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Continuity and Change in the Italian Model: Italy's Laborious Convergence towards the European Social Model

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Continuity and change in the Italian model

Italy's laborious convergence towards the European social model

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Abstract

Changes in social patterns and in social policies have profoundly transformed the Italian family and society. New technological and economic conditions have challenged the old pattern of production, employment and labour standards. Italy's response has been a "limping reformism": the various components of the Italian social model have developed along different lines. While convergence on legislative features and on macroeconomic policy has been almost mandatory, owing to the external constraints represented by European directives and the common currency, in other fields, namely the labour and product markets, reforms have often been "at the margin" or have not substantially altered the Italian model. Failure (or only partial implementation) of reforms in one area has shifted the cost to other areas. The end result has been the exacerbation of old segmentations and the creation of new ones and the convergence at different speeds on the "European social model".

JEL classification: I00; J00; O52.
Keywords: European social model; welfare state; labour market reforms; productive systems.

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Introduction

The Italian model does not fit well with the existing classifications of production and welfare regimes. According to the varieties of capitalism approach, Italy is a “deviant” case, characterised by “a mix of logics, a high degree of institutional incoherence and an apparent absence of complementarities” (Molina, Rhodes 2007: 223). A predominance of small, family firms, a large state-enterprise sector, and a familistic welfare state place Italy firmly within the Southern European model. The dynamic interaction of economic, social, political and cultural factors characterising the industrial district economy of the North of the country, however, conforms more to the continental model of coordinated market economy (Becattini ed. 1987; Brusco 1989). Two production systems are thus nested within the Italian production model. Over time, the economic divide has trickled down to the social sphere so that two varieties of social services have been developed within the national familistic welfare system. This latter divide, which spans from education, to health and social care, is characterised by a Northern model of local services which, for quality and quantity, tends towards the continental model, and a Southern model which is struggling with economic, structural, and political difficulties. The North-South dualism of the production *and* social models is the most distinctive trait of the Italian model. These models, at the national and local level, are confronted by various challenges.

At the national level, Italy must still make the macroeconomic adjustments required by participation in the EMU and the challenge of globalisation. The response has been sought in a wide program of liberalisations aimed at enhancing competition and efficiency. The piecemeal deregulation of the labour market which started in the 1980s has been extended to the product market through an ambitious privatisation program. The progress of reforms, however, has been hindered by lack of consensus within politically weak coalitions subject to the veto power of various interests. The need to mediate between conflicting claims has opened the way to fragmented, often contradictory policy measures. The end result of these reforms has been an increased segmentation of the labour market - which has not been mitigated by a much needed reform of the social protection system - and a process of privatisation that, in spite of its size, has been unable to remedy the inefficiencies and the rents in the production of services and utilities.

The local productive systems in the North and in the South, which are subject to even tighter budget constraints and have very different economic and political capabilities, have responded in various ways to the increasing demands raised by changes in the demographic, social and production spheres. The industrial district model, and the pattern of specialisation upon which its success was based, have been subjected to heavy pressure by the competition of low cost countries in the Far and near (European) East. The South, which is at risk of being even more marginalised by the recent eastward enlargement of the European Union, has been unable to release itself from the grip of a pervasive underground, irregular economy. The end result does not suggest convergence between the two sub-systems: signs of a successful restructuring of the productive systems in the North, pulled by a resurgence of medium firms operating *within* the prevailing pattern of specialisation, coexist with signals suggesting the drift of the *Mezzogiorno* away from the North and towards a Southern model no longer supported by a generous transfer of funds.

In the following sections we shall briefly outline the main features of the Italian social model (section 1) and the main reforms of the labour and product markets (section 2). It is argued (in section 3) that these reforms have not tackled the structural weaknesses of the Italian model, namely its specialization pattern, the North-South divide, and the dualism in social protection. The end result is likely to be a low and unequal convergence of the Italian models towards the European social model.

1. The making of the Italian social model

Up until the 1980s Italy's growth performance was good in comparative terms. The Italian pattern of specialisation was based on a division of labour within the EU whereby Italy specialised in the production of consumption goods while Continental/Northern countries specialised in investment goods.

The peculiar structure of the Italian productive system allowed rapid economic growth because it was prompt to take advantage of the changes in the technological and market environment that took place in the 1970s and 1980s, favouring flexible producers of semi-customised high quality products (Streeck 1997). In the North-East, a dense network of small firms, clustered in industrial districts, specialized in the manufacture of "traditional" consumer goods, upgrading over the years to manufacture of the machinery and equipment required to produce the consumer goods (Brusco 1989). At the same time, the Italian share in sectors characterized by economies of scale (transport equipment) and/or high R&D intensity was shrinking.

In the 1980s, Italy had to defend its comparative advantage in the production of traditional goods by resorting to frequent devaluations of the lira. It is still an open question whether this exchange rate policy had the unintended effect of procrastinating the industrial restructuring required to adapt the Italian productive system to the changed conditions in global production and demand, thus paving the way to the later competitiveness decline.

The South of Italy only partially shared in this growth: the gap with respect to the North narrowed in the 1950s and 1960s, but it opened again in the 1970s and in the 1990s. The search for the causes of the enduring "*Questione meridionale*" produced an enormous body of literature: geographical reasons pointing to the South's distance from the core markets of Continental Europe; cultural, sociological, and institutional factors with their roots in a distant past (Cipolla 1995) and resulting in a lack of social capital (Putnam 1993); the classical mechanisms of "unequal exchange" between developed and less developed areas: these were among the explanations suggested. Disillusion with the efficacy of public policies - public investment in infrastructure, creation of state-owned enterprises, incentives to private firms to invest in the South - in promoting growth and employment, together with observance of restrictive EU directives in the field of public subsidies, were at the basis of the abandonment of any direct policy in favour of the *Mezzogiorno*.

The years of high economic growth saw enactment of several reforms that contributed to construction of the so-called "Southern model" of welfare (Ferrera 1996). These reforms concerned employment and pension schemes, as well as education and health.[1] The regulatory framework of the labour market was established in the post-war period by gradually reinforcing the protection afforded to the "standard worker", i.e. an employee working full-time on an open-ended contract. The epicentre was approval of

[1] The health care reform law of 1978 introduced tax-financed universal coverage, while pension benefits, computed on the basis of earnings (final salaries) since 1969, were gradually extended to various occupational groups.

the Workers' Charter (*Statuto dei Lavoratori*, L. 30/1970), which laid down principles for the protection of workers and union activists at the workplace, as well as for the regulation of both industrial disputes and union organisation. This law decreed the reinstatement of workers in cases of unfair dismissal in firms with at least 15 employees.[2] In 1975, two inter-confederal agreements reinforced the degree of protection granted by law. The first agreement modified the wage indexing system (*scala mobile*) and established full compensation against increases in the cost of living. The second agreement created the CIG (*Cassa Integrazione Guadagni*) for companies undergoing restructuring.[3] Protection against inflation was general (as it applied to all employees), while protection against industrial disruption (and collective dismissals) applied almost exclusively to workers employed in large firms. The combined effect of the state regulatory system (with distinct rules according to the size of firms) and differences in union power created an accentuated dualism between large and small firms. In large firms, where protection was high, unions were also able to improve working conditions through local collective bargaining; in small firms, where protection was lower, access to the CIG was much more limited, union organisation was weaker, there was no decentralised bargaining, and managements had greater scope for discretion.

The social protection system did not - and still does not - provide universal safety nets. The functioning of the labour market and the institutional schemes grant protection to core workers, mostly prime age men – heads of households – while they tend to discourage the young, women, and older workers. The income maintenance schemes, based on occupational status, display a high degree of dualism: peaks of generosity (pensions, CIG) are accompanied by large gaps of protection. There are no national minimum income schemes for individuals and families with insufficient resources, no safeguards for workers employed in the irregular economy (a fairly large occupational area)[4], no benefits for first job seekers, no safety nets in case of uninsured unemployment. In this dualistic system, the way to protect oneself (and one's family members) is to gain access to the "citadel of *garantismo*" (Ferrera 1996): that is, gain access to a standard employment contract, either in the public sector or in a large enterprise. The weak segments of the labour force must rely on their families for protection.

Finally, monetary transfers (especially pensions, but also disability benefits and CIG) played a primary role, while public services - not only child care and elderly care, but also public employment services - were neglected. The focus on the family as the main care provider had important consequences for both the product and the labour markets, namely underdevelopment of the market for services, lack of job opportunities for women and a correspondingly low female employment rate.

[2] The threshold of 15 employees is crucial in the case of Italy, given the large weight of small firms: roughly about 30% of all employees work for small firms (< 15 employees).

[3] The CIG is a national fund financed by the state and by contributions of employers and employees. In essence, it is a system of subsidized labour hoarding: the laid-off workers maintain their formal employment status and receive a generous wage subsidy.

[4] There is a significant underground economy in Italy. It is more widespread than in other European countries, accounting for 27% of GDP and over 30% of people in employment (Schneider, Enste 2002: 51-52). It is important to stress that it is a structural but non-homogeneous phenomenon: the underground economy in the Centre-North is mainly characterized by fiscal evasion; the one prevailing in the South due to lack of entrepreneurship, technology and infrastructures absorbs substantial numbers of people working for low wages and without standard social benefits and protections. The question is whether the underground economy is the problem of the South, impeding its growth, or rather a consequence of the South's underdevelopment.

2. Changes and reforms

Over the past three decades, the performance of the Italian economy has worsened substantially in terms of both growth and job creation (tab. 1). Poor job creation (a low and declining annual average rate of growth since the mid-1970s) has translated into a low stationary employment rate (on population aged 15-64): 56% in 2003 against 54.5% in 1977.

Tab. 1. GDP, employment, unemployment in Italy, 1961-2006

(annual percentage change, unless otherwise stated)

	GDP (at 2000 market prices)	GDP per person employed (at 2000 market prices)	Adjusted wage share (% GDP at current factor cost)	Employment (national accounts)	Employment rate (% population) *			Unemployment rate (%LF) *	
					MF (15-64)	F (15-64)	MF (55-64)	MF (15-24)	MF (15-64)
1961-1970	5.7	6.2	72.2	-0.5	na	na	na	na	na
1971-1980	3.8	2.8	72.2	0.7	54.7	32.8	36.1	18.7	5.3
1981-1990	2.4	1.8	68.7	0.6	53.6	34.8	34.1	25.9	8.0
1991-2000	1.6	1.6	64.6	0.2	52.1	36.8	29.3	31.4	10.7
2001-2006	0.9	0.0	62.0	1.3	55.3	41.9	29.0	27.5	9.2

* Average employment and unemployment rates refer to the following periods: 1977-1980, 1981-1990, 1991-2000; 2001-2003.

Source: For data on GDP, wage share, employment: *European Economy*, Statistical Annex (Spring 2007). For data on the employment and the unemployment rate (1977-2003): our elaboration on FGB-Istat-Cnr (1977-1996) and Istat (RTFL 1993-2003).

The currency crisis of September 1992, and the ensuing severe recession[5], marked the watershed between two different economic policy scenarios. The macroeconomic context characterising the pre-1992 period was one of macro-economic instability: a tight monetary policy, aimed at accelerating the process of disinflation to keep Italy within the EMS, slowed down growth, kept unemployment high and fed public deficits. The enduring inflation differential with the European partners had to be compensated by frequent devaluations. With the decision to enter the EMU, monetary policy was lost as a policy tool. With fiscal policy restrained by the Stability and Growth Pact, and exchange rate adjustment precluded, labour and product market reforms were the only policy instruments left to the government to sustain competitiveness and growth.

2.1 Income policies: de-indexation and wage moderation

In the 1980s the persistence of Italian inflation[6] and the difficulties faced by the Italian economy were blamed on the labour market: namely, wage indexation and labour market regulation. In the early 1990s a cooperative season in industrial relations (so-called "concertazione") brought wage moderation and disinflation. Two inter-confederal tripartite agreements, signed in 1992 and 1993 in emergency conditions for the Italian economy, abolished the *scala mobile* (which had already been drastically reformed in 1984) to break the wage-price spiral, and reformed the bargaining system by setting two

[5] The drastic readjustment of the public budget that followed the 1992 currency crisis exacerbated the economic slowdown. GDP growth dropped to 0.8% in 1992 and became negative, to –0.9%, in 1993. The repercussions on the labour market were dramatic. The recession of the early 1990s was the most severe of the post-war period in terms of job losses (Brandolini et al., 2007).

[6] Following the second oil shock, in the early 1980s there was another burst of inflation above 20%.

levels of bargaining: the national level, devoted to preserving the purchasing power of wages, and the firm-level, to distribute productivity gains.

Wage increases were linked to the government's target inflation, with ex-post adjustment in case of a gap between the actual and the target inflation rates, to be negotiated at the end of the two year national agreement. Thanks to the wage freeze, by 1997, the crucial year for Italy to qualify for the EMU, the inflation rate was down to 2 per cent. However, since the target inflation systematically underestimated actual inflation, the real wage in 2004 was 2.9% lower than in 1992. On the other hand, since the diffusion of bargaining at the firm level was very limited in medium and large firms, and virtually absent in small firms, the second part of the agreement (envisaging pay increases linked to productivity) underwent very limited implementation (Naticchioni, Lucidi 2006; Brandolini et al. 2007).

Finally, by drastically flattening the progression of pay, reform of the bargaining system introduced a new element of inequality between those who were employed before the agreements, who had already accumulated seniority pay, and those entering after the agreements, whose wage profiles remained flat at the lower entry wages.

2.2 A two-tier labour market reform

The deregulation of the labour market started mildly in the mid-1980s and progressed more thoroughly in the last decade.[7] Up until the end of the 1980s, given a relatively even balance of power in industrial relations, reforms of labour market policies proceeded by consensus among government and social parties. Greater internal flexibility (in working hours, hiring practices, share of part-timers) was exchanged for a limited extension of external flexibility by allowing for "exceptions" to the standard employment contract for the hiring of youngsters and/or unemployed, to ease their access to employment. Thereafter, the deregulation of the labour market progressed in an erratic way, with no formal agreement with employers and unions. To avert the risk of conflict, flexibilization of the labour market was realised through the introduction of the so called "non-standard" employment contracts for particular groups, basically new entrants, while standard employment contracts (applying to the bulk of people already in employment) were left untouched.

As in other EU countries, Italy implemented two-tier reforms of employment protection: flexibility was increased "at the margin" by changing the rules on hiring but leaving unchanged the rules on firing and income maintenance schemes for the core workers.

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[7] Labour policies aimed at favouring the entry of young cohorts into the labour market date back to 1984, when work-and-training contracts for young people (allowing for a temporary contract at a discounted wage) were introduced. A weakening of the strict rules for fixed-term contracts was approved in 1987 (law 56/1987); thereafter these contracts were made more convenient for firms (law 451/1994; law 608/1996). New working arrangements such as collaborations and freelance relations grew exponentially after the 1995 pension reform, when INPS opened a new fund for the so called "parasubordinati" (a special status of self-employment, mainly characterised by a close and continuous relation with a single company, as well as freelance relationships), enabling firms to "hire" workers with no commitment and lower contributions. After a creeping process of de-regulation, the 'big bang' arrived with the Legge Treu (law 196/1997), which introduced a wide range of atypical contractual arrangements. In 2001, the regulation of fixed-term contracts was reformed (law 368/2001), making use of these contracts easier. Finally, the so called "Legge Biagi" (law 30/2003 and legislative decree 276/2003), enacted in 2003, further enlarged the variety of atypical contractual arrangements, while establishing more stringent rules to curb the indiscriminate recourse to collaborations and freelance relations.

This policy was somehow instrumental to preservation of the basic framework of the Mediterranean welfare regime based on the male, prime age breadwinner. The end result was a new segmentation among successive cohorts entering the labour market, with the latest cohorts experiencing both lower employment protection and lower income (Berloffa, Villa 2007).

From 1995 to 2005 the share of employees with fixed-term contracts (in total employment) rose from 7.3% to 12.3%, but it reached about 50% among newly hired people in terms of flows. Other atypical contractual arrangements (such as collaborators and freelance workers) expanded as well. This process was accompanied by less security (in terms of future employment prospects), insufficient protection (against illness, unemployment, maternity) and lower earnings.[8] The compensating differentials theory (according to which temporary workers should command a risk premium to compensate for their higher employment instability) does not seem to hold. Available data indicate that, after controlling for observed and unobserved personal characteristics, temporary workers earn less than their permanent counterparts, allowing firms to save on the wage costs (Picchio, 2006). There is also evidence that entry wages are often below the poverty line. Increasingly precarious jobs thus command increasingly lower entry wages; hence the gap between entry wages and regular wages has widened (Rosolia, Torrini 2006). With low pay unable to guarantee economic independence, young people hired on these contracts must often rely on their parents. This results in long cohabitation with the family and delayed formation of a new family (Facchini, Villa 2005; Simonazzi, Villa 2007).

The main argument in favour of deregulation of the labour market was that it would favour entry into employment of weaker segments of the work force, primarily youngsters. The idea was that a (bad) job is better than no job at all, because once in employment, it would be easier to move to more stable jobs. Empirical studies finding partial evidence in favour of the “stepping stones” hypothesis (Ichino et al. 2005) have been countered by other research showing that the risks of entrapment have increased for the younger cohorts (Barbieri, Scherer 2005). The two positions agree, however, that there is no evidence to support the hypothesis that high turnover across various atypical jobs is equally distributed among workers. Temporary contracts may provide a stepping stone for the strongest segments of the young population, while worsening the prospects for the weakest segments. Education, gender, geographical area and the business cycle affect the probability of transition, even if not always in the expected direction. The implications in terms of social equity are significant: those families that cannot afford to support their members while they search for a good job will be discriminated against, and their children will lack opportunities to transit to good jobs. Difficulties in transition to a regular job will result in an extended period of mobility, which means passing through extended spells of unemployment.

2.3 Demographic change and pension reforms

Italy is ageing rapidly as a result of a declining birth rate and an increase in life expectancy. By affecting the size of flows in and out of active life[9], demographic factors explain the parallel downward trend in youth employment and unemployment rates

[8] Atypical workers (collaborators, to a larger extent) are not covered by employment protection legislation, and minimum contractual wages do not apply. Moreover, social security contributions and pension benefits are lower than those for standard employees, making their lifetime outlook even worse.

[9] For the cohort of people aged 20 inflows into active life have fallen from about 800 thousand per year until the late 1970s to less than 600 thousand in 2005.

(Simonazzi, Villa 2007). In fact, despite the labour market reforms intended to favour the entry of young cohorts into the labour market, their employment rate remains very low. The reduction in youth unemployment rate since the mid-1990s (tab. 1) is due more to the fall in the numbers of young cohorts (resulting in a reduction of inflows into the labour force) than to the supposedly beneficial effects of de-regulation policies.

Italy also has one of the lowest employment rates for older workers (tab. 1), particularly for females. Access to generous early retirement schemes (i.e. earnings-related seniority pensions) has certainly played a role: workers in their 50s were allowed (or even encouraged) to exit the labour market (very often to re-enter the grey market, owing to legislation that restricted the possibility of having a dependent work contract once retired). However, the lower participation of older workers is also the result of choices made in the whole life cycle: first and foremost, for women, the life cycle "decision" of not participating in the labour market.

The combination of ageing with the generous pension schemes developed in the years of high growth severely strained public finances. The pension reforms undertaken in the 1990s[10] in order to curb the share of pension expenditure in GDP relied on three factors: benefit computation rules (from earnings-related to contribution-related schemes); indexation rules (benefits no longer indexed to real wage growth but to GDP growth rate); retirement age and eligibility criteria (modified on the basis of actuarial rules).

Pension reforms have reduced expectations concerning the future level of pension benefits. First, the replacement rate (i.e. the ratio between the first pension benefit and last wage) has been significantly reduced, so that it is almost impossible for an atypical worker to provide for a decent public pension in retirement.[11] Second, the changes introduced in the indexation mechanism will lead to a progressive reduction in pension benefits after retirement.

But the implementation of the pension reforms has been gradual, with a very long transitional period. Hence, the reforms have created three different groups: senior employees (still enjoying not only earnings-related pension benefits but also the possibility of "seniority pensions" allowing early retirement once they reach 35 years of contributions); prime-age employees (with benefits computed partly on the old and partly on the new rules); and the young employees (only the new rules will apply). These three groups have been affected by the pension reforms to very different extents (including pension age).[12]

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[10] The main normative interventions are D. lgs. 30 December 1992, no. 503 (Riforma Amato), and the laws 24 December 1993, no. 537; 23 December 1994, no. 724; 8 August 1995, no. 335 (Riforma Dini); and 27 December 1997, no. 449 (Riforma Prodi); finally, law 23 August 2004, no. 243 (Riforma Maroni).

[11] Under the earnings related scheme (pre-1992 reform) a representative employee, retiring at the age of 60 (with 37 years of contribution) was expected to have a replacement rate of around 75%. Under the contribution related scheme (after-1995 reform) the same individual is expected to have a replacement rate of around 58% (if an employee) and 35% (if self-employed) (Berloffa, Villa 2007).

[12] Workers with contributory records equal to or exceeding 18 years on 31.12.1995 have their pensions calculated with the old defined-benefit scheme; workers having entered the labour market before the end of 1995, but with less than 18 years of payment, have their pensions calculated in part with the old and in part with the new system; all new entrants from 1996 will have their pensions entirely computed according to the notional defined-contribution scheme. The legal retirement age differs accordingly. Under the new system, retirement will be possible between the ages of 57 and 65. But at present, for workers still enjoying earning-related pensions, entitlement to the old-age pension is acquired at age 65 for men (60 for women); entitlement to the seniority pensions is acquired at age 57 with 35 years or contributions or at any age with 38 years of contributions. Recent estimates put the average retirement age at 60 years.

By interacting with deregulation of the labour market, the pension reform has superimposed yet another dualism on an already dualistic structure, affecting the young generations in particular. The cohorts born in the 1940s-1950s, the only ones to have fully benefited from the brief season of employment protection, must cope with the insecurity of their grown-up children caused by their present increased precariousness and their future meagre pensions, as well as with the increasing risk of skyrocketing costs in the case of loss of self-sufficiency in their own old age. With no safety nets in place, greater vulnerability at these various levels - on the job, in the family income, and in the macro-economy - affects future perspectives and can explain the widespread perception of increasing poverty and insecurity.

2.4 Privatisation and corporate governance

During the past 15 years, the Italian economy has undergone a long wave of privatisations (the largest in Europe in terms of total revenues), combined with gradual liberalisation in public utilities. Various factors have combined to trigger privatisation plans: the need to reduce the national debt, the crisis of large firms, stringent European legislation in the field of competition and state subsidies, and the search for greater efficiency and competitiveness. The creation of a national Antitrust Authority (AGCM) in 1990, significantly later than in most other European countries, is a landmark in the change of attitude in favour of competition.

Deregulation and privatisation are still ongoing. But after 15 years, market inefficiencies, rent-seeking positions and shortages in the supply of collective services are widely denounced.[13] These massive reforms have created only the *conditions* for a truly market-oriented capitalism, while they have only marginally changed actors' expectations and behaviour (Barca 2005). The impact of privatisation on the productive system has been different in regulated sectors, which operated in a natural monopoly regime, and in market sectors, where state-owned and private companies co-existed. In the former case, with the possible exception of telecommunications, privatisation transferred a dominant position from a public to a private enterprise, thus calling for effective regulation in order to prevent abuses. In the latter case, involving more traditional industries, the main outcome has been an increase in market concentration: privatised companies have been acquired by companies operating in the same sector in order to achieve economies of scale and expand their market share.

Whether these reforms generated greater efficiency is still an open question. Costi and Messori (2005) pass severe judgement on the entire process of privatisation. They maintain that privatisation provided the few remaining large private Italian firms with opportunities to enter protected sectors, where high rents could still be earned. The way in which privatisations were implemented produced three negative results: it created a tight web of interests in favour of rent-seeking positions, thus reinforcing opposition to further liberalisation of public utilities; it diverted financial and organisational resources from the core businesses of the buying firms, thus reinforcing the negative trend in competitiveness in sectors open to international competition; the acquisitions were financed by resorting to debt, which was shifted to the balance sheets of the newly privatised firms. Privatised firms, which in the previous regime of state owned enterprises had benefited from a "soft budget constraint" and made up the core of the R&D activity, met their enormous indebtedness by cutting back on investment in

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[13] The national Antitrust Authority (AGCM 2005: p.8) denounced that, in recently liberalized sectors, former monopolists still tend to "refuse competitors access to essential infrastructures or prevent their entry into the market with predatory strategies".

innovation and moving to the more lucrative activity of service provision. Costi and Messori conclude that the privatisation and liberalisation process in Italy had the result of destroying positive externalities for the Italian productive system and represented a missed opportunity really to innovate the Italian productive structure.

The privatisation process also affected financial markets. In particular, it contributed to the development of the Italian stock market, whose size had been traditionally exiguous. In 1992 the value of listed companies was only 7.6% of GDP, while in 2000, at the end of the main wave of dismissals, it was 51.9%; 60% of this increase was related to the flotation of privatised companies (Mediobanca 2000: Ch.3). At the same time, the number of savers investing in the stock exchange increased considerably, providing more opportunities for firms to finance themselves by equity. However, the privatisation programme probably missed the chance to create "public companies" on the Anglo-Saxon model. As regards the ownership structure, the privatisation programme did not affect the peculiar features of Italian corporate governance: Italian companies maintained a high level of concentration in ownership and a limited separation between ownership and control, even in large firms.[14]

Also the modernization of financial markets – which unfolded during the 1990s with the aim of extending and liberalizing the role of financial intermediaries (in order to transpose Community directives into Italian law) and of strengthening the protection of investors and minority shareholders - did not significantly modify the corporate governance of Italian firms. The ownership structure of Italian firms did not change greatly in the last decade: high levels of concentration, stability of control and intra-family portfolio swaps were still the norm (Giacomelli, Trento 2005).

To sum up, since the 1980s the various components of the Italian social model have developed along different lines, converging at different speeds on the "European social model". While convergence on legislative features and on macroeconomic policy has been almost mandatory, owing to the external constraints represented by European directives and the common currency, in other fields, namely the labour and product markets, reforms have often been "at the margin" or have not substantially altered the Italian model.

3. Remaining challenges

3.1 Frozen specialization?

The structure of the Italian economy has evolved along the lines followed by most industrialized countries, with a reduction in the share of agriculture and manufacturing in favour of services.[15] Within manufacturing, however, the specialization pattern has not changed greatly over time, raising concerns about the ability of the Italian productive model to adjust to changes in the composition of world demand and to the increasing competition on traditional goods raised by developing countries.

[14] Historically, the main role in the ownership structure during the post-war period was played by "families" and coalitions, while institutional investors and banks had only a marginal role in monitoring companies and exerted little influence on corporate governance.

[15] Between 1980-1984 and 1999-2003 the share of services in value added rose from 64 to 68.1% (from 53.2 to 65.5% in terms of employment). Contributing mainly to this increase were financial intermediation and business services (from 19.8 to 25.4%) while the share of other service activities (education, social and personal services, public administration) decreased (from 20.7 to 18.5%). Own computations on ISTAT national accounts data.

All standard indicators seem to support the hypothesis of "frozen specialisation" in low-skill intensive sectors, marking a divergence from the common European model, which has moved away from mature sectors (Bugamelli 2001)[16]. In spite of wage moderation since the 1990s, a substantial slowdown in labour productivity growth has resulted in a sizeable increase in relative unit labour costs. Loss of competitiveness and industry specialisation are exerting their effects in Italy's share of world trade, which was down to 3.7% in 2004 from a post-depreciation peak of 4.7% in 1996. Table 2 summarises the structure and the dynamics of Italy's export performance in recent years. Italy has lost market shares in high-growth sectors – characterised by economies of scale and high intensity of R&D – as well as in those sectors characterizing its specialisation, namely traditional goods and specialized suppliers goods. Slower growth in world demand and increasing competition from low-cost countries have taken their toll, setting in motion a severe process of selection among the firms operating in these sectors. The relatively young clusters of firms in the South of Italy, formed from the delocalisation of Northern firms, are among those most heavily damaged by the increasing competition (resulting in delocalisation to neighbouring low-cost Eastern European countries).

Table 2. Structure and dynamics of manufacture exports in Italy and in the world. 1996 and 2002

Economic activities	**Italian exports (% composition)**		**World exports (% composition)**		**Growth rates**		**Italian share (% of world exports)**	
	1996	**2002**	**1996**	**2002**	**Italy**	**World**	**1996**	**2002**
Traditional manufactures	44.9	42.7	31.9	28.5	-4.5	7.6	7.6	6.7
Textiles and clothes	*16.0*	*14.1*	*8.8*	*7.7*	*-11.5*	*5.9*	*9.8*	*8.2*
Economies of scale	22.3	23.0	28.9	29.7	3.4	23.9	4.2	3.5
Automobiles	*3.2*	*2.7*	*5.4*	*6.2*	*-15.1*	*38.2*	*3.2*	*2.0*
Specialized supply	22.4	21.7	15.5	14.4	-2.6	12.3	7.7	6.7
Machinery and equipment	*16.9*	*15.8*	*8.9*	*7.5*	*-6.0*	*2.6*	*10.3*	*9.4*
High intensity of R&D	10.4	12.6	23.7	27.3	22.0	39.0	2.4	2.1
ICT	*5.5*	*5.0*	*16.6*	*18.4*	*-9.9*	*33.4*	*1.8*	*1.2*
Pharmaceuticals	*1.8*	*3.7*	*1.7*	*3.0*	*108.6*	*112.8*	*5.5*	*5.4*
Total	**100.0**	**100.0**	**100.0**	**100.0**	**0.4**	**20.5**	**5.4**	**4.5**

Source: Istat (2005: Ch.2)

The view that the Italian competitiveness problem lies in its specialisation pattern calls into question the viability of the Italian productive system. The much-praised virtues of the industrial district economy – once regarded as a comparative advantage of the Italian production system - have come under severe scrutiny and are now mostly regarded as hindering growth.

The debate on the structural weaknesses of a productive system based on small firms dates back to the late 1970s, when the crisis of the large enterprise and the processes of downsizing, delocalisation and outsourcing tilted the Italian firm structure even more towards small size. It is now argued that the factors which favoured the growth of the small firm in the 1970s and 1980s (post-Fordist production techniques reducing the importance of firm-level scale economies, and changes in demand requiring increased

[16] According to the Balassa index - defined as the ratio between country i's market share in sector j's world exports and its market share on total world exports - the specialization in office and electrical equipment, which was significantly positive in the 1970s, turned negative in the early 1980s, when the ICT revolution started (Faini , Sapir 2005).

flexibility in production) have been overpowered by the new forces of information technology and globalisation. In the new environment, where R&D, ICT and human capital investment are crucial for competitiveness, medium and large enterprises perform better in terms of labour productivity, profitability and wages (Melitz, Ottaviano 2005; Fabiani, Schivardi, Trento 2003).

Delocalisation to low-cost countries and the upgrading of production to higher stages of production (within the value chain or to new products) have been singled out as the only feasible defence strategies (Istat 2005, Ch. 2). There is no agreement, however, on the extent of the upgrading process.[17] Standard indicators of innovativeness seem to support the pessimistic view. Italy's investment in R&D (1.1% of GDP in 2004) is far below the European average and even farther below the figures for France, Germany, Japan and the US, well below the Lisbon target of 3% (by 2010). Italy's pattern of specialisation and its prevalence of small firms explain the extremely low share of R&D performed by the private sector (48% as against 63% for the EU25) (Istat 2007: Ch.2). Finally, data from the European Patent Office (EPO) show that in 2003 Italy submitted 87.3 patents per million inhabitants, against a EU15 average of 160.6.

The relatively short supply of educated people[18] has been cited in explanation of both the initial specialization of the Italian productive system in traditional sectors and its delay in undertaking innovative and R&D based production paths (Faini, Sapir 2005). This interpretation is in line with the skill-biased technical change literature, which posits a causal relation from skills to specialization of production (Acemoglu 1998). The implication is that a more rapid increase in the supply of skills may accelerate demand, with a consequent adaptation of the structure of supply. This approach lies behind the Lisbon strategy, which stresses the primary importance of education and lifelong learning policies for innovation and growth.

This interpretation is not fully convincing, however. It seems more plausible that, given the pattern of specialization, firms' demand for skills falls short of potential supply. Indeed, returns to education contradict what would be expected from a shortage in the supply of skilled labour. In Italy, returns to tertiary education are much lower than in most other OECD countries, and they have been decreasing since the 1990s (Naticchioni et al. 2007). Scant demand for skills and low wage premiums may discourage young people from attaining higher educations. In this case, policies acting only on the supply side by encouraging education and lifelong learning, though important per se, would not stimulate a change in the pattern of specialisation. Structural policies which address both the demand and supply sides and focus on the complementarities between skilled workers and investment in high technologies and R&D would be more rewarding.

The "rhetoric of decline"[19] has come under scrutiny, also in light of recent data on exports and profitability. The consensus view – it is argued – mistakenly equates a delay in reallocating manufacturing activities to high-skill intensive sectors with a lack of up-

[17] Although on average, the Italian model is characterized by "vertical negative" specialization, that is, the average unit value of imports is higher than the average unit value of exports (Chiarlone 2001), this is not the case of all sectors. In the clothing industry, for instance, in 2002 the average unit value of Italian exports was 4.8 times higher than the world one (Onida 2003).

[18] In terms of expenditure in education, Italy is largely in line with the other industrialized countries, although still below the EU average. In terms of outcomes, however, in spite of remarkable progress in recent decades, Italy is still behind the European average in university education.

[19] The expression is Pietro Modiano's, head of the Istituto S.Paolo, an important Italian private bank (Vianello 2008). See also Ginzburg (2005) for an early criticism of this thesis.

grading *within* the sectors of specialisation. This error derives from over-estimating the role of process innovation, cost reduction and price in long-term competitiveness, and correspondingly underrating product innovation. Sectors are thus ordered in a hierarchy that assumes an internal homogeneity. That is, consideration is not made of the fact that many high-value added, high skilled stages and products are included in the so-called "traditional" or "mature" sectors, and many low value-added, low-skilled production are widespread in "high-tech"/research intensive sectors (as proved by the high and rapidly increasing export share of low-cost countries in "high-tech" industries) (Ginzburg, Simonazzi 2005). R&D and patenting statistics are not necessarily good indicators of technological progress either. In many consumer sectors (and even more so in the case of small firms), most product innovations are not protected by patents and process innovation occurs through adoption of new technologies rather than through R&D expenditure. Finally, the role of 'tacit knowledge' has already been firmly established in the literature on innovation. A different assessment of the innovation performance of firms is obtained by addressing firms directly through surveys (see the *Community Innovation Survey*). Although confirming the overall weak performance of Italian firms, these surveys find that Italian small enterprises achieve better innovative performance, ranking higher than their UK and French counterparts. In short, there is evidence of the dynamic behavior of Italian small firms.[20] The hypothesis that a process of upgrading is currently occurring within the pattern of specialization, with firms competing in market niches where quality rather than price matters, is supported by recent data on medium firms' performances (in terms of turnover, profits, exports) and by Italy's diverging pattern in market shares at current and constant prices. The constancy of the value index, compared with the fall in the quantity index, can be interpreted as an indicator of the price-setting capacity of Italian firms.

3.2 The North-South divide

Lack of economic development in the *Mezzogiorno* is still the main structural weakness of the Italian economy and a source of economic and social inequalities. The economic divide between the rich North and the poor South has increased over time, as testified by all indicators on labour market conditions. In 2003 the employment rate in the South was 20 percentage points lower than in the North (tab. 3) and it decreased between 1977 and 2003. This is the combined effect of both a lower male employment rate and a much lower female employment rate which has been fuelled by a huge difference in the increase (only 2 percentage points in the South as against 15 in the North and in the Centre).

The unemployment rate (8% in 2004) broken down by age, gender and region confirms the extremely diversified situation across regions, gender, and age: it ranges from 1.2% for men aged over 35 resident in Trentino-Alto Adige to 36.8% for women aged 15-34 resident in Sicily (Istat 2005: 173-177).

Paradoxically, the labour market in Southern Italy is far more flexible than in the Centre-North. The pervasive presence of an underground, irregular, often illegal, economy has resulted in the debasing of job quality. Poor jobs, in terms of both pay and

[20] While small size can be an obstacle to taking full advantage of scale economies, new technology, delocalisation and foreign market penetration, it is overlooked the fact that often small firms do not operate in isolation. The unit of analysis, to which to compare the minimum efficient scale, should thus be referred to the system of small enterprises, be it the group, the district, or the vertically integrated value chain, in which the single firm is integrated (Ginzburg 2005).

working conditions, in many sectors of the economy have been taken by an increasing flow of often illegal immigrants, while internal South-North migratory flows have resumed to such an extent that concerns are raised about a brain drain depriving Southern economy and society of its more skilled and able members.

Table 3 Employment rates by sex and geographical area, 1977-2003 (%)
(population aged 15-64)

	North	Centre	South and islands	Italy
MF				
1977	58.91	53.89	48.97	54.57
2003	64.12	59.08	44.11	55.99
change 1977-2003	*+5.21*	*+5.20*	*-4.87*	*+1.43*
M				
1977	80.33	76.78	73.68	77.39
2003	74,61	71.42	61.40	69.31
change 1977-2003	*-5.72*	*-5.36*	*-12.29*	*-8.08*
F				
1977	38.01	31.73	25.05	32.39
2003	53.44	46.92	27.08	42.68
change 1977-2003	*+15.44*	*+15.18*	*2.03*	*+10.29*

Source: Authors' elaboration on data from ISTAT LFS.

Given the structure of social protection in Italy, with the family acting as a "social clearing house" (Ferrera 1996: 21), having at least one member within the primary segment of the labour market makes the difference in terms of poverty and social exclusion. This is why employment conditions in the South make for a situation of real social emergency: the South has the largest shares of all unemployed, of long term unemployed and of families with unemployed heads of household, and a very low percentage of dual earner-families. No wonder that the South accounts for the largest proportion of families in poverty (Morlicchio, Pugliese 2004: 191).

Following the recent eastward enlargement of the EU, and the need for the Northern production system to follow the new markets in order to survive, the South is at risk of becoming even more marginalised. With stalled economic growth, the devolution of government functions from the centre to the regions, which has implied higher financial autonomy and less generous transfers of funds, risks widening the gap in the quantity and quality of social services even further. These various elements raise concern about the drift of the *Mezzogiorno* further away from the North of the country as well as from Europe.

3.3 The gender gap

Changes in gender roles are among the most important innovations in the Italian social model, one which unifies the North and South of the country. In the past three decades, Italian women have closed the gender gap in education. Higher education has brought emancipation from traditional cultural values and higher aspirations with regard to work and lifestyles, shaping the identity of Italian women around waged work. Young women invest in education in order to secure good employment prospects, postpone motherhood till they have gained access to a decent job, and enter employment with the intention of remaining in it for life.[21] Education also shapes the pattern of non

[21]Poorly educated women account for a low share of the working female population: lack of job opportunities, greater difficulties in reconciliation (due also to the features of unskilled jobs), low economic incentives for second earners (as a combined result of low earnings and high reconciliation costs) may explain the lower share in Italy relative to other EU countries.

interruption over the childbearing interval: it is among the least-educated women that motherhood (as well as marriage) continues to have a marked negative impact on participation (Bettio, Villa 1999). With education weakening the impact of motherhood, strong attachment to the labour market has been the feature of the new cohorts of women entering active life. In 2003 four out of ten women aged 15 or over were in employment as against only three in 1977 (tab. 1).

However, gains in education have not been matched by equivalent gains in terms of employment or job quality. Italian women still encounter great difficulties, first in entering employment, then in balancing family responsibilities with paid work, and in gaining access to good jobs (Simonazzi ed. 2007). With respect to young men, young women have a higher unemployment rate, they are over-represented in all types of atypical employment, are at higher risk of losing their jobs, and receive systematically lower pay. The still extremely low female employment rate helps explain Italy's low overall employment rate, both in absolute terms and in comparison to the other European countries.

Lack of reform of the welfare system is yet another obstacle to change in the Italian model. The need to reconcile care and paid work, in the absence of any adequate public support, has resulted in different solutions for the two polar cases: children, and dependent elderly family members. Following the drastic fall in fertility rates, parents are now investing time and resources in their often only child, mobilising a complex network of family (grandparents), private and public kindergardens, and private child-minders hired by the hour. The need to provide long term care for an ageing population, on the other hand, has produced a new model which relies on a large inflows of care migrants. In the new division of labour, family carers (mainly women) provide the coordination, while the task of minding is entrusted to the female immigrant, and more skilled as well as prevalently native workers - private or public - take on paramedical tasks when necessary. A limited supply of specialised public services has thus been supplemented by an abundant supply of cheap, often irregular, labour, giving rise to a complex segmentation of the care market along gender and ethnic lines, and raising issues of social equity and long term viability (Bettio et al. 2006; Simonazzi 2007).

4. Convergence towards the EU social model?

Changes in social patterns and in social policies have profoundly changed the Italian family and society. New technological and economic conditions have challenged the old pattern of production, employment and labour standards. Italy's response has been a "limping reformism". Macroeconomic and budget constraints, conflicts of interest, and economic ideology have shaped the process of reform. At the macro level, the EMS first and then the EMU have provided the cogency of (and the scapegoat for) an external constraint on the attempt to cope with structural disequilibria. This has encountered the difficulty of tackling deeply rooted features of the Italian society, of countering vested interests and reducing rent-seeking activities. We thus observe selective reform of the labour market unaccompanied by reform of the so called "shock absorber" systems (i.e. unemployment benefit schemes), and reform of the product market limited to privatisation and unaccompanied by true liberalisation.

Failure (or only partial implementation) of reforms in one area has shifted the cost to other areas. Hence, the failure of privatisation to increase efficiency and to reduce rents has translated into a persistent inflation gap vis-à-vis Italy's main European competitors (especially Germany). The continuing emphasis on labor and product markets deregulation, which reflects an unshakable confidence in the market mechanism, has diverted attention from the need to cope with the structural features of the Italian model: the problem of the Italian economy's dualism, and the need to reshape the pattern of production and to upgrade skills. The inability to restrain the informal economy, when not political acquiescence with it, is a formidable obstacle against changing the model. By drastically reducing the tax base, the large size of the underground economy (which expands and contracts with the political cycle) makes it impossible to finance a true income support system and social services.

The end result has been the exacerbation of old segmentations and the creation of new ones. While the Northern production system seems to have managed to restructure, the South is still locked-in in low efficiency and low growth. The level, coverage and effectiveness of income safety nets are still highly differentiated and unequal, which transfers the burden of flexibility to the most vulnerable sections of the labour force. Because of the interaction between working status and social rights, precarious or atypical arrangements in the labour market affect social citizenship. The result of the deficiencies in the Italian welfare regime is that families maintain an important role in shaping the life chances of individuals.

And yet, reform of the Italian model is slowly finding its way forward, supported by both external pressures (EU recommendations, directives, constraints) and internal awareness. In spite of its store of incoherence and experimentation, Italy is laboriously shifting towards the European social model.

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