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The Political Economy of Italy and the Centre-Periphery Perspective on Europe

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Centre-Periphery Relations in Europe and the Political Economy of Italy

An introduction

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Claudius Gräbner-Radkowitsch[b,c,*]

Abstract

The purpose of this introduction is to set out the analytical and historical framework for the following contributions. To this end, it introduces the concept of double peripheralisation in Italy, describes six interrelated crises in Europe that have had a lasting impact on the Italian economy and society, provides a brief history of the Italian economy, and, finally, succinctly outlines the contributions that follow.

Keywords: Italy, Europe, crises, core-periphery, double peripheralization.

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1. Italy and the multiple crises in Europe

This volume is dedicated to the political economy of Italy, taking into account both the specific characteristics of the Italian economy, as well as its relations with the European Union (EU) and the member states. More specifically, the guiding interest is to take into account both country-specific as well as structural factors located on the supranational level in order to examine how the multiple crises in Europe are a result and further driver of socio-economic inequalities within and between Italy and other EU member states. In doing so, we address the problem of *double peripheralisation* (internal and external), aggravated by external events. To this end, this introduction first describes the crisis events that have exacerbated the problem of a double peripheralisation, then turns to the question of how we can conceptualise the centre-periphery problem for Italy and its position within Europe, before, finally, briefly outlining the contributions collected in this volume. These contributions aim not only to present the specific case of Italy and the EU – and to revise many of its sometimes distorted features – but also to describe the problem of impending peripheralization more generally.

When trying to understand the drivers of Italy's socio-economic development, one inevitably encounters some explanatory factors that are country-specific. But there are also a number of supranational events that have affected Italy in ways that have exacerbated existing disparities between Italy and other member states. More precisely, since 2008, the European Union has been shaken by at least six interrelated crises that have led to deep conflicts between EU member states and countries in other regions of the world, all of which have had very heterogeneous impacts on different member states, thereby exacerbating existing inequalities.

The first major crisis was the financial and sovereign debt crisis of 2008. After an apparent period of economic convergence, the financial crisis revealed structural inequalities between the member states, and marked the beginning of a period of persistent polarization between countries of Northern and Southern European countries, which was then clearly visible in common macroeconomic indicators (Gräbner et al. 2020). For instance, as a consequence of the financial crisis, Italy's

general government gross debt increased from 103.9 per cent of GDP in 2007 to 135.4 per cent in 2014, reaching 141.7 per cent of GDP in 2022, also as a result of the measures taken to combat the coronavirus crisis (Eurostat 2024a). Restructuring public debt or borrowing on acceptable terms in order to remain politically effective has emerged as a major problem for Italian policymakers. The country's rising public debt has often been interpreted as an indicator that Italy has used expansionary fiscal policies to buy political room for manoeuvre at the expense of the stability of the single currency. However, the opposite is true. Italian governments have exercised remarkable budgetary discipline, which has severely constrained the state's capacity to act (on this see also Heimberger 2024 in this volume). As a result, these decisions, which are in line with the conservative budgetary EU policies, have led to an intensification of the conflict between the centre and the periphery and to a political conflict between the member states over the question of how the eurozone should be governed.

The second major crisis event is the humanitarian crisis resulting from the large waves of migration since 2015. This has once again pushed the countries of the South, most of which were already reeling from the financial crisis, to the limits of their capacity to act and beyond. Greece is the most well-known example, but Italy has been and continues to be particularly affected by these challenges as well. Although the Dublin Regulation requires refugees to apply for asylum and be registered in the EU country where they arrive, the authorities in countries experiencing a huge influx of migrants were unable to reliably maintain this system. The resulting increase in uncontrolled migration led to humanitarian emergencies in the countries of first reception, to a temporary suspension of the Dublin Regulation in Germany, and ultimately to a conflict between member states, especially with some Eastern European countries, over the distribution of responsibility as it was ineffectively laid down in the Dublin III Regulation of the European Parliament and the Council (REGULATION (EU) No 604/2013).

Despite the recent migration flows, Italy's population has been declining steadily since 2014 – from 60.3 to 58.9 million inhabitants in 2023 (ISTAT 2024a). Only about 8 per cent of these are people with foreign citizenship. One might therefore assume that migration is not perceived as a crisis phenomenon in the country. However, Italy origi-

nally had more of a tradition as a country of emigration. The recent influx of refugees and other migrants is therefore a relative novelty compared to other Western countries. As a result, anti-migrant forces have become firmly entrenched in the Italian party spectrum, and the humanitarian crisis has contributed to triggering another one.

The third major crisis has been the rise of right-wing populism and the subsequent democratic regression, i.e. the regression from democratic systems to autocracies, within the member states and outside the EU (Schäfer and Zürn 2021). Although the literature on democratic backsliding and authoritarian capitalism in Europe tends to focus on countries such as Hungary or Poland (Fabry 2019), the fundamental problem of right-wing populism and extremism can unfortunately also be illustrated very well with examples from Italy and Germany. In the latter case, the rise of the *Alternative für Deutschland* (AfD) and its growing electoral success in German state parliaments, as well as its success in two federal elections, shows very clearly how the crises in Europe have directly favoured the rise of these parties. The AfD was founded in 2013 and initially emphasised Eurosceptic positions, especially with regard to the functioning of the common currency. At that time, the consequences of the financial crisis, in particular the fear of the communitarisation of national sovereign debt and the lack of monetary autonomy, were the main sources of criticism of the European Union and the Eurozone – and this was a general trend:

> "The financial crisis and the reaction to government austerity measures coincided with a rapid increase in the vote for Eurosceptic parties since the early 2010s. Support for hard Eurosceptic parties in national parliamentary elections has mostly remained slightly below 15% of the total vote since 2012. But the share of the combined soft and hard Eurosceptic vote has continued to rise since the financial crisis, reaching 27% in 2022" (Rodríguez-Pose et al. 2023: 7).

This criticism of the EU by right-wing populist parties has also led to racist resentment, for example against Greece and the generalised attribution of the sovereign debt crisis as a purely self-inflicted problem. The German case illustrates how the humanitarian crisis changed party systems once again, as in 2015 the economically liberal founders left the AfD, leaving a party that quickly became far-right. With its anti-

migrant resentment, it then responded to the second major crisis, whose humanitarian suffering it exacerbated, by stigmatising asylum seekers fleeing war as welfare state fraudsters and criminals.

Regional voter analyses now clearly show that negative economic change favours the support for such parties. This does not mean that weaker households are generally more likely to vote Eurosceptically, but that the likelihood of such a voter orientation increases when households experience (relative) income losses either compared to their own history, their country or the EU (ibid: 31; Greve et al. 2022). This is why such parties are quite successful in very wealthy regions, such as northern Italy, while they may receive less support in regions where income levels have been below average for some time. Eurosceptic and (right-wing) populist parties have thus exploited the first two crises in Europe for their electoral success – but it is not insignificant to what extent this populism meets a situation of growing socio-economic inequality.

Italy has suffered particularly badly from these developments because it was hit especially hard by the financial crisis. Unemployment among workers aged 20-64 rose from 7.6 per cent in 2009 to 12.6 per cent in 2014. These figures have improved again due to the considerable flexibilisation of the Italian labour market (which contributed to the unemployment rate falling to 8.0 per cent in 2022), but at the cost of a strong dualisation (Eurostat 2024b). At least for a while, the consequences of the financial crisis were not only much more extreme in the Italian labour market than in Northern Europe – with, for instance, youth unemployment rising from 25.4 per cent in 2009 to 42.2 per cent in 2014 – but this situation also continued to deteriorate, while countries like Germany saw a steady recovery. But even in 2022, youth unemployment in Italy was still at 23.7 per cent (ibid.). Moreover, the country's geographical location in the Mediterranean has made it particularly vulnerable to the humanitarian crisis resulting from the growing migration flows from the Arab and North African world. As a result, right-wing populism and even radicalism has also reached a disturbing level of normalisation in the country (see below; Glassmann 2023).

Yet, this development was further intensified by the fourth major crisis, the one that followed the 2016 *Referendum on the UK's membership of the European Union*. The resulting Brexit showed that anti-

European parties could win referendums in favour of leaving the European Union. Interestingly, however, while the AfD in Germany immediately called for an opt-out procedure in its basic programme (AfD 2016) and the post-fascist *Fratelli d'Italia* party originally stoked similar anti-European resentments, the actions of the current Italian prime minister were less radical and much more pro-European. Yet at the same time, right-wing populism has a much longer tradition in Italy than in reunified Germany, and therefore shows a worrying stability within the party system.

As early as 1994, when the first Berlusconi government took office, there were signs of an alarming rise in right-wing populist support among voters. Even then, the coalition partners were also right-wing populist parties. In addition to Berlusconi's *Forza Italia*, the coalition included the then strongly separatist and anti-immigrant *Lega Nord* and the national-conservative *Alleanza Nazionale*, which had emerged from the neo-fascist *Movimento Sociale Italiano*. This triumvirate has lasted until the present day, even if the constellations of government formation have been very different since the Berlusconi I-IV governments, partly due to the success of the left-wing parties and the emergence of the *Movimento Cinque Stelle*. Forza Italia has undergone several transformations, and the *Lega* has undergone a change of programme and leadership with the current deputy prime minister and party leader Matteo Salvini, known as l'enfant terrible of Italian politics, who during his time as interior minister took numerous measures against rescuing refugees at sea, continuing the anti-immigrant stance of his predecessor.

Finally, the post-fascist *Fratelli d'Italia* have replaced the *Alleanza Nazionale*. While the majorities between these parties have changed several times, first with *Forza Italia* as the dominant party, then with the *Lega*, the *Fratelli d'Italia* now enjoy the greatest voter support, with 25.9 per cent of the votes in the Chamber of Deputies in the last parliamentary elections. Overall, however, the phenomenon of right-wing populism in Italy is older than the last fifteen years. It was fuelled by corruption scandals in the old party system, the collapse of the party system in the early 1990s and the fact that the Christian Democrats never recovered from this scandal. As a businessman, Berlusconi stepped into this power vacuum, which is still being filled by right-wing populist parties today. As these changes were taking place,

the sociologist Colin Crouch (2004) wrote his first book on post-democracy, developing a theory of the decadence of European democracies against the background of the Italian case. In Crouch's view, democracy was moving elsewhere: "The 'elsewhere' to which I saw our politics moving were the small circles of overlapping business lobbyists and a politico-economic elite" (Crouch 2016: 71). In Italy, however, this transformation was reinforced by the almost complete disappearance of Christian Democracy from the effective party spectrum, interestingly in a country where Catholic culture permeates politics as in few other countries. The comparative case for Italy was Great Britain. As such, the two cases inspired the debate on post-democracy, and when Brexit happened, it appeared like an even better example.

The implementation of Brexit coincided with the fifth major crisis, the coronavirus pandemic, which once again hit Italy exceptionally hard. The first major outbreak occurred in February 2020 in the province of Bergamo, in the Lombardy region. By March 2020, mortality in Bergamo had increased by 568 per cent compared to mortality in the months of March between 2015 and 2019 (ISTAT 2020). Jason Horowitz later reported in the New York Times (2020): "Bergamo became one of the deadliest killing fields for the virus in the Western World..." But once again, the crisis met with "favourable" conditions on the ground: Later on, it was not only the government's inability to respond adequately – which, in the case of Bergamo, would have meant to implement an immediate lockdown, also against powerful economic interests. It was also the policy of cutting funding for public health infrastructure that was now criticized because of its contribution to the overburdening of the medical infrastructure during the Covid crisis.

However, the severity of the outbreak in an affluent region of the country suggested that these were not the only causes. Italy went through a period of severe lockdowns, with restrictions varying from region to region depending on the severity of the event. Apart from the many human suffering that accompanied these measures, the sometimes strict closures and curfews also threatened the already weak Italian economy. However, unlike during the financial crisis, the common threat to all member states in the coronavirus crisis has led to a higher level of financial solidarity, even if not all member states have benefitted equally from these measures. At least the member states have agreed

to relax the Stability and Growth Pact and have designed a reform of the framework that is less strict than in the past, particularly with regard to debt reduction in highly indebted countries. This reform path and the allocation of investments from the EU's NextGeneration programme are certainly beneficial for the Italian economy. Italy is granted EUR 191.5 bn from the EU's Recovery and Resilience Facility, which will finally finance a long-awaited public investment programme until 2026.

The sixth crisis was then the result of Russia's attack on Ukraine, which has reactivated geopolitical concepts from the past, although they had hardly seemed to play a role before. The question now arises again of how Europe reacts when (former) superpowers reduce other territories to spheres of influence. The resulting military threat has led to a new discourse on power constellations, defence capabilities and deterrence, forcing member states and the EU to rethink their own defence roles. What is Italy's role in this new era? According to Italian thinkers such as Gian Enrico Rusconi, Europe has sought to become a civil power whose essential core is (economic) interdependence (Rusconi 2006). In this context, Rusconi recognised that the Europeans had overestimated the civilising effect of international law and had jeopardised the forward-looking project of a civil power by relying unilaterally on interdependence without coherence. In Rusconi's view, this lack of coherence was particularly evident in foreign and defence policy, but in the light of the contributions collected here, it can also be understood in terms of economic and financial policy. Italy's economic peripheralisation also had a very important political implication, since the EU as an international actor sought to exert its influence through the strength of its market and the legal norms that underpinned it. It is therefore not surprising that even before the financial crisis, Rusconi argued that Germany in particular was acting as if it no longer needed Italy.

Giorgio Agamben expressed himself in a slightly different but similarly pessimistic way. A world order conceived in power blocs prompted Giorgio Agamben to publish an article in the Italian daily newspaper *La Repubblica* back in 2013, in which he revived the idea of a Latin Empire, which originally came from the Russian-French philosopher Alexandre Kojève. Kojève believed that two power blocs would emerge

after the Second World War, the Anglo-American Protestant power bloc on the one side and the Russian Orthodox bloc on the other. The integration of Germany into the Anglo-American power bloc would inevitably lead to the suppression of Latin (Catholic) countries and mentalities. Given Germany's economic hegemony after the financial crisis, which in the context of a civil power had to be synonymous with political hegemony, the idea of a Latin counter-power formation seemed plausible to some Italian intellectuals. In any case, this debate shows that the process of peripheralisation, which gained momentum with the financial crisis, was not only an economic conflict at the time, but that it was already a fundamentally political conflict from the point of view of Italy and other Mediterranean countries.

Russia's attack on Ukraine has put an end to Europe's self-perception as a civilian power and restored a previously abandoned geopolitical dimension to the question of which countries are regarded as central or peripheral. However, the economic dimension of peripheralisation is not overshadowed by these processes – on the contrary, the war-induced inflation and other economic problems are placing an additional burden for the countries that have been pushed to the economic periphery.

To understand Italy's position in this context requires an understanding of both Italy's domestic political economy and its relationship with the EU. Italy and the EU are thus a prime example of how both a methodological nationalism and a methodological structuralism miss important explanatory factors (on this see also Gräbner-Radkowitsch and Kapeller 2024 in this volume).

2. The political economy of Italy and the process of double peripheralisation – a historical perspective

In order to understand how Italy's political economy has evolved and, in particular, how the process of double peripheralisation came about, a brief outline of economic history will be helpful. In 2022, the Italian economy was the ten largest in the world in terms of gross domestic product (GDP). Italy's economic rise as an industrialised nation began after the Second World War, when the country experienced an economic miracle. During the decade of the 1950s, average annual growth

in GDP was more than 6 per cent. Although Italy's employment structure in the immediate post-war period was still predominantly agricultural, the country then underwent a very rapid process of industrialisation, which started late (compared to the pioneers of industrialisation) and was abruptly interrupted, first in the mid-1960s and more severely by the stagflation crisis of the 1970s (Simonazzi and Ginzburg 2015). From the beginning, the state played an important role in investing in the economy, and this role became even more important during the stagflation crisis in order to combat the negative effects on the labour market. The significant influence of the Italian state can only be explained in the light of the extensive nationalisation measures during the period of Italian fascism and, in particular, during the Great Depression of the 1930s.

In 1933, a new organisation called the *Istituto per la Ricostruzione Industriale* (IRI) was set up to rescue banks such as the *Banca Commerciale Italiana* and Italian companies in difficulty, particularly in heavy industry. This holding company for the "reconstruction of industry" initially acquired shares in ailing companies and was then supposed to initiate appropriate restructuring measures in order to enable these companies to be reprivatised at a later date. This rarely happened, however, and after the Second World War the party-political elite used the instruments of state control for a publicly financed modernisation and industrialisation of the country. For example, the airline *Alitalia* was placed under the control of IRI, as was the majority of the public broadcaster RAI.

It was this constellation that allowed the large public debt that Italy fell into after the stagflation crisis, and it is the reason, along with the very heavy regulation of the labour market that began in the 1970s, why the Italian economy has been described as state capitalist (until the 1990s). However, this picture of the Italian economy is distorted because it ignores the country's private sector companies, which have occupied leading positions on the world market in the classic "Made in Italy" products such as clothing, shoes, furniture, specialised machinery, etc. This development, based in part on the artisanal production of micro-enterprises that have adopted the production method of flexible specialisation, has not been evenly distributed across the regions, but has been concentrated in central and north-eastern Italy: While large industrial enterprises were concentrated in the north-west,

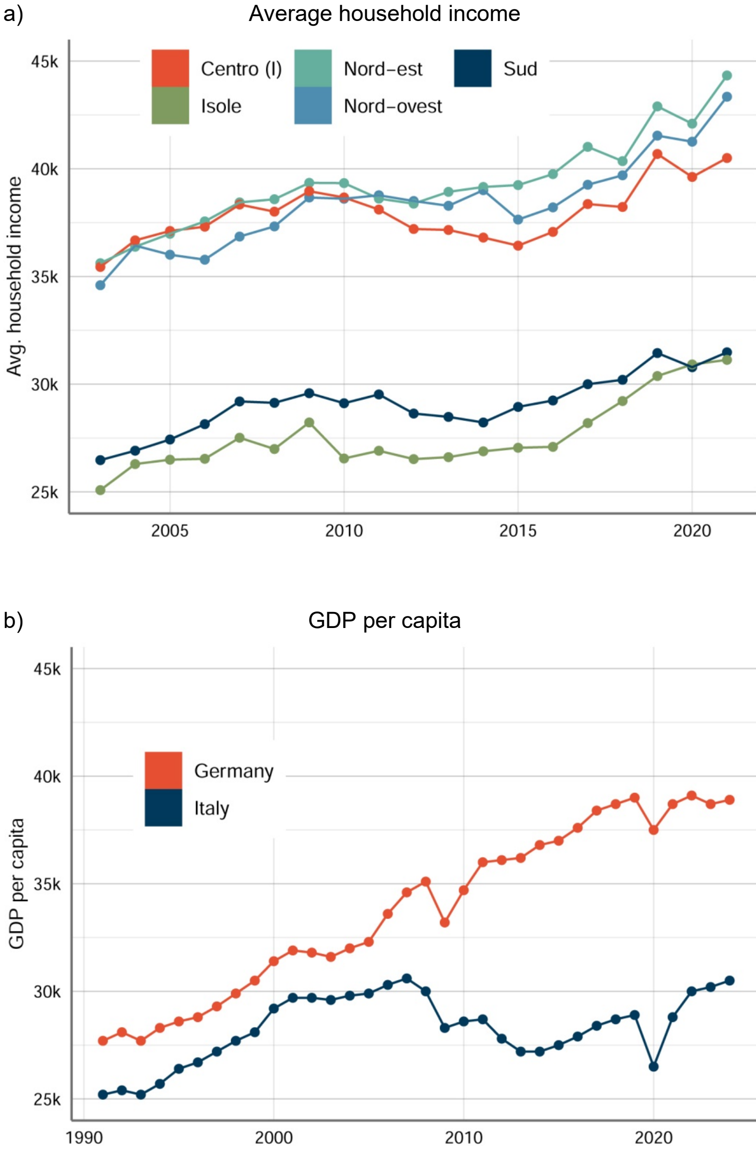
the southern regions and the islands did not follow this path of private sector development.

In contrast to the North with its small-scale farming structures, agriculture in the South was characterised more by large-scale land ownership. Agricultural wage labour has therefore long been an important part of the regional economy. This led to two directions of development: On the one hand, the Italian state invested heavily in the establishment of large-scale industrial production in order to transfer labour from this sector of the economy to the more productive industrial sector, thus attempting to create regional development potential. However, this has led to a number of efficiency problems and, above all, to a lack of sustainable social investment, for example in education policies geared to the needs of the population (see Busemeyer and Glassmann, this volume).

On the other hand, where state-led industrialisation failed or was absent, regions switched from agriculture to services such as tourism, either immediately or over time. However, the desired development potential remained untapped, and by the 1970s Italy's regions had drifted apart again, for example in terms of labour market data. This development contributed to the first process of internal peripheralisation, which made the *Mezzogiorno* a fundamental problem not only for economic cohesion but also for the cultural unity of the country. This suggests that economic inequality has been a long-standing problem in the country and that the effects of the crisis phenomena mentioned above have been particularly felt in the southern regions. As Figure 1a shows, the average household income in the southern regions and islands was already significantly lower than the average in the northern and central regions before the financial crisis. The difference between the northern and central regions is relatively small, but the real gap does remain between the North and the South.

However, it is precisely this process of internal peripheralisation that has led to a major perception problem among the European public, namely that Italy's problems may be entirely home-made and that only internal reforms in the areas of public administration, the judiciary, tax administration and a better fight against organised crime are necessary to solve the country's persistent economic problems. In support of the thesis that the country lacks the will to reform, reference is usually made to the high level of public debt. The almost tragic

Figure 1.



aspect of this situation is that nothing could be further from the truth than to accuse the Italian governments of being unwilling to reform. This is tragic because all these reforms have not yet led to the desired improvement in the country's economic growth and the theory of unwillingness to reform therefore persists.

There is no denying that Italy's economic problems are also due to internal institutional and structural factors, but these factors are not the result of an institutional deadlock in the system of government or the unwillingness of governments to reform, but rather the result of the ineffectiveness of some of these reforms. In particular, they have not solved the core problem of the Italian economy, which is the lack of productivity growth.

A second process of peripheralisation has thus taken place, in which not only southern Italy, but the Italian economy as a whole, has moved away from the productivity development of other European economies. The main debate in the academic literature focuses on how this could have happened (Krahé 2023). While some approaches continue to point to national causes of the problem (high number of small family firms, unfavourable specialisation in consumer goods sectors threatened by international trade, low employment rate, dysfunctional vocational training system, etc.), other authors emphasise the problem of Italian integration into the European currency area. The associated market-liberal reforms and the need for fiscal discipline have created a very longstanding investment gap, which has not been closed even after the financial crisis, but has been exacerbated by politicians' adherence to the austerity policies of the pre-crisis period (see also Heimberger in this volume). This is clearly reflected in the evolution of GDP per capita (see Figure 1b). In terms of this indicator, the impact and management of the financial crisis in particular contributed to Italy's slide to the European periphery. Other authors see the beginning of the stagnation phase earlier, around the 2000s (Krahé 2023). Whatever the chronology of the problem, however, it is undeniable that the Italian economy has moved to the European periphery, and that this is not only due to domestic problems in the past, but also the specific impacts of the six crises on the European level on the Italian economy (see also Celi et al. and Gräbner-Radkowitsch and Kapeller in this volume). The question is why these problems, in particular the lack of growth and investment, have not been resolved – and this vol-

ume seeks to answer this question by devoting chapters to its specific aspects.

3. *The structure and contributions of this volume*

In this volume, the contributors devote several chapters to the question of the determinants and effects of Italy's economic development in recent decades, and its relation to the rest of Europe. On the one hand, the contributions draw a rich empirical picture of the country's political economy, while at the same time placing its economic conditions in an international or sub-national (regional) context. In this way, they address the problem of double peripheralisation in different contexts: Growth, debt, education, welfare, fiscal policy and other issues.

In the first chapter of this volume, Philipp Heimberger analyses Italy's macro-fiscal developments and discusses them against the relevant academic and policy literature. He rejects widespread views that suggest Italy's socio-economic decline in recent decades has been due to its unwillingness and incapacity to maintain fiscal discipline and implement structural reforms. To the contrary: he shows that Italy has been a top performer in implementing fiscal consolidation and market liberal reforms since the 1990s. However, some of these reforms have exacerbated Italy's economic problems, particularly with regard to low productivity growth. In this context, he argues that a more plausible explanation of Italy's socio-economic problems should focus on the interplay between domestic institutional conditions and policy constraints imposed by European monetary integration.

The chapter of Claudius Gräbner-Radkowitsch and Jakob Kapeller builds upon these insights and makes a methodological contribution by outlining an evolutionary approach to examine divergence patterns in Europe, that does justice to Heimberger's demands. Above all, they discuss the relative importance of both country-specific as well as supranational drivers of development within the EU. In this context, they introduce the concept of 'development models', which can be used to elucidate key drivers, structural dependencies, and interrelations between countries. By focusing on Italy as a key example, the authors illustrate both the strengths and weaknesses of such an approach that tries to take serious structuralist dependencies while still paying attention to country-

specific characteristics. By doing so, they underscore the simultaneous relevance of various ontological levels and the significance of history in analyzing comparative development patterns in the EU.

The chapter by Giuseppe Celi, Dario Guarascio, and Francesco Zezza expands on this perspective and examines the post-war trajectory of the Italian economy through a structuralist lens. Using the framework of European cores and peripheries, the authors highlight the weaknesses of the 1960s ‘economic miracle’ and illustrate how external constraints have caused Italy to move from the EU’s center to its periphery since the 1990s. The chapter emphasises the role of Germany, highlighting asymmetric complementarities between the countries, and German influence on European institutions that have shaped Italy’s development. The authors argue that Italy’s structural evolution reflects the self-defeating nature of Europe’s export-led growth model, which is argued to exacerbate core-periphery divergence within the Union. Against this backdrop, the chapter explores possibilities for reshaping European institutions to benefit Italy and the entire continent.

The chapter by Lucio Gobbi and Stefano Lucarelli then focuses on two particular aspects of the Italian economy that are regularly subject to considerable debate: public debt and inflation. In their chapter, the authors examine the development of these indicators since the late 1960s to the present day, identifying five distinct phases. The first phase (1969-1979) saw an increase in debt and inflation, influenced by international shocks and trade union struggles. The second phase (1979-1993) reveals a conflict between the government and the Bank of Italy, which impacted the stability of public accounts. The third period, spanning from 1994 to 2007, represents a convergence towards the Maastricht parameters. The fourth period, from 2008 to 2019, was marked by financial crises and the impact of austerity measures. The fifth period, which spans from 2020 to 2023 and is linked to the pandemic and Russia’s war on the Ukraine, is grappling with high public debt and rising inflation amid uncertain outcomes. The chapter concludes by discussing the implications for policy and the public debate. It illustrates the need to consider historical facts and path dependencies when discussing contemporary policy problems.

Valeria Cirillo and Jelena Reljij then examine Italy’s enduring North-South divide from a structural labour market perspective and trace its roots to pre-unification. The authors demonstrate how Southern

regions are trapped in a cycle of precarious employment, low wages, and limited productivity. This cycle is perpetuated by a self-reinforcing dynamic and aggravated by various crises, including the 2008 financial crisis and the Covid-19 pandemic. In their conclusion, they recommend implementing targeted regional interventions such as labor market, innovation, and industrial policies to address the entrenched North-South disparity and promote economic resilience and social cohesion.

Martino Comelli's contribution is dedicated to another cleavage in the Italian political economy: the different levels of welfare state support for young and old generations. Because of the large share of social expenditure devoted to pensions and benefits for the elderly, the author portrays Italy as a particular type of conservative welfare state, a gerontocratic system that creates a structural imbalance between transfers to older and younger age cohorts, to the detriment of the young. As a result, the welfare state fails to adequately cushion the life risks of the younger population. This has serious consequences for the future orientation and economic behaviour of the population. Not only is economic pessimism reinforced by the lack of institutional support for younger people, but this welfare state practice also creates a situation in which people tend to avoid future economic risks, leading, for example, to a high reluctance to borrow on the part of households.

Finally, the contribution by Busemeyer and Glassmann considers these two lines of conflict in combination. The article deals with the regional skill regimes in Italy and first analyses the policy outcome in terms of regional education and training systems. This analysis reveals some counter-intuitive findings, such as the higher university enrolment rate in the South of the country than in the North, and the strong company focus in the area of vocational training in the South. The chapter not only explains these findings but also compares them with the population's preferences in the regions. Using the dataset from the Investing in Education in Europe (INVEDUC) survey, the authors analyse whether citizens want these regional differences or whether they persist for other reasons contrary to their preferences. The analysis shows, *inter alia*, that higher investment in education is favoured everywhere in the country. But it also shows that large majorities reject the idea of shifting spending from pensions to education or young families with children. And this opposition is strongest in the South of the country.

In all, the contributions collected in this volume thus show how the phenomenon of double peripheralization has developed in Italy on the basis of different problems, some of them domestic, others coming from the supranational level. More precisely, the chapters show that while long-standing national problems persist, it is also the embedding of the Italian political economy in the institutional structure of the EU that has exacerbated this situation – not because Italy is a country unwilling to reform, but on the contrary because it makes great efforts to adapt its economic data to the expectations of the European Commission and other member states. We believe that on top of the academic insights that such analysis delivers, there is also a political lesson to be learnt from this: whatever unresolved lines of conflict still characterise the country's political economy, the EU and other member states should acknowledge Italy's willingness to reform and admit that market liberalisation and austerity have not produced the desired positive results – and are highly unlikely to do so in the future. There are some early signs that this lesson has indeed been learned by some actors on the European level since the EU's NextGeneration investment programme certainly marks a step in the right direction. Let us hope that Italy and the EU will continue to follow this direction and resist the current calls to return to the problematic 'solutions' of the past.

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Italy's decline: A critical reassessment of prevailing explanations

Philipp Heimberger[a]

Abstract

This paper reviews the dominant explanations of Italy's economic decline in recent decades. I analyse Italy's macro-fiscal developments and discuss them against the background of the relevant academic and policy literature. My analysis rejects views according to which Italy has been unwilling or unable to maintain fiscal discipline and implement structural reforms. Since the 1990s, Italy has been a top performer in implementing fiscal consolidation and market liberal reforms, including in the labor market. However, the nature of some of the reforms undertaken has exacerbated Italy's economic problems, in particular with regard to low productivity growth. In this context, I argue that an emphasis on the interplay between domestic institutional conditions and policy constraints imposed by European monetary integration and globalization may provide a more plausible explanation for Italy's decline compared to its large Eurozone peers.

Keywords: Italy, fiscal policy, public debt, liberalisation, reforms, Next Generation EU.

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1. Introduction

Italy – highly indebted, unwilling to reform, and responsible for the instability of the Eurozone as a whole. In Germany and other EU countries, the view that the Eurozone might be better off without Italy is alarmingly wide-spread, linked to wrong perceptions about Italy's role in the EU (e.g. Braun et al. 2021). In the first half of 2020, the narrative of "profligate" Italian governments strongly influenced the politics of the European economic policy response to the Covid-19 crisis, as Italy was initially hit particularly hard by the consequences of the pandemic (e.g. Heimberger and Kowall 2020; Celi et al. 2020; Pianta 2021). Significant political resistance had to be overcome to establish Next Generation EU, with EU grants to Italy and other countries aimed at mitigating the economic impact of the Covid-19 crisis. The standard narrative about Italy in the media and political discourse in Germany and other Eurozone countries is still that reckless fiscal spending and a lack of "structural reforms" based on European best practices in market liberalization are the main causes of Italy's economic problems. The prevalence of these narratives in the public sphere should not be underestimated, as they can have a profound impact on political processes and policy outcomes (e.g., Strömberg 2015; Zhuravskaya et al. 2020).

This paper critically assesses the dominant views on the sources of Italy's economic problems, challenging conventional narratives. Have Italian governments proven to be profligate and unwilling to undertake major structural reforms? In this context, I review the academic literature on the factors that have been driving Italy's long economic decline reflected in a slump of labor productivity growth and major losses in Italian living standards relative to its large Eurozone peers. This is important not only to avoid oversimplified explanations of why Italy is now at the center of most European macroeconomic policy discussions. It is also important to counter misleading narratives, especially in the public sphere, and to contribute to a more rational discourse on European economic policy.

The remainder of this chapter, which is about challenging powerful economic narratives with regard to Italy and their policy implications, is structured as follows: Section 2 discusses selected aspects of Italy's macroeconomic developments over the past decades to describe the

extent of Italy's decline. Section 3 reviews selected fiscal data. Section 4 discusses reforms along several dimensions. Section 5 considers the role of euro membership and globalization. Section 6 concludes.

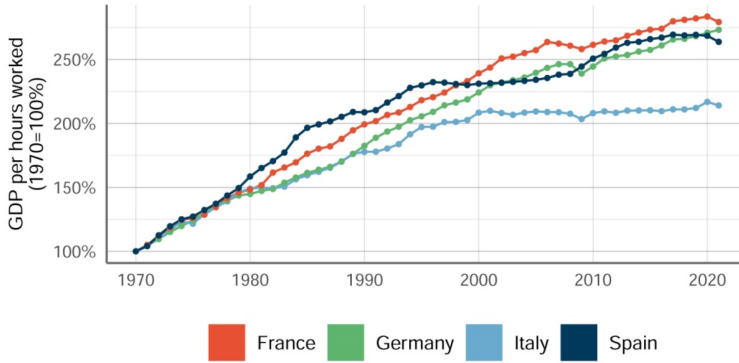
2. Italy's decline

Italy is the third largest economy in the euro area in terms of economic output,[1] and although its industrial base has deteriorated, Italy remains the second largest industrial location in the EU.[2] Italy's northern manufacturing structure is strongly linked to the European industrial core centered on Germany (e.g., Stöllinger 2016; Celi et al. 2020), and Italy's export basket is highly diversified.[3]

Nevertheless, from an economic point of view, Italy has been in decline and has lost ground relative to its Eurozone peers over the last few decades. This is undeniable when looking at macroeconomic statistics. A decline in labor productivity has led to significant losses in relative living standards. Italy's labor productivity growth (measured as GDP per hour worked), while still among the highest in the world in the 1980s, has significantly underperformed its European peers in recent decades (see Figure 1). While this can be seen as a major obstacle to long-term economic growth, the causes of the slowdown in labor productivity growth remain controversial (e.g. Capussela 2018; Krahé 2023; see Section 4 for a more detailed discussion).

[1] In 2021, Italy's real Gross Domestic Product stood at €1678 billion, which accounts for close to 15% of the Eurozone's whole output. Germany (28.4% of the Eurozone) and France (20.7%) are the only economies larger than Italy's.
[2] In 2021, Italy's share in the EU's total value of sold industrial production stood at 16%, which is significantly lower than the 27% for the EU's largest industrial location Germany, followed by France (11%) (Eurostat 2022).
[3] In 2020, Italy ranked 16th out of 133 countries in terms of economic complexity, which is regularly used as a proxy for technological capabilities (Atlas of Economic Complexity 2023).

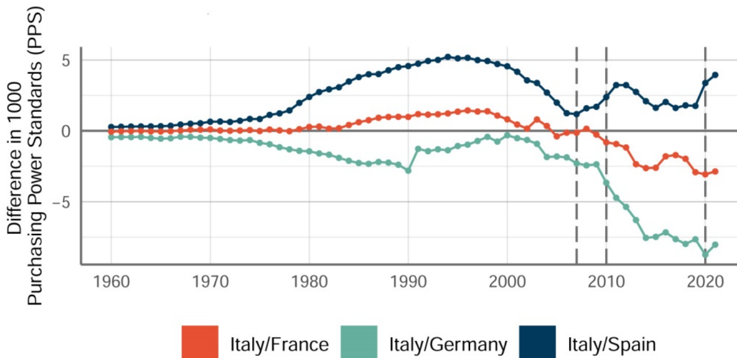
Figure 1. Labor productivity



Data: AMECO; own calculations.

Until the late 1990s, Italy's per capita income was still higher than that of France and only slightly lower than that of Germany. In the last two decades, however, a large gap has emerged; by 2021, Italy's GDP per capita was about 8000 purchasing power standards (PPS) lower than Germany's and 3000 PPS lower than France's (see Figure 2). Italy has been particularly hard hit by the euro crisis. The country has

Figure 2. Differences in real GDP per capita



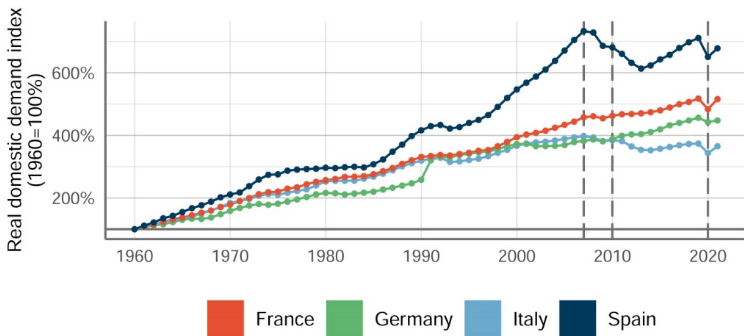
Note: The vertical lines indicate the start of the financial crisis in 2007, the Euro Crisis in 2010 and the Covid-19 crisis in 2020, respectively.

Data: AMECO; own calculations.

experienced a series of recessions over the past fifteen years. Real GDP has still not recovered to its pre-crisis level: in 2019, the year before the pandemic led to another major downturn, Italian output was still 3.7% below its 2007 level (data from AMECO, own calculations).

Italy’s trade balance (exports minus imports of goods and services) averaged -0.2% over the period 1970-1989, but it rose to a surplus of 1.5% over the period 1990-2021. However, the improvement in Italy’s trade balance was largely driven by a decline in the growth of imports of goods and services, which is linked to weak domestic demand (e.g. Baccaro and Bulfone 2022). Indeed, Italy’s domestic demand has developed much weaker since the 1990s compared to Germany, France and other euro area peers (see Figure 3). I will return to the sources of aggregate demand weakness in the following sections.

Figure 3. Real domestic demand



Note: The vertical lines indicate the start of the financial crisis in 2007, the Euro Crisis in 2010 and the Covid-19 crisis in 2020, respectively.

Data: AMECO; own calculations.

Thus, there is little doubt that the trend of economic development in Italy has not been favorable in recent decades. However, even if major challenges – the decline in productivity growth, the lag in living standards compared to European peers, the increase in public debt, etc. – cannot be denied, their explanations must still be critically assessed, since only a rigorous identification of the underlying reasons for Italy’s

decline can serve as a viable vantage point from which to construct public policies that can reverse, rather than accelerate, Italy's economic decline. Therefore, the next section turns to a discussion of the possible reasons underlying Italy's fiscal trajectory over the past decades.

3. Public debt is high because of the legacy of the 1970s and 1980s and low growth thereafter

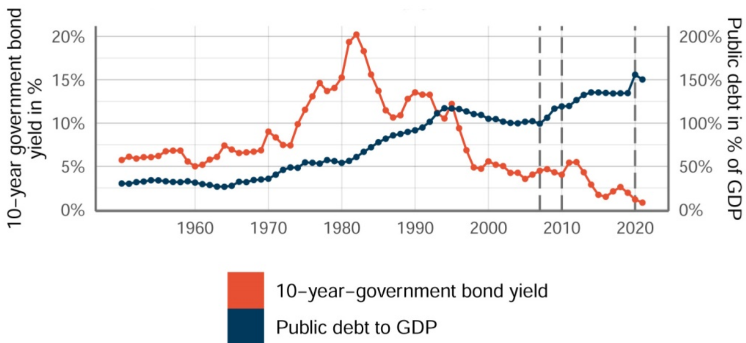
Does Italy have a fiscal discipline problem? At least private sector debt in Italy is low compared to other OECD countries (Heimberger and Kowall 2022). Total debt in relation to the size of economy is not higher in Italy than in other Eurozone countries, especially in comparison to those that are highly financialized (e.g. Gräbner et al. 2020a). However, Italy's *public-debt-to-GDP ratio* stood at more than 140% of GDP in 2022, the second highest in the Eurozone after Greece.[4] Debates focus on the public-debt-to-GDP ratio as the EU's fiscal rules consist of a public debt limit of 60% of GDP, and the debt-to-GDP metric is easy to communicate for journalists and politicians looking for simplifications. However, it is questionable whether such a strong focus on the public-debt-to-GDP ratio is justified, as the public-debt-to-GDP ratio can be seen as a potentially misleading metric of a country's fiscal sustainability (e.g. Furman and Summers 2020).[5]

Italy's public debt-to-GDP ratio began to diverge sharply from that of Germany, France and other Eurozone peers only in the 1980s (e.g. Storm 2019), when it rose from 54.0% in 1980 to more than 100% in 1992 (Figure 4). What happened during this period? In the early 1980s, there was the "divorce" between the Italian central bank (Banca d'Italia)

[4] Greece was the only euro area country to have a higher public debt-to-GDP ratio than Italy in 2021 (193.3% vs. 150.8%; see European Commission 2022).

[5] Furman and Summers (2020) discuss three reasons why the public-debt-to-GDP ratio is a problematic metric. First, while debt can be repaid over time, the debt ratio compares the stock of debt at a particular point in time to one year's GDP. Second, the public debt ratio does not reflect interest payments, which may point in the opposite direction. Third, it is backward-looking, i.e. it does not consider future policies that are likely to be needed, such as costly measures in response to future emergencies. Fundamentally, their criticisms are about comparing a stock (debt) to a flow (GDP).

Figure 4. Long-term government bond yield & public-debt-to-GDP ratio



Note: The vertical lines indicate the start of the financial crisis in 2007, the Euro Crisis in 2010 and the Covid-19 crisis in 2020, respectively.

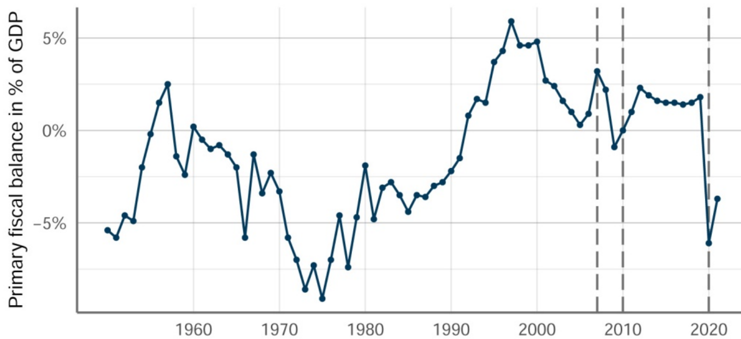
Data: Macrohistory database.

and the Ministry of Finance. To enhance its credibility and independence, the central bank stopped directly assisting the government in financing its budget deficits (e.g., Tabellini 1987). This was followed by a rise in Italy's long-term interest rates relative to its European peers, which sharply increased the government's financing costs (e.g. Celi and Guarascio 2021). Indeed, Italy ran large fiscal deficits in the 1970s and 1980s as it expanded the welfare state; combined with high interest rates, the fiscal stance led to a rapid and sharp rise in the public debt ratio (for more details see the chapter by Gobbi and Lucarelli). In 1992, a currency crisis drove Italy out of the European Monetary System after Italian policymakers failed to fix the nominal exchange rate. Italy signed the Maastricht Treaty and committed itself to joining the euro area, thereby introducing an "external constraint" that deliberately brought about tighter policy restrictions implying support for fiscal and monetary rectitude (Giavazzi and Pagano 1988; Dyson and Featherstone 1999). Signing the Maastricht Treaty meant that all Italian governments would in the future operate under the constraint of having to meeting European deficit and debt limits, thereby reducing fiscal space. Joining the Eurozone took away the option of devaluing the Italian currency vis-à-vis Germany and other Eurozone member coun-

tries, putting more pressure on domestic wage and reform policy in ensuring cost competitiveness.

As a consequence of developments in the 1980s, Italian governments have had to bear a heavy interest burden. However, excluding the interest burden shows that the Italian government consistently ran budget surpluses from 1992 until the Covid-19 crisis (see Chart 5). Even for Germany, Austria and the Netherlands, a comparable primary budget surplus can be found much less frequently than for Italy (Heimberger and Kowall 2020). This shows that since Italy signed the Maastricht Treaty in the early 1990s and committed itself to joining the Eurozone, Italian governments have pursued a course of fiscal discipline. Primary surpluses were highest in the 1990s; fiscal policy became less restrictive with a reduction in primary surpluses in the 2000s. Moreover, joining the euro led to a significant reduction in interest payments on Italy's public debt. However, as growth slowed significantly, interest rates on government bonds were still typically higher than the growth rate, contributing to adverse public debt dynamics through unfavorable interest-growth differentials (Storm 2019; Baccaro and D'Antoni 2022).

Figure 5. Primary fiscal balance in Italy



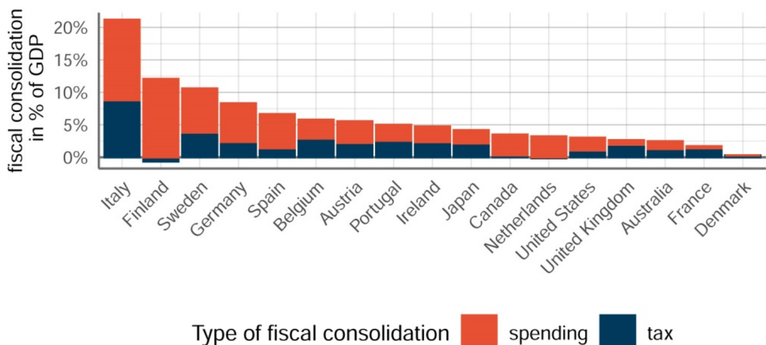
Note: The vertical lines indicate the start of the financial crisis in 2007, the Euro Crisis in 2010 and the Covid-19 crisis in 2020, respectively.

Source: Cesaratto and Zezza (2019), Istat; calculations by Francesco Zezza.

Moreover, the Italian government has not been inactive in terms of fiscal consolidation: IMF data show that between 1992 and 2009, Italy implemented the largest cumulative fiscal consolidation packages of all advanced economies, especially in terms of government spending cuts (see Figure 6 based on Devries et al. 2011). These fiscal consolidation efforts were mainly implemented to meet the criteria for joining the euro at its inception, as set out in the Maastricht Treaty, i.e. fiscal consolidation was frontloaded in the 1990s (e.g. Baccaro and D'Antoni 2022).

Fiscal developments in the 1980s were highly relevant for what happened in the decades that followed: the interest burden – high due to legacy debt – has repeatedly pushed the Italian government's overall budget balance into negative territory. As the crises of the last fifteen years (financial crisis, euro crisis, Covid crisis) have negatively affected economic growth, the crisis episodes have led to a further increase in the public debt ratio, thereby increasing the pressure for fiscal consolidation in the context of EU fiscal rules (e.g. Heimberger and Kapeller 2017).

Figure 6. Fiscal consolidation measures motivated by a government's desire to cut deficits and debt (1992-2009)



Source: Devries et al. (2011).

4. Italy has carried out major market-liberal reforms

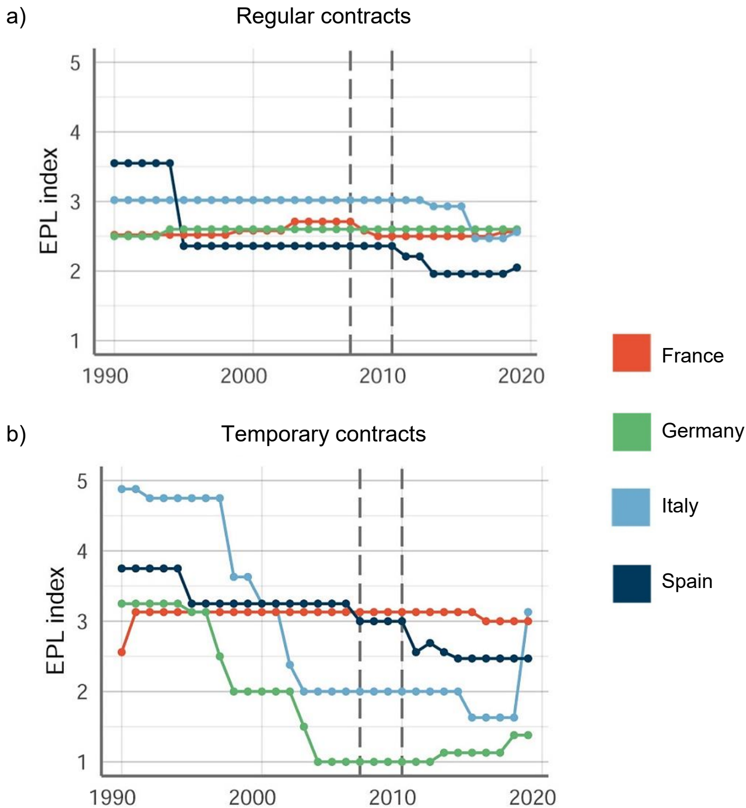
There is a widespread view that Italy's decline can be attributed to an unwillingness to undertake sufficient "structural reforms," particularly with regard to labor market liberalization; in the absence of reforms, the economy has allegedly been unable to adapt to the challenges of changing economic circumstances. According to this view, employment protection and product market regulation were too rigid, the welfare state too generous, and trade unions too strong (e.g. Daveri and Tabellini 2000; OECD 2012). The causes of Italy's decline are attributed to deep-seated structural rigidities, including cronyism and familism and a lack of government stability (e.g. Amatori et al. 2013; Alesina and Giavazzi 2006). This view has also shaped public discourse on Italy in media and policy circles. The proposed solution is typically that while the Italian economy needs to be more thoroughly liberalized to break the trend of economic stagnation, Italian governments need to provide more stability.

However, several recent studies have pointed out that the "lack of reforms" view does not hold up well against the data (Storm 2019; Notermans and Piattoni 2021; Baccaro and D'Antoni 2022; Krahé 2023). First, Italy has undertaken significant structural reforms over the past three decades, including major rounds of labor market liberalization. Second, there is a strong case to be made that the nature of some of the reforms undertaken has exacerbated Italy's economic problems, particularly in terms of low productivity growth. Third, there is the problem that some of the institutional deficiencies emphasized by the "lack of reforms" view have been present for much longer, including the decades after the Second World War when Italy transformed itself into a leading industrial powerhouse while growing much faster than its European and global peers (e.g. Celi and Guarascio 2021; for a more detailed discussion see the chapters by Celi et al. and Cirillo and Reljij).

As noted above, Italy has been a "top performer" in terms of liberalization reforms over the past decades compared to other advanced economies. In fact, overall, Italy has followed the recommendations of "structural reforms" promoted by institutions such as the European Commission and the OECD much more closely than France, Germany and other peers (Storm 2019; Baccaro and D'Antoni 2022; Krahé 2023).

Significant labor market reforms have been implemented over the past thirty years, as reflected in the OECD Employment Protection Index (see Figure 7). In the 1990s, Italy's index for permanent contracts was slightly stricter than in Germany and France, but by 2019 it had become looser than in Germany as a result of liberalization. For temporary contracts, Italy's index shows a sharp decline in employment protection from the early 1990s to 2015, after which the data suggest re-regulation, particularly due to the "dignity decree" introduced in 2018 (e.g. Tassinari 2022).

Figure 7. Employment protection legislation

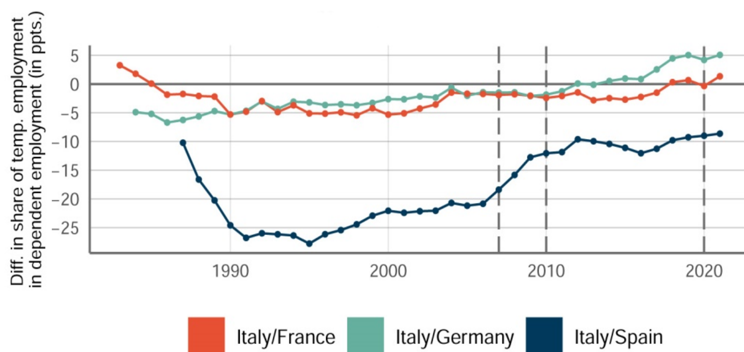


Note: The vertical lines indicate the start of the financial crisis in 2007 and the Euro Crisis in 2010. Data: OECD.

In terms of labor market liberalization, the early 1990s brought an end to automatic indexing of wages to inflation and the abolition of the public monopoly on employment services. Liberalization led to the introduction of insecure temporary contracts. Flex-insecurity jobs became particularly widespread among young Italians. Atypical unemployment increased, but those in precarious jobs were not covered by unemployment insurance, had lower pension claims and no sick leave or paternity leave. Permanent employment contracts, in contrast, came with significantly more security in all these dimensions (Berton et al. 2012). From 2012, dismissal protection for new permanent contracts was also reduced, while active labor market policies were expanded. In 2018, employment protection for flex-insecurity contracts was increased (Tassinari 2022).

The flexibilization of the labour market since the 1990s has led to a steady decline in fixed-term contracts, reflected in an increase in the share of temporary contracts (see figure 8), a backlash against trade unions and a substantial decline in inflation-adjusted wages compared with Germany and France (see figure 9). In theory, labor market deregulation should increase the cost competitiveness of Italian firms, allowing them to gain export market share as they come under increasing pressure from competition from China and other emerging economies, particularly in Asia. However, the deliberately deflationary macroeconomic policy mix since the 1990s has not only reduced wages and inflation. Cheap labor has also increased the labor intensity of production, reducing the incentives for firms to make labor-saving investments (Storm 2019). Private investment, however, is the key to productivity growth and is particularly important in high-tech sectors (Kleinknecht 2020). Productivity growth, in turn, is the basis for growth and rising incomes. Labor market liberalization has also made it more difficult for firms to accumulate human capital (Hoffmann et al. 2021). Therefore, it can be argued that reforms to liberalize the labour market have done more harm than good to Italy's productivity growth (e.g. Cirillo et al. 2017), thus counteracting improvements in competitiveness in terms of unit labour costs. Labour market flexibilization was also not helpful when it comes to accumulating technological capabilities (e.g. Dosi et al. 2015; Dosi et al. 2017; Gräbner et al. 2020a; Gräbner et al. 2020b).

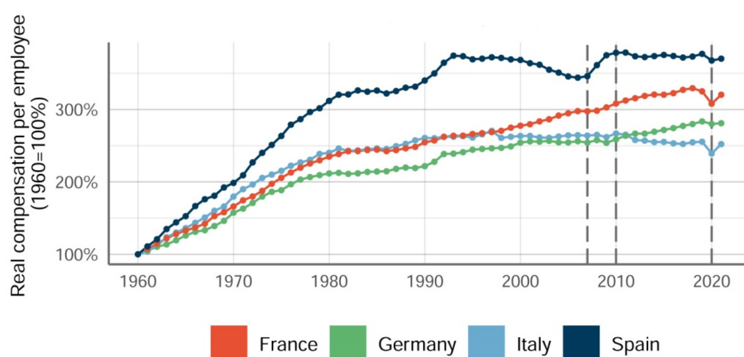
Figure 8. Temporary employment in Italy



Note: The vertical lines indicate the start of the financial crisis in 2007, the Euro Crisis in 2010 and the Covid-19 crisis in 2020, respectively.

Data: OECD; own calculations.

Figure 9. Real compensation per employee



Note: The vertical lines indicate the start of the financial crisis in 2007, the Euro Crisis in 2010 and the Covid-19 crisis in 2020, respectively.

Data: AMECO; own calculations.

As Italy was under pressure to improve its public debt statistics as part of its eurozone entry process, privatizations were seen as a quick way to generate one-time tax revenues. In addition, the European Commis-

sion was opposed to Italy's system of financing state-owned enterprises. The 1990s were then characterized by a series of privatisations of state-owned enterprises in banking, electricity, petrochemicals, telecommunications, industry and insurance. In addition, several markets were deregulated through the introduction of modern competition law, including transport, communications, and electricity. The 2000s saw the liberalization of service professions such as law, insurance brokerage, architecture and pharmacies (e.g. Toniolo 2013; OECD 2021). These privatisations reduced the number of large firms in mature sectors of the economy and contributed to a decline in investment, as private owners were unable or unwilling to maintain the level of investment of previously state-owned enterprises (e.g. Baccaro and D'Antoni 2022). The lack of large firms with high levels of technological sophistication is often argued to be an important factor contributing to the slowdown in Italian productivity growth (e.g. Amatori et al. 2013; Capussela 2018). However, to the extent that one is willing to follow this argument, the wave of privatisations and market liberalization since the 1990s has contributed to this decline in large firms in mature sectors and thus also to lower productivity growth.

Another important part of the structural reform debate relates to pension spending, which is the largest part of Italy's government budget; in 2020, Italy's pension spending accounted for 15.1% of GDP or 26.4% of total government spending.[6] However, several pension reforms since the 1990s have slowed the rise in pension spending. The pension system has been transformed into a benefit system in which the level of pension benefits is indexed to changes in life expectancy (Nadalet 2020; see also the chapter by Comelli). Italy's effective exit age from the labor market is currently the highest in the EU and is projected to increase (European Commission 2021, p. 222). While the European Commission projects Italy's public pension expenditure to rise to 17.3% of GDP in 2045, it is projected to decline to less than 13.6% in 2070 (European Commission 2021, p. 68).

Finally, some of the institutional problems that are argued to be at the heart of Italy's economic decline have not worsened in recent decades, but have actually improved. For example, the argument that corruption is an important factor behind Italy's persistent institutional

[6] Source: Eurostat; own calculations.

deficiencies, which also contribute to lower growth (e.g., Del Monte and Papagni 2001), is at odds with comparative data on perceived corruption, which suggest that the relative level of corruption has declined over time.[7] Moreover, political instability in the sense of very frequent changes of government is not new. From 1945 to 1995, Italy had 52 different cabinets in 50 years; but in the 27-year period from 1996 to 2022, Italy had "only" 20 cabinets. This means that government stability has increased as productivity growth has declined.

In sum, the "lack of reform" narrative that dominates public discourse on Italy is inconsistent with the relevant data. Italian governments have undertaken important structural reforms since the 1990s, as they have deregulated labour markets, pursued privatization and implemented pension reforms. The next section deals with the consequences of the policy measures introduced against the background of the dominant view, showing that these measures worsened, rather than improved Italy's outlook.

5. *The role of Euro membership and globalization*

When Italy signed the Maastricht Treaty and committed to joining the euro in the early 1990s, leading politicians and economists argued that this would promote the modernization of the country by forcing Italian governments to make tough policy choices in the face of tighter constraints on their domestic policy options (e.g., Giavazzi and Pagano 1988; Dyson and Featherstone 1999). In previous decades, Italy had frequently devalued its currency to support export competitiveness. In the early 1990s, however, it effectively gave up the option of nominal exchange rate adjustments, since euro membership implied fixed exchange rates vis-à-vis other member countries. The idea was that this would force the unions to moderate their demands, as downward pressure on wages was now the only game in town to improve cost competitiveness and support Italy's exports. Indeed, the 1990s saw a number of measures coordinated between governments, unions and employers

[7] Italy has steadily improved in Transparency International's Corruption Perception index, from the 72nd rank out of 180 in the year 2012 to 42nd in 2021; see Transparency International (2023).

to facilitate disinflation, such as the abolition of wage indexation, the introduction of new collective bargaining structures and labor market reforms to promote more flexible employment contracts (Baccaro and D'Antoni 2022, p. 18). As shown in Figure 9 and discussed in Section 4, wages in Italy have indeed experienced significantly more downward pressure than in euro area peer countries. As discussed in Section 4, Italian policymakers implemented a series of market liberalization reforms aimed at improving business conditions and the competitiveness of firms competing in export markets. Real wages grew even more slowly than productivity, leading to a significant decline in the wage share. Competitiveness as measured by unit labor costs did not improve as productivity growth stalled (e.g. Krahé 2023). Finally, the constraints imposed by the signing of the Maastricht Treaty fostered the establishment of persistent primary budget surpluses, as shown in Figure 5 and discussed in Section 3.

Globalization has put further pressure on Italian exporters through increased trade competition from China and other emerging economies, particularly in Asia (e.g. Gräbner et al. 2020b). Some explain the slowdown in productivity growth by Italy's specialization in sectors with low human capital and the inability to promote technological upgrading (e.g. Faini and Sapir 2005). However, more recent studies reject that more intense competition from China was a driving factor in economic stagnation, as productivity grew faster, not slower, in sectors with greater exposure to China (Pellegrino and Zingales 2017; Calligaris et al. 2018).

The specificity of the Italian experience over the past decades is that all components of aggregate demand for goods and services slowed down. Exports became more difficult as the real exchange rate appreciated. The decline in real wage growth dampened household consumption; investment declined as the economic outlook worsened and as privatization encouraged a decline in the number of large firms in key sectors. In fact, all the potential drivers of the Italian growth model took an unfavorable turn. In the run-up to the financial crisis of 2007/2008, Italy's overall economic growth was mainly driven by domestic demand. The economic downturn during the euro crisis further destroyed demand and reduced imports. Real interest rates in Italy were higher and fiscal policy more contractionary than in Spain, Germany and other euro area countries (Baccaro and Bulfone 2022). As borrow-

ing costs rose during the euro crisis, the ECB initially failed to credibly signal that it would support sovereign bond markets (De Grauwe and Ji 2013), which had a particularly negative impact on Italy. This was because Italy entered the crisis with an already high level of public debt; the rise in government bond rates in 2011 and 2012 and the decline in economic growth implied unfavorable interest-growth differentials, causing Italy’s public debt ratio to rise further. Italy continued to run primary budget surpluses throughout the euro crisis, in contrast to other countries such as Spain, but government spending cuts further reduced aggregate demand and contributed to growth problems, requiring even larger primary surpluses to stabilize the public debt ratio (Storm 2019).

Why have all components of Italian aggregate demand deteriorated? The malaise of the Italian economy in recent decades can only be properly understood by looking at the interaction between international economic policy constraints and domestic conditions (e.g. Guarascio et al. 2023; Baccaro and Bulfone 2022). Italy’s growth model was inconsistent with the opportunities offered by euro membership and globalization. The manufacturing sector was the second largest in the euro area when Italy joined the currency union. But it suffered from an over-representation of small firms, which had a lower capacity to invest in innovation than the pool of firms in other countries. Italy’s technological competitiveness tended to decline as it faced more competition from China and other emerging economies (e.g., Storm 2019; Gräbner et al. 2020b). In addition, the manufacturing sector needed periodic currency devaluations to maintain competitiveness (e.g., De Cecco 2007). However, euro membership brought an appreciation of the real exchange rate, which facilitated even more wage moderation to ensure cost competitiveness, further depressing domestic demand. The role of the state in intervening in the economy was stronger in Italy than in many other countries when Italian policymakers embraced European integration at a time of intensifying international trade competition. As the European regulatory framework made the use of industrial policy interventions more difficult, traditional industrial policy experienced a decline; the Italian economic model was particularly hard hit (e.g., Guarascio and Simonazzi 2016). During the euro crisis, Italy lost about a quarter of its industrial output, but recovery was limited by the lack of fiscal and industrial policy space (Lucchese et al.

2016). However, the South of Italy experienced a much sharper decline in manufacturing value added than the North; household consumption and business investment also fell much more sharply in the South, contributing to stronger North-South polarisation (see also the chapter by Cirillo and Reljij).[8] Production structures in southern Italy are less integrated into value chains, making southern firms dependent on external inputs (e.g. Bronzini et al. 2013).

Euro membership and globalization are not by themselves causal factors in Italy's long decline. However, features of Italy's specific domestic institutional set-up have played an important role. A series of interactions between domestic conditions and the policy constraints imposed by the increasing international and European integration of the Italian economy facilitated a process of economic decline, the first signs of which were already visible in the 1980s at the latest, well before the signing of the Maastricht Treaty, when GDP growth and productivity growth started to show a declining trend (e.g. Celi and Guarascio 2021; Guarascio et al. 2023). If domestic conditions in Italy had been different, euro membership could arguably have been managed more successfully. For example, if Italian policymakers had recognized that rapid labor market liberalization was inconsistent with the goal of strengthening and upgrading the industrial structure of the economy, wages and productivity could have evolved more favorably, which could have fostered innovation and technological upgrading while counteracting downward pressures on domestic demand (e.g. Guarascio and Simonazzi 2016). A less hasty process of disinvestment could have avoided a drive towards smaller firms in critical sectors, which is often argued to be one of the main drivers of the decline in productivity growth (Amatori et al. 2013). But from the 1990s onwards, Italian policymakers invested heavily in the idea that the "external constraint" of European integration should be used to push through a specific liberalization agenda. What Italy got was a deflationary policy

[8] Manufacturing value added declined by 33.1% in the South between 2008 and 2014, while it fell by are more modest 14.2% in the North. Household consumption in the South slumped by 13.2% vs. 5.5% in the Centre-North. Gross fixed investment in the South and in the rest of Italy declined by 38.1% and 27.1%, respectively. (Guarascio and Simonazzi 2016, p. 316).

mix that exacerbated the macroeconomic decline that had already been set in motion – without improving competitiveness.

6. Challenging prevailing views on Italy to improve economic policy

Italy has undeniably experienced economic decline relative to its eurozone peers in recent decades. But the standard narrative, which blames Italy's lack of lack of fiscal discipline and willingness to reform is contradicted by the data. Italy has been at the forefront of fiscal consolidation and market-liberal reforms over the past thirty years. I have argued that Italy's domestic institutions have interacted with international constraints on with international constraints on economic policy to facilitate Italy's decline, the first signs of which began to emerge in the 1980s at the latest with a declining trend in productivity and GDP growth.

Similar to other European countries, Italy certainly has its own significant structural problems. A non-exhaustive list of problems includes the country's long-standing north-south polarization, weak productivity growth, an aging population, and dysfunctional elements of the political system. As the third largest economy in the euro area with close trade links to Europe's industrial core, other member states certainly have a strong interest in positive economic developments in Italy. But instead of asking how European policy mistakes in past crises may have further contributed to economic problems – e.g. by pushing governments deeper into counterproductive deflationary macro policies during the euro crisis – the public discourse on Italy, especially in media and policy circles, is often detached from basic facts, which is a recipe for flawed policy conclusions.

The combination of a common currency, highly integrated financial markets, and a central bank facing (political) constraints on its ability to support government bond markets has made the euro area more vulnerable than other large currency blocs of advanced economies (e.g. De Grauwe 2012). Given Italy's systemic importance as the Eurozone's third largest economy, with a legacy of high public debt, a large banking sector, and close trade links to Europe's industrial core, the country's long decline has indeed made it a particularly vulnerable point for

the Eurozone as a whole (Guarascio et al. 2023). However, doubling down on the prescriptions from the euro crisis, when European policymakers increased pressure on the Italian government to pursue tighter fiscal consolidation and structural reforms from the market-liberal playbook (e.g., Sturm 2019), could push Italy further down the path of decline. This would neither address the systemic instability of the eurozone, which can only be solved by institutional reforms at the European level, nor the complex domestic institutional problems in Italy that have made it difficult to develop a coherent domestic economic policy strategy.

There is arguably too little critical reflection on how EU policymakers could help Italian policymakers to develop a credible approach to opening up a positive long-term development perspective for Italy, beyond sticking to the national pandemic recovery plan in the context of Next Generation EU. A first step would be to have a serious conversation about the distortions of the standard narrative on how Italy ended up in long-term economic decline. If overly tight fiscal policies and market-liberal reforms have failed to move the country forward in recent decades, then a promising approach would be to develop a coherent long-term investment plan and to boost Italy's economy by introducing a modern and green industrial policy. Macroeconomic and labor market policies need to take into account that efforts to reduce labor costs have had a negative impact on wages and domestic demand, aggravating the problems of weak domestic demand and low labor productivity growth. European policymakers need to support proper coordination of wage, industrial and fiscal policies by rethinking the rules of the game, e.g. with regard to reforming the EU's fiscal rules and industrial policy strategies.

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Development models in the EU: opportunities and challenges

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Abstract

This chapter presents an evolutionary approach to studying divergence patterns in Europe and their implications for current policy debates. The approach is rooted in evolutionary economics but also incorporates theoretical and methodological arguments from different paradigms in economics and political economy, which are triangulated into a consistent framework for further analysis. The main concept introduced in this context is that of 'development models'. This concept summarises the key drivers of developmental dynamics and highlights structural dependencies and mutual interrelations between countries. The chapter uses Italy as a core example to illustrate both the strengths and weaknesses of this approach. It argues that, within the EU, no country can entirely alter its development outlook on its own. The countries in Europe are bound together in a community of fate, where the successes and failures of each country are related not only to their own choices, but also to those made by other countries in the Union and supranational institutions. However, country-specific problems and opportunities still remain relevant. In conclusion, the simul-

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taneous relevance of different ontological levels and the importance of history make the analysis of comparative development patterns in the EU both challenging and fascinating.

Keywords: development, growth models, inequality, path dependency, structuralism, systemism

1. Introduction

In 1981, Stefan Musto articulated the sinister long-term apprehension that "growing inequalities, caused by regional concentration of economic activities, will lead to permanent structural crisis in the Union, predetermining the development outlook of the new [Southern] member states and hinder further integration" (Musto, 1981, p. 245; translation by CGR). Today, these warnings seem to have greater relevance than ever, not only, but also because the turbulent economic and political developments in the past 15 years reinforced and accelerated existing tendencies towards economic disintegration. Relevant events that shaped these periods include the financial crises in 2007, the following years of the Great Recession, a major influx of migrants in 2015 and the related political struggles, the recent Corona pandemic, and the ramifications of the war in Ukraine. While these events have reinforced economic polarization – and thereby scattered temporary hopes for a closer convergence, as diagnosed, e.g., after the economic upswing during 2016-2018 (e.g., Zezza, 2020) – focusing too much on these singular events would mean to distract much needed attention from the long-term patterns of socio-economic divergence.

What are the main reasons for the divergence between European economies? Why is it that some economies in the EU are persistently (and increasingly) richer than others? The standard approach in economics would be to search for an answer in national characteristics, especially the quality of the economic institutions in the single economies (e.g., Acemoglu & Robinson, 2010). The idea that the long-term growth and development outlook is most fundamentally determined by a countries' economic and political institutions has become a mainstream conviction in development economics. What is more, there is also much consensus in (mainstream) economics about what

kind of institutions can be expected to yield long-term economic success, irrespective a country's global position in economic, geographic, or geopolitical context. This gold standard of institutions is commonly referred to as the "global standard institutions" (Chang, 2010, p. 474), and it comprises a number of liberal institutions such as an independent legal system facilitating free contracting and strong private property rights, a developed financial system, sufficiently flexible labor markets, or a shareholder-oriented corporate governance system (Chang, 2010, p. 474).

This approach has been criticized both from within economics (mainly by heterodox economists and political economists) as well as other disciplines (mainly by historians, anthropologists, and political scientists). The most frequent criticisms concern the neglect of socio-historic specificities, insufficient attention to path dependencies and historical constraints, a bias in favor of free market-based solutions and the interests of more powerful shareholders vis-à-vis those of other stakeholders, as well as a systematic neglect of structural interdependencies between countries as a major determinant for development outlooks (e.g., Chang, 2010; Kvangraven, 2020; Mazzucato, 2018).[1] The radical alternative to this mainstream approach is represented by contributions in the tradition of the world systems theory, according to which the development outlook of a country gets determined by its position within the global capitalist system with its cores, peripheries, and semi-peripheries, not the national institutions of the different economies (e.g., Wallerstein, 2011).

The present chapter follows an evolutionary approach to make sense of the divergence patterns in Europe and to delineate implications for current policy debates. While rooted in evolutionary economics, the approach is pluralist in the sense that it takes theoretical and methodological arguments from different paradigms in economics and political economy into account, and triangulates them into a consistent framework for further analysis (for more details see Gräbner-Radkowitsch,

[1] Others criticize the idea of global standard institutions from a postcolonial perspective, stressing the reliance on false Western universalisms and the dubious practice of *Othering* countries that do not endorse this set of institutions. While relevant, this critique receives less attention in this chapter, which focuses on the European Union as a core entity of the Global North.

2022). This allows one to take a pragmatic middle way between the strict “methodological nationalism” (Wimmer & Glick Schiller, 2002) of the mainstream approach, and the radical ‘methodological structuralism’ of alternative approaches as outlined above. Thereby, this pluralist approach is well-suited to highlight both country-specific determinants of economic development, as does the mainstream economic approach described above, as well as the role of structural interdependencies between different economies in the EU, as does the structuralist approach. This implies that, within the EU, it is impossible for any country to alter its development outlook entirely on its own. Rather, the countries in Europe are bound into a community of fate, where the successes and failures of each country are related to the choices made not only by the country itself, but also in other countries in the Union, as well as in supranational institutions such as the European Commission, the European Central Bank or the European Parliament. At the same time, attention for country-specific problems or opportunities is not given up entirely. Within such a balanced multi-level approach, a central analytical category is the concept of the ‘development model’, which summarizes the key drivers of the developmental dynamics and is used to highlight structural dependencies and mutual interrelations between countries. It is this simultaneous relevance of different ontological levels, as well as the importance of history that makes the socio-economic analysis of comparative development patterns in the EU challenging and fascinating at the same time. And while the chapter regularly takes a bird eye perspective on the European Union, the main focus will be on Italy, a country that is well suited to point out both the opportunities but also the challenges for our evolutionary approach.

To this end, the chapter proceeds as follows: Section 2 elaborates on the drivers and dimensions of socio-economic divergence in the EU and introduces the concept of the development model. Section 3 then discusses three main challenges one regularly encounters when working with development models. Section 4 illustrates the concept by focusing more concretely on the case of Italy. Section 5 then proceeds with a more general discussion, especially of the implications for policy making. Finally, Section 6 summarizes and concludes the chapter.

2. *Socio-economic divergence and the co-existence of different development models in the European Union*

2.1 Four development models in the EU

The vantage point of this chapter has been the claim of a socio-economic divergence within the EU. This claim requires both empirical evidence as well as qualification. First of all, it is noteworthy that there has not been a 'universal' divergence among countries. Rather, several groups of countries followed quite similar development patterns. This is illustrated in Figure 1a,[2] which shows the dynamics of average GDP per capita for Central, Eastern, and Southern Europe. This geographical grouping is far from perfect, but already points to the growing *divergence* between a Central European 'core' and a Southern European 'periphery', which has frequently been highlighted in the related literature (e.g., Simonazzi et al., 2013; Celi et al., 2018; Gräbner, Heimberger, Kapeller et al., 2020a; see also Celi et al., 2024 in this volume). At the same time, it also suggests a certain *convergence* of Eastern European countries to both Central, but especially Southern Europe during the previous decades, that was only interrupted by the advent of the financial crisis in 2007ff.

Nevertheless, Figure 1a suffers from at least two deficiencies: first, its underlying taxonomy rests primarily on the geographical location of the countries. Second, it considers only GDP per capita as a socio-economic variable of interest. The existing literature on comparative development dynamics in the EU has come up with a variety of different country taxonomies for the EU, each based on a different set of socio-economic variables and theoretical arguments. The aim of these taxonomies is to group countries in a way that maximizes the distinctiveness of the different groups while grouping countries that share important properties.

In the following, we will use a taxonomy first delineated in Gräbner et al. (2020b). Their classification is based mainly on inductive reasoning and can be understood as an exercise dedicated to assessing the validity of existing theoretical groupings of countries by trying to replicate such groupings with stronger reliance on empirical data.

[2] Code and data to replicate the Figures of this chapter is published as Gräbner-Radkowitsch & Kapeller (2024).

Specifically, they studied the country specific effect of increasing economic integration in the EU on key socio-economic characteristics of the economies, such as GDP, unemployment, export performance, public debt or the functional income distribution by means of a local projection approach (see Jordà, 2005). Taking the estimates for the country specific impact (i.e. the estimated fixed effect terms of the corresponding regression) they employ tools from unsupervised machine learning to cluster the countries along the unobserved heterogeneity supposedly captured by the respective fixed effects estimates.

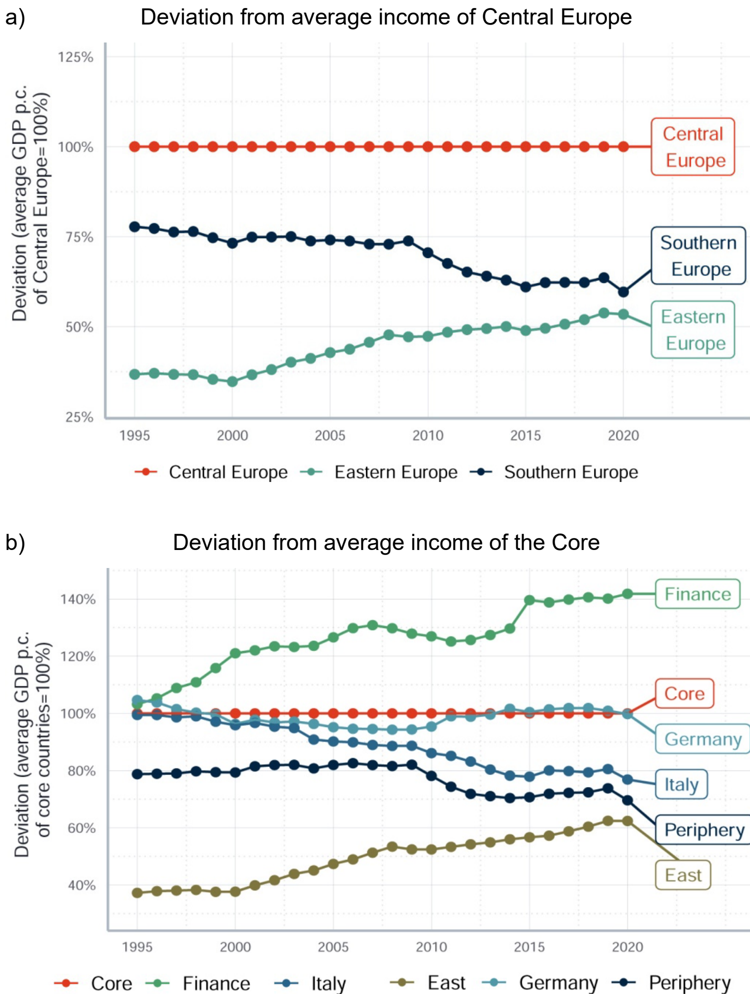
Interestingly, the country groups resulting from clustering the fixed-effect estimates obtained in the course of analyzing the impact of European integration on diverse macroeconomic outcome variables in a local projection framework coincided largely with theoretical considerations about the main drivers of economic development. The resulting classification could, therefore, be thought of a generalization, empirical operationalization or extension of the concept of 'growth models', proposed by Baccaro & Pontusson (2016) to highlight the differences of the main drivers of economic growth. In contrast to the growth model approach, however, development models focus not only on the determinants for aggregated demand, but also integrate supply-side considerations.

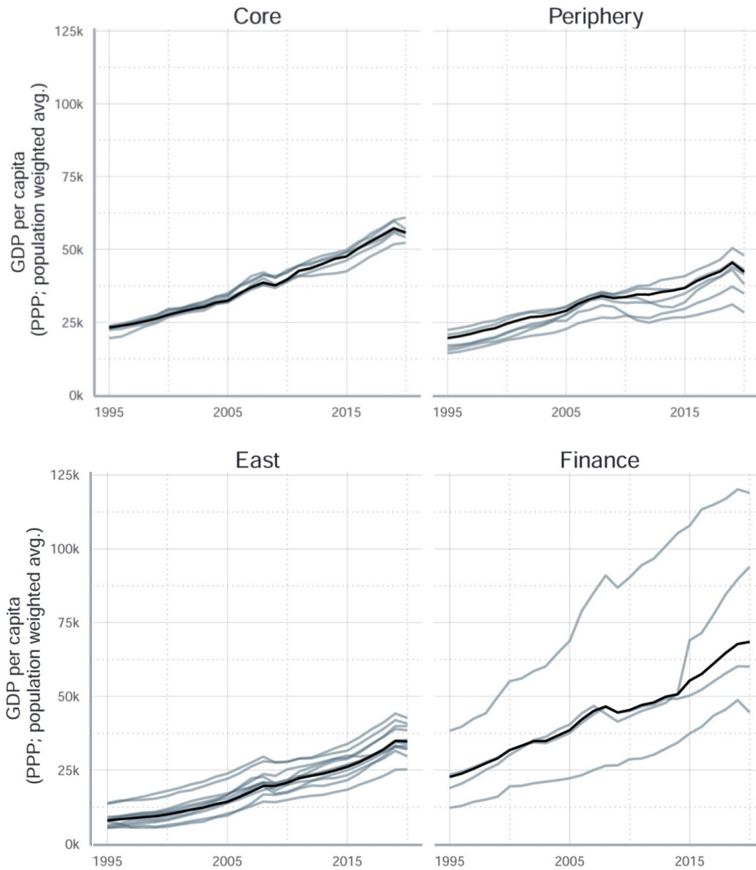
Specifically, the analysis proposes complementing the classic distinction between core and periphery countries by two additional categories. These categories – *Workbench* and *Finance* – highlight important nuances in the developmental trajectory of specific country groups (see also Table 1).[3] They are especially helpful to cover some specific cases that emerged in the course of the development of the EU in the past decades. Firstly, we observe that Eastern Europe by and large follows a catch-up trajectory that is based on a highly skilled workforce in combination with low wages. As such Eastern European countries are in a leapfrogging position keeping close connections to core countries in terms of international value-chains (e.g., Stöllinger, 2016) although the catch-up has been halted for several years after the advent of the financial

[3] This is a similar strategy as the one followed by Nölke and Vliegenthart (2009) when adding the category of dependent market economies to the Varietes-of-Capitalism (VoC) categorization. We do not use this exact category since we deviate in some ways from the VoC approach (for more details see Gräbner and Hafele, 2020) and also wish to highlight different forms of dependence (see below).

crisis. Also, the developments in Eastern Europe are far from uniform (e.g., Bohle, 2017): especially the Baltic countries have not enjoyed the same integration in international production networks as, e.g., Poland or Slowenia, and, hence, it seems questionable whether these countries can sustain their position in this group or whether they will downgrade and add to the number of countries being considered economically peripheral.

Figure 1. Income polarization in the EU





Data: World Bank; own calculation.

Secondly, the category on Finance is hugely important for spotlighting countries that benefit most from increasing international integration by providing a suitable legal infrastructure for attracting financial sector institutions, headquarters, financial investments, and production sites of multi-national corporations as well as high-net-worth individuals and households. As shown in 1b, on average these countries (here: Luxembourg, Netherlands, Malta, and Ireland) profit over proportionally from international integration as they gain a somewhat substantial

stake by sharing the rents of these highly powerful and profitable institutions. But they do so at least to some extent at the expense of other countries, e.g. by incentivizing companies from relocating into their own jurisdiction and, thereby, by draining tax revenues away from others (e.g., Cobham & Garcia-Bernardo, 2020). All this makes the consideration of this particular development model highly relevant, yet its peculiarities are often overlooked by less granular approaches, that aim to position countries in a strict core-periphery dichotomy (as, e.g, in Del Río-Casasola, 2021).

Taking all this into account we follow Gräbner et al. (2020b) and suggest the co-existence of four different development models in the EU, which are described in greater detail in Table 1. As the structural differences between those development models also map unto GDP, the latter is used in Figure 1c to illustrate how the four groups are different to each other, but rather consistent internally. The fact that the internal consistency is lowest for the finance model reflects the fact that its distinguishing features are allowing for a greater heterogeneity of growth trajectories.

It is worth noting that the above typology not only resembles and partially integrates results from related applications trying to delineate suitable typologies of developmental trajectories, but also goes beyond past characterizations in various respects. More specifically, *core* and *periphery* are quite established categories that are classically associated with a World Systems approach, but also align well with characterizations as provided by a growth-model perspective (Baccaro & Pontusson, 2016; see also below) or a Varieties of capitalism approach (e.g., Hall, 2018), in which core countries tend to be coded as 'coordinated market economies', while peripheral countries are coded as 'mixed' or 'dependent market economies' (see, e.g., Nölke & Vliegenthart, 2009). Core countries are characterized by technological superiority in certain branches, which map into a strong position on international markets for manufactured goods. Hence, core countries tend to have a higher and positive current account balance and also enjoy a favorable position on international financial markets. However, membership within these core countries is subject to high internal competition, which can lead certain countries to lose their position within this group in the medium run (e.g., Finland is currently at risk of losing its position within the core due to technological downgrading).

Table 1. An overview over the different development models within the EU

Development model	**Core**	**Periphery**	**Workbench**	**Finance**
Key driver for national income	Technological superiority	Credit, intermediate production	Cheap factor prices	Regulatory setup (financial regulation, taxation)
Requirements	Foreign demand, tech. capabilities, capital outflows, trade openness	Capital inflows, de-regulated financial markets, credit supply	Price competitiveness, moderate amount of technological capabilities, trade openness	De-regulated financial markets, competitive regulations and tax rates, wealthy firms/individuals
Central actors	Manufacturing firms	Banks, households, Governments	Manufacturing firms, foreign corporations	Banks and other financial actors
Negative side effects	Net lending to foreign countries	Increasing total debt (private + public), financial instability	Potential lock-in in low-wage and dependent subcontracting activities; ecological stressors	Reliance on beggar-thy-neighbor policies
Current account implications	Positive	Negative	Positive	Negative in terms of traded goods, positive in terms of services
Typical characteristics	High GDP per capita levels; Importance of industrial production; Production of complex products; Relatively low unemployment	Lower export shares; Relatively high public debt; Tendency to current account deficits; Relatively high unemployment	Relatively low levels of wages and GDP per capita; High degree of foreign ownership; Small service sector, but (partly) important manufacturing sector	High debt levels of private firms; Important share of finance in terms of gross output; High foreign investment inflows; Large incomes from wealth taxes
Members in the EU	Austria, Belgium, Denmark, Finland, Germany, Sweden	Cyprus, France, Greece, Italy, Portugal, Spain	Bulgaria, Romania, Czech Republic, Estonia, Latvia, Lithuania, Hungary, Poland, Slovenia, Slovakia	Luxembourg, Netherlands, Malta, Ireland

In contrast, peripheral economies are lacking, inter alia, the technological capabilities of the core countries and typically compete with South-East Asian low-cost (and low-tech) producers for international market shares (Gräbner, Heimberger, Kapeller et al., 2020a). They also suffer a structural deficiency in domestic demand, that has, before the financial crises, been compensated by additional household debt, while after the financial crisis public debts showed a stronger increase, also because of the government intervened in a time of private debt consolidation. As such these countries are generally to be considered on a 'losing track', that is, a developmental trajectory without clear prospects towards increased prosperity in the long-run.

2.2 Some analytical benefits of studying development models

Moving from an analysis of individual countries to the more aggregated level of development models comes with the need to aggregate potentially heterogeneous elements into more general categories. This begs the question of why such aggregation should be considered attractive in the first place. Put differently: what is the analytical benefit of considering development models as compared to study the comparative development of different EU Member States directly?

Firstly, the analysis and consideration of development models is not meant to substitute the analysis of single countries or regions. To the contrary, development models can be seen as an analytical tool that allows us to group countries with similar structural characteristics thereby complementing more fine-grained studies on the country-level. Secondly, the approach to study comparative development as advocated here rather calls for a nuanced micro-meso-macro framework, in which supranational entities, individual countries, regions, and even lower-level entities such as firms play an important role. In fact, it is precisely the interplay between these different ontological levels of analysis that adds an analytical benefit that is rarely considered when prioritizing one particular level of analysis, such as individual countries.

The relative merit of a development-model approach (as juxtaposed to cross-country or regional analyses) is that it is relatively easier to identify and emphasize shared macroeconomic patterns and structural

constraints that are associated with the predominance of a particular development model. Hence, investigating which countries follow similar development models also allows for the identification of structural similarities and, thereby, facilitates analytical generalizations that are attractive from a scientific point of view. Similarly, the dependencies that a country has because of the relative position of its development model to others can be more effectively diagnosed in this way. In this vein, the concept of development models also points our attention to the relationships between countries, something that is more easily overlooked when national institutions receive the privileged position as in the mainstream approach (see Section 1). In all, we argue that the consideration of development models as proposed here is particularly attractive for the reasons discussed in the following.

2.2.1 Easy integration into an evolutionary micro-meso-macro framework

As discussed in more detail in Gräbner-Radkowitsch (2022), it is rather straightforward to address any potential macro bias that might stem from a focus on development models by embedding them in a proper micro-meso-macro framework in the spirit of Bunge (1996). While the concept allows for different interpretations of the respective levels, depending on the study object at hand, one potential set of layers that lends itself in the context of analyzing comparative development trajectories in the EU is one of *individuals – firms – regions – countries – EU – World-Economy*. While the concept of development models might be thought of being located at the supranational level, it actually draws our attention to processes on various ontological levels: for instance, one prerequisite for countries to be part of the European core is to have a viable reaction to the reductions of domestic demand experienced by many advanced economies as an effect of rising intra-country inequality (e.g., Stockhammer, 2015).

The path taken by countries in the core was to substitute decreases in domestic demand by global demand, i.e. by increasing exports. To achieve this, the firms of these countries must be sufficiently competitive. Since firms in EU usually cannot compete cost-wise with firms from regions with much lower social and environmental standards, a

main option is to achieve considerable technological competitiveness. To this end, firms must accumulate the respective amount of technological capabilities, meaning that they need to develop an appropriate set of organizational routines, establish suitable links to other firms, and attract capable individuals (for more details on the process of capability accumulation see, e.g., Aistleitner et al., 2021). At the same time, regional infrastructure and national institutions affect their abilities to do so. Thus, the question on whether a country can achieve the level of international competitiveness that is necessary to become a core country, touches upon several ontological levels, many of which reside below relative to what is commonly referred to as the *macro level*.

2.2.2 Easier consideration of international dependency structures and relationships

Among the most widespread critique of the mainstream approach to study economic development, i.e. to search for the decisive determinants on the level of national institutions, is its potential neglect of structures of dependency, and relations between countries in general. The focus on 'Global Standard Institutions' (which only refer to *national* institutions) is one symptom of this (Chang, 2010; Kvangraven, 2020). Aside from its close relative, the 'growth model' (Baccaro & Pontusson, 2016), the main inspiration for the concept of development models comes from structuralist and dependency theory (Cimoli & Porcile, 2013; Kvangraven, 2020; see already Cardoso & Faletto, 1969). These scholars stress that to understand the development trajectory of a country we must take its relative position in the international economy into account, including its place in the economic and political hierarchy and its dependencies on others.

Development models are one important factor for the emergence and stabilization of these dependencies and hierarchies. For countries in the European periphery, for instance, it is difficult to address their current account deficits without core countries changing their economic policy agenda as well (Simonazzi et al., 2013; Gräbner, Heimberger, Kapeller et al., 2020a; Celi et al., 2018). Countries are not isolated, but dependent from each other, and these dependencies come with hierar-

chies that become more clearly visible when taking a development models perspective. In this sense, development models are also a concept that could be part of a strategy that takes recent critiques from postcolonial scholars seriously and aims to integrate key notions constructively into a decolonized approach to comparative development studies (for more details on the postcolonial critiques and possible reactions see, e.g., Go, 2016).

2.2.3 Adequate consideration of path dependencies

A second critique of the methodological nationalism common in development economics refers to the neglect of historical path dependencies. Again, while not being automatically immune to such a fallacy, an approach taking seriously the idea of development models lends itself towards an adequate consideration of history. Indeed, the notion of path-dependency is inherently inscribed in the concept of development models, as the latter are typically reinforced over time and in many instances they cannot be easily changed. In other words, a key argument for why development models are relevant in the first place is an inherent path dependency of economic development: countries cannot simply switch from one development model to another, because past dynamics constrain the contemporary action space.

Again, this manifests itself on several ontological levels simultaneously. At the firm level, for instance, the ability to accumulate new technological capabilities is constrained by the set of capabilities that the firm already has at its disposal (Aistleitner et al., 2021; Hidalgo et al., 2018). This gives a considerable head-start to firms in countries that are already technologically superior and aggravates the task for firms in less developed countries to catch up (which, in the absence of counteracting policies, is barely possible). On the national level, this phenomenon can be illustrated via the concept of *Economic Complexity* and the corresponding product space (Hidalgo et al., 2007; Hidalgo & Hausmann, 2009): through the use of export data, this concept quantifies the set of technological capabilities that a country has already accumulated, and which capabilities are in reasonable reach from the status quo. Countries with particularly central capabilities have it much easier to further expand their set of technological capabilities, thereby

securing their economic well-being. For countries that have less capabilities (and, thereby, are given a lower *Economic Complexity Index, ECI)*, the same task is much more difficult, simply because of the historical circumstances they are in (Gräbner, Heimberger, Kapeller et al., 2020a).

2.2.4 Facilitation of generalizations and common features

Finally, while the move towards a higher level of aggregation necessarily comes with generalizations that potentially shallows particularities of lower-level entities, it also facilitates the identification of more general mechanisms. For instance, the fact that the strategy of substituting domestic demand by exports comes with considerable capital outflows and puts pressure on countries with the same currency to facilitate capital inflows is not specific to the German economy. Rather, it is similarly relevant to other countries in the European core. This general insight also facilitates the explanation of the role these countries play in policy debates about questions of trade policy, industrial policy or financial regulation, which all have particular implications for their shared development model.

This is not to say that the multi-level approach described above does not come with potential drawbacks or that such an approach will never shallow relevant details. As every scientific strategy it comes with both opportunities and challenges, as will become evident from the next section.

3. Three challenges for the development models approach

The previous sections have argued that the concept of development models, alongside the structuralist and evolutionary theories that have inspired the concept, come with some very attractive features. At the same time, one has to acknowledge that such an approach also exhibits blind spots on its own. These require additional efforts to avoid overlooking other important aspects of comparative development patterns. More precisely, such an approach comes with three distinctive challenges: (i) the challenge of *ambiguity*, (ii) the challenge of *dynamics*,

and the challenge of *granularity* (Gräbner & Hafele, 2020; Gräbner-Radkowitsch, 2022). While these challenges do not invalidate the approach as such, they point towards potential blind spots, which require particular attention in practice, i.e. when drawing conclusions from the development model approach for answering applied questions.

3.1 The challenge of ambiguity

The challenge of ambiguity arises whenever a country would be classified differently depending on the dimension or field considered. For instance, France is a politically very important player in the EU. Thus, when considering the political sphere, one would most likely classify France as a core country. If one focused, however, on the economic dimension, France occupies a middle ground between core and periphery (but lies slightly closer to the Southern European periphery, especially in more recent years). The resulting ambiguities, however, are best understood as the interesting exceptions to a rule since real economies are quite complex systems exhibiting a degree of heterogeneity that escapes the rough patterns on which the development model analysis is necessarily based. This caveat also implies that whenever we encounter an exemplary case for the challenge of ambiguity, there are usually some important structural or historical events that warrant closer inspection. In the case of France, for instance, one cannot make sense of the development trajectory of France without taking into account its central role in the founding of the European Communities after 1951, its early industrialization as well as its specific role of a nuclear power and permanent member of the security council of the UN. The shadow of these historical events continues to shape the contemporary position of France and that serves as a powerful counterweight to the in many ways detrimental economic development within the country.

3.2 The challenge of granularity

Countries are internally heterogeneous, and especially larger Member States often show pronounced levels of regional inequality. In some cases, this gives rise to a ‘fractal’-like structure, where core-periphery

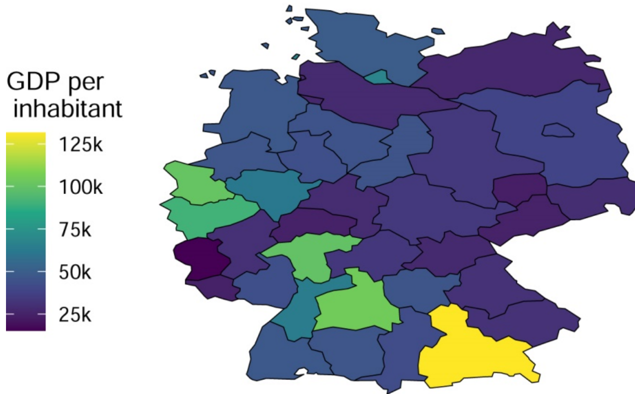
structures visible on the European level are mimicked on lower, regional levels within countries as well. In these cases, one might speak of a challenge of *granularity*: while a country as a whole can be considered to be part of the European core, *within* this country we find different regions, where some of these regions would be assigned a peripheral role in a more fine-grained analytical setup.

Germany serves as an excellent example to illustrate this challenge: while Germany as a whole regularly serves as a prime example for a core country, it is also coined by internal fragmentation that reflects historical path-dependencies and, in turn, also translates into internal political cleavages. Figure 2a, for instance, illustrates the pronounced differences in regional GDP in Germany, highlighting the persistent differences between East and West. Several additions to this figure are important, however: first, the East-West divide is today being complemented by an increasing income gap between the manufacturing-intensive South and the economically weaker North. Second, these internal inequalities not only relate to income, but also address dimensions as diverse as infrastructure, innovation activities, and political orientation. Finally, these geographical core-periphery structures within Germany are complemented by various functional core-periphery structures. The dual nature of the German labor market with its growing low-wage sector is often considered a flipside of the export-oriented German model (Celi et al., 2018). In any case, Germany, despite being the common prime example for a core country, suffers from internal divisions and inequalities, which give rise to persistent within-country core-periphery structures that are unlikely to dissipate without considerable policy efforts (and indeed already have withstood such efforts on various levels).

Other important examples for the challenge of granularity include Spain with the economically strong North and the peripheral South, or Italy with the manufacturing core in the center-North, and its peripheral *Mezzogiorno* in the South (see also Cirillo, 2024 in this volume, as well as the elaborations below).

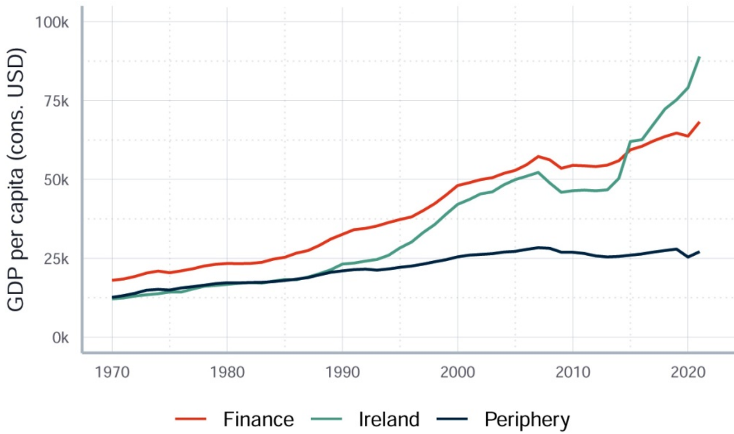
Figure 2.

a) The challenge of granularity in Germany



Data: Eurostat.

b) The challenge of dynamics for Ireland



Data: Eurostat, own calculation.

3.3 The challenge of dynamics

While the path dependencies underlying the stability of development models are highly relevant, they do not deterministically condition the future of a country. Rather, they represent obstacles (or safe posts) in the sense of additional constraints that need to be overcome before a country structurally changes its relative position in the European economic system. While such changes are difficult to achieve, it is not impossible, and this is what the challenge of dynamics is about: the fact that some countries might switch from one group to another over time.

Within the EU, the most prominent example, next to Italy, which is discussed in more detail in Celi et al. (2024; this volume) and below, is Ireland (see panel b of Figure 2). Ireland has long been a typical member of the European periphery, very dependent on the political and economic development of the UK. It has, however, managed to move to the group of highly financialized countries, and has managed to attract a number of international high-tech companies, especially in the IT and pharmaceutical sector (for a more detailed analysis of the Irish case see, e.g., Barry & Bergin, 2012). While the strategy of Ireland can be criticized for relying on very low tax rates and the attraction of company headquarters at the expense of other EU Member States, not only is this behavior typical for countries following a financial development model, it also has led to at least a temporal boost in GDP growth, irrespective recent ambiguities of Irish GDP accounting.[4]

4. The case of Italy

As a periphery country, Italy is suffering from several structural difficulties common for countries following this development model. For instance, due to a lack of resilience and unfavorable structural specializations, periphery countries often suffer more from exogeneous negative shocks than countries in, for instance, the core. This was clearly visible, e.g., in the aftermath of the financial crisis in 2007ff, which hit

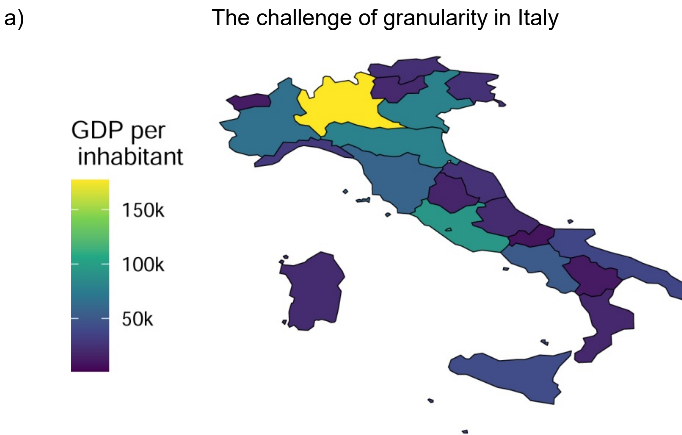
[4] For more in-depth discussion of the complex and ambiguous case of Ireland see, e.g., Barry & Bergin (2012) and Brazys & Regan (2017).

the periphery hardest, or the Covid-19 pandemic, against which periphery countries were much less capable to react as countries in the core (Gräbner, Heimberger, & Kapeller, 2020).

Italy is also among the countries that suffer most from a loss of tax money to countries following the finance model, especially the Netherlands (Cobham & Garcia-Bernardo, 2020), but has not yet managed to push through its interest for a stronger EU-level regulation that would prevent such practices. Similarly, due to its historical high levels of debt (for more details see Gobbi & Lucarelli, 2024 in this volume), Italy is constrained to a particular degree by the European Stability and Growth Pact with its procyclical (and, therefore, highly dubious) output gap rules (Heimberger & Kapeller, 2017; Heimberger et al., 2020; see also Heimberger, 2024 in this volume).

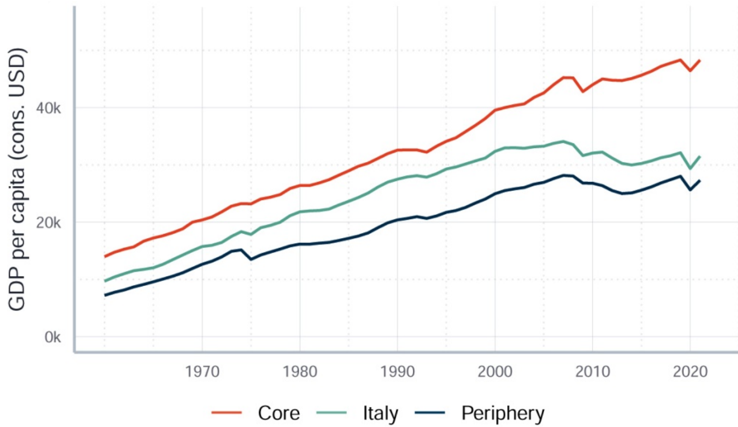
While this descriptive account already points to the analytical merit of a development model or growth mode perspective, the previous section has highlighted, that such concepts also come with particular challenges. In this context, Italy is a country that might serve as a particularly good example for all three challenges introduced above.

Figure 3.



Data: Eurostat.

b)



Data: Eurostat, own calculation.

Firstly, as discussed above (and, in more detail, by Cirillo, 2024; this volume), the Italian North-South divide is a prime example for the challenge of *granularity*. Not only is the centre-North of Italy much richer than the poorly industrialized Southern *Mezzogiorno* (see Figure 3a), it is also their relationship that shows a typical core-periphery relationship: for instance, workers from the South effectively served as a "Industrial Reserve Army" for the manufacturing companies in the North, thereby supporting their competitiveness and stabilizing the structural inequalities (Celi et al., 2024 in this volume). Similarly, effects of national austerity policies had much more severe implications in the economically less resilient areas in the South as compared to the Centre-North, a fact that further reinforced the within-country core-periphery structure (Dario Guarascio et al., 2023; Celi et al., 2024 in this volume).

Secondly, as also discussed in more detail by Celi et al. (2024 in this volume), Italy has been taken an intermediate position between European core and periphery since its entry to the European Economic Community in 1957, illustrating the relevance of the challenge of *dynamics*: while it has taken a position in between the core and periphery after joining the EU and has tended to converge towards the

core until the 1990, it then lost track and followed the typical development trajectory of a periphery country (Figure 3b; for a more concise discussion of the reasons see also Celi et al., 2024 in this volume.)

Finally, due to historical reasons, but also the sheer size of its economy, Italy has always been a politically very influential country. Not the least, it is member of the politically powerful G7 group. Thus, it is not the 'typical' periphery country one might think of in the first place given the framing associated with the somewhat pejorative term of 'periphery'. Rather, it is a periphery country that especially in the political field also shows many features one would typically associate with the European core, illustrating nicely the challenge of *ambiguity*: one the one hand, Italy's political power was sufficient to enforce a number of exceptions from the Temporary Crisis Framework and to realize considerable subsidies for its domestic industries (though, to a much smaller extent than the core country Germany), as well as to ensure relatively favorable rules within the NextGenerationsEu program, where it is the second largest beneficiary.

On the other hand, Italy has been unsuccessful in attempting to change the rules of, for instance, the European Stability and Growth Pact, which severely limits Italy's policy space and poses particular risks to its economy due to historically high levels of debt (for more details see Heimberger, 2024 and Gobbi & Lucarelli 2024, both in this volume). Therefore, while Italy illustrates the challenge of ambiguity with a political position that is untypical for a country in the periphery, its economic situation prevents it from leaving the group of peripheries and keeps it locked at a path towards economic stagnation.

Does this imply that the concept of development models is especially problematic when studying Italy? Probably not, as we, for one, already showed that the focus on development models highlights some particularly important features of Italy's development trajectory. For another, also the elaborations on the three challenges indicate this potential. If the challenges are addressed explicitly, a potential drawback can be transformed into a feature of any analysis: discussing the challenges of ambiguity, dynamics, and granularity for Italy helps both highlighting and structuring the complexity the different factors underlying Italy's development experience.

5. *Policy implications and discussion*

We have seen from the elaborations above, that, especially when taking into account the three challenges from Section 3, the concept of development models can highlight some relevant aspects of the comparative development dynamics in the EU. Yet, these aspects are not only interesting from an academic point of view, they also bear serious implications for policy making. In particular, they help avoiding an individualist (or: nationalist) bias that is often associated with the mainstream approach in development: the idea that national problems must first and foremost be addressed by national policies. Especially poorer countries are often lectured by richer ones about the need for 'fixing their institutions' or implementing 'structural reforms' to address their socio-economic calamities. A notorious prime example is the debate on Greece in the context of its sovereign debt crises with the subsequent decision to put the country under strict fiscal supervision by the Troika and to enforce massive austerity measures.

What is missing from this common narrative are the many interdependencies between countries that are highlighted by a structuralist approach that takes development models seriously: in many important ways, the reasons for the economic success of countries in the core and finance group are often the flipside of the reasons for challenges for the periphery and Eastern countries. This observation, thereby, not only relates to issues of political governance, but is also reflected by basic economic data, which indicates that the rise of China as the world's main workbench had asymmetric effects on core countries (which profited from additional exports in machinery to China) and periphery countries (which compete more strongly with Chinese exports and, hence, suffered from Chinese expansion; Gräbner, Heimberger, Kapeller et al., 2020a).

This is not to say that national (or regional) institutions are not part of the explanation or do not require attention. Rather, we intend to stress that for addressing socio-economic inequalities within a closely integrated system as the EU, *both*, periphery as well as core (and finance) countries, must probably adapt their policies. For instance, as long as most core countries rely heavily on realizing export surpluses to substitute their decrease of domestic demand, other countries in the EU are under increased pressure to increase their national debt (Gräbner-

Radkowitsch et al., 2022). Similarly, as long as countries following a finance development models attract companies and individuals through low taxes and, thereby, drain tax income from countries in the periphery, the challenge for the latter to realize much needed tax revenues to finance their infrastructure is greatly aggravated. At the same time, it is barely disputable that, for instance, the Italian *Mezzogiorno* suffers from a detrimental focus on price sensitive mass products (in contrast to the regions in the North, see, e.g., Amighini & Rabellotti, 2006), an issue that must also be taken more seriously by the Italian federal government.

Thus, addressing the problem of socioeconomic divergence in the EU, and the more general challenge of ensuring decent living standards all over the Union, the simultaneous policy reforms on both the regional, national, and supranational level.

On the European level, this necessarily includes a consistent agenda for industrial policy, which addresses the uneven distribution of technological capabilities within the EU by moving from the current focus on horizontal industrial policy to a vertical approach that is geared to stimulate the accumulation of capabilities especially in countries and regions that are currently lagging behind (e.g., Kapeller et al., 2019; Pianta et al., 2020). More generally, EU Member States must establish a more cooperative policy framework, which prevents beggar-thy-neighbor policies at the expense of other member states, such as the intra-EU externalization of ecological costs to supplying industries (e.g., Gräbner-Radkowitsch et al., 2023), a regulatory race to the bottom (e.g., Kapeller & Gräbner-Radkowitsch, 2021), or the attraction of wealthy individuals or companies through low taxes at the expense of other EU members (e.g., Cobham & Garcia-Bernardo, 2020). All this becomes even more relevant in the context of the necessary green transformations of the European economies, a challenge that is closely related to the topic of socio-economic polarization and the structural differences across growth models (e.g., Wildauer et al., 2020; Gräbner-Radkowitsch & Hafele, 2022).

In this context, greater flexibility in terms of fiscal policies will be necessary for public actors and infrastructures to support the transition towards carbon-neutral processes and systems of provisioning while keeping inequality at bay at the same time. Similarly, broadening the portfolio of goals to be achieved by the European Central Bank by

dispensing the currently established main focus on price stability could help to better utilize the institutional potentials of the EU to work towards internal integration and convergence. However, such a perspective is hampered by the wide-spread, but erroneous conviction that assigning a greater role to public investment will inevitably lead to sovereign debt and default issues (Wildauer et al., 2021). In this spirit, novel policy measures that expand the policy space in more than one dimension are highly needed in times of multiple crises and constraints. A prime example is given by a European wealth tax that would allow for levying substantial amounts (300-400 bio. €) of revenues to be dedicated for transformation purposes while at the same time contributing to greater wealth equality within the population of European citizens (Kapeller et al., 2023). Also, the introduction of such a tax would be a game-changer in political economy terms as it would the first instance in which the EU would acquire an explicit and autonomous fiscal capacity.

6. Summary and conclusion

This chapter discussed the concept of 'development models' and their appeal when studying comparative development trajectories in the EU. This approach comes from an evolutionary and structuralist tradition and highlights the relevance of structural and dependency-related determinants for socio-economic development. Thus, it can be thought of as an important counter-weight against the common focus on national institutions as determinants of economic development. Rather than unilaterally prioritizing structural and macro factors, however, the approach outlined here acknowledges the simultaneous relevance of reforms in different ontological levels, and rejects the idea that the solution to national problems necessarily lies in the change of national institutions. At the same time, the use of development models also comes with some particular challenges, most notably the challenges of *dynamics*, *ambiguity*, and *granularity* as discussed above. These must be taken into careful account if the concept is to be used successfully in practice.

In the context of the EU, the paper discussed four different but related development models: a core, a periphery, the finance-led coun-

tries, as well as the workbench model. Italy was discussed as a specific example of the periphery model, that illustrates both, the strengths as well as challenges associated with the development model approach. Finally, the consideration of development models suggested some immediate policy implications, such as a shift towards more vertical industrial policy, a restructuring of European fiscal and monetary policies and the necessity to introduce effective measures against beggar-thy-neighbor policies within the EU.

Since this chapter was meant only as an introduction to the concept of development models, a number of important topics were necessarily ignored or touched upon only insufficiently. This includes, inter alia, the ecological dimension of development models, above all the question of whether green transformations are more likely to stabilize or break the path dependencies associated with growth models. This question is particular relevant against the backdrop of the new European guiding principle of Competitive Sustainability (e.g., Gräbner-Radkowitsch et al., 2023). Similarly, the place of the EU within the global economic system (in which many periphery countries in the EU may count as global core countries) calls for the use and extension of the concept of development models. In this broader context, topics such as ecological externalization and global unequal exchange become more relevant than in the European context (e.g., Wood et al., 2020), yet we are convinced that just as for the case of the EU, the development model approach may provide a nuanced and inspiring multi-level alternative to more conservative micro or macro approaches.

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From Miracle to Decline

Italy's long-term development trajectory between core and periphery

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Abstract

This text analyses the evolution of the Italian economy in the post-war period. It shows how the factors that allowed the Italian 'economic miracle' of the 1960s revealed their inherent weakness and inability to withstand external constraints as the latter became more binding. Since the 1990s, the Italian economy has been in decline, moving from the centre to the periphery of the European Union. The text highlights the crucial role of Germany. Both the asymmetric complementarities linking the two countries and Germany's influence on the construction of European institutions are fundamental to understanding the structural evolution of the Italian economy, in good times as well as in bad. Italy's vulnerability epitomizes the self-defeating nature of Europe's export-led growth model, as the internal core-periphery divergence deepens, while Europe continues to lose ground against competitors. Finally, we discuss how the current global turmoil may reshape Europe and Italy's trajectory.

Keywords: core-periphery relations, growth models, inequality, structural dependencies

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1. Introduction

In this chapter we analyze the evolution of the Italian economy in the post-war period. We show how the factors that allowed the Italian "economic miracle" of the 1960s – i.e., macroeconomic convergence to the levels of advanced European economies such as Germany, France, and the United Kingdom – revealed their inherent weakness and inability to withstand external constraints as the latter became more binding. Since the 1990s, the Italian economy has been in decline, moving from the centre to the periphery of the European Union (Guarascio et al., 2023a). Crisis after crisis, Italy's vulnerability begins to epitomize the self-defeating nature of Europe's export-led growth model, as the internal core-periphery divergence deepens, while Europe continues to lose ground against United States and China[1].

In this context, the role of Germany is crucial. The asymmetric complementarities linking Germany and Italy are fundamental to understanding the structural evolution of the Italian economy, in good times as well as in bad. The German influence on the construction of European institutions is another important piece of the puzzle. As the "poster child" of austerity (Storm, 2019), Italy has shown that adherence to the EU rulebook – e.g., fiscal restraint, wage moderation and labor market fragmentation, state retrenchment and the abandonment of selective industrial policies, etc. – may support exports, but at the cost of undermining the structural prospects of the economy in the medium term.

Things are now being reshaped by the disruptive combination of the Covid-19 pandemic and the Russia-Ukraine war, which pose new challenges for Europe and Italy. While the pandemic has exacerbated the core-periphery polarization, the war is exposing Europe's structural vulnerability as its dependence on foreign energy and technology suppliers threatens to limit long-term growth prospects and jeopardize energy transition plans. How this will affect the further evolution of the Italian economy is difficult to predict. What is certain is that Italy's ability to increase its resilience to a turbulent global environment will depend on the fiscal space available for countercyclical and industrial

[1] Using World Bank data for the period 1999-2022, and setting 1999=100, the Euro Area GDP per capita (expressed in constant 2017 international $) increased 25%, against +32% of USA and a staggering +567% of China. In contrast, over the same period Italy only scored a timid +5%.

policies, which will be affected by future decisions on the EU rulebook. Italy's journey is thus a tale of a country moving from the periphery to the centre and back, and whose growth trajectory has been shaped by both domestic and international factors (see also the chapter by Gräbner-Radkowitsch and Kapeller).

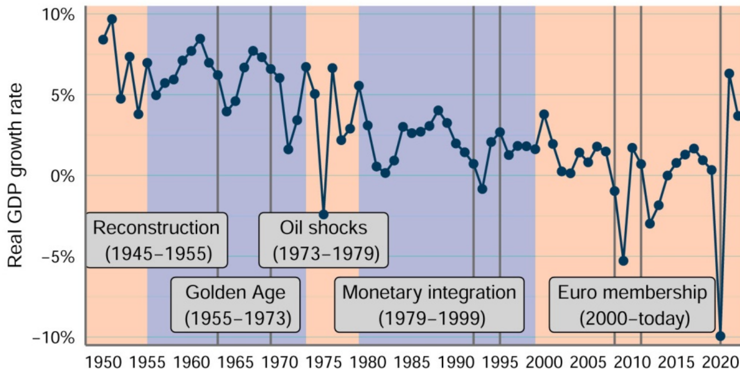
The rest of this chapter is structured as follows. The next section briefly illustrates the long-term evolution of the Italian economy, highlighting the main discontinuities and historical phases. Section 3 looks at the interaction between domestic structural weaknesses and external constraints, examining how both have evolved over time. Then, in Section 4, we analyze the peculiar relationship between Italy and Germany, focusing on their asymmetric complementarities as a key to understanding Italy's structural evolution. Finally, in Section 5, we conclude by discussing how the current global turmoil may reshape Europe and Italy's trajectory.

2. *A brief history of the Italian economy*

To understand the long-term pattern of economies in terms of their growth performance, changing industrial specialization, positioning within global value chains (GVCs) and trade hierarchies, it is necessary to pay tribute to history. In the case of Italy, it is necessary to highlight the main discontinuities that mark the path from "economic miracle" to sustained decline – in the face of a changing global and European landscape (Celi et al., 2018). According to Graziani (1998), Italy's long-term development can be divided into five distinct phases (Figure 1; see also the chapter by Gobbi & Lucarelli): Reconstruction (1945-1955); Golden Age (1955-1973); Oil shocks (1973-1979); European monetary integration (1979-1999); Euro membership (2000-today).

Reconstruction (1945-1955). After the Second World War, two problems had to be solved. The first was to rebuild the manufacturing base by converting war plants, mostly in the north, to civilian use. The second was the reduction of structural unemployment through agrarian reform and the construction of large public infrastructures.

Figure 1. Growth in historical perspective (1950-2023)



Notes: vertical lines correspond to, respectively: the unions' protests of 1963 and 1969; the lira devaluation of 1992; the change in fiscal stance of 1995; the Global Financial Crisis of 2008; the Sovereign Debt Crisis of 2011; the Covid Pandemic of 2020.

Data: AMECO.

Golden Age (1955-1973). Large migratory flows to northern European countries and rapid industrial development helped to (temporarily) dwarf unemployment, freeing up resources to sustain investment, expand the export sector, and achieve a balanced balance of payments (BoP) (along with low inflation rates). In this phase, Italy moved "from the periphery to the center" (Zamagni, 1993) and experienced a rapid catch-up with its more advanced European peers. By the end of the 1960s, however, migration flows had declined significantly (also due to the restructuring of the German, Belgian and French industrial base), leading to a new wave of unemployment, especially in the south. Meanwhile, full employment was reached in the northwest, fueling the first union uprising, which was promptly deescalated by two restrictive monetary interventions (1963 and 1969), leading to a first restructuring of labor relations based on the decentralization of production and the rise of industrial districts.

Oil shocks (1973-1979). In the 1970s, the international landscape changed dramatically. In Europe, only Germany seemed capable of meeting these challenges. Italy was caught in the middle of the storm,

finding it difficult to compete in international markets both with the more developed and technologically advanced group of three (USA, Japan, Germany) and with the developing countries, whose lower labor costs made it difficult (if not impossible) to resort to the usual strategy of currency devaluation, putting additional pressure on the Italian export sector.

European monetary integration (1979-1999). In 1979, the European Monetary System (EMS) was created, with semi-fixed exchange rates among member countries and floating rates against the US dollar. Italy entered the EMS with a higher public debt-to-GDP ratio and a relatively more fragile industrial structure than its more competitive peers (i.e., Germany). In order to achieve price stability, monetary and fiscal policies had become restrictive. However, this backfired in terms of growth and unemployment. This was particularly true in the manufacturing sector, where employment rates fell and the bargaining power of unions was weakened (Cesaratto and Zezza, 2019). The combination of these elements fueled income inequality and widened the North-South divide. From a macroeconomic perspective, the EMS contributed to the deterioration of Italy's external competitiveness, as exports were burdened by an overvalued lira and investment was penalized by high real interest rates. In 1992, the accumulated tensions culminated in a severe currency crisis. In its aftermath, the devaluation of the lira provided some relief, and Italy's GDP and productivity began to grow again. The recovery was short-lived, however, as the external constraint was about to return. A few months before the crisis, twelve EU countries (including Italy) signed the Maastricht Treaty, which introduced even tighter fiscal and monetary constraints. To meet the Maastricht convergence criteria, Italy adopted a "draconian" approach to fiscal policy, with the primary balance rising to 6% of GDP by 1997.

Euro membership (2000-today). The first years of the European Monetary Union (EMU) seem to have been a time of prosperity for Italy and other southern countries. Falling interest rates, capital inflows, declining public debt, and growth rates above those of France and Germany gave the illusion of convergence (Zezza, 2020). Behind the euphoria, macroeconomic imbalances and structural divergences built up (Guerrieri and Esposito, 2012; Özgür and Memiş, 2017; Stockhammer et al., 2015). In Italy, wage stagnation and investment constrained productivity growth and contribute to the deterioration of

the BoP as competition from China and Eastern European countries intensified. When the Global Financial Crisis (GFC) hit, the Italian banking sector proved to be more resilient than other peripheral countries as it was less financialized and less exposed to the US subprime market. However, in keeping with the Maastricht rules, the government's response to the crisis was characterized by fiscal restraint. As the EU response turned a private debt crisis into a sovereign debt crisis, Italy was forced to adopt fiscal austerity measures, resulting in a double-dip recession that lasted until 2013 (Heimberger, 2017). The following years were marked by a slow recovery, constrained by the implementation of further fiscal consolidation packages. The current account improved markedly due to a sharp decline in imports and the depreciation of the euro against the US dollar. However, growth did not resume and the divergence from the core countries deepened (Gräbner et al., 2020), reflected in a growing territorial divide and large migration flows, both within the country (from south to north) and abroad (on the Italian north-south divide see also the chapter by Cirillo and Reljic).[2]

The Covid-19 pandemic and the Russia-Ukraine conflict mark two additional discontinuities in the long-term trajectory illustrated above. The former furthered the core-periphery polarization: where post-GFC austerity policies were more prevalent, such as in Italy and the rest of the southern periphery (Celi et al., 2020), the death toll and socioeconomic costs of Covid-19 skyrocketed (Prante et al., 2020). On the other hand, the war is exposing Europe's structural vulnerability: dependence on foreign suppliers of energy and technology is jeopardizing the EU's

[2] Italy's North-South divide and its dynamics have always been one of the main drivers of the country's development. The so-called "Southern Question" (Questione Meridionale) has been a long-lasting and much debated phenomenon since the unification of the country. Its origins and determinants remain controversial (Daniele and Malanima, 2011). Despite its persistence throughout Italy's development, the dimension of the North-South divide has experienced three distinct phases – of increase (between unification and the 1950s), decline (during the Economic Miracle), and stabilization at a higher level (during the Europeanization of the Italian economy) – characterized by different rates of industrialization and structural change corresponding to major shocks in the international environment (Iuzzolino et al., 2013). For more details see also the chapter by Cirillo and Reljic.

industrial policy plans, especially those aimed at accelerating digitalization and energy transition. Rising inflation is particularly penalizing low incomes and the most vulnerable components of the labor market, contributing to widening inequalities. This is particularly problematic in Italy, where the share of precarious and low-income workers has steadily increased over the past two decades (see, among others, the chapter by Cirillo and Reljic). Given the strong uncertainty that characterizes this phase, it is not easy to predict how the two shocks will affect Italy's structural trajectory. However, if the internal contradictions of the EU's economic policy framework persist and there is no structural strengthening of the periphery, there is a serious risk that Italy's position will deteriorate further. The next section looks at the co-evolution between domestic structural weaknesses and external constraints and discusses how the two have evolved over time.

3. The interaction between structural weaknesses and external constraints

Throughout its history, the evolution of the Italian economy has been shaped by ambivalent forces, both internal and external. Internally, factors that drove growth and development in good times turned out to be structural ballast in bad times (Celi and Guarascio, 2019). The first element concerns the availability of a large mass of cheap labor. During the "golden age" (see above), the massive flows of workers from the poor and relatively under-industrialized *Mezzogiorno* to the north contributed to a downward pressure on wages, supporting the competitiveness of northern manufacturing industries, which gained significant positions in international markets (De Cecco, 1971). Since most firms were concentrated in medium-tech industries[3], exporting firms had to penetrate foreign markets by focusing on price competitiveness rather than product quality. Therefore, downward pressure on wages became the main strategy to achieve continuous productivity gains and

[3] The country specialization in traditional and unsophisticated manufactures is a long-lasting problem of the Italian economy, which predates WWII (Domini, 2016), and which results from the abundance of cheap unskilled labour and resource scarcity preventing heavy industries from developing (Nuvolari and Vasta, 2015).

expand export market shares (Storm, 2019). A strategy that is self-reinforcing due to some peculiar structural conditions: a low industrial labor force participation rate – particularly in the *Mezzogiorno*[4] – and a strong emigration pattern, both within the country (from south to north) and abroad (Cipolla, 1990, 1995). What sustained export growth in the early postwar period, however, became a ballast that subsequently constrained Italy's structural development. With the onset of globalization and the intensification of technological competition, Italian industries began to lose momentum (Celi et al., 2018).

After reaching the crossroads of globalization, low wages and intensive exploitation of labor turn out to be increasingly unsatisfactory substitutes for product innovation and quality upgrading (Celi et al., 2019). As a result, Italy is beginning to retreat (or be displaced altogether) in key sectors such as ICT or pharmaceuticals, where R&D and complex innovation are the basis for success (Gallino, 2003). The overestimation of Italy's competitiveness in good times, the abundance of cheap labor, and wage repression have reduced innovation incentives for private firms, providing a temporary (and ephemeral) competitive gap as the economy begins to show the first signs of its prolonged decline (Cresti and Virgilito, 2023; Guarascio et al., 2023a).

The second element concerns state interventionism and industrial policy. Between the Second World War and the late 1960s, Italy experienced a fairly rapid (albeit partial) technological catch-up with its main competitors, notably France and Germany. This is also reflected in the increasing quality of its manufactured goods (Dosi and Guarascio, 2018). Three main factors have favored these developments. First, a particular policy mix based on an expansionary fiscal policy-mostly based on public investments aimed at strengthening infrastructure, providing public goods (schools, health, and social housing), and promoting territorial convergence-and a selective industrial policy aimed at broadening the productive base in capital- and innovation-intensive sectors. Second, a group of innovative state-owned enterprises (SOEs)-coordinated by the Istituto per la Ricostruzione Industriale (IRI)-operating in technologically strategic sectors such as shipbuilding, chemicals, and electronics, have made a significant contribu-

[4] Mezzogiorno refers to Southern Italy, and includes the regions of Abruzzo, Molise, Campania, Puglia, Basilicata, Calabria, Sicily, and Sardinia.

tion in terms of value added and accumulation of technological capabilities (Gasperin, 2022). The growth of SOEs partly compensated for the rather low innovation intensity of private firms, which in turn tended to be small and undercapitalized, thus facilitating the diffusion of technological spillovers, imitation, and learning. Third, coordinated networks of highly dynamic SMEs clustered in "industrial districts", mostly located in the northeast (Emilia Romagna and Veneto). In this case, the interplay between relatively efficient local institutions, widespread innovative capacity linked to old artisanal traditions, and a wealth of technical skills made it possible to exploit economies of scale and scope despite the relatively small size of the firms. In the 1980s, the strength of these drivers began to fade, halting the catch-up process (Ginzburg and Simonazzi, 2015) and accelerating Italy's decline (Guarascio et al., 2023a). As Bank of Italy and the Treasury 'divorced'[5], a privatization of financial institutions starts and limits on international capital movements are removed, fiscal resources start being drained by rising interest rates, with negative implications for investments, growth and territorial convergence (Cesaratto and Zezza, 2019). In a context of growing unemployment, what remains are mostly crony current expenditures with harmful consequences for the efficiency of public services and productivity. At the same time, selective industrial policies are abandoned in line with the market logic that begins to hegemonize the Italian (and European) economic policy framework (Celi et al., 2018). The dismantling of IRI (Gasperin et al., 2021), which paved the way for one of the largest privatization processes in Europe, had two negative (and intertwined) consequences: the impoverishment of the technological and productive capacities of the Italian manufacturing base and the isolation of industrial districts, significantly reducing their contribution to productivity and growth.

The third and final element concerns Italy's long-lasting territorial divide. In this respect, internal weaknesses and contradictions are exacerbated by external constraints that become increasingly binding over time. Until the end of the Gilded Age, the parallel growth of investment and exports was the winning formula that allowed Italy to

[5] In 1981, under the Governorship of Carlo Azeglio Ciampi, the Bank of Italy gained full autonomy to decide whether or not to absorb Treasury bills in excess of brokers' demand at auctions.

join the ranks of the more advanced industrial powers. Trade surpluses provided important resources for importing capital and high-tech goods, while industrial policies strengthened domestic capabilities and allowed a degree of autonomy in key sectors. Public investments, especially in infrastructure, and those made by state-owned companies such as *Ente Nazionale degli Idrocarburi* (ENI) in the energy sector and *Italsider* in the steel industry, provided the backdrop for Italian exporters to strengthen their competitiveness and increase their market shares (Ciocca, 2020). During this period, the *Mezzogiorno* experienced significant growth rates, mainly driven by increasing productivity growth, and regional disparities decreased accordingly (Felice, 2018). This convergence process has been influenced by a wide range of public policy initiatives. A crucial actor is the state-owned Development Fund for Southern Italy, also known as the *Cassa per il Mezzogiorno* (Cassa, hereafter). Initially (in the 1950s), the *Cassa* focused on infrastructure and agricultural development projects. In the 1960s and early 1970s, it shifted its attention to industrial incentives aimed at promoting capital-intensive sectors (Felice and Lepore, 2017; Papagni et al., 2021). National programs based on per capita spending expanded the role of the state in areas such as welfare, health, and education, resulting in substantial fiscal transfers from the North to the South. This was accompanied by significant interregional trade. Unfortunately, North-South convergence is quickly encountering structural barriers. The prevalence of SMEs clustered around the so-called "cathedrals in the desert" (i.e., large industrial SOEs located in areas with poor industrial capacity, supply and demand linkages) hindered the *Mezzogiorno's* industrialization process and impeded further convergence (Fanti et al., 2023).

In this context, the gradual construction of the European market plays a fundamental role, since its development since the mid-1950s has meant a multiplication of outlets for Italian exporters and growing market shares. Of particular importance is the complementarity with the German manufacturing industry (for a detailed analysis see, among others, Ciocca, 2020, and the next section). The latter is an important buyer of Italian medium-technology intermediate goods, thus fostering the growth of export clusters located in the northern regions. In some cases, Italian firms are competing directly with their German counterparts and, by successfully combining price competitiveness with

product quality, are able to gain significant market shares. But all that glitters is not gold. The relative scarcity of natural resources, the small size of firms, a comparatively lower rate of innovation than in Germany, low public resources devoted to R&D, and a persistent territorial divide: the combination of these elements constrains Italy on a trajectory of medium-tech specialization, giving rise to what De Cecco (1971) calls "asymmetric complementarity". The latter refers to the asymmetric relationship between a structurally fragile economy establishing intensive trade and financial relations with more advanced counterparts. In order to catch up with its stronger counterparts, the former needs to strengthen and diversify its production matrix by entering markets with sustainable demand flows that promote the expansion of the production base. In certain situations, however, these two objectives may conflict. When growth is rapid but structural weaknesses are deep, as in the Italian case (Celi and Guarascio, 2019), the relative fragility and limited diversification of the production matrix can make the economy vulnerable to dependence on foreign capital and technology, generating external imbalances that reduce resilience in the event of a crisis (Cresti and Virgilito, 2023).

The combination of international openness and internal fragility can reduce the effectiveness of economic policies aimed at promoting structural upgrading, reducing internal disparities (both regional and - in terms of income distribution), and sustaining internal demand (Cesaratto and Zezza, 2019). With the end of the golden age, all these knots are coming to a head. The demand for higher wages undermines the competitiveness of less innovative firms, while public investment is curtailed by austerity policies aimed at curbing inflation. Unemployment and import dependency rise, while some of the state-owned enterprises that had previously supported the catch-up process go into crisis, contributing to a widening of the North-South divide. Several factors are at work. First, the South's industrialization slows down after the *Cassa* crisis, constrained by growing political pressures (Felice and Lepore, 2017; Del Monte and Papagni, 2007; Trigilia, 1992), while its industrial structure proves less able to follow the new paths taken by the country and more exposed to the risks of growing international competition. Second, the role of demography as an engine of growth began to fade. As the demand for labor in the north slows down and internal migration flows ease accordingly, the demographic trends of

the two areas begin to converge (downward). Finally, there is a quantitative and qualitative change in public spending in the South. The scale of intervention is reduced following the abolition of the Cassa and the gradual reduction of IRI investments. The quality of spending also changes, as policy priorities shift from industrial development to income support and welfare institutions, but in an environment that is often conducive to inefficiency and corruption (Daniele and Malanima, 2011).

Italy is thus caught between internal weaknesses and increasingly binding external constraints. Global financial instability and rising interest rates are draining resources for fiscal and industrial policy. Italian firms' attempt to (re)gain competitiveness by pushing down wages fuels social conflicts and domestic instability. The nepotistic use of state enterprises as a means of fighting unemployment accelerates their crisis. In this context, European integration is interpreted as a way to modernize the country, cure its structural weaknesses and strengthen the resilience of companies in the new global context. However, the acceleration of the integration process, which started in the 1980s, brings with it financialization (i.e., the banking sector is liberalized by removing administrative controls and restrictions on the size and type of activities of banks, while restrictions on capital movements are permanently removed), the adoption of the neoliberal agenda in economic policy, and thus a further tightening of external constraints (Celi and Guarascio, 2019).

Since the 1990s and throughout the period leading up to EMU, globalization has brought significant changes to the European economy. First, there has been increased competition from emerging economies, which, due to their high growth rates, posed not only a threat but also opportunities for European companies (see Section 2). Second, the widespread use of information and communication technologies (ICT) has fostered the international fragmentation of production, reducing the importance of economies of scale, and favoring network economies. This phase also witnessed a major shift in the European industrial, technological, and hierarchical landscape due to the reorganization of the German production platform. This reorganization involved a massive relocation of production abroad, especially to Central and Eastern European countries (Celi et al., 2018).

On the one hand, Germany's position as a major importer of intermediate goods from abroad, combined with its growing links with Eastern European countries, led to a reorganization of the European industrial structure (Simonazzi et al., 2013). As a result, Italian suppliers were partly displaced and replaced by cheaper producers from the East. On the other hand, the restructuring of the German economy, including its labor market reforms such as the "Hartz reform," further disadvantaged Italian exporters of consumer goods. This was due to two main reasons: the flexibility introduced in the German labor market increased the relative competitiveness of German goods by moderating wages; and the growing share of low-paid workers in Germany reduced the level and quality of imports of consumer goods, diverting demand towards cheaper goods exported by countries such as China (on this point, see the empirical evidence provided by Celi et al., 2018).

Between 1999 and 2008, the combination of eastward delocalization, labor market reforms, and wage moderation led to a remarkable trade surplus for Germany, especially with Southern European countries. This period witnessed profound changes in interdependencies and hierarchical relations within Europe, with the emergence of two peripheries (Southern and Eastern), both subordinated to the same core, i.e., Germany. The Eastern periphery became an integral part of the German-led European production platform (Stehrer and Stöllinger, 2015), strengthening its industrial base and displacing some production from Southern Europe. During this phase, Italy experienced a weakening of its industrial base and became increasingly dependent on foreign financial flows. This further exacerbated its structural weaknesses, leading to a severe crisis when capital flows abruptly stopped in 2008.

The external constraint associated with the deflationary nature of EU fiscal rules and the ECB's obsessive (and almost exclusive) focus on price stability is (temporarily) alleviated after the pandemic crisis. To mitigate the effects of the crisis and avoid a massive loss of productive capacity, fiscal rules were suspended (Celi et al., 2022), monetary policy remained expansionary (with interest rates close to zero or even in negative territory), and the extraordinary measures introduced by Mario Draghi in 2014 to prevent financial fragmentation were doubled. These developments allowed Italy, as well as the rest of the southern periphery, to avoid a more severe downturn in economic

activity than that observed and to experience a significant recovery once normalcy returned (with the completion of the vaccination plan and the lifting of restrictions). As the economic context has become uncertain again due to rising inflation and GVC disruptions related to the Russia-Ukraine war, the outlook has become gloomy again and old contradictions have come to the fore. On the one hand, rising prices and a shortage of inputs are calling into question the ability of Italy's National Recovery and Resilience Plan to deliver the hoped-for growth stimulus. On the other hand, the risk of a return to a regime of austere fiscal rules (Heimberger, 2017) and the use of restrictive monetary policy to fight inflation exposes the periphery and Italy to the risk of a renewed deterioration in their relative position. In a relatively changed global environment, and despite the post-Covid warnings of changes in the European economic policy framework, external constraints are back on stage and risk significantly affecting the outlook for the Italian economy.

The next section analyzes the evolution of Italy's structural weaknesses and their interaction with changing external constraints in the "German mirror". Indeed, a significant part of the discontinuities that characterize the long-term path of the Italian economy have to do with its relationship with Germany or, in other words, with what De Cecco (1971) called "asymmetric complementarities".

4. Italy and Germany: asymmetric complementarities

As many scholars have pointed out (De Cecco, 1971; Ginzburg, 1984; Valli, 1981), Italy's economic development has been strongly influenced, for better or worse, by its relations with Germany. On the one hand, the strong productive complementarity represented an important growth opportunity for the Italian economy, both in terms of greater sectoral (and intra-sectoral) specialization and diversification, and in terms of the benefits derived from the increase in investment and employment triggered by German demand, as well as from the exchange of knowledge and innovation at the industrial level. On the other hand, especially in recent decades, Germany has represented for Italy (but also for other countries) a kind of structural and policy constraint on growth, due to the tensions stemming from the financial and fiscal

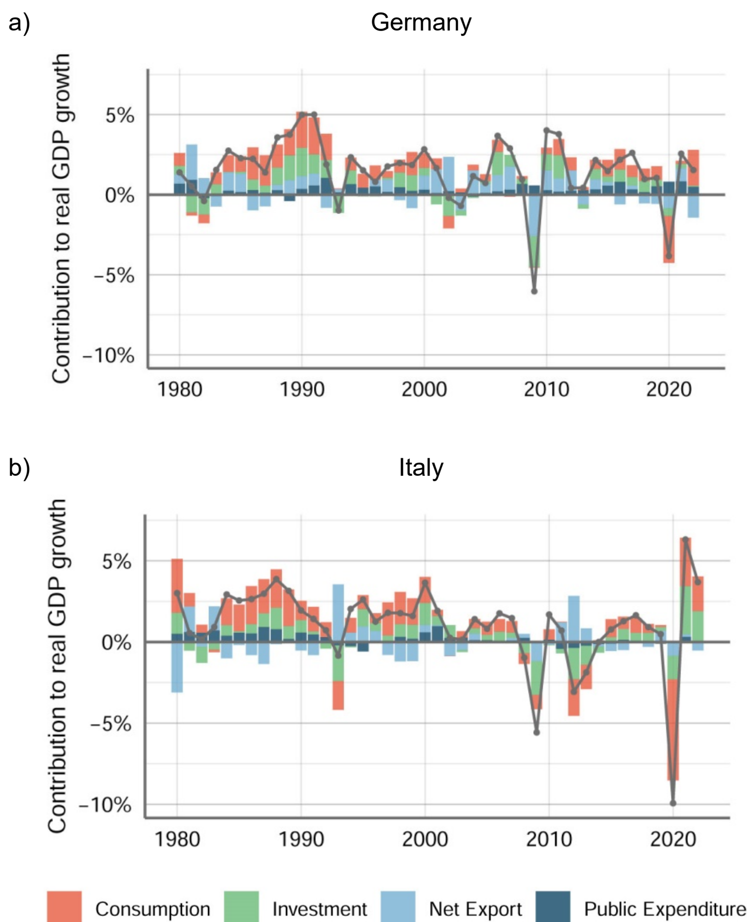
straitjacket imposed by the "German-led monetary union" (Celi et al., 2018).

Therefore, development opportunities and policy constraints are two sides of the same coin in this complex relationship. Similarly, the historical evolution of productive complementarities between Italy and Germany has not followed a linear path. In fact, it has been an uneven process marked by accelerations, peaks and sudden stops in terms of trade, industrialization, integration/divergence of productive structures and common/competitive innovation dynamics. It is worth recalling the key historical phases that mark such a complex evolving relationship. Already during the period of political unification (1861-1914), Italy showed a pattern of specialization in traditional sectors such as agriculture and textiles. Comparatively speaking, the Italian economy lags behind Germany in terms of the size and technological quality of its production base, the latter being highly specialized in more advanced sectors such as iron and steel, chemicals, and machinery. In the following period (1914-1945), despite Mussolini's attempt to modernize the production system by promoting heavy industries, especially those related to the military sector (De Cecco, 2000), the Italian economy remained dependent on Germany for the import of key raw materials and technology. During the Golden Age (see Figure 1), productive links between Italy and Germany intensified under the impetus of post-war reconstruction, US-led trade liberalization and the creation of the European Common Market. During this period, Italy's per capita income and productivity approach the German level, thanks to the flexibility of a production system that was able to compensate for the technological disadvantage relative to the first movers (such as Germany) with lower labor costs and/or, at most, incremental innovation and the adoption of foreign technologies.

The decision to further open the Italian economy to international trade influenced subsequent developments. Due to a specialization concentrated on consumer goods, the relevant part of the country's production matrix remained relatively underdeveloped (De Cecco, 1971). The peculiar mechanism of industrial development and related trade relations can be described as follows. Instead of increasing productivity through wage incentives (virtuous productivity-wage interaction), Italian firms exploit the large "industrial reserve army", mostly coming from the agricultural sector of the Mezzogiorno, and resort to a

high turnover rate of workers (which maintains low wages, a necessary condition to sustain competition in foreign markets). From Germany and other advanced economies, large amounts of capital and innovative goods are imported, while large flows of Italian workers move to these countries to meet the growing demand for low-wage jobs.

Figure 2. Contribution to real GDP growth



Data: AMECO.

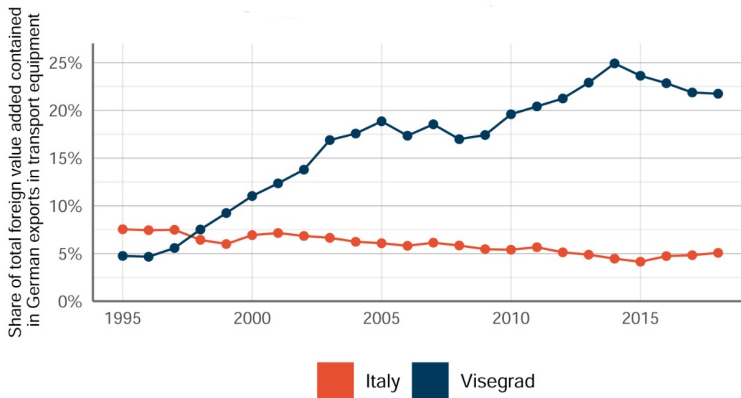
The productive complementarities between Italy and Germany in the post-war period were analyzed in detail by Ginzburg (1984). This author emphasized that, already in the early 1960s, the Italian economy was dependent on the evolution of the German business cycle. The (inter)dependence linking the waves of accumulation in the two countries can be described as follows. On the one hand, the changing composition of German investment allowed Italy to increase productive capacity in low-value-added sectors that were gradually being abandoned in Germany (also due to the repeated revaluation of the Deutsche Mark). On the other hand, coinciding with each wave of accumulation in Italy, the growing import of German capital goods reduces the value of the Keynesian multiplier, with negative consequences for the Italian labor market. According to Ginzburg, this co-movement (on the export and import side) contributed to increasing Italy's vulnerability in two directions, one "external" and the other "internal". Externally, the medium low-tech specialization of Italian exporters is favoured by the process of "negative import substitution" taking place in Germany, i.e., taking advantage of the Italian supply of medium low-tech goods, German industries tend to disregard such productions, strengthening in turn technologically superior ones. Internally, the degree of dependence on German capital goods and technologies is related to the characteristics of the Italian accumulation phases and, more specifically, to two different restructuring mechanisms: a "light" and a "heavy" restructuring. The first (prevalent in the early 1970s) refers to the fact that Italian suppliers of capital goods and medium-tech intermediate goods were predominantly SMEs with limited production capacity. As a result, supplying foreign markets tends to imply a trade-off between exports and domestic investment: to meet demand from domestic firms, exports have to be reduced and vice versa. The result is both a constraint on the expansion of domestic productive capacity and a relative increase in import dependence. The second mechanism concerns the generalized renewal of production techniques that characterized large Italian factories in the late 1970s.[6] In the absence of backward linkages, most of these firms resort to German im-

[6] In this phase, the Italian government pushes for a technological upgrading of SOEs neglecting the lack of an adequate supply of intermediate goods and technologies. This led to a rapid increase in import dependency (Ciocca, 2015).

ports, further impoverishing the Italian production matrix. As these two accumulation modes continued to interact/overlap (see Figure 2), import dependence increased and Italy's technological/productive gap with Germany deepened (Ginzburg, 1984).

These structural constraints become even more binding in the 1980s. As discussed in the previous section, the process of monetary integration and the subsequent establishment of EMU exacerbated the external constraint. In this context, the relationship with Germany became increasingly difficult. On the real side, the eastward expansion of the German production platform reshapes the asymmetric complementarity that binds the two countries. As the Visegrád countries become the main suppliers of intermediate goods to German industry, Italian medium-tech firms are partially displaced. This is clearly illustrated by the evolution of the foreign value added included in German exports of transport equipment, a key manufacturing industry for Italian-German trade relations (see Figure 3).

Figure 3. Value added contained in German exports



Data: OECD TiVA; authors' own elaboration.

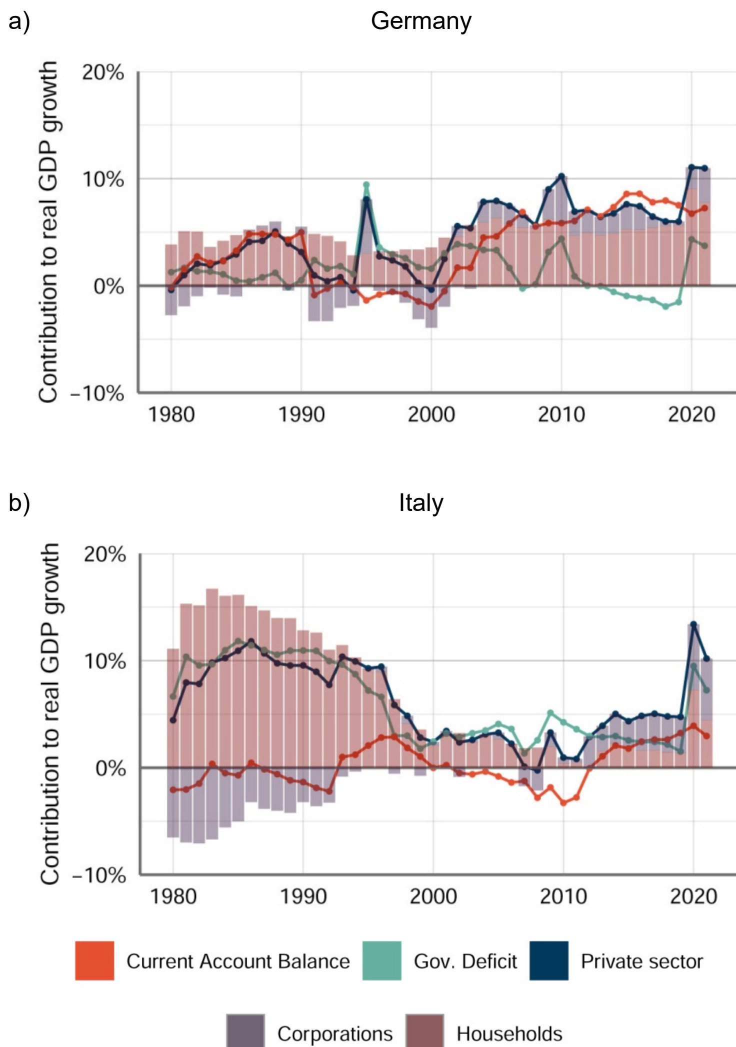
Moreover, as already highlighted in the previous section, the increasing incidence of low-wage employment contributes to the reorientation of German imports towards Chinese low-priced/low-quality consumer goods, to the detriment of Italian medium/high-end production (Celi et al., 2018). Thus, the hierarchical reorganization of German industry penalizes Italian exports of intermediate and consumer goods alike. On the financial side, the massive capital inflows from the core, including Germany, help sustain Italian imports of German goods (in this case not capital goods, but mainly high-end cars, which accounted for about 18% of Italian imports from Germany in 2007, cf. OEC 2023). Such a deterioration of Italy's relative position could be captured by looking at the evolution of its current account balance (see Figure 4).

In the aftermath of the 2008 crisis, Italy is further penalized by the worsening of EU-based macroeconomic restrictions, which were made more stringent with the decisive contribution of the German government (Germann, 2018). This new architecture of monetary and fiscal constraints introduced since 2010, such as the two-pack, the six-pack, and the fiscal compact, makes EU supervision and sanctions more binding, reduces the fiscal space of southern countries like Italy, imposes deflation, and deepens the structural gap with the core without addressing the "problem" of growing public debt.[7]

The austerity policies that severely undermined the resilience of highly indebted countries, including Italy, and that later proved fatal in weakening these countries' ability to respond to the pandemic crisis, were advocated by German policymakers because they were, in a sense, functional for their export-led model. Some authors see a continuity in the way Germany handled the crisis of the 1970s and the recent Euro-

[7] The set of policy instruments introduced in Europe under German influence to enforce fiscal discipline, especially in the period of austerity, is significantly more binding than the prescriptions imposed by international institutions in the 1970s. As shown by Germann (2021), countries with high debt levels were given significantly more discretion over their national economic policies. The example of Italy, which received $5 billion in financial aid from Germany in 1974 under the guarantee of one-fifth of its gold reserves, pales in comparison to the sophistication of the mechanism (administered by the Troika but proposed by German Finance Minister Schauble in 2015) to transfer Greek public property to a trust fund that would sell it to service Greek debt.

Figure 4. Financial Balances



Data: AMECO

zone (EZ) crisis (see, among others, Germann 2022). Although they took place in historically different international contexts, both crises significantly favored Germany. In the 1970s, when the fight against stagflation was in order, the German model, based on wage moderation and low inflation, benefited from a broad social consensus ranging from exporting firms to trade unions (in continuity with the post-World War II social pact that saw export success as beneficial to society as a whole). However, while Germany's achievements in fighting stagflation were appreciated in other European countries (McNamara and Jones, 1996), the adoption of the same model abroad was not as obvious, as the political and economic costs of deflation were considered too high. For example, while Italy relied on a policy mix of monetary expansion and lira depreciation to support exports in the 1970s (see Giavazzi and Spaventa, 1989), Germany pursued the same goal by maintaining a restrictive monetary stance without undermining the social pact between capital and labor.

As the monetary union project accelerates and the basic institutions are being designed (e.g., the ECB), the German export-led model based on fiscal restraint and deflationary policies becomes the only game in town (for a thorough analysis of the process leading to the current EU monetary institutions, see Celi et al., 2018). This has two main effects. First, it strengthens Germany's competitiveness vis-à-vis the rest of the EMU. Second, reducing the instruments – such as public demand and selective industrial policies – that were crucial in previous decades to support industrialization, development and, to some extent, the catching-up of peripheral countries. The final acceptance of this as the dominant economic policy model in Europe, instead of being a driving force for harmonization, where the hegemony of one country also favors the others (as other historical phases have shown; see Arrighi, 1994), fueled polarization, mainly to the benefit of the hegemon. In this respect, the sovereign debt crisis and the ensuing austerity policies are a relevant case. As austerity led to the strangulation of domestic demand and reduced the import capacity of southern periphery countries, a large part of German exports had to be diverted to China and other non-EC countries (Celi et al., 2018). According to Hübner (2015), the growing role of non-EU global markets explains why the German government refused to provide financial assistance to indebted countries, even if this implied a collapse of intra-EU demand. In fact,

China not only represented an opportunity for German exporters, but also made austerity policies in Europe work for the German model on the supply side. In other words, Europe served mainly as a "production platform" for German exporters, rather than as an outlet market. German policymakers' insistence on structural reforms (in addition to public budget cuts) in Italy and other highly indebted countries confirms this hypothesis. Germann (2021) provides evidence of German institutions (such as the Association of German Chambers of Commerce) emphasizing that, thanks to the high unemployment rates in the EU's southern periphery, a large pool of highly skilled workers proved easy and cheap to recruit. Similarly, the author argues that structural reforms and deflationary policies led to "the renaissance of Europe in the eyes of German investors". Overall, the German hegemony that characterized the late stages of monetary integration not only accelerated the core-periphery polarization – exacerbating the process of structural weakening that had been affecting the Italian economy since the 1980s – but also transformed the European project into a peculiar "fusion" of neoliberalism and mercantilism.

The former shapes the EU's institutional set-up (fiscal, monetary, and industrial) to ensure wage moderation, state retrenchment and primacy of finance. The latter puts the interests of exporting industries, especially German ones, at the top of the political agenda. In the next and final section, we will see how recent changes in the global landscape – the H1N1 pandemic, the Russia-Ukraine war and the ongoing struggle between the US and China for global markets and technologies – are reshaping intra-EU relations with potential implications for Italy's positioning.

5. Conclusions: Europe and Italy in the new global order

After the GFC and the pandemic, the war shock is shaking the global order, increasing uncertainty, leading to falling incomes and destabilizing GVCs (Rodrik, 2018). Like previous shocks, it is having asymmetric effects across Europe, this time in terms of energy dependence and structural vulnerability (Guarascio et al., 2023b). The war also makes the environmental and digital transitions more urgent. Again, however, intra-EU asymmetries are at work. As we have shown else-

where (Celi et al., 2022), Italy, Germany and the Visegrad countries show a significant degree of energy vulnerability, as their share of employment and value added in energy-intensive sectors is the highest among EU countries. The same applies to the degree of dependence on Russian gas and the consumption of energy from renewable sources. In this case, the Visegrád countries (especially those belonging to the German-led manufacturing core) are the most dependent on Russian gas without having any compensation in terms of renewables, a position also shared by Germany and Italy. Again, the shock has asymmetric effects across the EU, but with a reshuffling of the traditional core-periphery division. For example, Portugal and Spain, which were among the countries that paid the highest price as a result of the GFC, are now in a relatively less vulnerable position due to their lower dependence on Russian gas and higher share of renewables in their consumption matrix. In any case, the energy transition is becoming a matter of the utmost urgency, not only in the more energy-dependent economies, but in the EU as a whole. And the same goes for the digitization process. Without an adequate supply of digital goods and technologies, the smart grids needed to pursue decarbonization will be difficult to achieve. Unfortunately, the growing tensions between the US and China in key digital industries (e.g., semiconductors, artificial intelligence) show how far Europe is lagging behind the two competing giants.

Although technological dependence can be seen as an EU-wide problem, internal asymmetries still play a role. On the one hand, peripheral countries (including Italy), which lack technology, skills and productive capacity to a greater extent than the core, face an even greater challenge. In their case, the investments needed to accelerate the energy transition and digitalization may well lead to import dependency or be constrained by the lack of skills and intermediate goods. On the other hand, the dysfunctional nature of the EU's institutional set-up, especially in terms of fiscal rules (Heimberger, 2017), reduces the room for maneuver where it is most needed. Similarly, the first attempts to design an EU-wide industrial policy (e.g., RePowerEU, EU Chips Act, etc.) do not seem to be up to the task, both quantitatively and qualitatively (Guarascio et al., 2023b). As a result, Europe risks missing its ambitious decarbonization and digital sovereignty goals, while internal polarization is likely to deepen. From an econom-

ic policy perspective, the path cannot be one of austerity, carried out by each country in isolation – but enforced by EU institutions – as was the case in response to the GFC. Rather, it should be the (cooperative) path taken by the Next Generation EU. For example, common funds could be used to finance a common energy policy aimed at reducing energy dependence in the short term and accelerating the transition to renewable energy sources in the long term.

In conclusion, the pandemic and the war have shown how important it is for European countries not to lose the ability to produce domestically what they urgently need and what is strategic for their survival. This is particularly true for a peripheral country like Italy, which has thrown away much of its technological-productive capacity due to a long-lasting (and perverse) interaction between structural weaknesses and external constraints. At the same time, it is clear that austerity and lack of cooperation can only aggravate the socio-economic situation in Europe, and especially in the periphery. Across Europe, awareness of the crisis of the export-led model and the related need for an EU-wide industrial policy represents a discontinuity with the obsession with competitiveness that has hegemonized the political agenda in recent decades. If this is true, then the building blocks of the export-led model must also be questioned: wage moderation, compression of domestic and public demand, state retrenchment, lack of incentives to diversify production. The question is therefore: will the alleged crisis of the (German) mercantilist model lead to a retreat of the core country and thus to a downward convergence in Europe, or will it alternatively open up the possibility of an expansion of the domestic market in Europe? In the first case, the model will survive, but at the cost of a broad decline in Europe's socio-economic conditions: Germany risks becoming a hegemon in the ruins. The second alternative, coupled with a rebalancing of productive capacities within the EU, would certainly be more desirable, finally unleashing the socio-economic potential of the European economy. Of course, the transition from an industrial platform designed to maximize exports to one aimed at strengthening the domestic market is a formidable challenge. But this transformation would be beneficial for Germany itself, given the reduced space for German exports that has emerged in recent years due to the US-China trade war and the fragility of GVCs revealed by the pandemic crisis and the war in Ukraine. Thomas Mann's words at

the University of Hamburg in 1953 are still relevant today. It is up to Germany to decide whether it wants a "German Europe" or whether it wants to be a "European Germany"!

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Public Debt and Inflation in Italy's Political Economy

Then and Now

Lucio Gobbi[a] *and Stefano Lucarelli*[b]

Abstract

This contribution analyzes the evolution of public debt and inflation in Italy between the late 1960s and the present. In particular, five distinct phases are identified. The first phase (1969-1979), in which the evolution of public debt and inflation was strongly influenced by international shocks and trade union struggles. This period was characterized by an increase in public debt and inflation. The second (1979-1993) was characterized by a lack of consistency between fiscal and monetary policies. During these years there was a conflict between the government and the Bank of Italy, as the Italian government focused on expanding the public budget and the central bank on reducing inflation. This had a strong impact on the stability of the public accounts. The third phase (1994-2007), marked by the beginning of the process of monetary and fiscal convergence towards the Maastricht parameters. The fourth (2008-2019), which began with two financial crises and ended with deep stagnation and low inflation. During this phase Italy suffered the negative effects of the austerity policies that affected the PIIGS countries. Finally, the phase associated with the pandemic and the Russian-Ukrainian conflict (2020-2023), characterized by high

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public debt and rising inflation, for which we still do not have a clear picture.

Keywords: Inflation; Public Debt; Italy; Monetary Policy; Fiscal Policy

Jel Codes: E40; E50; H12

1. Italy in trouble

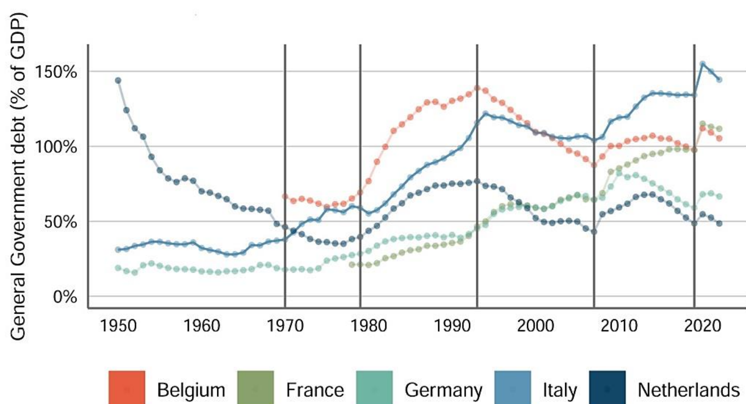
In this chapter we to analyze the relationship between public debt and inflation in Italy over the last sixty years. Moreover, we will highlight the implications that it could have for the future of Europe. In fact, it is important that today's economic decisions are conceived by politicians and economists in the light of history and of the relationship between these two variables in the Italian context.

The Italian public debt is usually considered one of the main financial problems of the euro area. During the sovereign debt crisis, it was considered the main cause of a possible break-up of the latter. In the aftermath of the pandemic shock, the public debt-to-GDP ratio has exceeded 150% and raises serious questions about its sustainability in light of the Russian-Ukrainian conflict and the European Central Bank's (ECB) interest rate hike to combat rising inflation. The question is therefore: When did Italy's public debt become a problem?

Figure 1 shows the dynamics of Italy's public debt-to-GDP ratio from 1950 to 2021. The graph shows that the dynamics of the public debt did not follow an unstable path until the late 1960s. From that period on, there were changes that would have a lasting impact on the Italian economy. Our analysis divides this subsequent time into five periods. The first is from the late 1960s to the late 1970s, a period marked by international shocks and trade union struggles. The second, from 1979 to 1993, was characterized by an unstoppable increase in public debt. The third, between 1994 and 2007, when debt management policies under the Maastricht framework seemed to succeed in bringing Italian debt dynamics back onto a path of stability. This perception disappeared with the Great Financial Crisis (GFC) of 2007. From then on, debt increased due to the economic downturn, austerity policies and the sovereign debt crisis (period 4). In the last period, we

analyze the impact of the pandemic in 2019 and the Russian-Ukrainian conflict on Italy's public debt.

Figure 1. Public debt in a historical perspective



Data: IMF.

2. *Five phases*

In the following, we analyze the main features of each phase and, in particular, the dynamics of public debt and inflation. At the end of each phase, we present a brief summary.

2.1 *Phase 1: international shocks and trade union struggles from the late 1960s to the late 1970s*

We begin our review of the first phase by highlighting the systemic elements that affected Italian economic dynamics until the late 1960s. Between 1968 and 1975, the world economy experienced three systemic shocks: the collapse of the Bretton Woods monetary system (Amato and Fantacci, 2012; Triffin, 1960), the 1973-1975 oil crisis (Garavini, 2019), and the end of a wave of innovation (Freeman, 1996; Freeman and Louçã, 2002).

By the end of the 1960s, the Bretton Woods monetary system was in crisis. The Bretton Woods system was based on the convertibility of the dollar into gold. This feature allowed the US dollar to circulate as a global currency. This meant that the demand for dollars for international trade and financial transactions was structurally high. At the same time, dollar convertibility imposed constraints on U.S. monetary policy and the balance of payments (Amato and Fantacci, 2012; Triffin, 1960). The Vietnam War put both at risk and eventually forced the US to abandon gold convertibility. This was due to the fact that the Vietnam War was mainly financed by monetary expansion and led to a balance of payments deficit. For this reason, the conflict in Indochina inevitably led to inflation in the US and in the main Western economies, especially in the commodity markets (e.g. Fantacci and Gobbi, 2018). It is worth emphasizing that the inflationary dynamics in the Western countries were the result of the American inability to reconcile "welfare" and "warfare" within the Bretton Woods agreements. In fact, in the decade between 1960 and 1970, both social (welfare) and military (warfare) expenditures increased (e.g., Fantacci and Gobbi, 2018) to the detriment of dollar-gold convertibility, which was suspended in 1971 and never restored.

The second international shock was the oil crisis that resulted from the Yom Kippur War fought by the alliance of Egypt and Syria against Israel (Garavini, 2019). The other Arab countries associated with OPEC decided to support the actions of Egypt and Syria through significant oil price increases and embargoes against the most pro-Israeli countries. OPEC's actions led to a spike in prices and a sudden interruption in the flow of oil to importing countries. October 1973 is considered a turning point in the history of international oil relations (Garavini, 2019). In particular, it was the moment when oil producers became aware of their power (Hallwood and Sinclair, 2017) over Western economies. Indeed, the oil crisis put an end to the cycle of economic development and growing prosperity that had characterized the post-World War II era in Western countries. It had serious consequences for the production system of these countries, which for the first time had to face the problem of energy conservation due to "imported inflation" of raw materials.

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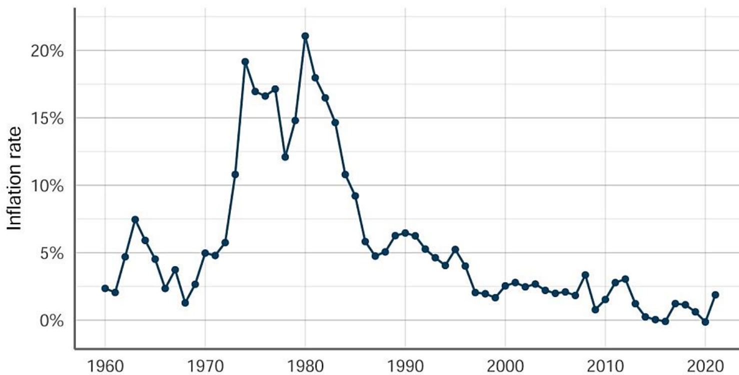
As far as Italy is concerned, in addition to these structural shocks, we highlight another relevant factor: the aggravation of social conflict due to the escalation of trade union demands, combined with the advance of the Italian Communist Party under the leadership of Enrico Berlinguer. In fact, in the 1976 national elections, the Italian Communist Party (PCI) registered the highest consensus point ever achieved by a communist party in the Western democracies (33.8% of the votes cast) Unlike in other European countries, this factor prevented the establishment of a stable and balanced social pact in the decade between 1969 and 1979. In this context, the economic policy response of the Italian governments to the inflationary shock was a general increase in wages, systematically supported by an increase in the public deficit. Since 1975, wage indexation has been applied in almost all industrial sectors in order to maintain "social peace", taking advantage of the increase in debt from 37% of GDP in 1969 to about 59% of GDP in 1979.

Despite the global slowdown in 1973-75, Italy's average real growth rate for the decade was 3.6%. However, as noted by Cesaratto and Zezza (2018), the period of social conflict reduced private investment, especially in innovation. In 1970, the Labor Statute was approved. It was a package of regulations that included the protection of acquired employment status; cultural, recreational, and welfare activities; the granting of leave to student workers; and the strengthening of the right of trade union representatives to monitor the company's implementa-

tion of regulations to protect workers' health and physical integrity. The high level of employment protection stifled the dynamism that had characterized the postwar Italian economy.

From then on, the percentage of companies with more than 500 employees declined steadily. In 1950, this percentage was 25% of the total number of companies, in 1980 it was 19.5% (Di Martino and Vasta, 2017). From this perspective, the decline in Italian productivity in the eighties seems to be clearly rooted in these earlier dynamics.

Figure 2. Inflation rate in Italy



Data: ECB.

As far as inflation is concerned, Figure 2 clearly shows that this rate was sustained from 1968 to 1974 and then never fell below 10% until the second half of the 1980s. In addition to the international factors already mentioned, it is worth emphasizing that the strength of the Italian trade unions was a decisive factor in the persistence of inflation. In 1975, the main Italian trade unions (CGIL, CISL and UIL) reached an agreement with the representatives of industrialists (CONFINDUSTRIA) to extend the so-called *Scala Mobile* to almost all industrial sectors. to almost all industrial sectors. The term *Scala Mobile* refers to the indexation of wages to the consumer price index.

Summarizing, the first period was characterized by:

a) growing debt due to lower growth and the escalating capital-labor conflict
b) rising inflation due to American expansionary policies, the oil crisis and the strength of the trade union front.

2.2 Phase 2: Italy's debt explosion betweeen 1979 and 1993

The late 1970s were marked by a new oil shock caused by the Iranian crisis, which triggered a sustained rise in inflation. In response, FED Chairman Paul Volcker raised interest rates to 20%. The depressive effect was very pronounced domestically and globally, with the US unemployment rate reaching 11% by 1982.

In the wake of these events, the Governor of the Bank of Italy, Carlo Azeglio Ciampi, outlined a new economic policy line based on three pillars: central bank autonomy, expenditure procedures that respected the budget constraint, and wage dynamics consistent with price stability (Ciampi, 1979). In the summer of 1981, the so-called "divorce" introduced the full autonomy of monetary policy, which had been included in the exchange rate agreements of the European Monetary System (EMS) that had entered into force two years earlier. On the one hand, with this change in the governance of economic policy, part of the Italian establishment marked and signaled that the rigorous ordoliberal path was the way to go. On the other hand, the international political context of the Cold War, in a country with the strongest communist party in the Western bloc, legitimized governments to pursue expansive budgetary policies in order to maintain a high electoral consensus. The governments in power failed completely to implement public policies aimed at growth, but only increased unproductive spending for immediate electoral returns. In the early 1990s, for example, a series of judicial investigations led by the Milan Prosecutor's Office revealed the high level of corruption among politicians and civil servants in the awarding of public works contracts. In addition, governments failed to implement the urgent pension reforms required by the aging of the population: until the end of 1992, most Italian workers received a pension that corresponds to 80% of the salary received in the ulti-

mate five years of employment, without taking into account the actual contributions paid. In 1995, a contributory system was introduced under which pensions were gradually parameterized to the level of contributions paid over the entire working life.

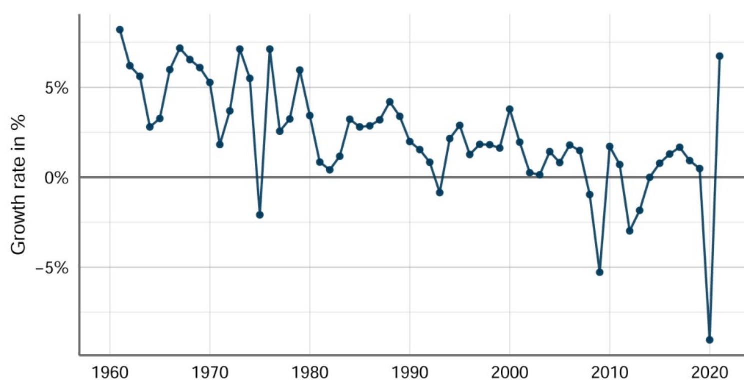
This period was marked politically by the 'Pentapartito' governments (a coalition the Christian Democratic Party, the Italian Socialist Party, the Italian Social Democratic Party, the Italian Republican Party and the Italian Liberal Party). From the point of view of public finances, it can be considered the greatest disaster that ever happened to Italy after the Second World War. Between 1981 and the early 1990s, public debt rose from less than 60% of GDP to over 100% of GDP. During the 1980s, government intervention in the economy was very strong. This intervention mainly took the form of precautionary public financial support to enterprises. A very large number of firms never had to resort to explicit bailout because they were constantly subsidized by public spending. Supporting policies implemented in this way have been very costly and inefficient. These bad practices started to end only after the implementation of the Maastricht Treaty.

Another reason for the soaring public debt is that with the entry into the EMS, currency devaluation ceased to be an instrument of economic policy. Looking at the period between 1980 and 1992, the Italian current account was in surplus in only three years (0.1% in 1983, 0.4% in 1983 and 0.4% of GDP in 1986). In the period between 1983 and 1988, Italy witnessed a positive cycle of GDP growth, but this was followed by five years of sharp decline (Figure 3).

Monetary tightening reduced inflation, but to a much lesser extent than in other Western bloc countries. Italy's inflation rate fell from 20% to 10% in the first five years of the 1980s and settled at around 6% in the early 1990s (see also Figure 2). High real interest rates over such a long period reduced private investment, although social conflict declined considerably. The fixed exchange rate regime was unsustainable because of inconsistencies in Italian economic policy. On the one hand, the central bank wanted to defend the exchange rate; on the other hand, the treasury expanded public spending. Although Italy signed the Maastricht Treaty in February 1992, the inconsistency of the implemented policy mix led to the speculative attack on the lira on September 16, 1992, which forced Italy to temporarily leave the EMS.

The devaluation of the lira gave oxygen to the Italian economy, which recorded real GDP growth of 2.1% in 1994.

Figure 3. GDP growth rate in Italy



Data: World Bank.

In the political context, the dissolution of the Soviet Union on December 7, 1991, pushed the world into a new historical phase and led to a radical refoundation of the Italian Communist Party. In the years that followed, an institutional earthquake, linked to the ongoing corruption cases involving the Pentapartito, swept away the other traditional political parties. In this way, the parties that had characterized the First Republic disappeared from the scene, and the 1994 elections saw an almost complete renewal of the political party system (see next section).

The end of the Scala Mobile was decreed in July 1992. This led to a steady reduction in inflation. Moreover, the end of the Cold War meant a gradual reduction in the bargaining power of the unions. In fact, the end of the Cold War accelerated the process of globalization of real and financial markets. More precisely, the opening of real markets, the end of state aid to companies and the intensification of migration processes undermined the strength of trade unions.

In summary, the period from 1979 to 1993 was characterized by a bipolar economic policy. It was the result of different economic policy between the government and the central bank. All planned economic

policy objectives failed inexorably. In particular, this period was characterized by:

a) a decline in the real growth of the economy (4% on average in 1969-1979; 2% on average in 1980-1993);
b) an increase in public debt (from about 56% in 1980 to 115% of GDP in 1993);
c) a decline in inflation rate (from about 21% in 1980 to 4.63% in 1993). However, the decline was very slow and less substantial than in the major European economies;
d) a substantial decrease in the number of large enterprises (it was 19.5% in 1980; 12.9% of the total in 1991);
e) an increase in unemployment (from around 6 % in 1979 to 10 % in 1993).

2.3 Phase 3: From 1994 to the 2007 crisis

The 'new center-left' government

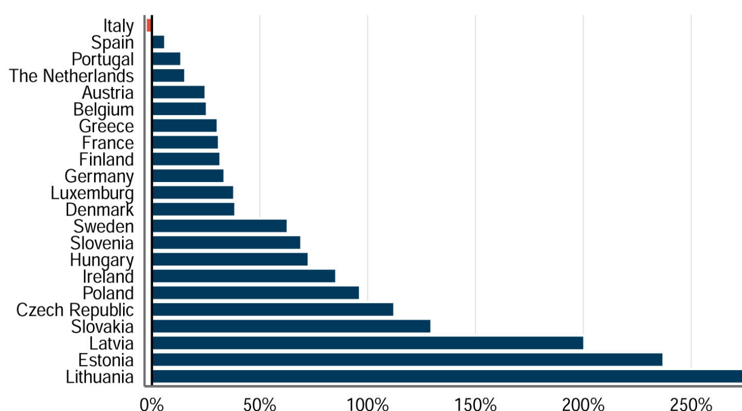
With the exception of the brief interlude of the first right-wing Berlusconi government, which lasted less than a year, the period leading up to the new millennium was characterized by a technical government (composed exclusively of technical ministers) led by Lamberto Dini (center-left coalition). This was followed by center-left governments that included parties that had emerged from the dissolution of the Italian Communist Party.

The economic policies of the center-left, led by Romano Prodi, were characterized by fiscal rigor and the reduction of public debt. The government's strong commitment to joining the euro and strengthening public accounts protected Italian debt from speculative attacks and triggered the process of convergence of Italian interest rates with those of the major European countries. In the five years of the center-left government, the debt fell from 130% to around 108%. Unemployment growth slowed from 2000 and continued to fall until the 2007 crisis. The center-left government did not create an economic miracle, as employment growth was mainly due to the increase in non-permanent

jobs made possible by the labor reforms enacted in those years ("Treu package"). These reforms increased employment but not labor productivity. This was mainly due to the decline of large Italian companies and the abandonment of strategic sectors that characterized Italy's industrial development in the post-war period. In 2001, the share of large companies in total employment was about 9.6%. This can be identified as the result of more than a decade of liberalisation of the industrial sector.

When taking into account inflation, the dynamic has been declining. The main factors that can explain this phenomenon are the increase in competition due to the globalization of markets and the decrease in real wages. In short, during the 1980s the inefficiency of the Italian production system was compensated by the growth of the public debt. Since the second half of the 1990s, this inefficiency has been paid for by the working class. This evidence becomes clear when combining data on real wages with data on tax evasion. Figure 4 shows the change in Italian real wages between 1990 and 2020 in comparison to other European countries. In addition, the propensity to evade corporate tax increased to 23.7% from 2015 to 2020 (Ciotti and Scinetti, 2022). The data also show that the propensity for personal income tax

Figure 4. Changes in inflation−adjusted wages (1990-2020)



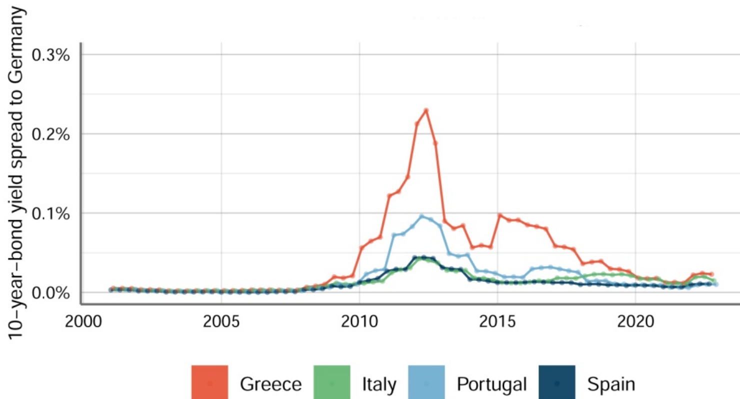
Data: OECD.

evasion from businesses and self-employment also continues to increase (Ciotti and Scinetti, 2022). Consequently, the tax burden is increasingly falling on the Italian labor force, which is increasingly called upon to compensate for the fiscal gap caused by growing tax avoidance.

Entry into the euro area

Joining the euro area helped Italy considerably in managing its high public debt. Figure 5 shows that public debt markets were highly fragmented when Italy joined the euro area in 1999. At that time, Italy benefited from this phenomenon by being able to take advantage of the high liquidity of its debt. In addition to this advantage, Italy experienced a reduction in credit risk as a result of euro area membership and the elimination of exchange rate risk.

Figure 5. Spread to German 10-year-Bonds



Data: ECB.

The process of convergence of spreads prior to the financial crisis is interpreted by many economists as the product of the standardization of the Maastricht countries' parameters and thus of the effectiveness of the European architecture in containing expansionary fiscal policies (Bernoth and Wolff, 2008; Schuknecht et al., 2010). Others, however,

argue that market discipline was unable to sanction inefficient fiscal policies (Faini, 2006, Afonso and Strauch, 2007; Manganelli and Wolswijk, 2009).

Although there was still considerable heterogeneity among euro area economies, actors at the financial markets believed that the convergence process was on a stable path. Today, it is clear that the macroeconomic imbalances between northern and southern Europe were unsustainable. At the time, capital flows from the core to the periphery were seen as the natural outcome predicted by the neoclassical growth model (Blanchard and Giavazzi, 2002; Giavazzi and Spaventa, 2010). Capital would have moved to peripheral countries that could offer a higher marginal return on capital than core countries.

The neoclassical growth model, however, is based on the assumption that financial markets are able to channel investors' private resources to the most productive uses by determining the socially optimal configuration. What happened in reality is that financial markets financed real estate bubbles, unproductive public spending and private consumption (Lane, 2012).

Although to a lesser extent than in countries such as Ireland, Greece, Spain and Portugal, this dynamic can also be observed in Italy. It should be emphasized that the idea of leaving the process of convergence among European economies to the financial markets has proven to be totally inefficient. This is because financial investors, who focus on portfolio investments, tend to have a short-term horizon and do not care about the long-term performance of financial projects. This is not only due to information asymmetries or the bounded rationality of investors, but also to the way modern financial markets are designed (Keynes, 1936; Amato and Fantacci, 2012, Amato et al., 2021).

Despite falling interest rates, Italy's economic growth remained low, mainly due to low international competitiveness, the "fixed exchange rate" and restrictive fiscal policy. The current account balance was always negative from 2002 to 2007. The great financial crisis therefore hit Italy in a precarious position.

In conclusion, the historical period analyzed was characterized by the process of Italy's entry into the euro area. For this period we show the evolution of inflation and public debt.

a) Between 1994 and 2007, debt relative to GDP fell from 120% to about 104%. This decrease was mainly due to the pension and labour reforms and the public expenditure containment policies implemented by centre-left governments.

b) If we consider inflation, it went down from 4.63% at the end of 1993 to 1.83% in 2007.

c) From the point of view of public accounts, the country seemed to be heading in a good direction. The GDP growth rate of 1.6% compared to 2.3% in France and 2.9% in the Netherlands showed a good performance. Germany had a similar growth rate to Italy, due to the recent reunification process.

2.4 Phase 4: From the Financial Crisis to the Pandemic

Although the Italian situation was worrying from a production perspective, from a financial perspective Italy was not overly exposed to foreign financial systems (BIS, 2011). For this reason, the Italian banking and financial system withstood the impact of the global financial crisis better than those of France, Germany and the United Kingdom. As shown in Table 1, the degree of financialization of the Italian banking system was not high. The ratio of total assets to GDP was around 201%, compared with 520% in the UK, 361% in France and 304% in Germany. This was due to the fact that the Bank of Italy has historically viewed high leverage with suspicion (Montanaro and Tonveronachi 2011). Leverage, calculated as the ratio of total assets (annual average) to common equity, was 10 in Italy, compared to 27 and 33, respectively, in highly financialized countries such as the United Kingdom or Ireland.

In contrast to other European countries, the government did not have to launch bank rescue plans that threatened the stability of the public accounts. At the time, the main concern for the stability of Italy's public debt was the deterioration of the current account of the balance of payments due to the fall in global demand. As a result, public debt increased less than the average of other euro area countries. Specifically, it increased by about 12% from 2007 to 2009.

Table 1. European countries financial indicators (Assets/GDP and Leverage)

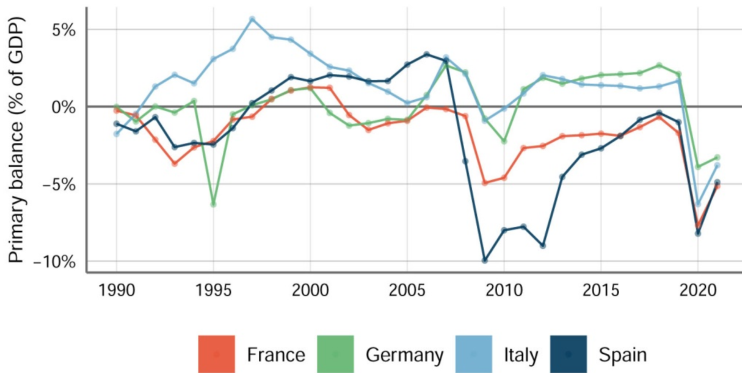
Country	Asset/GDP ratio	Leverage
Austria	310	16
Belgium	361	23
Denmark	365	19
Finland	162	14
France	361	25
Germany	304	26
Greece	156	15
Ireland	831	33
Italy	201	10
Netherlands	358	17
Portugal	246	8
Spain	262	17
United Kingdom	520	27

Notes: Assets are calculated as the ratio of total financial assets (annual average) to common equity. Leverage refers to the ratio of total assets held by domestic banks (annual average) to common equity.

Source: Montanaro and Tonveronachi (2011).

Comparing the series of Italian primary surpluses and government deficits with those of other European countries, it is clear that the fiscal response has been rather restrained. Figure 6 shows the evolution of the primary surpluses of the main euro area economies. Looking at the number of years of primary surpluses, Italy has been the most virtuous country over the last three decades (see also the chapter by Heimberger). However, such a long period of surpluses has led to a compression of public investment, which has severely weakened the growth of the Italian economy.

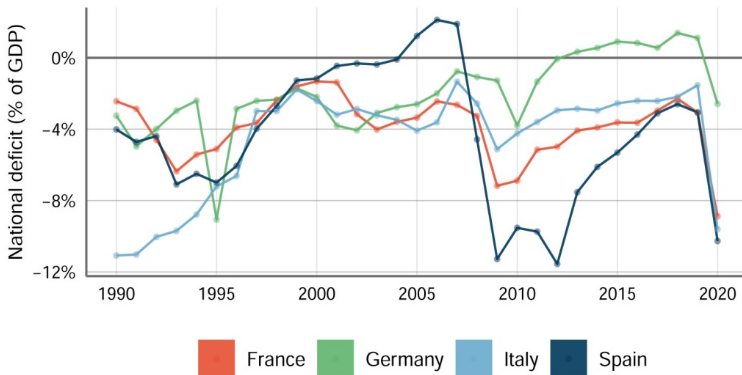
Figure 6. Primary balance as percentage of GDP



Data: Eurostat.

Figure 7 shows the deficit trends of the major European countries. Comparing the Italian deficit-to-GDP ratio with the primary balance-to-GDP ratio, it is clear that Italy has fallen into a debt trap. Although primary surpluses have been high, the ratio of the budget balance to GDP has always been negative. This has led to further debt accumulation.

Figure 7. National deficits over time



Data: Eurostat.

During this period, governments tried to contain debt as much as possible. Why did they do this? There were two main reasons: First, because an economy characterized by high public debt, especially in the absence of monetary sovereignty, must always be cautious in its use of fiscal policy. The risk of capital flight is very high. Second, the financial crisis has led to a rebalancing of international investors' portfolios in terms of their exposure to Italian government bonds. In the previous decade, appetite for BTPs had always been high, given their liquidity, low risk and higher yield than other European safe assets.

Before the sovereign debt crisis, Italy's share of debt held by international investors was very high: the share of foreign debt exceeded 50%, indicating a strong international exposure of more than 750 billion. Until mid-2011, Italy's public debt was on a sustainable path. As Figure 4 shows, in June and July 2011 the spread between German bonds and Italian BTPs started to widen. This happened despite the fact that the dynamics of the public accounts improved compared to 2010 (D'Ippoliti and Roncaglia, 2011).

Looking at the evolution of the ten-year public debt yields of the main euro area countries, the so-called "European sovereign debt crisis" can be divided into three phases. The first, triggered by the revision of the Greek budget deficit in October 2009, led to a divergence between the cost of Greek debt and that of other countries from the beginning of 2010. The second was characterized by a rise in government bond yields in Ireland and Portugal. Both countries faced fiscal constraints and had to seek bailouts from the European Union and the IMF in the fall of 2010 and spring of 2011, respectively. The third was the sharp divergence of Spanish and Italian bond spreads from those of Germany. In June 2012, Spain requested EUR 100 billion in aid, which definitely triggered panic in the financial markets. Italian bonds were also under attack, leading to open fears that the eurozone would break up. Only ECB President Mario Draghi's speech on July 26, 2012 was able to reduce the spreads between peripheral and central countries. Italy, although solvent, found itself dangerously overwhelmed by investors' negative expectations, leading to high liquidity premiums and high refinancing costs.

In the aftermath of the sovereign debt crisis, the share of Italian debt held by non-residents fell below 30%. Considering only foreign investors, this share reached 24% at the end of 2018.

The rising cost of Italian debt during the crisis also triggered the "doom loop" phenomenon. This phenomenon can be defined as a vicious circle that occurs when a country's banking system becomes overly exposed to its government bonds. In Italy and the other "PIIGS" countries, a high correlation has been observed between the assets on banks' balance sheets and the value of their sovereign debt. This correlation could threaten the stability of the national financial system. Moreover, in the opposite direction, the possibility of bank bailouts could increase the riskiness of a given country's public debt. Italy's public debt will remain highly vulnerable until the banking union is completed or a sufficient number of eurobonds are introduced in the national financial systems of the most risky countries (e.g., Farhi and Tirole, 2018; Alogoskoufis and Langfield, 2020).

The austerity policies that accompanied the sovereign crisis have proven counterproductive. To date, even most mainstream economists admit that the fiscal constraints imposed by the Stability and Growth Pact have significantly worsened the economic conditions of the most troubled countries (e.g., Blanchard and Leigh, 2013; De Grauwe and Ji, 2013; Okeke et al., 2021). As far as Italy is concerned, fiscal multipliers have been higher than 1 over the last 30 years (e.g., Deleidi, 2022). The policy of primary surpluses pursued by Italian governments in times of crisis proved to be self-defeating and did nothing but further increase the public debt-to-GDP ratio.

Table 2 shows the yield on 10-year BTPs (r), the nominal GDP growth rate (g) and the difference between the two (r-g). This difference indicates whether the cost of debt is fully absorbed by GDP growth. If the difference between r and g is negative, the implementation of expansionary policies does not imply a "burden" on the government budget. The opposite is true when the ratio is positive. Italy has almost always had a positive trend, forcing policymakers to be extremely cautious. The table shows that between 2011 and 2013, the rise in yields combined with declining GDP growth put a strain on Italy's public finances.

The sovereign debt crisis and the resulting stagnation had a serious impact on unemployment and, consequently, on inflation levels. Between 2009 and 2015, Italy's unemployment rate rose from 7.7% to 12.68% and remained consistently above 9% until the beginning of the pandemic. This led to strong negative pressure on wage growth.

This pressure reduced the inflation rate; between 2015 and 2019, the average Italian inflation rate was around 0.6%.

Table 2. Debt sustainability in Italy (2002-2021)

Years	**10 year yield (average)**	**GDP growth rate**	**r-g**
2002	5,03	0,25	4,78
2003	4,25	0,14	4,11
2004	4,26	1,42	2,84
2005	3,56	0,82	2,74
2006	4,05	1,79	2,26
2007	4,49	1,49	3,00
2008	4,68	-0,96	5,64
2009	4,31	-5,28	9,59
2010	4,04	1,71	2,33
2011	5,42	0,71	4,71
2012	5,49	-2,98	8,47
2013	4,32	-1,84	6,16
2014	1,71	0,00	1,71
2015	1,71	0,78	0,93
2016	1,49	1,29	0,20
2017	2,11	1,67	0,44
2018	2,61	0,93	1,68
2019	1,95	0,48	1,47
2020	1,17	-9,04	10,21
2021	0,81	6,74	-5,93

The employment crisis would certainly have been more acute without the quantitative easing policy implemented by the ECB since January 2015. The initial plan was to expand the purchase of financial assets by 60 billion euros, which became 80 billion euros from 2016. Subsequently, this plan was gradually reduced until the pandemic crisis, without ever being terminated, given the persistence of below-target inflation.

In all, the main features of this period can be summarized as follows:

a) The financial crisis of 2007 initially hit Italy more because of general economic balance effects than because of the inadequacy of its financial system. The real economic system was hit hard afterwards.

b) The sovereign debt crisis created a divergence between the cost of servicing the public debt of central and peripheral countries.

c) The average growth rate of Italy's economy between 2007 and 2019 was about -0.29, the inflation rate went from 1.83% to 0.61%. As for the growth rate of public debt, it increased by about 26 % over the period.

2.5 Phase 5: The Pandemic and the War in Ukraine

In the year 2020, the entire world was hit by the Covid 19 pandemic. Italy was one of the first European countries to impose lockdowns and dramatically increase healthcare spending to cope with the pandemic. Italy's public debt increased from 134% to 155% of GDP between 2019 and 2020. The unemployment rate exceeded 10% due to repeated production stoppages. 2020 ended with an inflation rate of -0.1% and GDP growth of -9%.

In contrast to the sovereign debt crisis, where the fiscal policy response was austerity, in the summer of 2020 the European institutions formulated a proposal to establish a fund, known as NextGenerationEU, of EUR 750 billion. (European Commission, 2022). It was hoped that the European Commission's oversight of the investments to be financed will increase growth.

The easing of restrictions and the introduction of vaccines allowed Italy to reactivate its economy in the second half of 2021, with GDP growth of 6.7%, one of the strongest in the euro zone. In the post-pandemic period, inflation increased significantly. This dynamic was an almost natural consequence of the pandemic, as commodity stocks were unable to fully meet demand as production was reactivated. Bottlenecks in supply and in the reallocation of global value chains also contributed to the rise in inflation. The inflation problem became more

acute in the second half of 2021 and later after the outbreak of the war of Russia on the Ukraine.

In summary, the central features of this period were as follows:

a) the last quarter of 2022 showed inflation of 8.7%, the first quarter of 2023 saw a decline to 6.5%. The dynamic is declining but remains a great uncertainty about the fate of the war of Russia on the Ukraine;

b) public debt accounted for 144.7% of GDP in Dec 2022, compared with the ratio of 146.2% registered in the previous quarter;

c) the European Commission estimated real economic growth of 3.9% in 2022 and 0.8% in 2023

Discussion and outlook

As we have discussed, Italian public debt and inflation were influenced by several internal and external factors over the period considered. The main lessons about Italian public debt that we can extrapolate from our analysis are as follows:

- The main internal drivers contributing to the Italian debt explosion are: (i) social conflict occurred in the 1969-79 decade (phase 1), (ii) clientelism and unproductive public expenditure in the nineteen eighties and (iii) high level of state interventionism to avoid big enterprise bankruptcy.
- All the aforementioned drivers have been tamed, as a consequence of the Maastricht treaty stipulation in 1992, by the effective economic policies undertaken by the center-left governments from 1995 to 2001.
- The high of level of debt inherited from pre-Maastricht years, forced Italian governments to maintain an almost constant primary balance surplus from 1995 so far.
- The positive impact of public surplus is nonetheless weakened the constant decreasing of big enterprise productivity due to lack of private investments, a long term pattern undermining the economic Italian tissue.

- The main external driver affecting Italian public debt have been the following global economic crisis: (i) Yom Kippur crisis in 1973, (ii) the Volcker shock in 1979 provoking an increase in the interest rates, (iii) the financial crisis between 2007-09 which originated by a subprime debt shock, (iv) the European sovereign debt crisis between 2010-12, (v) the pandemic crisis between 2020-21, followed by the ongoing war by Russia on the Ukraine.

For what concerns the Italian inflation, main internal drivers have been:

- wage indexing to inflation among 1969 and 1992 strengthening the inflation-wage spiral;
- a lack of coordination between the Italian Central Bank and the government, that can be charged of the failure in reducing price inflation during the nineteen eighties despite the high interest rate policy undertaken by the Italian Central Bank with a positive contribution in containing the inflation rate.

On their side, external drivers influenced the Italian inflation trend in different directions:

- the Yom Kippur crisis (1973-75) contributed in increasing inflation rate due to commodities price spike
- the Volcker shock, increasing world interest rate, reduced the price growth in advanced economies
- the Maastricht Treaty pushed competition among firms, reducing the level of final prices and
- a supply chain shortage and bottlenecks due to the 2020 pandemic and the war of Russia on the Ukraine triggered a new inflation growth wave

Italy is currently on a very dangerous path. The interest rate hike implemented by the ECB to fight inflation and in response to the interest rate hike decided by the FED is raising serious doubts about the long-term sustainability of public debt. These doubts are largely linked to the prospect of a further expansion of expenditure due to the continuation of the war of Russia on the Ukraine. The ECB has designed the TPI (ECB, 2022), an instrument dedicated to the protection of European public debt. This instrument, together with all the measures taken

in recent years to combat the pandemic (Böninghausen et al., 2022), is necessary to avoid the mistakes of the past. As conceived, the TPI remains an instrument whose activation is at the discretion of the ECB and without defined rules (Amato et al., 2023). The risk is that its use will become the result of political bargaining between countries. This could make it difficult to activate when needed.

At the beginning of 2023, the Italian unemployment rate was 7.8%, while the ratio of public debt to GDP fell to 147.2% (September 2022). The European Commission estimated Italian GDP growth at 0.8% and inflation at 6.1%. Scenarios are still uncertain. What we can highlight is that, as far as the Italian debt is concerned, its size is such that only stable economic growth and moderate inflation (above 2%) will make it sustainable. As far as inflation is concerned, it is no longer driven by a conflict between capital and labor, as was the case until the early 1990s, but almost exclusively by the cost of raw materials, migration flows and international market trends.

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Old and hopeless: gerontocratic welfare, household indebtedness, and economic pessimism in Italy

Martino Comelli[a]

Abstract

This chapter analyses the impact of Italy's gerontocratic welfare system on household indebtedness and economic pessimism. After outlining the history and conservative nature of Italian welfare, this study employs a comparative approach and structural equation modelling to investigate how the Italian welfare model's preferential allocation of benefits to the elderly, at the expense of the working-age population, affects economic behaviour and sentiment. This economic outlook is influenced by a preference for the elderly that discourages future-oriented financial practices and risk-taking, such as borrowing.

Keywords: Gerontocratic welfare systems; Conservative welfare; Household debt; Economic pessimism.

1. Introduction

This chapter aims to explain the reasons for Italy's low household debt. It focuses on how the country's gerontocratic welfare system influences economic attitudes and behaviours. Often viewed as a personal journey, aging is a phenomenon with profound political and social implications. Political science has rarely prioritized age in its research, with

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some notable exceptions, such as the political power of older segments of the population (known as 'gray power') or the distribution of welfare across generations (Vanhuysse, 2014; Vlandas et al., 2021; Vlandas, 2022). As Western societies experience an increase in their elderly populations, policymakers need to recognize the impact of their decisions on demographic structures.

Welfare states, which have traditionally focused on pension schemes, may neglect the needs of the working-age population, who face new challenges such as work-life balance and adapting to technological advancements. Economic behaviour, as demonstrated by Ando and Modigliani (1963), typically follows a life-cycle pattern: borrowing in early adulthood, usually to buy a house, followed by debt repayment and saving during the working years, and finally disinvestment in old age. This chapter examines the effects of interrupting the cycle. Italy, a country with an aging population and a challenging labour market, is used as a case study.

The chapter's second part demonstrates how welfare changed after the end of Bretton Woods, with a greater emphasis on financialization and increased use of household debt to deal with welfare retrenchment. However, Italian household debt has remained low by European standards, which is puzzling.

The third part traces the origins and evolution (or lack thereof) of the Italian welfare state, highlighting its ageist tendencies. It is argued that the Italian welfare system has not adapted to the challenges of globalization.

The fourth and fifth sections employ a comparative approach and a structural equation model (SEM) to address the private debt puzzle. They demonstrate how welfare systems that primarily focus on the elderly lead to a less optimistic working population, which in turn affects future-oriented activities such as private debt.

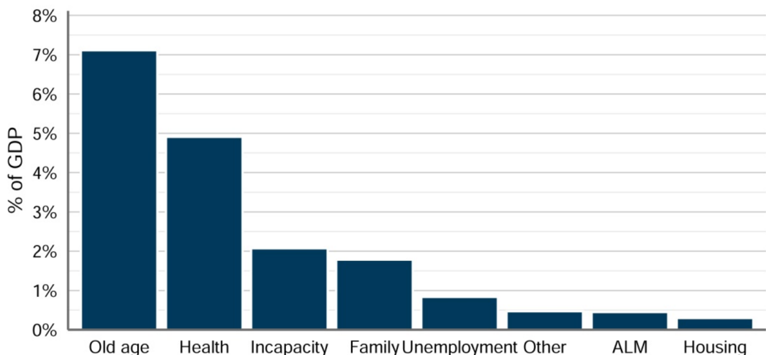
It is argued that a gerontocratic welfare system impacts all aspects of long-term economic outlook and decision-making. In a society where the future is uncertain and risky, individuals are hesitant to make long-term financial commitments such as borrowing. Low indebtedness in Italy, which is often mistaken for familial frugality, is also a result of a precarious labour and welfare system. In contrast, countries that distribute welfare spending more evenly between working and elderly populations tend to have higher levels of private

indebtedness. This is because they foster greater economic optimism and a willingness to take long-term financial risks. This chapter argues that Italy's gerontocratic welfare system not only fails to address current economic challenges but also perpetuates a culture of economic pessimism among its working-age citizens.

2. *Welfare, financialization, and the puzzle of household debt*

The welfare state has always been closely associated with age; indeed, the welfare state was primarily created to deal with ageing. During the golden age of industrialism, after the Second World War, incomes were sufficient to maintain households and welfare provision was 'residual', designed to protect those who could no longer be employed in formal work, mainly the elderly. This basic function of the welfare state remains the same today, and in all OECD countries the bulk of social spending goes to pensioners (see Figure 1). In this sense, the welfare state should not only be regarded as a 'Robin Hood institution' that takes from the rich to give to the poor, but also as a piggy bank that smoothes consumption over the life cycle (Vanhuysse et al., 2021), where welfare takes from the working population and gives back to children and the elderly.

Figure 1. Average welfare spending of OECD countries (1980-2021)



Data: OECD SOCX; author's own calculation.

Post-war welfare systems emerged during a period of stable, controlled economic activity (Bordo & Eichengreen, 2007; McNamara, 1998). In contrast, the pre-World War I period under the gold standard experienced volatile capital movements that contributed to the 1929 economic crisis and the Great Depression. After World War II, countries responded to these lessons by imposing strict controls on capital movements, restricting global banking and maintaining monetary stability under the Bretton Woods system established in 1944 (Gallagher, 2012). The so-called golden age of the welfare state in the West developed within this unique institutional configuration of relatively high global stability, industrial labour and heavy regulation.

The end of the Bretton Woods system led to increased economic instability, exacerbated by the oil crisis and stagflation that disrupted the post-war economic order. Capital mobility increased, shifting job creation in Western societies from high-productivity, capital-intensive industrial jobs to low-productivity, labour-intensive service sector jobs. Policymakers blamed poor employment performance on labour protections, leading to a broad wave of labour and financial market liberalisation. According to Chauvel and Schröder (2014), these changes have resulted in increased precariousness and instability, leading to younger generations facing lower living standards than their predecessors.

Globalization has led to the emergence of new social risks (Bonoli, 2005; Bonoli, 2007). Unlike the post-war industrial era, income alone is no longer sufficient to ensure a comfortable life, as jobs have become more precarious. Issues such as low-quality employment, working poverty, inadequate social security contributions, difficulties in reconciling work and family life, and low fertility rates have arisen. The provision of welfare services by countries has become a crucial factor in achieving economic and social stability. One strategy to address emerging risks is to expand welfare coverage beyond its traditional beneficiaries, making it a countercyclical tool to tackle economic crises and foster innovation and competitiveness (Stiglitz & Greenwald, 2015). The Scandinavian countries, in particular, adopted the strategy of social investment: welfare had to be refocused on the working population, fighting in-work poverty or mass unemployment with guaranteed minimum incomes, and implementing active labour market poli-

cies to retrain and integrate more people into the labour force. The focus on human capital development is the main objective.

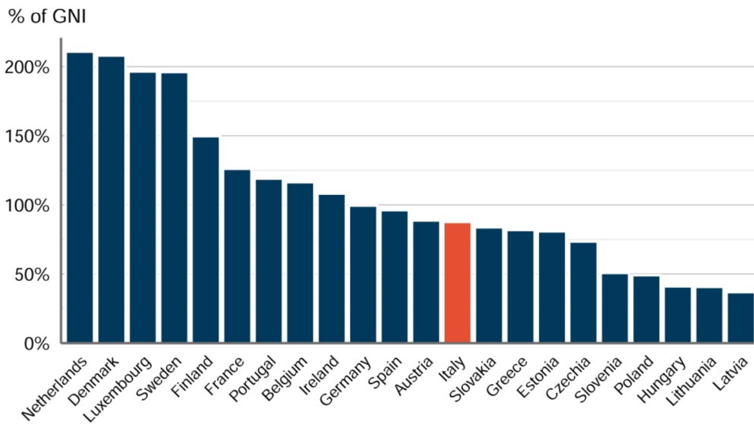
The second strategy was to marketize welfare. Policymakers saw the costs of the post-war welfare system as unsustainable and inefficient. The strategy has been to replace or supplement publicly funded welfare programs with financial instruments and insurances. In Anglo-Saxon countries, finance has played a major role in welfare reform, and financial markets have been incorporated into social policy, with a focus on the 'financial inclusion' of low-income earners in the financial system. For instance, this resulted in the reorganization of pensions from government-run to privately managed funds invested in financial markets. Additionally, housing was used as a security asset in an 'asset-based welfare' system, where ownership and debt became a new way to achieve financial security and stability (Prabhakar, 2013; Hay, 2011; Montgomerie & Büdenbender, 2014). Policymakers have tried to encourage home ownership through tax incentives (Prasad, 2012). Private debt has risen in all OECD countries, as have house prices. The inclusion of regular citizens into the financial system through private pensions and complex mortgages has resulted in the inadvertent exposure of typical households to financial crises (Fligstein & Goldstein, 2015).

The 2008 global economic meltdown is widely believed in the United States to have been caused by excessive household debt resulting from the reckless lending practices of financial institutions. Private debt has since been recognized as a source of concern beyond the borders of the United States, where the crisis originated. The European Commission has included household debt in its framework for assessing the financial stability of countries (Eurostat, 2023)[1]. Sociologists argue that the household debt crisis has emerged due to financialization and the retrenchment of public policy. Welfare has filled the void left by a starving welfare state (Crouch, 2009; Prasad, 2012; Trumbull, 2012; Wiedemann, 2022). This is known as the welfare-debt trade-off hypothesis.

[1] Countries with private sector debt above +133 (% of GDP) are considered at risk according to the EU's Macroeconomic Imbalance Procedure (MIP) Scoreboard 2022.

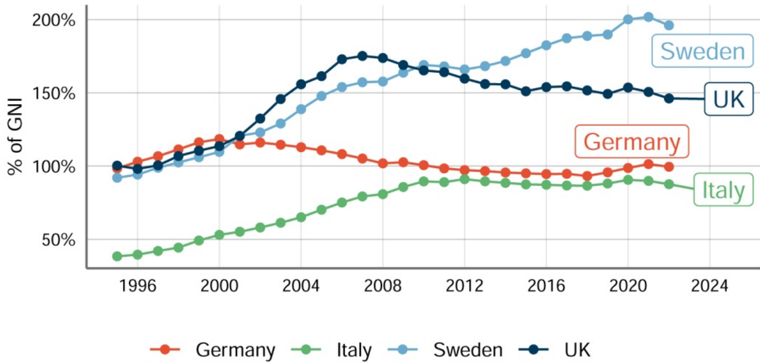
Despite its elegance, this theory does little to explain the very high levels of private debt in Nordic European countries, which are known to have very generous and comprehensive welfare systems. In response, other scholars have pointed out that countries with robust welfare systems coupled with lenient financial markets may actually encourage increased borrowing and indebtedness among households (Annarelli, 2022; Johnston et al., 2021; Tranøy et al., 2020). This trend is evident in northern European countries such as Denmark, Norway, Sweden and the Netherlands, all of which have extensive welfare programmes and yet report high levels of household debt (see Figure 2). However, it is paradoxical that robust welfare states, such as those in Germany and Italy, have relatively low levels of household debt (see Figure 3). In the later sections of the paper, I propose that this paradox can be resolved by examining the structural intricacies of the labour market and the age-orientation of welfare provision.

Figure 2. Household debt in Europe (2022)



Data: OECD.

Figure 3. Household debt in selected OECD countries



Data: OECD.

Marketisation has also taken place in opposition to labour regulation. Italy has partially liberalised its labour market by introducing more flexible contracts, especially for new entrants, while maintaining existing privileges for insiders. This has led to a dualization of the labour market. The age dimension of liberalization is evident, given its 'partial and selective' nature, mainly focused on access to the labour market, targeting young workers in particular (Barbieri & Lucchini, 2007; Barbieri, 2009; Barbieri & Cutuli, 2015). Labour market insiders were able to retain the privileges of very stable contracts and accumulate generous pensions, creating a de facto dual labour market divided by age. This measure was politically convenient because it did not touch the privileges of current voters, but it put the entire burden of labour market reform on the shoulders of the younger generation. A further step was to give significant tax incentives to self-employment, which is often used as a substitute for more stable employment contracts (even for jobs that have nothing to do with freelancing). The same applies to the pension system: Italy is one of the few countries in Europe that has moved from a pay-as-you-go system, in which current contributors pay current pensioners (i.e. based on intergenerational exchange), to a mixed investment-based system (based on lifetime savings); due to a long transition period, these changes mainly affected those who started working after 1995, while older generations were still protected

by the first system, raising again questions of intergenerational justice. As in Anglo-Saxon societies, Italian policymakers have attempted to financialise welfare by adding private pillars and tax incentives for private pension funds, but in the Italian case there are no mandatory private pension funds. The results have been mixed, as low wages cannot support private capitalisation for a large part of the population. Private pensions are used by 30% of the workforce. This, together with the partial and selective flexibilization of the labour market, has not been followed by a reform and expansion of the welfare state in terms of social investment. Instead, the nature of Italian welfare has remained focused on pensions, and this will be the subject of the next section.

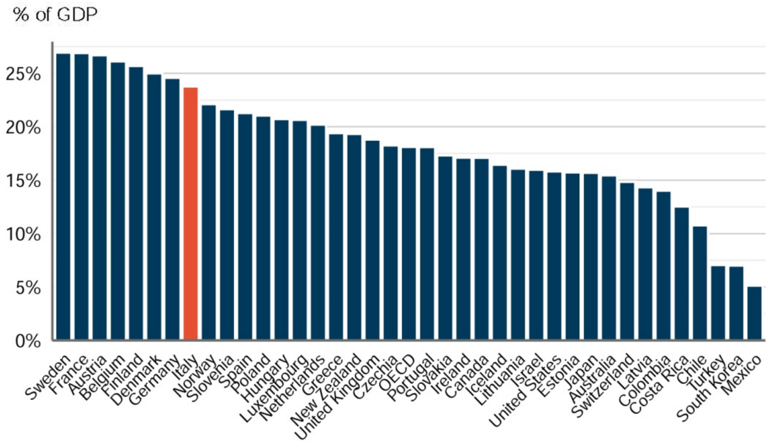
3. The nature of Italian welfare

Welfare spending in Italy is comparable to that of other countries of similar size (see Figure 4). However, the composition of spending is significantly different, with a heavy emphasis on pensions (see Figure 5). This system has resulted in a pattern of poverty that disproportionately affects younger generations, while poverty levels among the elderly remain low (see Figure 6). The suppression of wages systematically will have repercussions for future generations, widening the gap between those who can steadily contribute to social security during their working lives and those who will remain on the margins not only of the labour market but also of the welfare and pension system (see Figure 7).

The welfare state, in the classical Marshallian conception, is the development of social citizenship, or ‘the right to a modicum of economic welfare and security to the right to share to the full in the social heritage and to live the life of a civilised being according to the standards prevailing in the society’ (Marshall, 1950, p. 11). In other words, the welfare state should enable the development of active and free citizenship. Social rights make political and civil rights meaningful and allow one to ‘live the life of a civilised being’. Charity, piety, benevolence, family obligations and other material help or mutualism may create welfare, but they alone do not contribute to the development of social citizenship because they are not rights and their actions are idiosyncratic or even discriminatory, for example based on faith or other considerations (McGoey, 2012).‘The norms prevailing in society’ are

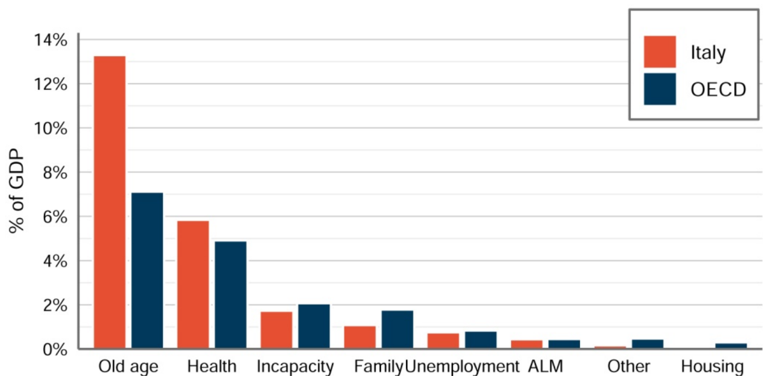
dynamic and subject to change; in the previous section we have seen that the needs of post-industrial society, the reconciliation of work and family, are more complex than those created by the economic dynamics of post-war industrialism.

Figure 4. Average total welfare spending (1980-2021)



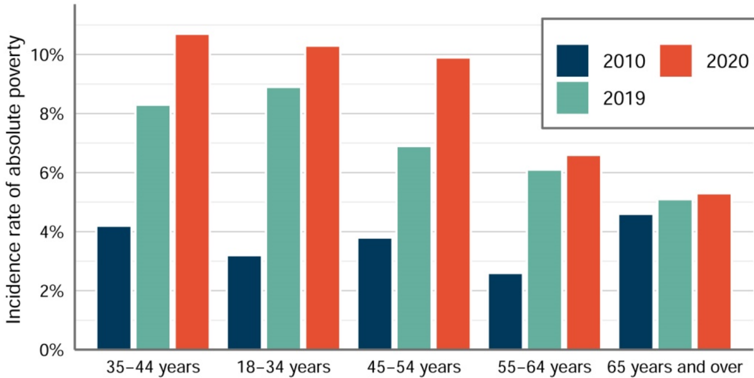
Data: OECD SOCX; author's own calculation.

Figure 5. Average welfare spending in Italy and the OECD (1980-2021)



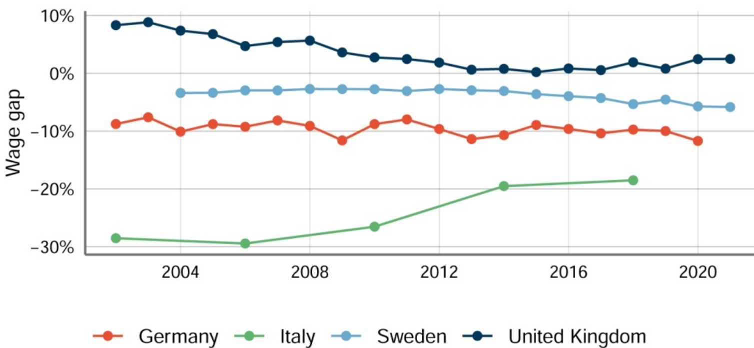
Data: OECD SOCX; author's own calculation.

Figure 6. Incidence rate of absolute poverty in Italy



Data: dati.istat.it.

Figure 7. Senior to prime-age wage gap



Note: A negative number means that seniors earn X% more than prime-age workers.

Data: OECD.

Italian welfare has never fully developed the idea of social citizenship and it has remained much more anchored in the idea of deservingness. In the Italian case, welfare provision is linked to occupational status, making it part of the conservative Bismarckian type, according to the classic work of Gøsta Esping-Andersen (1990). Conservative welfare

systems are status-oriented and tend to redistribute within rather than between classes; they apply a corporatist logic and emphasise the role of subsidiarity, private or family assistance rather than expanding the provision of social services (Esping-Andersen, 1990; Esping-Andersen, 1999). The only exceptions to this logic in the Italian case are education and health care. Otherwise, the nature of Italian welfare has been remarkably stable despite the extensive changes and challenges of the global economy, and it can be said to have five main characteristics (Ascoli, 2002).

1. Italian welfare is *particularistic*: it is based on occupational status and specific conditions, categories, or groups, and therefore has little universalist elements like those found in social-democratic welfare states. Its roots are clearly Bismarckian, with mutualistic and horizontal protection and little or no vertical redistribution. All social benefits are linked to employment status. For instance, the pension system used to be divided into 50 different occupational fund categories, each with varying degrees of privileges. Although most of these funds have now been consolidated, the system still heavily relies on a pure capitalized contribution scheme known as Notional Defined Contributions (NDC). This means that the benefits provided will reflect the existing market distribution, perpetuating any inequalities. Soon, contributors with low wages and frequent periods of non-payment (also associated with work on reduced wages) will lead to limited accumulation of contributions and higher poverty rates also in old age. Currently, there are no universal minimum pension schemes in place.
2. Italian welfare is *regionalist*: Welfare is implemented by local authorities, which have varying capacities and resources, resulting in uneven quality and quantity of services provided. The establishment of regions in the Italian constitution in 1945 initially served as administrative and statistical divisions without much autonomy, but later gained greater independence in the 1970s. This led to an ongoing conflict of responsibilities between the central government and local authorities. Structurally, Italy's northern region has a robust economy. Due to the highly 'occupational' nature of Italian welfare, the north receives more welfare transfers, primarily in the form of pensions. In contrast, the weaker job market in the south

results in fewer transfers. However, this is counterbalanced in two ways: first, by the widespread use of invalidity benefits, and second, by providing most of the workforce for the army and public administrations. Despite lower pay, public jobs have the quality of being stable and secure; Cassese even spoke of the 'southernisation' (*meridionalizzazione*) of public administration (Cassese, 2012).

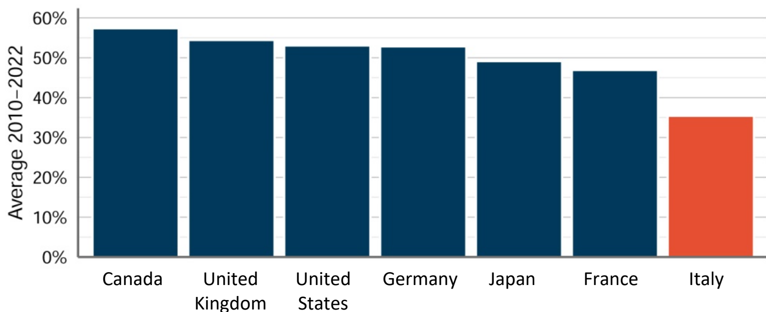
3. The welfare system often relies on clientelist cultures rather than clear criteria for access. It is mainly administered by local powers who may distribute benefits for their own electoral gain. In the past, welfare has even been used for electoral purposes. For instance, until 1984, invalidity benefits were extended to those deemed 'socially invalid', which allowed healthy individuals living in difficult or remote areas to receive benefits. While this may seem a progressive measure, it was used by local politicians as a way of consolidating an electoral base and redistributing resources. The criteria for determining 'invalidity' were unclear and decided adhoc by local authorities. The particularistic and categorical nature of the Italian welfare system also leads to strange anomalies, where there are even hierarchies between physical disabilities, and this leads to a further stratification in the generosity of benefits, where blind people receive more money than people with paraplegia.

4. The Italian welfare system focuses mainly on monetary redistribution, mainly through pensions and fiscal incentives such as tax subsidies, while it has significant shortcomings in terms of service provision. This service gap, which has traditionally been filled by unpaid female labour, particularly in care work, highlights the system's reliance on domestic contributions. Furthermore, the approach to public service provision in Italy is characterised by a preference for public procurement and public-private partnerships. This is reflected in the widespread practice among municipalities of outsourcing services such as nursing homes to cooperatives or companies through public tenders, a method in line with 'New Public Management' reforms aimed at streamlining service delivery. However, this approach has resulted in fragmented service delivery due to a lack of effective coordination mechanisms. In addition, the strong decentralisation of decision-making has led to poorly integrated services and economies of scale. Italy's limited

administrative capacity at the local level exacerbates these problems, creating challenges in managing tenders and increasing vulnerability to corruption and organised crime.

5. It is a system that relies heavily on familism and traditional gender roles (Glassmann, 2016). Even today, and especially in southern Italy, the employment rate of women is extremely low (see Figure 8). When it comes to caring for the elderly, public support is marginal. The system has focused on incentivising familism, as women are disproportionately responsible for unpaid care work in the family. The state has tried to formalise this situation, and those caring for elderly family members with severe disabilities can also take advantage of the so-called ‘Law 104’, which allows for two years of exceptional paid leave. This leave is granted to workers in a specific order of priority (partners, parents, sons, brothers and other family members). Another way of dealing with the problem has been to encourage immigration and the use of flexible employment contracts for foreign migrant carers, creating a de facto marketisation of care work. This has had several consequences, including the exploitation of migrant workers, who are often employed on precarious contracts with low pay and poor working conditions, and the lack of adequate training and support.

Fig. 8. Employment-to-population ratio among women (2010-2022)



Data: ILO; author’s own calculation.

Unlike more modern approaches, which are based on social investment and are universalist, Italian welfare has remained deeply tied to targeting and industrialist dynamics. This approach does not align with the current state of the Italian economy, which is a modern, tertiary-driven economy that must compete in a global environment. Some scholars have even pointed out that the main characteristic of southern European welfare, despite the wide variety of policies enacted, is its lack of adaptability to changing economic conditions (Burroni et al., 2020). The Italian system is still fragmented and mostly focused on the elderly, which hinders its ability to provide viable answers to the challenge of globalization. There is a significant lack of research and development and investment in human capital that would be needed for a 'high road' to development. It is important to address these issues to achieve sustainable development. Although the labour market has been liberalized, it was not accompanied by new measures of conciliation or training. The fragmentation of the Italian welfare system also limits the development of human capital.

Healthcare is the second largest expenditure in the Italian welfare system. Prior to 1978, the Italian healthcare system resembled the rest of the Italian welfare system, with numerous professionally oriented mutual funds, charities, and private foundations. However, due to pressure from social conflicts, trade unions, and left-wing parties, a universal system was established in 1978 (Giorgi, 2023). The Italian healthcare system is publicly funded and offers comprehensive coverage to all citizens and legal residents. It is primarily financed by taxes and managed at the regional level. The system places a strong emphasis on preventive care and provides comprehensive coverage, including primary care, hospitalisation, diagnostic tests and specialist consultations. It is designed to be accessible and affordable, with low out-of-pocket costs for patients. The system has contributed to Italy's high life expectancy, one of the highest in the world. The implementation of the 1978 reform of the Italian health system faced significant political challenges from private lobbies. Especially after 1989, there was an ideological preference for private healthcare providers, which were seen as more efficient. This led to a shift towards health care models that contradicted the universalist principles on which the *Servizio Sanitario Nazionale* (National Health Service) was founded. Moreover, due to the regionalisation of the system, the quality and governance of

the system are very uneven (Bertin & Carradore, 2016; Carradore, 2014) and private providers have increasingly replaced public ones, often with the implicit support of local elites: the region of Lombardy, for example, is paradigmatic in this sense – private providers are encouraged through political support. As a result, the system is gradually moving towards a single-payer model, where public money is used to pay private healthcare providers, and the amount of out-of-pocket spending by the end user is increasing for premium services and shorter waiting times.

Education is also universal in principle. However, the reality of strong regionalisation makes the results very uneven. The 1963 reform introduced compulsory secondary education, which increased the length of schooling and delayed the tracking of pupils. High schools introduce some elements of tracking, but they all allow access to higher education, reversing the previous fascist policy of allowing access to higher education only for lyceum students. Instead, the management of vocational training is left to the regions and often outsourced to private companies, associations or trade unions (Regini, 1997). This, in turn, exacerbates regional inequalities in a key area of education and production, blurs the organisational boundaries between public and private interests, and fragments the quality and conditions of training.

Two major innovations have been added to the Italian welfare system in recent years: the 'Citizen's Income', a minimum income scheme, and the 'single and universal allowance for dependent children'. The General Confederation of Italian Industry has strongly criticised the first measure because of its impact on wages. On 1 January 2024, the Citizen's Income was abolished and replaced by two programmes for the poor, but both were drastically reduced in both generosity and duration. It can be said that the system was dismantled in order to return to the previous status quo of small, extremely targeted programmes. The first, called inclusion cheques (*assegno di inclusione*), is aimed at people responsible for caring for minors, the elderly or disabled family members – again emphasising the role of private provision of care services within the family. The second programme, known as 'Aid to Vocational Training' (*supporto alla formazione e al lavoro*), is aimed at unemployed people who are actively seeking work but who do not qualify for inclusion cheques.

Another universalist programme recently introduced to address the incredibly low birth rate is a form of financial support for families called the Universal Child Benefit (*assegno unico e universale per i figli a carico*), which is granted for each dependent child up to the age of 21, with no age limit for disabled children, and is guaranteed at a minimum level to all families with dependent children without any form of means testing. This policy was implemented in 2022 after a difficult legislative process and aims to reverse Italy's demographic decline.

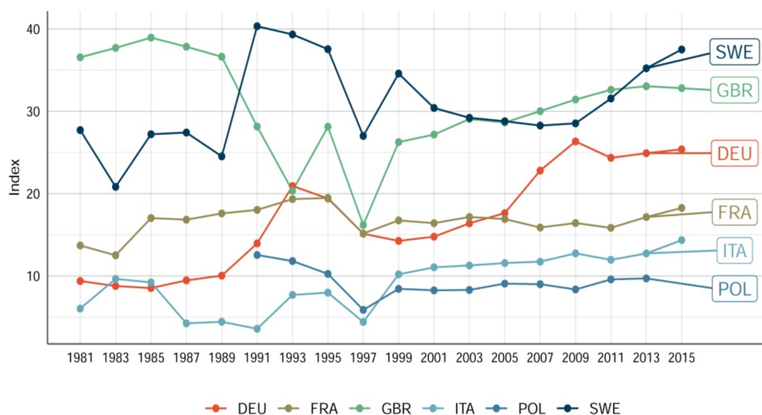
Thus, reforms may be possible, but challenging the path dependency and ageist bias of Italian welfare is difficult. The 'citizenship income' policy, with its universalist framework, faced widespread criticism as many found the concept of inclusive welfare entitlements difficult to comprehend, showing a preference for a system that targets the 'deserving'. The Italian electorate is more receptive to a welfare system that is based on age and targeting. In the following section, we will compare how different welfare systems address the issue of age.

4. Age orientation of welfare

Despite the reforms mentioned in the previous section, the nature of Italian welfare has remained largely unchanged, firmly placing it in the conservative Bismarckian welfare camp. The over-reliance on pensions has resulted in higher poverty levels among the young population, while the old population has a relatively low poverty rate, at least for the time being.

In her study on the pensions system, Lynch (2006) created an index of OECD data to provide comprehensive spending information for different demographic groups. She used percentage figures of GDP per capita to highlight spending patterns. Lynch's analysis of expenditures on education, unemployment, elderly care, children, and healthcare reveals significant disparities, particularly in Italy, where there is a notable emphasis on spending for the elderly.

Figure 9. Age−orientation index of welfare spending



Data: OECD SOCX; author's own calculation.

Figure 9 displays an index similar to Lynch's (2006) that indicates the direction of welfare spending for selected OECD countries. The index is a ratio of social spending for the economically active (numerator) to spending oriented towards the elderly (denominator).[2] A smaller value indicates a welfare system that is more oriented towards the elderly, while a higher value indicates a more balanced spending approach. Although there is a slight trend towards more inclusive welfare, Italian

[2] The welfare age-orientation index is calculated using data from the OECD's SOCX. This index takes into account public spending programs that are specifically targeted towards both the elderly and the non-elderly. For spending that is oriented towards the elderly, it includes: (1) cash and in-kind benefits related to old age, such as pensions, early retirement pensions, residential care, and similar services; (2) cash and in-kind benefits for survivors, including funeral expenses; (3) disability pensions; (4) pensions related to occupational injuries and diseases; and (5) early retirement due to labor market factors. However, the index's spending on non-elderly individuals includes: (1) family benefits, such as family allowances and maternity/parental leave, as well as day care services; (2) active labour market programs, which encompass employment services, training, youth initiatives, subsidised employment, and measures for disabled workers; (3) cash benefits for income maintenance; (4) unemployment compensation and severance pay; and (5) educational expenditures across all levels, from early childhood education to university.

welfare still primarily focuses on the elderly, as does the welfare system in Poland and other Central Eastern European countries. Germany, which traditionally followed the same Christian-democratic welfare model as Italy, has successfully reformed its system. Despite starting from a similar level as Italy, Germany has been able to gradually rebalance its welfare spending.

The aim is to analyse the implications of a predominantly gerontocratic welfare system. The analysis will follow two distinct paths. Firstly, the role of financialization in supplementing welfare, particularly in liberal welfare systems like those in the US and UK, will be highlighted. It has been noted that household debt has become crucial in supplanting public welfare provisions. Crouch (2009) introduced the concept of 'Privatised Keynesianism', suggesting that public expenditure to foster welfare and support aggregate demand has been replaced by private financial leverage.

The following sections will discuss the macroeconomic consequences of the welfare age orientation. Modigliani's classical study on life consumption smoothing shows that individuals tend to accumulate debt early in their working lives when their income is low but their financial needs are high (e.g., buying a house, having children), and repay it as they age (Ando & Modigliani, 1963). The question is, how does a gerontocratic-biased welfare system affect this? How does the welfare orientation towards the elderly affect borrowing? Although household debt has increased globally with financial liberalisation, it has not increased uniformly. As previously mentioned, many political economists attribute this trend to a trade-off between private debt and welfare retrenchment, which has been viewed as an alternative to welfare. Is this also the case in Italy? The following section presents a model demonstrating that a greater focus on elder welfare results in lower levels of household debt at the aggregate level.

5. *Welfare and household debt*[3]

Two models are used to examine the relationship between the age orientation of welfare and household debt (see Table 1). The dependent variable in both models is household debt as a percentage of Net Disposable Income (NDI). The sample comprises a panel of 30 OECD countries over the period 1995-2017. All countries are members of the European Union, except for Canada, New Zealand, Norway, South Korea, the United Kingdom, and the United States. Model one examines welfare generosity, a qualitative measure that describes the length of time and coverage of welfare measures for unemployment, pensions, and sick pay insurance. The second model examines how welfare spending affects household debt.

Model 1 shows a statistically significant negative correlation between public pension generosity and household debt. Model 2 analyses the correlation between household leverage and nine welfare spending variables, with four variables showing statistically significant results. In line with our expectations and consistent with generosity results, we have observed a significant negative correlation between spending on old age and household debt. Conversely, spending on education shows a positive and significant correlation with household debt, suggesting that countries that invest more in human capital tend to have citizens who are better positioned in the labour market. Countries that implement active labour market policies, such as Denmark, Sweden, and the Netherlands, have a significant and positive impact on household debt.

On the other hand, spending on unemployment and families has a negative impact on household debt, as seen in both model 1 and model 2. This can be attributed to the varying nature of welfare spending across countries, which can be better understood as a welfare regime. As previously mentioned, in conservative, continental European welfare regimes, unemployment benefits often do not cover temporary workers, precarious workers, or the self-employed. Instead, they provide more robust protection to those with stable jobs, creating a division between insiders and outsiders in benefit provision. Unstable occupations have

[3] This paragraph revisits the findings from a previous study (Comelli, 2021). Table 1 in this paper replicates the table from that study, providing further context for the results. For information on the methodology, please refer to that study.

Table 1. Household debt and welfare

	MODEL 1		***MODEL 2***		***MODEL 3 (CONTROLS)***	
	Household debt (b/se)		Household debt (b/se)		Household debt (b/se)	
PUBLIC PENSIONS	-3.3499	*				
	(1.37)					
UNEMPLOYMENT INSURANCE	-5.0468	***				
	(1.49)					
SICK PAY GENEROSITY	7.2896	***				
	(1.21)					
OLD AGE			-14.5897	***		
			(1.41)			
INCAPACITY-RELATED BENEFITS			0.5100			
			(4.36)			
HEALTH			-2.5448			
			(2.38)			
FAMILY			-10.4380			
			(9.92)			
UNEMPLOYMENT			-17.2793	***		
			(4.41)			
ACTIVE LABOUR MARKET			83.9352	***		
			(8.08)			
HOUSING			-9.5267			
			(7.44)			
OTHER PROGRAMS			-9.3405	+		
			(4.93)			
EDUCATION			17.5040	***		
			(5.20)			
TEMPORARY EMPLOYMENT	1.7025	**	1.0872	**	1.4815	***
	(0.59)		(0.39)		(0.35)	
TEMPORARY EPL	4.7969	+	3.4195	+	1.4051	
	(2.80)		(2.04)		(2.08)	
EMPLOYMENT RATE, 15-64	5.9539	***	-0.6488		4.7089	***
	(0.79)		(0.52)		(0.62)	
HOUSING PRICES INDEX	0.5105	***	0.3810	***	0.3801	***
	(0.08)		(0.11)		(0.09)	
SAVING RATE	-3.3042	***	-3.8054	***	-1.6390	**
	(0.81)		(0.72)		(0.50)	
PEOPLE AGED 65+	-11.9101	***	3.5900	*	-6.8729	***
	(1.25)		(1.41)		(0.83)	
LOG GDP	90.1541	**	156.8218	***	109.7789	***
	(32.29)		(14.05)		(11.71)	
CONSTANT	-1071.7940	***	-1480.5285	***	-1264.7318	***
	(307.55)		(120.64)		(108.72)	
R2	0.7513		0.8532		0.5913	
N	217		270		321	

NOTE: + P<0.1, * P<0.05, ** P<0.01, *** P<0.001.

become common entry points to the labour market, and jobs intended as stepping-stones to more stable occupations often become job traps. This division frequently aligns with generational fault lines.

A comparable trend is evident in terms of family policies expenditure. Countries with conservative welfare regimes in continental and post-socialist regions allocate a greater proportion of their funds to family policies, which exacerbates and prolongs the gap between those who are included and those who are excluded. In these countries, the family assumes a central role in critical life choices, and family members perform vital welfare duties such as caring for children and the elderly. Family networks become the exclusive source of these services.

Bismarckian and Christian-democrat social policies aim to support families through assistance. However, this can result in women being burdened with an additional 'second shift' of caregiving responsibilities after work or being pushed out of the labour market. In contrast, nations that prioritize individuals do not reinforce traditional gender roles within families. Instead, they prioritize policies that make it less exclusionary to choose between family and career by focusing on the individual through active labour market policies, as suggested by Esping-Andersen (1999).

Active labour market policies aim to upgrade workers' skills and increase their long-term employability, providing an alternative to unemployment benefits. These policies often target disadvantaged groups, creating sponsored employment opportunities and resulting in a more secure financial outlook. Countries implementing such programs tend to have higher household debt levels, as with education. Housing prices contribute to household debt but do not offset the impact of welfare spending. Additionally, GDP performance is linked to higher household indebtedness. It is worth noting that older societies tend to have lower private debt, although this control does not invalidate our previous findings.

6. *Welfare and economic pessimism*

Through a comparative analysis, it is evident that the age orientation of welfare can partially account for the low indebtedness of Italian households. This is a positive outcome as higher household debt can lead to significant leverage in the banking sector and overall economic instability.

However, it is important to note that gerontocratic welfare affects long-term expectations beyond just household debt, including people's perceptions of the future. Avoiding household debt is a manifestation of a broader trend. Debt, like having a baby or starting a company, is a long-term commitment that carries long-term consequences.

The nature of welfare redistribution can also impact our perception of the future. It is argued that age-biased and highly targeted welfare, such as the Italian system, may not be effective in stabilising future expectations. This is because its generosity is focused only on the elderly and insiders, leaving the active population and the precarious to fend for themselves. A more universalist coverage could help stabilise perspectives by providing a sense of security despite the volatility of the labour market.

Using a structural equation model, this study aims to analyse the interaction between the age orientation of welfare and both household debt and economic pessimism (see Figure 10). The study will investigate how the age orientation of the welfare index, as presented above, interacts with the percentage of household debt (as a percentage of NDI, from OECD), the number of homeowners with arrears on their mortgages (from EU-SILC), and a variable measuring economic pessimism created[4] by using data from the OECD Risks That Matter Survey (see Table 2). In essence, the question is whether gerontocratic welfare has a direct or indirect impact on economic precarity, as well as the long-term perception of economic instability.

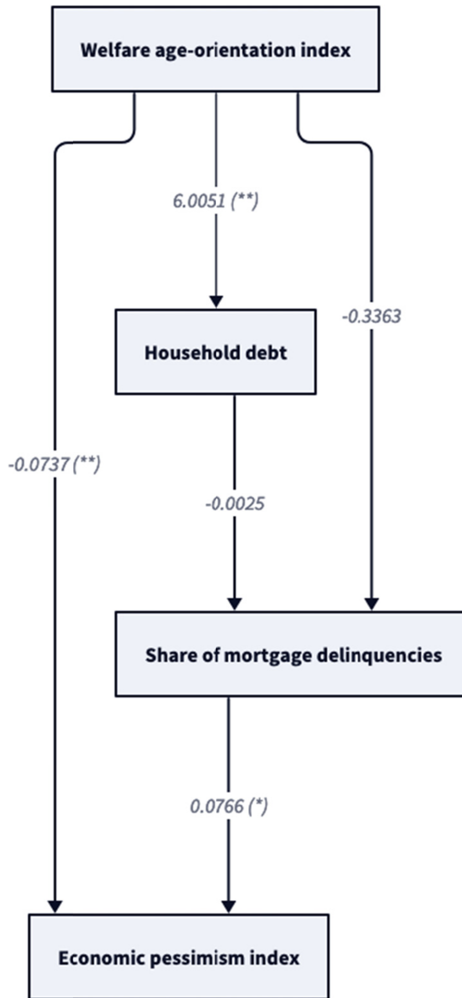
[4] To construct the index of economic pessimism, mean values for survey questions regarding long-term worries about personal finances (q3a) and young family members' financial security (q3b) were aggregated by country. The index was then formed by summing these mean values for each country, and normalized using the Z-score method to allow for cross-country comparison.

Table 2. Descriptive Statistics

Country	*Economic pessimism (2020)*	*Share of homeowners with mortgage deficiencies (2020)*	*Household debt (2020)*	*Age orientation of welfare (Average 1995-2015)*
DNK	-1.76	1.40	259.20	25.95
NOR	-1.36	2.00	247.41	30.26
NLD	-1.29	0.70	224.87	27.85
FIN	-1.25	3.00	154.32	25.72
AUT	-0.87	2.40	94.58	17.51
CHE	-0.68	0.40	223.30	21.65
DEU	-0.66	1.70	98.63	17.22
EST	-0.57	1.70	80.31	23.15
POL	-0.51	2.40	57.10	10.47
BEL	-0.40	1.30	117.76	25.71
IRL	-0.25	6.80	119.83	31.00
LTU	-0.22	4.10	40.94	19.65
FRA	0.12	3.00	123.31	17.52
ITA	0.60	2.30	90.51	11.08
PRT	1.43	2.90	127.37	15.40
ESP	1.68	7.50	102.67	17.89
GRC	1.73	26.10	97.56	9.70

Figure 10 shows that greater age equality in welfare spending has a positive and statistically significant effect on household debt. This confirms the findings of the previous section that increased funding for the active population impacts future-oriented activities, such as debt. Notably, there is no correlation between higher private indebtedness and mortgage delinquencies among homeowners. There is a negative relationship between the two, but it is not significant. Among OECD countries, the most indebted countries at the personal level are in Northern Europe. However, those with a larger proportion of the population struggling to repay their debts are primarily concentrated in Southern and Eastern Europe, where the average indebtedness is moderate to low (see Table 2).

Figure 10. Structural equation model



Note: Illustrating causal associations between all the study variables. Standardized regression coefficients are displayed for each relationship (*$p < 0.05$, **$p < 0.01$, ***$p < 0.001$)

Increased welfare spending is positively correlated with higher household debt in a statistically significant way. However, it is negatively correlated with a lower struggle to repay debt, although this correlation is not statistically significant. This suggests that higher welfare spending encourages people to take on more debt, but also has the potential to reduce the number of people struggling to repay their mortgages.

Moreover, a welfare system that is more focused on the younger generation has a statistically significant negative impact on economic pessimism. This is a relevant factor that is often overlooked in welfare literature. Inclusive welfare policies not only affect material conditions but also shape individual perceptions of the future. It is worth studying the personal and social consequences of this phenomenon, including how individuals conceptualize their future and how their perception of the future influences their present actions.

7. Conclusion

Welfare should be seen as part of a country's growth strategy. In the past, the welfare state focused primarily on protecting those who were unable to work because of age or illness. In today's society, however, social policy and the welfare state are expected to play a more active role in promoting economic growth by shielding individuals from market volatility, retraining them, supporting aggregate demand, and encouraging economic dynamism.

This chapter discusses the role of welfare in economic dimensions that are often overlooked in welfare research, such as its impact on household debt levels. Welfare can stabilize expectations and shape perceptions, thereby influencing attitudes and behaviour. It is argued that the age targeting of welfare spending is a crucial factor in influencing these dynamics. The aim of this chapter has been to demonstrate that the direction of welfare spending is just as important as the amount spent.

Although all OECD countries allocate most of their welfare spending to the elderly, those that also allocate some of their spending towards the working population tend to inadvertently encourage long-term decision-making, such as taking out mortgages. This, in turn,

affects a country's economic growth, as well as the size and nature of its financial system.

The main characteristics of Italian welfare are presented as industrialist welfare that failed to reform to the new needs of a post-industrial society. Italian welfare remained focused on the protection of senior citizens, while remaining deaf to the problems and demands of the active population.

Using a structural equation model, this study demonstrates that in OECD countries, welfare systems that balance spending between the elderly and the working population tend to increase private debt while reducing the share of people struggling to repay their debts. Additionally, there is no correlation between the amount of private debt and the percentage of households struggling to repay their mortgages.

It is worth noting that the Italian welfare system is particularly gerontocratic. However, this characteristic is not unique to Italy; it is widespread in several European countries, particularly in Central and Eastern Europe. These countries, such as the Visegrad countries and Slovenia, have exhibited what Vanhuysse refers to as a 'premature pro-elderly bias' (Vanhuysse & Perek-Białas, 2021; Vanhuysse, 2023). This trend is especially noticeable in the context of significant shifts of working-age individuals into early and disability pensions. This phenomenon has been observed in Hungary, Poland, Slovakia, and Slovenia, but not in the Czech Republic.

In countries such as Hungary and Poland, the period following 1989 witnessed a significant increase in the number of individuals receiving early and disability pensions, which were more generously protected. The strategic use of public pension systems acted as a buffer against widespread transitional unemployment. As a result, there was a significant increase in the number of pensioners, which had substantial macro-fiscal and political-electoral implications. For example, in Hungary and Poland, the proportion of pensioners in the electorate increased significantly during the early years of the post-communist transition. This transformation reshaped the landscape of political and economic conflict, mirroring trends observed in Italy where social conflicts re-aligned along generational lines.

Policymakers must consider the age orientation of their strategies to avoid trade-offs between age groups, given the rapid escalation of inequality in Italy and other countries with similar policies. The Italian

experience highlights the complex interplay between welfare policies, economic conditions, political dynamics, and perceptions. It underscores the need to consider welfare as an integral part of a growth strategy.

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The North-South Divide

A Structural Labor Market Perspective in Italy's fragmented Landscape

Valeria Cirillo[a] *and Jelena Reljic*[b]

Abstract

This chapter analyses the persistent North-South divide in Italy from a structural labour market perspective. It traces the origins of this divide back to the pre-unification period and examines its development over the past fifteen years. The argument presented is that the southern regions are caught in a vicious cycle characterised by precarious employment, low wages, inadequate skills, limited productive capacity, and low productivity. The structural weaknesses of the Mezzogiorno are perpetuated by a self-reinforcing circle, which exacerbates inequalities and limits economic growth and social cohesion. It is argued that various crises, including the 2008 financial crisis, the sovereign debt crisis, and the Covid-19 pandemic, have worsened structural weaknesses in Europe and Italy, albeit in different ways. These crises have contributed to further fragmentation and weakening of labor. The chapter concludes with policy recommendations to address these disparities. It advocates for targeted and coordinated regional interventions, such as labor market, innovation, and industrial policies, capable of breaking the North-South divide.

Keywords: North-South divide; labour market; inequality; employment dynamics

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1. *Introduction*

More than a century and a half after its unification, Italy is still divided into two main areas characterized by different socioeconomic structures (Svimez, 2019; 2020). This dichotomy extends to a weaker economic performance compared to other European countries, as seen from a core-periphery perspective (Celi et al., 2018). More precisely, in parallel to the decline in Italy's relative overall performance compared to other European countries, a persistent intra-country divergence is observed between the north-center and the south (also known as the *Mezzogiorno*). At the same time, there are also important heterogeneities within each macro-region (Franzini, 2019; Prota et al., 2022), highlighting that the Italian *Mezzogiorno* cannot simply be reduced to a monolithic block (on this methodological issue, see also the chapter by Gräbner-Radkowitsch and Kapeller).

In the broader context of advanced economies, regional disparities have been on the rise since the late 1980s. The 90/10 ratio within these economies, including the United States, reached nearly 1.7 in 2019, indicating that the 90th percentile region is on average 70 percent richer than the 10th percentile region in terms of real GDP per capita (Bluedorn et al., 2019).[1] Regional disparities in Europe are even more pronounced: the 90/10 ratio is 2.4 for the euro area, and nearly 2.8 for the EU (Hudecz et al., 2020). These figures suggest that regional incomes tend to vary tremendously within countries, with regions in advanced economies increasingly polarizing, resulting in a division between 'places that matter' and 'places that don't matter', with greater potential for conflict (Rodríguez-Pose, 2012; 2018).

This is particularly true in the European context, where growth in Central and Eastern EU Member States (CEE) has been the main driver of convergence in the EU over the last decade, while Southern Europe has suffered from economic stagnation and fallen into what has been

[1] The average 90/10 ratio is computed by dividing regional real GDP per capita in the region at the 90th percentile by that of the region at the 10th percentile within a country. The composition of the sample is described in the Annex Table 2.1.2 'Territorial Grid of Country Sample' of Chapter 2 'Closer Together or Further Apart? Subnational Regional Disparities and Adjustment in Advanced Economies' in the *World Economic Outlook*, October 2019.

defined as a "development trap" (VIII Cohesion Report, European Commission).

Goecke and Hüther (2016) show that regions in Eastern European countries are catching up due to the relative size of their manufacturing sector, while Southern European regions have diverged from the EU average, especially since 2011 (see also the chapter by Gräbner-Radkowitsch and Kapeller). Although the EU Cohesion Policy has facilitated some convergence between Member States in terms of employment, social inclusion and health, the latest Cohesion Policy report underlines the persistence of structural challenges, in particular related to poverty and social exclusion, which affected more than one in five Europeans in 2019.

What are the causes of these phenomena? To what extent have recent crises – the 2008 financial crisis, the sovereign debt crisis, the pandemic outbreak in 2020, the Russia-Ukraine war (Celi et al., 2022) – affected regional disparities in Italy? Is there a "development trap" or (more likely) a deep structural divide between Italian regions, in line with rigid production hierarchies across Europe? And how does integration into the European economy relate to core-periphery structures within Italy?

Different streams of research have highlighted that polarization patterns in the European Union can be explained by a combination of factors, ranging from path dependence in development trajectories to divergences in the accumulation of technological capabilities, which, in turn, has exacerbated structural dependence (Gräbner-Radkowitsch, 2022). In this chapter, we address the above-mentioned research questions by focusing on the dynamics of labor markets, within the framework that links evolutionary economics to a structural analysis of regions. We propose a structural view of labor markets that is able to link, on the one hand, features of production in terms of sectoral specialization, technological development, and the nature of firms' competitive strategies, with specific features of job quality – skills, wages, type of contractual arrangements – which in turn are related to social inclusion, household income, and, from a macroeconomic point of view, aggregate demand. Indeed, the labor market perspective not only reflects important changes in production structures but also provides insights into the capabilities accumulated by the workforce overtime, which co-evolve with the technological change.

We argue that various crises – the 2008 crisis, the sovereign debt crisis, Covid-19 – have exposed and aggravated structural weaknesses in Europe and Italy, albeit in different ways, leading to a further fragmentation and weakening of labor. The Covid crisis has exacerbated long-standing problems in Italy, such as sluggish productivity, a growing share of low value-added and low innovation productive activities, wage stagnation, a growing share of precarious work and, above all, the deepening of the North-South divide. The latter will be the main focus of this chapter, which is structured as follows. After reviewing Italian regional disparities from a historical perspective in Section 2, we present our conceptual framework in Section 3. In Section 4, we show the patterns of regional disparities in the labor market using several data sources. Finally, in Section 5, we present our conclusions based on the results of our analysis and provide policy recommendations aimed at reversing regional disparities and promoting a "virtuous circle".

2. From Pre-Unification to Today: At the roots of Italian regional disparities

Since its unification in 1861, Italy has been characterized by persistent regional divisions. The Kingdom of the Two Sicilies – the largest sovereign state in Italy in terms of population and size before unification, covering most of what is now the *Mezzogiorno* – and the central-northern states exhibited considerable economic disparities already in the 19th century. These were particularly pronounced in the agricultural sector, which was the main source of income at the time. Several scholars, including Cafagna (1989), Eckaus (1960; 1969), Esposito (1992), Saraceno (1961), have attempted to quantify this economic gap between the southern and northern regions, estimating it at between ten and twenty percentage points. However, the emergence and consolidation of a socio-economic divide between these regions became particularly evident at the beginning of the 20th century, reaching a gap of 20% on the eve of the First World War (Daniele and Malanima, 2007). Although significant disparities already existed between Italian regions, it was the process of industrialization that shaped Italy's productive structure that further accentuated the heterogeneities between

northern and southern areas of the country. After the unification and throughout the industrial evolution, *la Questione meridionale* (the southern problem) emerged, representing a chronic disparity in the development of the two parts of Italy.

Several historians, warning that the differences between the Italian territories predated unification, have argued that progressive international economic integration, rather than the formation of a national market, was one of the drivers of economic divergence between these territories. While the northern regions exported agro-industrial goods, the southern regions lagged behind, especially in the context of opening up to international markets. Therefore, the unification period was largely characterized by a divergence between the two macro-areas.

A major discontinuity occurred during the "golden age" of economic growth (1950-1973), due to the favorable international economic environment and the policies implemented during the so-called "extraordinary intervention" that began after the Second World War and largely coincided with the first part of the life of the "*Cassa per il Mezzogiorno*" (1950-1984). Looking at the long-term performance of southern Italy, macroeconomic figures show that the only period of convergence of this region towards the Italian and European average took place between 1951 and 1973 (Felice and Lepore, 2017; Papagni et al., 2021).[2]

After the 1970s and the oil crisis, public intervention in the south gradually lost momentum and southern Italy began to fall behind the Italian and European average (again), a trend from which it has not recovered. In the 1980s and 1990s, factors such as the restructuring of the industrial system, the spread of unregulated liberalism, the introduction of the euro, and the 2008 financial crisis contributed to the widening of the South's gap, further distancing it from the Italian and European "core" (Lepore, 2012). In particular, the creation of the EU single market has increased competition, while the EU regulatory framework has limited public interventions (e.g., fiscal stimulus and industrial policies) and depressed domestic demand, especially in the southern regions. This way it contributed to a further concentration of

[2] Several authors highlighted that during this period the *Cassa per il Mezzogiorno* was more efficient and successful: according to Martinez Oliva (2009), in those years the convergence of southern Italy (towards the Centre-North) was faster than the one observed in eastern Germany after 1995 (towards western Germany).

economic activity in the more advanced northern regions of Italy. Moreover, the negative effects of imposed austerity policies were more pronounced in less resilient areas such as the *Mezzogiorno* due to its structural weaknesses, perpetuating the core-periphery structure (Guarascio et al., 2023). Indeed, during the financial crisis and the subsequent sovereign debt crisis, Italy lost further ground compared to more advanced countries and the rest of Europe (Torrini et al., 2022). In this context, the *Mezzogiorno*, which was already struggling to keep pace with the rest of the country, progressively lost its economic weight. The Covid pandemic broke out when the *Mezzogiorno* was still suffering from the negative legacy of the double recession. The health crisis and the strong economic fluctuations that characterized the two-year period of 2020-21 were another shock of exceptional magnitude.

From a policy perspective, the different stages of development of the South have been linked to heterogeneous forms of public intervention, ranging from top-down policies, such as those promoted by the *Cassa per il Mezzogiorno*, inspired by the Big Push type of development approach (Rosenstein-Rodan, 1943), to bottom-up initiatives linked to the *Nuova Programmazione* season (1996-2005). Today, great expectations are based on the Italian National Resilience and Recovery Plan (NRRP), which provides for the allocation of at least 40 percent of total resources to the southern regions. However, major bottlenecks in the implementation of the plan are currently emerging (Viesti, 2023).

To some extent, the development pattern of southern regions seems to follow an inverted S-shaped trajectory rather than an inverted U-shaped pattern, as persistent divergences and regional disparities follow convergence[3]. For instance, Daniele and Malanima (2014) highlighted that in Italy per capita income levels diverged in a first long-phase of about 60-years (1891-1951), slightly converged in a second short period of about 20-years (1955-1975), and remained roughly stable in the subsequent period till 2000. If this was the case, Kuznets' prediction of income convergence after industrialization had not materialized, leading to a consolidated structural North-South gap over time.

[3] The same inverted S-shaped pattern was also highlighted by Amos (1988) and, for the US, by Fan and Casetti (1994) pointing to the role of economic growth as a 'continuous process' in which regional convergence may be followed by divergence in a later phase.

From this perspective, theoretical approaches based on different theories of economic development that address the problem of divergence can explicitly contribute to the analysis of the North-South divide. As recently highlighted in Fanti et al. (2023), at least three approaches can facilitate the understanding of this divergence: (i) asymmetries in production structures, patterns of technological learning and heterogeneous specialization, as in the *structuralist approach* (Cimoli and Dosi, 1995; Dosi et al., 2009); (ii) *core-periphery* contributions that shed light on asymmetries among member states within the European Monetary Union (Storm and Naastepad, 2015; Landesmann et al., 2015; Celi et al., 2019) and uneven development along global value chains; (iii) power relations in the global economy due to productive specialization and terms of trade deterioration, drawing from *dependency theory* (Kvangraven, 2021; Prebisch, 1950).

3. A structural view of labour markets: a conceptual framework

The analysis of labor markets provides crucial insights into the state of production structures – which in turn are related to global value chains, sectoral specialization and participation in international trade – but also into the spread of inequalities. Blanchet et al. (2019) estimate that more than 75% of European inequalities are explained by the within-country component. Moreover, the within-country component of inequalities in Europe has increased over the past decades (Atkinson, 2015).

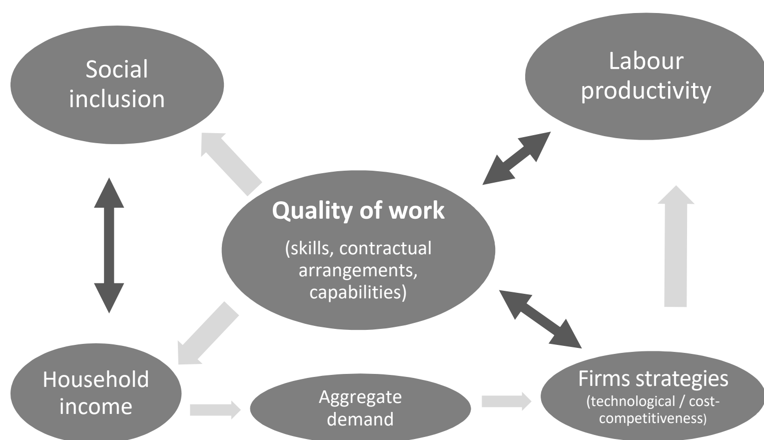
Income inequalities arise in labor markets, as they mainly concern market incomes (more than disposable incomes), which exclude the effects of public transfers and taxes, and are generated – according to the economic approach embraced – by a combination of supply and demand factors related to family background, ethnicity, gender, inequality of opportunities related to access to education and health care, as well as weaknesses in productive structures, low investment and lack of employment opportunities. Therefore, policies to address regional disparities and inequalities, such as those implemented by the EU Cohesion Program, aim to reduce regional disparities and strengthen social, economic and territorial cohesion, ranging from interventions for businesses, transport infrastructure to skills development and training

programs. However, these policies have demonstrated their inability to reshape the industrial infrastructure of European countries and regions, mainly due to the lack of well-designed industrial policies (Pianta et al., 2020), capable of addressing the recent digital and green transition (Pianta and Lucchese, 2020). Italy is one of the countries with the highest levels of inequality (Franzini and Raitano, 2019), with persistently low-growth regions located in the south. Several studies have examined how and to what extent differences in productive performance can negatively affect inequality and regional disparities between the North and the South (Viesti et al., 2011; Viesti, 2021). However, asymmetries in the labor market and inequality also generate and consolidate asymmetries in productive performance (Fanti et al., 2023). From this perspective, Svimez (2019) highlights the growing socio-economic inequalities for the southern Italian regions over the last twenty years, together with a relatively higher risk of poverty and weaker overall working conditions. The fragmentation of labor markets, caused by a general weakening of productive structures, leads to increasing inequalities and social exclusion, which in turn are likely to affect industrial structures, productivity and regional disparities (Capriati et al., 2023). The purpose of the present analysis is to examine these interrelated channels in more detail.

Adopting a structural view of the labor market that includes interactions between supply and demand side mechanisms, we argue that southern regions have been severely affected by a damaging vicious circle that goes from non-standard work – the accumulation of precarious forms of employment (part-time and temporary jobs) – to low wages, low skills, low qualifications, low productivity and, finally, low aggregate demand. The availability of precarious forms of employment, the result of a process of labour market flexibilization in response to the OECD's (1994) recommendations, has pushed firms towards cost-competitiveness strategies, especially in the South. A number of empirical papers have highlighted the links between job quality and production structures, suggesting that a higher share of temporary and part-time jobs is likely to create a negative vicious circle (Cetrulo et al., 2019; Pianta and Reljic, 2022; Reljic et al., 2023) and is aimed at maintaining profits at the firm level by reducing labor costs (Cirillo and Ricci, 2022). The concentration of low-quality jobs leads to lower incentives to adopt new technologies and capital-inten-

sive innovations due to the reduction in wage growth associated with the flexibilization of the labour market (Sylos Labini, 1984; Kleinknecht, 2020). From an evolutionary perspective, low-quality work is also associated with lower organizational skills and procedural knowledge of organizations, which in turn negatively affect innovative capabilities based on the long-term accumulation of tacit, firm-specific knowledge (Dosi et al., 2008; Teece, 2019). Moreover, from a macroeconomic post-Keynesian perspective, part-time and temporary jobs imply lower wages, lower consumption and lower demand (Vergeer and Kleinknecht, 2010; Lavoie and Stockhammer, 2012). Figure 1 illustrates these links between job quality, social inclusion, income, aggregate demand and firm/sector performance.

Figure 1. A structural view of labour markets



Source: Own elaboration based on Pianta and Reljic (2022)

To sum up, this chapter highlights the importance of creating "good jobs" in Southern Italy in order to promote social, economic and territorial cohesion and reduce regional disparities. In the following section, we document how the various crises – the financial and economic crisis of 2008, public debt (2011-2012), and pandemic outbreaks (2020-

2021) – have further exacerbated territorial divisions. These events have been accompanied by an impoverishment of investment strategies, especially in research and innovation, and a general lack of strategic planning and industrial policy (Felice et al., 2019; Pianta et al., 2020; Dosi et al., 2021; Guarascio et al., 2023). As emphasized by Fanti et al. (2023), the recent crises have further highlighted the importance of the North-South divide in terms of the capacity to absorb shocks, as pre-existing divergences have been exacerbated.

4. Unravelling Territorial Dualism in the Italian Labour Market

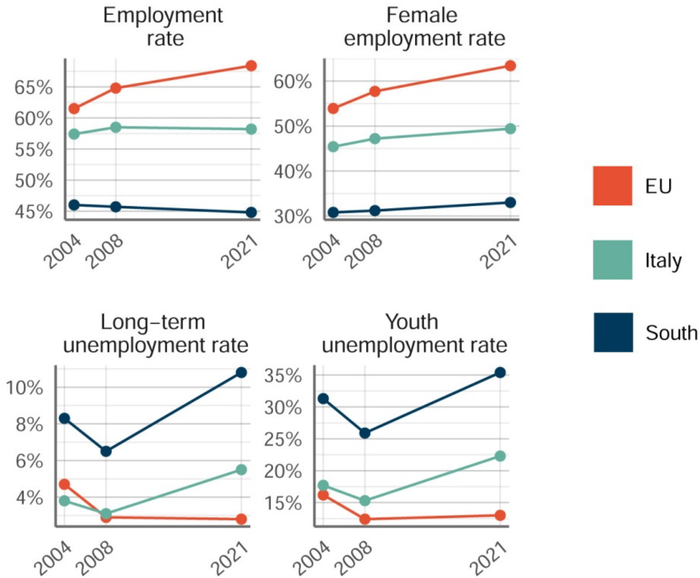
To understand the current state of the Italian labor market, it is imperative to consider not only its long-term evolution in the European context, but also the persistent regional disparities within the country. This will allow us to identify some of the most pressing challenges facing regional labor markets and their impact on increasing insecurity and the risk of poverty.

Figure 2 provides an overview of the selected labor market indicators. Looking back over the period from 2004 to 2008, we can observe an improvement in labor market conditions both in Italy and in the EU: increasing employment rates, decreasing gender gaps in employment, as well as barriers faced by the long-term unemployed and young people. However, despite these positive developments, all four labor market indicators suggest that Italy consistently lags behind. In 2021, Italy's employment rate was 10 percentage points below the EU average, indicating a significant divergence since 2008. The same is true for the female employment rate, which was 14 percentage points below the EU average. Moreover, Italy's long-term unemployment rate is almost double that of the EU, while the youth unemployment rate is nearly 10 percentage points higher.

A closer look at the *Mezzogiorno* reveals an even more alarming picture. Three out of four indicators show a deterioration between 2004 and 2021. In particular, the employment rate in the South is 24 percentage points below the EU average. In addition, long-term and youth unemployment rates are almost four and three times higher respectively than in the EU. Although the gap with the national average was

relatively small, the situation in the South was significantly worse, pointing to marked territorial disparities.

Figure 2. Selected labour market indicators



Note: Youth unemployment refers to population 15-29 years; the remaining indicators to population 15 to 64 years.

Source: Authors' elaboration based on Eurostat and Istat data.

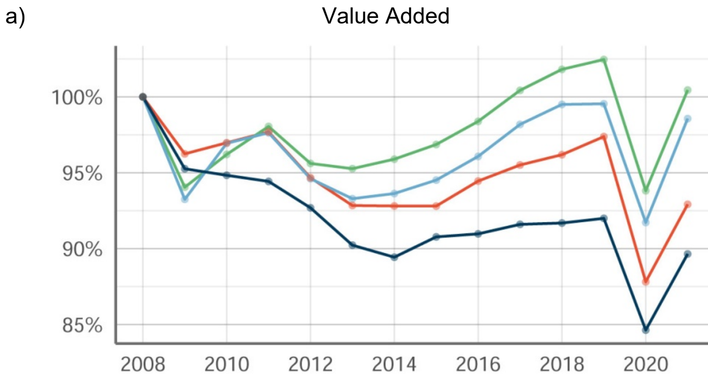
To fully assess the territorial dualism that characterizes the Italian labor market, we need to go beyond standard labor market indicators and consider structural factors as the driving force behind these figures (Prota et al., 2022). The following subsections examine several developments related to the recent dynamics of the Italian labor market. Particular attention is paid to recent trends in value added and hours worked, industrial specialization, occupational structure and job quality.

First, we focus on regional disparities in the level of value added and hours worked (Figure 3). Despite a fairly similar pattern of cycli-

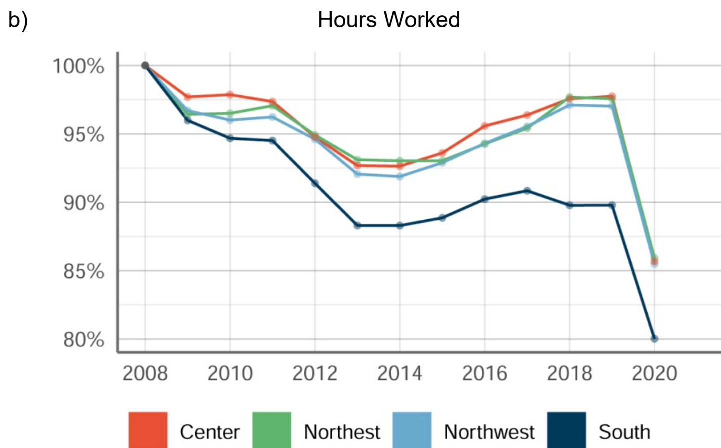
cal movements, there are notable differences between regions, particularly in terms of value added. The data suggest that the level of value added was below its 2008 level throughout the period in all macro-regions, with the exception of the Northeast, which surpassed its 2008 level only ten years later. This reflects that the Italian economy has struggled to recover from the 2008 and sovereign debt crises, as well as the recent pandemic, highlighting its lack of resilience, especially in the South. Moreover, between 2008 and 2014, there was also a decline in hours worked in all regions, although the South experienced a relatively steeper decline. This was partly due to the impact of the negative shocks mentioned above, which led to the use of job retention measures such as short-time work schemes to prevent layoffs. Nevertheless, hours worked fell relatively more than value added and recovered at a much slower pace than value added, suggesting a "jobless" recovery. This phenomenon was particularly relevant in the *Mezzogiorno*, where hours worked fell sharply during the Covid crisis and temporary workers were pushed out of the labor market (ILO, 2022).[4]

Figure 3. Evolution of value added and hours worked by macro regions

a)



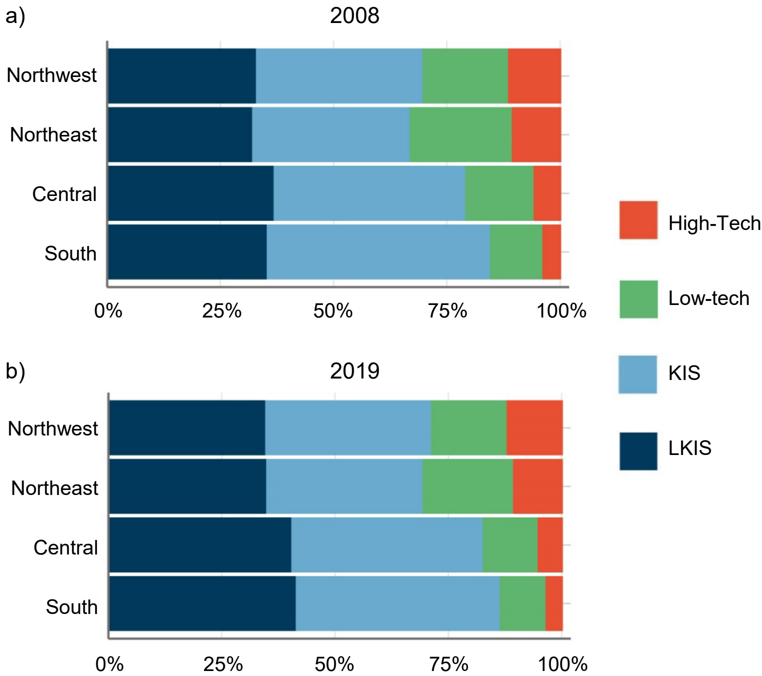
[4] There are also significant differences within the North Central region, indicating that it cannot be treated as a homogeneous block. Regions characterized by a stronger productive structure, as shown in Figure 4, fare better.



Source: Authors' elaboration based on national accounts data (ISTAT).

Sectoral specialisation. Figure 4 illustrates the sectoral composition of employment in the Italian macro-regions in 2008 and 2019 according to technological intensity. It shows that the share of employment in services, ranging from low to high knowledge intensity, is considerably high. The share of employment in low knowledge-intensive sectors, typically characterized by lower value added and lower wages, has increased in all regions, employing almost 40 percent of the workforce in Central and Southern Italy in 2019. On the other hand, the manufacturing sector, especially the high-tech segment, remains concentrated in the northern regions, where the country's most dynamic production systems are located, including Emilia-Romagna, Piemonte, Lombardy and Veneto. Overall, these figures suggest that the regional disparities can be attributed, at least in part, to the asymmetric transformation of the productive structure between regions. This transformation has been characterized by deindustrialization and specialization in low-technology services.

Figure 4. Medium-high and high-tech manufacturing share

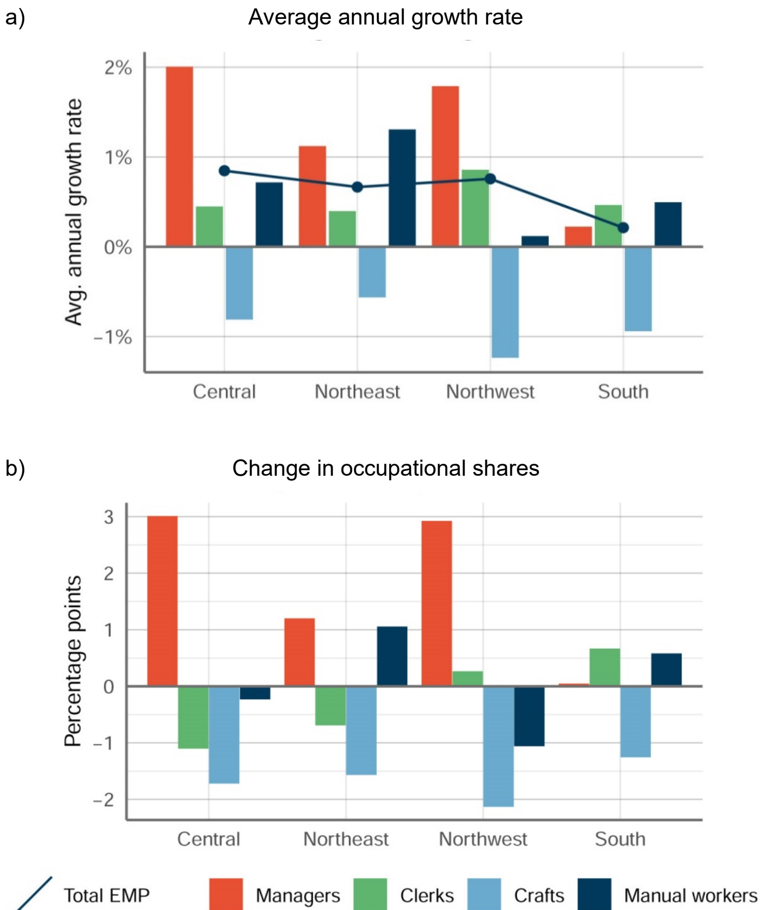


Source: Authors' elaboration based on the EU LFS.

Upgrading, downgrading or polarisation? The occupational structure of the Italian labor market has also undergone significant changes. Using the International Standard Classification of Occupations (ISCO), we examine employment patterns across regions and investigate whether there is a trend towards occupational polarization or upgrading towards more skilled occupations. To do so, we group ISCO 1-digit classes, based on the taxonomy proposed by Cirillo (2018), into four macro occupational groups, as follows: Managers (ISCO1 – Managers, senior officials and legislators, ISCO2 – Professionals and ISCO3 – Technicians and associate professionals); Clerical workers (ISCO4 – Clerical workers and ISCO5 – Service and sales workers); Craft workers (ISCO6 – Skilled agricultural and fishery workers and ISCO7 – Craft and related trade workers); Manual workers (ISCO8 – Plant and machine

operators and assemblers and ISCO9 – Elementary occupations). This approach provides a more accurate reflection of the occupational hierarchy in terms of differences in wages, educational requirements, diversity of skills and job tasks.

Figure 5. Change in employment growth and occupational composition (2012-2020)



Note: Figure 5a represents the average annual growth rates in employment for each occupational group, while Figure 5b refers to the changes in occupational structure.

Source: Authors' elaboration based on the EU LFS.

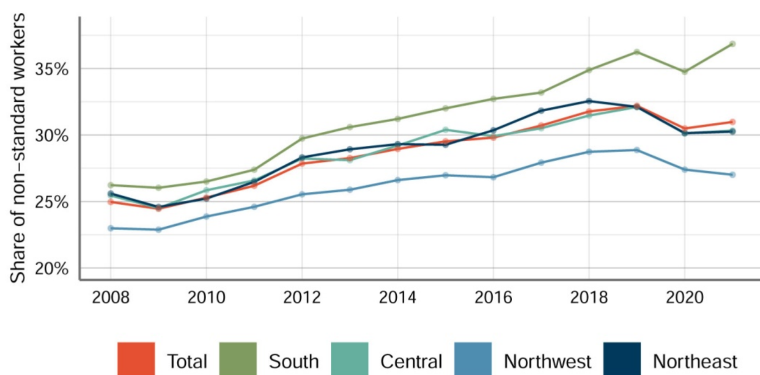
Looking at the average annual growth rates over the period 2012-2020, we observe an overall low (less than 1%) and asymmetric employment growth across regions, mainly concentrated in the north-central regions (Figure 5a). A decline in middle-skill jobs, including skilled agricultural, craft and related trades workers, is common to all regions, while managerial jobs – high-wage, high-skill jobs – increased everywhere except in the South. Despite an increase in manual jobs in Central Italy over the period 2012-2020 (see Figure 5, panel a), we observe a compositional shift towards high-skilled occupations (Figure 5, panel b). Similarly, a process of occupational upgrading is also taking place in Northwest Italy. In contrast, Figure 5a and 5b show a growing polarization of the skill structure in Northeast Italy, with job creation concentrated at the top (i.e. managers) and at the bottom (i.e. manual workers) of the occupational hierarchy. In the south, there is no clear trend, but we can observe what can be called a "downgrading polarization", since only the share of managers has remained constant. These heterogeneous employment dynamics can be attributed to differences in the production system discussed above and in the technologies adopted by firms in different regions. This may contribute to increasing wage inequalities between regions, as workers' skills are closely linked to their remuneration.

Non-standard work. The asymmetries in Italian regional labor markets are also evident in terms of job quality. Since the mid-1990s, Europe has witnessed a profound shift in the composition of employment in terms of contract type, marked by a significant increase in non-standard work (NSW). This phenomenon, which includes temporary and part-time work and, more recently, work performed through digital platforms, has been well documented by Reljic et al. (2023) and Hipp et al. (2015). The rise of NSW in Italy can be traced back to labor market reforms, first introduced as a means to combat unemployment and later as a "solution" to the negative effects of the 2008 crisis. The first set of reforms, including the *Treu Law* of 1997 and the *Biagi Law* of 2003, aimed to reduce employment protection legislation for new hires, thereby liberalizing the use of 'flexible' work arrangements (Tassinari, 2022). The second set of 'structural' reforms, including the *Fornero Law* in 2012 and the *Jobs Act* in 2015, aimed at reducing employment protection for workers on permanent contracts and facili-

tating dismissals (see Cirillo et al., 2017 for a review). However, a paradoxical situation has emerged in which the negative consequences of financial deregulation have been attempted to be addressed through further labor market liberalization. Contrary to what these reforms promised to achieve, a growing body of literature finds that the latter is associated with underinvestment in innovation (Cetrulo et al., 2019; Hoxha and Kleinknecht, 2021; Pieroni and Pompei, 2008; Pianta and Reljic, 2022; Reljic et al., 2023) and lower productivity growth (Lucidi and Kleinknecht, 2009; Lisi and Malo, 2017).

Figure 6 shows the overall deterioration in the quality of jobs created over the last two decades, with southern regions particularly affected. Between 2000 and 2008, the share of NSW increased on average by 10 percentage points, with one in four workers in Italy having a temporary contract, working part-time or both in 2008. This pattern was relatively similar across all macro-regions. However, the share of NSW has continued to rise steadily since then, exceeding 35% of employees in the South by 2021.

Figure 6. Evolution of non-standard forms of work

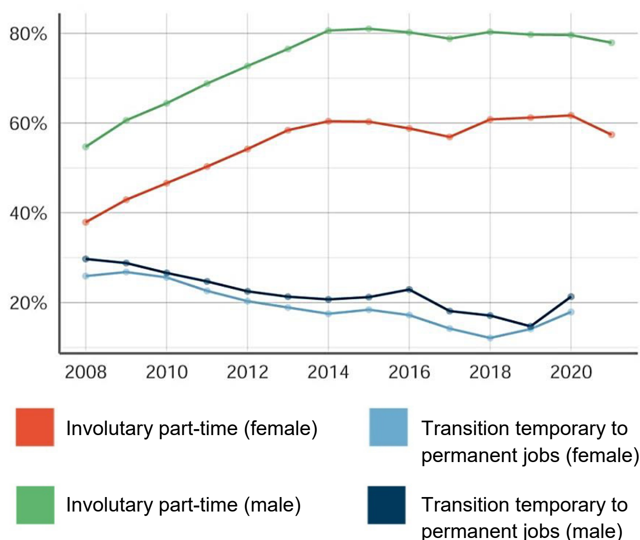


Source: EU LFS; authors' own computation.

We observe a slowdown in the use of temporary contracts in Italy, except in the South, following the introduction of the *Dignity Decree* in 2018, which aims to counter temporary employment (Tassinari, 2022). In the South, the share of non-standard workers is only slightly lower in 2020 due to the outbreak of the pandemic, which has led to the expulsion of the most precarious categories of workers from the labor market. This trend is not uniform across the southern regions, however, with Calabria, Sardinia and Sicily having the highest share of workers in non-standard jobs, at 40%. Such patterns risk exacerbating existing barriers to decent work and creating more atypical jobs, especially in the South.

Some argue that nonstandard work is not inherently negative, as part-time work can be beneficial for women by increasing their labor force participation (Barbieri et al., 2019), and temporary jobs can serve as a stepping stone to more stable employment opportunities. Against these arguments, in Figure 7 we plot the share of involuntary part-time work and the probability of moving from temporary to permanent employment, distinguishing between female and male rates. It provides compelling evidence that temporary jobs do not act as a "stepping stone" to "stable" employment, as the rate of transition from temporary to permanent employment has been declining since 2008. Specifically, the share of temporary contracts that converted to permanent employment was less than a fifth in 2019. This is in line with previous research suggesting that temporary jobs are often "traps" rather than "stepping stones" to permanent employment (ILO, 2016; Hoffmann et al., 2021). In other words, temporary workers are often trapped in a vicious cycle of low-quality jobs. In addition, the share of involuntary part-time workers increased over the reference period. As shown in Figure 7, four out of five men and three out of five women are in involuntary part-time work, which means that the likelihood of moving into full-time work is low regardless of gender. However, the involuntary nature of part-time work is more pronounced for men.

Figure 7. Involuntary part-time and transitions from temporary to permanent jobs



Source: Eurostat; authors' own computation.

Risk of poverty and social exclusion. Building on the evidence on labor market fragmentation presented here, we further enrich the discussion by examining how this transformation relates to the risk of poverty. In this context, we look at the relationship between an indicator of 'at risk of poverty' (AROP), measured as the share of people with an income below 60% of the national median income after social transfers, and several characteristics of regional labor markets.

As Figure 8 shows, at-risk-of-poverty in 2021 varies considerably across regions. The incidence of people at risk of poverty was significantly higher in the southern regions represented by the red dots (30% on average) than in the north-central regions (around 10%, ranging from less than 8% in Bolzano to 20% in Lazio). The share of people at risk of poverty was highest in Sicily and Campania, with an incidence of 38% (or almost 4 million people in absolute terms).

To develop effective strategies and policies aimed at reducing the risk of poverty as well as regional disparities in this regard, it is essen-

tial to understand its underlying drivers. To this end, we explore several dimensions related to labour market status that are likely to contribute to the risk of poverty: unemployment, inactivity, precarious employment and low work intensity.

First, long-term unemployment is an important factor that can contribute to a higher risk of poverty in the absence of effective social protection systems (Brülle et al., 2019). When people are unable to find a job for an extended period of time, workers' skills erode and their motivation and chances of being hired decline significantly (Heidenreich, 2022), leading to a higher risk of poverty for liquidity-constrained individuals. Indeed, we observe a positive relationship between AROP and the long-term unemployment rate in Panel a of Figure 8, implying that regions characterized by higher unemployment rates are also those with a higher share of people at risk of poverty. The stubbornly high long-term unemployment rate, particularly in the South, may also be related to the broader process of deindustrialization and technological change, which has led to a lack of job opportunities and a decline in the availability of stable and well-paid jobs. In addition, the lack of public intervention – smaller buffers, less fiscal space and public administration capacity – further reduces the chances of reintegrating the long-term unemployed.

Second, the labor force participation rate is another relevant factor to consider. The opportunities and choices that shape labor supply can have an impact on poverty risks (Brülle et al., 2019). The activity rate typically reflects the low participation of women in the labor market and the pronounced gender segregation of roles, which may make women more likely to be poor. Panel b of Figure 8 confirms that the activity rate is negatively correlated with the risk of poverty. This means that the southern regions with the lowest employment rates, such as Molise (49%), Sicily (50%) and Calabria (51%), also have the highest proportions of people at risk of poverty. On the other hand, northern regions characterized by relatively high employment rates, such as Valle d'Aosta (80%), Friuli-Venezia Giulia (79%), Emilia-Romagna (78%) and Marche (73%), have the lowest at-risk-of-poverty rates, below 10%.

However, having a job is no longer sufficient condition for escaping poverty (Crettaz, 2011; see also the chapter by Comelli). Recent data show that the risk of in-work poverty is significantly higher for tem-

porary and part-time workers (Bavaro and Raitano, 2023). For example, almost one in four temporary workers and one in five part-time workers in Italy were at risk of poverty in 2021, compared to 8% (10%) of workers in permanent (full-time) jobs. Thus, the degree of precariousness in the labor market, as indicated by the share of part-time temporary workers, which reflects insecurity and earnings volatility with serious consequences for household income, may be an important driver of poverty (Heidenreich, 2022; Hoffmann et al., 2021; Svimez, 2019).

Panel c of Figure 8 suggests that two distinct clusters can be identified: the north-central regions, represented by the black dots, and the south – Abruzzo, Basilicata, Calabria, Campania, Molise, Puglia, Sardinia, and Sicilia. The northern regions have lower levels of both precarious employment and poverty risk. The case of Lombardy is particularly virtuous, with the lowest degree of precariousness. Conversely, people in the southern regions are more likely to be in a precarious job and face a higher risk of poverty.

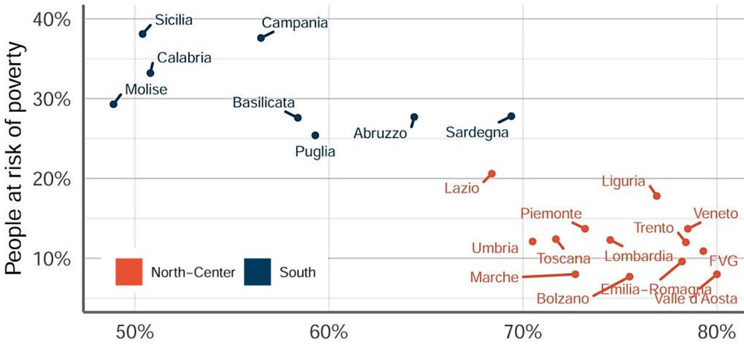
This worrying evidence has negative implications for workers, as an increasing incidence in low-quality jobs reflects higher levels of precariousness and poverty risk. Workers in precarious jobs not only receive lower annual wages, but also face problems in accessing social protection measures (Kalleberg, 2011). For example, the lack of an adequate unemployment protection system can perpetuate a vicious cycle in which individuals with liquidity constraints are often "forced" to accept the first job offer available, leading to a situation in which they become trapped in unstable and low-wage jobs (Ernst et al., 2022).

In this context, *work intensity* is another important factor to consider. We move from the individual to the household perspective by considering the share of people living in households with very low work intensity, where working-age members work equal to or less than 20% of their working-time potential. This can lead to income shortfalls and increased poverty risk, as suggested by the positive correlation between low work intensity and poverty risk in panel d of Figure 8. In 2021, this low work intensity rate ranges from 4% in Emilia-Romagna and Bolzano to almost 30% in Campania. It is worth noting that the high proportion of people living in low work intensity households in Campania is particularly worrying given its large population size, with around 1.7 million people affected.

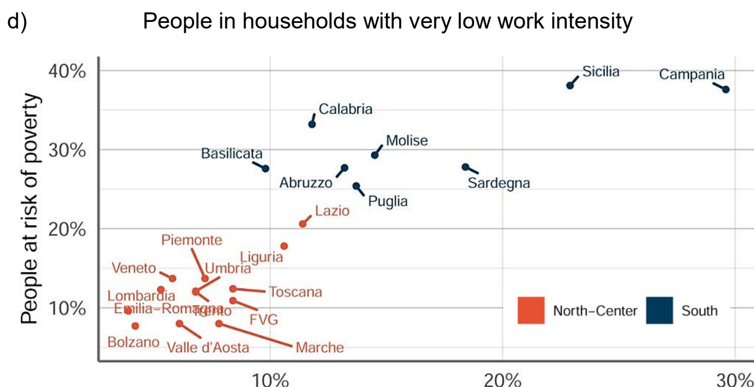
Figure 8.

a) Long-term unemployment rate

b) Activity rate



c) Part-time and temporary work



Data: Eurostat and EU LFS; authors' own computation.

The data presented here point to marked North-South divides. Regional labour markets are characterized by a strong division between 'insiders' (employed) and 'outsiders' (unemployed and inactive) and by an increasing dualism in the labour market between 'good jobs' and 'bad jobs'. The southern regions of Italy are characterised by highly segmented labour markets – highest long-term unemployment rates, lowest activity rates due to low female participation, highest levels of 'precariousness' proxied by the share of temporary part-time jobs and low work intensity/low wages – making them highly vulnerable to poverty risks.

The detrimental effects of labor market fragmentation, leading to increased social exclusion and inequality, have far-reaching consequences for industrial structures, productivity and regional disparities in Italy. Taking stock of the evidence presented here, it is clear that Italy is characterized by profound divisions that have become deeply entrenched over time. The southern regions of Italy have been particularly affected by a vicious circle of proliferating precarious forms of employment, low wages, low skills, limited productive capacity and low productivity. This cycle has incentivized the pursuit of cost-competitiveness strategies, exacerbating the region's economic challenges.

5. Conclusion and policy implications

The aim of this chapter was to discuss and analyze the North-South divide in Italy. Our descriptive analysis focuses on the last fifteen years, although, as reviewed in Section 2, the roots of such divide can be traced back to the late XIX century.

To this end, we argue that regional disparities should be framed within a more comprehensive context that links the economic and social dynamics of each region to the overall trajectory of the European economy in the global context. This is particularly relevant for *Mezzogiorno d'Italia*, whose analysis cannot neglect major geopolitical changes that have occurred in Europe and the ongoing shifts in the world economy (Guarascio et al., 2023).

As Viesti (2021) pointed out, 'the destiny of any territory depends not only on what happens within it or in the country of which it is a part.' Southern territories are regions within the national economy but are also part of a much more integrated European economy. Taking this perspective, regional disparities are rooted in a process of increasing divergence in the Eurozone, including technological capabilities, among the other factors (Gräbner et al., 2020). The latter are linked to the manufacturing base and, in turn, to the workforce composition and its quality. For instance, the history of the European Union suggests that the enlargement of the Union has shifted the industrial axis of the continent toward northeastern regions around the German manufacturing core (Stehrer and Stöllinger, 2015). This change has particularly affected Southern Italy, contributing to a reshaping of its industrial base and reinforcing processes of knowledge deterioration.

By adopting an integrated framework capable of linking sectoral features with labour market characteristics, we have highlighted that the North-South divide in Italy persists due to the path dependency of the technological trajectories and the accumulation of specific sets of capabilities (Dosi et al., 2021). In detail, our contribution suggests that southern regions are caught in a vicious circle of non-standard work, low wages, low skills, low productivity and low aggregate demand. This further entrenches the structural weaknesses of the *Mezzogiorno*, perpetuating inequalities and limiting the potential for economic growth and social cohesion.

Our analysis has some important policy implications. It is clear that addressing the underlying structural challenges of the North-South divide in the Italian labor market, disentangled here, will require a comprehensive policy approach across labor market, innovation, and industrial policies. The aim should be to promote regional convergence in line with the virtuous circle narrative proposed by Pianta and Reljic (2022). To achieve this, a set of policies must be put in place, including targeted regional interventions that focus on selective investment policies (vertical innovation and industrial policies) aimed at building productive and technological capabilities, particularly relevant in the context of the green transition (Fanti et al., 2023; Zezza and Guarascio, 2023). Long-term investments in social infrastructure are needed to remove barriers that women face in the labor market and thereby increase female participation rates (Reljic and Zezza, 2023). Investment in education and training to upgrade workers' skills is crucial in the face of technological change to ensure that no one is left behind. Finally, strengthening labour market institutions – i.e. reversing labour market flexibilization – is fundamental. Only policy coordination could help break the vicious circle of precarious employment and low innovation and productivity, and promote more inclusive and sustainable growth and development for the country as a whole. However, if national policies are constrained by EU fiscal rules in the absence of EU-wide policy coordination, the North-South divide is likely to persist, exacerbating existing challenges and limiting social cohesion (Guarascio et al., 2023).

In line with Gräbner et al. (2020) we claim that coordinated fiscal, labor and industrial policies will be needed to counteract the on-going structural polarisation process. Such a coordination is of utmost importance in the context of ongoing digitalization and green transitions, which are reshaping industrial ecosystems, production geographies and competition hierarchies. Without targeted and selected industrial and social policies, no convergence process will take place spontaneously.

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The regional variety of skill regimes in Italy: What is the citizens' view?

Marius R. Busemeyer[a] *and Ulrich Glassmann*[b]

Abstract

This article deals with the different regional skill regimes in Italy. The country offers an interesting mix of a national school-based system with vocational tracks and a regional apprenticeship system. A reform in 2015 attempted to link these two regimes to create a German-style dual training system. In this article, we show that regional differences in the orientation towards certain forms of school-based education (vocational or general), firm-based training and academic education have nevertheless remained. Using the dataset of the 'Investing in Education in Europe' (INVEDUC) survey, we analyse whether citizens want these regional differences or whether they persist for other reasons contrary to their preferences. While a strong support for a better system of vocational education is evident in all regions, a strong preference for firm-based training is particularly evident in southern regions, where external economies are least developed. However, this approach to training is associated with particularly high labour market risks. At the same time, there is less willingness in the South than in the North to cut traditional welfare state transfers in order to implement the necessary measures in education.

Keywords: Italian regions, skill regimes, public opinion, INVEDUC dataset, reform of vocational training system

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1. Introduction

This article analyses the different skill regimes within Italy and examines the extent to which citizens in different regions of the country have similar or different attitudes and preferences towards local and regional institutions and vocational training programmes. In this way, the analysis ties in with prominent research on the supply side of the political economy as presented in the Varieties of Capitalism (VoC) approach (Hall and Soskice, 2001). However, in contrast to the national approach of VoC, regional differences in the institutional design, quality and use of supply-side institutions are considered here, and thus regional varieties of capitalism are examined (Glassmann, 2016).

The socio-economic differences in the performance of the Italian regions are more than obvious. In 2022, for example, the employment rate for people aged 25-64 in the southern regions was 22.7 percentage points lower than in the northern regions. However, education has a major impact on employability and therefore on regional labour market outcomes. Looking only at university graduates of the same age group, the employment gap between North and South shrinks to 12.6 percentage points (ISTAT, 2023: 13), clearly demonstrating the value of (higher) education for employment. After Romania, though, Italy has the second highest rate of young people (aged 15-24) who are neither in employment nor in education or training (NEET) in the European Union. In 2022, the Italian rate was 15.9 per cent, compared with just 6.8 per cent in Germany. But again, the regional worlds in Italy are very different; in 2022, the NEET rate varied from 11.2 per cent in the North-East to 21.5 per cent in the South and 24.2 per cent in the islands (Eurostat, 2023c).

So far, European policy has not ensured that these conditions have been harmonised, but has rather reinforced them by redirecting cohesion policy towards (smart) territorial specialisation approaches that aim to further develop existing specialisations and competitive advantages. However, it is not necessarily clear whether the institutional weaknesses on the supply side of vocational education and training, especially in the southern regions of Italy, are only due to a political failure in these areas to create better conditions on the ground, or whether the population there simply has different views and preferences with regard to policy. In the latter case, institutional differences

would reflect not so much a lack of responsiveness on the part of political actors, but rather different views on the importance and specific design of vocational education and training, as well as specific regional preferences regarding the composition of social spending and investment. Our research question is therefore: To what extent do existing regional variations in skill regimes reflect citizens' attitudes and preferences towards education?

This question is very important because the answer allows us to draw conclusions about the influence of public opinion on social investment and education policies. If public opinion is largely congruent with the status quo, it can be concluded that public opinion has an impact, but also that the *Mezzogiorno's* often-mentioned institutional shortcomings are to some extent supported by corresponding attitudes among the population, for example with regard to the lack of priority given to education. If, on the other hand, it turns out that public opinion supports policy options that differ from the status quo, latent public support can become an important factor for political actors promoting change. However, it is also worth asking why, in this case, these demands have so far been ignored by regional policy-makers.

To answer the above research question, we use data from the 'Investing in Education in Europe' (INVEDUC) survey (conducted in 2014). Further details on the survey and its results can be found in Busemeyer et al. (2018) and Busemeyer et al. (2020). For the purposes of this analysis, we have only assessed the attitudes of Italian respondents and analysed them at the regional level. In the following paragraphs, we first discuss the regional differences in the Italian skill regime. We then look at the survey results, which reveal the preferences and attitudes of the regional population. In the conclusion, we summarise the results in terms of the differences found and discuss the extent to which public opinion matches or diverges from the actual skills regimes in place. Finally, we reflect on the potential to initiate necessary changes in the field of vocational training in the Italian regions.

2. The existing variety of skill regimes between Italian regions

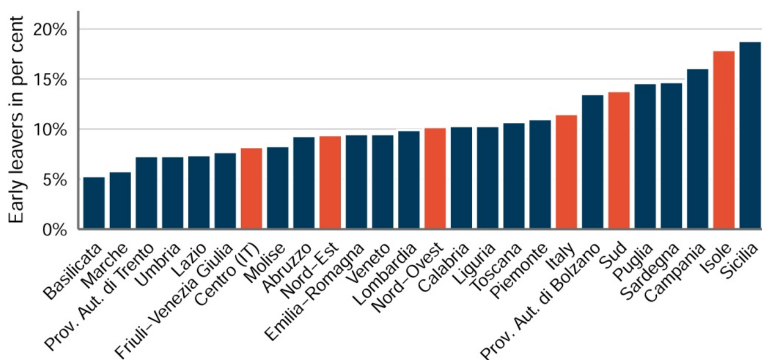
According to the classic analysis by Hall and Soskice (2001), coordinated and liberal market economies differ in the area of skill regimes in that the first type (CMEs) tends to produce industry-specific skills because it is based on nationally regulated dual training systems, while the second type (LMEs) tends to produce general skills because vocational skills are imparted only through school-based training, if at all, or firm-specific on-the-job training. The case of Italy can be characterised as a mixed market economy because it does not have a national system of dual vocational training (despite recent reforms), although the strengths of the Italian economy clearly lie in established product markets typical of CMEs. The poor fit between the spheres of labour markets, capital markets and vocational training therefore prevents beneficial spillovers from educational institutions to the labour market and vice versa.

The Italian vocational education and training (VET) system is quite complex, as it has both a purely school-based system, in which vocational skills can be acquired at upper secondary and post-secondary level, and an apprenticeship system, in which companies also participate. A reform carried out in 2015 attempted to develop the upper secondary system into a dual system of vocational education and training (Rustico et al., 2020, see below). Despite this reform, the traditional governance structures have been maintained, so that the school system is regulated nationally by the state, while the legal competences for apprenticeship training are in the hands of the regions. The strengthening of the regions' competences in the area of VET was mainly brought about by a constitutional reform in 2001, according to which this orientation should help to better serve the regional demand for VET resulting from territorial specialisations (Filippetti et al., 2019: 220). However, in both cases, school-based education and apprenticeship, VET is a regional rather than a national collective good. This is partly due to the fact that even nationally regulated educational institutions are characterised by varying quality and performance. Precisely because VET is part of this system, this area of qualification suffers considerably from the North-South divide.

The PISA 2022 study shows that Italy is below the OECD average in mathematics and science, but above the OECD average in reading

literacy and ahead of Germany in this area. The ten-year trend in Italy is negative in all areas (OECD, 2023). However, following the systematic approach of Gräbner-Radkowitsch and Kapeller (this volume), the challenge of granularity, i.e. regional differences in performance, is also evident in education in Italy. In all three areas of educational competence, the PISA 2022 results in the north-western and north-eastern regions of Italy are well above average, while in the southern regions and islands they are all well below average. On the basis of quality of performance alone, it is therefore difficult to argue that there is a national education system, even if it appears to be one in terms of regulation. Participation in education also varies systematically between regions. Although the overall rate of early school leavers in Italy has fallen in recent years, from 20.6 per cent in 2011 to 13.1 per cent in 2020 (due to a reform of the census regulations, the time series is not directly comparable with values from 2021 onwards), the regional differences have largely remained (see Figure 1).

Figure 1. Early leavers from training and education (2023, by NUTS-2 regions)



Data: Eurostat (2023a).

The larger regions, Central Italy, North-East, North-West, South and islands, show a clear difference in performance to the detriment of the South and islands. However, there are also notable exceptions, such as

the southern region of Basilicata with the lowest early school leaver rate (5.3 per cent) and the autonomous province of Bolzano in the North-East with a comparatively high rate (13.5 per cent). Sicily remains the leading region in terms of early school leavers, with a rate of 18.8 per cent. This means that in 2022, 18.8 per cent of the population aged 18-24 has completed at most lower secondary education and is not participating in further education and training at the time of the survey. The indicator is therefore very sensitive to the level of exposure to vocational education and training.

Looking at the extent of this phenomenon between the sexes, we can see that in all the major regions – North, Centre and *Mezzogiorno* (South and islands) – males are more likely to leave school early than females. For Italy as a whole, the difference is around 5 percentage points. In the *Mezzogiorno*, the gap is one percentage point higher to the disadvantage of males than in the North and Centre. The gap is more extreme within regions: For men, the rate in the *Mezzogiorno* was 17.7 per cent in 2020, compared to 12.2 per cent for women (ISTAT, 2023a).

Moreover, in the *Mezzogiorno*, the overall early leaver rate in 2020 was 16.3 per cent; if only the share of people with foreign citizenship is taken into account, the rate rises to 48.1 per cent. The rates are significantly influenced by migration throughout Italy, but this effect is most pronounced in the South (ibid). As a result of the generally high rates of early school leavers, particularly in the southern regions of Italy, the country has in the past achieved much poorer averages than, for example, Germany. Interestingly, however, this situation has now been reversed. In 2022, the average early leaver rate in Italy (11.5 per cent) was lower than in Germany (12.2 per cent), which, in addition to demographic factors, is an important explanation for the shortage of skilled labour. In this respect, Germany and Italy have become more similar than different. However, the gap in educational participation is extremely important for understanding where these problems are particularly pronounced and the extent to which different skill regimes contribute to them.

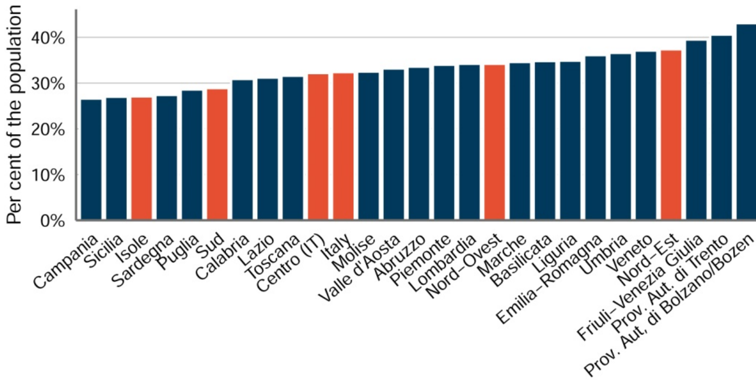
As some vocational education in Italy takes place at upper secondary level, early school leaving has a significant impact on the skill and employment base of a region. Five-year programmes combine general and vocational education, either in technical schools (*istituti tecnici*)

or in vocational schools (*istituti professionali*), leading to technical or professional education diplomas; four-year programmes can lead to a technician professional diploma and three-year programmes to a vocational qualification. These programmes are all school-based, but can also be obtained through apprenticeships in three- to four-year programmes coordinated by the regions. Finally, students can return to upper secondary school to complete the 5th year. In addition, the system also offers post-secondary higher (technical) programmes.

In general, the VET system allows students to move between the regional (company-based) apprenticeship system and different tracks of upper secondary education. The 2015 reform (Law 107/2015) attempted to link school-based training more closely with workplace-based training. Since then, schools can apply for public funding if they can demonstrate project-based cooperation with companies for joint training (Benassi et al., 2020). Employers have to cover their own costs. This model was originally agreed at the State-Regions-Conference as a trial run for a dual system to encourage greater participation by companies and potential trainees. The OECD even reports that Italy has 'put in place a fully-fledged dual system encompassing education and work' (OECD, 2017: 65).

However, an evaluation of this attempt to establish a dual system based on the German model has shown that the reform of so-called type 1 apprenticeships, vocational training at upper and post-secondary level, was a failure (Rustico et al., 2020). The reform did not create the necessary coordination bodies and did not focus specifically on the needs of enterprises. As a result, Italian companies made very little use of these opportunities. It also turned out that when companies did participate, they were mostly micro-enterprises that gave family members or friends the opportunity to work (ibid: 96). Nevertheless, this reform was at least an attempt to take a step towards a national system of vocational training. Because of this half-hearted reorganisation, however, it is still appropriate to present Italian VET as a regional qualification system. Especially as there are other important reasons for doing so. The first two have already been mentioned. The quality of programmes and participation in upper secondary education varies between regions, to the detriment of the South. But people in the Italian regions also have different orientations towards vocational training (see Figure 2).

Figure 2. Share of population with vocational education (2022, by NUTS-2 regions)



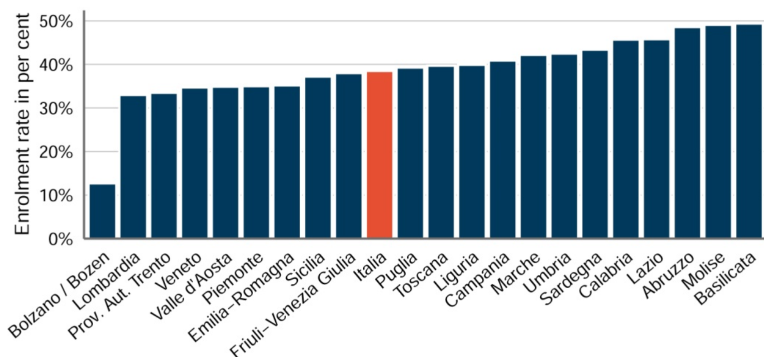
Data: Eurostat (2023b); population comprises people aged 25-64; vocational education refers to upper and post-secondary, non tertiary education.

Figure 2 shows that many more students in the North than in the South and on the islands choose the VET route to obtain a qualification in upper secondary and post-secondary education. This should not be read as a mere reflection of the situation in the area of early school leaving. The data in Figure 2 do not show the acquisition of a general qualification at upper secondary level, but only the percentage of the population aged 25-64 who have attended vocational tracks. Thus, the indicator only provides information on the tendency of students to prefer vocational education to general education. However, qualifications tell us little about students' preferences. For example, they may not attend vocational schools because they are dissatisfied with the quality and focus of the education. It is therefore important not only to infer people's preferences indirectly from their behaviour, but also to consider the results of surveys, as we will do in section 4.

Further evidence that we are dealing with different regional qualification regimes and corresponding behaviours is the fact that university education is clearly more attractive to students in the South than in the North, at least if we take enrolment rates as an indicator (see Figure 3). With the exception of Sicily, all southern regions have enrolment rates above the Italian average, while many northern regions are below it.

The enrolment rate measures the percentage of university students residing in a region out of the population aged 19-25 living in the same region.

Figure 3. Enrolment rate in university education (2017, by NUTS-2 regions)



Data: Istat (2023b).

However, these figures should also be interpreted with caution. If we look at graduation rates, there are hardly any differences between the regions. This is probably due to the fact that the lower quality of education also leads to greater difficulties in completing higher education.

The overall picture is as follows: In the South, students leave school earlier than in the North, and those who remain in the school system are more likely than in the North to choose to go to university rather than qualify for the labour market through the school-based vocational training system. Compared to the North, therefore, it appears that a larger proportion of the population in the South is seeking general and portable skills by enrolling in university programmes (similar to liberal market economies). This is understandable, given the more difficult labour market situation in the southern regions, and can be taken as an indication of a greater willingness to migrate from the region. In fact, ISTAT reports for 2023:

> "Migration rates of young university graduates among Italian provinces show a clear spatial direction: the gain in human capital is evident for all northern and central provinces. They record, indeed, largely positive migration rates to the detriment of the South and Islands area, where the loss of human capital due to internal mobility is net and persistent." (ISTAT 2023: 16)

However, as we have only looked at the distribution of students within the school and university system, we have not yet fully recognised the phenomenon of different skill specificities between regions. In addition to the differences mentioned above, there are also differences in the involvement of enterprises in the provision of specific skills. This is briefly analysed in the next section.

3. Skill specificity in the Italian regions – a complex regional divide

The fact that students generally seek general rather than specific skills does not mean that enterprises in the southern regions are not active in firm-specific training. On the contrary, the acquisition of exclusively firm-specific skills and knowledge seems to be even more pronounced in the southern regions than in the northern regions (Fillippetti et al., 2019). However, this should not be misinterpreted as evidence of a well-functioning dual VET system – on the contrary, as we will see below. Rather, it can be interpreted as a consequence of a specific industrial structure, which, like the production methods of enterprises, varies between regions. In particular, north-east and central Italy have a large number of small firms whose production of high-quality, high-priced goods requires a high degree of craftsmanship. These firms are known for producing classic 'Made in Italy' products such as shoes, clothing, furniture and leather goods, as well as capital goods such as machine tools. Since the 1970s, economic sociologists and political economists have analysed these production sectors and found that many of these products are produced in so-called industrial districts (Becattini, 1979). These are local concentrations of sectorally specialised small and medium-sized enterprises that work together to produce a final product on the basis of close horizontal cooperation (Crouch et al.,

2001). As the more open global economy has greatly increased the pressure on industrial districts, these business relationships have become somewhat verticalised. Leader firms, with larger numbers of employees, a larger capital base and a global distribution network, now act as agents for Italian industrial districts on the global market (Glassmann, 2007). For example, the large northern Italian fashion labels have contracted the small artisanal shoe producers in the North as their production base, thus establishing a supply network for high-quality products that allows them to respond very flexibly to global demand (Amighini and Rabellotti, 2006). Employees in such leader firms or in networks of small firms acquire a very high level of industry-specific knowledge as a result of the close cooperation between firms or between firms and associations and public agencies.

The situation is very different in the southern regions, where firms may have chosen similar product specialisations but have adopted different production methods. The footwear sector, for example, is more characterised by mass production and low quality products, which are more vulnerable to international competition as companies compete for lower prices (ibid). As a result, workers there do not require high quality training, but are more likely to do work that can be taught through less complex firm-specific training. The external economy in the North therefore leads to more industry-specific skills among workers, while the lack of this kind of networking and mass production in the South, which is mainly organised by companies in-house, tends to produce more firm-specific skills among workers (Filippetti et al., 2019). The INVEDUC survey data should therefore show strong support for company-based training in the South, if respondents answer according to the most promising regional training option. As we will see below, there is overwhelming support for such firm-based training – much more so than in the North and Centre.

However, such support is not the same as promoting an apprenticeship model, as is the case in Germany. This requires substantial investment by the state, the regions and companies, and given the different industrial structures and production methods described above, it is unlikely that companies and regions in the south of Italy will make similar investment efforts as those in the North. Indeed, a comparison of the funds committed by the regions and autonomous provinces shows that the North and the Centre channel much more funds into

apprenticeship programmes than the South: Of the total amount committed to apprenticeship funding in 2015, the North committed 78.7 per cent, the Centre 12.9 per cent and the South only 8.4 per cent (Angotti, 2019: 38). Similar to the differences in financial commitment to apprenticeship training, the number of participants also varies. In 2012, the North accounted for 55.7 per cent of all apprenticeships, compared to 25.6 per cent in the Centre and only 18.7 per cent in the *Mezzogiorno* (South and islands) (CEDEFOP 2014). However, for the reasons mentioned above, these differences do not indicate that firm-specific skills are less pronounced in the South than in the North.

Overall, the skills regime in southern Italy can be characterised as follows: On the one hand, students acquire portable skills that tend to be taught exclusively in schools and universities; on the other hand, students who prefer to enter the regional labour market quickly develop a portfolio of skills that is predominantly firm-based. As Filippetti et al. (2019) show, workers with this portfolio of skills are more likely to be unemployed during periods of decline than those with industry-specific skills, partly explaining the labour market crisis in southern Italy. The South of the country lacks exactly what has been tried to be copied from Germany for decades, namely a functioning system of dual vocational training, which is much more available in the northern part of Italy. We will now examine whether the different regional worlds of education and training are in line with the attitudes and preferences of the population.

4. Citizens' views on education policy and skill regimes

In this section, we carry out a (re-)analysis of public opinion data on education policy. These data were collected in the context of the project 'Investing in Education in Europe' (INVEDUC 2013-2018). An essential part of the project was the collection of internationally comparative survey data in eight Western European countries (besides Italy, these were Spain, Denmark, Sweden, France, Germany, Ireland and the UK). The survey mode was computer-assisted telephone interviews; the field period was the spring of 2014. In the Italian case, 998 interviews were completed (the total number of observations for the whole survey was 8.905). Further details on the survey and the

results of the ensuing analyses can be found, for example, in Busemeyer et al. (2018) and Busemeyer et al. (2020).

The survey also asked respondents which sub-national region they lived in (at the level of NUT2 regions). The total number of observations places an upper limit on what can be done with the survey data in terms of exploring sub-national variation. For the purposes of this chapter, we undertake a largely descriptive analysis of the survey data in order to highlight existing differences. Table 1 provides an overview of the codification of regions into the three main categories of North, Centre and South. Note that the table uses the labels for the regions as they are coded in the survey (where some regions are merged due to low numbers of cases) and therefore does not cover all 20 regions equally. With the exception of Sardinia and Sicily, we have followed the standard EU classification. There, the islands are always listed separately. We have assigned Sicily to the South and thus follow the standard classification of the Italian National Statistics Authority (ISTAT), in which the islands are assigned to the *Mezzogiorno* and thus to the southern mainland regions. In the case of Sardinia, the allocation to the *Mezzogiorno* is controversial for historical and cultural reasons. We have therefore classified Sardinia as a central region.

Table 1. Codification of regions and associated case numbers

North	Centre	South
Liguria, Lombardia, Piemonte/Valle D'Aosta, Emilia-Romagna, Friuli V.G., Trentino A.A., Veneto	Lazio, Marche, Sardegna, Umbria	Abruzzo/Molise, Calabria, Campania, Puglia/Basilicata, Sicilia
430 observations	221 observations	347 observations

In the following analysis, we focus on and discuss a number of attitudes and preferences towards education that are relevant to the institutional design of skill regimes. We begin with a broad question about the purposes of education. Specifically, respondents were asked: “In

your personal opinion, what is the primary purpose of education?" The response categories were: "to expand knowledge as a goal by itself", "to provide young people with the skills they need to be successful on the labour market", "to enable young people to have a better life than their parents", and "none of the above". These different response categories reflect different perspectives on the purpose of education. The first option refers to the humanistic view that is critical of functionalist perspectives on education and is – across the whole sample – more supported by highly educated and high-income individuals (Busemeyer and Guillaud, 2023: 130). The second option, in contrast, emphasises the functional view on education by pointing to its relevance for labour market success. Finally, the third option, also implies a functionalist view, but in this case focuses on the potential of education to promote social mobility and reduce inequalities.

Table 2. Views on the purposes of education across regions

Primary purpose of education	**North**	**Centre**	**South**
… to expand knowledge as a goal by itself	27.5	19.5	21.9
… to provide young people with the skills they need to be successful on the labour market	51.4	52.5	49.6
… to enable young people to have a better life than their parents	20.5	20.5	26.8

Note: The difference between the sum of the values in the table and 100 are those that tick "none of the above" or "don't know" (not shown).

Given the variety of skill formation regimes across regions (see previous section), it might be a plausible expectation that these views on the purposes of education also vary to some extent across regions. Table 2 shows that this is partly confirmed. A first important finding from this table is that there are differences between the North and South in the relative balance between the humanistic ideal of education and the function of education in promoting social mobility and

reducing inequality. In the North, relatively more people hold the view that increasing knowledge should primarily be a goal by itself (27.5 per cent vs. 21.9 per cent in the South). Conversely, people in the South are more likely to express the view that education should promote social mobility (26.8 per cent vs. 20.5 per cent in the North).

However, a second important finding is that the large (relative) majority of Italian respondents subscribes to the view that the main purpose of education should be to equip young people with the skills they need for the labour market. Furthermore, there is very little variation in this regard across sub-national regions (with values hovering around the 50 per cent mark). This suggests that there is considerable support for a more functionalist perspective on education that is reminiscent of the social investment model of the welfare state (Bonoli, 2013; Hemerijck, 2018). Moreover, the international comparison shows that this 'labour market perspective' on education is also supported by relative majorities in other Western European countries (Busemeyer and Guillaud, 2023: 128).

Moving on from broader views on education to more specific issues, Table 3 shows responses to a question focusing on support for vocational education and training (VET) as an alternative to academic education. As noted in the previous section, the relative importance of VET, in particular firm-based apprenticeship, varies across regional skill formation regimes. The interesting question then is to what extent the relative importance of VET is also reflected in differing values and attitudes. The data in Table 3 is based on the following question: "Now please think of a young person with average grades in school. According to you, which type of education and training is best suited to prepare this young person for the labour market?" The wording of the question specifically refers to young people with "average grades" in order to get a realistic assessment of what type of education is recommended for 'average' students, i.e. not the highly talented who are usually destined for university, nor the decidedly low-qualified. Response categories were "academic education, e.g. university", "school-based vocational education" or "firm-based apprenticeship".

Table 3. Support for different educational options for average students across regions

Which type of education for average students?	**North**	**Centre**	**South**
Academic education, e.g. university	15.6	20.5	19.7
School-based vocational education	24.6	25.1	19.4
Firm-based apprenticeship training	59.9	54.4	70.0

Note: The difference between the sum of the values in the table and 100 are those that tick “none of the above” or “don’t know” (not shown).

The main conclusion to be drawn from Table 3 is that there is an exceptionally high level of support for firm-based apprenticeships in the South (70.0 per cent). The figure is considerably higher than in the North and Centre (59.9 and 54.4 per cent respectively). This finding is consistent with the depiction above illustrating that companies mainly impart firm-based knowledge and thus corresponds to real-world experience. The fact that university education is mentioned more frequently in the South than in the North also corresponds to the actual behavioural patterns in the regions. However, in all three regions, a minority recommends academic education to average students; most probably because this type of education is associated with above-average students in people’s minds. In contrast, a clear majority of respondents recommends firm-based apprenticeship to school leavers with average grades. There is also an interesting variation regarding the support for school-based VET, which is highest in the Centre (25.1 per cent), middling in the North (24.6 per cent) and lowest in the South (19.4 per cent). These differences in support could be related to the actual and perceived quality of school-based VET across these regions.

A related, but slightly different perspective is provided in Table 4. In this table, we move from the level of general attitudes towards education to more concrete policy preferences, i.e. preferences that are directly related to government policies and reform alternatives. This table shows the proportion of respondents (across the different regions) who agree or strongly agree with two statements about gov-

ernment policy on the relative balance between vocational and academic education: the first statement is “The government should put pressure on employers to provide opportunities for vocational education and training.”; and the second is “The government should encourage young persons to pursue vocational education and training rather than university and academic higher education.”

Table 4. Attitudes towards government policies on the relative balance between vocational and academic education

The government should…	**North**	**Centre**	**South**
… put pressure on employers to provide opportunities for vocational education and training.	92.2	93.6	94.2
… encourage young persons to pursue vocational education and training rather than university and academic higher education.	60.3	58.5	64.3

Note: The difference between the sum of the values in the table and 100 are those that tick “none of the above” or “don’t know” (not shown).

The results are again an interesting combination of differences and commonalities. In terms of commonalities across regions, the data show overwhelming support for the expansion of VET and even more support for making employers responsible for providing VET opportunities. From an international comparative perspective, this finding is remarkable in the sense that support for VET is significantly higher across Italy than would be expected if public opinion patterns simply reflected the prevailing status quo (Busemeyer et al., 2018). Compared to other countries, VET pathways are and remain somewhat weakly institutionalised in Italy, but these data show that public opinion is clearly calling for change in this regard.

This pattern of ‘self-undermining policy feedback’ (i.e. policy feedback that is not congruent with the prevailing institutional status quo, but calls for change) is also evident in the differences in prefer-

ences between Italian regions. Support for putting pressure on employers to provide vocational training opportunities is highest in the South (a staggering 94.2 per cent agree or strongly agree with the statement), and almost two-thirds of southern respondents are in favour of the government encouraging young people to pursue vocational training rather than academic education (compared with 60.3 per cent in the North).

In the next step, we get even more concrete by examining preferences for government spending. The data in Table 5 show the proportion of respondents who support more or even much more spending on different policy areas. Here, we present data on support for education compared with other major policy areas. Further below, we analyse support for spending support on the different sub-sectors of education.

Table 5. Support for spending on education and other policy areas across regions

Share supporting (much) more public spending on…	**North**	**Centre**	**South**
Health care	63.6	71.6	72.8
Unemployment benefits	43.0	48.1	52.9
Old age pensions	68.1	71.5	75.5
Education	86.0	89.4	87.1

Again, there are a number of important takeaways from this table. First, it is important to emphasise that the wording of the question does not force respondents to choose between different spending priorities, allowing them to express a higher preference for additional public spending across the board.[1] Nor does the question force respondents to worry about the additional revenue that would need to be

[1] The INVEDUC data also allow for the analysis of fiscal trade-offs (see, for example, Busemeyer and Garritzmann, 2017; Neimanns et al., 2018), but as these analyses largely use split-sample designs, we lack the number of observations for each region to pursue something similar here.

raised in order to finance additional spending – we come back to both of these issues below. As a result of the particular wording of the question, the proportions of respondents expressing a preference for more spending are consistently high, indicating majority support for additional spending in most cases.

A first interesting observation is that support for additional public spending in various social policy areas generally increases as one moves from the North to the South. This in turn may indicate 'self-undermining feedback' effects in the sense that support for the further expansion of welfare state policies and institutions is highest in the South as these institutions are relatively less developed in that part of the country. The only notable exception is the case of education, where support for additional spending is only marginally higher in the South than in the North (87.1 per cent vs. 86.0 per cent) and where the Centre reaches the highest value (89.4 per cent).

Second, Table 5 shows that public support for additional spending on education is highest compared to other parts of the welfare state. This is consistent with findings from international country comparisons, although in the latter case, education competes with health care for first place (Busemeyer et al., 2018). This is not the case in Italy, where respondents seem to prioritise additional investment in education over the expansion of other parts of the welfare state. To some extent, this contradicts the common perception of Italy as a country that privileges social policy programmes aimed at the elderly, especially pensions, but also health care (Ferrera, 1996; Lynch, 2006). Nevertheless, the equally high support for additional spending on old-age pensions, particularly in the South, may be indicative of competing spending priorities.

In Table 6, we look more closely at the variation in support for spending on the different sectors of the education system. As before, the data show the proportion of respondents who support more or much more spending on the different sectors. To this, we add the responses to a further question which probes the willingness of individuals to pay additional taxes to finance this additional investment. Specifically, the question reads: "Imagine the government proposes a new tax to finance additional investments in the following parts of the education I will read out to you. Would you support a new tax to finance additional investments in the area of…" Respondents are then given the different

education sectors, as shown in Table 6, and are simply asked to indicate their support or opposition with a yes/no answer. The table shows the proportions of respondents who answered affirmatively.

Table 6. Public support for additional spending on education sectors and willingness to pay new tax across regions

	North		**Centre**		**South**	
Educational sectors	Spend	Tax?	Spend	Tax?	Spend	Tax?
Pre-school and early childhood education	48.1	27.3	56.3	31.3	56.7	27.5
General school education	63.4	43.8	75.5	46.7	68.9	44.6
Vocational education and training	72.5	49.9	73.7	48.6	74.4	46.3
Universities and other higher education	62.5	37.0	68.3	36.0	69.0	36.7

There are a number of things to note in Table 6. A first important finding is, that among the different sectors of the education system, the sector of vocational education and training is supported by most people to receive additional financial support (the exception being the Centre, where support for additional spending on general schools is higher). This is noteworthy as public discourse often focuses on higher education or schools, but it seems that most Italian respondents would rather target VET to receive additional spending. Second, as in Table 5, support for additional spending increases in all educational sectors as one moves from North to South (again, the only exception is general school education in the Centre), signalling a particularly strong demand for additional public spending in a context where the education system is currently relatively more underfunded.

The third finding, however, needs to be added to this picture with a grain of salt. If we take into account not only the demand for spending on education at the individual level, but also the willingness of individuals to pay additional taxes to finance this investment, there is a notable gap between the share of respondents who demand more

spending and those who are willing to pay an additional tax. This gap is higher in the case of Italy compared to other countries (Busemeyer et al., 2018). Moreover, as Table 6 shows, the size of the gap is larger in the South than in the North. While in the North it is mostly in the range of 20 to 25 percentage points, in the Centre and the South it is closer to 30 percentage points, and in in the case of university education spending the gap is even higher (25 per cent in the North, 32 per cent in the Centre and 33 per cent in the South).

Thus, although respondents in the South call for higher levels of spending, they appear to be less willing to pay additional taxes for it, including in the case of VET. Interestingly, the size of the gap remains relatively constant across education sectors, i.e. the proportion willing to pay additional taxes varies broadly in line with the overall support for spending. These regional differences in the willingness to pay taxes may be due to different perceptions of the role of the state, as well as prevailing levels of political and institutional trust in state institutions.

Following this line of thought, Table 7 adds a final piece of information by focusing on the direct trade-offs between investment in education on the one hand and spending on old age pensions on the other. Before moving on, a disclaimer is in order: As the sample design in this case is based on a split-sample design, the number of observations per region is further reduced to about half of the above mentioned figures. In addition, two treatment conditions have to be combined in order to obtain sufficiently large numbers. Nevertheless, the data in Table 7 should only be taken as indicative of broad trends, as they are based on a small number of cases.

Table 7 is based on the following trade-off question: “Imagine the government plans to increase spending on education by 10% [first treatment]/enacts reforms involving a 10% increase in the budget for financial support and public services for families with young children [second treatment] and wants to finance this by cutting old age pensions. Would you… strongly agree, agree, neither agree nor disagree, disagree, strongly disagree?” For convenience, Table 7 shows the proportion of respondents who disagree or strongly disagree with this statement.

Table 7. Responses to trade-off question on spending on education/families with young children in exchange for cutting old-age pensions across regions

	North	Centre	South
Share disagreeing (strongly) with shifting spending from pensions to education/young families	78.6	75.0	86.2
Share agreeing with shift or being indifferent	21.4	25.0	13.8

Again, we find an important commonality across regions: Large majorities reject the idea of shifting spending from old-age pensions to education or young families with children (this finding is in line with Comelli's analysis of gerontocratic welfare in Italy, see this volume). But this is quite similar in other countries (Neimanns et al., 2018), although the opposition seems to be particularly strong in Italy. Looking at cross-regional differences, some of the above patterns and findings are confirmed: Opposition to such a shift is particularly strong in the South. Opposition to the proposed transfer is significantly higher in the South than in the North (86.2 per cent vs. 78.6 per cent), reflecting differences in the demographic composition of the population. These differences correspond to some extent to the prevailing regional welfare state and skill formation models (Glassmann, 2016), with the North being more attuned to a social investment approach focusing on skills and education and the South being more inclined to support a traditional, compensation-oriented model with a particular bias towards old-age pensions.

5. *Conclusions*

In this chapter we have presented the regional skill regimes in Italy and used survey data from the INVEDUC dataset to identify the attitudes and preferences of the population towards (financial) support for different areas of the education system in the regions. In what follows,

we discuss the main findings of the survey and consider the extent to which these findings correspond to the institutional characteristics of regional skill regimes, or whether the preferences indicate that these preferences are not being taken into account by national and regional education policies.

The data in Table 2 have shown that in the South and the Centre there are more tendencies towards an instrumental understanding of education than in the North, and that education is seen as a means of upward intergenerational mobility, especially in the South. This is hardly surprising given the difficult labour market situation in the southern regions. The data in Table 3, on the other hand, are quite remarkable and, at first sight, difficult to interpret. They deal with the question of what type of education or training would be recommended to an average student. The choice was between university education, school-based vocational training and firm-based apprenticeship. In the latter category, 70.0 per cent of respondents in the southern regions were in favour of recommending this option. Indeed, this recommendation is very much in line with the actual experience of young people in the southern regions. As explained in section 3, the lack of external economies in the South, unlike in the North and Centre, means that southern firms internalise most of the functions of production. Company-based training, although not always of the best quality, is therefore a common model. We therefore assume that the respondents here have answered what they consider to be an obvious strategy under the given circumstances. However, the fact that employees with a company-based knowledge portfolio are also more likely to be unemployed than employees trained in other ways is just one indication of why the promotion of this training route is generally problematic.

It is also interesting to note that respondents in all regions are most likely to recommend vocational training. In all regions, only a minority recommend academic higher education. Again, it seems counterintuitive that the proportion of those recommending such a route is highest in the South. As discussed in section 3, this can be explained by the fact that many young people seek to acquire portable skills and at the same time associate the acquisition of a university degree with a desire to migrate due to the difficult labour market situation in the South. To a certain extent, these responses are also in line with our expecta-

tions when the specificities of the skill regime in the South are included in the analysis.

Table 4 looks at preferences for the relative balance between vocational and academic education. The data clearly show that vocational education is much preferred to academic education in all regions and that there is also a very strong preference for greater employer involvement. Due to the weak institutionalisation of dual VET in Italy, we read this statement as a clear demand to policy makers that has not yet been met. However, it is important to bear in mind that in 2015 Italy underwent a reform of its VET system which aimed to combine the previously exclusively school-based VET at upper secondary level with a workplace-based training programme. However, the results of this reform show, on the one hand, the inability of the political actors to set up a new national vocational training system and, on the other hand, the unwillingness of many enterprises to participate adequately in such a system. The answers to the question of company participation could also be read as a judgement on what the failure of this reform has revealed: the fundamental difficulty of effectively linking school education and workplace training.

The data in Table 5 concern support for spending on education and other policies in the regions. It shows that support for all categories of the welfare state and for education increases as one moves from North to South. It also shows that support for additional spending on education is highest. This is a peculiarity of Italy, as in other countries support for health care is often on a par with support for spending on education. This does not apply to Italy. Table 6 provides information on the extent to which citizens would actually be prepared to support such higher education expenditure in different parts of the education system through higher taxes. Although the vocational education system is favoured in both the North and the South, there is a gap between the desire for additional funding and the willingness to pay higher taxes, which is particularly large in the South and reaches 33 percentage points in the case of university education.

Finally, Table 7 shows that the overwhelming majority of citizens would not be prepared to reduce pensions in order to finance more measures in favour of education and young people. Rejection of a shift in favour of young people in Italy is strongest in the southern regions. When it really matters, southerners may be more likely to support a

welfare state model that places a greater emphasis on transfers rather than on social investment. This confirms the assumptions of different models of capitalism in the Italian regions, according to which families in the South survive through a family welfare model (Glassmann, 2016), which overrides individual career orientations of young people by requiring them to contribute to the family income through work at an early age. Pensions, as an indispensable component of family income, are also part of this survival model.

It is therefore not enough to try to improve vocational education and training through institutional reforms alone. Financial flexibility is urgently needed to enable companies and families to invest jointly in education. This is particularly important for economically disadvantaged regions. Education should become more of a European responsibility, but without excessive bureaucracy. It is important to provide sufficient public funding to support this task.

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