



Ministero dell'Economia e delle Finanze
Dipartimento del Tesoro

Assessing Italy's Reform Challenges:

What Do Growth Accounting and Structural Indicators Say?

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A comprehensive assessment of reforms and GDP growth

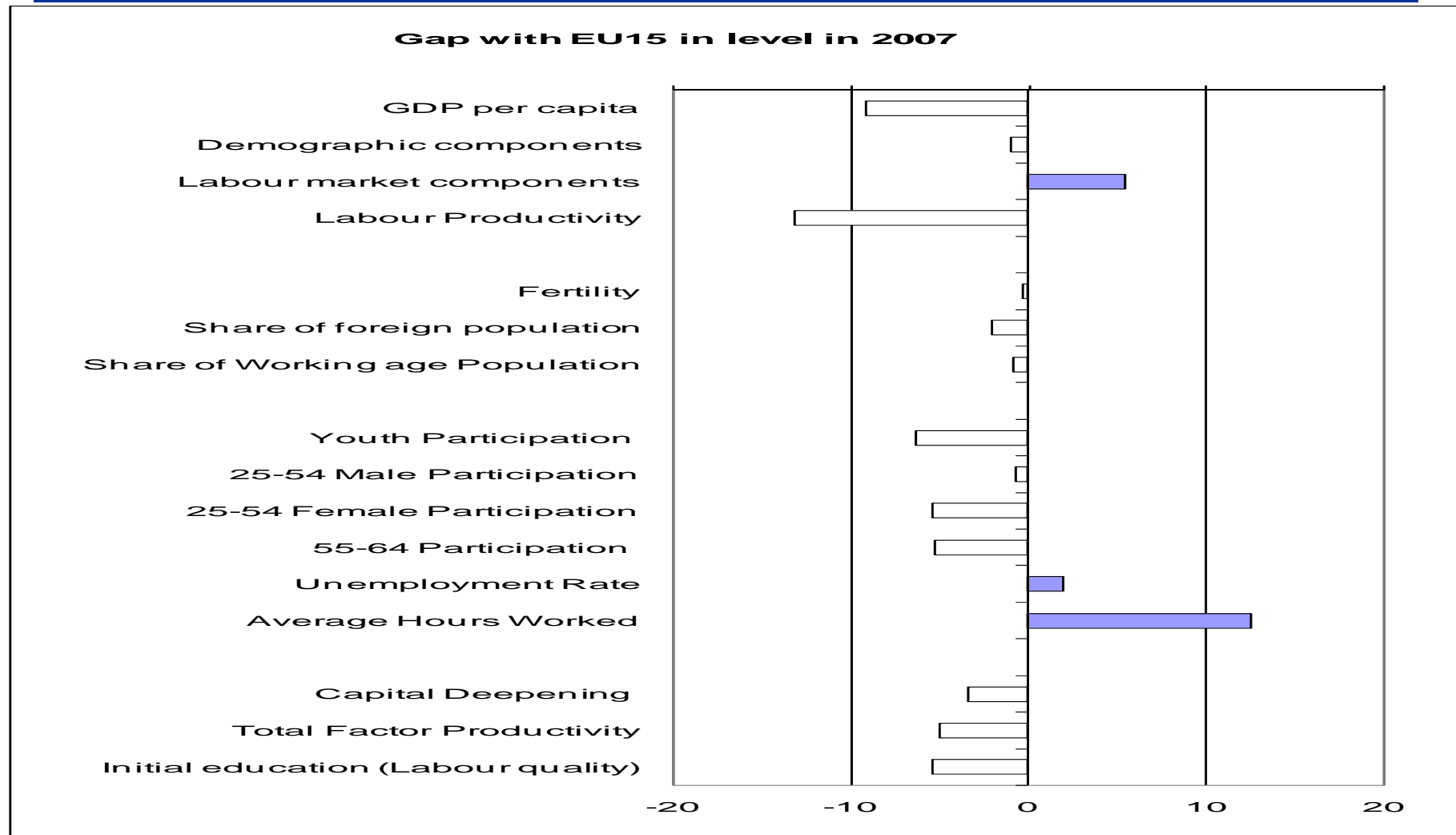
- What link can we see between structural indicators and GDP components that can explain Italy's dismal performance in GDP growth?
- Have reforms implemented in the past been effective in stimulating GDP growth?
- Is there any fresh insight into Italy's reform process?

LIME data at work

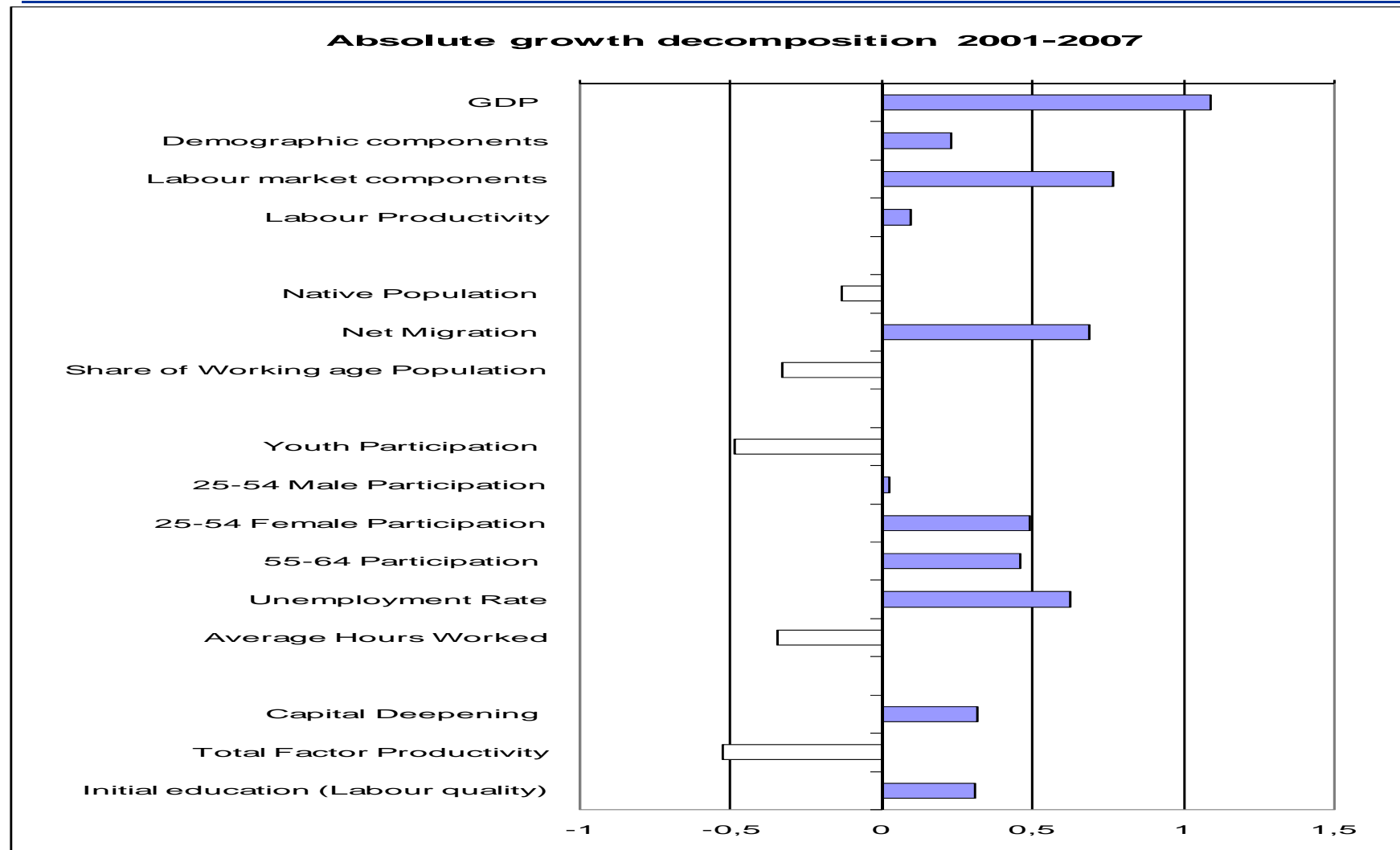
- Used newly available 2001-2007 information developed by the Lisbon Methodology WG (LIME) (and EU KLEMS)
- Analysed Italy's performance against EU15 countries in a simple framework (although, of course, there are some caveats)
- Linked GDP growth components to structural indicators on policy areas of reform through a mapping exercise
- Compared results with policy objectives and recommendations

A BIRD'S EYE VIEW OF THE ITALIAN PERFORMANCE

Per capita GDP driven down by poor productivity

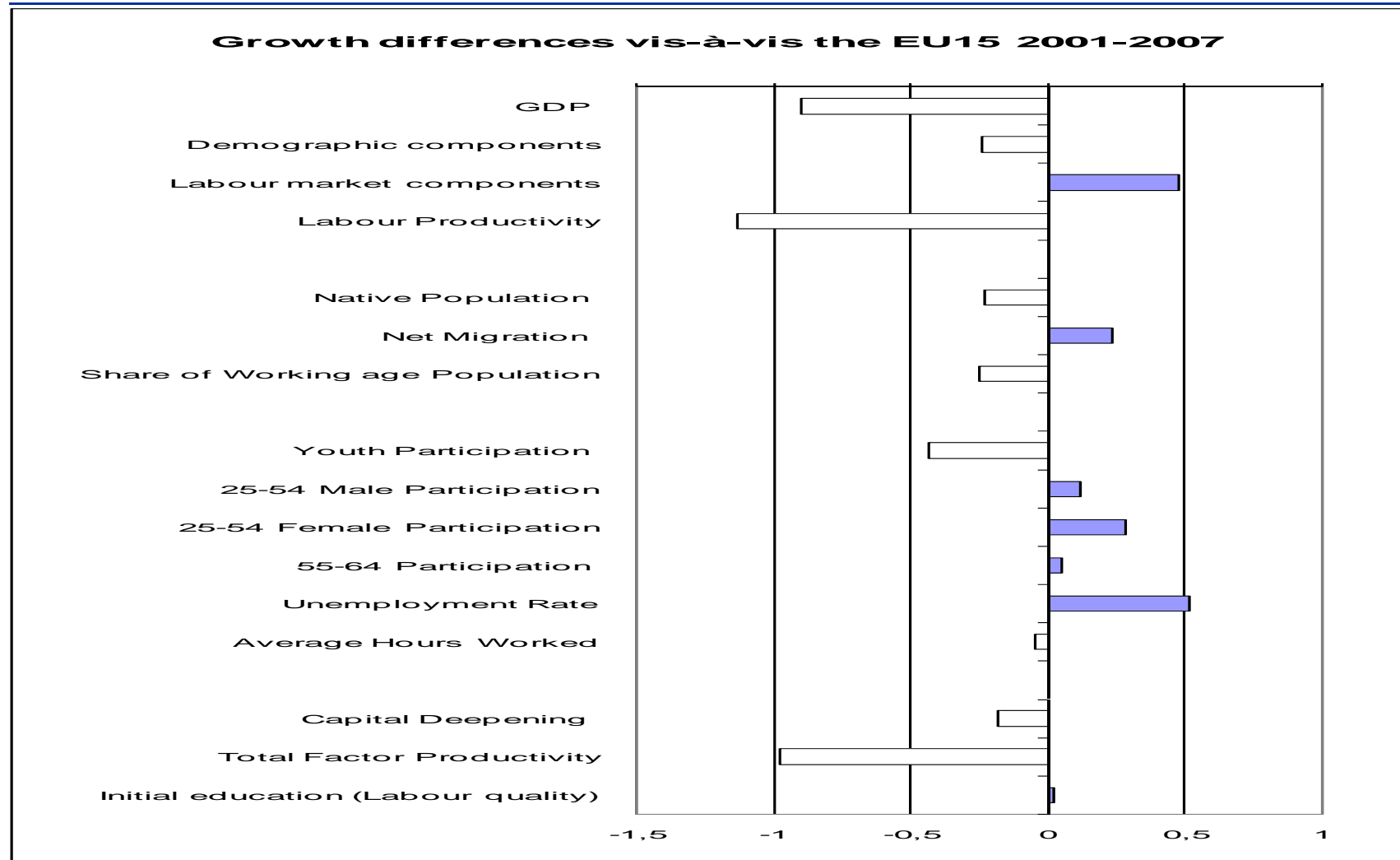


TFP was a substantial drag on GDP growth



A BIRD'S EYE VIEW OF THE ITALIAN PERFORMANCE

In relative terms, growth again affected by poor productivity



1.0pp. GDP underperformance in 2001-2007: why?

GDP components	Level	Growth	Absolute contribution to annual growth
Demographic component	-8	-4	0.2
Fertility / Native Population	-9	-10	-0.1
Share of foreign population / Net Migration	-8	6	0.7
Share of Working age Population	-5	-10	-0.3
Labour market component	6	11	0.8
Youth Participation	-14	-20	-0.5
25-54 Male Participation	-15	9	0.0
25-54 Female Participation	-20	11	0.5
55-64 Participation	-15	2	0.5
Unemployment Rate	5	18	0.6
Average Hours Worked	13	-2	-0.3
Labour productivity	-9	-17	0.1
Capital Deepening	-6	-11	0.3
Total Factor Productivity	-6	-15	-0.5
Labour quality (Initial education of labour force)	-17	2	0.3
GDP per capita (level) / GDP (growth)	-8	-10	1.1

Labour outperformed, but participation remained low

- Italy outperformed the EU15 in terms of reduction in unemployment rate and increase in labour participation (with the exception of youth participation)
- However, the level of participation remained substantially below the EU15, especially for female participation
- Italy's performance was strongly influenced by sizeable regional differences
- Demographic developments were unfavourable

Focus on TFP

- TFP made a negative contribution to growth in Italy in 2001-2007, while it did not in the EU15
- The drag on GDP growth was 0.5pp. a year
- Capital deepening grew at a pace slower than the EU15 average, and it was below the EU15 average level in 2007
- Labour quality lagged deeply behind the EU15 average in 2007

What do structural indicators say?

Policy areas – Aggregate scores for IT	Level	Change	No. U.L.	No. U.C.	No.
Labour market					
Active labour market policies**	-3	10	3	0	6
Making work-pay: interplay of tax and benefit system***	0	-5	2	7	10
Labour taxation to stimulate labour demand ***	-4	8	1	0	4
Job protection and labour market segmentation/dualisation**	-5	-3	3	3	5
Policies increasing working time***	13	3	0	1	3
Specific labour supply measures for women***	-3	-1	7	4	12
Specific labour supply measures for older workers***	-5	2	6	4	8
Wage bargaining and wage-setting policies**	0	6	1	0	4
Immigration and integration policies***	-2	-7	3	3	6
Labour market mismatch and labour mobility**	-6	2	2	1	4
Product and capital market regulations					
Competition policy framework*	-1	1	1	0	5
Sector specific regulation (telecoms, energy)**	-2	3	4	4	10
Market integration - Openness to trade and investment**	-2	2	2	1	5
Business environment, Regulatory barriers to entrepreneurship**	-8	3	5	2	8
Business Dynamics – Start-up conditions***	-11	-5	3	2	4
Financial markets and access to finance**	-4	0	8	0	20
Innovation and knowledge					
R&D and Innovation***	-8	9	3	0	4
ICT**	-1	1	2	1	5
Education and life-long learning***	-8	2	9	2	11
Macroeconomy					
Orientation and sustainability of public finances ***	-4	-1	2	0	6

Labour market: a mixed message

- Active labour market policies have recorded a sizeable improvement in 2001-2007, while still lagging the EU15 in terms of level
- Some improvement in wage bargaining and wage setting policies and labour taxation to stimulate labour demand
- Relative deterioration in making work-pay, job protection and labour market segmentation/dualisation and immigration and integration policies

Product markets: small gains but not enough to close the gap

- Initiatives to liberalise and open up markets in 2001-2007 resulted in a small overall overperformance
- However, in level terms, Italy was still below EU15 average in 2007
- Business dynamics was a weak spot
- Improvement in R&D and innovation and in education and life-long learning, but the 2007 gap remained wide

ASSESSMENT OF PRIORITIES

Which policy areas are in need to be tackled?

	Fertility / Native Population	Share of foreign population / Net Migration	Share of Working age Population	Youth Participation	25-54 Male Participation	25-54 Female Participation	55-64 Participation	Unemployment Rate	Average Hours Worked	Capital Deepening	Total Factor Productivity	Initial education of labour (Labour quality)
Active labour market policies												
Making work-pay: interplay of tax and benefit system												
Labour taxation to stimulate labour demand												
Job protection and labour market segmentation/dualisation												
Policies increasing working time												
Specific labour supply measures for women												
Specific labour supply measures for older-workers												
Wage bargaining and wage-setting policies												
Immigration and integration policies												
Labour market mismatch and labour mobility												
Competition policy framework												
Sector specific regulation (telecom, energy)												
Business environment - Regulatory barriers to entrepreneurship												
Business Dynamics - Start-up conditions												
Financial markets and access to finance												
Market integration - Openness to trade and investment												
R&D and Innovation												
ICT												
Education and life long learning												
Orientation and sustainability of public finances												

ASSESSMENT OF PRIORITIES

Policy areas responsible for GDP performance: labour market

Policy area	Level		Growth	
	(*)	GDP components involved	(*)	GDP components involved
Labour market				
Active labour market policies	S	Youth Participation 25-54 Female Participation 25-54 Male Participation 55-64 Participation		Youth Participation
Making work-pay: interplay of tax and benefit system	S	Youth Participation 25-54 Female Participation 25-54 Male Participation 55-64 Participation Total Factor Productivity	B	Youth Participation Total Factor Productivity
Labour taxation to stimulate labour demand	S			
Job protection and labour market segmentation/dualisation	B	Youth Participation 25-54 Female Participation 25-54 Male Participation 55-64 Participation Total Factor Productivity	S	Youth Participation Total Factor Productivity
Policies increasing working time		Total Factor Productivity		Total Factor Productivity
Specific labour supply measures for women	S	Youth Participation 25-54 Female Participation 55-64 Participation	S	Youth Participation
Specific labour supply measures for older workers	B	55-64 Participation		
Wage bargaining and wage-setting policies	S			
Immigration and integration policies	S	Net migration	B	
Labour market mismatch and labour mobility	B	Youth Participation 25-54 Female Participation 25-54 Male Participation		Youth Participation

ASSESSMENT OF PRIORITIES

Policy areas: product market and innovation

Policy area	Level		Growth	
	(*)	GDP components involved	(*)	GDP components involved
Product and capital market regulations				
Competition policy framework	S	Total Factor Productivity Capital Deepening	S	Total Factor Productivity Capital Deepening
Sector specific regulation (telecoms, energy)	S	Total Factor Productivity Capital Deepening		Total Factor Productivity Capital Deepening
Market integration – Openness to trade and investment	S	Total Factor Productivity Capital Deepening Labour Quality		Total Factor Productivity Capital Deepening
Business environment – Regulatory barriers to entrepreneurship	B	Total Factor Productivity Capital Deepening		Total Factor Productivity Capital Deepening
Business Dynamics – Start-up conditions	B	Total Factor Productivity Capital Deepening	B	Total Factor Productivity Capital Deepening
Financial markets and access to finance	S	Total Factor Productivity Capital Deepening		Total Factor Productivity Capital Deepening
Innovation and Knowledge				
R&D and Innovation	B	Labour Quality		Total Factor Productivity Capital Deepening
ICT	S	Total Factor Productivity Capital Deepening		Total Factor Productivity Capital Deepening
Education and life-long learning	B	Youth Participation 25-54 Female Participation 25-54 Male Participation 55-64 Participation Labour Quality (Education) Total Factor Productivity	S	Youth Participation Total Factor Productivity

MAPPING

Are results in line with policy targets and recommendations?

Policy areas	Level	Change	Key C	CSR	PTW	O Ind.	O Qual.
Labour market							
Active labour market policies	-3	10					
Making work-pay: interplay of tax and benefit system	0	-5					
Labour taxation to stimulate labour demand	-4	8		X		X	
Job protection and labour market segmentation/dualisation	-5	-3					
Policies increasing working time	13	3					
Specific labour supply measures for women	-3	-1			X		
Specific labour supply measures for older workers	-5	2			X		
Wage bargaining and wage-setting policies	0	6					X
Immigration and integration policies	-2	-7					
Labour market mismatch and labour mobility	-6	2	X				
Product and capital market regulations							
Competition policy framework	-1	1	X	X			X
Sector specific regulation (telecoms, energy)	-2	3	X	X			
Market integration - Openness to trade and investment	-2	2	X				
Business environment - Regulatory barriers to entrepreneurship	-8	3			X	X	
Business Dynamics - Start-up conditions	-11	-5					
Financial markets and access to finance	-4	0					
Innovation and knowledge							
R&D and Innovation	-8	9	X		X		
ICT	-1	1					
Education and life long learning	-8	2	X	X		X	
Macroeconomy							
Orientation and sustainability of public finances	-4	-1	X	X			
Environment and sustainable development			X		X		
Infrastructure			X		X		

Any match between LAF, Italy's, EU's and OECD objectives?

- Italy recorded progress in 2001-2007, mainly in the areas where the level scores show underperformance
- This seems to suggest that the right policy issues were addressed, but also that the progress achieved was not enough to close the gap in level terms
- As a result, most recent policy recommendations still insist on the areas of weakness where progress was most notable but also insufficient

Is there a sectoral explanation for Italy's performance?

- Could Italy's GDP and productivity performance be attributed to unfavourable trend in one and more sectors?
- Macro sectors show a decline in productivity, with only a few exceptions
- The gap is particularly significant in manufacturing (-1.9pp) and the distribution sector (-1.5pp)
- Italy's gap in value added growth can be attributed to four sectors: real estate services, retail sales, optical and electrical equipment, and financial intermediation

CONCLUSIONS

A trade-off in the labour market?

- The relative improvement in the labour market component of GDP growth is not matched by an equally clear advance in labour market structural indicators, possibly suggesting it was a lagged response to policies implemented in the '90s
- The decline in both TFP and the number of hours worked may partly reflect positive developments in the labour market, the most relevant phenomenon in the period considered

CONCLUSIONS

Some gains in indicators but no impact on GDP growth

- Relative progress was moderate in labour market indicators, following notable improvement in previous years, and in product and capital market regulations and innovation and knowledge. In these areas, the relative performance in level is unsatisfactory.
- There was overall progress in reforms as against the EU15 according to LAF, although this appears to have had little impact on economic growth or on its components in relative terms.

CONCLUSIONS

What are the possible answers?

- The reform process in Italy started later than in other EU15 countries, and thus the effects may have yet to come
- It could be that reforms are not as effective in stimulating economic activity as the economic literature suggests, and this may be especially true for Italy due to country-specific reasons. Therefore, a lot more needs to be done.
- There may still be measurement problems to be solved
- It may be a combination of the above answers