

Italy needs to focus on productivity growth



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Over the years, I have observed this about the political economy of economic reform in Europe: there is an inverse relationship between the number of objectives and measures of a reform agenda and its ultimate success. The most successful reform agendas have a single overriding objective and a short list of measures. The worst are lists with 316 proposals, as recently published in France, or the 281-page election platform published by Romano Prodi's centre-left alliance ahead of the 2006 Italian elections. The European Union's verbose Lisbon Agenda falls into the same category. It is not bad in substance, but lousy in terms of political economy.

I am moderately optimistic about the future of economic reform in Italy, primarily because of this inverse relationship. The new administration

has offered no long lists, no convoluted objectives, a few sensible measures and a few less sensible ones. So why should Silvio Berlusconi, prime minister designate, deliver now when he failed to deliver during his first two administrations? I share those doubts that others have expressed on these pages and elsewhere. To push through a reform agenda, one needs a strategic purpose, solid majorities and the ability to overcome political and administrative obstacles. Mr Berlusconi has the last two and is probably lacking the first.

But Italy's outgoing administration fared worse on all three counts. Mr Prodi was elected prime minister on a promise of change. In the end, his administration managed only two noteworthy reforms. The first are two Bersani decrees, named after the

industry minister, that brought more competition to the professions and the retail trade. They are not far-reaching, but should have a moderately positive effect on Italy's long-run performance. The second is fiscal consolidation, achieved almost entirely through higher tax revenues. One of the most important measures was a crackdown on tax evasion. This sounds like an idea difficult to fault, except that tax evasion has causes that remain in place. Taxes are as high as in Finland, but the welfare state is less generous and the quality of public services poorer. I am not surprised Italians have ejected their government under these circumstances.

So what reform priorities should Italy's new government pursue? Italy's foremost problem is chronically low productivity growth. Since the start of

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the decade, Italy's total factor productivity (TFP) – the part of productivity considered to be the structural component – has stagnated. The UK, Germany, Denmark and the Netherlands managed TFP growth rates of close to 1 per cent. In fairness, Italy did have some success raising employment, but this improvement unfortunately came entirely at the expense of productivity growth. Without an improvement in TFP, I cannot see how Italy can prosper in the eurozone in the long run or reduce its high levels of public debt. So the TFP growth problem needs to be fixed with utmost priority.

Most of Italy's abysmal productivity performance is concentrated in the public sector, one of Europe's most expensive and least efficient. Neither the centre-left nor the centre-right offers an agenda of full-scale reform, but the centre-right is marginally more ambitious, promising to abolish

entire layers of public administration and with this the excessively large number of people who make a living in politics. Given its high level of public debt, Italy is not in a position to pay off inefficient public sector workers as part of a radical overhaul. The Prodi government tried a consensual approach and got nowhere. Without the willingness to confront the public sector trade unions, there will be no substantial reform.

A priority within the public sector is education. Italy has abysmally low educational scores in international comparisons, due not to a lack of public spending but the setting of wrong priorities, and the acceptance of restrictive practices by teachers. An intriguing recent study by the Centro Europa Ricerche* found that rates of TFP growth in the EU correlated strongly with an ability to speak English. Why should this be? English is the dominant language of the internet and some economists have attributed increases in TFP growth to how countries use information and communication technologies.

According to Eurostat, the EU's statistics office, 56 per cent of respondents in Italy in 2005 had never used a computer and 72 per cent had never used the internet. A vast number of Italians are, in effect, not participating in the 21st century. The situation is gradually improving as broadband internet becomes more available, but Italy still has a long way to catch up.

These issues would be my priorities. Tackling them would get Italy further than any 100-point list; and allow the Berlusconi government to do all the stupid things it is going to do in any case with some impunity.

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