (Depalo and Lattanzio 2023), indicating a polarisation of firms within the same industry.
- After Covid, employment increased but the intensity of employment fell. Low wages and short working hours resulted in increasing incidence of working poor: 14.4% of total workers and 19.2% of total female workers.

Has labour market deregulation backfired?

- A third of young people under 34 have fixed-term or part-time jobs. Temporary contracts are associated with lower productivity, lower wages and higher profits. Flexibility reduces productivity the most in inefficient firms (Cirillo and Ricci 2022).

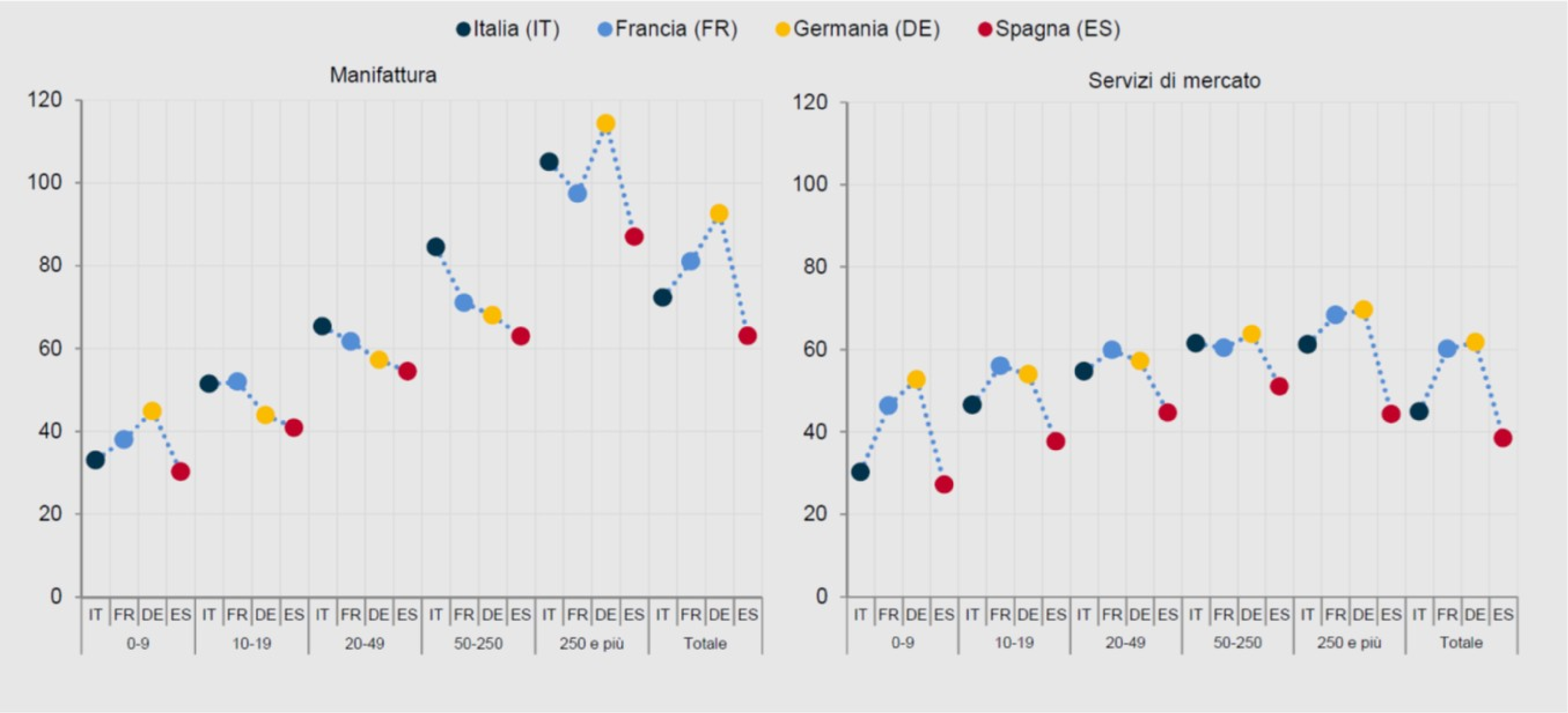
The quality of employment, wages and productivity nexus

- The demand effect: income and aggregate demand (consumption and investment, + fiscal austerity)
- The "whip effect": incentives to invest in innovation, capital and knowledge intensive investment.
- Labour supply effects: brain drain (skilled labour)

2. Resource misallocation

- Managerial scarcity and market rigidities can freeze specialization, keep less efficient small firms in business, reducing the adoption of innovative technologies and productivity.
- The scourge of small firms.

Value added per employee of companies, by size class and macro-sector in the major economies of the EU27. Year 2021 (thousands of euros per employee) (excludes the financial and real estate sectors) Istat 2024.



Are all small firms alike? Do they crowd out resources away from more efficient firms?

- Istat's analysis on "dynamic" firms found strong heterogeneity of companies, across size and sector. Factors considered: governance, human capital, relations between companies, competitive levers, technology, finance, internationalization, sustainability).
- Polarisation (efficient vs marginal firms, small vs large) does not mean separation: Firms do not produce in a vacuum: they are embedded within a complex of private and public relational networks (Ginzburg 2012). Marginal firms are integrated in value chains and are functional to the efficiency of the system.
- Vertical integration: outsourcing of (not necessarily low value-added) tasks to smaller mfg firms/services. Each company positions itself at the scale of the "minimum efficient size" for its production and often uses the most updated technology (Brusco 1982 and recent literature).
- This productive system results in a wide range of highly diversified products and greater flexibility when technology or tastes change rapidly, or a crisis occurs. Power relations can shift orders, value added and profits along the value chain: statistical effect on productivity (and wages).
- Cleansing may increase average productivity, but can be painful: in a growing context, we may have creative destruction; in a stagnant context we may end up with plain destruction.
- Dutch disease (Reda et al 2025)? in a situation of lasting stagnation, the low wages and high profits of protected sectors (e.g. tourism) can draw out resources from other sectors.

3. Questions and policy

- Why are Italian wages so low? Is it mainly, but not only, about services? If quality more than price is important for competitiveness, what prevents to pay higher wages?
- In the 1970s competences and skills required by the new conditions were not too different and allowed the creation of a new model (Arrighetti et al), (with high costs for the South). Do digital technologies challenge the capacity of the Italian productive system to adapt and evolve?
- Productivity or “well being”? By definition, the growth in output per capita is equal to the growth in output per worker plus the growth of the ratio of number of workers (or hours) over the total population. Too small a productive basis (and employment) may result in relatively high productivity but low per-capita income. How to expand the productive base and employment?
- North-south divide: The South of Italy is suffering from a two-fold displacement: the growing distance from the North of Italy, and Italy’s growing gap with the European core. An incomplete matrix of production, frail insertion in GVC… How to thicken the productive basis?

Policies

In the past, two types of policies: investment subsidies and labour deregulation. The first was aimed at "efficient" firms that might have invested anyway (deadweight cost?). The second was used by marginal firms, which followed the low road (though other companies also followed).

Need for a multilevel analysis that takes into account the interactions between firms and institutions, the interdependence between aggregate demand, products supply and capabilities.

- Macro (Draghi?): redirect demand towards the domestic market, and common funding for public goods
- IP must take care and fit the needs of countries/regions at different level of development, e.g., extending value chains connecting the periphery to the core in new industries.
- Labour policy: higher wages, needed not only for higher productivity, but also for social cohesion and democracy