

What Happened? Italian GDP and TFP slow between 1960 and today

1960

6% GDP Growth

2.85% TFP Growth

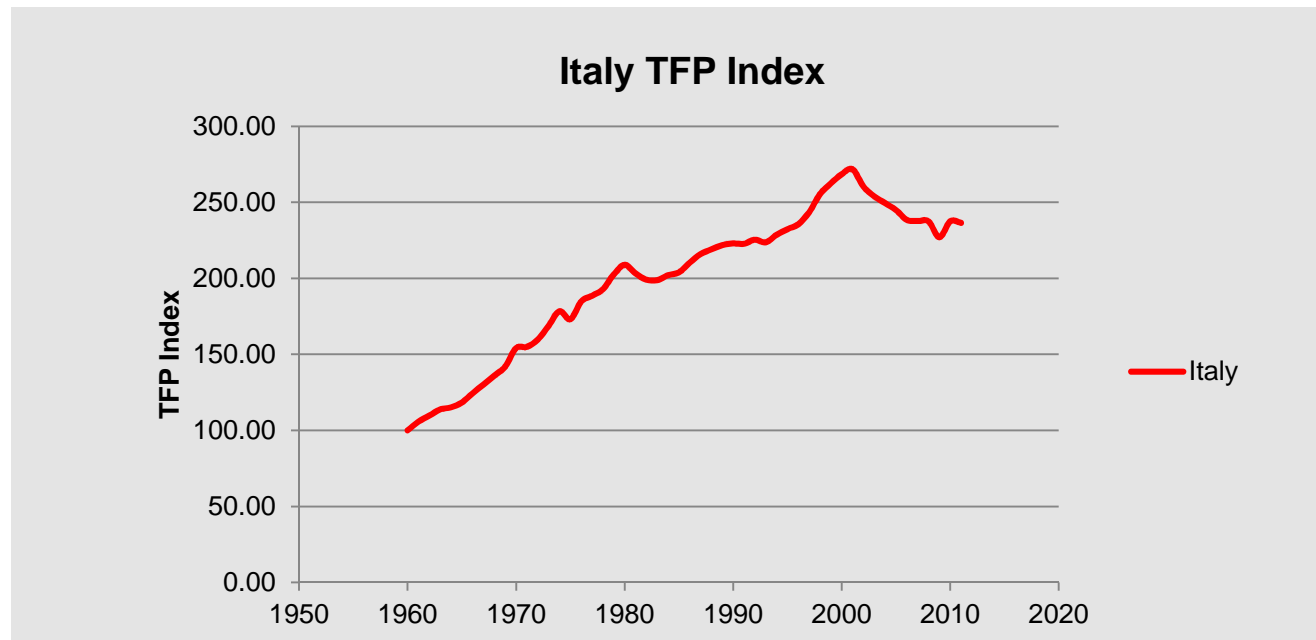
1.7% Capital Accumulation

Current

> 1% GDP Growth

.57% TFP Growth

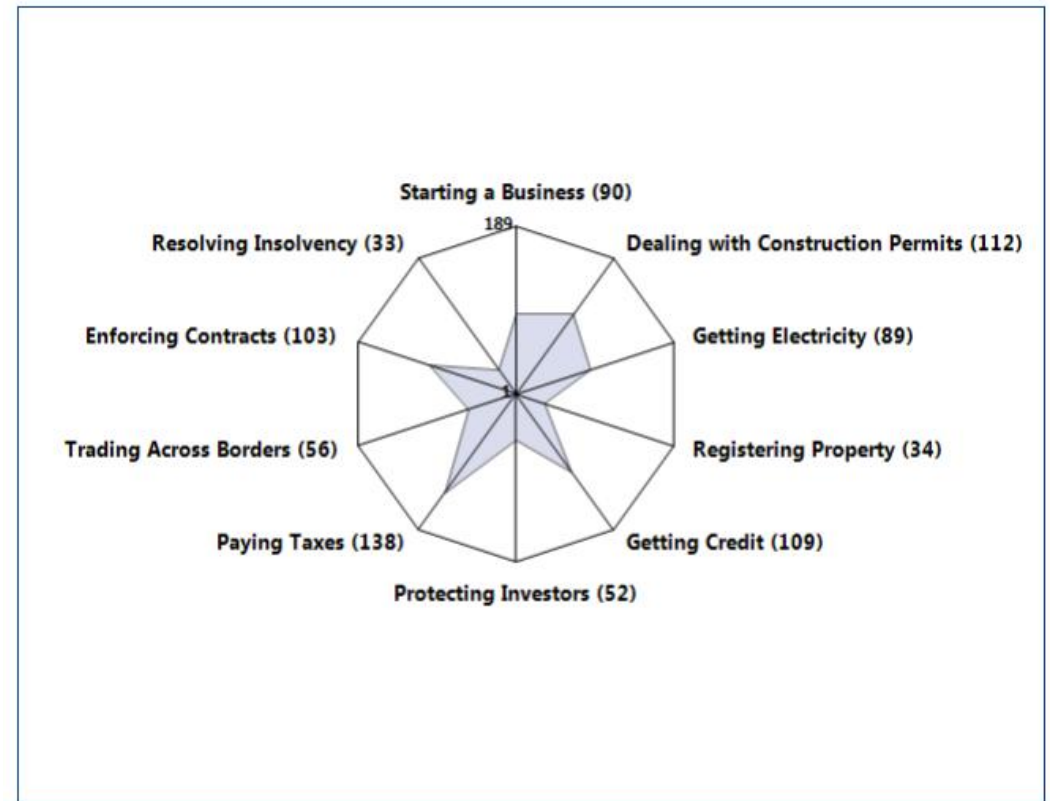
Italy	Y/N	K/L	L/N	TFP
1960-85	4.2%	1.7%	-.35%	2.85%
1985-'01	2.01%	1.22%	.23%	.57%



Doing Business Index indicates difficult business environment relative to EU peers

Institutions and Credit Access Leading Drivers of Poor Business Environment

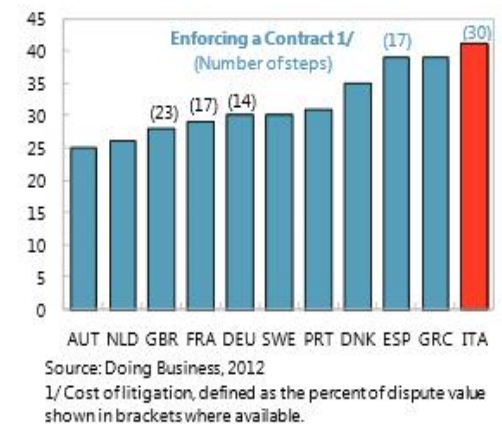
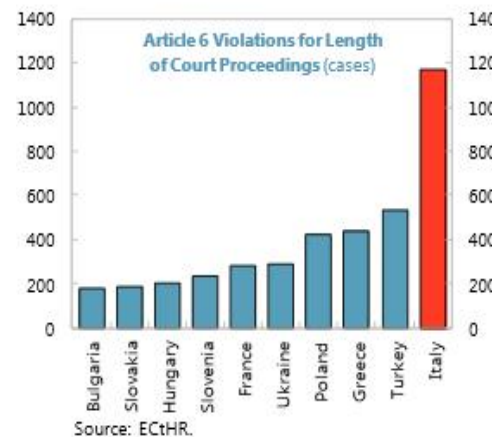
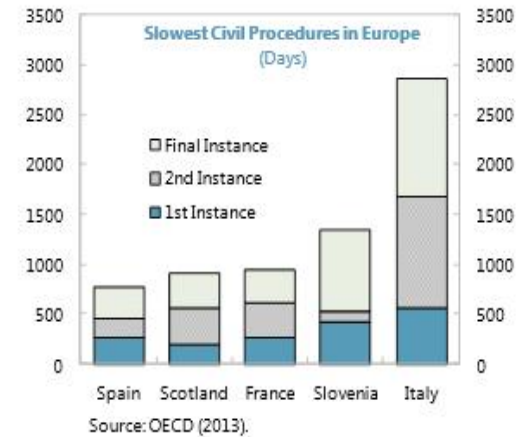
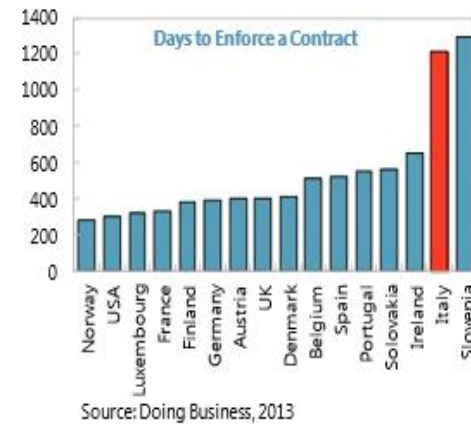
- On a scale of 1 to 189 indicating the ease of doing business, Italy ranks 65, far below comparable economies
- By comparison, the United Kingdom ranks 10, and the EU Regional average is 29
- Key elements leading to Italy's ranking include the ease of getting construction permits, starting a business, getting credit, paying taxes, and enforcing contracts



Source: Doing Business database.

Inefficient judicial system inhibits efficient business environment

- 1,200 days to enforce a contract
- 8 years to complete a civil case up to Supreme Court
- Modest court fees, frequent legislative changes encourage litigation and create backlog of cases
- Contract uncertainty inhibits entrepreneurship, reduces access to credit:
 - 2014 Doing Business: 109th in “Getting Credit”
 - Limited FDI
 - Negative impact on TFP, GDP



Other institutional issues create further economic lag

Legislative Issues

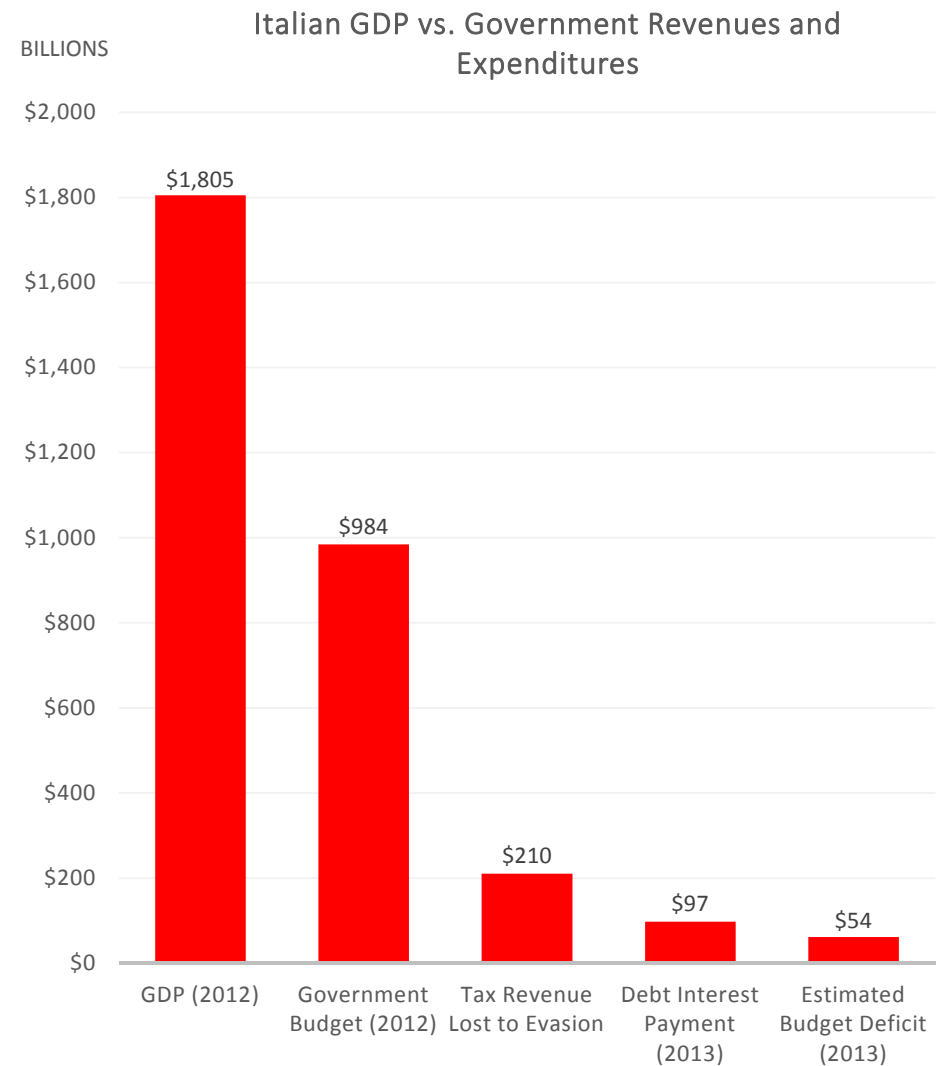
- Oversized = inefficient
- Decentralization limits broad national impact
- Legislation by government decree not subject to debate
- Lack of transparency
- Frequent changes in regulation create time consistency problem

Corruption

- “Deeply rooted” in public administration
- Bribes commonly paid:
 - To obtain licenses or permits
 - To secure public contracts
 - Even to practice medicine
- Added transaction tax that increases the cost of doing business in Italy

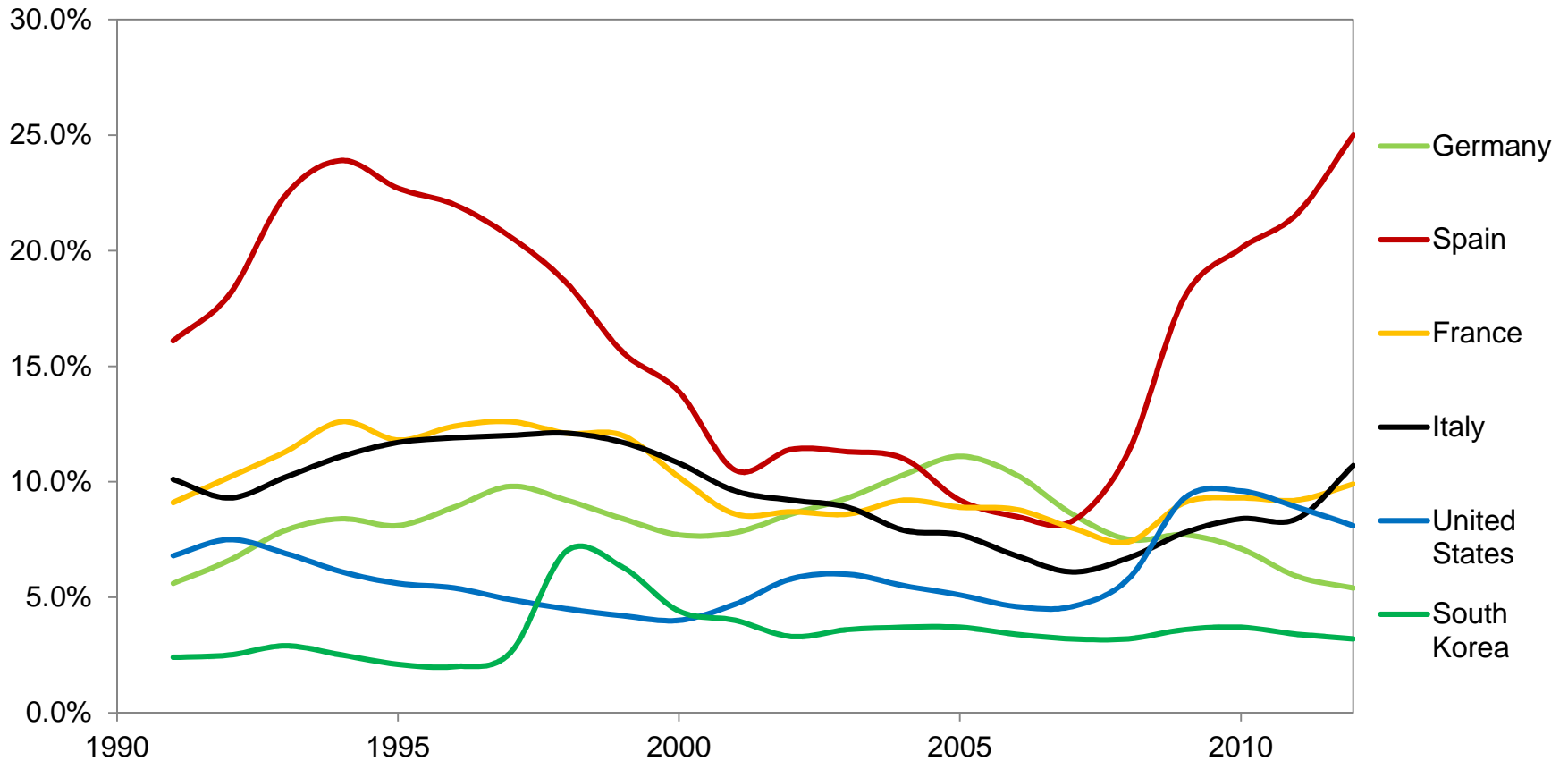
GDP, revenues, taxes and evasion: closing the deficit and freeing resources for productive spending are essential

- Debt interest payments account for nearly 10% of the budget, and more than 5% of the Italian economy
- Potential tax revenues lost to evasion and avoidance equal 21% of the budget and roughly 11.5% GDP
- Reducing evasion/avoidance rate by 25% would reduce the budget deficit from 3% of GDP to zero, balancing the budget
- A balanced budget improves credit worthiness, reduces debt interest payments & frees resources for productive spending
- Ultimately, only GDP growth will sustainably drive greater budget surpluses



Unemployment rates remain higher than most global counterparts

Total Unemployment (% of total workforce)



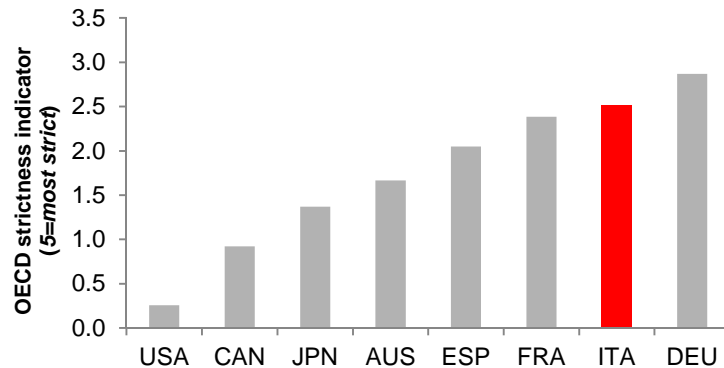
High unemployment rates are due to inadequate labor market policies and lead to lower economic growth

Rigid labor market characteristics restricting economic growth: four key improvement areas need to be addressed

1

Inflexible dismissal laws

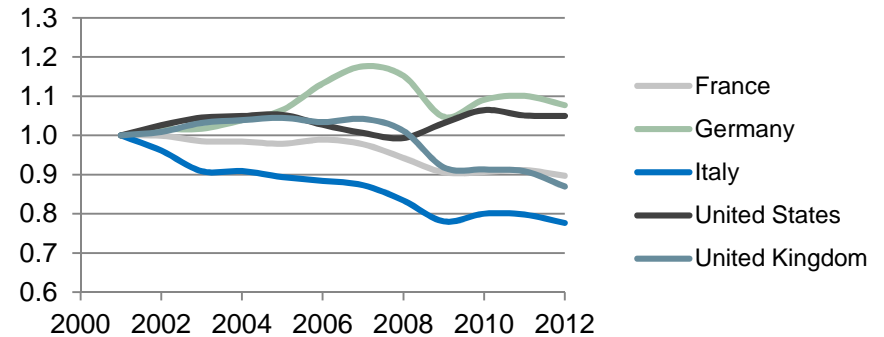
Strictness of employment protection (2013)¹



2

High wages but low productivity

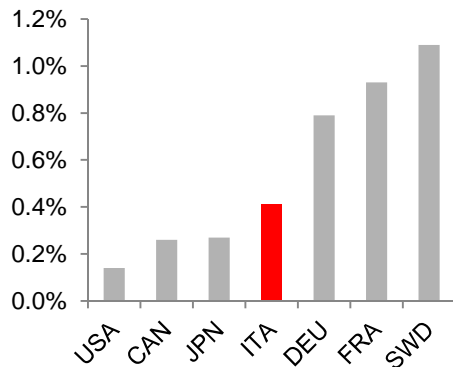
Gross Value Add per worker / Unit Labor Cost (2001=1)



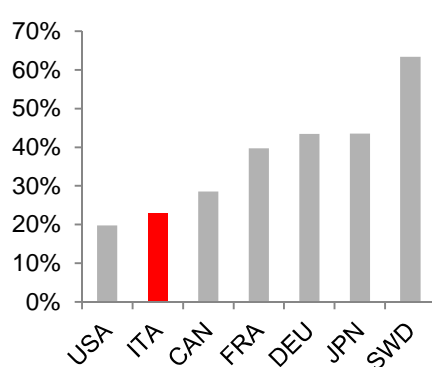
3

Weak active labor policies

Spending on active labor market measures as % of GDP (2011)



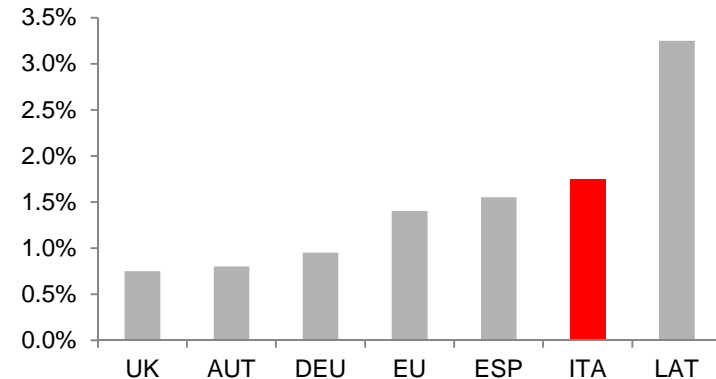
Active labor spend as % of total labor policy spend (2011)



4

Significant skill shortages

Skills Mismatch Index (2010)²



1. OECD indicator of strictness of employee protection includes 8 data items concerning regulations for individual dismissals 2. The skills mismatch index (SMI) is calculated as the gap between the average proportions of the low-, medium- and high-skilled in the working age population and the corresponding proportions in employment.

Strict changes needed for high productivity and growth

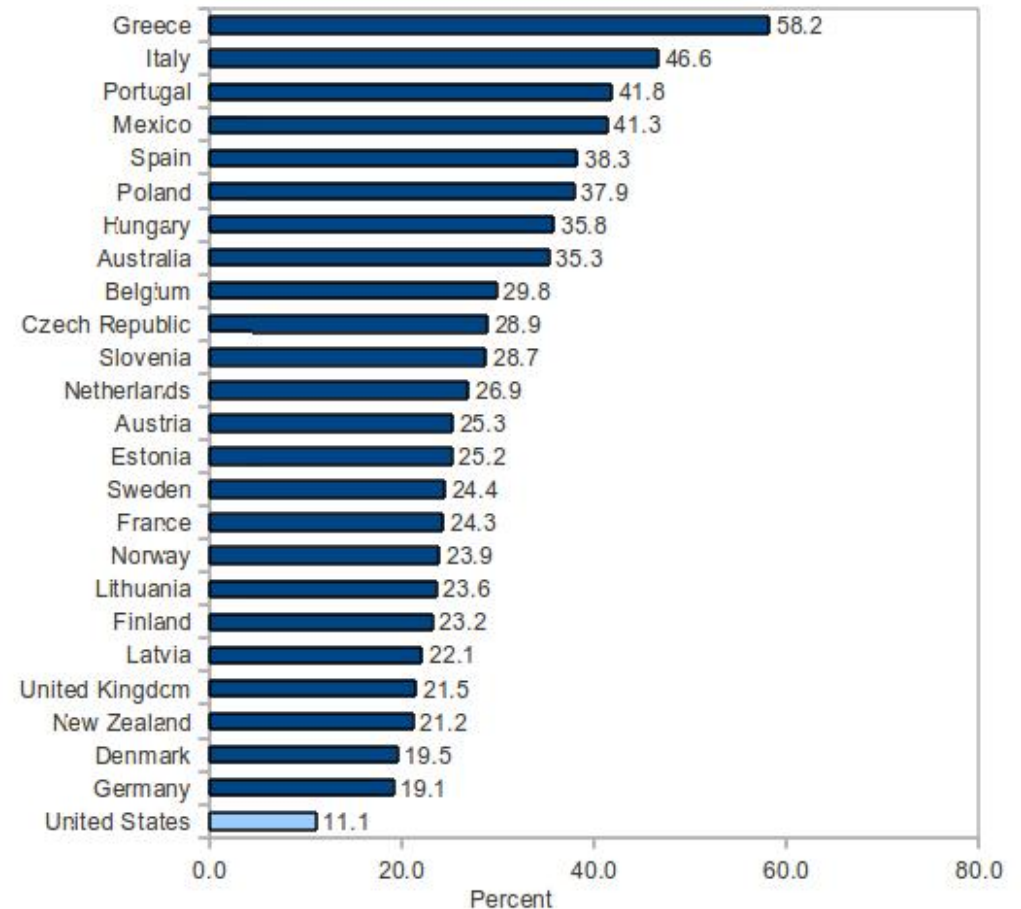
Key area for reform	Negative effect on growth	Proposed reforms
Inflexible dismissal laws	<ul style="list-style-type: none">• Firing employees very lengthy and costly• Judiciary tends to side with employees in lawsuits <ul style="list-style-type: none">• Lowers accession rates and raises unemployment• Hurts business growth, especially those facing financial difficulty• Labor allocation may be suboptimal	<ul style="list-style-type: none">• Cut legal and cost barriers to firing for underperforming staff and struggling firms
High wages but low productivity	<ul style="list-style-type: none">• Collective bargaining on a national level and additional taxes raise wages• Wages high despite low labor productivity <ul style="list-style-type: none">• Less value add to GDP per unit cost of labor• Businesses tend to migrate abroad• SME business growth hurt	<ul style="list-style-type: none">• Decentralize wage bargaining to firm level• Remove any uncompetitive wage restrictions
Significant skill shortages	<ul style="list-style-type: none">• Large gap between skills demanded in market and supply• Low test scores and technical knowledge and skills <ul style="list-style-type: none">• Labor not as productive due to missing skillset• Suboptimal allocations leads to lost economic growth potential	<ul style="list-style-type: none">• Strict educational reforms to equip labor force with skills (incl. tech) demanded by market
Weak active labor policies	<ul style="list-style-type: none">• Unemployment programs not fully developed• Unemployed not equipped and pushed into suitable jobs <ul style="list-style-type: none">• Restricts labor supply required for growth• May also result in suboptimal allocations and lost growth	<ul style="list-style-type: none">• Reform unemployment assistance programs with strong training and placement initiatives

Policy restrains new business growth and leads to unstable, unproductive supply of SMEs

- To launch a business in Italy: 90th “easiest” country behind the likes of Saudi Arabia, Rwanda and Mongolia
 - 6 steps, cost is nearly 15% of average GDP to launch, requires paid in capital of 10%

- In Italy, 46.6% of people work at firms with 10 people or less, and 69% at firms with 50 or less
- Prevalence of SMEs is due to weak contract enforcement, corruption, and bureaucratic licensing system that prohibits growth and limits potential upside
- Small firms are unable to build creditworthiness to take on debt, or allocate investments effectively

Share of employees in enterprises with 1-9 employees, 2007



Source: CEPR analysis of OECD data.

Recommendation for long-term growth focuses on institutional changes leading to business development

Driving element

Strengthen and centralize institutional oversight within judicial, and legislative systems

Focus Areas

Centralized legislative reforms that improve clarity in the language of bills

Judiciary reforms that bring weight to common law precedence and allow for predictable responses

Ultimate Goal

- Increase openness and competitiveness of Italian markets, while decreasing corruption
- Improve ability of businesses to enforce contracts
- Promote investment in scale as well as entrepreneurial activities
- Ensure productive and efficient firms have the ready access to licensing, capital, and flexible workforce