The Political Economy of Italy's Decline

LSE Department of Government public lecture

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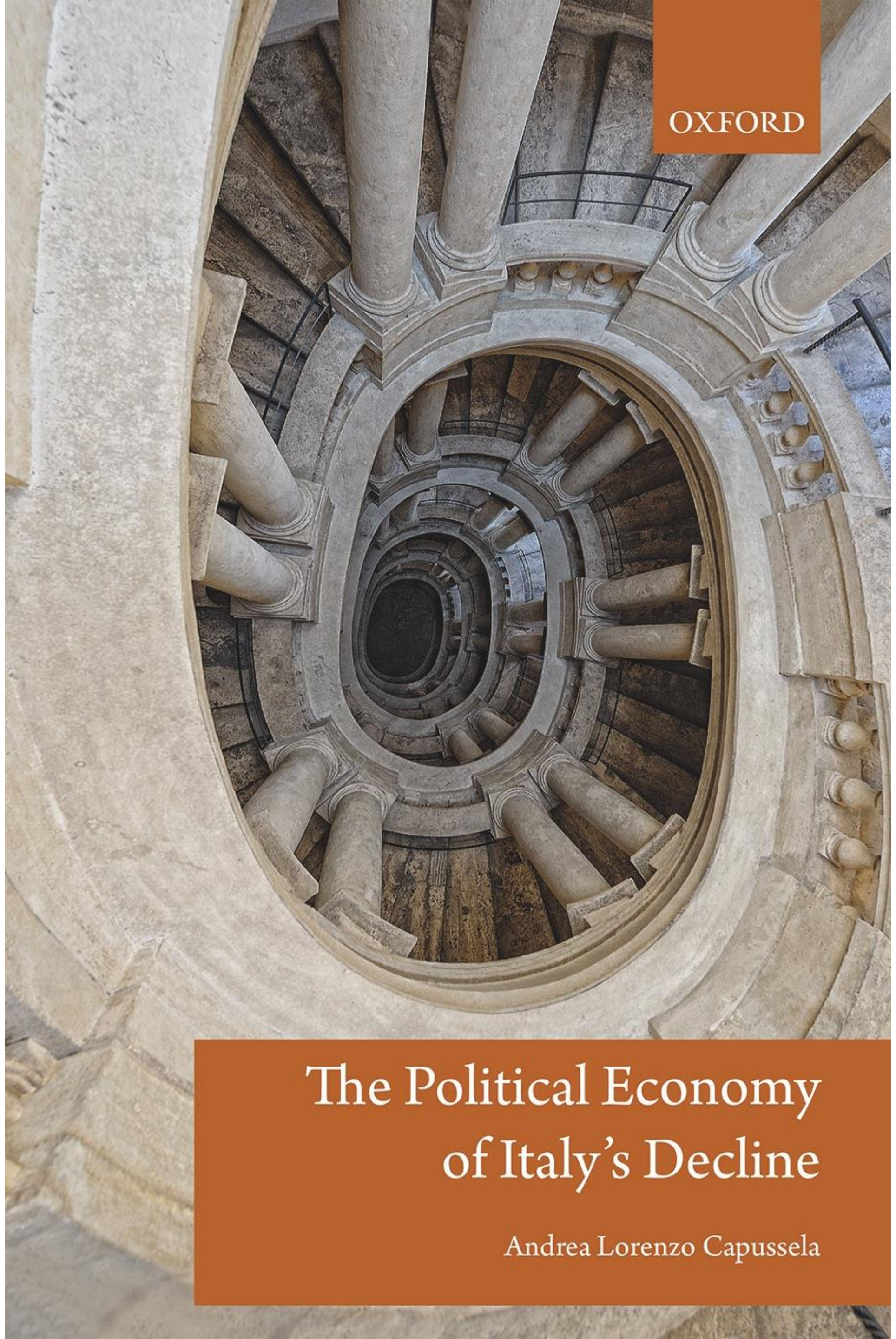
Event hashtag: *#LSEItaly*



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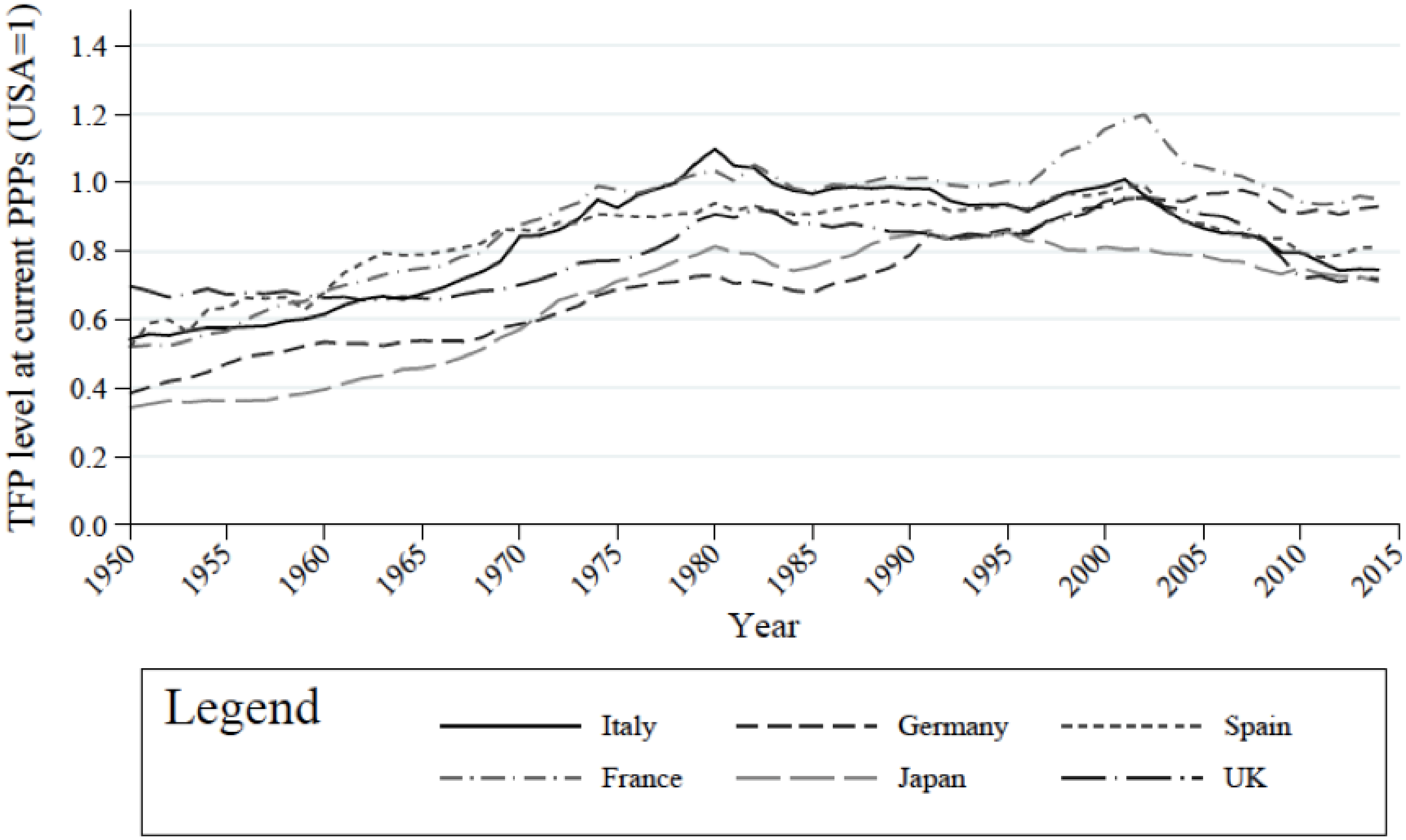
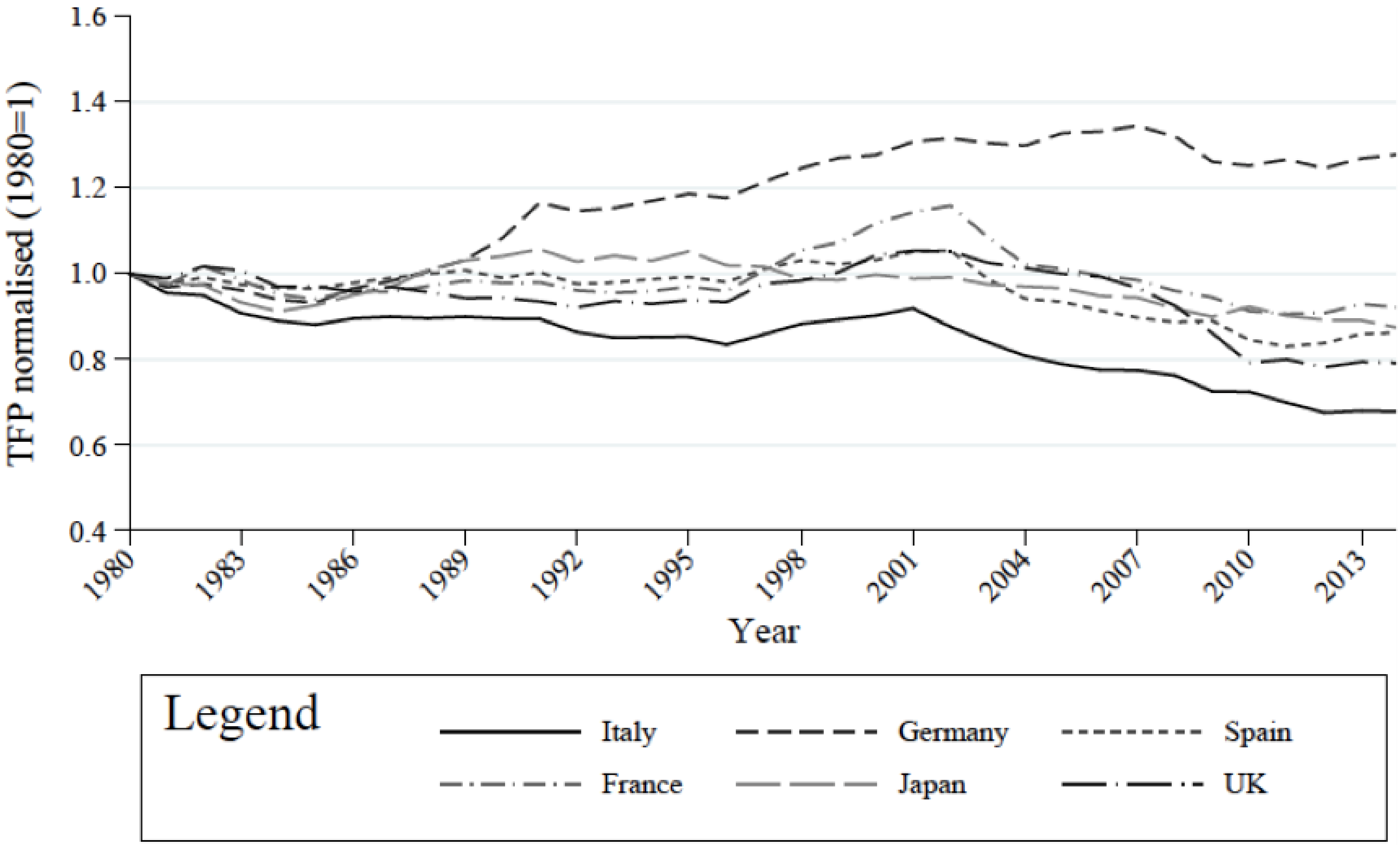
TFP 1950–2014 (US=1)



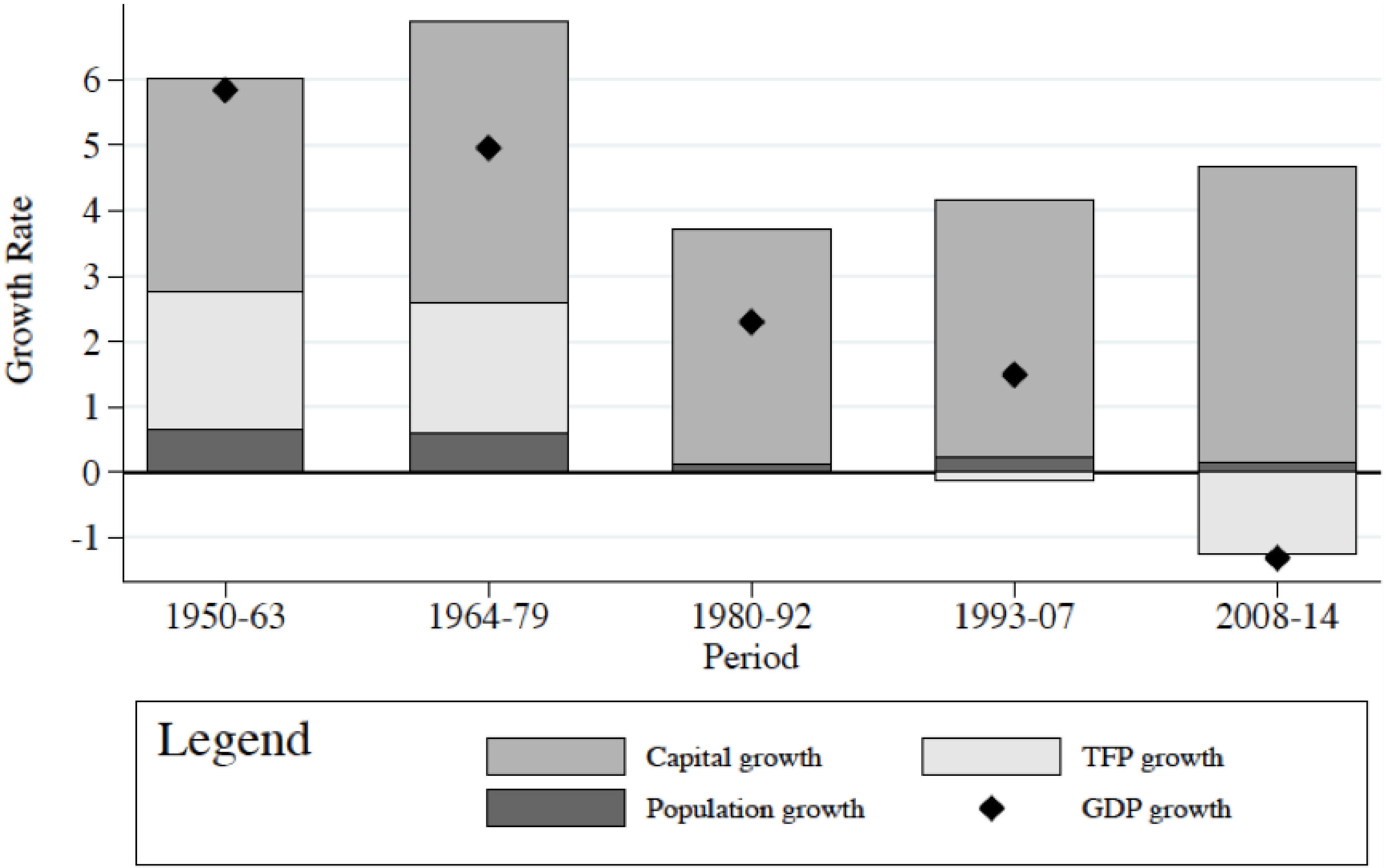
Source: Penn World Table

TFP 1980–2014 (1980=1)



Source: Penn World Table

Contributions to growth 1950–2014



Source: Penn World Tables

A fairly reliable analysis

Wide consensus on proximate causes:

- small average firm size, low propensity to grow and innovate, comparatively few large firms;
- poor public services (e.g., justice, education);
- resource misallocation, low ICT diffusion, poor management practices, 'low-skills trap'.

So, the four large post-1990 shocks (globalisation, ICT revolution, China/India, EMU) shocks were less opportunities for growth than 'fetters' to it.

Some data: TFP and misallocation

'[I]f in 2013 misallocation had remained at its 1995 level…productivity would have been **18%** higher in manufacturing [and] **67%** higher in services'.

Calligaris et al. (2016, 32)

They also find that misallocation:

- is due far more to its *within* component than to its *between* component (sector, size, geo);
- grew esp. in North-West and among large firms.

Moreover, misallocation grew *despite* rising product market competition (thanks to single market, €).

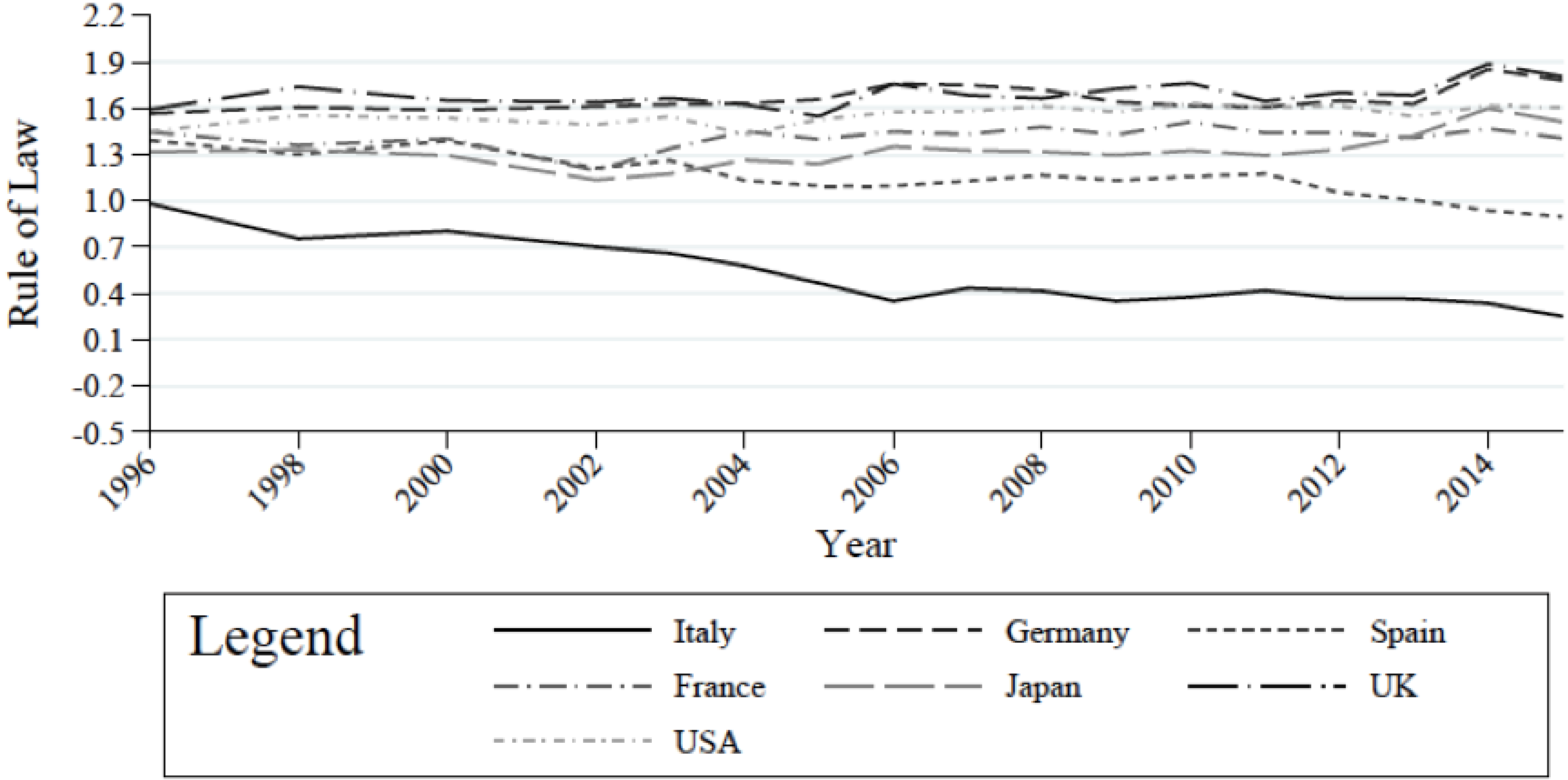
Intermediate causes: institutions

That analysis suggests that Italy's transition from a catch-up growth model to one based more on frontier/endogenous innovation was incomplete.

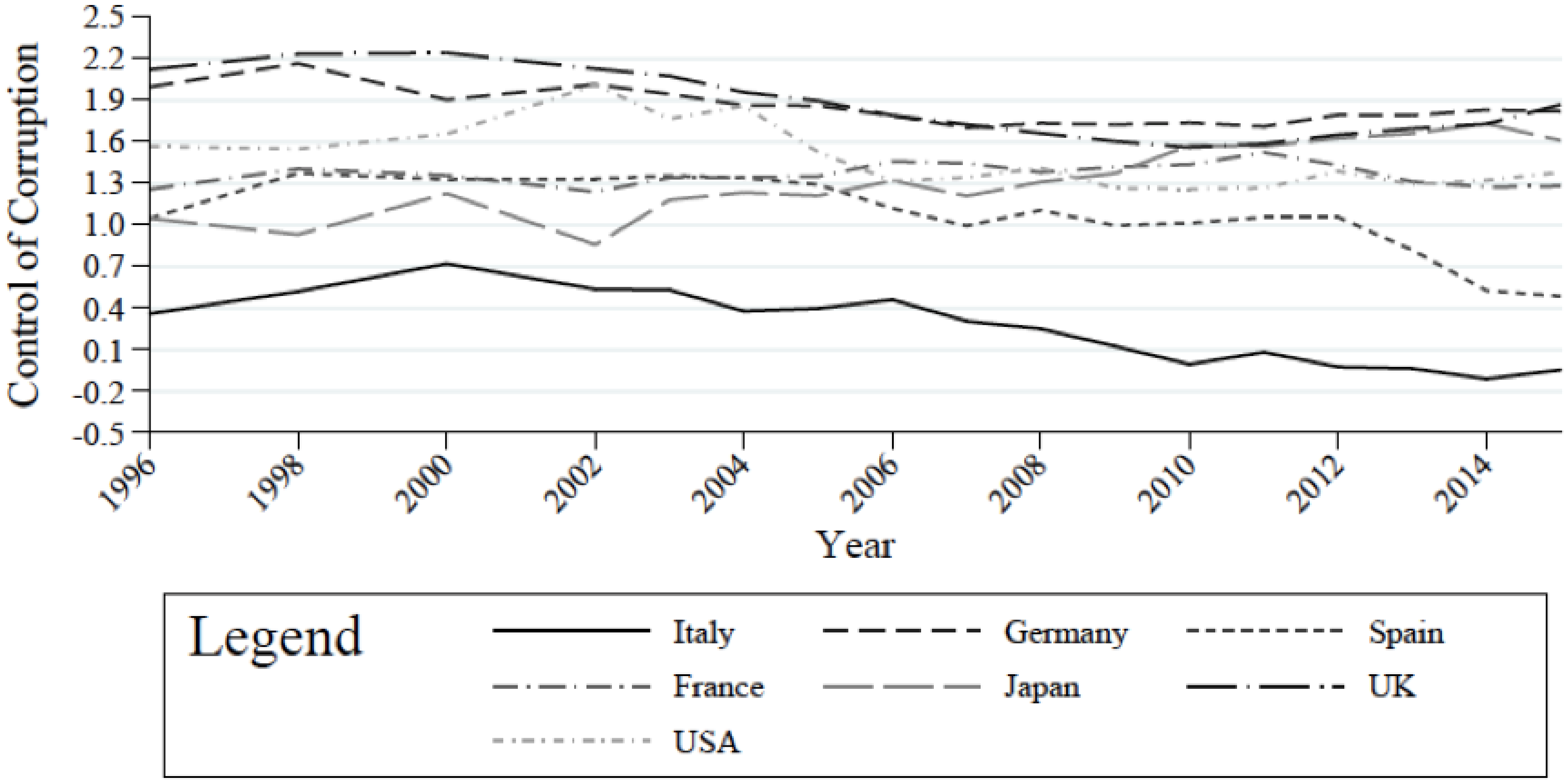
This suggests that institutions (North: 'rules of the game') are the main intermediate causes, as they:

- determine the efficiency of product and factor markets;
- more generally, they shape the incentives to invest and innovate.

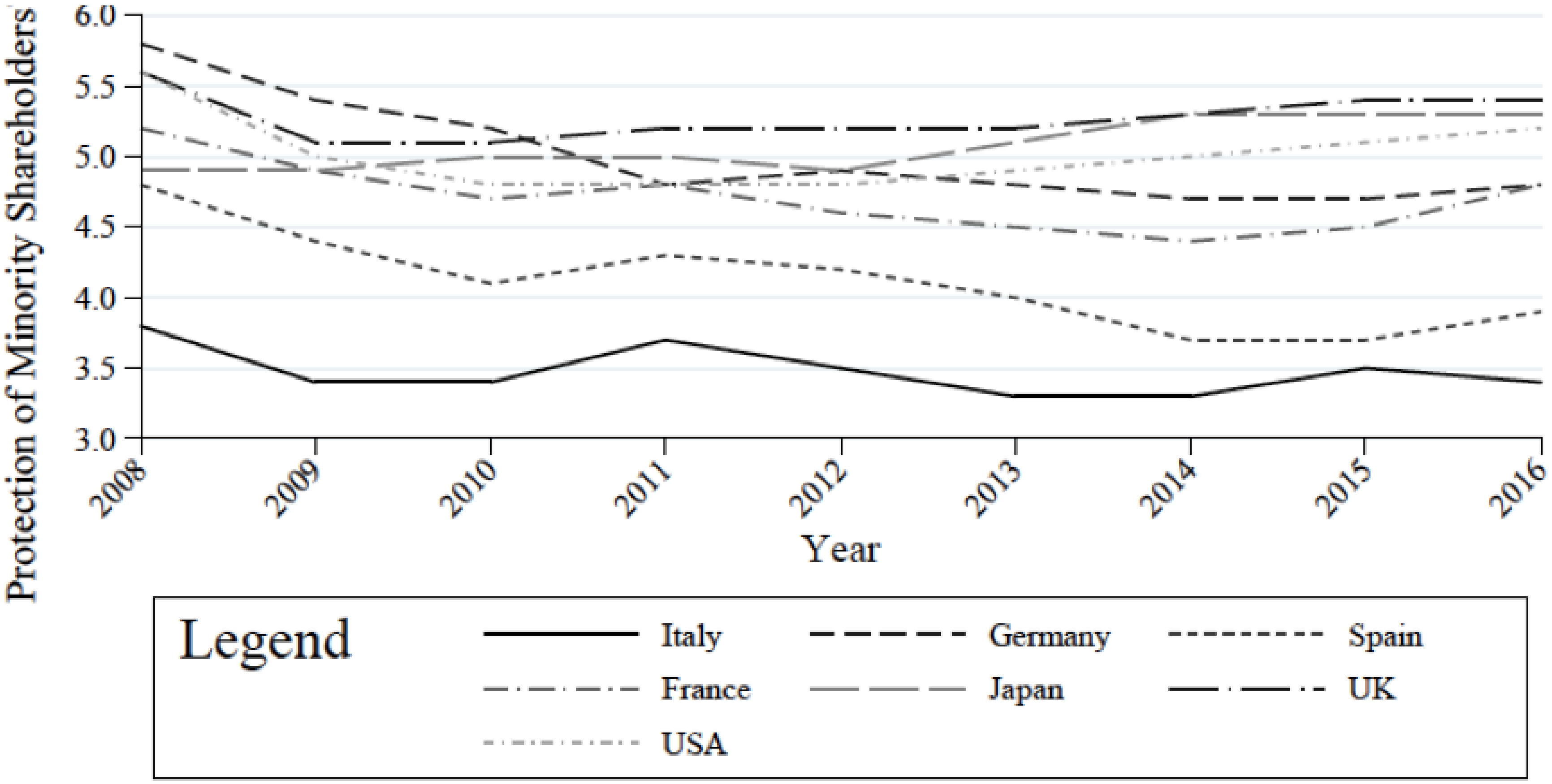
Rule of Law 1996–2015 (WGI)



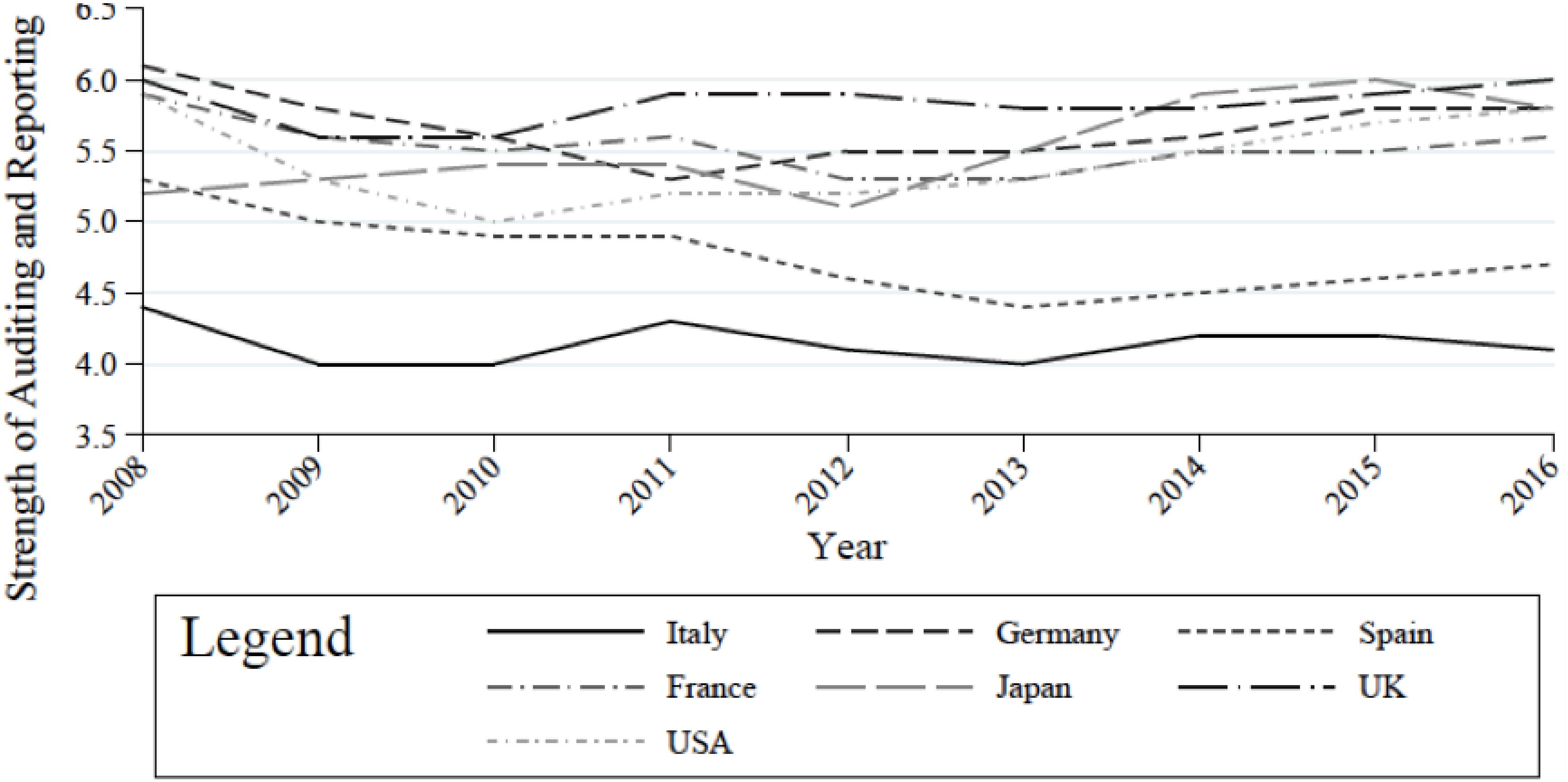
Control of Corruption 1996–2015(WGI)



Minority sh. protection 2008–16 (GCR)



Accounting & rep. standards 2008–16 (GCR)



Institutional explanation: questions

Italy's institutional problems are old: why would they have become a binding constraint circa 1980 (or 1990)?

'Appropriate' institutions (Gerschenkron, Aghion): the synchrony between approach to frontier, evolution of growth model, and institutional reform was broken.

After 1990 many 'good' institutional reforms were made: why did they not work?

Social order (North), or the allocation of power: reforms were distorted, undermined by its logic.

Deeper causes: Italy's equilibrium

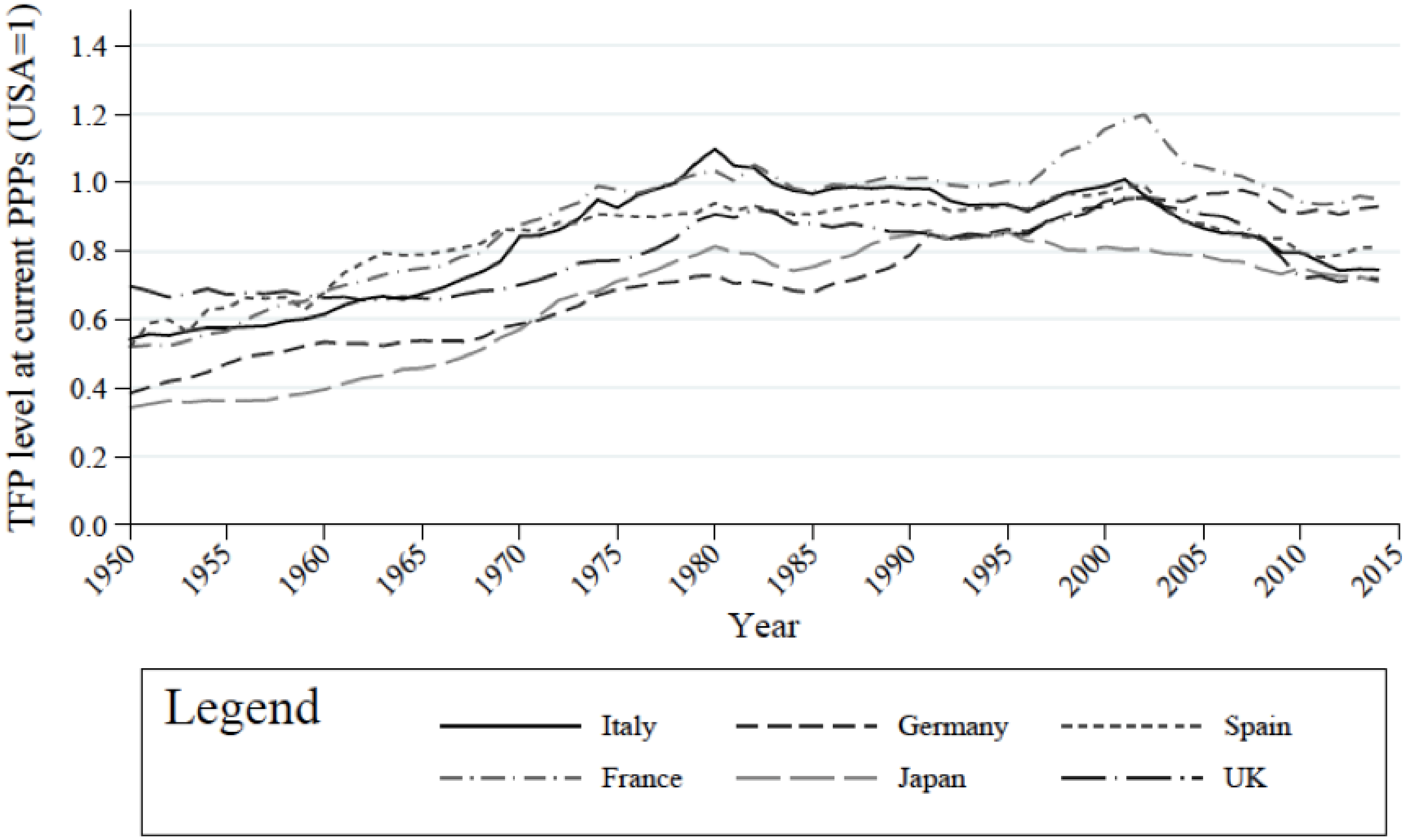
Why was that synchrony broken? Why does a democracy not overcome this problem?

Multiple equilibria: for ordinary citizens and firms those dilemmas are assurance games, *not* PDs.

Several consistent vicious circles: a spiral.

So, multiple collective action problems, exacerbated by the coherence of the politico-economic equilibrium (power, institutions, norms, trust, culture).

Again: TFP 1950–2014 (US=1)



Source: Penn World Table

One pillar of Italy's equilibrium

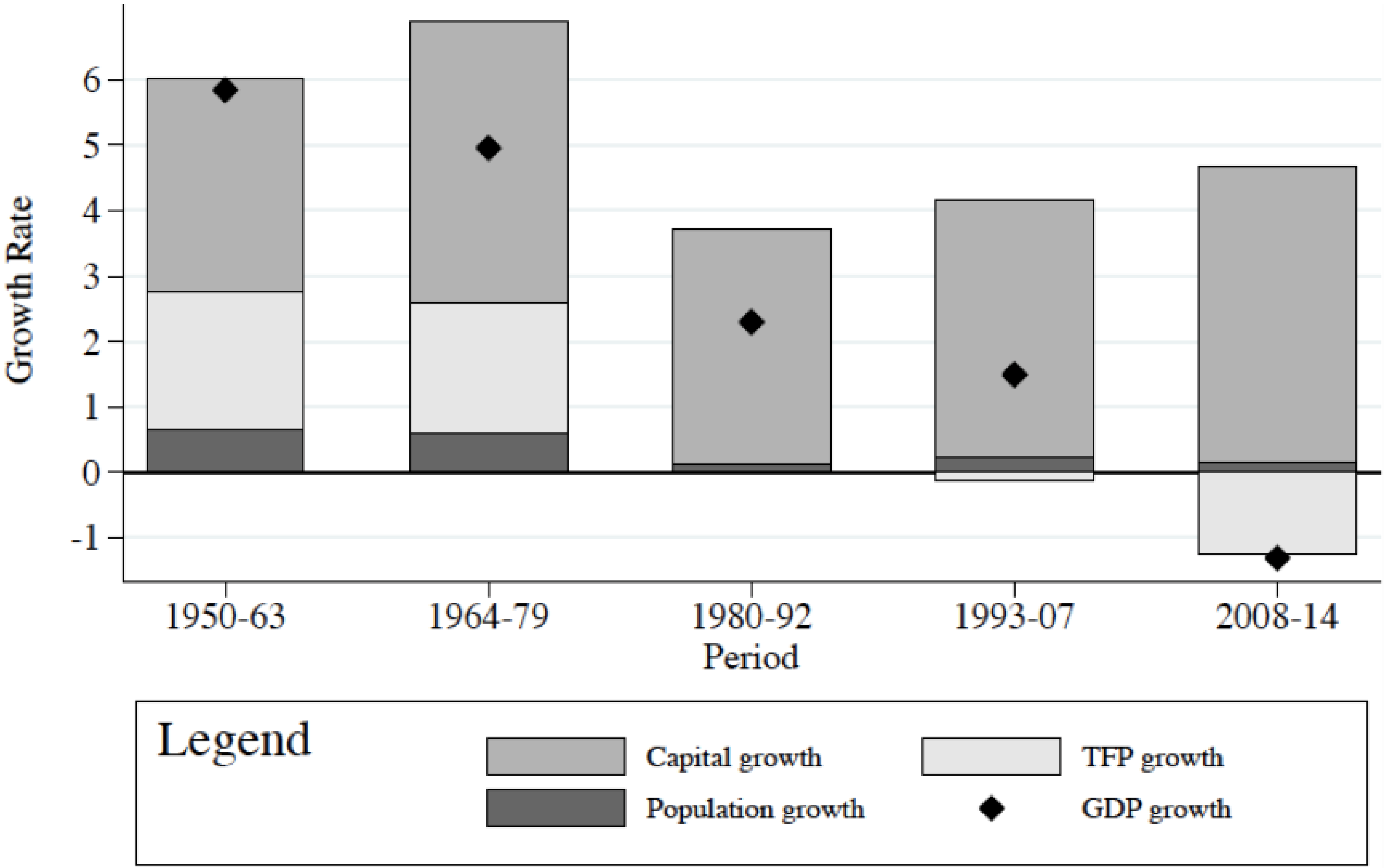
The spirit of a people, its cultural level, its social structure, the deeds its policy may prepare—all this and more is written in its fiscal history, stripped of all phrases.

Joseph Schumpeter, 1918

Monetary- or debt-financed fiscal expansion:

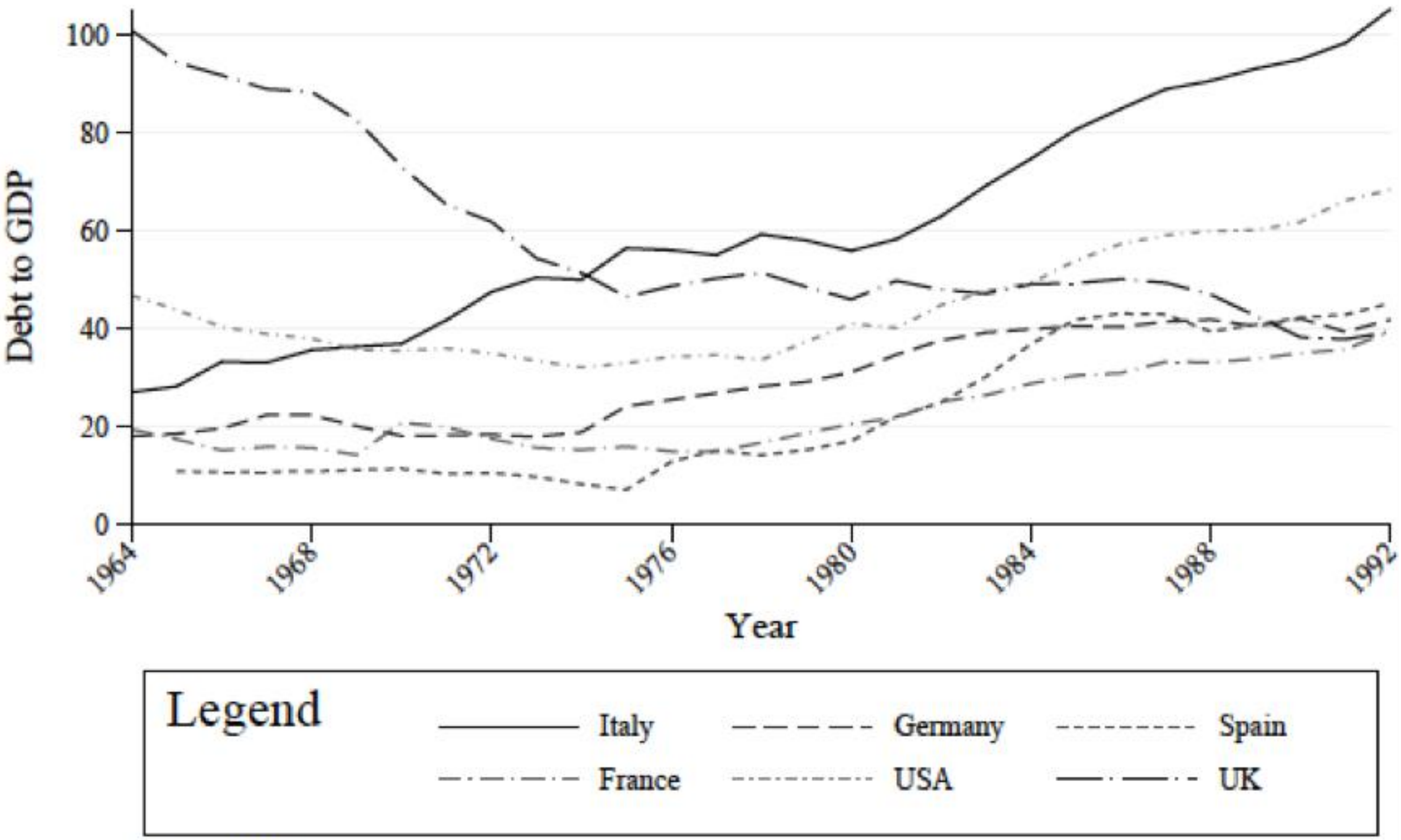
- contributed to off-setting the decline of TFP growth;
- financed policy of selective inclusion, which aligned the interests of segments of society with the elites'.

Again: contr. to growth 1950–2014



Source: Penn World Tables

Debt-to-GDP ratios 1964–92



Source: IMF

A battle of ideas?

Italy's equilibrium is internally consistent and self-reinforcing, but might be near the limit of its sustainability (e.g. erosion of selective inclusion).

Ideas are part of the equilibrium. But they are freer from its grip, and they:

- 'trump' interests, in the long run (Rodrik 2014);
- can change fast: 'rebound effect' (Hirschman 1982).

So, a discussion along these lines: 'What kind of a society are we? What kind do we want to be?'