

DYNAMO

Dynamics of national employment models

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THE ITALIAN REPORT

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Introduction.

In this report we want to investigate the transformation process that has taken place in the Italian economy in order to accomplish the objectives introduced by the Lisbon strategy. Actually, the implementation process of the Lisbon strategy started in 1997 (the Amsterdam Treaty), and it has been changed several times, modifying the priority of targets and policies. In 2003, the European Council appointed a taskforce –directed by Wim Kok- to evaluate and redefine the main targets of the Lisbon Strategy, which can be restated as in the follow:

- a) increasing adaptability of workers and enterprises,
- b) attracting more people to the labour market,
- c) investing more and more effectively in human capital,
- d) ensuring effective implementation of reforms through better governance.

According to these targets, in all European countries in the last ten years the industrial and labour policies had to be inspired by, or at least related with, these common targets. More specifically, the European commission has established 10 guidelines in which the previous targets are better specified and explained. Moreover, the EES has also set some general objectives that has to be reached within 2010, such as employment rates for men and women, lifelong learning attendance, education targets etc. This process is monitored over time through the NAP (National Action Plan), in which each country explains the reforms that have been implemented in order to converge to the EES targets. Besides, the European Commission provides comments and revisions using the yearly recommendations.

As far as the Italian case is concerned, in the last decade most of the reforms have been encouraged by the EES guidelines, such as the reforms of the labour market and of the pension system.

In this report we want to sketch out a survey of these Italian reforms related to the EES, trying also to provide interpretations of these complex processes. Of course, the application of the EES guidelines in each EU country strongly depends on the previous economic and social situation of that country. For this reason we begin our reconstruction, when possible, since the eighties, trying to outline the main economic and social features of the Italian economy.

Basically we divide our report in three main sections.

The first one concerns a brief and general overview of both the legislation setting and the institutional framework related to the labour market. More specifically, we sketch out the

dynamics of industrial relation between the government and the social parties in the nineties, up to the last legislation setting concerning the reforms undertaken by the last government.

The second section investigates the changes occurred in the production system, since the beginning of the nineties. Two main issues are investigated in this section. First of all, we describe and evaluate the long wave of privatisations that has taken place since the beginning of the 1990s, together with a gradual liberalisation in public utilities. Further, we assess the issue of the reforms in corporate governance in Italy. Secondly, we investigate the different patterns of specialization of Italian economy, in particular with respect to sectoral dynamics, internationalisation, and firm size.

In the third section of this report we consider the main quantitative and qualitative features of the Italian labour market, in particular with respect to the dynamics of employment, unemployment and participation rates, gender and age structure of employment, education and careers, and the pension system.

In the conclusion, we try to put together the main insights of the three sections of the report, briefly pointing out the pervasive relations between the production system and the labour market, especially with respect to specialization, internalisation and educational levels of the labour force.

I. Changes in wage setting institutions

Since the beginning of the 1990s, important changes occurred in the institutions regulating the Italian wage setting system. These novelties came along with a new attitude in industrial relations that, after a prolonged period of harsh conflicts among the social parties, gradually became more cooperative.

The main feature of the previous model, survived until July 1992, was a mechanism of automatic wage indexation (*scala mobile*). This mechanism, since the mid 1970s, was characterized by identical wage adjustments, in response to past inflation, for all workers (*punto unico di contingenza*). An important consequence of this system was a heavy compression of wage differentials, with the wages of low-skilled workers being even over-indexed, in absence of wage adjustment mechanisms in response to the individual productivity dynamics.

On average, in the early 1980s the indexation coverage (i.e. the elasticity of wage increases with respect to past inflation) stood at about 80%. The high inertia coming from this system was such that external inflationary shocks (oil shocks and currency devaluations, primarily) were not absorbed by reductions of real wages but, on the contrary, generated wage-price

spirals: as a consequence, from 1973 to the mid 1980s Italy experimented a two-digit inflation rate, with a peak of 21.1% in 1980. An important corollary was that restrictive monetary policies (in order to control inflation) were less effective in Italy than in other countries, because a high loss in terms of unemployment would be needed in order to break the institutional linkage between wages and prices (Tarantelli, 1986).

It is evident that such a system, even after the corrections negotiated with trade unions in 1983 and 1984¹, could not last in the successive decade. In fact, the permanence of high inflationary differentials with regard to the other European countries, together with the serious unbalances in public finance, exerted a strong pressure on the Italian exchange rate, in turn involving several devaluations during the 1980s (when, however, the positive business cycle helped in maintaining the wage setting rules unchanged). Consequently, this model became no more sustainable during the 1990s, when the European exchange rate system became more rigid, as a consequence of restrictive monetary policies and the gradual opening of international financial markets.

Moreover, it is worth noting that even at a micro level the wage indexation system created significant distortions, because it reduced the incentives for high-skilled jobs, because of limited bargaining autonomy among the parties at the sectoral and local level and, further, induced a transformation of the economy toward a capital-intensive structure.

The first tripartite agreement to reform the Italian bargaining system dates back to July 1992. It was signed by the government, the trade unions and the representatives of entrepreneurs (inaugurating a cooperative season in industrial relations, the so called *concertazione*), in an emergency situation, under the threat of a new devaluation of the lira. This agreement aimed at breaking down the wage-price spiral by abolishing the *scala mobile* and stopping, de facto, any wage increase until the establishment of new contractual institutions. Even if it did not avoid an exchange rate devaluation in the same year, this severe treatment braked at once the wage growth, that slowed down from 9% at the beginning of 1992 to less than 2% at the beginning of 1994, notwithstanding the inflationary effects of the devaluation (Casadio et al., 2005).

Further, in July 1993 another agreement was signed among social partners establishing new rules and wage setting institutions. The new bargaining arrangement was founded on a two-tier system: the first level was based on national labour contracts (whose length was fixed to four years), whose main purpose was to maintain the purchasing power of wages; the

¹ These changes excluded from indexation the fraction of the inflation rate due to changes in indirect taxes, oil prices and the exchange rate, and enabled a stronger predetermination of wage increases (therefore diminishing the indexation coverage by about 15%). Moreover, they can be considered the first experiments of income policy in Italy.

second level, on the other hand, was based on firm-level contracts (not compulsory for firms, however), whose main purpose was to distribute company-level productivity gains to workers.

One of the most relevant innovations introduced by this reform concerns the forward-looking nature of the wage increases negotiated through the national labour contracts. Actually, the reform established that, for the first two years of the contract length, wage increases should refer no more to past inflation, but to a new policy instrument, the government's target inflation (*tasso di inflazione programmato*). Conversely, during the successive two years the partners should negotiate further increases in case of a discrepancy between the actual inflation rate and the target one.

Through the target inflation rate, the government could have played an active role in influencing the inflationary expectations and in curbing the inertial behaviour of prices. Moreover, by construction, price increases due to devaluations and oil shocks were excluded by the target inflation rate, if fully anticipated. Therefore, the government could have easily announced low inflation targets, in order to moderate the wage growth, leaving to the ex-post adjustments the task of maintaining the purchasing power of wages.

Effectively, target inflation systematically underestimated actual inflation: in the period 1992-2002, the price change implied by the target inflation rate (one year after) resulted below the actual price change by about 9 percentage points; five of these points were recouped by contractual wages through the ex-post adjustments, while the remaining part was lost due to the deterioration of the terms of trade (Brandolini et al., 2005). According to Tronti (2005a), there have been two phases of authentic wage moderation in the years 1993-95 and 2000-03, the first one due to the employment crisis and the introduction of the new bargaining arrangements, and the second one due to the unexpected increase of inflation following the introduction of the euro. Conversely, contractual wages grew more than actual inflation in 1996-99, due to the high growth of employment and to the ex-post compensation mechanism, and in 2004. What happened in the last year appears quite worrying. The negotiations, in fact, began neglecting the role of target inflation, that lost much of its influence due to the persistent discrepancy with regard to actual inflation: contractual wages, for instance, grew by 2.9% in 2004, against a target inflation rate of 1.7% and an actual inflation rate of 2.2%. These facts came along with a certain deterioration of industrial relations after a prolonged period of cooperation, which occurred in particular during the left-centre government (until 2001) and allowed other important reforms in the labour market (for instance, providing for new flexible labour contracts, with the so-called 'Pacchetto Treu').

Taking into account the whole period 1993-2004, contractual wages for full-time employees grew on average by 2.7% per year, while the consumer price index grew by 2.9% per year. Therefore, during the decade the first level of bargaining only partially accomplished its task of maintaining the purchasing power of workers, which in 2004 was 2.9% lower than in 1992 (considering only national contracts). However, it is important to remark that the new contractual agreements, together with the favourable cooperation among the social partners, succeeded in addressing the inflation dynamics at the level of more “virtuous” European countries, in this way allowing Italy to access the EMU from the beginning (obviously, it is impossible to forget the parallel role of restrictive monetary and fiscal policies during the 1990s).

As for the second level of bargaining, the outcomes of the first ten years of enforcement appear less favourable. In particular, the diffusion of bargaining at the firm level appears limited to medium and large firms, while it is virtually absent in small firms (in particular, in those with less than 10 employees), where the bargaining power of workers is lower. According to the Istat survey on flexibility, in 1995-96 about 40% of workers in firms with more than 10 employees were covered by firm-level bargaining, but only 25% of workers in manufacturing and 20% in services were covered by performance-related premia (in the South, this share fell at 7%). The different distribution of these premia according to firm size appears from the Bank of Italy’s Survey on Investments in Manufacturing. According to this survey, in 1999 the share of workers covered by these benefits in firms with more than 50 employees stood at about 75%, while in firms from 20 to 49 employees it was below 14% (in 2001). At the aggregate level, the yearly wage increase due to these premia was 0.3% in 1995, reached 1.3% in 1996 and then started decreasing, until the actual 0.8% (Brandolini et al., 2005).

The scarce diffusion of firm-level bargaining and, in particular, of performance-related pay, entailed that productivity gains were not adequately distributed to workers. This is evident looking at Table A: in the whole period 1993-2003, while labour productivity grew on average by 1.0% per year, gross real wages (deflationated with CPI) grew by 0.6% and net real wages by only 0.1%. These dynamics can be explained mainly by the first two periods, since in the last one the productivity slowdown caused real wages to grow more than productivity.

Tab. A. Gross and net real wages and labour productivity - Years 1993-2003 (average yearly percentage rates of growth)

Period	Deflationated with consumer price index		Deflationated with value added deflator	Labour productivity
	Gross	Net		
1993-1997	0.1	-0.7	0.0	2.1
1998-2001	1.0	0.5	1.4	0.8
2001-2003	0.3	0.7	-0.1	-0.5
1993-2003	0.5	0.1	0.6	1.0

Source: Tronti (2005a). Elaboration on Istat data.

The implications of these results on income distribution are evident, both on personal distribution and on aggregate level. As for the former, it comes out that persistent differences in terms of real wages are likely to emerge between employees working in larger and Northern firms against those working in smaller and Southern ones. As for the latter, it can be observed that, since the introduction of the new wage setting system, there was a fall in the labour share, decreasing by about 0.7% per year from more than 82% in 1993 to below 77% in 2001, and only in recent years slightly increasing due to the productivity slowdown. At the same time, the profitability indicators for the Italian firms showed a generalized improvement.

An important critique concerning this evidence is carried out by Tronti (2005b), who claims that firms did not take advantage of this extraordinary phase of wage moderation to invest in new technologies, in order to follow the “high road to competitiveness” sketched by the Lisbon strategy. In fact, the ratio of fixed investments to gross profits slowed down from 76% in 1992 to 64% in 2003 as well as did the elasticity of investments to profits. The slowdown of labour productivity is another useful indicator of this tendency. In this sense, it is important to notice that low wages, in the long term, can curb the incentives to innovative activities (see for instance Sylos Labini, 1984) and preserve the survival of low-productivity jobs. Recently, a similar association between wage moderation and slow productivity growth has been observed for the Netherlands by Kleinknecht and Naastepad (2004).

1.2 Current legislation in the Labour market

The agreements signed in 1992 and 1993 presented in the previous paragraph were in force up to 2001-2002, when the last government broke down the strategy of the cooperation with the social parties –which was the main characteristics of those agreements-, introducing one wide reform of the labour market that finally took place in 2003, with the ‘legge 30’. In fact, this law does not represent a breaking point in the Italian legislation, in the sense that it continues the flexibility reform already undertaken by the centre-left win government (the so

called 'Pacchetto Treu'). More specifically, the most important modifications related to the Legge 30 are briefly presented in the following:

- According to the EES, the Public Employment services have been reformed, trying to augment the efficiency of this institution relaxing some constraints of the previous legislation. Moreover, for the first time in Italy also the private intermediaries have been admitted in the labour market, introducing in this way a competition between private and public employment services. Loriga and Naticchioni (2005) actually shows that the public employment services do not seem to increase the probability to find a job for unemployed, while the impact of private intermediaries seem to be slightly positive and significant. This also means that the reform process of the PES has not yet reached the expected results.
- Part time contracts have been extended also to the agriculture sector, and several constraints previously related to this contractual form have been relaxed;
- Temporary contracts have been reorganized, for instance the 'collaborazione coordinata e continuativa' has been replaced by the 'contratti a progetto', aiming at increasing the social security assistance for these type of contracts, whose share have strongly increased in the last decade;
- New atypical contracts have been introduced, such as the 'job-sharing' and the 'job on call' contracts. Actually, so far the impact of these new contractual forms seem to be negligible;
- The reorganization for the contractual forms related to the entry-contracts in the labour market for young workers (apprenticeship and training contracts -'formazione lavoro').

As for the firing side of the labour market no significative change has taken place in the last decade. It is worth noting that the legislation concerning individual dismissals was designed in order to discourage this solution by making its cost very high using strict regulation for unfair dismissal, generous wage supplementation for temporary dismissal etc. In fact, except for rare cases of clearly unsatisfactory behaviour of the workers, a dismissed employee will undertake legal action against the firm for unfair dismissal. These constraints concerning individual dismissal are stronger for firms with less than 15 employees (the well-known 'articolo 18').

As far as collective dismissals are concerned several policies have been introduced at the end of the eighties and they are still in force. The most well-known of these policies is the

wage supplementation scheme ('Cassa Integrazione Guadagni', afterwards CIG), which has become the most common way of making employees redundant. CIG was an easily extendable wage subsidization program for reduction in working hours and temporary lay-off, applicable to a wide range of situations, for example bankruptcy and reorganization. It is worth noting that this kind of policy favours long-lasting employment relationships, even if it does not increase firing costs, and that they are funded collectively by some "experience rating".

Basically, there exist two kinds of CIG, the ordinary scheme and the special one.

The ordinary CIG (GIGO) supplies 80% of the wage in the case of shortfall of hours caused by firm's temporary market problems. Any firm can use this scheme for 13 weeks with the possibility of extension up to a maximum of one year. To obtain the CIGO firms have to request the authorization to trade unions and to local authorities. The fund is financed by INPS ('Istituto Nazionale della Previdenza Sociale') and by contributions of 2.2% of the wage bill paid by all firms (1.9% for firms with less than 50 employees) and an additional contribution of 8% (4% for less than 50 employees) of the wage supplementation by firms that have asked for the CIGO.

The special CIG scheme (CIGS) offers the same wage conditions as CIGO but it subsidizes restructuring and reorganization activities. Since 1991, it can last 24 months with the possibility of 12 months extension. Authorizations that firms have to require are more demanding than for the CIGO's case because the consent of a government committee (CIPI, Comitato per la Programmazione Industriale) is explicitly required. Each firm contributes to the CIGS for the 1.9% of the wage bill (0.9% for less than 50 employees). An additional contribution of 4.5% (3% for less than 50 employees) of the wage supplementation is provided by firms demanding for the CIGS. Contributions double after 25 weeks and employees contribute 0.30% of their wage.

Although CIG was originally designed for reductions in hours, it was afterwards changed into a long lasting unemployment subsidy. In a sense, it is also in conflict with the extremely low unemployment benefit for people not included in the CIG program.

More recently, in accordance with European directives, an additional policy has been introduced. More precisely, if after the application period for the CIG (24 months), a firm realizes that a stronger reduction of employees is required, it can start a layoff procedure through 'mobilità', an institution which subsidizes workers while joining a special list for transfers to other firms ('lista di mobilità'). Firms that hire workers from this list benefit from reductions in payroll taxes (there are different reductions if the recruitment is temporary or permanent and according to the seniority of the workers employed).

As for the welfare system is concerned, very few changes took place in the last decades, meaning that the current welfare system is basically the same of the one in force at the beginning of the nineties. The Italian welfare system strongly protect household head, mainly prime age workers, suggesting the idea that protecting these kinds of workers provides a indirect assistance also for the other members of the family. This system was coherent with the organization of the Italian labour market features of the eighties, when atypical contract share was almost negligible. However, since the beginning of the nineties the share of atypical contracts both of young and adult workers increased considerably. In this new setting, the probability to incur in long unemployment spells also for household heads raised, invoking a reform of the welfare system, like for instance a reorganization of unemployment benefits policies –which has been actually reformed even if in a partial way- and other passive labour market policies. It is a long time that at the political and academic level there is a lively debate concerning the reform of the welfare system, even if it is still at the parliament.

The last remark we want to underline concerns the governance structure between active and passive labour market policies. Until the end of the nineties all policies were administered at the national level. Afterwards, along with the decentralization process inside the public administration, most of the active labour market policies are directly managed by local public institutions (such as for instance the PES and the training and lifelong learning policies), while the passive labour market policies are still administrated at the national level (CIG and unemployment benefits for instance).

2. Changes in production model

2.1. Privatisations and liberalisations: towards a market model

2.1.1. The role of privatisations in shaping Italian capitalism

During the last 20 years, Italian economy experienced a comprehensive and systematic change from a “mixed” model, characterised by the coexistence of a strong public sector and a deeply regulated market economy, to a market-oriented one, where the presence of the state has been reduced and competition has been gradually spread to nearly all sectors. The most striking episode in this direction can be identified with the long wave of privatisations that has taken place since the beginning of the 1990s, together with a gradual liberalisation in public utilities.

The wide diffusion of the public sector in Italy began with the foundation of IRI (Institute for Industrial Reconstruction) in 1933. IRI was created with the specific goal of acquiring shares of firms previously owned by commercial banks (which were experiencing a deep crisis due to the international economic situation), in order to avoid liquidity crises and to begin a reorganization of these acquired enterprises. After the end of World War II and the fall of fascist regime, IRI maintained and even reinforced its role in order to operate the reconstruction of the Italian industrial system, heavily hurt by the conflict. During the after war period, IRI became a holding operating in many sectors, ranging from steelworks to telecommunications, from food industry to transports. Public intervention in the economy extended along the years, with the creation of ENI (the national oil company) in 1953 and of EFIM (a holding company in the mechanical industry) in 1962. In the same year, it took place the nationalization of the electrical energy industry, with the foundation of ENEL, the national electricity company. It is worth noting that the banking system as well was largely controlled by the government.

The administration of this wide state-owned industrial system required the creation, in 1956, of a specific ministry, the “Ministero delle Partecipazioni Statali” (survived until 1993), in order to guarantee a political control of these holdings. Of course, the main objectives of this system were not market and profit oriented: public companies were in fact considered as agents of “economic development”, with the purpose of pursuing full employment and ensuring social equity. However, while this system promoted the reconstruction in the initial post-war years, since the 1970s a deep crisis began: the logic of public administration, far

from supporting efficiency goals (even because the choice of the management was under the influence of political parties), hindered the reorganization and the technological renewal which were needed after the oil crisis and as a consequence of the increasing internationalisation of the markets. The main consequence of this situation was the continuous need of public funding, in order to face the heavy losses experienced by most of public companies (not only those operating in a monopoly regime). The negative outcomes in terms of national debt are nowadays clear: in the years 1980-1994, public funding and interests due to IRI, ENI and ENEL caused an increase of the debt stock (in nominal terms) of about 120,000 billions lire, approximately 62 billions euros, corresponding to almost 0.5% of GDP per year (Mediobanca, 2000).

Even if some episodes of privatisation took place already in the middle 1980s, the conditions for a systematic privatisation plan were achieved only at the beginning of the 1990s: at that time, in fact, the negative business cycle, the forthcoming devaluation of the lira, the explosion of national debt and the stringent European legislation against state aid to enterprises accelerated the privatisation of state-owned companies. This process started with Law n. 359 of 1992, which stated the transformation of IRI, ENI, ENEL and INA (the main state-owned assurance company) into joint-stock companies, owned by the Ministry of Treasury. As a consequence, “public interest” ceased to be the main objective of management, and efficiency and profit seeking started to be – at least theoretically – pursued. Simultaneously, in 1992 a liquidation procedure started for EFIM, which began the sale of important firms to the private sector.

Since 1992, the majority of state-owned companies have been gradually dismissed. Privatisations covered nearly all the sectors of economy: food, distribution and restaurants; steelworks and aluminium; cement and glass; chemicals and man-made fibres; machinery, electrical equipment, plants and electronics; constructions; telecommunications; publishing and printing. Various types of procedures have been used to transfer shares (both control shares and minority ones) to private national and foreign investors. In some cases, mainly for public utilities (telecommunications, electricity, highways, etc.), the government preferred a public offer to the stock exchange rather than a direct sale to private investors. In other cases, it preferred negotiating directly with financial investors or with other companies, operating both in the same sector of the privatised firm (mainly in food, steelworks, mechanical industries) and in other sectors.

The second half of the 1990s was the most dynamic phase for dismissals, also because of the favourable increase of the stocks prices. At the end of that period, in 2000, about 198,000 billions lire, 102 billions of euro, were gained by the State as a result of the privatisations

programme (Mediobanca, 2000). After a break of two years, the process started again in 2003, with the important sale of ETI (national tobacco company) and still continues; in 2004, for example, significant shares of ENEL have been sold in the stock market.

Nowadays, the Ministry of Economy still owns important shares of Alitalia, ENEL, ENI and Finmeccanica, the last two being considered strategic activities (in particular ENI, for the relevance of the oil market, and Finmeccanica, for the activities connected to the national defence). Moreover, railways and postal service are still under the public control, even if a small share of the latter has been sold in 2003.

Taking into account data concerning all the privatisation processes in the world since 1977, Italy stands at the second place in the world for revenues (in absolute value) and at the first place in Europe, followed by the United Kingdom, Germany, France and Spain (Ministry of Economy Privatisations Report, 2004). As a percentage of GDP, total revenues from transfers in Italy stand at the second place in Europe (Sgarra, 2005; see Tab. 1). It is interesting to notice that “effective” privatisations amount to only 4,0% of GDP, since Ministry of Economy still owns control shares of the companies above mentioned.

Tab. 1. Value of privatisations (% of GDP)

	France	Germany	Spain	United Kingdom	Italy
Value of transfers	8.8	5.0	8.3	14.4	13.4
- Transferred debt	-	-	-	1.5	1.3
= Net revenue	8.8	5.0	8.3	12.9	12.1
- Non control transfers	3.0	2.7	0.1	-	6.7
= Control transfers	5.8	2.3	8.2	12.9	5.5
of which uncertain:	0.2	0.1	0.1	-	-
= Certain control transfers	5.6	2.2	8.1	12.9	5.5
- Transfers to Foundations	-	-	-	-	1.5
= "Effective" privatisations	5.6	2.2	8.1	12.9	4.0

Source: Sgarra, 2005. Data are obtained by national Ministries of Economy, Mediobanca, Bloomberg, Ifr, Oecd, Privatization Barometer. These results are obtained by summing the ratios between privatisations and GDP in the main periods of privatisation (1982-2004 for UK, 1986-2004 for France, 1986-2003 for Spain, 1987-2004 for Germany, 1992-2004 for Italy).

The privatisation process entailed several effects on the Italian economy and on the production system. The main outcome, of course, was a positive effect on the public finance; furthermore, privatisations also affected the industrial structure, the stock market and the corporate governance.

As for the effect on the national debt, it seems important to stress that revenues from dismissals have been put in a specific fund for the amortization of State bonds, and have been used to gradually reduce the value of the debt. Adding the debt induced by state-owned companies to the revenues generated by privatisations, it comes out that ENI and ENEL have

more than paid back national funding, while IRI companies, in particular those operating in steelworks, show a largely negative result.

As for the impact on productive system, it is necessary to distinguish between effects on regulated sectors, which have been simultaneously opened to competitors (i.e. public utilities, the most evident case is telecommunications), and on market sectors, where state-owned companies operated together with private ones.

In the first case, privatisations aimed at stimulating higher competition in these markets and at attaining positive results, in terms of efficiency, for consumers. However, in some cases this goal has not been completely achieved, due to delays in the process of liberalization and to still existing barriers for new competitors in some markets (we will come back later about this topic). An important exception is the telecommunications sector, where a great number of companies (actually, more than 100) entered the market and the quality of services for customers generally improved. As mentioned before, the Ministry of Economy still owns control shares in electricity, oil and gas leading companies. These companies, moreover, still hold national infrastructures, and are privatising them only gradually, according to specific sectoral laws.

In the second case, which involves more traditional sectors, the main outcome has been typically an increase of market concentration, since privatised company shares were purchased by companies operating in the same sector, aiming at expanding their share in the market. The results of this concentration process were generally not detrimental for customers, since the achievement of a bigger size was, in most cases, necessary to privatised firms in order to compete in the international markets. Moreover, a bigger size allowed the attainment of scale economies, which, together with the higher levels of investments made by purchasers, definitely improved the efficiency of previously state-owned companies. The efficiency gains have not been achieved to the detriment of employment levels, which have been maintained, at least in the first period, as a consequence of specific constraints imposed to purchasers. Firings were normally not allowed in the first years (ranging from 3 to 5) after the privatisations; however, companies had the possibility to reduce the number of employees providing incentives to early retirement.

The privatisation programme affected also the corporate governance. The more evident effect was the substitution of most boards of directors in previously state-owned companies, and the reduction of their members (the nominations previously was a political issue, entailing an increase in the dimension of boards). However, managers were not fired, because of their competence, in most of the cases; substitutions were necessary only in those companies where the level of losses was excessive, for example in steelworks.

As for the changes of the internal structure, we can distinguish two cases: companies purchased by multinationals have integrated completely, with some exception, their administrations with the ones of the buyers; companies purchased by national corporations, instead, made only a partial integration of their activities and often remained quite autonomous, in order to exploit their reputation on the specific markets. In many cases there were processes of internal reorganization, aiming at simplifying the structure of control. An important example is given by the privatisation of telecommunications in 1997, which led to the creation of a single company, Telecom Italia, generated by the fusion of the earlier national holding (Stet) and the five market operators (Sip, Italcable, Iritel, Sirm and Telespazio); inside this new company, it was established a rigid separation between the finance division and the corporate one.

Finally, it seems important to mention the effects of privatisations on financial markets. Privatisations, occurred in the second half of the 1990s, coincided with a period of unexpected rise of the stocks prices, also related to the investors' shift from State bonds (whose returns were gradually lowering) to shares. This situation represented an important novelty for Italy, where State bonds, combining high revenues with low risk, represented to a large extent the main asset both for households and for institutional investors. In these framework, not only the Government had no problems in imposing high prices from the sale of national companies (with obvious benefits for the reduction of national debt), but also contributed, indirectly, to develop the Italian stock market, whose dimensions have been traditionally exiguous. Just as an example, in 1992, at the beginning of the process of privatisation, the value of listed companies was only 7,6% of GDP, while in 2000, at the end of the major wave of dismissals, it was 51,9%; 60% of this increase is related to flotation of privatised companies (Mediobanca, 2000). At the same time, the number of savers investing in the stock exchange increased considerably.

2.1.2 The process of liberalization in public utilities

Alongside the privatisation process, another important transformation took place in the Italian economy in the 1990s, namely the process of liberalization. This process was anticipated in 1990 by the creation, with Law no. 287 of 1990, of a national Antitrust Authority ("Autorità Garante della Concorrenza e del Mercato"). It is worth noting that in Italy this Authority has been set up with a conspicuous delay with respect to other industrialized countries: just as an example, Canada adopted an antitrust legislation in 1889 and the U.S.A. in 1890 (the well-known Sherman Act); after the mid-1980s almost all

European countries were adopting such a legislation, included Eastern European countries which were experiencing the transition towards a market economy. Nonetheless, this relevant delay clearly shows the high level of corporatism and centralization that dominated Italian economy until the 1990s. From this point of view, the foundation of the Antitrust Authority represents a landmark for the change of attitude toward a competitive production model.

Actually, the process of liberalization of services and public utilities in Italy has been largely forced by the interventions of the European Union about competition and free access to the markets. As a consequence, the main legislative measures aiming at guaranteeing free access to markets, for both producers and customers, have been carried out according to the Community directives.

The activity of deregulation involved nearly all sectors, ranging from public utilities to financial services, from assurance companies to retail trade. Focusing our attention on public utilities, which are more directly linked to changes in the productive system, for their earlier nature of national monopolies, the sequence of legislative acts that started their liberalization began with the telecommunications sector. In particular, the first act, in 1995, was related to the Community directive 90/388 (with a conspicuous delay with respect to the original deadline fixed for January 1992), which introduced competition for all activities different from voice telephony (in particular, data transmission and access to internet). Subsequently, liberalization of voice telephony, included mobile telephony, was concluded in 1998, according to the Open Network Provision framework. The situation was integrated, in 1997, by the “harmonization directives”, aiming at regulating access to infrastructures and interconnection obligations.

Liberalization in energy sectors was even more recent. In particular, electricity was liberalized with decree no. 79 of 1999, confirming the Community directive 96/92. The legislator provided for: the liberalization of production, with the obligation for the ex-monopolist (ENEL) to reduce its share in production under 50%; the creation of an “electrical exchange”; a rigid separation between producers and the infrastructure. As for the latter point, however, the infrastructure has remained property of ENEL for a long time, even if managed by an independent administrator; only recently it is going to be privatised, with constraints to the concentration of property. The process of liberalization in this sector has been gradual: actually, only business clients can choose freely their operator (since 1st July 2004), while households are still constrained to the company operating in their area.

Liberalization of the natural gas market started in 2000, with decree no. 164 of 2000, confirming Community directive 98/30. The adopted rules were very similar to those applied

in the electrical market: creation of market thresholds for the operators, at least in the short term; formal separation between producers and the gas-pipes owner (ENI), with the obligation for ENI to reduce its share to 20% by 2007; gradual opening to competition. By now, however, the operator choice is limited to big users, consuming more than 200,000 cubic metres per year.

A first balance of the process of liberalization in Italy is not completely positive, with some exceptions (the most evident one is telecommunications sector, where the development of competition has been very rapid, even if the ex-monopolist occasionally incurred in penalties for abuse of dominant position). As stated by the national Antitrust Authority in its last Report, often in recently liberalized sectors ex monopolists still tend to «refuse to competitors the access to an essential infrastructure or to compromise their presence on the market through predatory strategies» (Autorità Garante della Concorrenza e del Mercato, 2005). As a consequence of these still existing positions of rent-seeking, inefficiencies emerge primarily with tariffs for electricity and gas generally above the European average (this is also true for various services, such as retail banking and assurance companies); in indirect terms, moreover, this situation may seriously harm the international competitive position of Italy, since energy is a primary input of nearly all productions. From a structural point of view, it appears necessary to speed up the vertical separation between producer companies and the infrastructures owner; at the same time it seems important to reduce the level of concentration in the markets, bearing in mind, however, that even a too fragmented market can cause inefficiencies.

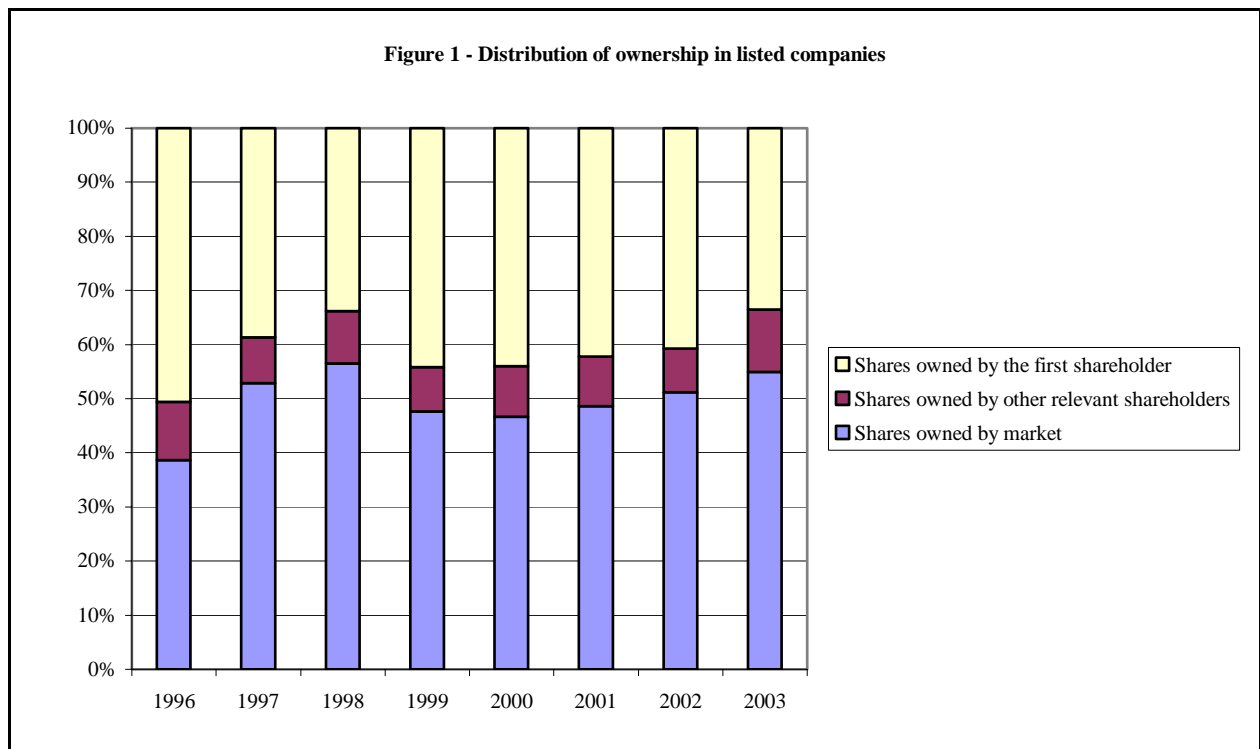
2.2.1 Changes in corporate governance

The nature of corporate governance in Italy has been traditionally related to the peculiar features of its capitalism, that escape the standard distinctions, for example, between the Anglo-Saxon and the German one. As far as the ownership structure is concerned, Italian companies have been historically characterised by a high level of concentration and a limited separation between ownership and control, even in large firms. Traditionally, the main role in the ownership structure was played by families and coalitions, alongside with the state, at least until the wave of privatisations. Conversely, institutional investors and banks had only a marginal role in monitoring companies and exerted little influence on corporate governance. The fundamental Banking Law of 1936, in fact, prohibited banks from holding equity shares in industrial companies, and imposed a specialisation between the intermediaries devoted to short-term credit and those committed to medium and long-term credit. This law, adopted in

the post-1929 crisis, was against the German-style relation between firms and commercial banks that dominated the former development stage of Italian capitalism. However, even in the post-war period the situation did not evolve toward diffuse corporate control, typical of the Anglo-Saxon model, with a number of listed companies widely below those of the main European stock exchange markets, and with a gradual expansion only in the last decade (actually, 278 companies are listed in 2005). On the other side, bank loans represented the main source of funding for growing firms, beside self-financing, suggesting that banks could apply only an indirect control over corporate governance, through lending decisions.

These circumstances, together with a legislation that both favoured the “certainty of control” and guaranteed little protection to minority shareholders (Melis, 2000), characterised the system with a high concentration of ownership and with the relevant presence of blockholders, controlling companies by means of different devices. According to a survey by La Porta et al. (1998), none of medium-size publicly traded Italian companies resulted widely held (considering a control threshold of 20%), against a share of 24% in the world; 60% of them, instead, were held by families, against a world average of 45%. Focusing on listed companies in the last years, Figure 1 (CONSOB, 2004) shows that shares owned by the market stand on average only at around 50% of the total, with peaks due to the sales of state-owned companies; however, it emerges also a slightly increasing trend toward widespread ownership.

Blockholders can control management not only by means of high concentration and direct ownership, but also using some widespread strategies, such as pyramidal groups, shareholders’ agreements and non-voting shares. In particular, pyramidal groups can be defined as “chains of companies”, where the last companies of the chain are controlled by the holding ones (which belong to a family, or a coalition) via a sequence of proprietary relations, aiming at controlling the majority of voting rights holding a minority of shares.



Source: CONSOB (2004).

Due to this structure, the main corporate governance problem in Italy is not an agency problem (i.e. the conflict between management and ownership), but concerns the protection of minority shareholders. According to Melis (2000), who in turn paraphrases Roe (1994), the traditional system of corporate governance in Italy could be summarized by the expression “weak managers, strong blockholders and unprotected minority shareholders”.

However, during the 1990s a process of modernization of financial markets started, with the aim of extending and liberalizing the role of financial intermediaries (in order to transpose Community directives into the Italian law) and of strengthening the protection of investors and minority shareholders. This reform process passed through three main acts: the Testo Unico Bancario (TUB) in 1993; the Testo Unico della Finanza (TUF) in 1998; the code of best practices (Preda code), in 1999 (modified in 2002).

After more than fifty years, the TUB allowed commercial banks to hold shares of non financial companies, therefore breaking the traditional distinction between intermediaries committed to short-term credit and those committed to medium and long-term one, in this way introducing the universal bank model. Further, a gradual privatisation of state-owned banks – which were partly devolved to foundations owned by local governments and partly sold to the market – was carried out at the same time. As a consequence, the banking system has been deeply reorganized, enhancing profitability and, at the same time, increasing the dimensions of the intermediaries through mergers and acquisitions.

The TUF (better known as Draghi Law) represented the most relevant reform of corporate governance since the 1930s. It aimed at fostering the development of financial markets through new rules ensuring greater transparency and protection of small investors. Among the innovations introduced by this act, it is worth to mention: lowering to 2% the threshold at which investors must communicate to Consob (the stock exchange regulatory authority) the purchase of a company's shares; lowering the percentage of shares necessary to exercise minority rights; new rules about takeover bids, according to which investors have to make a public bid for all of a company's ordinary shares once they have purchased more than 30% of its equity; the obligation to make shareholders' agreements public, limiting their duration up to three years, after which the parties are required to renegotiate their terms; allowing management to adopt takeover defence strategies only with the authorization of shareholders; separation between control on management – assigned to the board of auditors (“collegio sindacale”) – and control on accounting – assigned to external auditors. According to the index of investors' protection calculated by La Porta et al. (1998), Italy goes from 1 to 5 over 6 after the 1998 reform (Barucci and Falini, 2004).

Another important piece of this reform was the creation of a self-regulation code of best practice (Codice Preda), drawn up by university, business and government representatives and introduced by the Italian Stock Exchange in 1999 (further modified in 2002). It is important to underline that adhesion to the Preda code is on a voluntary basis. This code aimed at defining precise roles for the board of directors (exclusive powers of the board in approving strategic plans and significant transactions) and for the chairman, identifying two classes of directors (executive and non-executive, of which a certain number should be independent). According to the code, the board of directors should also define an internal control system (managed by a specific committee) deputed to monitoring internal efficiency and the remuneration of the same directors. In 2003 some of the code rules regarding information reporting were transformed from voluntary into compulsory; however, in the same year the Parliament approved a law which slowed down the process of increasing transparency, by a partial “decriminalisation of false accounting”. In spite of this, the need for transparent information reporting and for fair accounting appears evident, in particular after the recent financial scandals (in particular the Parmalat and Cirio cases).

An analysis of the results of these reforms does not lead to clear-cut conclusions. In fact, even if these new rules surely meet the requirements for a proper corporate governance and for a more modern and efficient financial markets, their effectiveness is quite dubious. In particular, after seven years since the release of the TUF, the purpose of more widespread ownership is still remote, and the pace of renewal of Italian capitalism appears slow: for

example, new legal rights accorded to minority shareholders have been rarely exerted. According to Barucci and Falini (2004), this does not necessarily mean that they are not relevant, since they can act as a deterrent for blockholders. However, it seems that in practice TUF has not modified significantly corporate governance of Italian firms. At the same time, the relevance of the Preda code, whose purposes are anyway valuable, is limited by its nature of self-regulation.

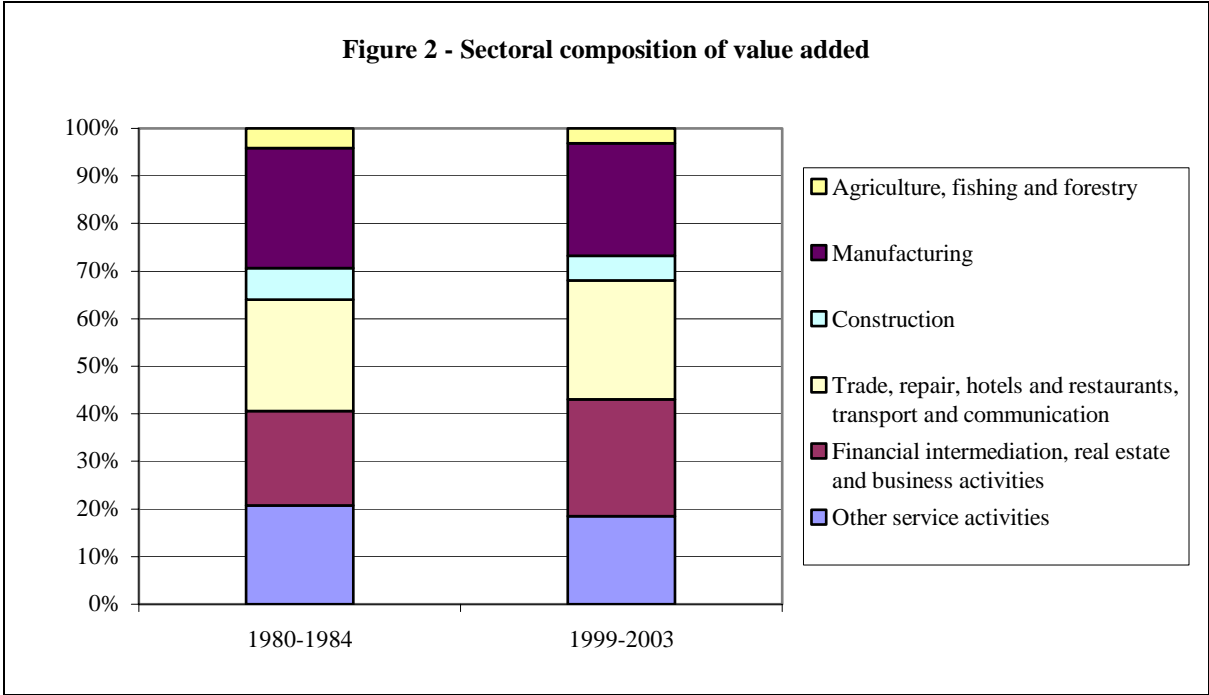
2.3. Patterns of specialization of Italian economy: sectoral dynamics, internationalisation, and firm size

2.3.1) Trends in sectoral composition and effects on international performance

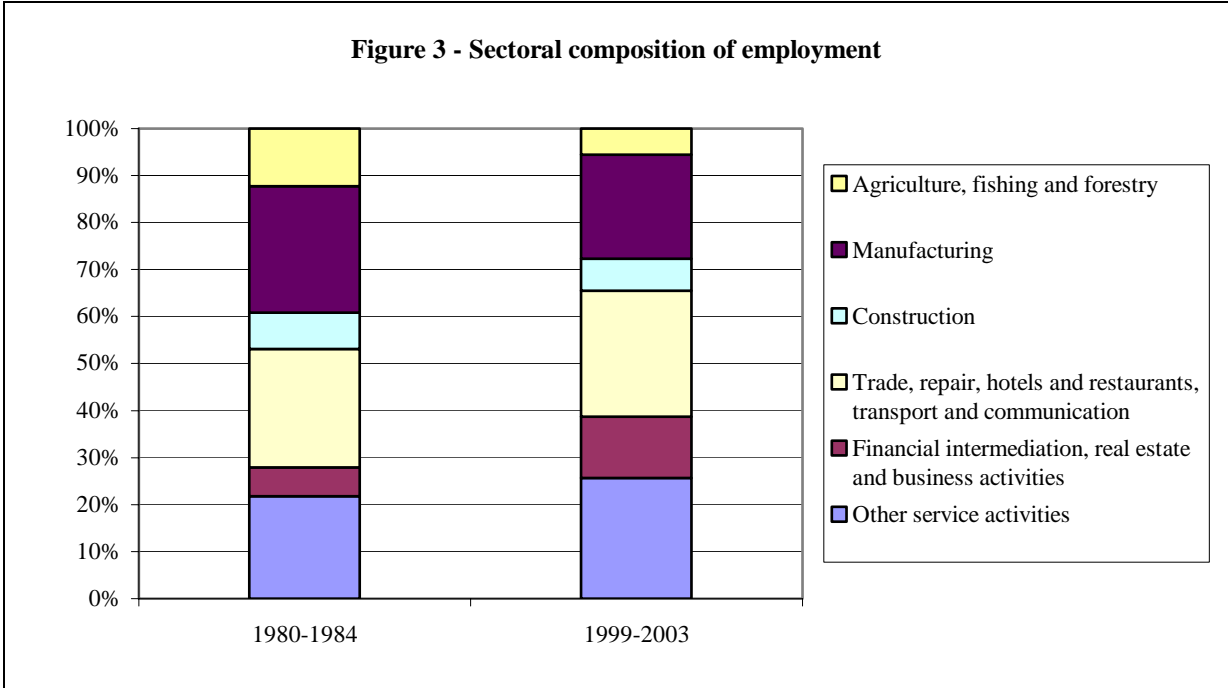
During the last twenty years the structure of Italian economy has evolved along the path of most of the industrialized countries, losing shares in manufacturing and agriculture and increasing the weight of service activities. However, this shift is more evident in terms of employment than in terms of value added, whose composition changed only slightly during this period. In particular, taking as benchmark periods the intervals 1980-1984 and 1999-2003² we observe that the share of services in value added rose from 64% to 68.1% (Figure 2). The main contribution to this increase is due to financial intermediation and business services (increased from 19.8% to 25.4%) while the share of other service activities (education, social and personal services, public administration) decreased from 20.7% to 18.5%.

In terms of employment, however, the sectoral reallocation towards service activities appears stronger (see Figure 3): in particular, the share of employees (full-time equivalent) in services increased by more than 12%, from 53.2% to 65.5%. More specifically, it is possible to observe that – also in this case – a strong increase of the number of workers in business services (from 6,1% to 13%), while the share of employees in trade, repair, hotels and restaurants, transport and communication is fairly constant. The category “other service activities”, which lost relevance in terms of value added, shows instead an increase in the number of workers (from 21.7% to 25.6%).

² We took five years average values in order to attenuate possible cyclical effects.



Source: elaboration on ISTAT data



Source: elaboration on ISTAT data

As for manufacturing, it is worth noting that while there was only a slight decline in terms of value added (from 25.2% to 23.6%), employment decreased significantly (from 26.9% to 22%), as a consequence of deep sectoral restructuring, with large increases of labour productivity during the 1980s and at the beginning of the 1990s. The increase of the employment share of business services at the expense of manufacturing can be explained, at least partially, as a result of this process of reorganization, which led to a downsizing of large

manufacturing firms (in particular, previously state-owned companies) and to the outsourcing of service activities previously performed inside the firms.

Focusing our attention on the composition of manufacturing it is possible to analyse how the structure of specialization (and, consequently, of comparative advantages) of Italian economy changed over time. As clearly shown in Table 2, the composition of manufacturing activities did not change too much (at this level of aggregation) during the last twenty years. The highest shares of value added are still covered by manufacture of metal products and machinery, respectively at around 13% and 10% of the total, and by manufacture of textiles and clothes, which in contrast experienced a decrease of about 1.5 percentage points to 9.2% (the decrease was steeper in terms of employees, whose share decreased by more than 3 percentage points). Looking at the other categories, refinery shows the strongest reduction in the share of value added, falling from 4.9% to a marginal 1.4%, while manufacture of electrical and optical equipment evidences the highest increase, from 6.2% to 8.5%.

Tab. 2. Sectoral composition of manufacturing activities

	Value added %		Employment %	
	1980-1984	1999-2003	1980-1984	1999-2003
Mining and quarrying	1.7	1.7	1.0	0.8
Manufacture of food products, beverages and tobacco	8.2	8.8	7.9	9.1
Manufacture of textiles and textile products	10.7	9.2	16.3	13.4
Manufacture of leather and leather products	3.1	2.2	5.2	3.9
Manufacture of wood and wood products	2.3	2.7	4.3	3.7
Manufacture of paper; publishing and printing	5.0	6.1	4.8	5.8
Manufacture of coke, refined petroleum products and nuclear fuel	4.9	1.4	0.5	0.5
Manufacture of chemicals and pharmaceuticals	5.5	7.4	4.6	4.5
Manufacture of rubber and plastic products	3.5	4.0	2.5	3.9
Manufacture of other non-metallic mineral products	5.2	5.8	5.2	6.4
Manufacture of basic metal and metal products	12.6	12.9	15.4	14.6
Manufacture of machinery and equipment	10.5	10.1	9.7	10.7
Manufacture of electrical and optical equipment	6.2	8.5	8.1	9.0
Manufacture of transport equipment	6.3	5.3	6.8	5.3
Manufacturing n.e.c.	4.4	4.3	5.1	5.8
Electricity, gas and water supply	9.9	9.6	2.6	2.7
Total	100.0	100.0	100.0	100.0

Source: elaboration on ISTAT data

However, the slow process of sectoral reallocation was such that the specialization patterns of the Italian economy have not changed much over time, maintaining a peculiar structure that is still different from that of other industrialized countries. Limiting the comparison to the European Union, Table 3 shows the coefficients of specialization of manufacturing activities (i.e. the ratios between a sector's share on national value added and

the share of that sector on EU25 value added) for Italy and for the main European countries in 2002. A coefficient greater than 1 indicates that a country is specialized in a specific sector.

Tab. 3. Specialization ratios of manufacturing activities – Year 2002 (calculated in relation to sectoral composition of value added in the EU25 area).

Economic activities	France	Germany	Spain	United Kingdom	Italy
Manufacture of food products, beverages and tobacco	1.3	0.7	1.2	1.2	0.8
Manufacture of textiles and textile products	1.0	0.5	1.3	0.6	2.5
Manufacture of leather and leather products	0.9	0.4	1.5	0.6	3.4
Manufacture of wood and wood products	0.9	0.7	1.2	0.8	1.1
Manufacture of paper, publishing and printing	0.9	0.8	0.9	1.5	0.7
Manufacture of coke, refined petroleum products and nuclear fuel	1.0	0.6	1.9	2.0	0.6
Manufacture of chemicals and pharmaceuticals	1.7	0.9	0.8	1.0	0.7
Manufacture of rubber and plastic products	1.2	1.2	1.2	2.0	1.0
Manufacture of other non-metallic mineral products	0.9	0.8	2.0	0.8	1.4
Manufacture of basic metal and metal products	1.0	1.2	1.2	0.8	1.2
Manufacture of machinery and equipment	0.8	1.4	0.7	0.7	1.3
Manufacture of electrical and optical equipment	1.8	1.2	0.5	1.0	0.8
Manufacture of transport equipment	1.2	1.5	0.9	1.1	0.5
Manufacturing n.e.c.	1.0	0.7	1.1	1.2	1.3

Source: EUROSTAT

It seems clear that, with regards to European Union, Italian productive system is significantly specialized in the manufacture of traditional goods, with low intensity of skilled workforce (in particular, textiles and clothing, leather, wood and metal products) and, following the classification *à la Pavitt*, in an only industry with specialized supply (manufacture of machinery and equipment). On the other hand, it shows a negative specialization in sectors characterized by economies of scale (transport equipment) and by high intensity of R&D (pharmaceuticals and ICT, included in manufacturing of electrical and optical equipment). The same results appear evident looking at the structure of international trade, by considering for example an index of comparative advantages, the Balassa's index, as calculated by Faini and Sapir (2005). This index is defined as the ratio between Italy's market share in a sector's world export and Italy's market share on the whole world export; furthermore, it has been made homogeneous (by eliminating Italy's export from the world aggregate) and symmetric (with a transformation such that the index may vary in the range: +100, -100).

The results from Table 4 confirm the previous hypothesis about Italian model of specialization. Italy shows high comparative advantages in traditional sectors (such as leather products, textile and clothes, footwear, furniture) and in mechanics; it shows, conversely, low comparative advantages in high-skilled and ICT intensive sectors, such as

office, telecommunication, electrical and scientific equipment, and in manufacture of motor vehicles. It is worth noting that Balassa's index for office and electrical equipment was significantly positive in the 1970s, but it became negative at the beginning of the 1980s, with the start of the "ICT revolution".

Tab. 4. Balassa's index (homogeneous and symmetric) for Italy

	1970	1975	1980	1992	1997	2002
Food products	-7.4	-12.7	-25.8	-15.1	-15.8	-10.7
Non-edible raw materials	-54.2	-56.3	-61.1	-59.1	-57.1	-50.2
Mineral combustibles and lubricants	29.7	16.2	-13.4	-94.0	-94.5	-87.6
Chemicals and derivatives	-9.1	-11.6	-16.9	-16.7	-14.7	-12.7
Finite products classified by materials						
Leather products	34.4	46.1	48.4	72.8	79.4	84.0
Rubber products	6.2	11.6	15.3	7.5	6.7	5.5
Paper	-43.8	-42.1	-37.7	-24.6	-17.0	-12.7
Textiles	14.5	15.9	26.6	43.2	44.5	46.2
Non-metallic mineral products	16.0	17.7	23.0	41.1	32.0	27.6
Iron and steel	-24.1	7.3	-3.5	8.4	15.1	16.8
Non-iron metals	-54.7	-43.6	-49.9	-30.1	-29.1	-23.7
Metallic products	14.8	15.0	23.6	28.1	28.8	27.9
Machinery and equipment						
Generators and engines	-93.4	-84.3	-14.2	-25.8	-18.3	-20.8
Specialized industrial machinery	20.6	13.6	12.4	28.7	31.6	32.9
Machinery for metal processing	25.3	-7.0	17.2	22.3	23.9	26.7
Other industrial machinery	17.1	13.3	15.3	22.6	28.2	30.5
Office equipment	30.6	21.8	3.8	-33.5	-53.8	-62.9
Telecommunication equipment	-53.8	-36.5	-39.9	-50.6	-43.2	-45.9
Electrical equipment	30.5	26.2	-2.6	-6.1	-16.1	-14.0
Motor vehicles	-1.2	-1.9	-13.7	-23.8	-20.7	-26.4
Other transportation equipment	-46.5	-71.5	-41.2	-32.4	-35.5	-13.3
Other finite products						
Furniture	36.3	44.2	63.5	61.3	64.2	61.8
Clothes	54.9	53.2	63.1	59.7	59.1	59.3
Footwear	86.7	86.4	87.8	83.5	80.8	78.9
Scientific and control instruments	-30.8	-38.7	-34.5	-32.0	-34.5	-35.7
Optical and photography equipment	-17.0	-29.0	-35.5	-23.0	-12.5	-8.5

Source: Faini and Sapir (2005). Elaboration on ICE data.

Moreover, we can observe that the specialization model has been remaining quite stable over time. While for most industrialized countries has been detected the existence of a convergence process among their industrial structures, this process does not hold for Italy. In particular, Bugamelli (2001) compared the specialization models of Italy, France, Germany and Spain, using a classification with 108 sectors sorted by indicators of skill intensity. This paper shows that the Italian model is the most polarized and unbalanced toward its sectors of specialization, while the structure of comparative advantages of France and Germany is quite similar to the average of the euro area. In addition, the convergence toward a common

model appears extremely slow for Italy, while Spain is rapidly changing its model toward high-skill industries (electronics and motor vehicles above all).

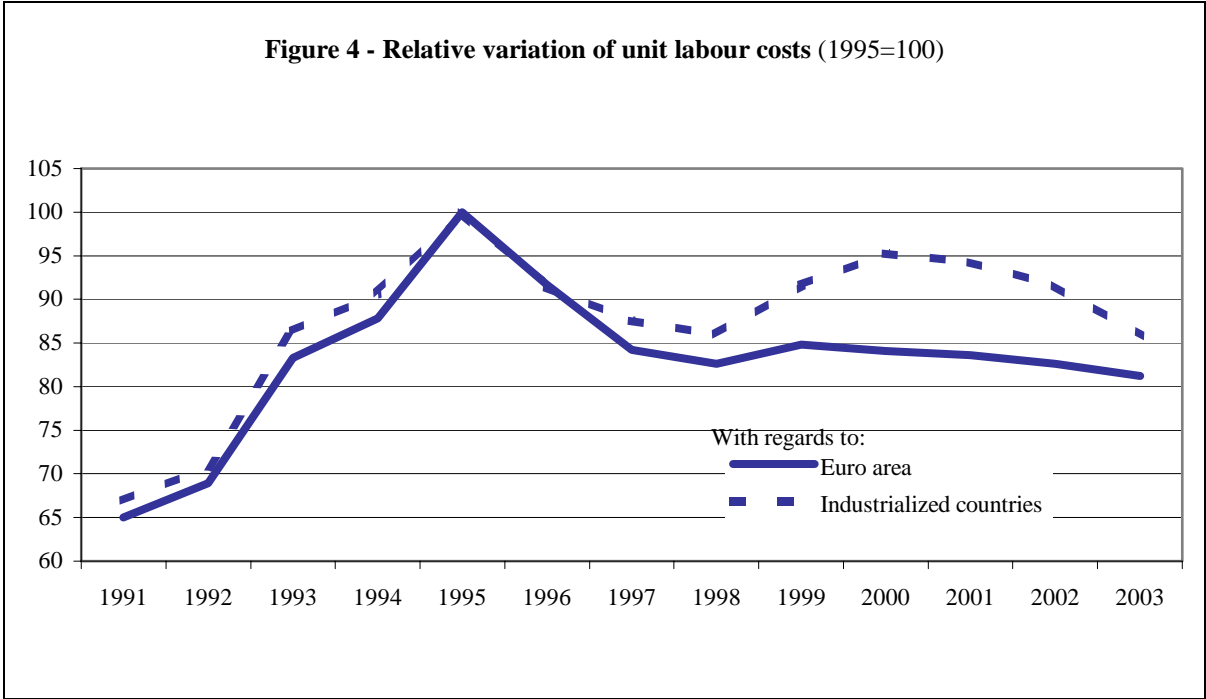
The peculiar structure of Italian productive model, anyway, allowed a rapid economic growth in the post-war period, when the process of liberalization of international trade mainly involved the industrialized countries, therefore allowing Italy to maintain its comparative advantages in the production of traditional goods. This trend was even strengthened during the 1980s because of the periodical devaluations of the lira and the consequent increases in Italian exports. Nonetheless, the result of this exchange rate policy was probably to procrastinate a sectoral reorganization, which was indeed necessary in order to obtain efficiency gains and to gradually reduce the relevance of low value added sectors, more exposed to international competition.

Nowadays, the Italian productive model is in a critical situation because of the increasing competition on traditional goods from developing countries, which actually exhibit lower labour costs, larger supply of low-skilled workers and looser regulation about environment protection and labour standards. Moreover, after the introduction of the euro currency, competitive devaluations are no more possible, therefore removing the possibility for enterprises to compete following the strategy of reducing “artificially” the export prices. It is also important to notice that the peculiar and unbalanced specialization structure described above may not allow to take adequately advantage of the evolution of the world demand, more oriented toward sectors characterized by both high intensity of R&D and high value added.

The first negative effects of this critical situation for Italy in the international situation are already taking place. During the 1990s, the share of Italian trade on world trade initially increased until 4.7% in 1996 (mainly due to the depreciation of the lira from the first 1990s up to 1995), then decreased until 3.7% in 2004. This performance is partly related to a loss of competitiveness, and partly to the specific sectoral composition of the Italian trade.

As for the former component, it is possible to consider the unit labour costs (see Figure 4) as an index of international competitiveness, computed with respect to both the euro area and to the industrialized countries. This index is such that an increase of it corresponds to a gain in international cost competitiveness. We can observe that it increases until 1995, essentially due to the depreciation of the exchange rate, then it starts decreasing because of the recovery of the lira. At this point, however, it is interesting to notice that after the beginning of EMU (1999) the index trends begun following different dynamics. While the trend of unit labour costs with respect to all the industrialized countries is mostly driven by the fluctuation of the euro, its dynamics with respect to the euro area can be exclusively

explained by internal factors. In particular, the loss of competitiveness with respect to the other EMU countries can be explained by the substantial stagnation of nominal labour productivity during the last years.



Source: Centro Studi Confindustria. Elaboration on EUROSTAT data.

During the period 1999-2003, in effect, labour productivity (value added per full-time equivalent employee) increased by just 0.2% per year, and its growth was virtually close to zero in manufacturing. Moreover, wage pressure cannot be considered as a plausible explanation for the increase of labour costs; in fact, since the beginning of the 1990s a wage moderation phase is characterizing the Italian labour market. Even if the stagnation of productivity, for the whole economy, is associated with an increase of employment (full-time equivalent) of about 1.0% per year, it appears therefore evident that the Italian competitiveness problem is more technologically oriented. We will come back later to this point.

As for the effects of the specialization model on the export performance, useful insights come out from Table 5. We can observe that, as expected, Italy lost market shares in sectors characterized by economies of scale and high intensity of R&D, that showed the highest growth rates at the world level in the period 1996-2002; the only exception concerns the pharmaceutical industry, where Italy's performance was in line with the world one. More worrying, however, appears the loss of market shares in those sectors that are more relevant in the Italian productive system, namely traditional goods and productions characterized by

specialized supply (following the classification *à la Pavitt*). In this case, Italy was penalized both by the stagnant evolution of the world demand and by the growing competitive pressure coming from developing countries. According to ISTAT Annual Report 2005, this situation determined a strong selection of firms operating in those sectors, for which the main defence strategies have been to delocalise (the stock of FDI from Italy, as a percentage of GDP, grew from 8.8% in 1995 to 16.4% in 2002) and to reallocate toward higher value added productions (i.e. *intra-industrial specialization*). For instance, in 2002 the average unit value in the clothing industry was 4.8 times higher than the world one. However, according to Onida (2003), this occurred only for few traditional consumer goods sectors. In fact, several studies (for instance, Chiarlone, 2001 and Cipollone, 1999) show that, on average, the Italian model is characterized by a “vertical negative” specialization, that is, the average unit value of imports is higher than the exports’ one.

Tab. 5. Structure and dynamics of manufacture export in Italy and in the world – Years 1996 and 2002

Economic activities	Italian export (% composition)		World export (% composition)		Growth rates		Italian share (% on world export)	
	1996	2002	1996	2002	Italy	World	1996	2002
Traditional manufacture	44.9	42.7	31.9	28.5	-4.5	7.6	7.6	6.7
<i>Textile and clothes</i>	16.0	14.1	8.8	7.7	-11.5	5.9	9.8	8.2
Economies of scale	22.3	23.0	28.9	29.7	3.4	23.9	4.2	3.5
<i>Automobiles</i>	3.2	2.7	5.4	6.2	-15.1	38.2	3.2	2.0
Specialized supply	22.4	21.7	15.5	14.4	-2.6	12.3	7.7	6.7
<i>Machinery and equipment</i>	16.9	15.8	8.9	7.5	-6.0	2.6	10.3	9.4
High intensity of R&D	10.4	12.6	23.7	27.3	22.0	39.0	2.4	2.1
ICT	5.5	5.0	16.6	18.4	-9.9	33.4	1.8	1.2
<i>Pharmaceuticals</i>	1.8	3.7	1.7	3.0	108.6	112.8	5.5	5.4
Total	100.0	100.0	100.0	100.0	0.4	20.5	5.4	4.5

Source: ISTAT (2005)

2.3.2. Towards a “knowledge economy”? R&D and innovative activity in Italy

According to these outcomes, a reallocation of manufacturing activities toward high-skill intensive sectors appears necessary, in order to conform the Italian productive system to the “knowledge economy” model sketched out by the Lisbon strategy. Italian delays along this path are evident, in particular if we look at the standard indicators of R&D, educational attainment and technological advance.

Table 6 shows some figures concerning the intensity of expenditure in R&D and in education in several EU countries, Japan and the United States. Italy’s investments in R&D (1.2% of GDP in 2002) stand far below the European average and even farther from the

figures for France, Germany, Japan and the U.S.A. Even if the Lisbon target of 3% for the ratio between R&D expenditure and GDP within 2010 appears remote for the EU as a whole, Italy's actual position requires even more efforts to devote resources to research activities. In this context, it is worth noting that some countries (such as Spain) that started with a lower level of investments in R&D are rapidly increasing their situation.

Tab. 6. Expenditure in R&D and education in a selection of EU countries, in Japan and in the U.S.A. – Year 2002

Country	Expenditure in R&D			Expenditure in education		
	Total expenditure (public and private)		Share of the private sector	Public expenditure		Private sector expenditure (% on GDP)
	% on GDP	Variation % 2002/1998		% on GDP	Variation % 2002/1998	
Italy	1.2	8.4	49.0	4.8	1.1	0.4
France	2.3	4.1	65.0	5.8	-2.4	0.5
Germany	2.5	9.5	69.0	4.8	-0.2	0.9
United Kingdom	1.9	3.3	69.0	5.3	9.6	0.9
Spain	1.0	15.7	54.0	4.4	-1.1	0.6
Sweden	4.3	18.0	78.0	7.7	-0.6	0.2
EU25	1.9	6.0	65.0	5.2	4.0	0.6
EMU	1.9	4.9	63.0	5.1	1.6	0.5
Japan	3.1	5.8	74.0	3.6	4.3	1.2
U.S.A.	2.6	1.9	75.0	5.4	9.2	1.9

Source: ISTAT (2005)

Another anomaly of the Italian system is the low share of R&D performed by the private sector. This situation is partly due to the peculiar industrial structure (not specialized in highly R&D intensive productions), but also to firm-specific characteristics, in particular the small average firm size. Programmes of incentives aiming at increasing private spending in R&D appear therefore necessary, also taking into account the limitations to increase public investments because of the binding constraints concerning the national debt.

Looking at the expenditure in education, Italy's figures appear more in line with other industrialized countries, even if still below the EU average. In particular, it is worth noting that education in Italy is almost exclusively provided by the public sector, while in Japan and in the U.S.A. a considerable share of this expenditure is private. The outcomes of the Italian educational system, however, are not fully satisfying: in 2004, only 69.9% of individuals in the age group 20-24 achieved upper secondary education (even if increasing from 66.3% in 1999), against a UE25 average of 76.4%: only Luxembourg, Spain, Portugal and Malta had worse performances. Moreover, in 2002 only 12% of the individuals in the age group 25-34 achieved

a five years degree (or equivalent), against, for example, 31% in the U.S.A., 25% in Spain and the Netherlands, 23% in Denmark, United Kingdom and Ireland (ISTAT, 2005).

As for the patenting activity, which can be considered the output of the R&D activities, data from European Patent Office (EPO) show that Italy in 2002 registered 74.7 patents per million inhabitants, against a EU15 average of 158.5. More specifically, Italy ranks far behind Germany (301.0 patents per million inhabitants), Japan (166.7), United States (154.1), France (147.2), United Kingdom (128.7), and all the Northern European countries that in the last years heavily invested in R&D and new technologies.

All these results point out that Italy needs to modernize its system in accordance with the Lisbon targets. However, R&D and patenting statistics are not always good indicators of technological progress. In particular, especially in some traditional sectors, an important channel for innovation (mainly process innovation) is imitation and not R&D by itself. Furthermore, sometimes innovations are not protected by patents (this is more likely in small firms). Therefore, it seems important to investigate directly the innovation performance of firms. At the European level, this is possible by means of the Community Innovation Survey, which detects the percentage of firms acting product and process innovations.

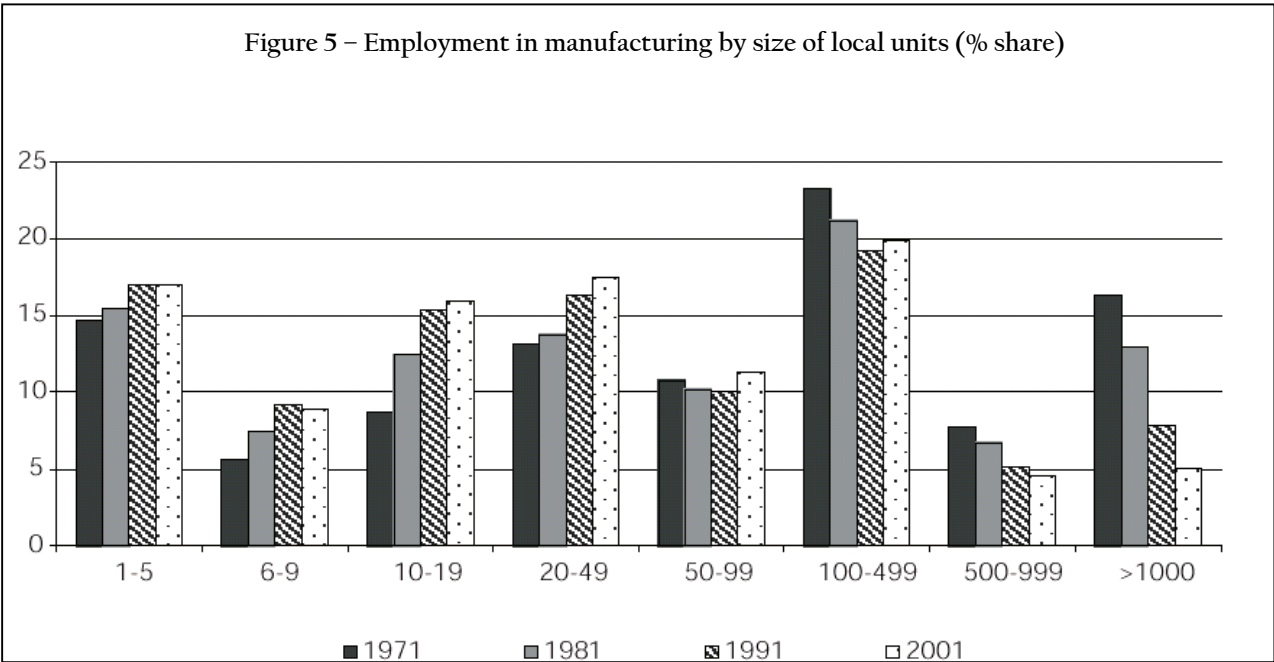
Nevertheless, the overall innovation indicators confirm the weak performance of Italian firms. According to the CIS-3 data for years 1998-2000, Italy's share of innovating firms is 36% (together with Norway and UK), higher only than Greece and Spain, against a EU15 average value of 44%. A better innovative performance is played by Italian small enterprises, which are ranked before UK and French counterfactuals, therefore showing a more dynamic behaviour.

2.3.3. The firm size issue

The small size of firms, as well, is a distinctive characteristic of the Italian productive model (see for instance Traù, 1999 and 2003). The process of downsizing started in the last 1970s, alongside with the crisis of large enterprises as a consequence of oil shocks, and the decline of manufacturing in favour of services. According to Onida (2003) other motivations that fostered this trend have been the gradual spread of ICT, reducing the importance of firm-level economies of scale, the shift of consumption toward goods produced by small firms, a legislation favouring companies with a small number of employees (normally, less than fifteen for labour market issues), and, recently, the privatisation process which broke down large state-owned groups. Among the factors limiting the expansion of firms, it is also worth to remind the traditional reluctance of families to lose control in their own business, and the

efficiency lacks of financial markets, in particular the impossibility for the banking system (at least until recently) to provide consulting services other than the traditional credit activities.

The dynamics of this process is reported in Figure 5, which is based on a periodical census of manufacturing enterprises provided by the national institute of statistics (ISTAT). It is possible to observe that since the 1970s the share of employment in firms with more than 1,000 employees decreased from more than 15% to about 5% in 2001, as well as the employment share in firms belonging to the size classes 100-499 and 500-999. Conversely, the share of employees in firms belonging to the lower size classes rose continuously over time. Nevertheless, in 2001 data show that there has been a slight increase of employment in the size classes 50-99 and 100-499, while the employment share in micro-enterprises remained roughly constant. Therefore, the process of firm downsizing in manufacturing seems to come to an end. A possible explanation of this phenomenon could be the end of the process of vertical disintegration that characterized the industrial development in Italy since the 1970s (Centro Studi Confindustria, 2004).



Source: Centro Studi Confindustria (2004). Elaboration on ISTAT data.

However, the average composition of firms is still unbalanced towards small dimension: for example, the share of employment in micro-firms (1 to 5 employees) in 2001 still stands at a significant 17% of the total. According to the ISTAT Annual Report 2005, in 2003 Italy ranked at the last position in Europe for the average firm size, with a mean of just 3.8 employees per enterprise, ranging from 2.6 in business services to 9.1 in manufacturing.

Small size has been considered, for a long time, an aspect fostering specialization and flexibility; this is true, in particular, with regards to industrial districts, which traditionally characterized the Italian manufacturing system (specially in the production of traditional goods). However, nowadays the small average size of firms is mostly regarded as a constraint for economic growth, due to different reasons³.

Recent data (see Table 7) show that medium and large enterprises perform better than small ones, both in manufacturing and in the whole economy. In particular, labour productivity grows along with dimension (presumably due to the higher amount of fixed investments, not shown in the table), and so does profitability. Moreover, because of the lower level of productivity, also wages paid by smaller enterprises are lower, therefore reducing the attractiveness for high-skilled workforce. Different studies also point out that small-sized firms are characterized by lower levels of R&D, ICT and human capital investments (Traù, 1999; Fabiani, Schivardi and Trento, 2003).

Tab. 7. Economic indicators by economic activities and firm size

Economic activities and size classes	Enterprises (% composition)	Employees (% composition)	Value added (% composition)	Value added per employee (thousands of euros)	Profits/ Value added (%)
Manufacturing	100.0	100.0	100.0	45.5	36.4
1-9 employees	83.3	24.8	14.4	26.5	25.1
10-49 employees	14.5	30.4	25.8	38.7	36.3
50-249 employees	1.9	20.4	23.8	52.9	37.3
250 employees and over	0.3	24.3	36.0	67.3	40.5
Total	100.0	100.0	100.0	37.3	32.3
1-9 employees	95.2	48.3	34.4	26.5	24.9
10-49 employees	4.3	20.9	21.4	38.2	36.2
50-249 employees	0.5	12.3	16.0	48.4	34.3
250 employees and over	0.1	18.5	28.2	56.9	37.4

Source: ISTAT (2005)

³ See for instance Melitz and Ottaviano (2005).

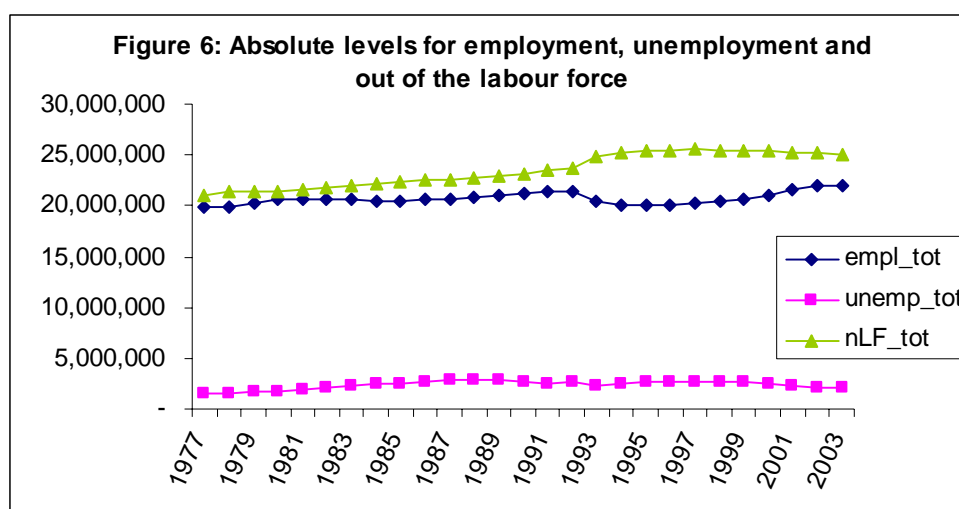
3. Labour market structure and labour supply composition

In this section we present some keys elements in order to outline a exhaustive pictures of the Italian labour markets, providing detailed figures for employment and participation rates, education levels and returns to education, gender and age composition, pension reforms etc. Moreover, we are interested in analysing a long period of time, since we want to provide some insights with respect to the dynamics of this aggregates over time.

In order to deepen these issues, it is not an easy task to collect the proper data. Actually, Istat (Italian National Institute of Statistics) do not provide a time series covering that period. For this reason we use data provided by AIEL (Italian association of Labour Economists), that reconstructed a reliable series from 1977 to 1992. Then we linked this series with the official data released by Istat (Italian Institute of Statistics) from 1993 to 2003. At the moment it is not possible to add this series to the data of the new Labour Force Survey started in 2004, since a retrospective reconstruction by Istat has not yet been released. At the end we use a time series from 1977 to 2003, which properly cover the period we are interested in. The data source is not an official one, and of course there might be some miscomputations in the time series. By the way, we think that these data can quite properly provide the main trends of those labour stocks we want to investigate.

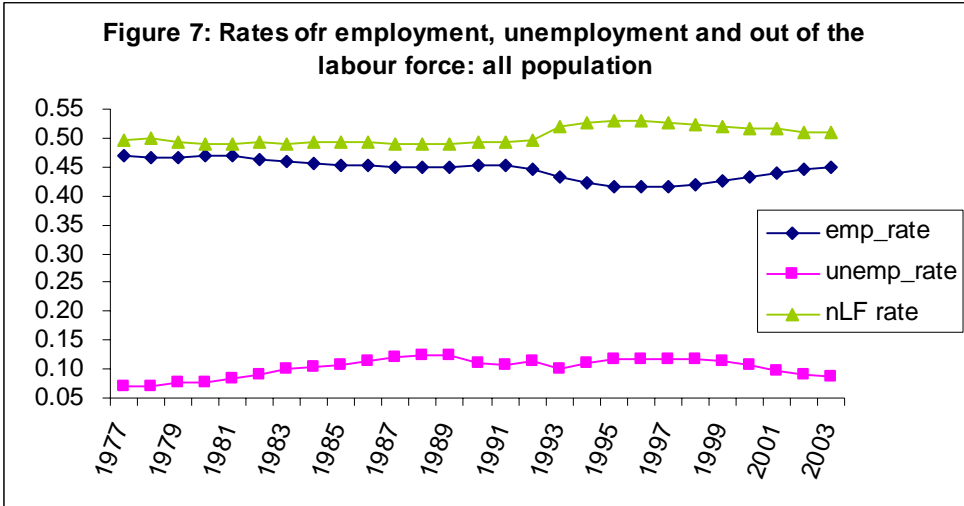
3.1. Employment, unemployment and participation dynamics

First of all, it is interesting to show the trends of the labour supply composition in the period 1977-2003. From figure 6 it is possible to analyse the Italian trends (in absolute values) for Employment, Unemployment and out of the labour force people.

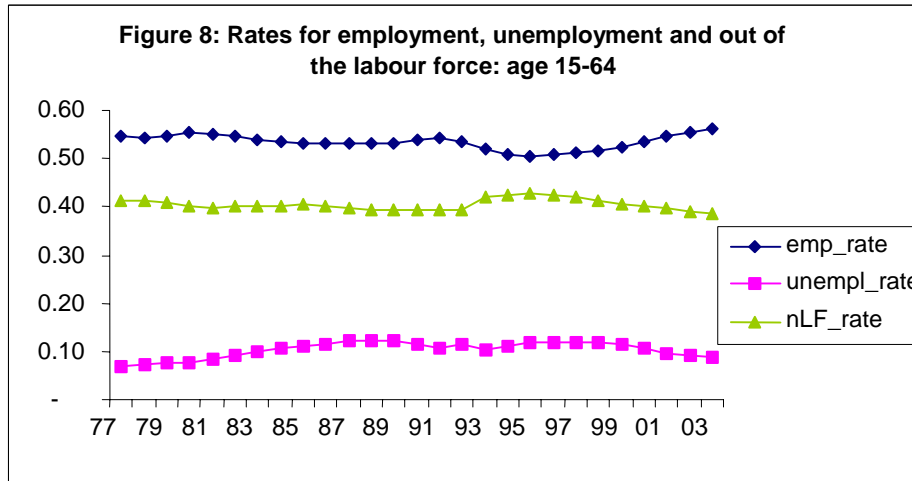


In the last 25 years employment did not growth too much (no more than 10% in all the period), and in the nineties it decreased sharply because of a relevant recession in 1992-1994. In the same period unemployment rose as well as the inactive people, even if at the end of the nineties they have begun to decrease again. A first interesting remark from this graph is that the amount of inactive people is always greater than the employed ones and that this difference increases over time. More specifically, in the period 1977-2003 employment increased by 10,5% while inactive people by 19%. This is quite surprising, especially because at the beginning of the period Italy showed one of the lowest European Activity rate. Moreover, unemployment is the aggregate that have most increased in this period (37%, from 1.521.000 to 2.096.000).

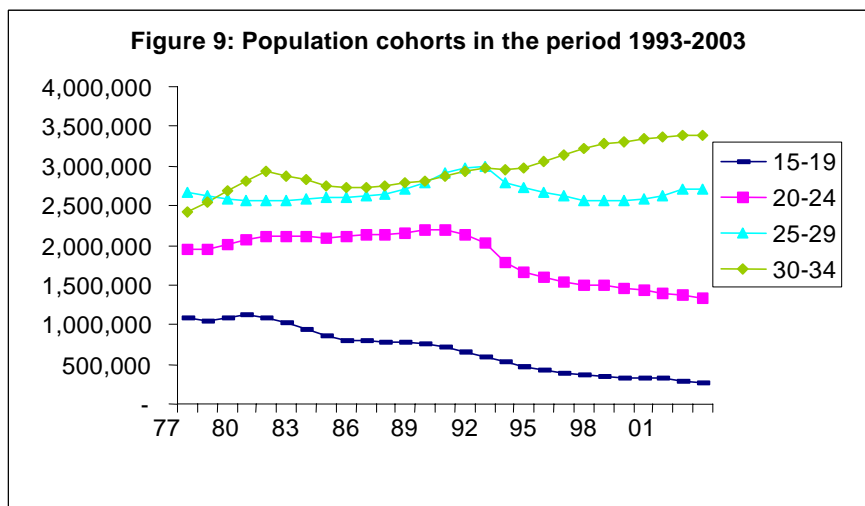
Another interesting remarks concerns the fact that considering the absolute levels of these aggregates the labour market conditions are not changed so much. Moving from absolute values to rates, trends are very similar, with the only significant difference that employment rates are decreasing over time.

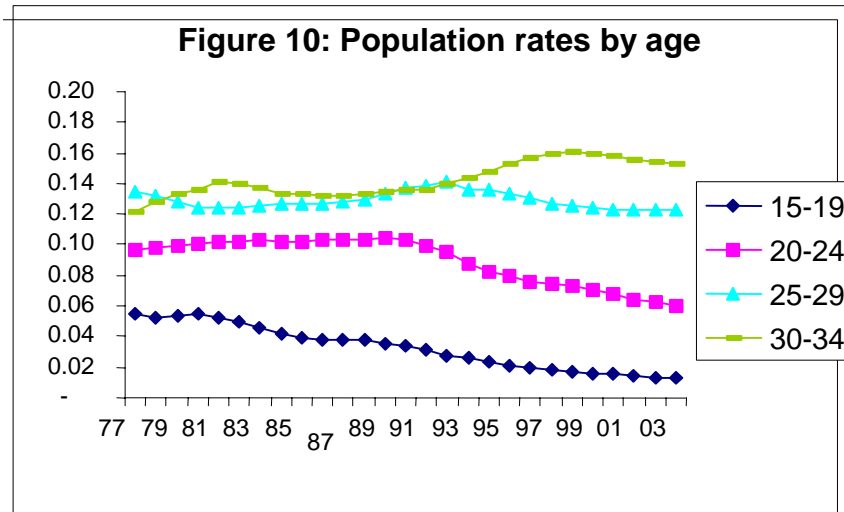


So far we considered the employed from 15 years old on. Restricting the analysis to the 15-64 age class results slightly change (figure 8). Employment rates are stable over the period and greater than the ones of inactive people. This is due to the fact that, as in other European countries, Italian population is rapidly getting older.

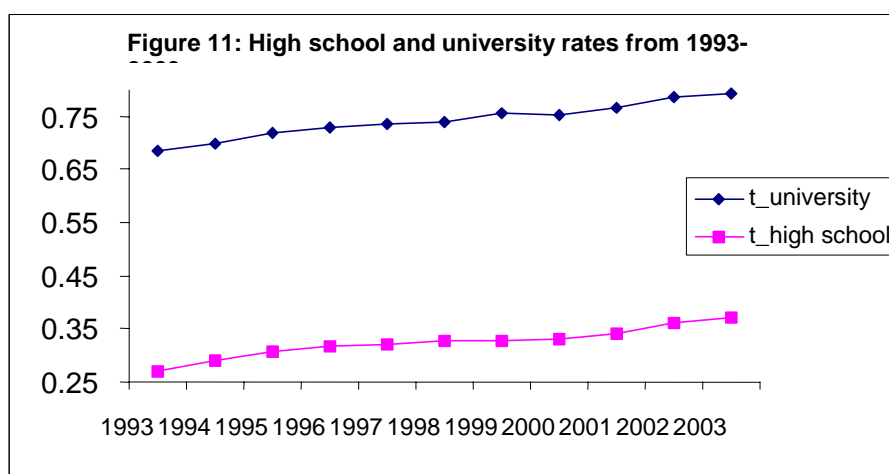


Taking into account the population structure, it is interesting to investigate the labour supply by age classes. Figure 9 concerns the trends of the younger age classes, from 15-19 to 30-34. It is clear and quite impressive that the employed in the young class dramatically reduce over time. This phenomenon might be explained in two different ways. The first one is that the cohorts of younger generations are much less consistent of the previous ones. For instance, the population in age 15-19 passed from 4.043.966 in 1993 to 3.005.877 in 2003 (-25%). This means that computing employment rates this phenomenon might disappear. Figure 10 shows that actually this does not seem to be the case.

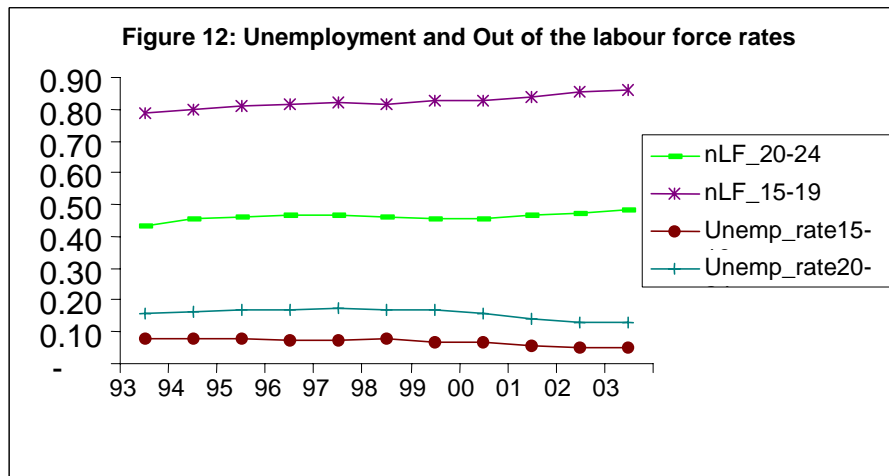




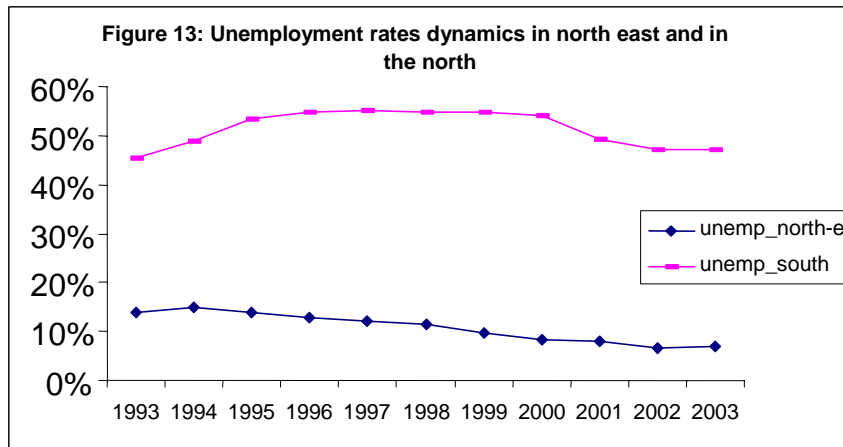
The second explanation concerns the increasing ‘love’ for education of younger cohorts. In the last 20 years an increasing share of children and young have attended schools and universities, as in other European countries. Unfortunately, we do not have data from 1977, but only from 1993. In figure 11 we use LFS data to compute the shares of people who attended schools and universities. More precisely, we use the age class 15-19 to proxy the share of students at the secondary school and the age class 20-24 to proxy the attendance at the university. Then, we simply compute the ratio between those who declare to attend school (university) and those who declare to be in another status (employed, unemployed, inactive). As shown in the figure, both the attendance share of secondary school and university has increased continuously in the last 15 years.⁴ It is worth noting that in the same period youth unemployment rate decreases and inactivity rate increases (inactivity includes students), both for the age class 15-19 and 20-24 (figure 14).



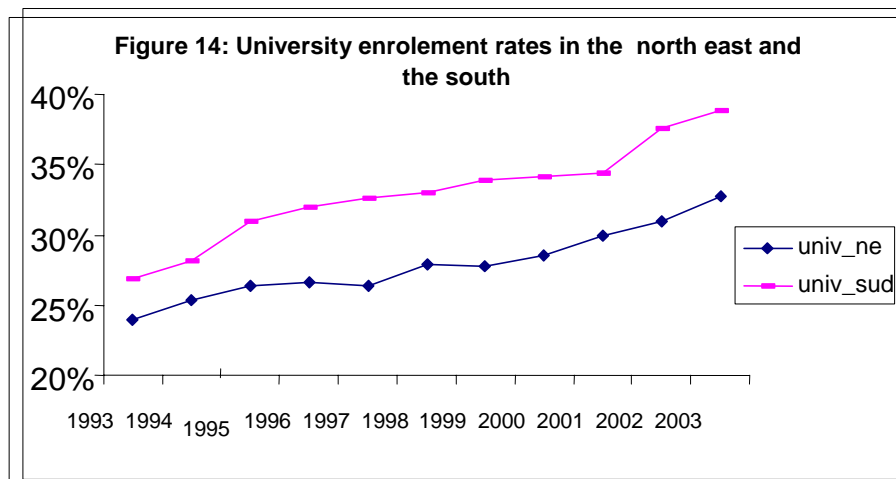
⁴ Note also that this does not hold when absolute values are considered, since population strongly decreases in that period.



To sum up, at first sight it would be possible to claim that in Italy young people moved massively from the labour market to education programs, both at the secondary school level and at the university. This is quite coherent with the European Employment Strategy, which stresses the importance of human capital accumulation as a driving force of the new European economic model. Nevertheless, it is worth noting that enrollment decisions at university cannot be considered as exogenous with respect to labour market conditions. More precisely, when the labour market offers many opportunities to young people only the students that really think that university is profitable for them in the long run will decide to enroll. On the contrary, when the labour market does not provide opportunities for students finishing the secondary school, then university can be considered as a temporary better solution than unemployment or inactivity. In other words, when labour market works the outside options for enrollment decisions are the labour opportunities, while when it does not work properly the outside options might be the unemployment status. This interpretation is confirmed by the Italian data. Figure 13 shows that labour market conditions are much worse in the south where the unemployment rate for the class 20-24 is increased from 45 to 47% in the period 1993-2003. An opposite situation takes place in the northeast, where the unemployment rate is much smaller, decreasing from 13.8 to 6.8%.

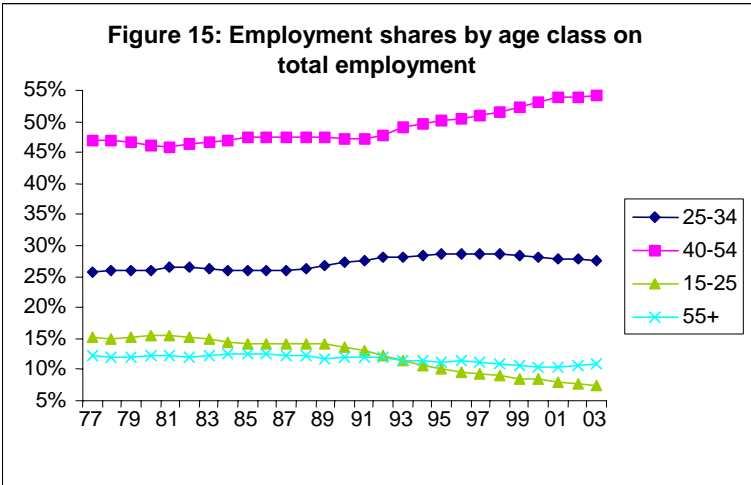


Hence, it is quite plausible to assume that in the northeast the labour market works, in the sense that it offers relevant opportunities to people finishing from secondary school. On the contrary, in the south the impressive high unemployment rate suggests that the labour market does provide fewer opportunities to young students. This also means that the opportunity cost of studying in the south is remarkably smaller than in the northeast. Figure 16 clearly confirms this intuition. In the south the share of students enrolled at the university is higher than in the north east, and it has grown much more in the period 1993-2003: at the beginning of the period the gap between south and north east was about 3%, while at the end of the period it was 7%. To sum up, in all the Italian regions there is a clear increasing trend in human capital accumulation (both secondary school and university), even if it is undoubtedly influenced by labour market conditions.



It is also worth noting that when considering the absolute values of recent demographic cohorts, the difficulties for young people to get in the labour market emerge more clearly. As already shown, the youth population is dramatically decreasing over time: the cohort of 15-24 decreased from 8.433.207 people in 1993 to 6.472.339 in 2004 (almost minus 25%). Ceteris

Paribus, it should have been much easier for young people getting in the labour market to find a job: less competitors. This does not seem to be the case: unemployment rates have decreased but not so much, employment rates decreased and inactive rates increased. Actually, it seems that the labour force is shifting towards a older composition. This is confirmed by figure 15, that shows that the employment share of workers age 40-54 increases remarkably in the period 1977-2003, the share of older workers is quite stable, while the share of young workers decrease significantly. This phenomenon of course might also have an impact on the demand side of the market, since it is plausible to argue that young workers are more complementary with new technologies, while old workers are more complementary with traditional productions.

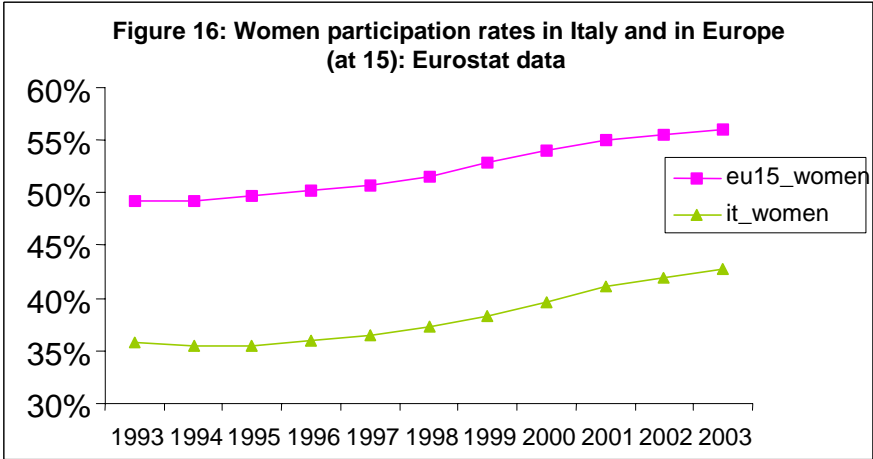


3.2. Gender decomposition and dynamics

To investigate the gender composition of Italian labour market it is useful to consider a comparison with the Euro area (15 countries). First, it is interesting to note that Italy displays a women employment rate much lower than the Euro area, and that this gap does not decrease over time (figure 16). This means also that convergence process between Italy and the Euro area is not taking place, convergence that was one of the main targets of the Lisbon Strategy.

Moreover, while most of the European countries are close to the Lisbon target for women employment rates (57% in 2005 and 60% in 2010), Italy seems to be too far from achieving these figures. Of course, this delay in the Italian convergence also depends on cultural issues that change very slowly over time. The Italian production and welfare system after the Second World War have been conceived as a system based on male prime age, usually head of households, and women were not encouraged to participate in the labour market. Also both

the institutional and welfare setting were set up in the sixties and seventies having in mind this kind of society structure. Hence, also for these reasons, in Italy are not traditionally widespread policies such as childcare and/or parental leave.



This society system has changed in the last decade. According to the Lisbon Strategy, higher flexibility (especially hiring flexibility) has been introduced in the labour market. The effects of such reforms are still taking place. However, it is worth noting that the welfare institutional setting is not following these labour market reforms. For instance, the reform of the unemployment benefits is under debate in the parliament, and the childcare reforms are still too weak to induce a real positive break in the women participation trend, meaning that a women that decides to get into the labour market has often to privately pay for childcare services, in order to conciliate family and working issues.

3.3. Education attainments and trend over time

According to the Lisbon Strategy, the issue of the importance of human capital accumulation of the labour force has been widely investigated in Europe. Also in Italy a debate concerning the levels of education and training of the labour force is taking place at the political and academic level. From Table 6 it is possible to analyse the cross-country differences in 2002 for several countries in Europe, concerning the highest educational attainment of the adult population. It emerges quite clearly that for primary and lower secondary education the Italian levels are often higher than the ones of the other countries, meaning that most of the Italian population has achieved a low educational levels. This is confirmed by the fact that for upper secondary education the Italian shares are lower than the other countries: only Belgium, Greece and Ireland displays lower figures. The situation is

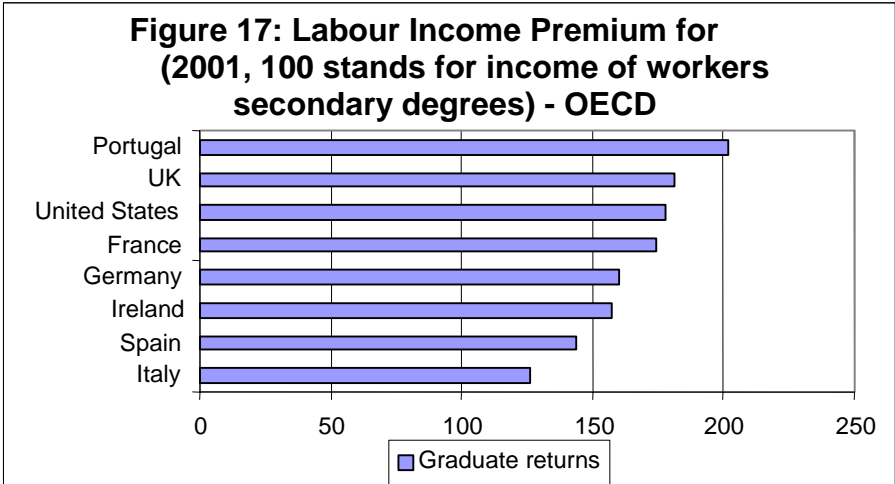
even worse for tertiary education where the Italian share is clearly lower than the European levels. For instance, in 2002 the share of graduates in the Italian population is only 10%, much lower than the figure for France (24%), Germany (23%), Netherlands (24%), Sweden (33%) and UK (27%).

Table 6. **Educational attainment: adult population (2002)**

	Pre-primary and primary education	Lower secondary education	Secondary	Post-secon. non-tertiary education	Tertiary education	Average years of schooling
Austria	x(2)	22	56	7	14	11,3
Belgium	19	21	31	1	28	11,2
France	17	18	41	n	24	10,9
Germany	2	15	54	5	23	13,4
Greece	37	10	29	5	18	10,5
Hungary	3	26	56	2	14	11,5
Ireland	21	18	23	12	25	12,7
Italy	20	33	34	2	10	9,4
Netherlands	12	22	37	5	24	13,5
Norway	n	13	52	3	31	13,8
Poland	x(2)	18	66	4	12	11,9
Sweden	8	10	49	-	33	12,4
UK	n	16	57	-	27	12,7

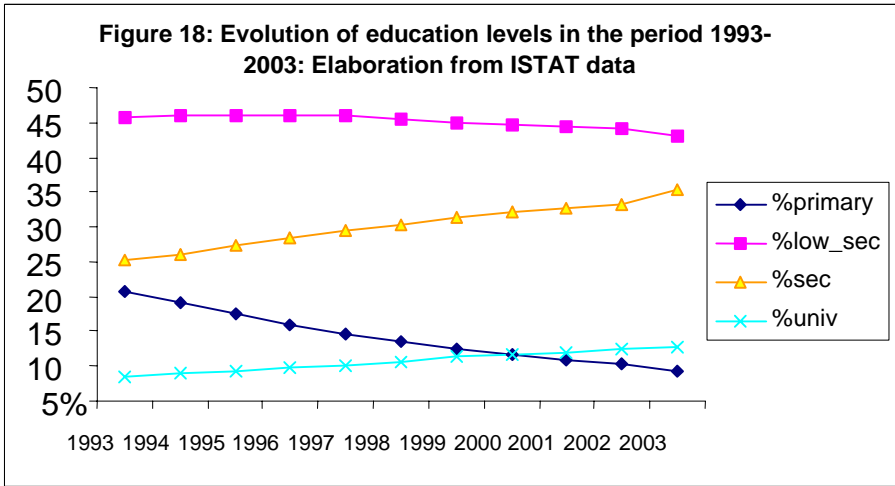
Education at a Glance, 2004, table A1.1. X(2), means that data are included in column (2)

In this framework one may think that since skilled workers in Italy are scarce their skill wage premium should be higher than in other countries where the supply of skills is higher. This is not actually the case. In Italy the returns for tertiary education are much lower. Figure 17 shows that in Italy the labour income returns for graduates are lower than most of the other OECD countries, such as Germany, France, UK and the US.



These figures show that the human capital issue in Italy cannot be tackled only using a supply side policy approach, since it concerns a structural situation: workers do not get higher education because there is a scarce demand for them, and because there are low wage premium. This means also that in order to copy with this issue it is necessary to implement structural policies, on both demand and supply side, focusing the attention on the complementarities between skilled workers and investment in high technologies and R&D⁵.

As for the dynamics of the human capital accumulation it is possible to observe a clear increasing trend in Italy (figure 18). More specifically, the share of workers with a primary level of education has been strongly decreasing over time and the lower secondary share is slightly decreasing. On the other hand, the share of upper secondary level has increase markedly (from 25 to 35%), meaning that the average educational levels of the labour force is improving. However, the share of graduates is slightly increasing over time, entailing that the speed of convergence in order to reach figures similar to other European countries is very slow.



3.4. Regional differences

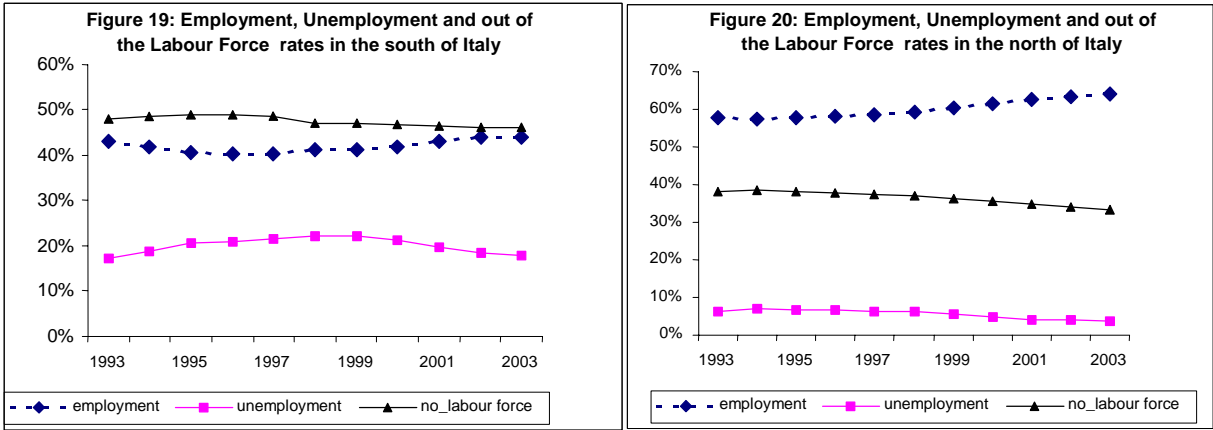
Italy is probably the most well known case of wide regional differences. The issue of the development of the ‘Mezzogiorno’, the southern part of the country, is an unsolved problem that has been faced by all the governments in the last 60 years unsuccessfully.

Figures 19 and 20 clearly show that the differences between these two regions are so important that it is hard to believe that they belong to the same country. First, it is worth noting that the north of Italy displays figures that are consistent and even higher than the

⁵ For this issue see also the production system section of this report.

targets of the Lisbon strategy. For instance, the unemployment rate is decreasing and equal to 4%.

On the contrary in the south the unemployment rates is close to 20% and it is not getting better over time. Further, the employment rate is very far from the Lisbon target, being equal to 44%, and the out of the labour force rate is dramatically high, higher than 50%, meaning that more than one person out of two does not participate in the labour force in the age class 15-64. The situation is even worse for some subgroups of the labour force: for instance the unemployment rate for women in the age class 15-29 in the south is close to 50% and it is not improving over time. This means that among the women looking for a job, one women out of two is not able to find it. Further, if we considered also the case of discouraged women this rate would be even higher. In this report it is not possible to further deepen this issue, even if it represents a crucial issue in the analysis of the Italian situation.



3.5. Contract type and atypical jobs

According to the Lisbon strategy also in Italy several reforms have been taking place since the middle of the nineties. More specifically, the “Pacchetto Treu” in 1998 and the “Legge 30” in 2003 have introduced in the Italian labour market some reforms that directly refer to the Lisbon Strategy. As for labour market flexibility, these two acts have increased the range of types of atypical contracts, in this way improving the opportunities for firms to have more flexibility and lower costs. Figures in Table 7 show that total atypical contracts in the period 1993-2003 has almost doubled, ranging from 6.8% to 11.9%, mainly at the expense of permanent contracts and self employment shares.

Table 7 : Share by contract types in the period 1993-2003 for the age class 15-64

	Permanent contracts	Permanent part time	Fixed term full time	Fixed term part time	Total Atypical	Self employed	Self emp. Part time
1993	65.4%	2.3%	3.0%	1.4%	6.8%	26.2%	1.6%
1994	64.5%	2.6%	3.4%	1.5%	7.5%	26.3%	1.6%
1995	63.7%	2.8%	3.7%	1.6%	8.0%	26.5%	1.8%
1996	63.5%	3.0%	3.7%	1.6%	8.2%	26.5%	1.8%
1997	63.1%	3.2%	3.9%	1.7%	8.8%	26.3%	1.7%
1998	62.4%	3.4%	4.2%	2.0%	9.6%	26.2%	1.8%
1999	61.8%	3.7%	4.7%	2.2%	10.7%	25.7%	1.8%
2000	61.1%	4.1%	5.0%	2.3%	11.4%	25.5%	1.9%
2001	61.5%	4.3%	4.9%	2.2%	11.4%	25.3%	1.8%
2002	61.6%	4.6%	5.1%	2.1%	11.8%	24.8%	1.8%
2003	61.6%	4.6%	5.1%	2.1%	11.9%	24.8%	1.7%

Elaboration on ISTAT data (LFS): total atypical is the sum of permanent part time, fixed term and fixed term part time

Furthermore, one can think that this impact should have been much stronger for young workers, since atypical contracts are supposed to be more widespread for this age class. Table 7 points out that it is actually the case, but this effect is not as relevant as expected: atypical contracts range from 11.7 to 20%, meaning that in 2003 one young employed out of five is atypical. Note also that, as expected, the self-employed rate is much lower for young, and that the decrease in permanent job is not much different from the one for the all active population. Moreover, women figures are not very different with respect to the men ones: gender does not seem to have a relevant impact on the choice of the atypical contract. In other European countries, where part time incentives are much stronger for women, for instance in the Netherlands, the part time is much more oriented to the women need to conciliate family and job. Moreover, it is worth noting that in absolute values the share of atypical contracts in Italy is still much lower with respect to other European countries, such as Spain and France, where the atypical contract share is constant or sometime decreasing over time.

Table 8 : Share by contract types in the period 1993-2003 for the age class 15-29

	Permanent contracts	Permanent part time	Fixed term full time	Fixed term part time	Total Atypical	Self employed	Self emp. Part time
1993	67.9%	2.5%	6.7%	2.5%	11.7%	19.1%	1.3%
1994	66.1%	3.1%	7.5%	2.8%	13.3%	19.2%	1.4%
1995	64.9%	3.2%	8.5%	2.7%	14.5%	19.1%	1.5%
1996	64.2%	3.4%	8.7%	2.7%	14.8%	19.4%	1.5%
1997	63.8%	3.5%	9.2%	3.0%	15.8%	18.9%	1.5%
1998	61.9%	3.8%	10.2%	3.6%	17.6%	19.0%	1.5%
1999	60.9%	3.9%	11.5%	4.1%	19.5%	18.1%	1.5%
2000	60.3%	4.1%	11.8%	4.0%	19.9%	18.1%	1.6%
2001	61.1%	4.1%	11.4%	3.9%	19.4%	17.8%	1.7%
2002	61.2%	4.0%	12.2%	3.8%	19.9%	17.3%	1.5%
2003	60.9%	3.9%	12.3%	3.8%	20.0%	17.6%	1.5%

Elaboration on ISTAT data (LFS): total atypical is the sum of permanent part time, fixed term and fixed term part time

Another useful data source to evaluate the impact of the EES is the OECD index of Employment Protection Legislation (EPL), which represents a measure of the strictness of labour market legislation.

Basically, the OECD EPL index is built weighting three main components: the legislation concerning regular employment (more in detail, governmental authorization to fire, notices of dismissal, severance payments, unfair dismissals), temporary employment and the legislation regarding collective dismissal⁶. This index ranges from 0 (lowest strictness of EPL) to 6 (maximum strictness of EPL). Table 9 reports the evolution over time of the OECD index from the late eighties to 2003, for both the legislation concerning temporary contracts and the overall legislation.

Both rankings clearly show that EPL strictness is decreasing over time, meaning that the reforms that have been introduced in Europe in the last 15 years increased both hiring and firing flexibility in the labour market. In Italy the temporary (overall) index has decreased from 5,4 in the late eighties to 2,1 in 2003 (from 3,6 to 1,9). It is worth noting that looking at the 2003 OECD index, Italy cannot be anymore considered as a strict EPL country, being more flexible than other countries characterized by flexible legislation, like the Netherlands.

Table 9. Summary indicators of the strictness of employment protection

	Temporary legislation			Overall Index (Version1)		
	Late1980s	Late1990s	2003	Late1980s	Late1990s	2003
Austria	1.5	1.5	1.5	2.2	2.2	1.9
Belgium	4.6	2.6	2.6	3.2	2.2	2.2
Czech Republic	..	0.5	0.5	..	1.9	1.9
Denmark	3.1	1.4	1.4	2.3	1.4	1.4
France	3.1	3.6	3.6	2.7	3	3
Germany	3.8	2.3	1.8	3.2	2.5	2.2
Greece	4.8	4.8	3.3	3.6	3.5	2.8
Hungary	..	0.6	1.1	..	1.3	1.5
Ireland	0.3	0.3	0.6	0.9	0.9	1.1
Italy	5.4	3.6	2.1	3.6	2.7	1.9
Netherlands	2.4	1.2	1.2	2.7	2.1	2.1
Poland	..	0.8	1.3	..	1.5	1.7
Portugal	3.4	3	2.8	4.1	3.7	3.5
Slovak	..	1.1	0.4	..	2.4	1.9
Spain	3.8	3.3	3.5	3.8	2.9	3.1
Sweden	4.1	1.6	1.6	3.5	2.2	2.2
UK	0.3	0.3	0.4	0.6	0.6	0.7

.. Data not available. Source: OECD Employment Outlook (1999, Chapter 2, 2004, chapter 2)

⁶ See: Employment Outlook, OECD, 1999, 2004.

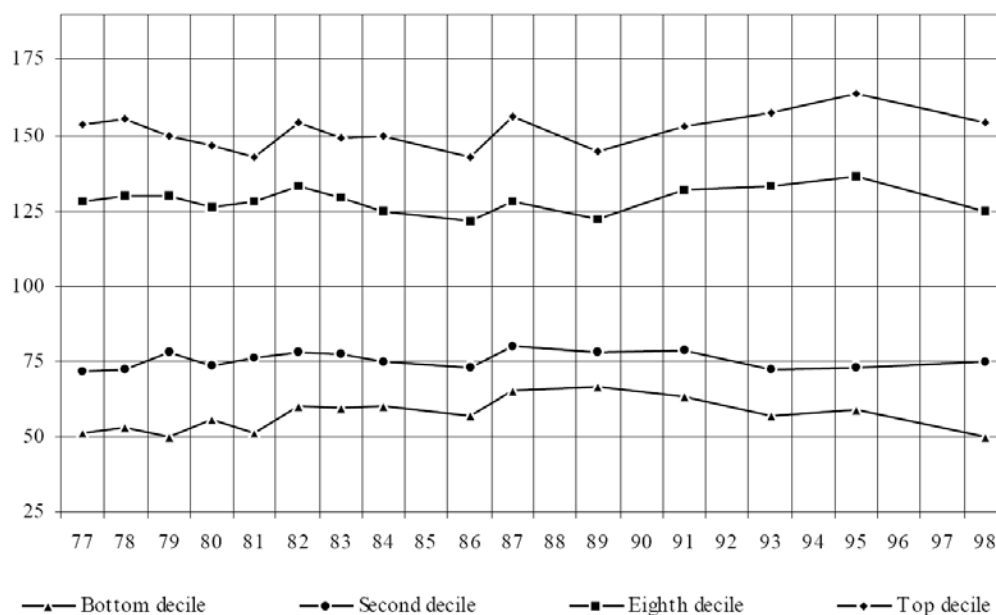
Nevertheless, it should be pointed out that the effect of changes that have occurred in terms of the labour market and employment protection legislation differs across the EU countries. On the one hand, the increase of both temporary jobs and overall labour instability leads to major job market flexibility. On the other hand, it is a synonym of greater precariousness and, therefore, uncertainty. More specifically, the uncertainty linked to the new contractual forms is usually due to both income and employment discontinuity, which might force young workers to postpone their decision to move to an independent living situation, up to a transition to a more stable employment status -for instance a permanent job- implying also a postponement for careers dynamics as well as for familiar decisions, like for instance for fertility decisions, etc.

3.6. Wage and structures and Career dynamics

The wage structure in Italy has not changed too much in the last 30 years. Actually, the paper that considers the longest spell over time is the one of Brandolini, Cipollone and Sestito (2001), from 1977 to 1998, exploiting the Household Survey provided by the bank of Italy. From the following figure it is possible to underline the following remarks: a) the bottom decile trend in 1998 goes back to the same level of 1977 (with respect to the median value of the distribution, as shown in the figure), while inside the period its trend was remarkably increasing up to the beginning of the nineties, probably up to the agreements among government, unions and entrepreneurs in 1992 and 1993. b) not surprising the eight and the top deciles followed different trends, i.e. increasing after that agreements.

As for the overall inequality, Brandolini et al (2001) argues that it has been stable over time, while other paper claims that in the last years wage inequality is increasing (Brandolini et al, 2004), underlying also that wealth inequality is increasing much more than the disposable income one.

PERCENTILE RATIOS TO MEDIAN FOR REAL MONTHLY NET EARNINGS, 1977-1998
(percentage ratios; median = 100)



Source: authors' elaboration on data from SHIW-HA (Release 1.0).

Moreover, it is worth noting that Italian labour market is one of the most well known example of centralized wage setting⁷, similarly to other European countries and contrary to Anglo-Saxon ones⁸. Nevertheless, this centralized setting entails an impact on the career dynamics of workers, which in Italy is mostly related to institutional features (qualification, age) than to individual characteristics, such as education, general or specific human capital. As shown in Naticchioni and Panigo (2004) and in Sulis (2004), returns to tenure – a proxy for specific human capital – are really low in Italy, sometimes not significantly different from zero and always much lower than the Anglo-Saxon countries, in which they vary from 7 to 25%.⁹ Similarly, as shown in figure 17 the returns to education are among the lowest of OECD countries. On the contrary, returns to ‘age’ are really high (Naticchioni and Panigo, 2004). A possible explanation for this phenomenon concerns the fact that age might be considered as a proxy for institutional and cultural factors which apply to all workers population. This is also quite coherent with the peculiar features of the Italian welfare state system, mainly interested in the protection of household head and prime male workers. It is not possible in this report to carry out an evaluation of this system, which for sure provided a generous

⁷ See section 1 for a more detailed description of the current Italian wage setting.

⁸ There is a huge literature concerning the impact of a centralized wage setting on labour market performance and educational choices, even if in this report we cannot get into this debate.

⁹ See for instance Topel (1991) and Altonji and Shakoto (1987) for the US.

welfare assistance for household head, probably without properly coping with education and specific human capital incentives.

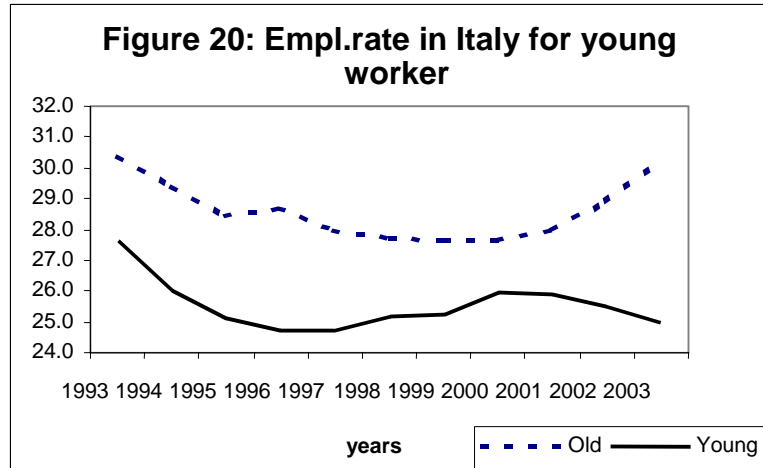
3.7. Pension system and effect on employment and growth.

According to the Lisbon Strategy, in the last decade in Italy the pension system has been strongly reformed. The goals of the Lisbon strategy are twofold. First of all, it is important to reform the pension system because of the European demographic trends. Actually, demographic forecasts clearly shows that if the pension system were not rapidly changed, this would seriously aggravate the public finance of most of the European countries. Second, the Lisbon strategy aims at increasing the employment rates for all age classes, according to the goal of full employment. For this reason the Lisbon strategy has also stressed the importance of the lifelong learning activities, in order to maintain high productivity levels even when a worker get closer to the retirement age.

In this way, the Lisbon strategy tries to kill two birds with one stone, i.e. increases the employment rates for older in order both to reduce public finance deficit and to increase employment rates. It is also worth noting that inside the Lisbon strategy the pension system is probably the objective that has mostly attracted the attention of policy makers, manly because of the interested in the public finance goal.

Killing two birds with one stone would not cause any problem if among the objectives pursued by the Lisbon strategy there were no trade off. However, in this report we claim that there might be some trade off mechanisms at work, concerning the relation between employment rates of older and younger workers. Let us explain more in detail this intuition.

In the last fifteen years in Italy four pension system reforms have been carried out, in 1992 the “Riforma Amato”, in 1995 the “Riforma Dini”, in 1997 the “Riforma Prodi” and finally in the 2004 the current government introduce some additional changes. All these reforms have increased the requirements to be eligible for retirement, such as the minimal required age and the length of the contribution period. Moreover, recently the Government has introduces some additional incentives for maintaining in the labour market those workers that had the rights to be retired, and it has also blocked new hirings in public institutions, increasing in this way the average age of public employees. All these reforms have actually succeed in increasing the employment rate of old workers in Italy. Figure 20 shows in the same graph the employment rates for young (15-24) and for old workers (55-64). It is quite impressive that up to the year 2000 the two lines seems to follow the same trend, slightly decreasing.



On the contrary, after 2000 (which is also the year of the Lisbon meeting), the two trends start to clearly diverge: the employment rate for young begin to reduce while the one for the older increases, in accordance with the implemented reforms. We claim that these two trends are correlated, *i.e.* the increases in employment for older workers have reduced the possibilities for young workers to get into the labour market. In other words, we claim that the public finance constraint forced the European states to increase the employment rates for older workers, and in turn this policy might have caused relevant negative effects on the labour market, especially for young.

Of course, one might argue that the decrease in young employment rates is related to others factors completely independent from pension reforms. For instance, one could claim that in the last years an increasing share of young people have preferred to enrol in higher education (mainly university), entailing an increase in the inactive rates. As shown in figures 14 and 18, this is partially true, being the enrolment university rate increasing in the period 1993-2003. However, it is worth noting that this rate is uniformly increasing in this period, while the decrease in the young employment rate takes place basically in the last 4-5 years. Moreover, the story of increasing higher education rates is not fully convincing, also because educational choices are not exogenous with respect to employment conditions of local labour market. As shown in figure 14, the university enrolment rates in the south –where young unemployment rates is really high- has increased more than the one in the north, where instead young unemployment is much lower. For these reasons, we claim that the education explanation cannot fully make clear of the patterns described in figure 20, suggesting the existence of some trade-off mechanisms between old and young employment rates.

What might be the effects of this crowding out between old and young employment rates on macroeconomic performance? Of course it is not an easy task to provide a clear-cut answer to this question.

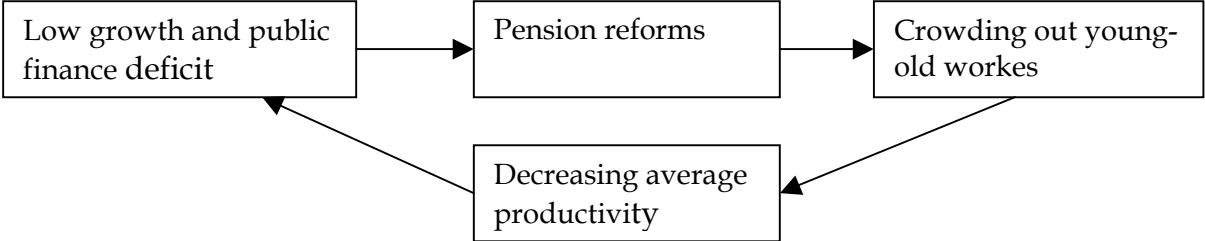
First of all, it is worth noting that workers at the end of their career entail a higher cost for firms with respect to young workers. In table 10 average wages by age classes are reported, using the two main database information in Italy, the Bank of Italy household dataset and the INPS panel (the Italian social security contribution institute). Figures show that wages strongly depend on age, implying that postponing the retirement age entails a relevant increase in the firm wage bill.

Table 10 Yearly average net wages annuale in lire, Banca d'Italia 2002			Yearly average before tax wages in lire, INPS data 1997		
Age class	Absolute level	Growth rate w.r.t under 30	Age class	Absolute levels	Growth rate w.r.t under 30
under 30	12,827		15-24	96,474	
31-40	13,672	7%	25-34	115,765	20%
41-50	15,238	19%	35-44	141,252	46%
51-65	15,243	19%	45-54	156,659	62%
65-	13,674	7%	55-64	148,783	54%

Of course, it would be important to say something about productivity of older workers in order to evaluate if the increase in the wage bill is more than compensated by an increase in the productivity. Unfortunately, no data are available to derive this information, meaning that we can just sketch out some insights on the relation between age and productivity, identifying three main effects. The first one would suggest that a worker at the end of his career reaches the highest level of his human capital accumulation, in turn entailing a positive impact on productivity. On the contrary, the second effect highlights the fact that an old worker might not be able to update his skills, also because of the rapid acceleration of technological progress. The third one concerns the incentive issue, claiming that an old worker might supply a lower level of effort because he is close to retirement. In the case where the second and the third effects dominated the first one in average, this would mean that the higher wage bill paid by firms is not compensated by higher productivity. The impact on economic growth is also quite clear. As long as there is a crowding out between young and old worker employment rates, then the average productivity level would decrease in average while the wage bill would increase, entailing a negative impact on growth.

Even worse, in this framework, a vicious circle might be at work, as shown in the next figure. More specifically, an economic situation characterized by a low economic growth and an increasing national deficit (like the Italian situation in the last years) would induce policy

makers to implement pension system reforms, increasing the incentives to extend the retirement age. These reforms would generate the crowding out between old and young workers, that in turn would reduce the average productivity entailing a even lower growth level.



Evaluation and Conclusion

The three main sections of this report clearly argue that the convergence process of the Italian system toward the ideal type defined by the Lisbon strategy is not only very slow, but also not properly structured and not consistent with the two main goal of the EES targets, i.e. attracting more people to the labour market and investing more and more effectively in human capital.

As for the first target –i.e. attracting more people to the labour market- the Italian figures shown in section 3 point out that it is not plausible to claim that the 2010 objectives of the EES will be achieved (employment rates, women employment rates, lifelong learning, etc).

As far as the second goal is concerned - investing more and more effectively in human capital- the situation is even more disappointing. As shown in section 3, the labour supply is among the less skilled in the OECD countries, and the convergence process toward the European average is very slow. Moreover, returns to education remain very low and they do not seem to increase over time. The last two remarks also concern the structure of the labour demand, structure that has not deeply changed in the last decades, and that of course reflects the structure of the Italian industrial system. As shown in section 2, the slow process of sectoral reallocation was such that the specialization patterns of the Italian economy have not changed much over time, maintaining a peculiar structure that is still different from that of other industrialized countries. Limiting the comparison to the European Union, Italian productive system is significantly specialized in traditional goods, with low intensity of skilled workforce (in particular, textiles and clothing, leather, wood and metal products). Moreover, it shows a negative specialization in sectors characterized by economies of scale

(transport equipment) and by high intensity of R&D (pharmaceuticals and ICT, included in manufacturing of electrical and optical equipment).

This empirical evidence is very straightforward and unambiguous: the Italian system is not converging toward the second goal of the EES concerning the “knowledge economy”, both with respect to the labour supply and labour demand. In this framework, two issues seem worth to be investigated. The first one concerns the interpretation of the reasons why the Italian system has ended up in this situation, why in period where other countries, such as France and Germany, moved toward new technological sectors the Italian system was still focused on traditional ones. Besides, was this process driven by the labour supply composition or by the structure of the labour demand?

The second issue concerns the exit strategies from this situation. In the following we will briefly try to sketch out some remarks on these two complex issues.

Why is the Italian production system still specialized in traditional sectors (and it has not followed the developing process of other European countries such as France and Germany)? Of course this is not an easy task to deal with. First of all, it is worth noting that there is a huge literature developed in the last 10 years concerning the skill bias technological progress, i.e. the idea that technical change favors more skilled workers, replaces tasks previously performed by the unskilled, and exacerbates inequality. This view is based largely by the experience of the past several decades for the US, which witnessed both major changes in technology, including the rapid spread of computers in workplaces, and a sharp increase in wage inequality. In the US, for example, the college premium—the wages of college graduates relative to the wages of high-school graduates—increased by over 25 percent between 1979 and 1995.

Recent papers have tried to enlarge this interpretation for other developed countries, often confirming this intuition. However, even in this literature it is not easy to identify the casual relation between skills and technologies. One of the most well known interpretation, due to Acemoglu (2002), argues that the casual relation goes from labour supply to the production system. More specifically, he claims: “new technologies have become more skill-biased throughout most of the twentieth century because the supply of skilled workers has grown steadily. This perspective also suggests that a faster increase in the supply of skills can lead to an acceleration in the demand for skills (Acemoglu 1998). So the timing of the increases in supply and demand is not a coincidence— instead, it reflects technology responding to the supply of skills”.

Acemoglu finds evidence supporting this interpretation with respect to the timing of the US development from the seventies, and also from previous US growth periods. It is worth

noting that this explanation lies in a sense also behind the Lisbon strategy, which stresses both the primary importance of increasing the average level of education of the labour force and the relevance of lifelong learning policies in order to update skills in the labour force. Relatively less importance is given to demand side policies, such as innovations and R&D incentives. Hence, also the Lisbon strategy seems to encourage an interpretation based on the labour supply, suggesting that an increase in the quality of the labor force will induce the production system to undertake innovative paths.

One might transpose this interpretation for the Italian case, claiming that since the Italian labour supply in the seventies was one of the less skilled of the OECD countries, then for the production system was profitable to specialize in traditional sectors, instead of undertaking innovative and R&D based production paths.

However, we are not fully convinced by this interpretation, arguing also that the empirical evidence supporting this interpretation is quite weak. Above all, it would not be easy to demonstrate that the opposite casual relation does not hold. For instance, it would be possible to claim that since the Italian production system was specialized in traditional sectors and the returns to education were really low, then there were not incentive for the labour force to get higher education, entailing an average level of education in Italy among the lowest in the OECD countries. If it were the case, the policy implications would be actually quite different, stressing the importance of demand side policies, such as incentives for innovation, subsidies for investments in R&D, etc.

Moreover, an additional element has to be considered to better understand which might have been the causal relation between supply and demand for skills, the international trade. Actually, in the seventies and in the eighties Italian firms increased their market shares in the international markets, especially in traditional sectors. It is worth noting that at that time the market share of developing countries in these markets were much lower than in recent years, meaning that the competition in those markets was much lower. In the last decade competition from developing countries increased considerably, especially in traditional sectors where the comparative advantage in term of labour cost was relevant. Of course this stronger competition has affected all the OECD countries, even if those countries specialized in high tech sectors has been less hurt by these international trade changes.

In a sense, it would be possible to argue that the Italian economy in the seventies got specialized in traditional sectors where the competition was lower. This choice was successful in the short run, entailing increasing investments in traditional sectors while leaving apart high tech sectors in which the competition against developed countries (US, Japan, France and Germany) was stronger. This process was also encouraged at the

beginning of the nineties by the Lira devaluation, which made Italian goods more competitive at the international level (see section 2), and by the centralized wage setting of the eighties that did not provide an incentive structure for high skilled workers (see section 1). The Italian competitiveness broke down at the end of the nineties, when competition on traditional goods coming from developing countries was unsustainable, because of the differences in labour costs, and also because with the euro currency is not longer possible to 'abuse' from exchange rate policies.

Of course this is only one possible explanation, even if several papers have stressed the importance of these kinds of mechanisms (see for instance Faini & Sapir, 2005). In this setting, the supply side policies are less relevant, or at least they represent only a part of the story, since the driving forces of this framework are related to the specialization of the industrial system and to the international trade.

The second relevant issue concerns the possible strategies of how to get out from this stagnant economic situation. As already stressed, the main difficulties are related to the fact the this situation depends on structural issues, such as low educational level of the labour force, specialization in traditional sectors, low competitiveness at the international level, an high national debt, small size of firms, enforcement of the public policies, etc. Actually, in the last years the political and academic debate stressed the importance of most of the issues considered so far, even if no radical change has occurred in real terms. And of course this is not odd when we think that structural changes take place only over time, usually very slowly¹⁰.

Some recent paper, for instance Faini and Sapir (2005) suggests that in order to be effective policies should be focused on both labour supply and production system. As for the labour supply they argue that the convergence speed between the Italian situation and the European one should be increased, augmenting public expenditure for education and research, considering also the issue of efficiency of the education system and the one of the 'education quality' of the immigrants, encouraging foreign high skilled workers to get into the Italian Labour Market. As for the demand side, they focus their attention on R&D subsidies, the introduction of a European agency promoting research activity –especially for pure-basic research. Moreover, they suggest implementing industrial 'horizontal' policies –i.e. favoring deserving activities irrespective of the sector- more than sectoral policies, more exposed to lobbying activities.

¹⁰ It is also worth noting that the current neoclassical models do not properly manage with time variant structural issues, with the intertemporal economic complementarities at work in such a process.

The Faini and Sapir (2005) proposals are well structured, although not really original, in the sense that in the last years many reforms have theoretically regarded the increase in the skills of the labour force and the incentive of innovative industrial activities. Unfortunately, at the end they did not work.

Doubtless, these failures are also deeply related to the governance of public policies, the enforcement levels and the credibility of the State to really begin a new deal for a reorganization of the industrial system and of the labour market. This is another very important issue to deal with, which has not really been too much investigated. There is a widespread common sense that the governance of the labour market in Italy is not efficient, without deepening the reasons of this inefficiency. Actually, it is not an easy task to investigate such reasons, because of the lack of a monitoring and evaluation structure. Differently from other developed countries –such as US, UK, France and Germany- in Italy the labour market policies (and also those regarding the industrial system) in the eighties and in the nineties were both only partially subjected to monitoring activities and not rigorously evaluated. In other words, in Italy it was not possible to conclude that a specific policy was ineffective, and above all it was not possible to identify both the main causes of inefficiency and the ones of partial effectiveness. In this framework, it is not possible to develop over time an efficient system of policies, improving those policies that had achieved some partial results and eliminating other inefficient policies.

To sum up, in this conclusion we wanted to provide some partial interpretation of the three main sections of this report, and also to show how the interrelations between the structural issues highlighted in this report (skills in the labour force, specialization of the industrial system, governance of public policies, size of the firms and of the bank system etc.) can compose a really complex framework to deal with, in which finding a proper policy to set up it is quite complicate as well as it is almost impossible to anticipate all possible impacts of such a policy, because of the not trivial interrelations among these structural factors.

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