

Back to Growth

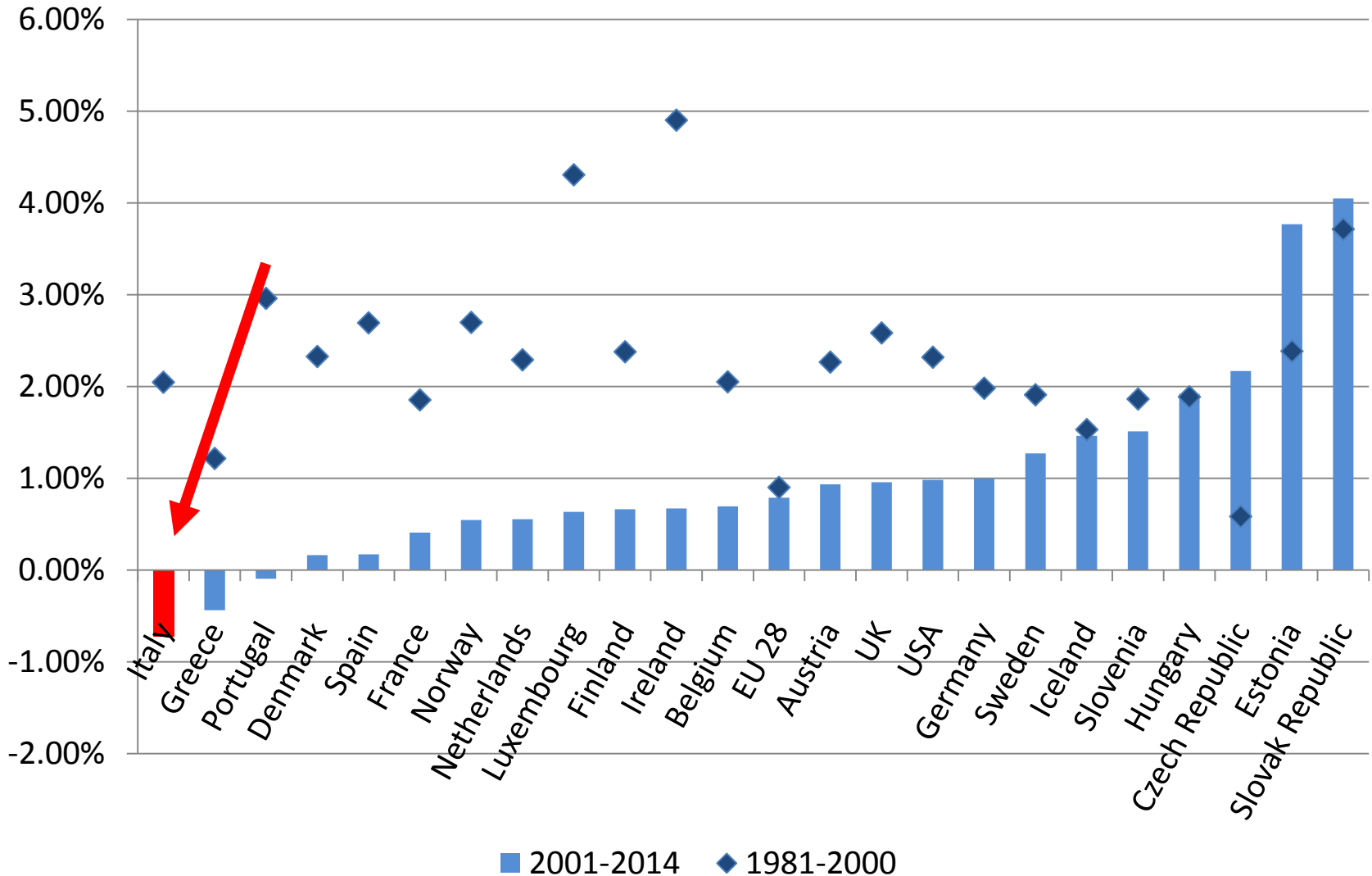
The Macroeconomic Reform Agenda for Italy

Filippo Taddei

SAIS Europe - Johns Hopkins University

The Starting Point

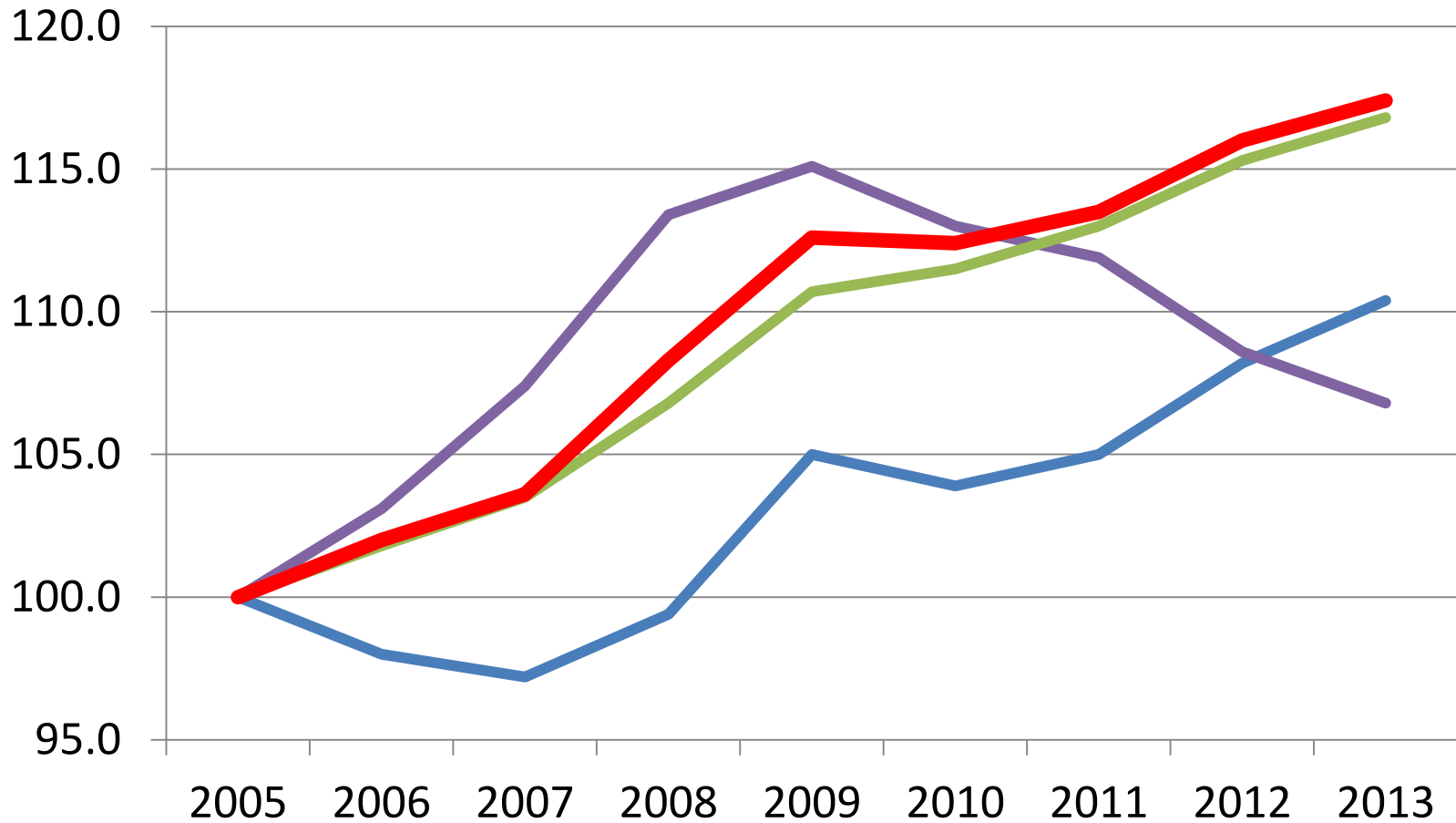
GDP per Capita Growth



The Productivity Slowdown Before and Through the Crisis

Productivity (ULC)

Unit labor cost (2005=100)

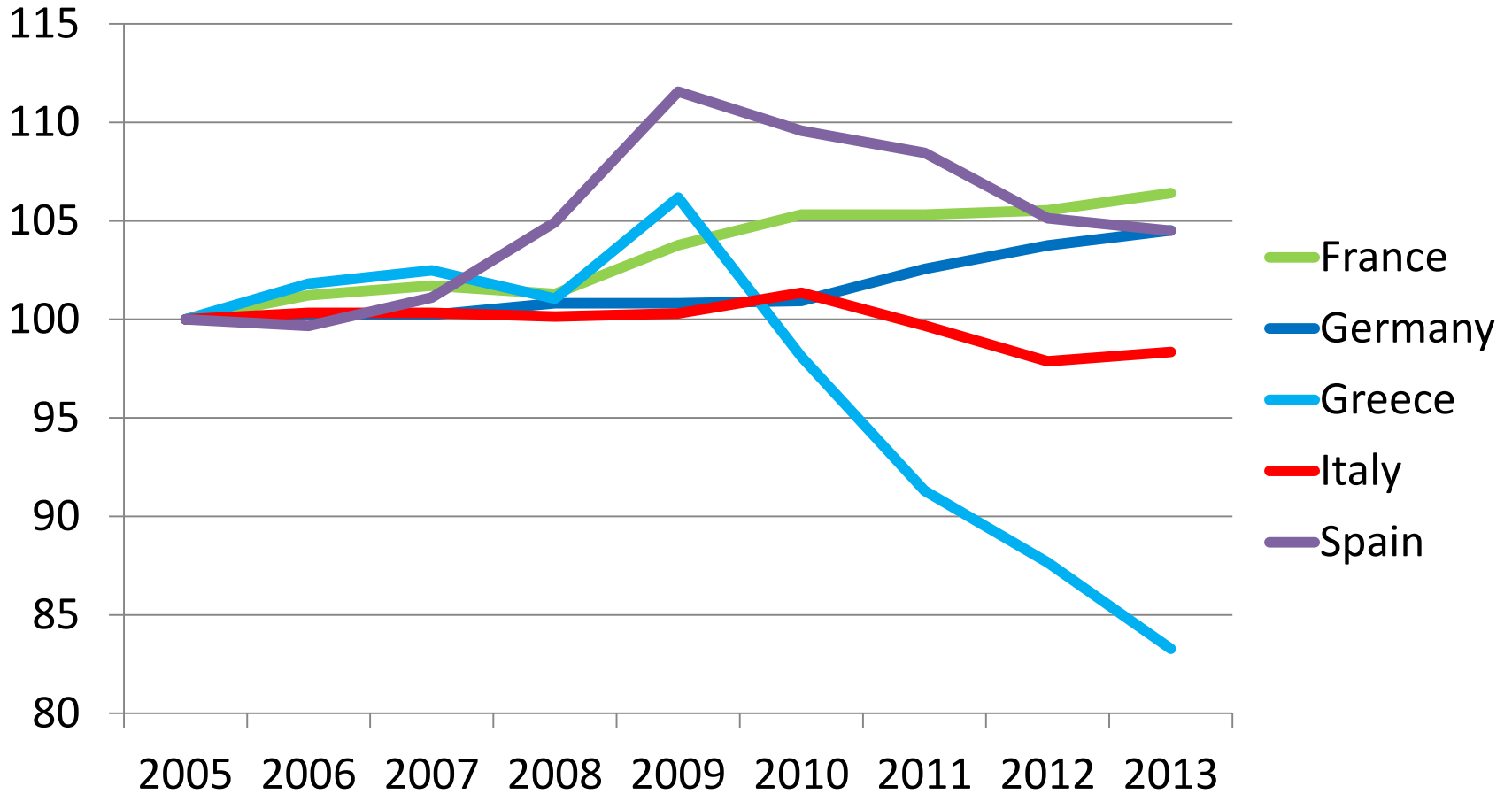


Source: Eurostat

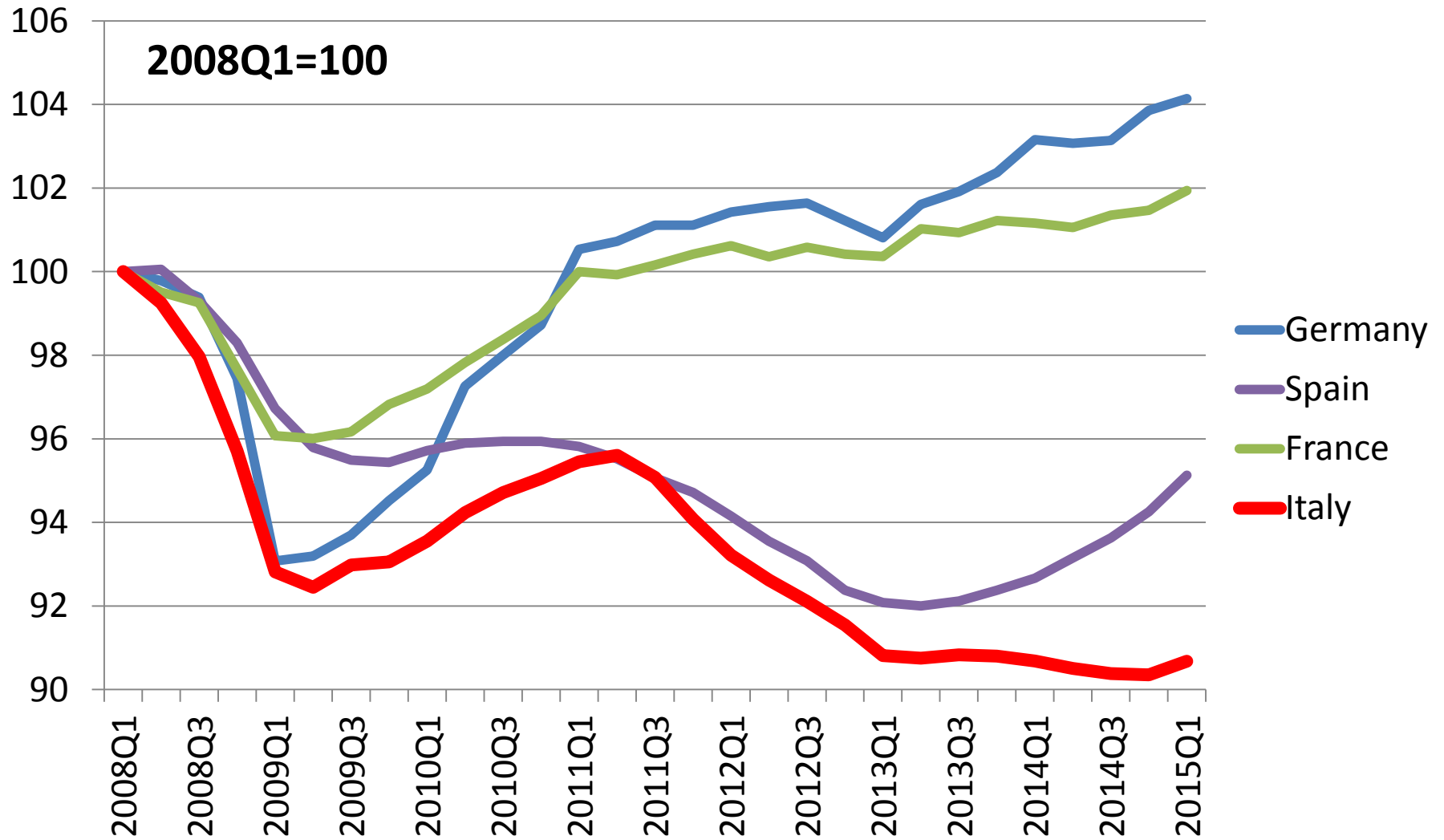
— Germany — Spain — France — Italy

Real Wages

Real Average Wage (2005=100, const. EUR)



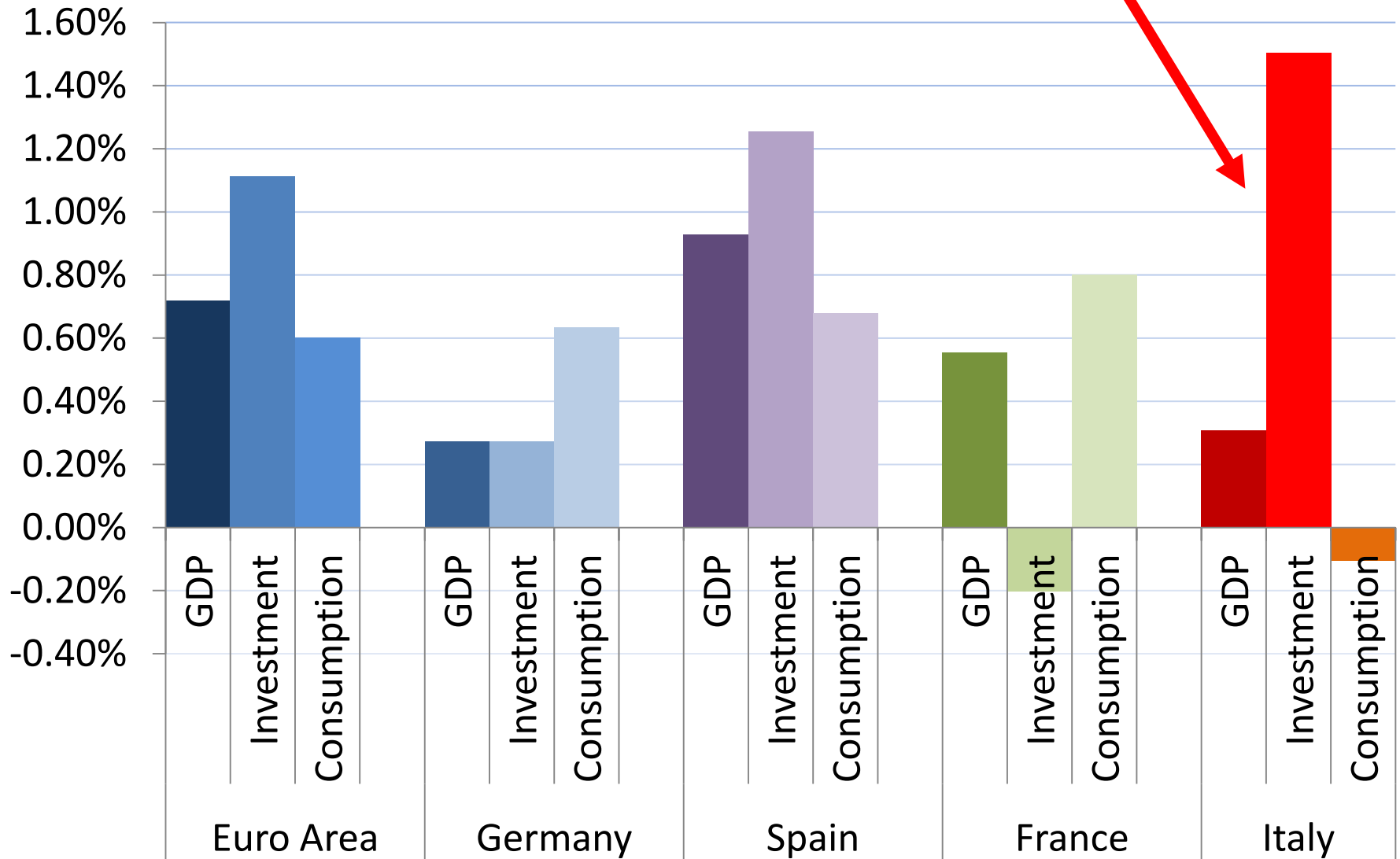
Real GDP



The Awaited Recovery

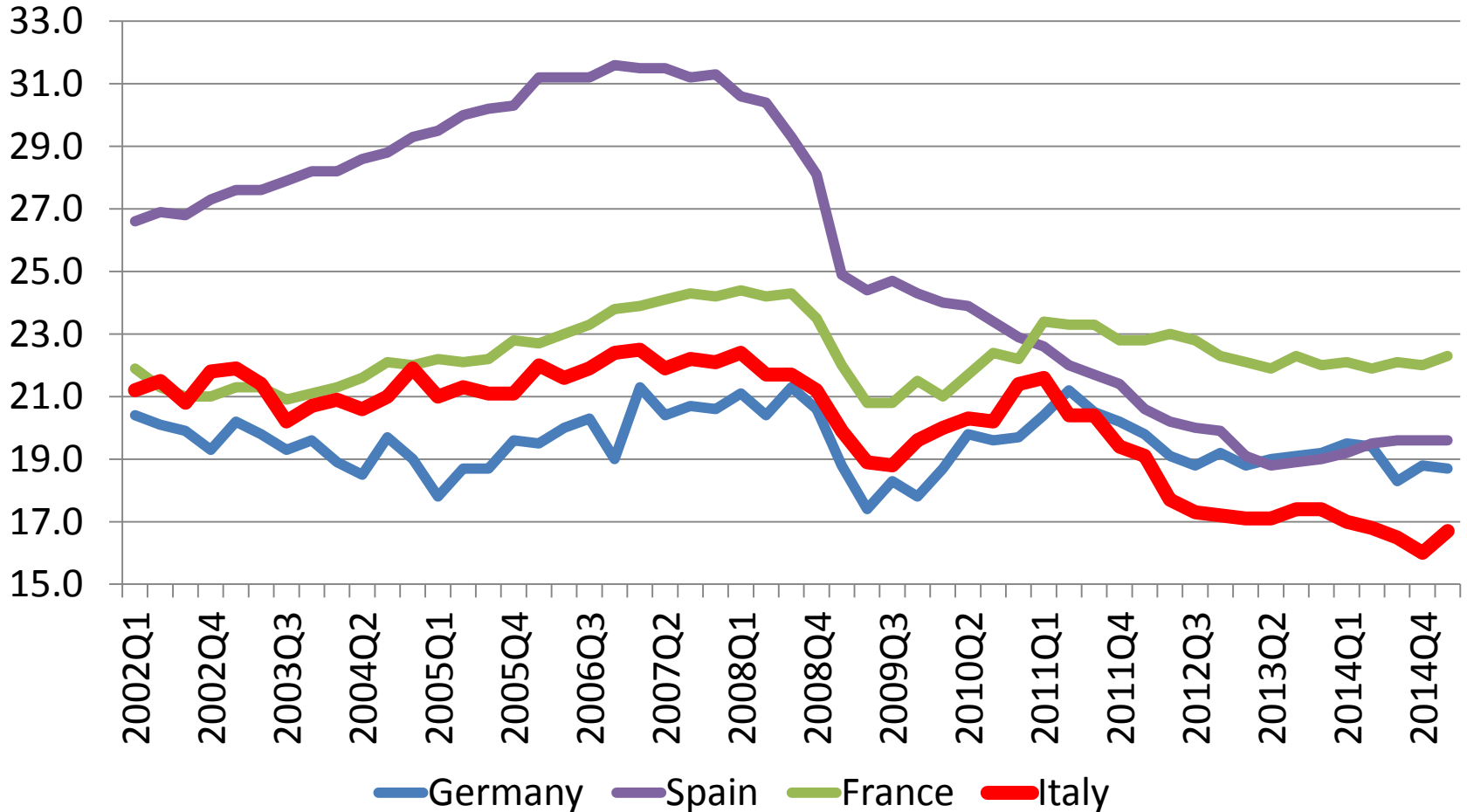
Growing out of Recession through Investment

Growth on Previous Quarter - Q1 2015



Italian “Investment Slump”: 2002-2015

Investment - % of GDP



Reform Challenge and Policy Trade-off

The Policy Game in Retrospective

1. Easy Way: Promises, Promises

- Front-Loaded Tax Cut & Spending
- Back-Loaded Spending Cut

2. Hard Way of Structural Reform

- Labor Market
- Tax Cut and Reallocation, Spending Review
- Tax Code (June), Public Administration, Justice (July)

Crucial Trade-Off:

Short Run **Impact** vs. Long Run **Effect**



International Context and Political Opportunity

Going «Structural»

- **Investment Slump**
 - What do Investors look for?
- **Credibility and Sequencing of Reforms**
 - Policy Shift and Political Consensus

3 Steps Strategy

1. *Contemporaneous* Tax and Spending Cut

2. Labor Market Reform and Human Capital

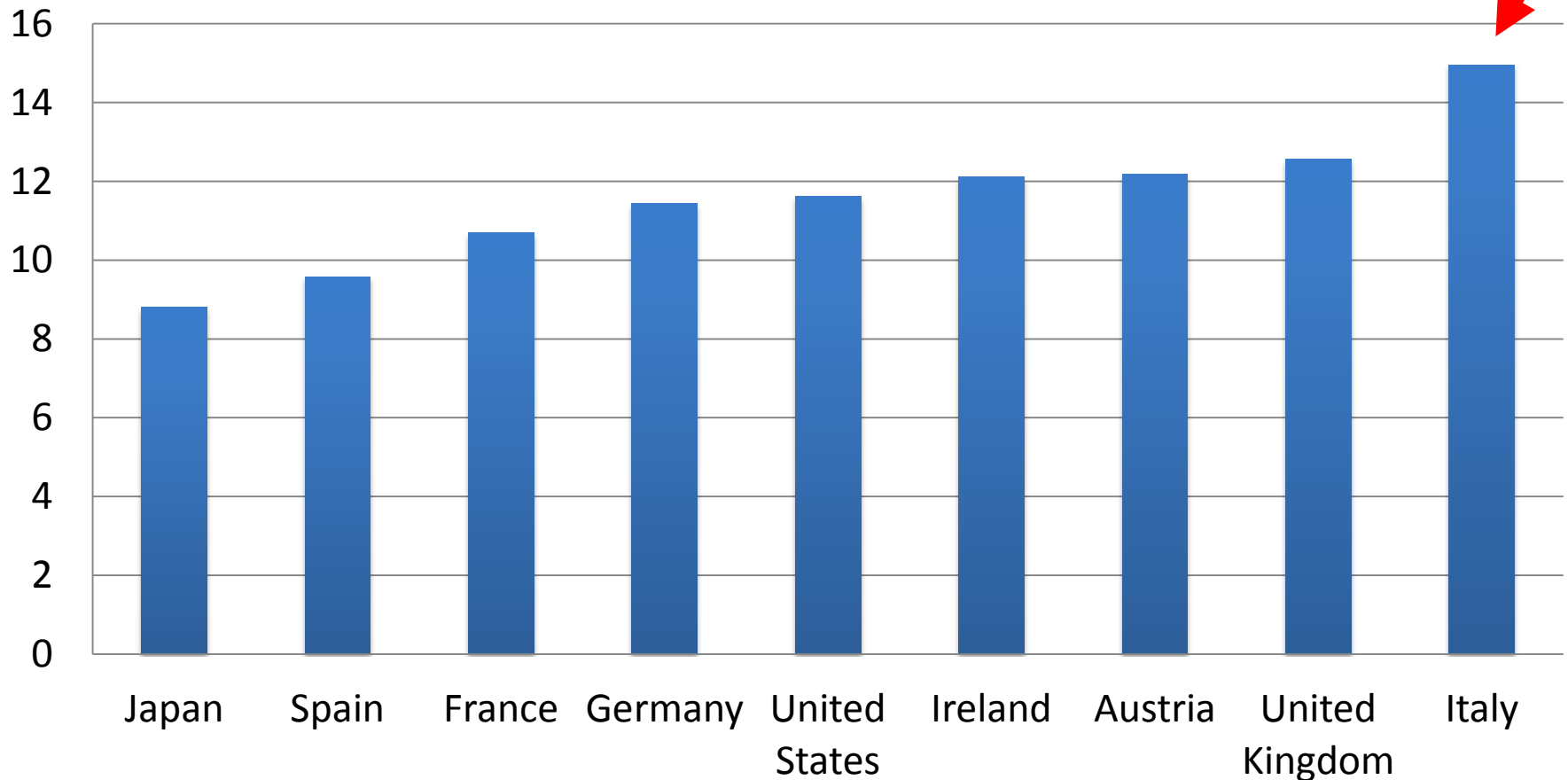
3. Foster Credit and Reallocate Capital

1. Tax and Spending Cut

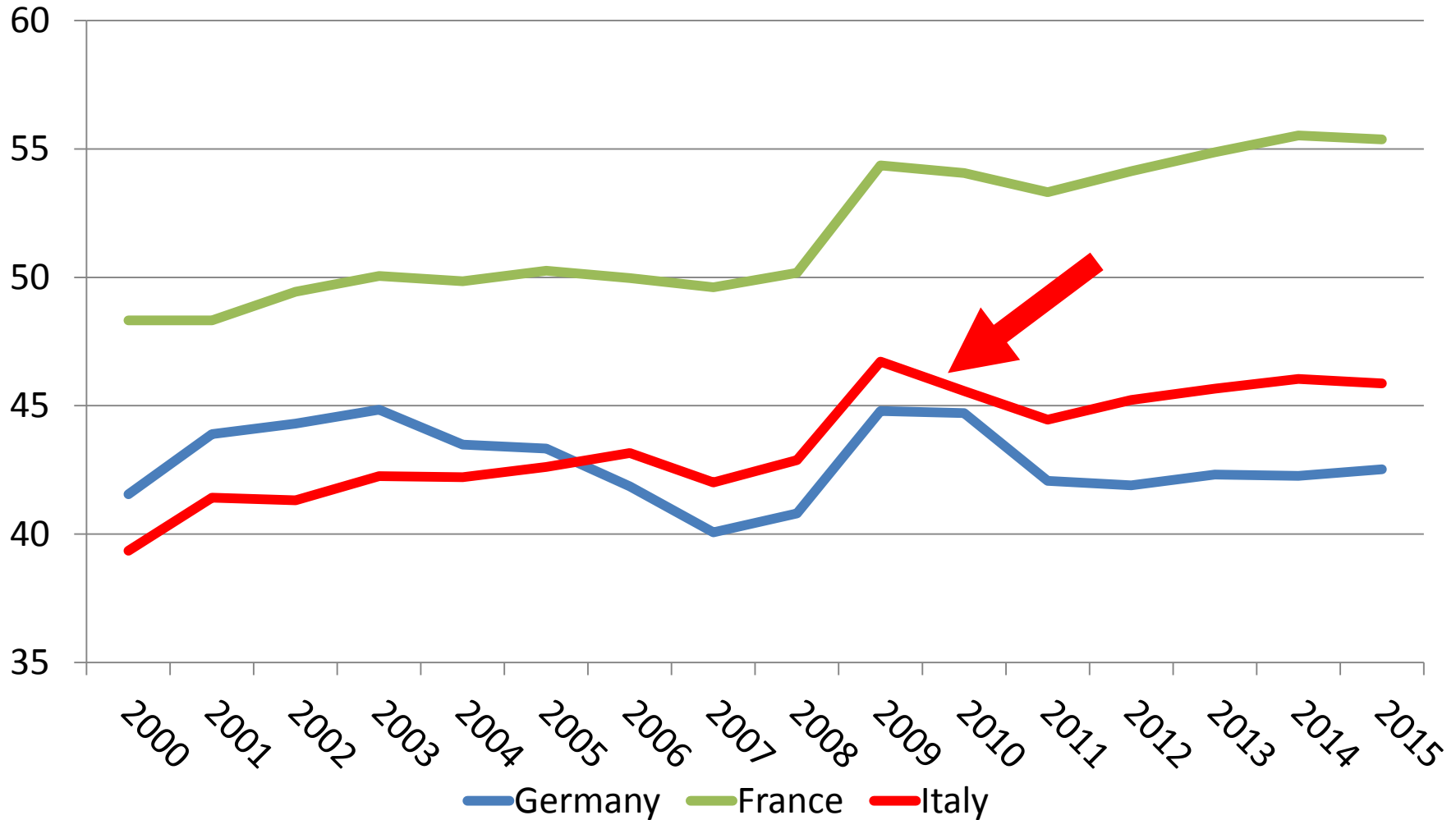
Peculiar Italian Tax System

Taxes on Individuals and Corporations: Revenue in % GDP

2013 – OECD, %GDP



Lowering Government Expenditure: Primary Government Spending (% GDP)



Tax Incentives for Open-Ended Employment

January 1st 2015

1. Cut Labor tax wedge for **Permanent Employees**:
 - **Lower Corporate Taxation (IRAP)**: 5,5 Billions
 - For **All** Permanent Employees
 - **ZERO** Social Security Contributions for 3 years (<8.020 Euro per year per employee): 1,9 Billions
 - **New hires** on Open-Ended Employees

2. Tax cut for **low-to-middle income employees** (10 Billions Euro) (Both Perm and Temp)

Actual Tax Revenue/GDP 2014: 43,1%, lowest since '11

Spending Review: from Macro to Micro

2015: Spending Cut 0,55% GDP by Government Functions



a) Central Government: 2,5 Billions

b) Regional Government: 4 Billions

c) “Provinces” and Municipalities: 2 Billions



2016: Spending Cut 0,75% GDP through Incentives

From Targets to Means

The Public Administration Reform (July)

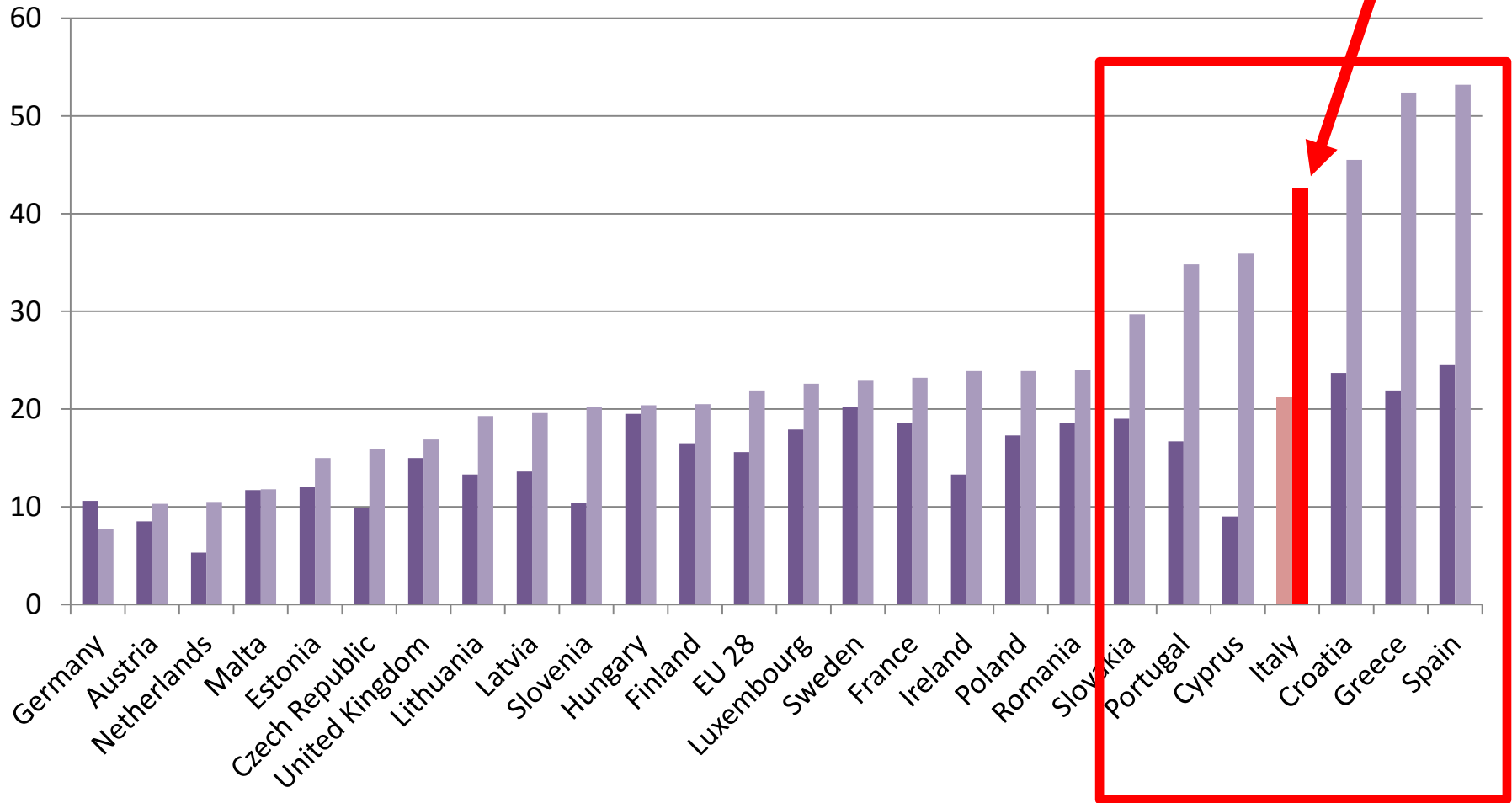
2. Overcoming Labor Market Duality and Enhance Human Capital:

***From Reform «at the Margin»
To Reform «at the core»***

The 4 Main Issues in the Italian Labor Market

1. Youth unemployment

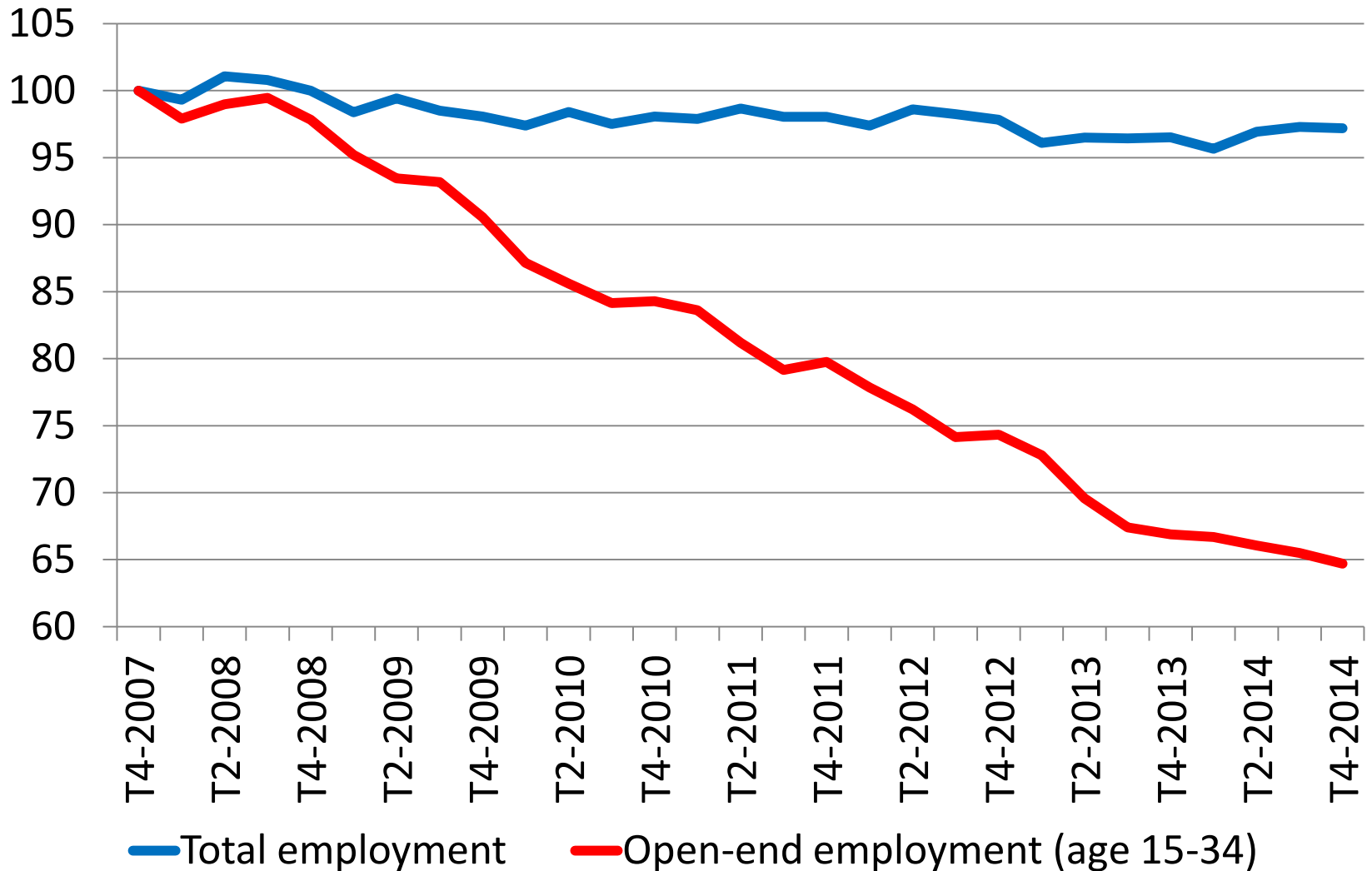
Youth Unemployment (age 15-24)



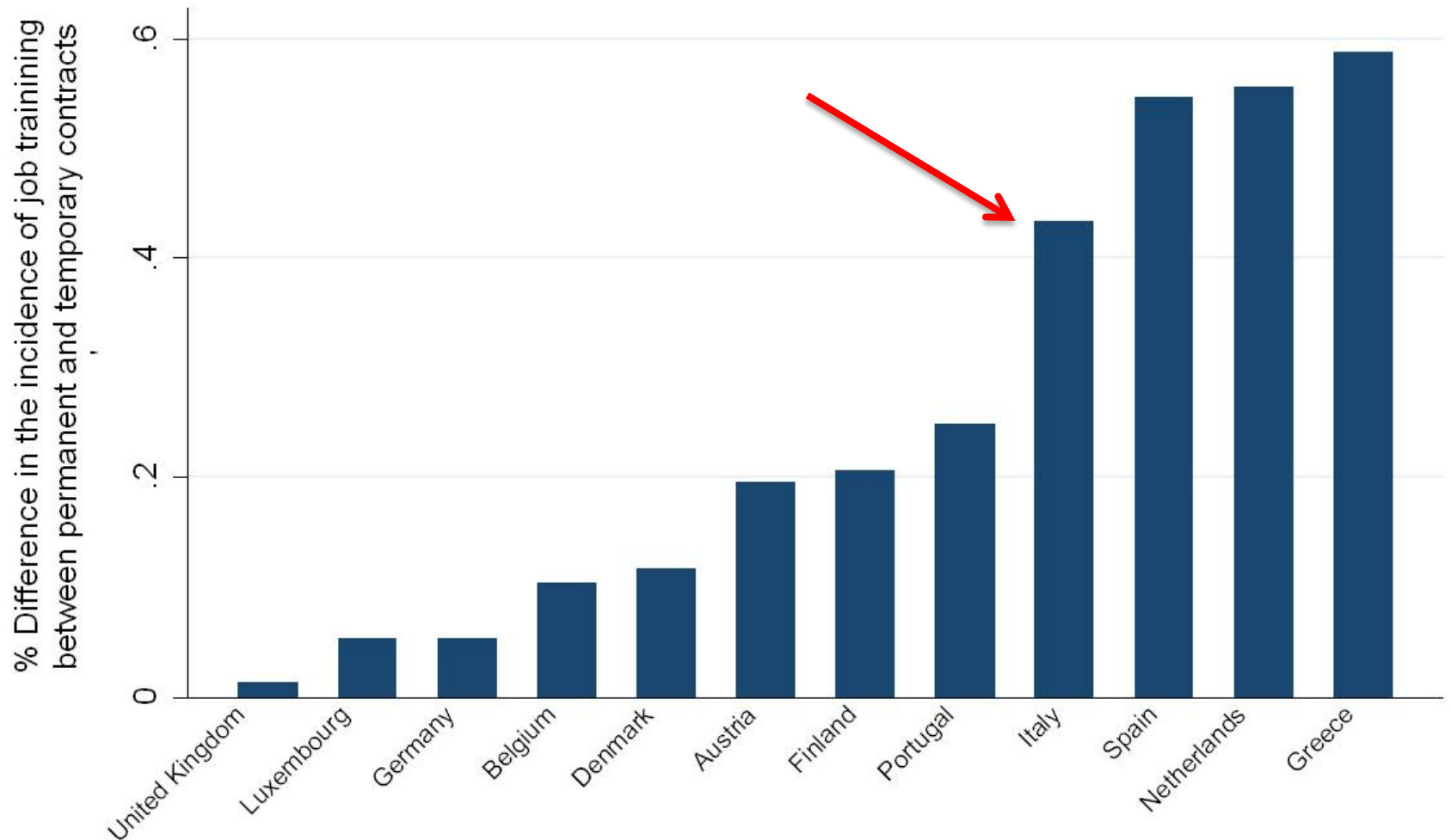
Source: Eurostat

■ 2008 ■ 2014

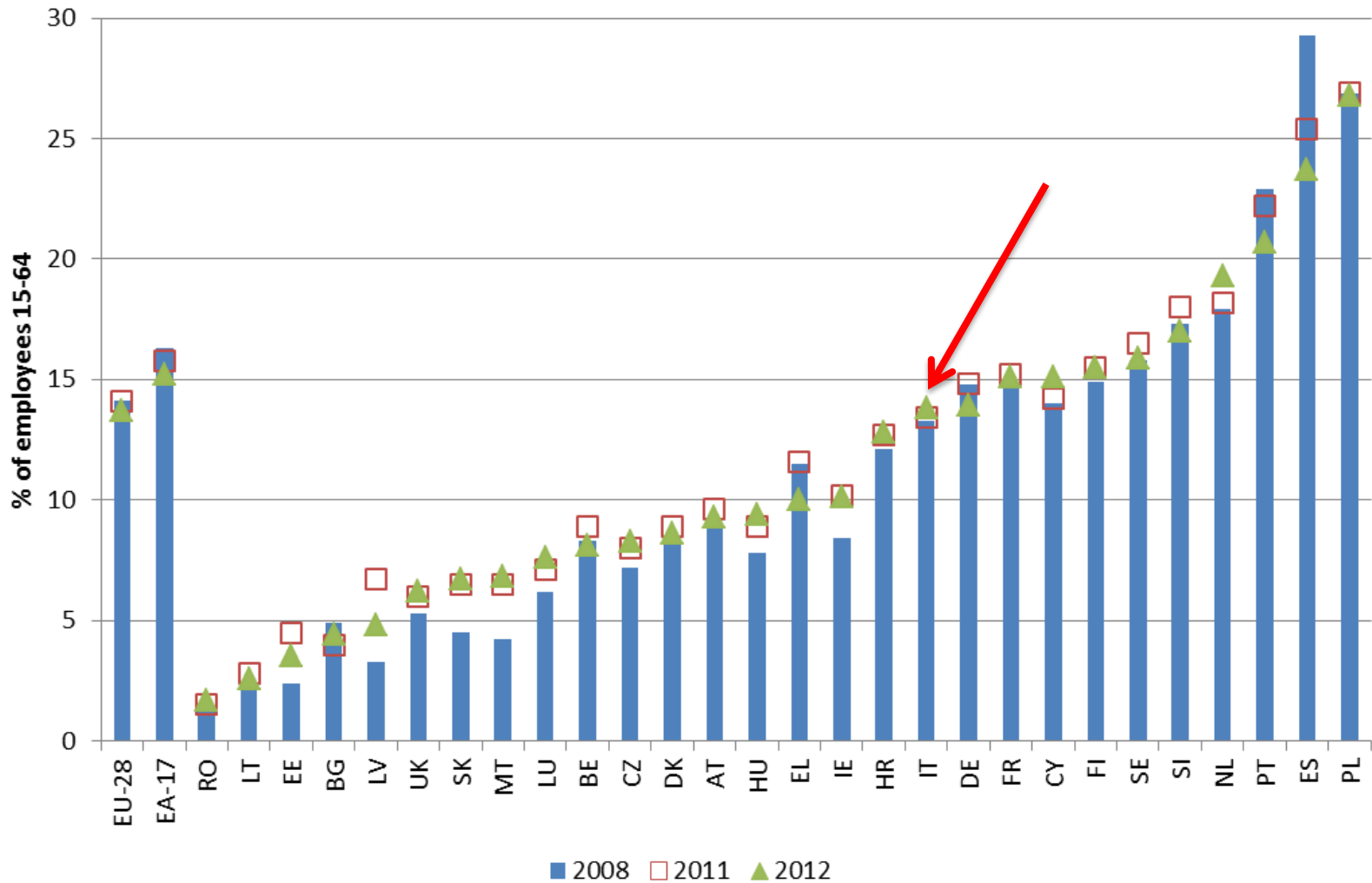
2. Disproportionate Drop in *Open-Ended Contracts* among the Youth during the Crisis



3. Disproportionate Low On-the-Job Training Opportunities for Temporary Workers (Boeri, 2010)



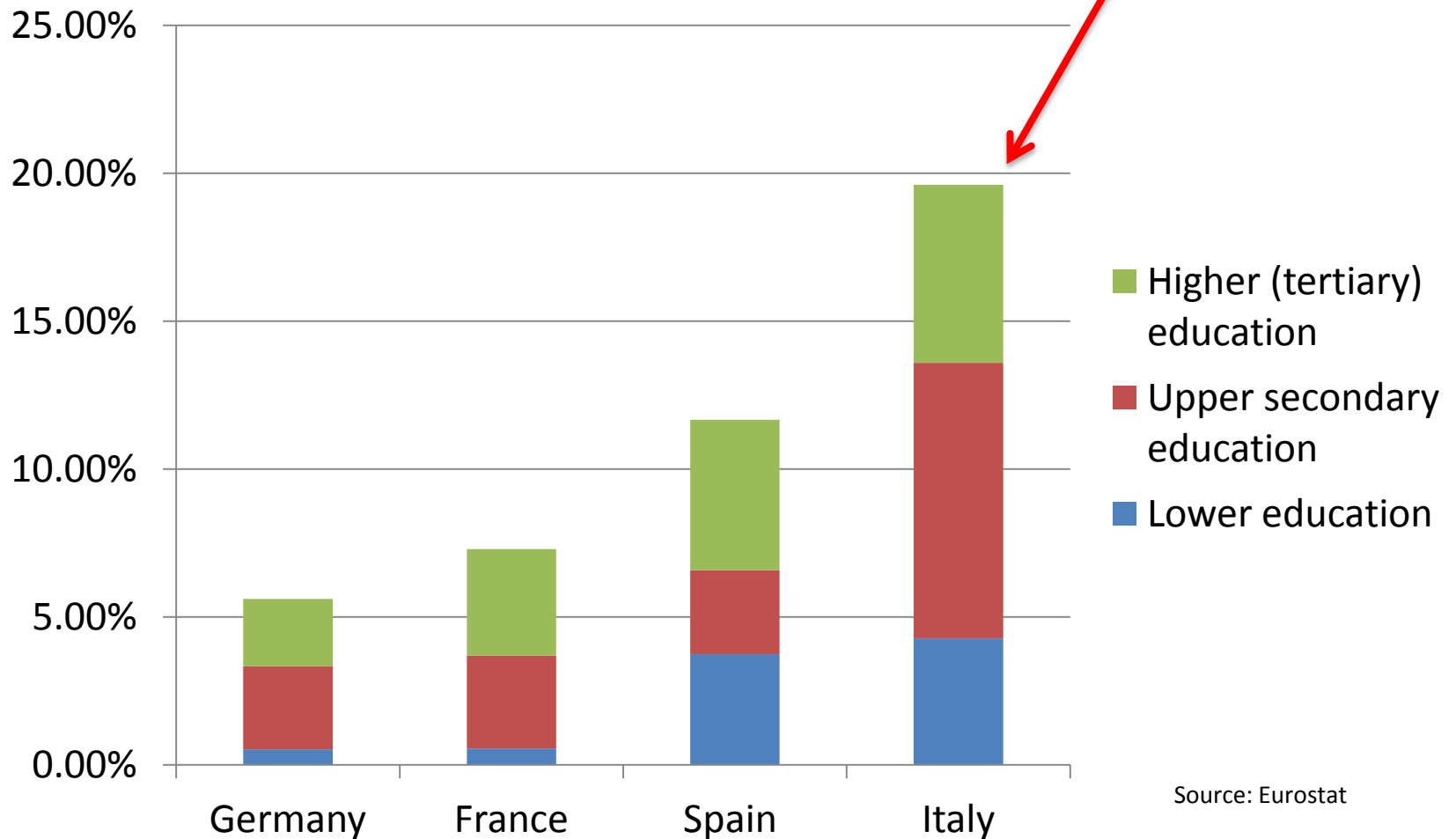
4a. Dual Labor Market correctly assessed: % Temp Workers in Italy is Misleading...



Source: Employment and Social development in Europe, 2012

4b ... But Large Share of Self Employed in Total Workforce

2014



Source: Eurostat

Italian Labor Market: from Duality to Stability



Issues

- Flex Contracts: from exception to entry gate
- Unemployment Insurance segmented and biased
- Drop in Stable and Quality Jobs

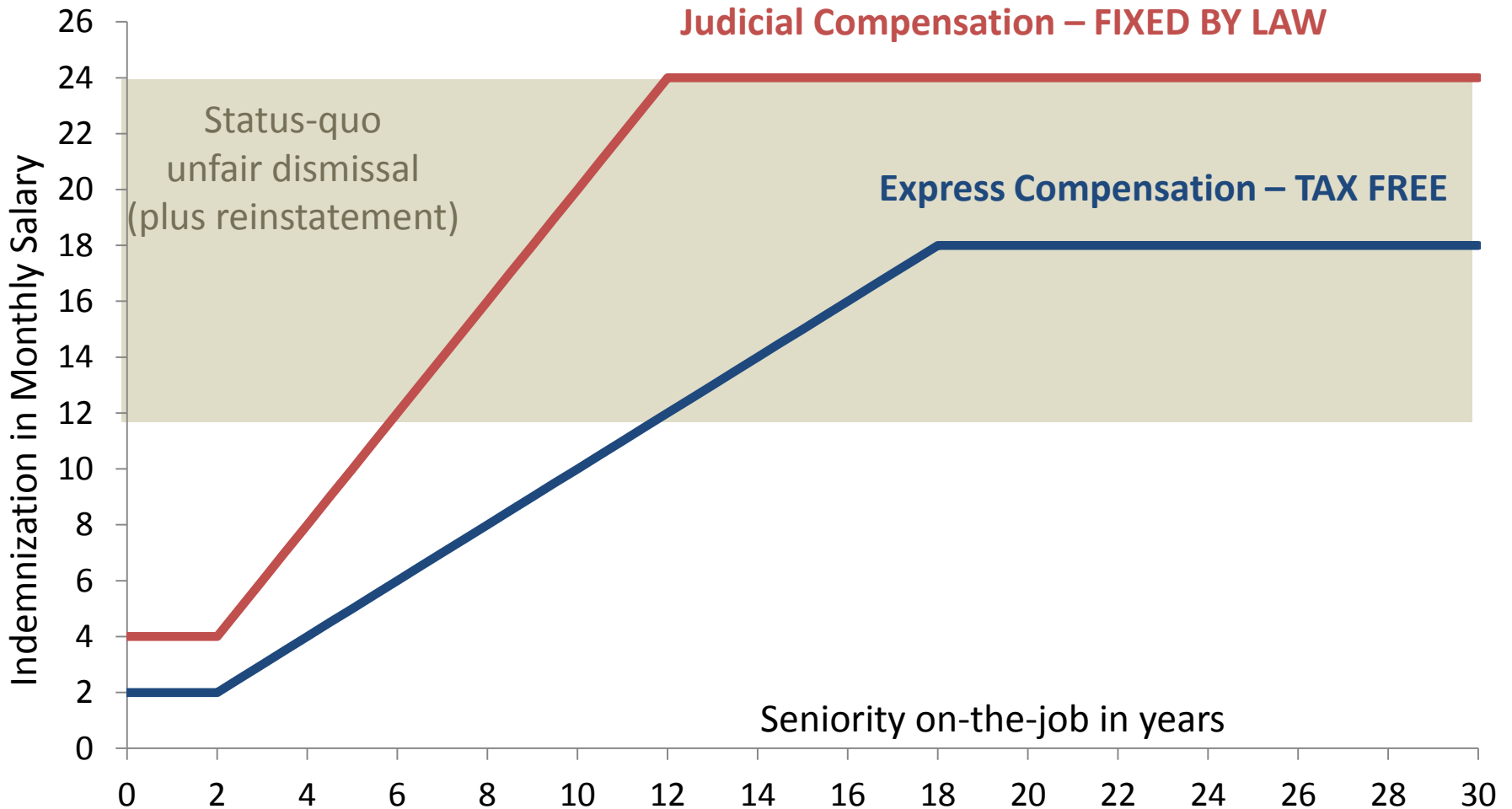


Enhance Human Capital

- From *Job property* to *Liability Rule*
- Permanent Contract with Increasing Protection
- Reform Unemployment Insurance
- Training «on-the-job»

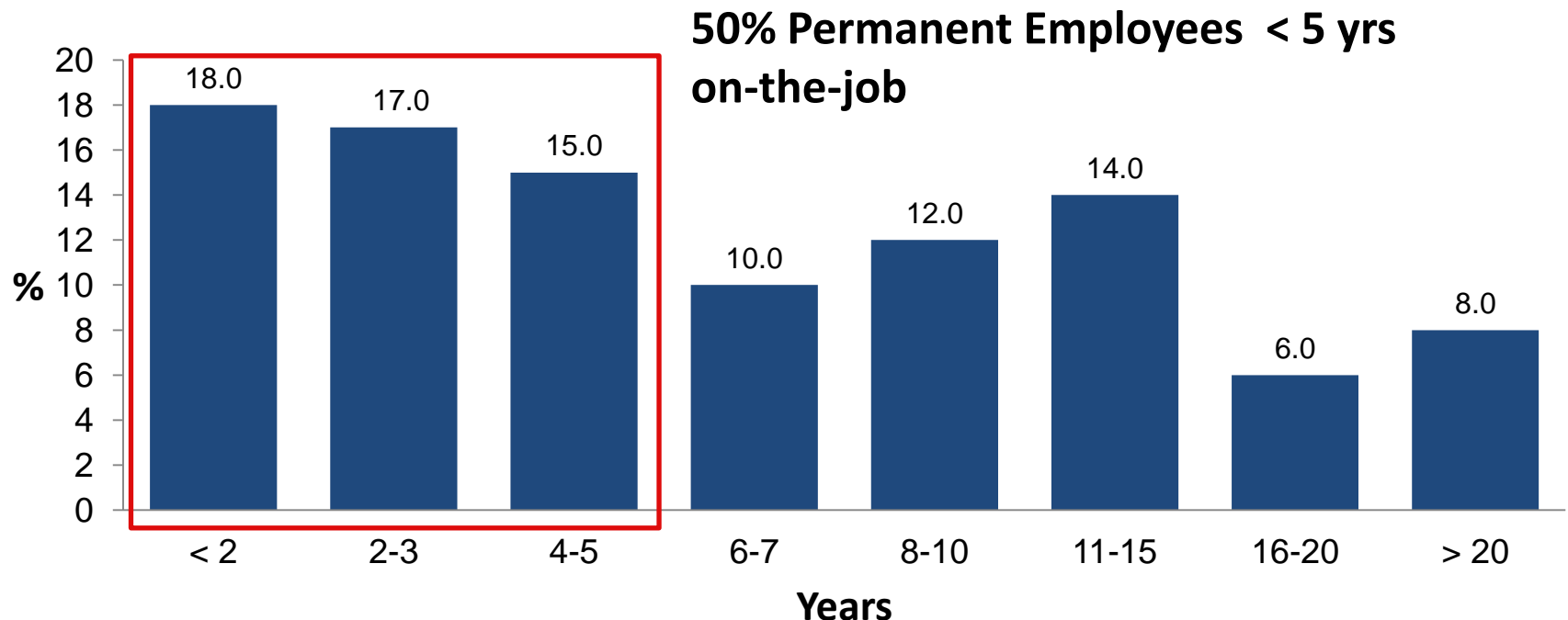
Open Ended Contract as a Stepping Stone

Worker's Protection for Individual Unfair Dismissal



Slow Transition to the new Labor Market? Unlikely!

- **Choice:** Open ended contract with Increasing Protection applies to New Hires *only*
- **Critique:** transition may be slow, risk new dualism?
- **Fact:** *Seniority on-the-job* in Firms >15 Employees?



Mobilizing Labor and Managing Firm Crisis

- **Unemployment Insurance (NASPI)**
 - *Increased Coverage*: 900 K more workers
 - *Extended Duration*: up to 2 years
 - *Increased Level and Phase-out Benefit Over time*
 - *Integrated*: with active labor market policies
- **Wage Supplementation Scheme (CIG)**
 - *Protect firm-specific Human Capital*: limited 0-hour work
 - *Bonus Malus*: pay-as-you-use
 - *Early Resolution of Crisis*: maximum duration 3 years
 - *Cut Employer and Employee Contribution Rate*

3. Foster Credit and Reallocate Capital to Revive Growth: NPLs ad SMEs

Credit Market: Accomplished Reforms

Issues

- (i) Credit not flowing efficiently toward corporate sector
- (ii) Regulatory Challenge by Basel-III: real economy financing 95% by banks

Policies (March 2015)



1) Improve Governance Banking Sector:

a. Popolari Banks (10 banks, with assets >8 bil Euro) have **18 months to convert into joint-stock** structure:

- i. No more “one man - one vote” mechanism on “systemic” coop banks;
- ii. consolidate banking sector

b. **Banking Foundations** must:

- i. reduce their exposure on a single bank at or below 30% balance sheet;
- ii. may not financially leverage their holdings

(2) Open- up Credit Market through Non-Bank Lending:

- a. no with-holding tax for Bonds issued by private companies
- b. Funds, SPVs and insurance companies allowed to lend to corporations

Capital Market Reforms: Next Steps

(1) Reform Bankruptcy and Tax Code (June)

- reduce overall cost of business and lending to real economy



(2) Accelerate Foreclosure Procedures

reduce NPLs on banks' balance sheets and free up capital

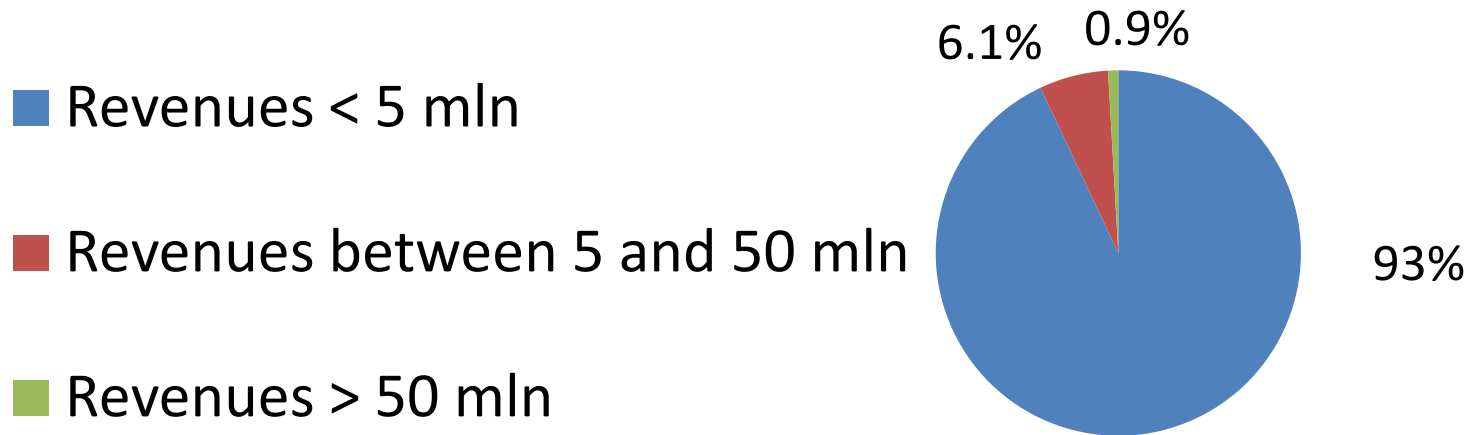


3) Self-reform of Smaller Cooperative Banks ("BCC")

- improve efficiency and stability of important segment in banking system and free up capital for new lending

The Investment Opportunity of SMEs

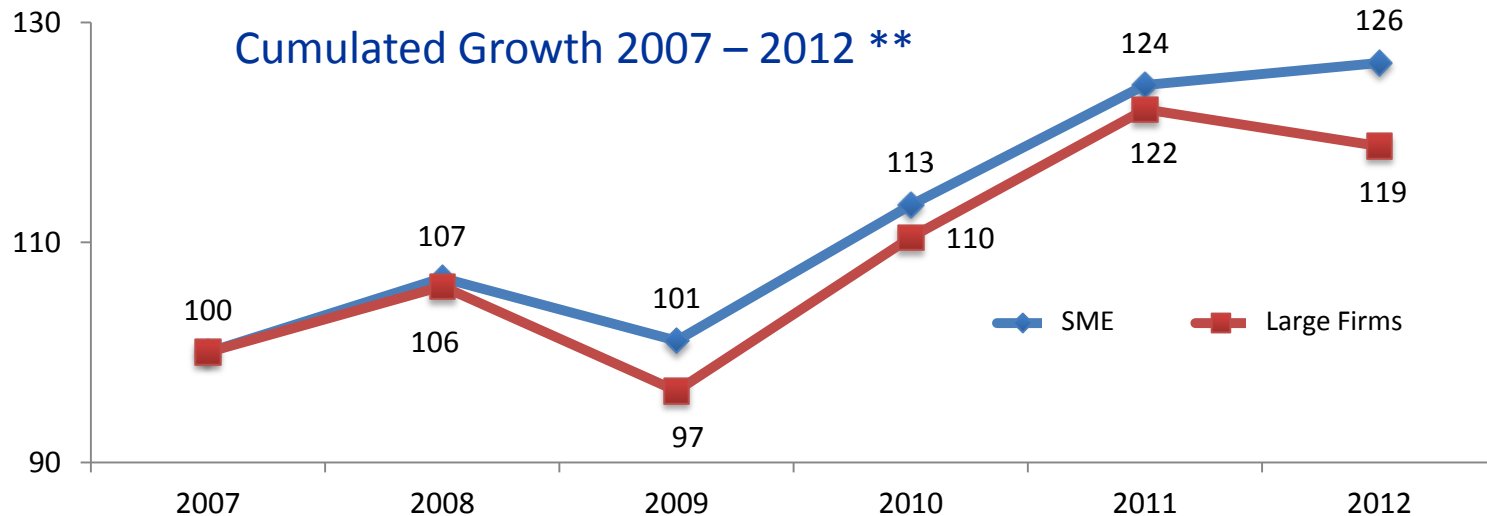
- SMEs: revenues < 50 mln: **99%** of Italian firms
- **2.3 mln workers** in SMEs 5-50 mln Revenue



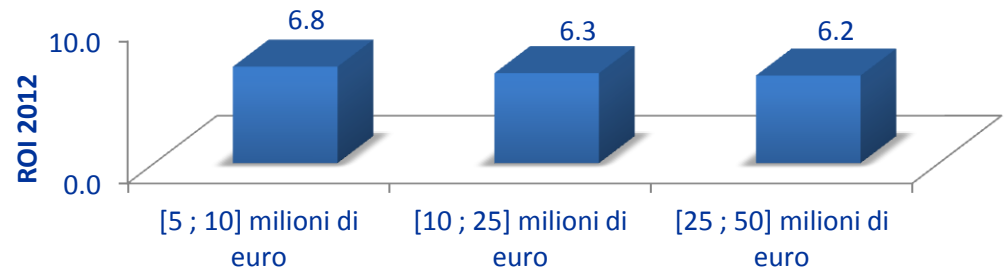
- **Successful SMEs:** mostly manufacturing firms
- **30% of SMEs innovated** in the period 2008-2010
 - Average **R&D/Revenues: 1.5%** (10% max)
 - 5% of SMEs: R&D/Revenues > 5%

Opportunities for Investors

Greater **growth** pace and faster **recovery**, with respect to larger firms



Smaller dimension =
higher profitability



The Italian Way to Reforms

Go Structural, Be Predictable



Enhance Human Capital in the Labor Market



Reallocate Capital through Investment Revival

Jackson Hole's Policy Message: **Be Comprehensive!**

- Change Fundamentals
- Leverage Political Consensus and International Conditions
- Country-Specific Response to Revive Investment and ...
- Foster Comprehensive European Policy toward Growth

The Benefits of Increasing Protection

- **Separation costs increasing** with seniority on-the-job
- **Low cost separation at early stage** of contractual relationship foster employers to try **stable employment**
- In Italian context: **likely** to have **strong effect on human capital**

- **Predictable** employer costs
- **Tax incentive for parties to settle** before involving the court
- **Judicial Uncertainty is severely reduced**

- In any case, firm pays small share of unemployment benefits
- **Job Property is overcome** and **reinstatement** is residual:
 - discriminatory dismissals
 - non-existing breach of conduct (severely unfair disciplinary dismissals)

4c ...including the *Strange Case of* “Consultants” (co.co.pro.)

2013	Total	Single employer (Mono-committente)	Exclusive contractors (Esclusivi)	Single clients and exclusive contractors
Contractors (Collaboratori a progetto)	502,295	448,067	416,664	370,991



Workers in transition: firm crisis, unemployment and Reallocation

- **New Requisites for Unemployment Insurance (NASPI)**
 - 3 months of contributions in the last 4 years
 - 30 days of work in the last year
- **Coverage**
 - Some 900,000 workers remained uncovered with ASpl
 - *DIS-Coll*: take care of «consultants»
 - Now: 97,2% of insured individuals is covered
- **Duration**
 - ASpl: covered workers up to 12 (18) months (over 55)
 - NASpl: everyone can be covered up to 2 years
 - *ASDI*: additional duration for workers in need (*means-tested*)
- **Level**
 - 75% of the salary up to 1,195 Euro, then 25% of surplus
 - Maximum: 1,300 Euro

The Opportunities for Pension Funds (Competition Act)

Facts:

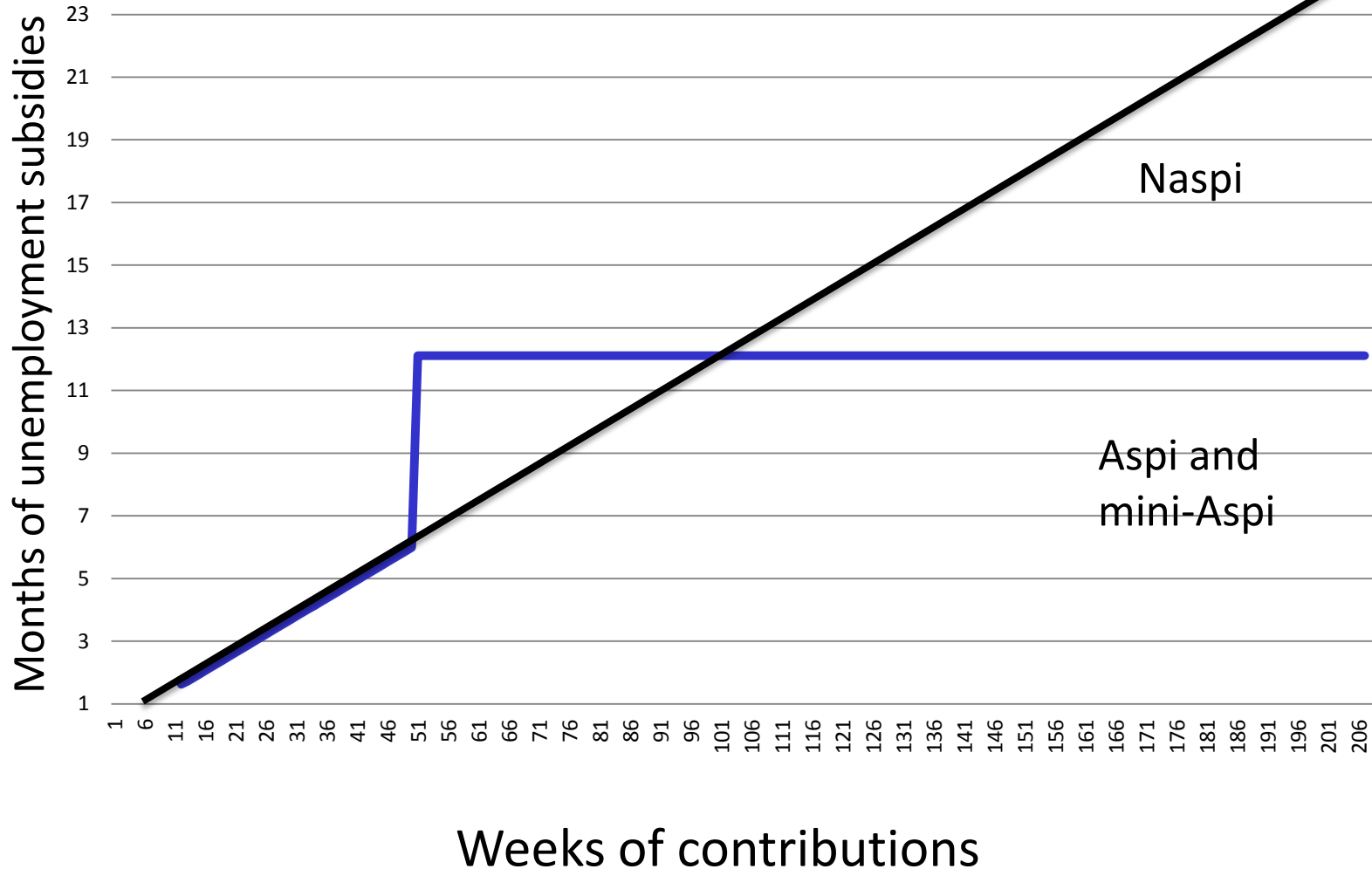
- 6,5 millions Italians contribute to pension funds (2014)
- fast growth (+6,5% yoy)
- Almost 2 millions in negotiated funds (*fondi negoziali*)

Main Innovations in the act to foster development:

1. Openness: Collect contributions from workers from other sectors
2. Provide benefit up to 10 years before retirement for Long term unemployed
3. Full transferability of employers' contributions to pension funds

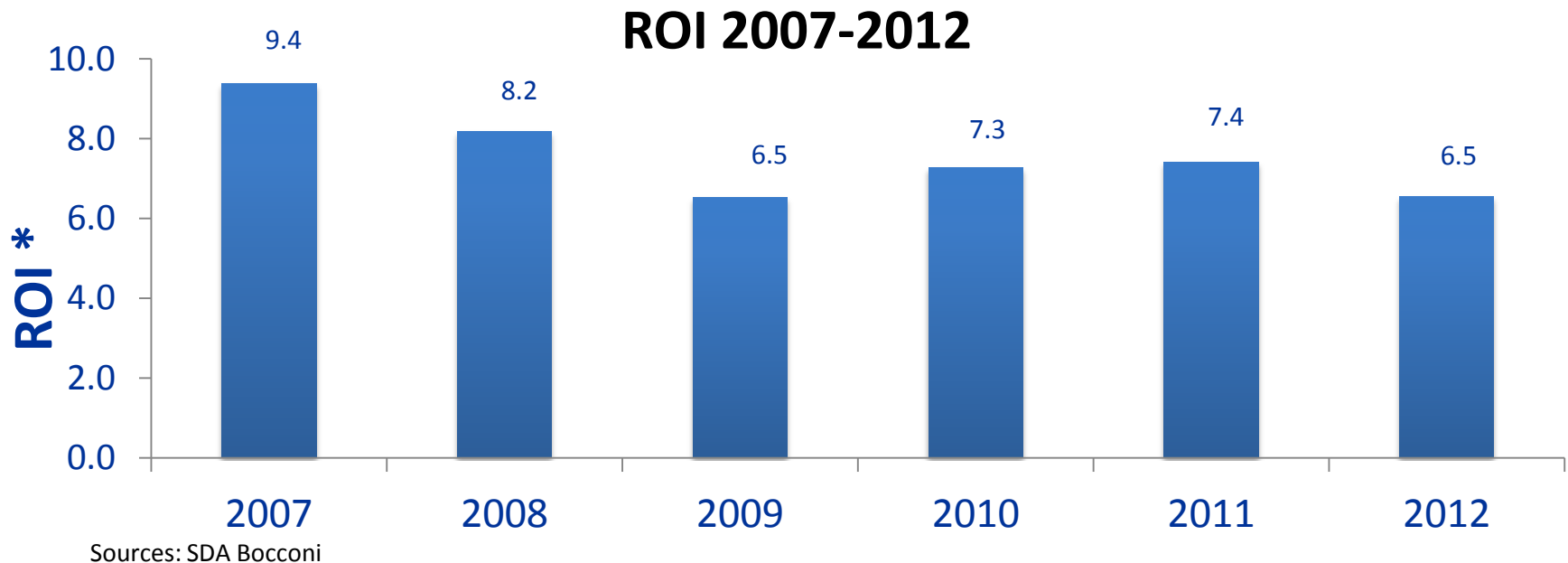
Unemployment Insurance: Old (Blue) Vs New (Black)

ASpl and mini-ASpl Vs Naspi



SMEs and the Crisis

Resilience: through crisis SMEs had good performance. Average ROI in the period 2007-2012 was 7.6%



Focus Shift: More importance to **quality** and to **market adaptation** and **response**, less to brand and reputation.