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Boosting an anemic growth: potential effects of structural reforms in Italy

Giovanni Di Bartolomeo (Sapienza & MEF),
Francesco Felici (MEF) and Alessia Franzini (Sogei)



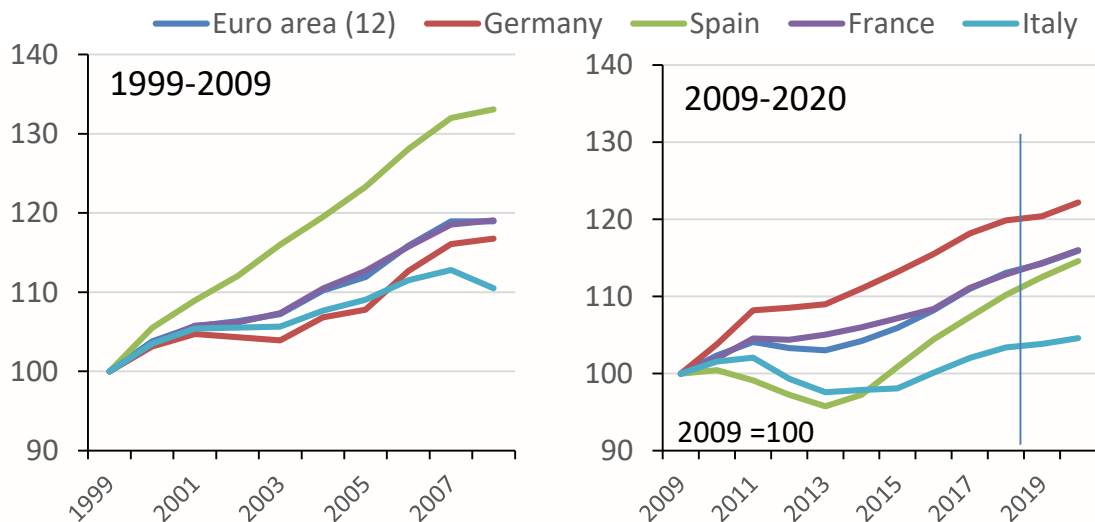
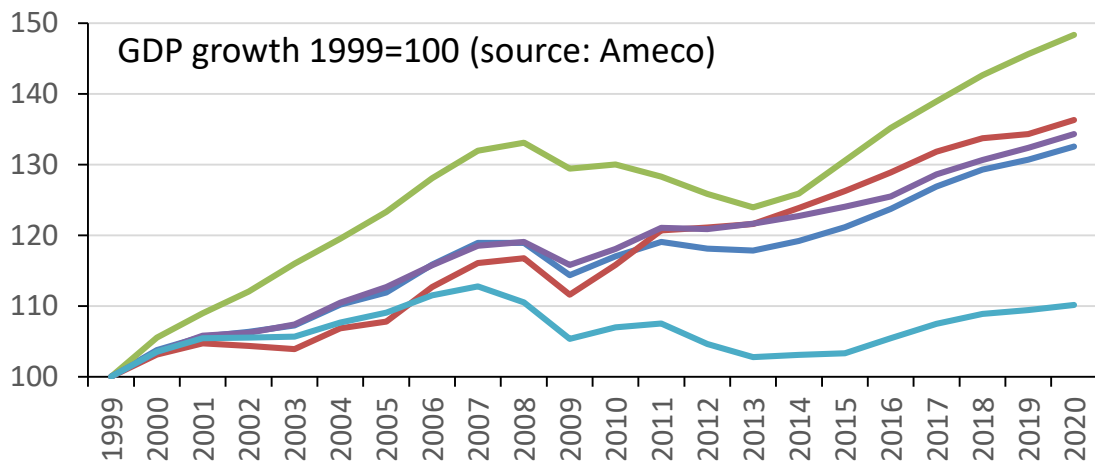
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Aim and outline

- Inspired by Varga and in 't Veld (2014, EP 541), the aim of this paper is twofold:
 - Explore the Italian structural indicators in a comparative perspective (focusing on comparable economies of the euro area: Germany, France, Spain).
 - Provide quantitative model-based assessment of the potential impact of structural reforms in Italy.
- We aim to discuss (this is a very preliminary version):
 - Reform targets
 - Reform instruments
 - QUEST implementation for potential evaluations

An anemic growth? Low resilience?



Potential structural reform paths

- Infrastructures
- Tangible capital and R&D sector
- Starting a business
- Labour market
 - Participation & skills
- Competition
- Justice
- Public administration
- Credit market
- Others

QUEST III: The model in a nutshell

- Multi-country model (different versions, we use the R&D country-specific one [Italy])
- Households [some liquidity constrained – all supply high/medium/low skilled labor]
- Firms [operate under monopolistic competition]
 - Intermediate good
 - Final good
- R&D sector [high skilled]
- International trade and financial markets
- Central banks/fiscal authorities

QUEST III

- Economy populated by:

Households
Low | Medium | High
skilled

Final goods producing firms
Monopolistic competition

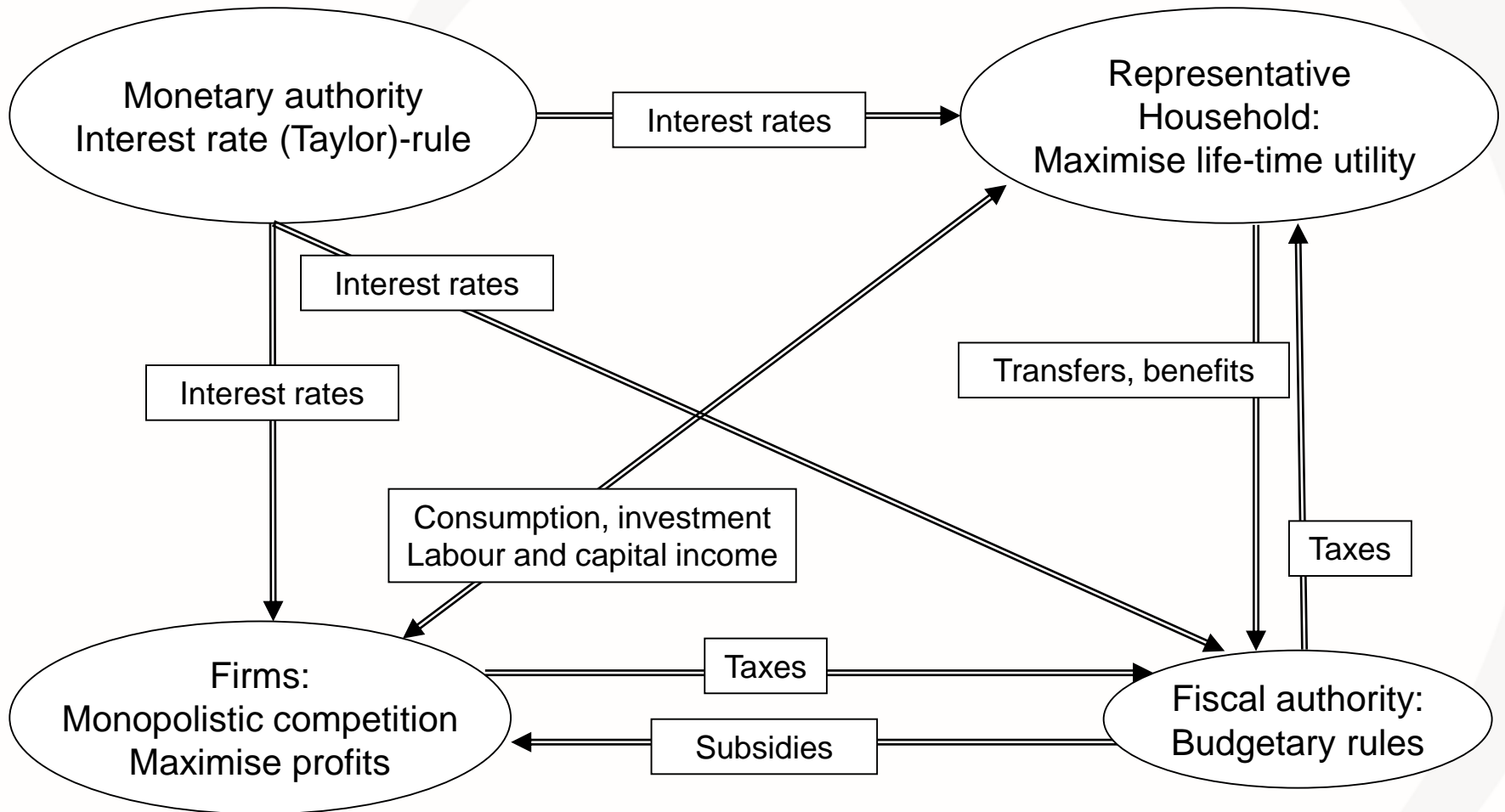
R&D institute

Intermediate goods
producing firms
Monopolistic competition

Monetary authority
Central Bank

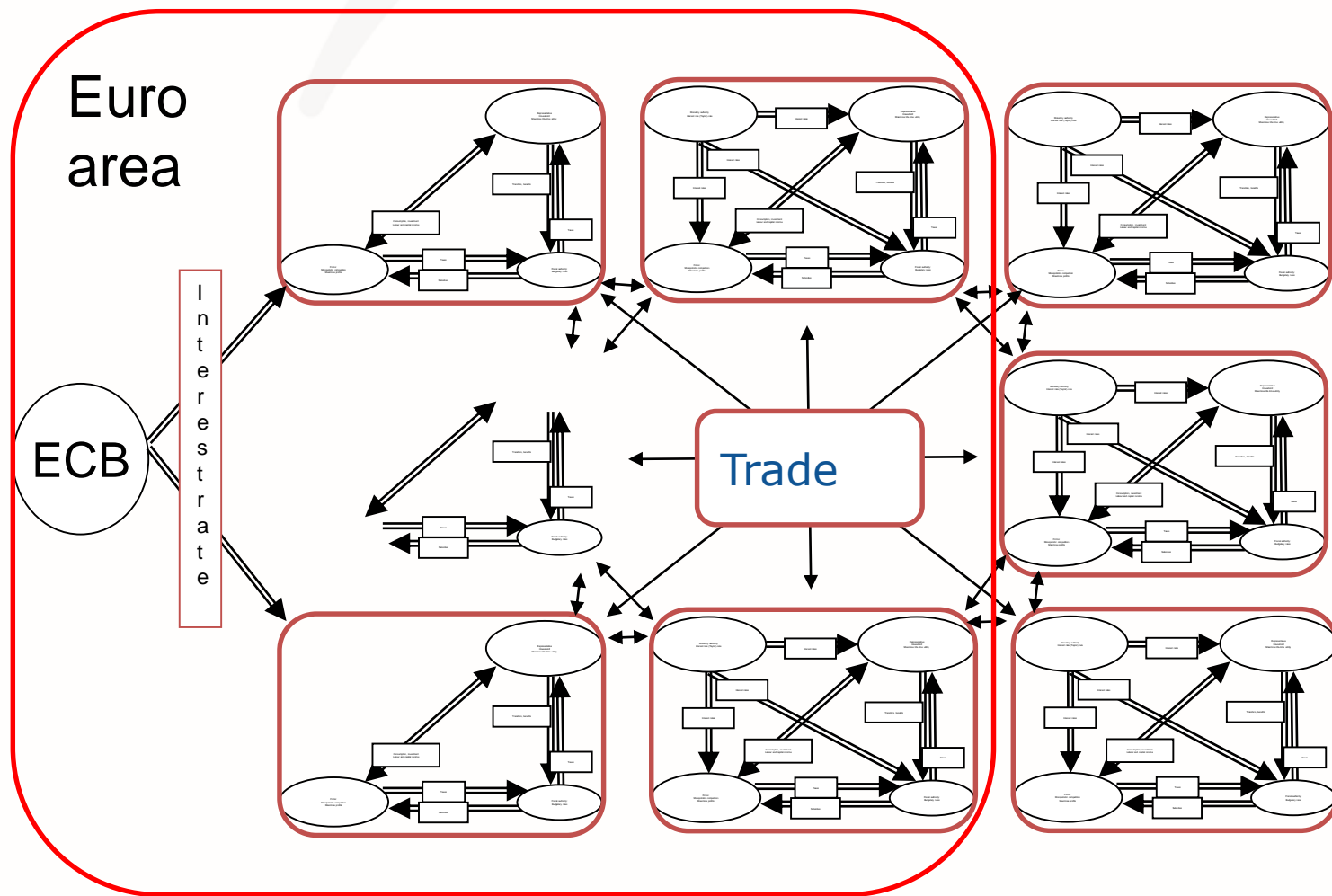
Fiscal authority
Government

QUEST III





QUEST III

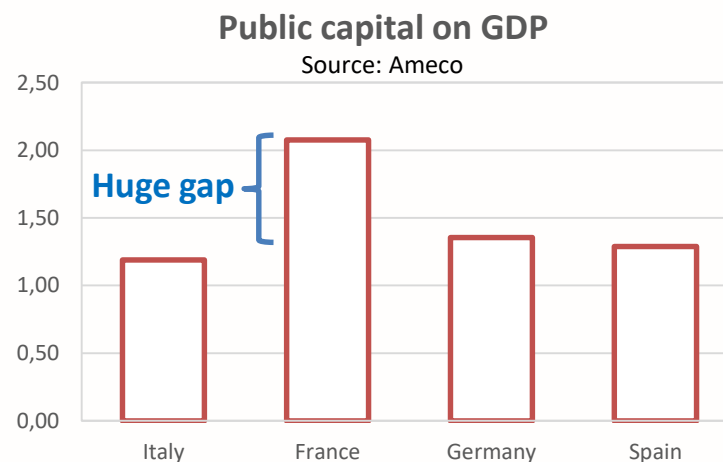
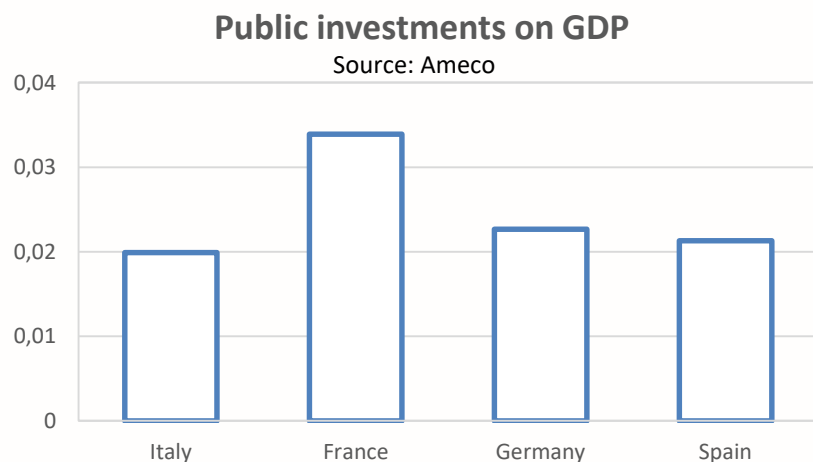


QUEST III: Calibration

- In the benchmarking exercise, we use the QUEST country calibrations
- Difference sources.
 - Components of GDP, labor (employment, activity rates etc.), capital, R&D inputs → AMECO/EUROSTAT
 - Tax data → TAXUD/EUROSTAT/EUROMOD
 - Trade matrix → COMEXT/ECFIN
 - Mark-ups → estimates based on WIOD/EUKLEMS (Canton and Thum-Thyssen, 2015)
 - Benefits → OECD
 - Structural parameters → estimated QUEST3
 - Entry costs → WORLD BANK (doingbusiness.org database)

Public investments and infrastructures

- Need of huge public investments?



- Potential issues (in 't Veld, 2017)
 - Monetary policy accommodation/non accommodation
 - Productivity of public capital (very prudential in QUEST?)
- Further caveats: management, timing, public debt constraint

Results of baseline simulations

- We consider three scenarios. In each, we fill the public capital gap with the other three countries in 30 years by raising public investments (EPS_IG). In the case of France, we consider $\frac{1}{2}$ of the gap [the gap is huge].
- Change in public investments: 0.00743 (France); 0.00276 (Germany); 0.00169 (Spain).

| Reform | 5 years | 10 years | 30 years |
|--|---------|----------|----------|
| Fill the $\frac{1}{2}$ public investment gap with France | 1.3 | 2.5 | 5.1 |
| Fill the public investment gap with Germany | 0.5 | 1.0 | 2.0 |
| Fill the public investment gap with Spain | 0.3 | 0.6 | 1.3 |

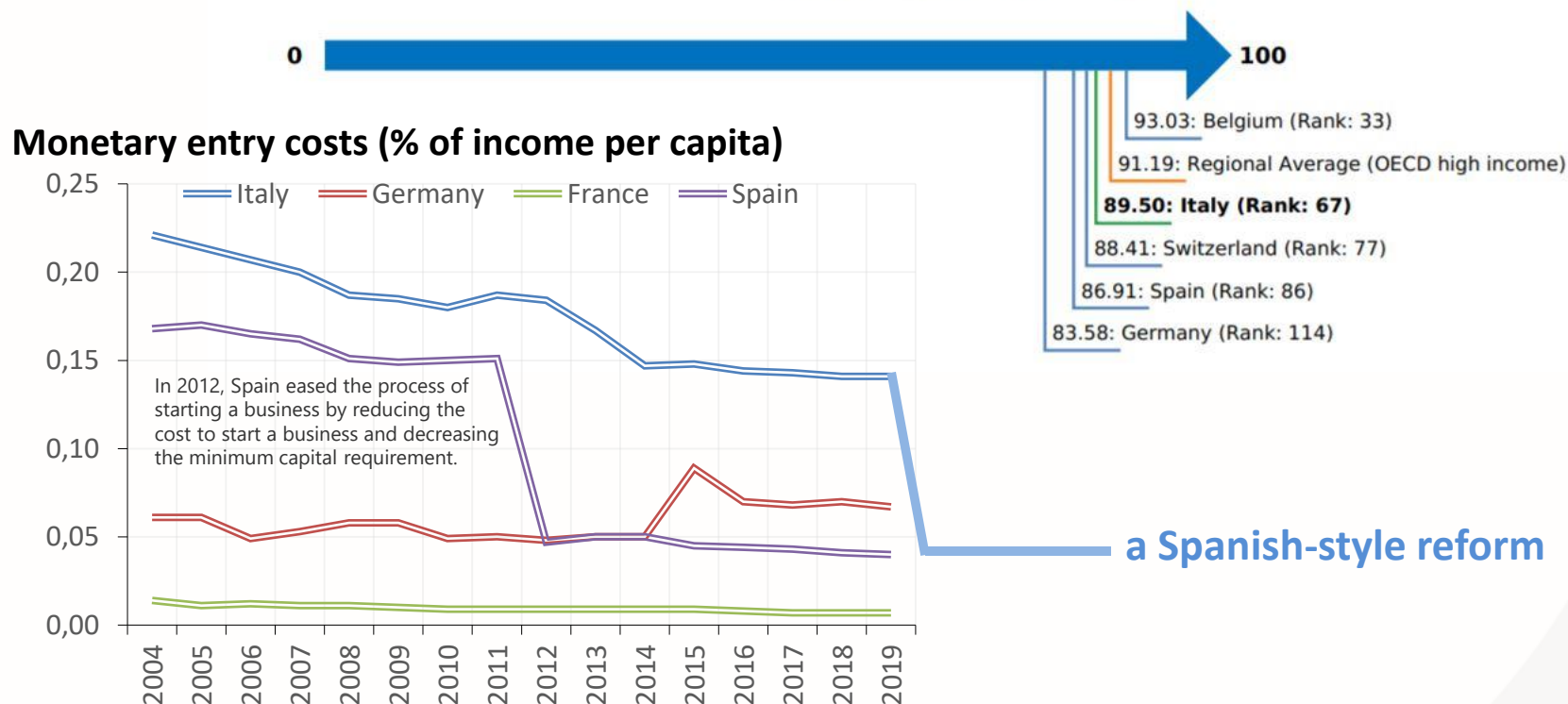
Starting a business

- Overall, good performance, but high entry costs

Figure - Starting a Business in Italy and comparator economies - Ranking and Score



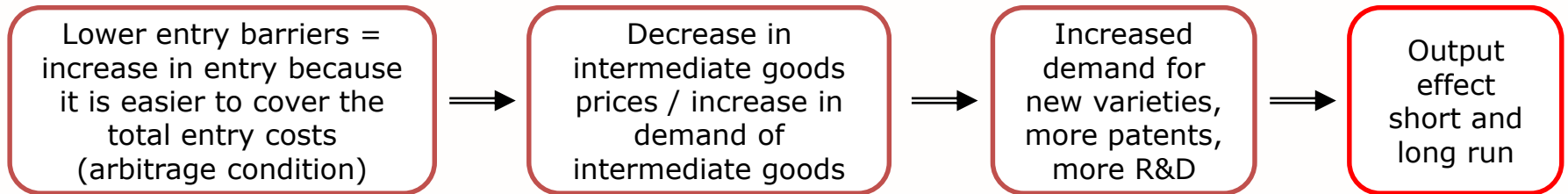
Source: DB 2019 Starting a Business Score



Mapping: Entry cost reform

- Entry barriers for start-ups in manufacturing (FCA)

Mechanism:



- Assumption: set of reforms to fill the gap with Spain

| Entry-barrier reform | 5 years | 10 years | 30 years |
|------------------------------|---------|----------|----------|
| Entry cost [benchmark Spain] | 0.1 | 0.3 | 0.7 |

Drawback: in the short term, the effects on GDP can actually be slightly negative, since increased demand for R&D leads to a reallocation of workers from the production of goods and services into research. However, the innovation resulting from R&D activities yields marketable benefits in the medium term

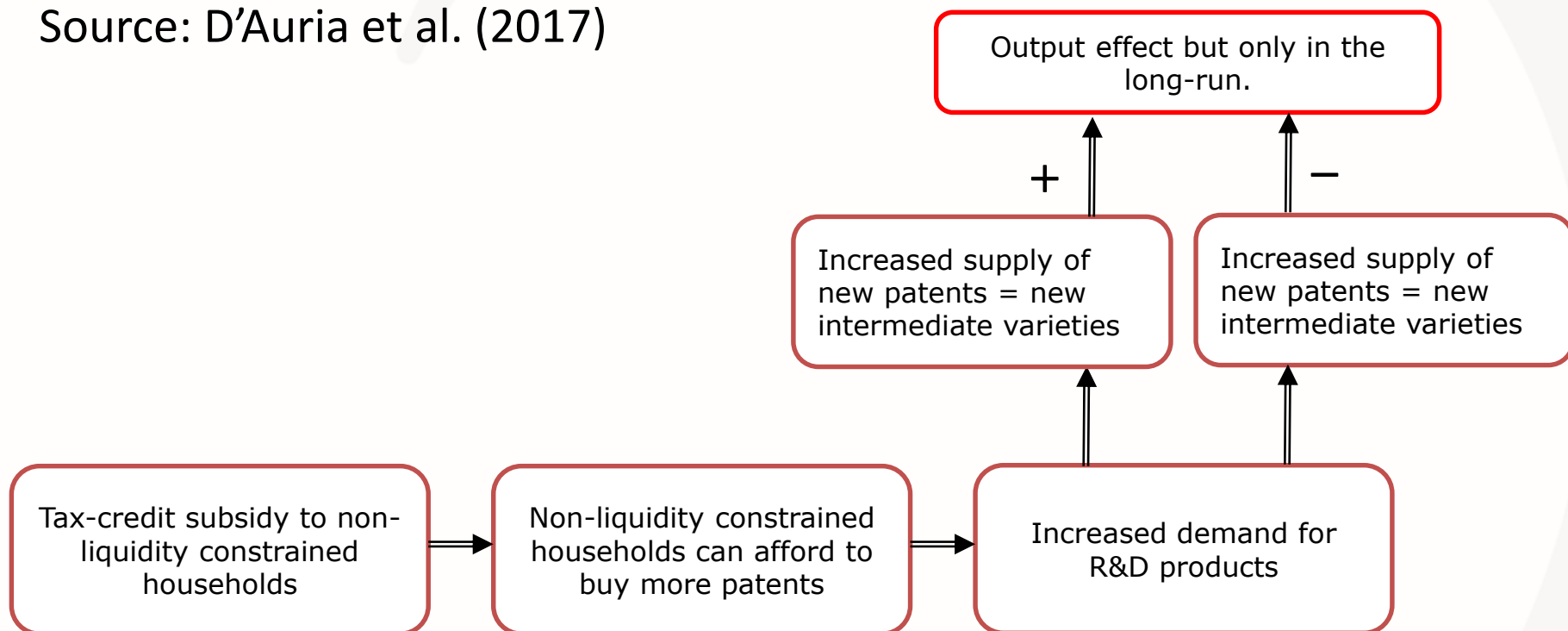
R&D and human capital

- Pro innovation/productivity measures
 - Indirect government subsidies [tax-credit subsidy (% of GDP)]
 - Human capital (a) low → medium skilled share; (b) medium → high skilled share [later]
- Tax credit subsidy on intangible as GDP % (source OECD)

| | | |
|-----------|------|-----------|
| – Italy | 0.02 | |
| – Germany | 0.01 | |
| – Spain | 0.27 | Benchmark |
| – France | 0.23 | |

Tax credit subsidy: Transmission

Source: D'Auria et al. (2017)



Caveat: in the short-run, the size and the quality of R&D labor force limits the effectiveness of this policy (education reforms needed, Thursby&Thursby, 2006)

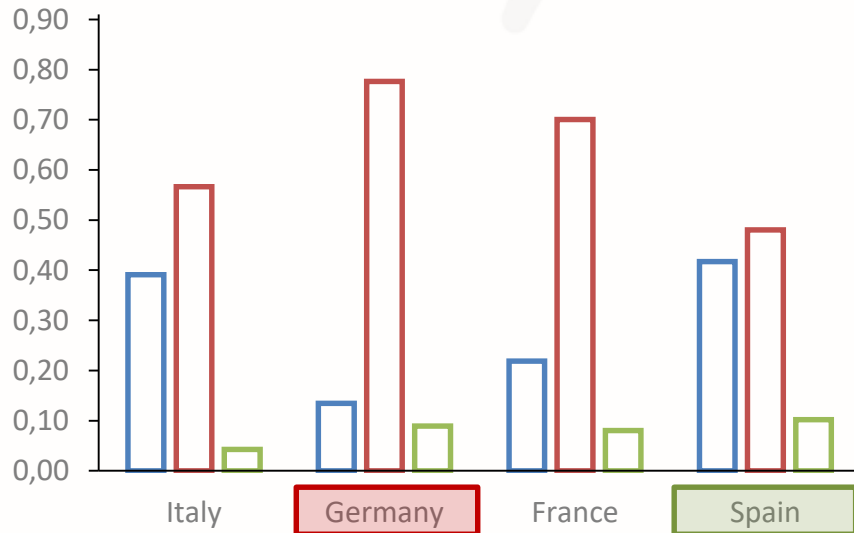
Outcomes of the simulations

- Three scenarios mapping reforms onto the variable tax credit subsidy on intangible as % of the GDP (TAXCR).
- Fill the gap with Spain by (1) $\frac{1}{4}$ [increase in TAXCR of 6.25 basis points], (2) $\frac{1}{2}$ [increase in TAXCR of 12.5 basis points], or (3) 1 [increase in TAXCR of 25 basis points].

| Reform | 5 years | 10 years | 20 years |
|--|---------|----------|----------|
| (1) increase in TAXCR of 6.25 basis points | 0.00 | 0.05 | 0.06 |
| (2) increase in TAXCR of 12.5 basis points | 0.01 | 0.14 | 0.19 |
| (3) increase in TAXCR of 25 basis points | 0.02 | 0.35 | 0.49 |

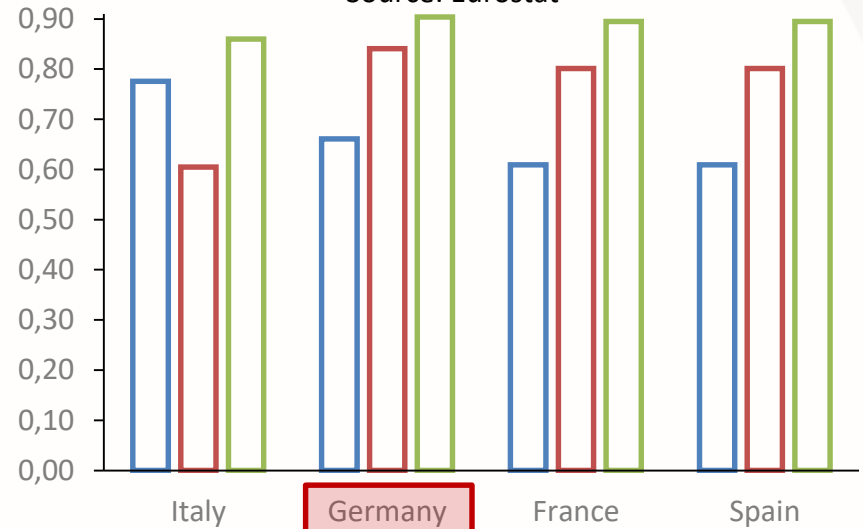
Workforce

■ Low ■ Medium ■ High
Source: Eurostat



Education (skills)

■ Low ■ Medium ■ High
Source: Eurostat



Participations

- Targets: Reducing labour mismatch, participation, ...
- Instruments: ALMP, incentives, welfare state, ...

Labour-oriented structural reforms

Skills a) Low-to-medium (halve the gap with Germany in 20 years); b) Medium-to-high (halve the gap with Spain in 20 years)

Results (% impact on GDP)

| Skill change (gap filled at 1/2) | 5 years | 10 years | 30 years |
|---|---------|----------|----------|
| Low-to-medium skilled [benchmark Germany] | 0.8 | 1.7 | 3.5 |
| Medium-to-high skilled [benchmark Spain] | 0.2 | 0.4 | 1.1 |

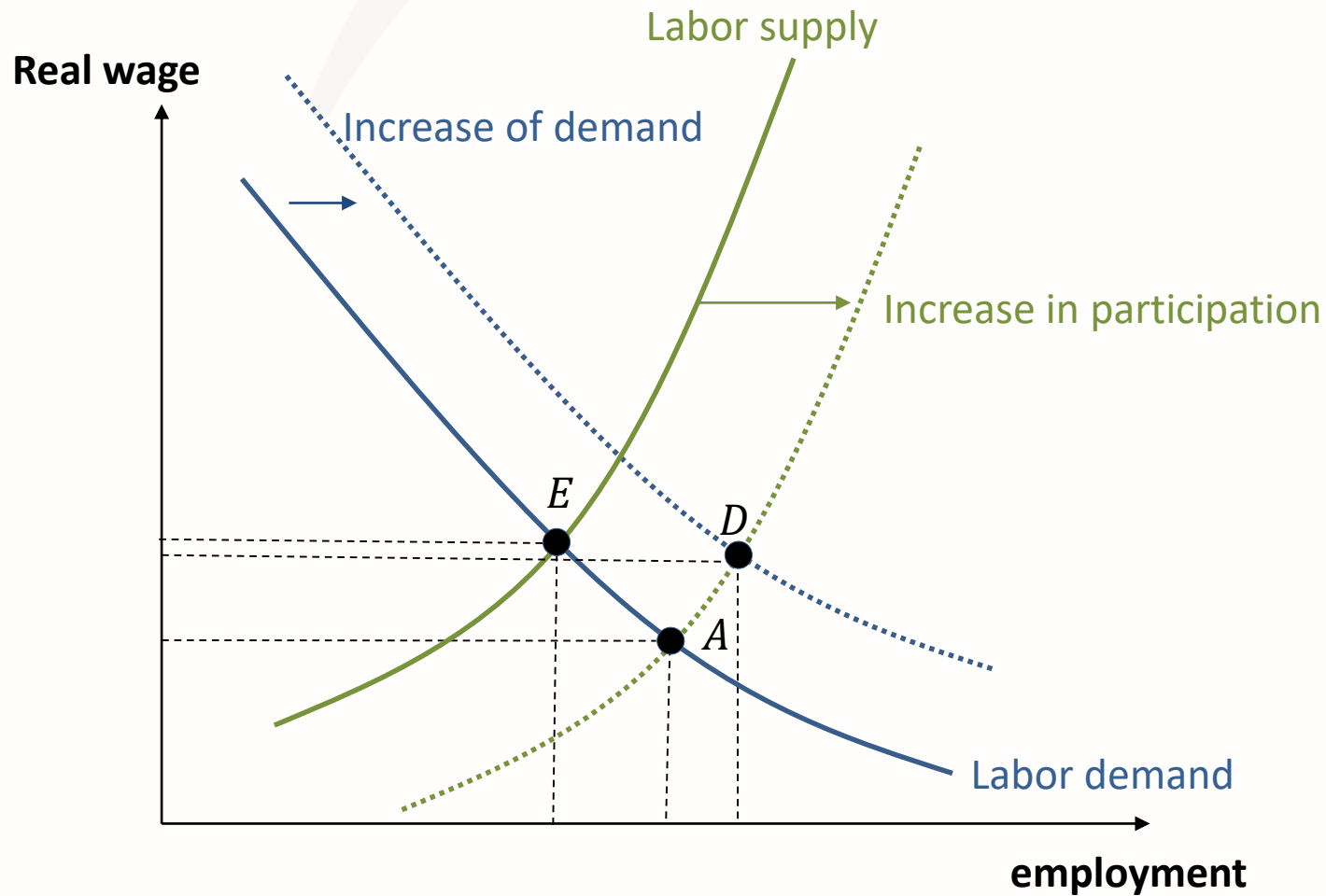
Participation: Medium skill (gap with Germany)

Results (% impact on GDP)

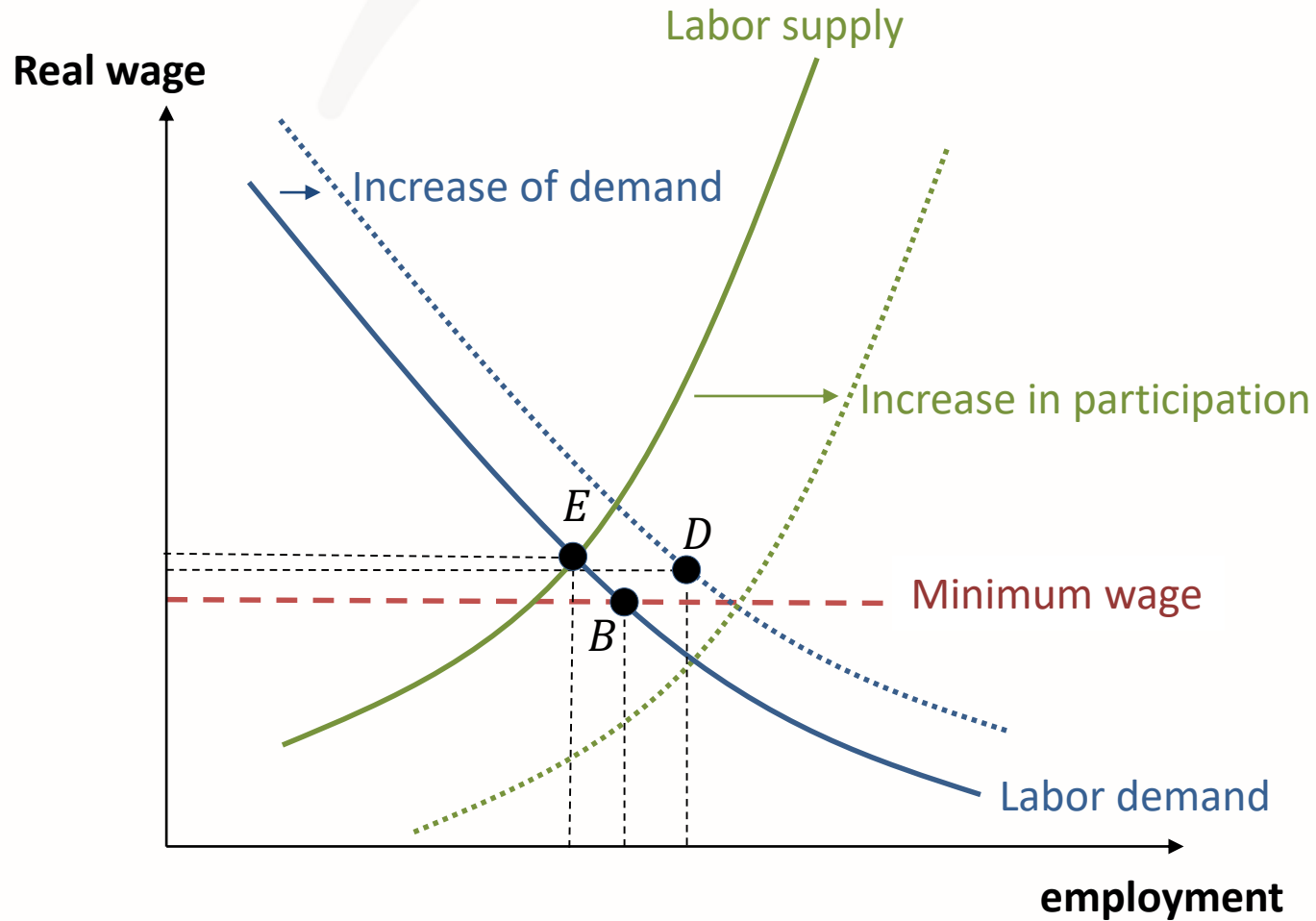
| Participation | gap filled at: | 1/4 | 1/2 | 1/1 |
|------------------------------------|----------------|---------|---------|---------|
| Medium-skilled [benchmark Germany] | | 0.9-1.2 | 1.8-2.3 | 3.8-4.6 |

Distribution: Adverse impact on medium-skilled wages

Distribution



Minimum wage



Competition

- Markups: No gap

| | Sector | |
|---------|------------|--------------|
| | Final good | Intermediate |
| Italy | 1.11 | 1.10 |
| France | 1.12 | 1.10 |
| Germany | 1.13 | 1.13 |
| Spain | 1.13 | 1.10 |

Sources: EUKLEMS

- Small space for further reforms?
- Similarly, overhead labor (FCL) and benefit replacement rate (BENRR)

New directions!

- Banking/credit sector
- Tax evasion/underground economy
- Spending review (public expenditure efficiency)
- Corruption
- Public debt burden
- Tax reform

Concluding remarks

- Further structural reforms attempting to increase market competitiveness seem to be not useful (limited impact and no gap).
- More promising:
 - Needs to fill the gap in public investments.
 - Specific measure to correct the participation/skill distribution (education, employability, skill matching).
 - However, short vs. long run tradeoffs and distribution issues.
- Other reforms are probably needed, but they need further attention in their design and evaluation.

The end

Thank you!!!

Contacts

Giovanni Di Bartolomeo

giovanni.dibartolomeo@uniroma1.it

Francesco Felici

francesco.felici@tesoro.it

Alessia Franzini

af Franzini@sogei.it