



ISTITUTO DI STUDI E ANALISI ECONOMICA

ISAE Report

Forecast on the Italian Economy

Economic cycle, businesses, employment

Introduction and Synthesis

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CREDITS

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Introduction and synthesis

The recession the global economy is currently facing seems the worst of the post-war period. This feature derives not so much and not only from the depth and the duration of the slump as from the complexity of the phenomena which policy makers have to confront themselves with in the various areas of the world.

A singular crisis

The crisis primarily stemmed from the marked macroeconomic imbalances accumulated over the past decade. Excess savings built up in countries with a current account surplus (mostly Asian emerging countries) were channelled, with the blessing of expansionary monetary policies, to the financing of the United States, thus fuelling consumption and real estate booms in this country; moreover, in a vacuum of rules, all this came along with the rapid development of structured financial instruments, which partially turned toxic. The correction of such a “hazardous” situation should have implied a reversal of underlying trends, with the downsizing of the export-led model in emerging countries to the advantage of a greater reliance on domestic demand, the gradual increase in the rate of private savings in the United States, and the shrinkage of global excess liquidity injected by central banks, which was at the base of the undue swelling of several markets. Such requirements continue to mark the new point of arrival towards which the global system should converge, but the prospect of their attainment increasingly moved away. Actually, due to the rushing of events, economic policies took paths which temporarily diverge from those which should have led to this new equilibrium: more, not less, liquidity was injected into the global economy; in the United States, consumers were helped to counter the sharp curtailing of spending decisions; in emerging markets, since weakening foreign demand was not compensated for by a rise in the domestic component, a slowdown in economic growth was feared, thus taking away what was a residual support to the international cycle. Under these conditions, the exit from the recession tunnel cannot coincide with an

automatic return to a period of stability. The path will still be bumpy and arduous for policy makers, who will again have to face the problem of managing the orderly absorption of potentially inflationary excess liquidity, the cutback of large public deficits, and the search for a more balanced global order.

***Interaction
between real
and financial
crises***

The bursting of the real estate bubble and the melting down of the US financial sector were reflected, after the summer (with the bankruptcy of Lehman Brothers), in a major global credit crisis, an upsurge in uncertainty among all operators, and a sharp fall in aggregate demand in most economies. Economic policy priorities thus dramatically changed, addressing two closely interconnected objectives. Policy makers attempted, on the one hand, to bring the financial system back to more normal operating conditions and, on the other hand, to support aggregate demand with massive doses of monetary and fiscal stimulus. The interdependence derives from the fact that several measures are common to the pursuing of these two different kinds of objectives: for instance, measures for the recapitalization and the cleaning up of toxic assets in the banking system also help the real economy in so far as they remove the credit squeeze, while the lowering of interest rates aimed at reviving expenditure and direct aid to families burdened by real estate mortgages are functional to alleviate the credit tensions. However, the interaction assumes a considerable importance also with regard to the chances of success of the efforts for coming out of the difficult situation: as some “local” crises in the last years have shown (see the opposite outcomes of the Japanese and Swedish cases in the nineties), the normalization of credit and financial conditions (and, in general, the adjustment of the balance sheets of banks, consumers and businesses) is an essential prerequisite for the success of the support to aggregate demand. Without the removal of impaired financial assets, measures of monetary stimulus are likely to become ineffective because of the emergence, under various forms, of liquidity traps, while fiscal measures to support demand may be neutralized by the need to reduce private sector debt and by operators’ precautionary behaviour due to uncertainty.

***Grandfather’s
recession?***

As noted by some analysts, the significant interconnection between the financial and the real crises renders the ongoing recession different from those which occurred after World War II and more

similar to the (disastrous) production setbacks of the end of the nineteenth and the beginning of the last century (according to Paul Krugman, “this is not your father’s recession; it’s your grandfather’s recession”). There are, however, two fundamental differences with respect to those distant crises. Firstly, trade and financial channels of transmission of impulses between countries are greater and deeper than those that distinguished those periods of equally intense globalization. This factor works towards increasing the risk of real and financial contagion during the negative phase, but also favours a more rapid spread of positive impulses when the cyclical upturn resumes. The second important difference is that today policy makers are aware of the need to counteract the negative economic cycle through a vast array of instruments, even though such actions are not always taken in a systematic way and are not applied with the required intensity in the various areas of the world.

The international dimension of the present crisis entails that the global economy’s main actors take as most general and concerted actions as possible. All areas, both industrial and emerging, have actually implemented fiscal stimulus packages and may still adopt further measures if needed by cyclical conditions. Nevertheless, the extent of the interventions launched up to now have varied noticeably across the economies. Actions were considerable (though not enough, according to some observers) in the United States and China, but more limited in Europe. In the Old Continent, one is more impressed by the disorganized way in which these measures were adopted than by their size. At a time when, due to the US difficulties, the European Union could have aimed at holding a larger leadership role in dealing with the international crisis, it failed to act as a sole entity, not being able to take actions in the homogenous and univocal way the economic situation and such aims should have required. The Report analyzes the reasons for this inability and concludes that it is attributable to the European institutional structure: in the absence of forms of centralized fiscal coordination, similar to the ones that distinguish monetary policy, nations are left operating individually in a short-sighted way, which is potentially damaging for all. The European countries are “small” open systems highly integrated with each other, which pay considerable attention to obtaining/maintaining fiscal balance. All this favours moving away from cooperation and pushes towards a free-riding

***Need for
coordination
and European
inadequacies***

behaviour. The ideal choice for each European country, aiming at stimulating economic development and safeguarding its fiscal balance, is to wait for other partners to act in its place in the implementation of expansionary policies. Since however this propensity tends to characterize all EU members (especially those with strong commercial ties), the overall result is a tendency towards inaction, with consequent, generalized drawbacks. Obviously the final outcome is not a lack of action, because under the impact of a domestic recession governments are indeed forced to act individually, but the effectiveness of such interventions seems limited, because they are late, non-homogeneous and cumbersome. Moreover, the absence of coordination in a situation of economic emergency such as the current one inevitably leads to the growth of nationalistic impulses: in a non-cooperative scheme, it may be a short step towards a view in which “my” fiscal effort, in terms of increased budget deficit, must primarily benefit businesses in “my” country, an approach which is in open contrast with the very foundation of European integration and which may also entail the risk of retaliation and reciprocal closing.

***The
international
outlook***

The novel characteristics of the ongoing recession, the doubts about the impact of measures aimed at normalizing financial markets, and uncertainty regarding the adequacy of fiscal measures for the support of aggregate demand make it very difficult to forecast a scenario. The assumptions adopted for defining the international reference framework give due consideration to the effects that policy interventions may have on the countries’ economic cycle, presuming comparatively greater efficacy in the United States than in Europe. For the US economy, which slumped between the end of 2008 and the early months of this year, monetary and fiscal stimulus measures may produce an impact in the second half of 2009, favouring a substantial reversal of the production trend. The US GDP is estimated to fall by 2% on average this year (+1.3% in 2008), but is expected to rise by 2.2% in 2010. In Europe, instead, the recession should come in milder than overseas at the beginning of this year, whereas the subsequent recovery could be much slower, due to the lower size and effectiveness of the fiscal stimulus. In accordance with this outline, the Euro Area GDP should drop by 2.5% on average in the current year (+0.7% in 2008) and resume a 0.7% growth rate in 2010.

In this scenario, world gross domestic product is projected to decline slightly in 2009. The decrease would mainly result from the fall in production of industrial countries. Growth in Asian emerging countries should slowdown markedly, though remaining in positive territory. A decline in productive activity is expected to occur in Latin America and, even more so, in Eastern Europe. Towards the end of the year, the main economies should gradually overcome this difficult period, entering 2010 with a more positive trend. The more favourable starting point and further cyclical improvement should bring the global economy back to growth in 2010 (+3.2%).

World trade ended up severely hurt by the economic downturn. Already at the end of 2008, global trade was markedly decelerating, because of the recession in advanced economies and the sharp economic slowdown in emerging ones. This year international trade is expected to decrease further, falling even more than overall economic activity. Global trade could shrink by almost 5% on average in 2009, thus posting its first contraction since the early eighties. With a gradual improvement in the economic trend towards the end of 2009, also global demand should partly resume strength and then continue to expand in 2010 (around +4% on average).

The intensification of the financial turmoil and the spreading of the crisis to the real economy were accompanied by the continuation of the decline, which started last summer, in the price of oil and other raw materials. The fall in raw materials' demand was connected to the deepening of the recession in industrial countries and to the spreading of the crisis to emerging economies, but also to the disappearance of the speculative component which contributed to the pre-summer peaks. The persistence of recessive or stagnating conditions during most of this year could contribute to depress prices. For 2010, instead, a gradual rise is assumed, in conjunction with a more sustained development of the international cycle. On average, the price of oil should come in at around 43 dollars in 2009, thus nearing 60 dollars in the following year.

The conditions of marked uncertainty and the simultaneous flight from risk, which dominated global financial markets, led to a reshuffling of operators' portfolios, which ended up favouring government securities, whose yields decreased significantly almost everywhere. This process does not seem to have affected the dollar.

Indeed, although the United States are at the origin of the financial crisis and despite the rapid deterioration of their public finances, US Treasury securities were still perceived as main safe haven assets. Probably the speed and intensity of the Fed's interest rate cuts and the adoption of large scale fiscal stimulus measures, with the advent of the new Administration, have generated more favourable expectations on the timing of exit from the economic crisis in the United States compared to the European Union, where monetary and fiscal actions were not perceived as equally prompt. Over the forecast period, with the conclusion of the expansionary action of the ECB, which should push reference interest rates down to 1% during 2009, the change in short-term interest rate differentials should favour a slight appreciation of the US currency against the European one. In annual average terms, the dollar-euro exchange rate should reach 1.32 in 2009 (1.42 in 2008) and stabilize around that value in 2010.

**Italy in
recession**

Similarly to what occurred in the Euro Area, in Italy the recession deepened in the last quarter of 2008, reflecting the marked weakening of all the underlying components of aggregate demand. The trend in production was driven down by exports, hit by the recession in Germany and the economic slowdown in emerging countries. In the wake of lower exports, also investment weakened further, while uncertain prospects for demand may have continued to reduce firms' desired level of inventories, pushing them to cut production. Household consumption, that in the last phase showed greater resilience, diminished especially with regard to the purchase of durable goods, for which the fall is estimated to have more than offset the apparently better trend in other expenses.

**Negative
signals, though
not uniform, at
the start of 2009**

For the first part of 2009, with few exceptions available cyclical indicators depict a gloomy picture. Some signs of improvement though emerged mainly with regard to consumer confidence, which increased in the first two months of the year probably because of the sharp slowdown of inflation. However, overall available information does not allow outlining the nearing of turning points.

News continues to be negative, particularly for industrial activity. At the beginning of 2009, firms' confidence climate decreased to a historical low, negatively influenced by the new deterioration in orders, both domestic and foreign. Operators' opinions on the level of inventories and short-term prospects for demand and production

remain unfavourable. After a pause in early 2009, firms' credit access conditions tended to worsen once more. ISAE estimates a further fall (-3.8%) in industrial production for the first quarter of 2009, which should be negatively influenced also by the plunge recorded at the end of 2008. Because of the negative trends emerging from cyclical surveys, manufacturing activity will probably extend its downward path into the second quarter of 2009. As for the other sectors, ISAE surveys show a slowdown for construction and still unfavourable developments for market services. The sharp drop recorded at the end of 2008 by the synthetic overall ISAE index, which tends to anticipate future economic developments four-five months in advance, confirms the persistence of a recessionary climate.

Overall, available indications point to a recession in Italy also for 2009, which, on average, will be deeper than in the year 2008. GDP is expected to fall by 2.6% (-0.9% in 2008), approximately the same amount estimated for the Euro Area. In the current year, the new fall in economic activity should be affected by marked, unfavourable carry-over effects (-1.8%) from the recession experienced at the end of 2008 and by the still negative trend in the first part of 2009. The Italian economy should start to stabilize in the second half of this year, thanks to the halt in the fall of world demand and the favourable impact of lower inflation on households' real income.

The trend in economic activity in the current year should provide a practically inexistent favourable base effect for 2010. The gradual overcoming of the factors of uncertainty reining in domestic spending and the expected acceleration of world trade should lead next year to a slow recovery also in Italy. In 2010, GDP is projected to increase by 0.4%, 0.3 points less than in the Euro Area.

In this perspective, Italy's growth gap with the rest of the Euro Area, which persistently characterized the last years, will tend to close. This realignment should however take place at a lower level of growth, in a generally depressed environment. Therefore it will not reflect the acquisition of a greater capacity of structural growth by the Italian economy, but will rather derive from overall European sluggishness. The reduction in the gap will also benefit from Italy's lesser degree of exposure to certain trouble spots, due to the absence of a true real estate bubble to get out from, to a condition of better solidity of banks' balance sheets, which are less burdened by troubled securities, as well

**Forecasts for
2009-2010**

**Realignment of
the European
economic
trends**

FORECASTS FOR THE ITALIAN ECONOMY: SUMMARY
(Percentage changes, unless otherwise indicated)

	2008*	2009*	2010*
National framework			
Gross domestic product	-0.9	-2.6	0.4
GDP (not adjusted for seasonality and working days)	-0.9	-2.5	0.4
Imports of goods and services	-2.9	-4.0	2.4
Exports of goods and services	-1.8	-6.7	1.9
Residential households' consumption expenditure	-0.5	-0.8	0.4
Public administration and ISP consumption expenditure	1.1	0.5	0.5
Gross fixed investment	-1.7	-5.7	0.4
Contributions to GDP growth (1)			
- Domestic consumption	-0.1	-0.4	0.3
- Total investment	-0.4	-1.2	0.1
- Net exports	0.3	-0.8	-0.2
- Change in inventories and valuables	-0.8	-0.1	0.1
Consumer prices	3.3	0.9	2.0
Producer prices	6.0	-3.0	4.0
Per-capita earnings in the economy	4.3	1.7	2.0
Total employment (2)	0.9	-1.0	0.2
Unemployment rate	6.8	8.1	8.5
Propensity to consume (percentage value)	87.0	86.5	86.5
Net borrowing of public administration (% of GDP)	-2.7	-4.0	-3.9
Primary surplus (% of GDP)	2.4	0.8	1.1
Tax burden (% of GDP)	43.0	42.8	42.7
Debt of public administration (% of GDP)	106.0	110.3	111.8
Twelve-month Ordinary Treasury Bill (BOT) interest rate (3)	2.5	1.3	2.1
<i>For reference:</i> nominal GDP (millions of euro) (4)	1,571,434	1,570,129	1,607,199
International references			
Gross domestic product			
- World	3.0	-0.4	3.1
- United States	1.3	-2.0	2.2
- Euro Area	0.7	-2.5	0.7
Dollar-euro exchange rate (level)	1.47	1.32	1.32
World demand	2.8	-4.9	3.9
Official interest rates (3)			
- ECB	2.5	1.00	1.25
- Federal Reserve (5)	0 - 0.25	0.25	1.00
Raw materials' prices (in dollars)			
- Non-energy	13.7	-28.4	4.1
- Energy	27.6	-44.7	29.4
of which: Brent (\$/barrel)	97.3	43.3	59.5

Source: ISTAT, Bank of Italy, US Federal Reserve, IMF, HWWA.

(*) – ISAE forecasts.

(1) – Percentage points.

(2) – Number of people.

(3) – End of year annual rates. Gross interest rate for Treasury Bills.

(4) – Annual GDP not adjusted for working days.

(5) – In December 2008 the Federal Reserve set a range of 0 to 0.25 percent for its target rate.

as to the lower level of households' indebtedness with respect to the European partners. However, the important role which the manufacturing sector plays in our country may, as in Germany, amplify the effects of the recession, since most of the fall in aggregate demand affects, through the channel of exports, industrial activity. On the other hand, in the phase of recovery this factor may represent a relative advantage, compared to countries with a lower manufacturing inclination, since the upturn is indeed expected to begin from the industrial sector, through the strengthening of international trade.

How will the Italian industry come out of recession? The question is appropriate because there are widespread fears that the dramatic fall in aggregate demand and the growth in uncertainty may cause a pause, if not the choking, of the processes of reorganization and restructuring, which started in recent years compelled by higher competitive pressures. However, even when hit by a deep recession the industrial base never remains completely paralyzed. This is because companies are not all equal and because they respond differently to the effects of the negative cycle, depending on higher or lower efficiency, level of bank indebtedness, degree of financial strength, management skills, and so forth. These differences mean that the recession may constitute a factor of change and selection (and thus an opportunity to increase overall productivity), in a similar way to when increased competition contributes to trim the number of producers and, mostly, of products. The Report shows that in the early two-thousands the Italian economy in fact went through intense upheavals, especially within companies. Between 2000 and 2005, the movement in industrial output was determined only for 60% by net change (increases less decreases) of produced quantities of pre-existing goods. The remaining 40% of the change in manufacturing production was attributable to selection among firms and products. Most of these changes consisted of product switching occurred within the companies themselves, which may explain (considering additions and cancellations of production lines) 30% of the change in total output over the five years. The replacement of firms, although appreciable in gross terms, contributed in net terms (entries minus exits of firms) to only 3% of the overall production trend. Clearly, though company reorganization in the early two-thousands was based on grounds different from those which prevail at this stage (a competitive crisis in the past and a crisis caused

***Businesses in
recession***

by the fall in demand currently), the mechanisms underlying the selective processes may be mostly the same, even in such diverse cyclical conditions.

Chronology of the cycle

Given the deepness of the current recession, the best comparison is not so much with the recession of 1992-93, but with the one which took place in 1974-75, caused by the first oil shock. In that case, the fall in GDP lasted four quarters, two of which (around late '74 and early '75) posted an even larger decrease than what is estimated to have occurred in the most acute phase of the current recession (between the end of 2008 and the beginning of 2009). However, in the economic cycle of the early seventies, the exit from the recession was more rapid and took place (starting from mid '75) with a strong rebound - higher than the one expected for this recession - which allowed to contain the "damage" for the annual average (in 1975 economic activity dropped about 2%, after a positive trend in 1974). These observations based on the sole change in GDP are in essence confirmed by the more rigorous ISAE dating of the business cycle, which takes into account, in addition to gross domestic product, a variety of indicators related to economic fluctuations. According to the new cyclical chronology proposed by the Report, the expansionary phase of the Italian economy should have ended in August 2007, after 51 months of "positive" growth (the initial trough stood, according to the new available information, in May 2003). Therefore, up to now, the current contraction has been lasting in Italy about 18 months, thus already exceeding the one posted in the mid-seventies (which lasted 14 months) and the average length of Italian recessions in the post-war period (about 16 months, according to the ISCO/ISAE dating).

Trends in the components of demand

Returning to forecasts, in 2009 the trend in Italian economic activity is negatively influenced by the sharply unfavourable contribution of both domestic and net foreign demand. In 2010, the projected slow economic recovery could be driven mainly by final domestic demand. The acceleration in exports could be partly offset by a pro-cyclical rise in imports, resulting in a still marginally negative contribution of net foreign demand to GDP growth.

Private consumption expenditure is expected to shrink in 2009 for the second straight year (-0.8%). Households' gross disposable income should be, on the one hand, penalized by the worsening of employment conditions and, on the other hand, sustained by the

improvement in purchasing power due to lower inflation. A precautionary attitude may however persist among consumers, influenced by uncertain economic prospects and the need to rebuild wealth, eroded by falling share prices. The dynamics in household spending should remain, as estimated for 2008, lower than the one in disposable income, resulting in a new lowering of the average propensity to consume. In 2010, consumers' spending capacity could step up again (with an increase in consumption of 0.4%), mirroring the improvement in cyclical conditions. The gradual overcoming of the factors of uncertainty should stop the decrease in the propensity to consume, which should then stabilize.

Investment spending suffered in full from the economic crisis (-5.7%). Lower profitability, more onerous financing conditions, and unfavourable expectations contributed, above all, to the fall in productive investment (-9.3%). Also construction investment diminished (-2.5%), mainly reflecting a period of withdrawal following the long expansionary phase of the recent years. In 2010, investment growth should recover slightly (+0.4% overall), in line with the gradual improvement of domestic and foreign demand.

With regard to foreign demand, exports should continue to fall significantly during 2009 (-6.7%), mirroring lower world demand and, particularly, the narrowing of the European export market. In 2010, the gradual strengthening of international trade should drive the resumption of Italian exports (+1.9%). The sliding in our share of the volume of world exports, which is expected to accentuate in 2009, could ease in the coming year, reflecting the possibility of resumption to the path of competitive recovery, which had started to emerge before the outbreak of the global crisis.

As for imports, the purchase of foreign goods and services should follow the development of domestic demand and of exports themselves, which are highly import intensive, thus falling in 2009 (-4%) and reverting to growth in the following year (+2.4%).

With regard to employment, after the sudden increase in the recourse to the Redundancy Fund (*Cassa Integrazione Guadagni*) at the end of 2008, the effects of the crisis became more apparent starting from the early months of 2009. The level of employment in the industrial sector is estimated to be mostly hit. In terms of equivalent work units, on average in 2009 work input should fall by 6.4% in the

Labour market

overall industrial sector. With regard to employees, due to the possibility of using the Redundancy Fund, most of the forecast cut in employment will probably not be reflected in a corresponding decline in total jobs, but rather in a substantial reduction in the total amount of work hours. In forecasts for 2009, in fact, a decline in equivalent full time work units of 2.2% for the overall economy compares to an overall fall in the total number of employed people of about 1%. The gradual strengthening of economic activity between the end of 2009 and the beginning of the following year could positively influence employment as of mid-2010. On average in 2010, the number of jobs should start to rise again, albeit modestly (+0.2%). In parallel, the unemployment rate, which already showed signs of upturn in 2008, is projected to increase on average to 8.1% in 2009 and 8.5% in 2010.

The surge in wages recorded last year, which resulted from the particularly intense season of contractual bargaining of 2007 and 2008, should gradually dwindle. In 2009 pending collective contracts, waiting for renewal, are less numerous and cover a relatively lower share of total contractual wages. This factor, along with the adverse effects on the growth of the total wage bill deriving from the resort to the Redundancy Fund, points to an estimated increase in gross earnings per employee of 1.7% on average in 2009 for the whole economy, slightly accelerating to 2% in the following year.

Inflation

The slowdown in inflation, which intensified in early 2009 due to the direct and indirect effects of falling oil prices, should continue in the next months; the growth in consumer prices should lower to less than 1% before the summer. Thereafter, year-on-year inflation could start to accelerate once more, remaining however at the end of 2009 at a lower level than at the start of the year. On average in 2009, the inflation rate (according to the national index) should amount to 0.9%, clearly down with respect to the 3.3% rate recorded in 2008. Next year, along with an increase in the foreign components of costs, the expected outturn for the domestic determinants of prices should lead to a resumption of inflation. However, following the sharp swings which distinguished 2008 and 2009, inflation should show a less volatile pattern, reaching 2% on average in 2010. In both forecast years, according to the harmonized consumer price index, Italian inflation should be higher than in the Euro Area, posting an unfavourable differential of 0.3 percentage points.

Public finance forecasts are considerably influenced by the decline in economic activity recorded in 2008 and by the sharper fall estimated for 2009. Since Italian public accounts are highly sensitive to the business cycle, the budget deficit is expected to considerably worsen this year, reaching 4% of GDP, and to only marginally diminish in 2010 (to 3.9%). The cyclically adjusted deficit should however post a significant decline. The 2009 peak, which compares to an estimated deficit of 2.7% in 2008, should reflect a decrease in total revenue, which is also caused by the measures cutting corporate taxation, the increase in expenditures related to actions aimed at reducing the impact of the crisis on the most disadvantaged families, and the rise in investment spending. In 2010, a moderate economic recovery and the effects (although not complete) of the corrective measures provided for by the three-year manoeuvre for stabilizing public finances should make it possible to curb the deterioration of the deficit. In the two-year forecast period, the government debt to GDP ratio should rise by about six percentage points, moving from 106% estimated for 2008, to 110.3% this year, and to 111.8% in 2010.

Public Finances

During a crisis such as the current one, labour policies tend to focus mainly on tackling unemployment risks, on improving the unbalanced mechanisms of social protection which characterize the Italian system, and on supporting the income of workers mostly vulnerable to the impact of the recession. It is rightly so, because, as also shown by the forecasts of this Report, after nearly a decade of positive developments, the labour market is now going towards a period of deterioration, with a significant reduction in labour demand by businesses and an increase in the number of people seeking employment. However, these priority issues do not cover all labour matters. The reason is that even the deepest recession is a complex phenomenon that entails, as discussed above, considerable redeployment of productive resources between different uses and destinations. These changes help prepare the ground for the next recovery, whose speed and intensity will also depend on the operating characteristics of the labour market. For this reason, looking ahead, ISAE decided to devote part of the Report's in-depth studies to three interconnected features which characterize some operating aspects of the job market: job reallocation between and within firms, territorial developments, and negotiating positions which determine wages.

**Work, mobility,
contractual
arrangements**

**Restructuring,
labour
reallocation and
productivity**

The first of these studies examines the consequences of the displacement of labour resulting from the reorganization which distinguished Italian industrial enterprises during the early two-thousands. The analysis of the data shows, in effect, a striking contrast between, on the one hand, the rise in the dispersion of firms' productivity performance (reflecting the heterogeneous way in which producers adapt to competitive pressures) and, on the other hand, the decrease in job reallocation between firms (as measured by various indicators of employment net flows). This discrepancy has led to investigate whether the decline in job reallocation between firms is in fact accompanied by changes in the composition of the workforce within the production units, which may come along with a wider range of productivity. This line of research is suggested by the evidence, already considered previously, of the existence of a "margin" of adjustment "within" firms (reshuffling production lines and raising tertiary activity upstream and downstream of downright manufacturing activity) which is larger than the one which distinguishes movements "between" firms. The empirical verification actually shows that during the considered period a significant reorganization of the labour force actually took place in the analyzed firms, with a reduction in the share of workers directly involved in the production process, the so-called "blue collar" workers (as well as a decline in full-time employees and permanent ones). In this context, a specific behaviour has distinguished exporting firms. This kind of firms, already structurally characterized by a lower proportion of workers devoted to production, also recorded in the early two-thousands a larger contraction of the share than for companies selling in the domestic market.

The reallocation of employment within the production unit towards non-strictly manufacturing activities favours over time the growth of corporate productivity. Even in this case, differences between exporting and non-exporting firms emerge: the higher labour productivity of exporting firms, with respect to firms oriented towards the domestic market, characterizes both white and blue collar workers. There remains a basic question in this type of analysis, that is whether the strong role played by mobility within the firm, compared to the one between firms, reflects, not only objective characteristics of the restructuring processes, existing also in other very flexible systems (as the US one), but also a specific weakness of incentives tied to wage

differences and labour mobility between firms in our country.

Labour market reforms, launched in Italy in the early nineties, have contributed to reduce the national average unemployment rate. However, the overall result tends to mask important geographical discrepancies. The ratio between unemployment in the *Mezzogiorno* and in the North worsened until the early two-thousands, slightly improving only in the most recent period. However, also the traditional dichotomy between North and South conceals very different situations. The second ISAE in-depth study focuses on this particular issue. Using data on 103 Italian provinces for the years 1995 to 2007, the ergodic distribution reveals the existence of a group of southern provinces trapped in a situation of high unemployment. The results of some simulations indicate that multiple factors determine this phenomenon of polarization. Above all, a key role was played by the deviation of these provinces from the dynamics of demand and supply of labour, as well as of migration movements taking place in other provinces, not only in the North and the Centre, but also in the *Mezzogiorno*. The impact of the imbalance in labour demand and supply may be attributed to the discrepancy between the mechanism of wage determination and the actual (heterogeneous) conditions of the local labour markets. Regarding the role of migration, one can assume that the rebalancing mechanism, through the movement of labour to areas with larger demand, is dominated by a selective process, according to which workers who emigrate are generally the more highly skilled, thus having a greater chance of finding a job than less skilled ones. In addition to these “structural” factors, an important role is also played by the externalities created by the geographical contiguity of areas: being close to areas with high unemployment increases the probability of being affected by a problem of unemployment.

Unemployment trends by area

Evidence from the above two in-depth studies sends back to the problems of mobility for the Italian labour market. The latter are inevitably intertwined with the system of contractual arrangements, which was only partly amended by the still deep reforms of the nineties. The July 1993 Protocol on incomes policy provided, in addition to the first tier sectoral bargaining at national level, the deployment of complementary local bargaining (company or territorial) to distribute the gains obtained through improvements in “productivity, quality and other elements of competitiveness” at

Second level collective bargaining

company and territorial level. More than fifteen years after the signature of the Protocol, this segment of collective bargaining is still largely underdeveloped, thus contributing to the weak link observed between growth in actual real wages and the trend in labour productivity. Starting from this observation, the new framework agreement for the reform of contractual arrangements, signed last January by the social parties, to the exclusion of Cgil (*Confederazione Generale Italiana del Lavoro*), aims, among its priorities, at the effective, greater development of decentralized bargaining as a means for ensuring a virtuous cycle of economic growth based on the rise in labour productivity and on an “efficient wage dynamics”.

In this context, given the lack of sufficiently detailed and updated information on the subject, ISAE considered useful to carry out an *ad hoc* survey on the diffusion and the key characteristics of second level collective bargaining in Italy, involving the same firms of the ISAE monthly surveys on manufacturing and market services. The collected data show a limited diffusion of second level collective contractual agreements: at the end of 2008, firms with complementary agreements amounted to just over one quarter of the surveyed sample (26.6%), with a marked difference between the industrial and the services sectors (28.8% and 19.2%, respectively). The results also confirm that the low average size of Italian firms is one of the main obstacles to the development of decentralized bargaining. The size of firms has actually a crucial influence on the possibility of having an internal second level collective agreement within both industrial and services sectors. The different geographical location, by contrast, seems to play an important role only for industrial firms: for firms located in the Centre and the South, the likelihood of having an agreement at firm or local level is markedly lower than for firms operating in the North of the country.

The observed differences between industrial and market services firms are not limited to the different degree of diffusion of second level collective agreements, but also concern some specific features of the agreements, such as the subjects of negotiation. Data show that, for example, in addition to problems merely regarding wages, a relatively high percentage of services firms declare addressing, within complementary agreements, issues such as work hour flexibility (49.7%) and vocational training (53.9%). In manufacturing and mining

firms, this percentage is markedly lower (29.2% and 32.1%, respectively), although the data show a high degree of heterogeneity among individual sectors of economic activity.

Finally, with regard to wages, the percentage of firms that introduced in their complementary agreements pay items related to company criteria exceeds 70% in both industry and services. In particular, about 62% of the companies with complementary contracts stated they provided in their agreement pay amounts that change with the company's performance. In most cases, however, such variable amounts are still only a rather marginal share of workers' overall earnings: in 53.3% of firms with a complementary agreement, the share of wages determined at decentralized level does not exceed an average of 5% of total earnings.