Discussion of Lorenzo Codogno
"Two Italian Puzzles: Are Productivity Growth and Competitiveness Really so Depressed?"

by Tito Boeri

Riccardo Faini's contributions to research have shed light on several economic puzzles in Italy. I still remember the first academic seminar I attended in Italy after coming back from the OECD. He presented a paper – published a year later by the European Economic Review (Faini et al., 1997) -- in which he convincingly explained how a rich Northern Italy with its shortage of workers and a poor Southern Italy with its shortage of jobs, were able to coexist for so long even though there was very little internal migration. Moreover, I am sure that, if Riccardo was still with us today, he would also be able to help us understand the two economic anomalies pointed out in this insightful paper by Lorenzo Codogno. These two new Italian puzzles are indeed also at the centre of Riccardo's research interests, in between trade theory and labour economics. The first puzzle has to do with the remarkable performance of the Italian labour market over the last decade and the dismal performance of labour productivity. The second puzzle has to do with Italy's export performance: why was it not poor even in the period which saw unit labour costs increase significantly in Italy in comparison to its major trading partners?

Lorenzo produces a large number of interesting statistics documenting these puzzles. It is difficult to argue with these facts. It is likewise difficult to argue with the measurement issues pointed out by Lorenzo. My only comment in this respect is that measurement problems typically go in both directions. We may underestimate or overestimate something and the direction of the bias is unpredictable. I also do not want to enter a sort of philosophical debate about whether we should be optimistic or pessimistic about the future of the Italian economy. It is a matter of taste. Fortunately none of us is so influential to affect the mood of Italian consumers and the business climate, hence we are not generating self-fulfilling prophecies.

I see my role here as confined to putting the evidence produced by Lorenzo in a (somewhat) broader perspective. Economic history books are overcrowded of Italian anomalies and my (secret) hope is to convince the readers that we may dealing with puzzles that do not necessarily speak Italian, let alone the fact that they are truly puzzles.

From jobless growth to growthless job creation

Let me begin then with the first puzzle, which I would call "growthless job creation" in opposition to the "jobless growth" of the early 1990s vividly documented by the OECD. As I was there at the time of the OECD Jobs Study in 1994, I am tempted to recall how Europe (not only Italy!) was perceived a bit more than 10 years ago.

"The labour market has become particularly worrying in Europe… slow employment growth has always been a feature of the Efta and EC regions…there are indications that employment has been unusually weak vis-à-vis output growth…In the EC employment growth has been generally sluggish…."

The OECD Jobs Study basically was pointing the finger to the low employment content of growth in Europe, suggesting that the employment to output elasticity should have been similar to that prevailing on the US. Since then there has been a sea change in the responsiveness of employment to output in Europe (not only in Italy!).

Figure 1, which displays average yearly growth rates in the employment rate (vertical axis) and GDP (horizontal axis) in the EU-15 in the period 1996-2005. The employment rate is taken to control for demographics, notably the large migration inflows occurred throughout the region in the last decade, which significantly affected total employment levels, notably in Spain and Italy. The red line throughout the origin is the US apparent employment to output elasticity (the ratio of employment growth rates to GDP growth rates) at the time of the 1994 OECD Jobs Study. As the above citations recall, the latter was significantly higher than in high-unemployment, sclerotic, European countries. Figure 1 documents that matters changed quite dramatically since then. The Olive Belt countries, in particular, display a responsiveness of employment to output growth which is considerably higher than that of US, we were looking with envy in the mid-1990s.

A possible explanation for this fact is in dual track reform strategies. As discussed in Boeri and Garibaldi (2007), the apparent employment-to-output elasticity increased after reforms that introduced two-tier systems of employment protection with an increasing number of flexible temporary contracts coexisting with rigid permanent contracts. The fact of the matter is that the dualism between highly flexible temporary contracts and rigid permanent contracts induces asymmetric adjustment of firms to shocks: under good times, employment increases more than in the past; under bad times downward employment adjustment is still constrained by rigid contracts. This increases average employment in firms per given output, reducing labour productivity.

Temporary contracts (including fixed term contracts, according to the definition provided by Eurostat) indeed contributed disproportionately to the growth of employment in these countries. Net variations in the stock of temporary workers were large both in absolute terms and relative to the stock of employees at the beginning of the period. In Spain, in particular, 3.3 million jobs were created in the so-called contractos temporales since the inception of this programme, contributing to a net growth of almost 30 per cent in the stock of employees. In Italy, fixed-term contracts accounted for about 850.000 new jobs and 9 hires out of ten for persons aged less than 35 are in these temporary contracts.

These reforms are creating two-tier regimes that have been successful in increasing employment rates in Europe. But this honeymoon is likely to be over soon as firms have no longer incentives to build up a "buffer stock" of flexible contracts to accommodate output fluctuations. Moreover, dual labour markets segregate many workers in jobs offering little incentives for human capital investment and highly exposed to labour market risk.

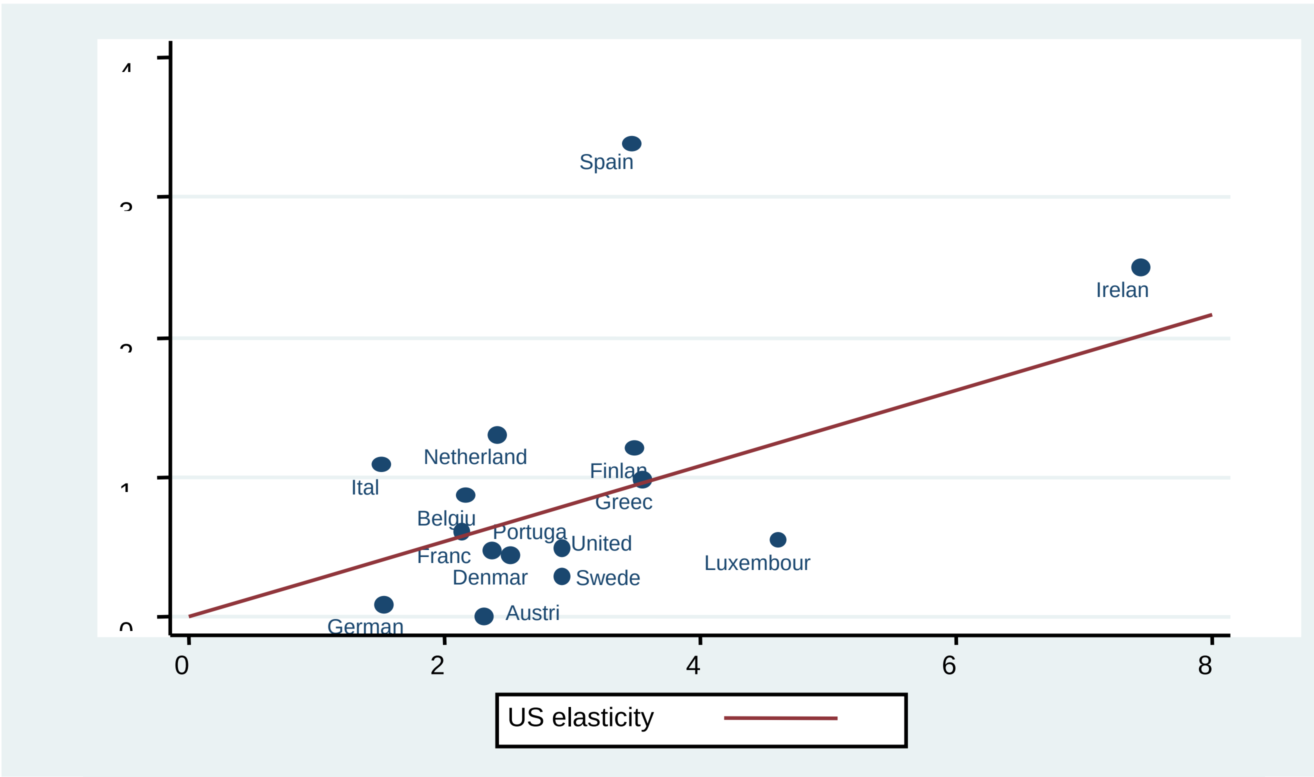

Figure 1. Employment (vertical axis) and output (horizontal axis) average yearly growth rates in the EU-15

Another factor which could have explained the diverging dynamics of employment and labour productivity is immigration. Migrant workers do not carry with them capital stock, which means that the influx of immigrants into jobs entails a decline in capital use per worker. Moreover, first generation migrants are typically employed in low-skill, gap filling, activities, and have little opportunities for training and upgrading. The dualism between temps and perms tend to segregate them in low productivity jobs.

Thus, my reading of the first puzzle is that European job creation in the last decade occurred at the costs of low productivity growth. Jobs were created for persons with little or no work experience, segregated in secondary labour markets with little training on-the-job. This trade-off between employment and productivity growth is ultimately due to the fact that we are still in the middle of the river in reforming labour markets and largely unprepared in managing migration. We as Europeans. The problem does not concern only Italy. Some solutions, notably those concerning migration, should be found at the European level.

Declining competitiveness, but not exports

I have less to say on the second puzzle, perhaps because I m much less poliedric than Riccardo. In order to understand the paradox of rapidly declining competitiveness without a collase of Italian exports, we should perhaps go more micro. It is a matter of increasing heterogeneity of Italian firms somewhat concealed by aggregate statistics capturing unit labour costs in an aggregate of firms including many non exporters. As noted recently by Baldwin et al. (2007), there is evidence of successful firms also in industries facing tough competition from cheap labour countries, as far as in high tech sectors. These successful exporters are relatively large, endowed with a high share of human capital, using more advanced technologies and investing heavily in ITC. Moreover, they export a large share of their output in several and far away markets and are involved in other international activities like FDI or foreign production agreements. Such strategies involve bearing high fixed costs and undertaking large risks.

These firms can benefit from the geographical unbundling of economic activities (Grossman and Rossi-Hansberg, 2006) made possible by the gradual reduction of the cost of trading goods, moving people and sharing ideas. This new dimension of globalization has, on the one hand, exaggerated the underlying weaknesses of Italy, but, on the other hand, has made it possible to some successful firms to penetrate very large and rapidly expanding markets.

We are bound to experience more and more of this heterogeneity in Italy. If policymakers want to avoid a trade-off between employment and productivity growth, they must favour more reallocation of capital and workers across firms. Bargaining structures artificially compressing wage structures, subsidies to ailing industries and obstacles to labour mobility will just make it more difficult to increase employment and productivity at the same time, that is, promote total factor productivity growth. Promoting reallocation does not mean deciding which type of reallocation should take lace. Governments should also abstain from deciding on which are the strategic advantages of Italy. Nobody knows them. They are increasingly unpredictable. The borders between advantages and disadvantages are within sectors more than across sectors.

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