Mario Draghi: Employment and development – the legacy of Giorgio Gagliani

Remarks by Mr Mario Draghi, Governor of the Bank of Italy, at the Colloquium in honour of Giorgio Gagliani, University of Calabria, Rende, 26 March 2007.

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Giorgio Gagliani's contribution to economic thought

Giorgio Gagliani liked to cross interdisciplinary borders, sallying into economic history and sociology. His output was penetrating, original, not voluminous, never complaisant towards passing fashions. His interest in economics lay in the determinants of long-term tendencies, in the factors underlying economic development. The keystone references were the works of Arthur Lewis on development economics and Simon Kuznets on the characteristics of economic growth and its relation with income distribution. In a profound, wide-ranging review-article published in the *Annual Review of Sociology*, Gagliani critically surveyed thirty years of research on "Kuznets's inverted U-curve", the hypothesis that income inequality increases during the transition from an agricultural to an industrial economy and then gradually decreases as society progresses towards more mature stages of development. He concluded that the hypothesis was not borne out by the data, drawing a conclusion that others would reach a decade later or more. His scepticism had immediately led him to discern the fragility of the statistical bases of the studies he was reviewing. This attention, uncommon in the profession, to the quality of statistical data and their comparability over time and space was a hallmark of Gagliani's research.

As with Kuznets, the fulcrum of Gagliani's analysis was the evolution of the sectoral and occupational structure of employment over the stages of development. At the time Giorgio was writing, Italy had completed the transition from agriculture to industry and was aligned with the other advanced nations. Subsequently, however, the convergence of the Italian economy halted and in some periods even went into reverse. According to OECD estimates, between 1991 and 2004 per capita national income went from 77 per cent to 69 per cent of that of the United States at purchasing power parity, falling back to levels not recorded since the mid-1970s. In the past decade the gap between our economy and the US and other advanced economies has widened.

Growth accounting

In these years the growth rate of productivity declined and eventually turned negative. A rapid increase in productivity is a prerequisite for the Italian economy's return to a path of stable growth. The most recent developments – the faster-than-expected growth of output, the expansion of exports in the last year – are promising signs for the future but not yet decisive.

Unquestionably, this is the main factor slowing the Italian economy, but it is not the only one. There are two other elements to consider: the labour force participation rate and the demographic structure. In the ten years 1997-2006 per capita GDP grew by 1 per cent per year. Labour productivity gains accounted for 0.5 percentage points of this annual growth and another 0.8 points came from the improvement in the employment rate, i.e. the ratio of the number of people in work to the population aged 15 to 64, while the rise in the demographic dependency rate – the ratio of those under 15 or over 64 to the working-age population – subtracted 0.3 percentage points per year from the growth in output.

The repercussions of population ageing have already begun to be felt in our labour market. Deaths have outnumbered births in every year since 1993 except for 2004. The years ahead will see a further sharp contraction in the working-age population, which only immigration flows much larger than those now projected would be able to offset. According to Istat's latest demographic projections, which assume a net migratory inflow of some 150,000 per year, the Italian population will fall to 56 million in 2050 and only just over half will be of working age. If the labour force participation rates by sex and age group remained unchanged, the labour force would shrink by about 25 per cent compared with today, that is, by more than 6 million people, with an average negative impact on per capita GDP growth of about 0.5 percentage points per year for the next forty years. The need not only to sustain the growth of productivity but also to raise the employment rate is evident.

Employment in Italy has increased significantly since the second half of the 1990s, considerably more than could be expected on the basis of the slow growth of output. Between 1996 and 2006 the total number of full-time equivalent workers rose by nearly 10 per cent, or by 2.2 million. An essential boost to employment came from immigrants, who now account for more than 5 per cent of the employed resident population.

Despite the recent progress, however, Italy's employment rate is still one of the lowest in the advanced world. In 2005 it stood at 57.6 per cent, against an EU average of 63.8 per cent; only Hungary, Poland and Malta had lower figures (Figure 1). The gap is especially wide for women (Figure 2).

In Italian society, then, there is no lack of unutilized human resources. A comparison of employment levels with the other advanced countries shows that the number of potential workers is a good deal higher than that of persons who on the basis of the rigorous international definitions are classified as "seeking employment" in the official statistics. Especially in the Mezzogiorno and among women, there are many who would be willing to work if they had the opportunity but have ceased looking for jobs because they are discouraged.[1]

It is up to economic policy to devise the measures that can mobilize these unutilized human resources, a necessary condition not only for raising the potential rate of GDP growth but also for ensuring a fairer division of resources. Attention must focus above all on female employment, where the disadvantage with respect to the rest of Europe is greatest.

Female employment

The employment rate has been rising steadily since the mid-1990s for women of all age groups except the youngest, where we see the effects of longer school attendance (Figure 3). Convergence with the European levels is nevertheless still far from accomplished. In 2005, 45.3 per cent of women aged 15 to 64 were employed in Italy, 11 points below the EU average, higher only than Malta's figure and far short of the 60 per cent target set in the Lisbon Agenda. The gap is due only in part to the different characteristics of the population; in particular, it cannot be ascribed to differences in the level of schooling. The disparity remains very great between the regions of the Centre and North and those of the South and Islands (Figure 4).

The failure of women to re-enter the labour market after having children is one of the factors that set Italy apart from many other European countries. In 2005, 41 per cent of Italian women between the ages of 25 and 54 with a child less than seven years old were not in the labour force, compared with the EU average of 35 per cent. The fact that many women do not return to work after giving birth to their first child may reflect the choice to concentrate on caring for their offspring, but it may also stem from the difficulty of reconciling work with maternity. The loss of human resources is plain. About a quarter of Italian women between the ages of 25 and 45 with a secondary schooling do not participate in the labour market, compared with 8 per cent for men. Nor is this lesser presence of women accompanied by a greater propensity to have children: the fertility rate in Italy, together with Spain and Greece, is significantly below the European average.

There is a broad consensus that part-time employment opportunities and adequate childcare structures are effective instruments to encourage women to enter and remain in the labour market. Italy is on a par with the most advanced countries in its availability of nursery schools and kindergartens for children between three and six years old, but there is an acute shortage of day nurseries, especially in the South and Islands. The estimates available indicate that increasing the number of places in day nurseries could have a positive effect both on women's decision to work and on their decision to have children. In the absence of public and private structures for very young children, home care provided by relatives or babysitters becomes essential. An indirect sign of the importance of this form of assistance is given by the positive correlation between the percentage of immigrants in the population at province level and the propensity of better-educated women aged 25 to 45 with pre-school children to participate in the labour market, particularly in the part-time segment. In general, improving the design of policies in support of dependent family members would have the twofold effect of raising female labour force participation and assisting the choice to have children.

[1] See A. Brandolini, P. Cipollone and E. Viviano, "Does the ILO definition capture all unemployment?", Banca d'Italia, Temi di discussione, no. 529, 2004; now in *Journal of the European Economic Association*, 2006, vol. 4, pp. 153-79.

The share of self-employment

Gagliani saw women's low labour force participation as a symptom of Italy's development delay. He identified a second aspect of this lag in what he called the "considerable anomaly" of the Italian case: the large share of self-employed workers in nonfarm employment. According to the labour force survey, in 2005 self-employment accounted for 27 per cent of total employment, against an EU average of 15 per cent (Figure 5). Among European countries, only Greece had a higher percentage. What are the causes of this disparity? Self-employment is a composite phenomenon. It includes high-income entrepreneurial activities and professions, but also marginal activities comparable to payroll jobs but with lower pay and less protection. Institutional regulation of the product and labour markets influences self-employment in many ways, including by creating barriers that protect rents and generating incentives to evade the rules.

Independence and entrepreneurship are significant factors in the choice of many workers to engage in self-employed activities. Often, they are the drivers of the capacity for innovation that has enabled Italian industry to gain and hold a role in important sectors of world trade. In many other cases, however, self-employment is the fruit not of a choice but of the impossibility of finding salaried employment. The anomaly that Gagliani underscored lay in this: the multiplication of formally independent but de facto subordinate employment positions, which he traced to the excessively large social contributions wedge and, more in general, to "administrative inefficiency, the tax regime and broadly political protective acquiescence" (2000, p. 82). In short, he viewed the hypertrophy of self-employment as an imbalance to be corrected. In 2000 he wrote: "A reversal of trend could come from (a) a strong and efficient public stimulus to innovation; (b) the opening up of retailing to large-scale distribution; and (c) the application to self-employment of effective tax treatment similar to that found in Italy's partner countries" (2000, p. 90).

Gagliani drew this conclusion from a structural analysis of development processes and comparison of the Italian experience with that of the countries that had industrialized earlier. His works did not contain an econometric test, but we can say today that his insight was correct. A comparative analysis on time series for 25 countries and 6 sectors shows that in countries where there is above-average tolerance of tax evasion, high tax and social contributions rates go together with a high share of self-employment. Furthermore, this share is greater, the more intrusive is product market regulation, especially if it is aimed at maintaining a fragmented supply structure, for example a traditional distribution network.[2] The removal of administrative barriers and restrictions can stimulate better exploitation of economies of scale and the growth of firms, above all in the service sector. Recent studies on the structure of retailing show that these barriers reduce productivity, brake the adoption of the new information technologies and increase profit margins, leading to higher consumer prices.[3]

Conclusion

As Gagliani suggested, a careful analysis of the composition of employment and comparison with other countries can show us where Italy's distinctive features constitute a problem and where they are a strength. Creating an environment in which productivity will return to rapid growth and increasing the employment rate are necessities imposed by our country's demographics if we are to create wealth and avert inequity. They are also the path to stronger social cohesion, because holding a job not only implies income creation but also generates respect and people's awareness of their role as citizens.

Gagliani ended his essay on the relationship between growth and inequality with the following words:

> Development can only occur via extensive restructuring and relocation of activities and occupations. The faster the process, the lower the proportion of relocations deferred to the next generation, and the higher the number of persons affected during their lifetime who are unable to adjust. These persons are those who are negatively affected by development and who should receive compensation until they find new jobs. Helping them to satisfy their basic needs is a moral duty.

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[2] See R. Torrini, "Cross-country differences in self-employment rates: the role of institutions", Banca d'Italia, Temi di discussione, No. 459, 2000; now in *Labour Economics*, 2005, vol. 12, pp. 661-83.

[3] See E. Viviano, "Entry regulations and labour market outcomes: Evidence from the Italian retail trade sector", Banca d'Italia, Temi di discusione, no. 59, 2006, and F. Schivardi and E. Viviano, "Entry barriers in Italian retail trade", Banca d'Italia, Temi di discussione, no. 616, 2007.

> Helping them to bequeath their old jobs to descendants may be harmful to the latter. (1987, pp. 329-30).

Gagliani's conclusion has a more general validity, not limited to the initial phases of development. The evolution of economic systems, changing technological paradigms and the integration of world markets require radical alterations in the structure of production and employment; they impose significant costs on those who will bear the burden of these adjustments. Italy is now going through one such phase. It would be vain to seek to stem the changes under way, and the consequences of such an attempt would be paid by the future generations. The answer lies in implementing instruments that will compensate the "losers" in the process of economic development and enable them to find a place in the new productive system. The context in which Giorgio Gagliani wrote was different, but his conclusions remain just as valid for us today.

Writings of Giorgio Gagliani

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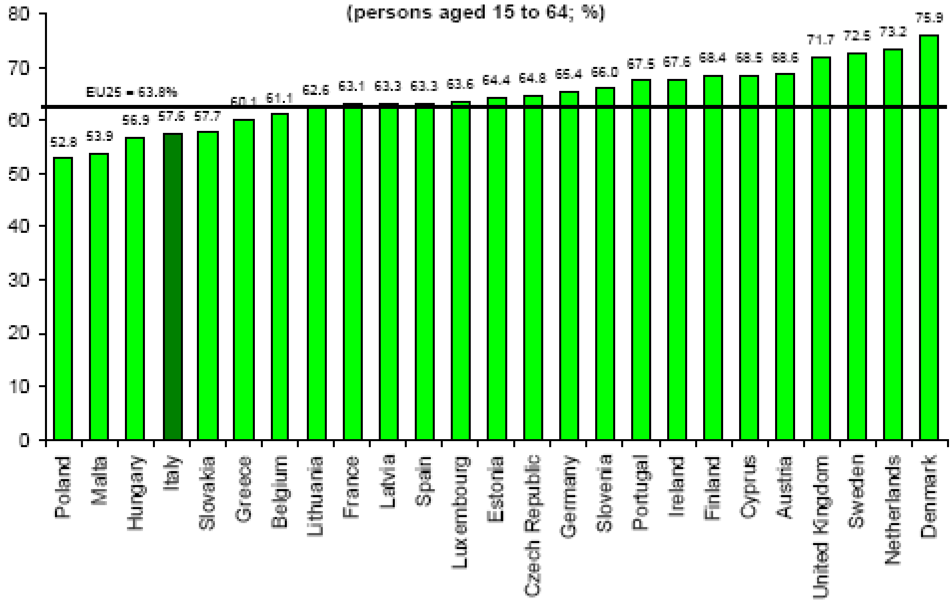
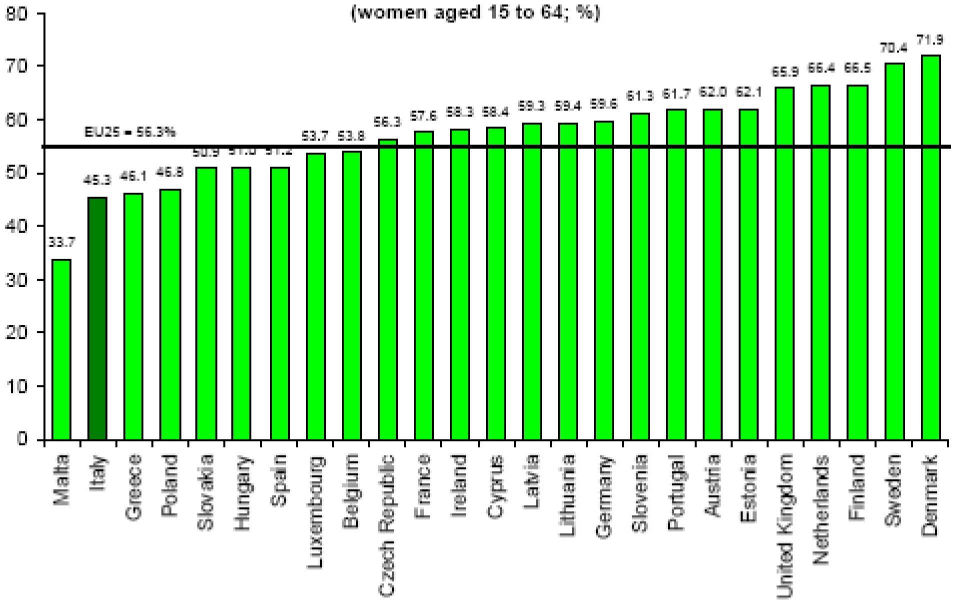
FIGURE 1: EMPLOYMENT RATE, 2005
(persons aged 15 to 64; %)



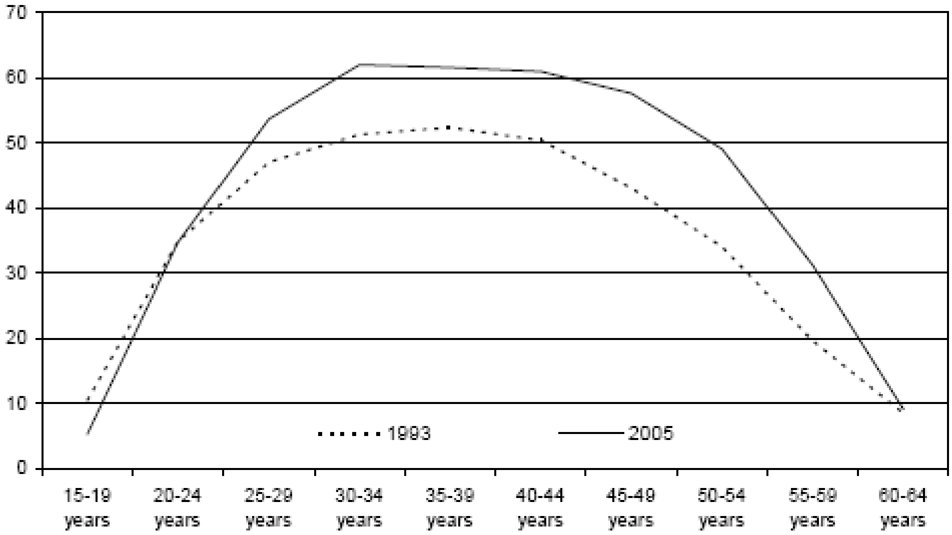
Sources: Based on Istat and Eurostat data.

FIGURE 2: FEMALE EMPLOYMENT RATE, 2005
(women aged 15 to 64; %)



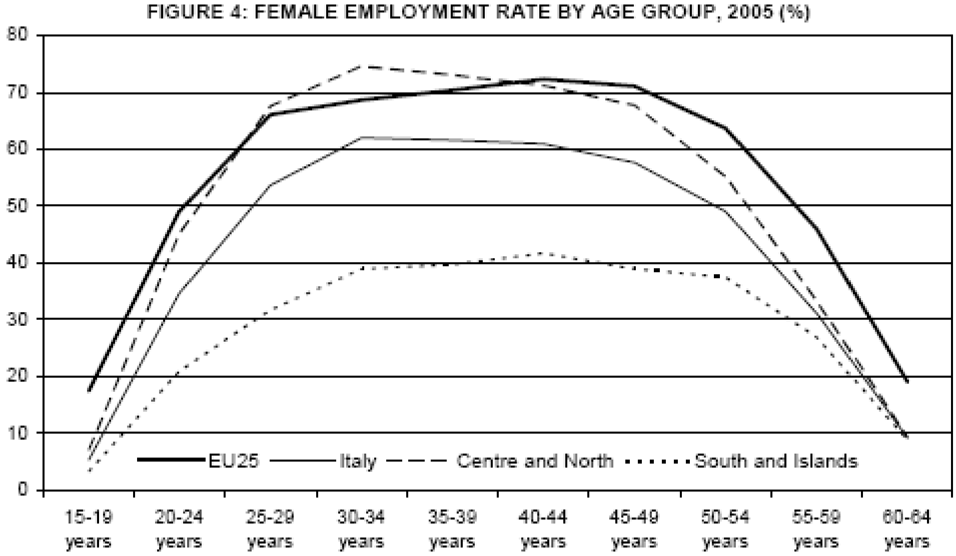
Sources: Based on Istat and Eurostat data.

FIGURE 3: FEMALE EMPLOYMENT RATE BY AGE GROUP IN ITALY (%)



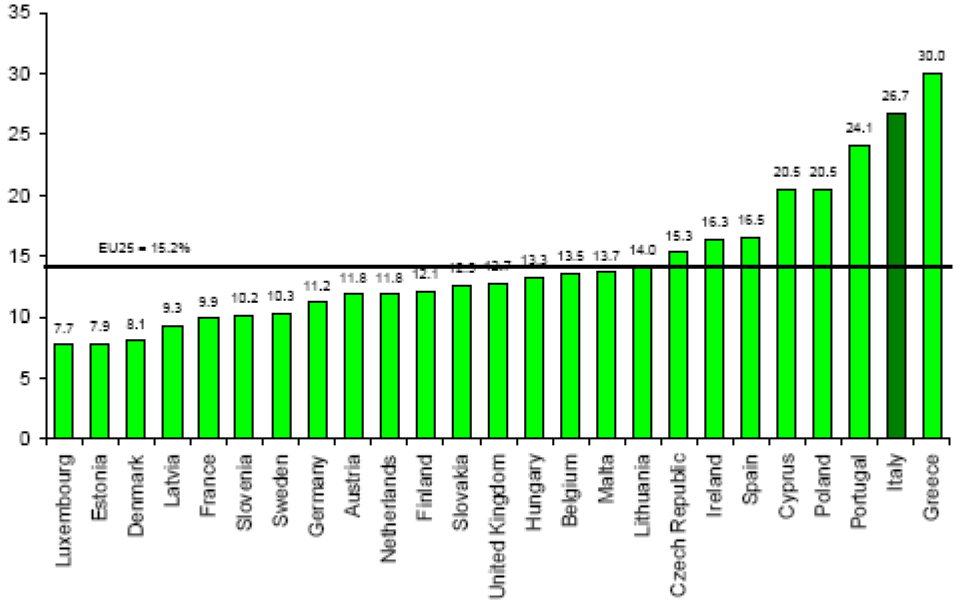
Source: Based on Istat data.

FIGURE 4: FEMALE EMPLOYMENT RATE BY AGE GROUP, 2005 (%)



Sources: Based on Istat and Eurostat data.

FIGURE 5: SHARE OF SELF-EMPLOYMENT, 2005 (%)



Sources: Based on Istat and Eurostat data.