MARX MEETS KALDOR: PUBLIC DEBT, LABOUR MARKET DEREGULATION AND LABOUR PRODUCTIVITY IN ITALY

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CCEPP WP02-18

DEPARTMENT OF LAND ECONOMY
UNIVERSITY OF CAMBRIDGE

JULY 2018

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This paper deals with the Italian recession in a theoretical framework which combines Marxian and Kaldorian elements. The interpretation proposed of the slow rate of growth of the Italian economy in the last decades is based on the view that the implementation of a liberal agenda (mainly in the form of increasing labour market deregulation and increasing taxation on labour) has generated increasing income inequality and the reduction of the growth rate. The basic idea, derived from Kaldor, is that the decline of labour share, the increasing precariousness and measures of fiscal consolidation have reduced domestic demand with negative effects on the level of employment and the growth of labour productivity. Moreover, the increase in public debt involves increasing taxation (mainly on labour), which, in turn, contributes to the reduction of the rate of growth of labour productivity via the deterioration of the quality of the workforce.

Preliminary draft – June 2018

Keywords: Italian economy, public debt, labour market deregulation, labour productivity

1 - Introduction

This paper deals with the stagnation of the Italian economy, in a theoretical framework which combines Marxian and Kaldorian elements. We will draw from Kaldor the idea that the path of labour productivity is dependent on the output growth, according to the so-called Kaldor-Verdoorn Law, and that the increase in aggregate demand is the main driver of economic growth both in the short-run and in the long-run (McCombie and Thirwall, 1994). We will draw from Marx the idea that capitalist reproduction needs State intervention, via increasing public debt, and that increasing public debt is associated with increasing income inequality, via taxation on labour (Forges Davanzati and Patalano, 2017). We expand these arguments assuming that:
a. the State must pursue two opposing aims: i.e. favouring capital accumulation and preserving social cohesion (O'Connor, 1973; 1984);
b. the main instrument it uses is taxation. The distribution of the tax burden reflects the political power of capitalists and workers in the labour market, which is translated into the political arena (Kalecki, 1943; Korpi, 1989). As a result, with the decline in workers' bargaining power – which is reflected in increasing unemployment – taxation on labour increases. Notice that increasing labour taxation can also occur through the reduction of tax progressivity (Streek, 2013).

This argument is also consistent with Kalecki's well-known view that unemployment is a *discipline device* that capitalists use in order to impede workers (and unions) from controlling economic policy. As Kalecki (1943, p.326) wrote:

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> "… under the pressure of the masses the maintenance of full employment would cause social and political changes which would give a new impetus to the opposition of the business leaders. Indeed, under a regime of permanent full employment, " the sack " would cease to play its role as a disciplinary measure. The social position of the boss would be undermined and the self assurance and class consciousness of the working class would grow. Strikes for wage increases and improvements in conditions of work would create political tension. It is true that profits would be higher under a regime of full employment than they are on the average under laissez-faire; and even the rise in wage rates resulting from the stronger bargaining power of the workers is less likely to reduce profits than to increase prices, and thus affects adversely only the *rentier interests*. But 'discipline in the factories' and 'political stability' are more appreciated by the business leaders than profits. Their class instinct tells them that lasting full employment is unsound from their point of view and that unemployment is an integral part of the 'normal' capitalist system".

Therefore, the distribution of the tax burden reflects the bargaining power of workers and capitalists (including rentiers) in the political sphere, which, in turn, reflects their bargaining power in the labour market.

Based on this theoretical framework, an interpretation of the crisis of the Italian economy - a "crisis in the crisis" (D'Ippoliti and Roncaglia, 2011) – will be proposed. We have shown elsewhere that it can be imputed to i) the fragility of its productive structure (with particular reference to the large number of small firms with low propensity to innovate) and ii) a long-run dynamics of fall of aggregate demand, which starts from the austerity measures at the beginning of the 1990s (cf. Forges Davanzati, Patalano and Traficante, 2017). This argument is expanded here, sustaining that the long path of Italian stagnation can be imputed to the implementation of the neoliberal agenda and the consequent increase in income inequalities. This particularly applies to the labour market (in the form of increasing deregulation) and to the distribution of the tax burden (even more at the expense of workers).

Starting from the beginning of the 1990s, Italy experienced a constant reduction of both private and public investment, which, combined with increasing precariousness and wage moderation, contributed to the decline of both labour productivity and economic growth. The lack of industrial policies amplified the problem of the poor macroeconomic performance, insofar as Italian firms – small sized and non-innovating – were incapable of staying competitive on the global scene (cf. Perri and Lampa, 2018). Net exports did not compensate for the decline of public spending, private investment and consumption (cf. Felettigh and Federico, 2011). For the sake of our argument, Italy is an interesting case-study for it was involved in the global process of intensifying the neo-liberal agenda in relatively recent times, but at a faster rate than other OECD countries. This particularly applies to labour precariousness and trickle down policies in the form of even more regressive taxation.

The combination of Marxian and Kaldorian theoretical issues aims to fill a gap: very few recent studies on Italian stagnation have been put forward from a Marxian theoretical standpoint[1]. Most studies of the crisis of the Italian economy lie within the mainstream approach, imputing the crisis to bureaucracy, corruption, and institutional weakness seen in the low duration of Governments (cf., among others, Macchiati, 2016). Italian Keynesian economists tend to focus their attention on the counterproductive effects of austerity policies and believe that deficit spending policies can restore Italian economic growth. The 'eurosceptical view' is based on the conviction that the Italian crisis basically depends on the adoption of the euro (cf. Bagnai, 2016). There is no doubt that the current institutional architecture of the Eurozone and the austerity policies implemented in recent years are

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[1] In recent times, a Marxian reading of the Italian economic decline has been provided by Moro (2015). This also depends on the marginalization of Marxism in Italian academia. Starting from the so-called Gelmini reform of 2010, Italian economists are forced to published in mainstream journals, according to a list imposed by the National Agency for the evaluation of scientific research. The long, important tradition of Italian Marxism has been lost.

dysfunctional, as they create continuous macroeoconomic disequilibria (in particular, increasing interregional divergences), mass unemployment and slow growth. There is no doubt that such policies have generated very significant increases in unemployment, waves of business failures, a drop in the growth rate and – in contrast to the aim stated – also increases in the public debt/GDP ratio, not only in Italy. The question that therefore must be answered, since it follows logically from the previous statement, is whether or not it is advantageous for a single country to go back to its own currency and, more generally, whether the debate that has sprung up around the question of whether or not it is advantageous to return to the lira is actually relevant. We have to clear up a misunderstanding: foretelling what may happen in the case of a unilateral exit is absolutely impossible, and while the study of what has happened in past cases of monetary union break-ups can help, it is obviously not set in stone, if only because it is almost impossible to repeat historical regularities[2]. More generally, as I have emphasised above, economic theory is almost irrelevant for providing a cost/benefit analysis in this case, and in many other cases (Forges Davanzati, 2017). Many arguments against 'Italexit' have been put forward. Perhaps the main argument is that the Italian 'eurosceptical' economists do not consider that the main problem of the Italian economy – i.e. the continual decline of labour productivity - started (at least) from the early 1990s and it is independent of the currency adopted. By contrast, it is strictly connected with low - and declining – private and public expenditure in R&D and a reduction of manufacturing employment much greater than that experienced in other European countries: from about 2,000,000 in 1971 to about 600 in 2015. Compared with 1971, the importance of big firms in terms of employment in the industrial sector declined from 39% to 24% (cf. Perri and Lampa, 2018). Leaving the euro also involves a loss of productive capacity imputed to the exit of the Italian firms from the 'global chain of value' (cf. Bellofiore and Halevi, 2011 ; Simonazzi *et al* 2013) and the return to some form of protectionism (which is labelled sovranism in the Italian public debate).

The basic idea proposed here expands what Forges Davanzati, Patalano and Traficante (2017) showed. They maintain that the stagnation of the Italian economy does not depend either on institutional weaknesses or on the adoption of the euro. The main problem lies in *structural factors*, pertaining to the 'fragility' of the Italian productive structure and its specialization. The Italian economy is mainly populated by small firms, operating on the domestic market, with low propensity to innovate, dependent on the banking sector for financing their investment, located in low-tech production sectors: agribusiness, tourism, luxury goods (ISTAT, 2015; 2016). The lack of innovation can be considered one of the main causes of the incapacity of most of the Italian firms to stay competitive in a context of globalization. This "productivity trap" (Pini, 2014) has been dramatically increased by policies of fiscal consolidation combined with labour precariousness and wage moderation, mainly because of the reduction of domestic demand they involve. Importantly, a massive reduction of public funds for scientific research has been implemented in the last few decades.

In the next sections, it will be shown that the implementation of a liberal agenda (mainly in the form of labour market deregulation and increasing taxation on labour) has also contributed to reducing the rate of growth of labour productivity, via the increase in income inequalities. In particular, it

[2] For a thorough reconstruction of cases of monetary union failure, see Brancaccio and Garbellini (2015).. In my opinion, it is an extremely interesting research study from the historical standpoint, but not very useful in interpreting the dynamics of the European Monetary Union, since i) the cases examined concern monetary unions that cannot be compared to the European situation, because of both the GDP of the member countries and their political importance; ii) given its specificity, the EMU is truly unique in the history of monetary unifications and also for this reason not to be compared with any other case. Furthermore, as has been pointed out, "Historical examples lead us to the conclusion that monetary integration, which involves total loss of monetary sovereignty, once established is unlikely to be questioned by the single member states, insofar as change is perceived as a leap in the dark, of which the costs are considered to be far higher than the benefits. The collective psychology in monetary questions is dominated by inertia" R. Patalano, *Una 'escape clause' per la zona euro*, Micromega on-line, 8.12.2013.

will be shown that increasing income inequality reduces the rate of growth for two main reasons: i) it produces wage moderation, the consequent reduction of domestic demand and, due to the operation of the Kaldor-Verdoorn effect, reduction of the rate of growth of labour productivity; ii) it generates an increase in the public debt/GDP ratio which leads to cutting public spending (mainly in the form of public transfers to workers) and increasing taxation (mainly on labour). The consequent reduction of disposable real wage reduces the rate of growth of labour productivity, due to the deterioration of the quality of the workforce. The first effect is Kaldorian, the second is Marxian.

This analysis is grounded on descriptive statistics. The exposition is organized as follows. Section 2 deals with the theoretical framework and, particularly, on the idea (based on Marx) that public debt is a locus of fiscal conflict; section 3.1 describes the dynamics of the Italian labour market, with particular emphasis on the dynamics of wages and labour productivity; section 3.2 outlines how increasing taxation on labour is linked to productivity, and section 4 concludes.

2 – The theoretical framework

The view that Kaldor's theory of economic growth reflects some of Marx's main theses is not new. Ricoy (2001) points out that: "in Marx's conception, the development of the forces of production constitutes a cumulative and evolutionary process of a macroeconomic-structural nature. This process is endogenous to capital accumulation and economic growth. The analysis further implies that Marx's conception can be seen as an antecedent of some modern views on the dynamics of productivity. In particular, his analysis can be seen as the most consistent and developed antecedent of Young's view of 'increasing returns and economic progress' and, more generally, of the view implied in the principle of cumulative causation as developed by Nicholas Kaldor". The so-called Kaldor-Verdoorn Law is based on the idea that variations of aggregate demand impact on the path of labour productivity. Net public expenditure, in turn, is regarded as the most important factor driving aggregate demand in the PostKeynesian tradition, although Kaldor also considered the major role of net exports. PostKeynesian scholars tend to consider that an increase in public expenditure can (and should) be financed by 'printing money' on the part of the Central Bank. Most of them neglect the distributive effects of increasing public spending and public debt.
Marx's analysis of the role played by public debt in capitalist reproduction can usefully integrate this view.

Karl Marx devoted particular attention to the fiscal system, focusing on so-called fiscal expropriation, i.e. the thesis that *i)* when the Government must reimburse its creditors, it needs to increase taxation, and *ii)* taxes are (directly or indirectly) levied on labour. Accordingly, the reimbursement of debt involves higher taxation on wages, since workers have less bargaining power in the political sphere than capitalists. The reduction in disposable income reduces consumption and deteriorates the quality of workforce with negative effects on the growth in labour productivity.
In Karl Marx's view, the problem of increasing taxation is closely related to the expansion of the State's role in capitalist society. In a modern society Marx argued that

> the executive power commands an army of officials numbering more than half a million individuals and therefore constantly maintains an immense mass of interests and livelihoods in the most absolute dependence; […] the state enmeshes, controls, regulates, superintends, and tutors civil society from its most comprehensive manifestations of life down to its most insignificant stirrings, from its most general modes of being to the private existence of individuals; where through the most extraordinary centralization this parasitic body acquires a ubiquity, an

> omniscience, a capacity for accelerated mobility, and an elasticity which finds a counterpart only in the helpless dependence, the loose shapelessness of the actual body politic" (Marx, 1869, pp.50-51).

The bourgeoisie has interests in maintaining the extensive "state machine in its numerous ramifications that are interwoven in the closest fashion. Here it finds posts for its surplus population and makes up in the form of state salaries for what it cannot pocket in the form of profit, interest, rents, and honorariums" (Marx, 1869, p.51).

The division of labour in the state administration has grown "at the same rate as the division of labour inside the bourgeois society created new groups of interests, and therefore new material. Every common interest was immediately severed from the society, countered by a higher, general interest, snatched from the activities of society's members themselves and made an object of government activity – from a bridge, a schoolhouse, and the communal property of a village community, to the railroads, the national wealth, and the national University of France" (Marx, 1869, p. 104).

This "enormous bureaucratic and military organization, with its wide-ranging and ingenious state machinery" is an instrument of repression and consensus through the development of public works and welfare. This expansion of the role of State creates "the constant excess of its expenditure over its income, a disproportion which is simultaneously the cause and effect of the system of state loans" (Marx, 1895, p. 42).

> In order to escape from this indebtedness, the state must either restrict its expenditure, that is, simplify and curtail the government organism, govern as little as possible, employ as few personnel as possible, enter as little as possible into relations with bourgeois society (Marx, 1895, pp. 42).

For this reason, in the modern State "the volume of national production stands at a disproportionately lower level than the amount of the national debt" (Marx, 1895, p. 42). The deficit increases the state's indebtedness and taxation. To service its debt, the state must produce "an immediate but transitory balance in its budget by putting extraordinary taxes on the shoulders of the wealthiest classes" [Marx, 1895: 43], but without a complete revolution in the social order and no revolution in the state budget [Marx, 1895: 43]. In the capitalist social order, public indebtedness is a necessity, and with indebtedness what is necessary is "the lordship of the trade in state debts" (Marx, 1895, p. 43).

The burden of national debt weighs on the working class and tax becomes "the source of life of bureaucracy, the army, the priests and the court, in short, for the whole apparatus of the executive power. Strong government and heavy taxes are identical" (Marx, 1869, p. 110).
An increasing public debt implies growing taxation:

> As the national debt finds its support in the public revenue, which must cover the yearly payments for interest, &c., the modern system of taxation was the necessary complement of the system of national loans. The loans enable the government to meet extraordinary expenses, without the tax-payers feeling it immediately, but they necessitate, as a consequence, increased taxes. On the other hand, the raising of taxation caused by the accumulation of debts contracted one after another, compels the government always to have recourse to new loans for new extraordinary expenses.

> Modern fiscality, whose pivot is formed by taxes on the most necessary means of subsistence (thereby increasing their price), thus contains within itself the germ of automatic progression. Over-taxation is not an incident, but rather a principle (Marx, 1867, p. 921).

The finance aristocracy (or, in general terms, state creditors) and productive capitalists have opposing interests[3].

> Along with this state budget necessarily goes the lordship of the trade in state debts, of the state creditors, the bankers, the money dealers, and the wolves of the Bourse. Only one faction of the party of Order was directly concerned in the overthrow of the finance aristocracy -- the manufacturers. We are not speaking of the middle, of the smaller people engaged in industry; we are speaking of the reigning princes of the manufacturing interests […]. Their interest is indubitably reduction of the costs of production and hence reduction of the taxes, which enter into production, and hence reduction of the state debts, the interest on which enters into the taxes, hence the overthrow of the finance aristocracy (Marx, 1895, p..43).

Moreover, fiscal expropriation can be regarded as a tool aiming at increasing working hours and hence absolute surplus value. A decline of wages below their subsistence level generates – according to Marx – deterioration of the quality of the workforce and, as a result, a decline of labour productivity. Marx approaches this question with reference to the variations of the absolute surplus value resulting from competitive pressures:

> the value of labour-power includes the value of the commodities necessary for the reproduction of the worker, for continuing the existence of the working class. If then the unnatural extension of the working day, which capital necessarily strives for in its unmeasured drive for self-valorisation, shortens the life of the individual worker, and therefore the duration of his labour-power, the forces used up have to be replaced more rapidly, and it will be more expensive to reproduce labour-power […]. It would seem therefore that the interest of capital itself points in the direction of a normal working day (Marx,1867, p.377).

Therefore, if the lengthening of the work-day generates deterioration of the quality of the workforce, thus reducing labour productivity, why do capitalists find this strategy profitable? To Marx, it is competition among capitalists who produce this outcome, which, in a long-run perspective, damages capital as a whole:

[3] Economic power involves political power: “Since the finance aristocracy made the laws, was at the head of the administration of the State, had command of all the organized public authorities, dominated public opinion through the actual State of affairs and through the press, the same prostitution, the same shameless cheating, the same mania to get rich was repeated in every sphere, from the court to the Café Borgne to get rich not by production, but by pocketing the already available wealth of others. Clashing every moment with the bourgeois laws themselves, an unbridled assertion of unhealthy and dissolute appetites manifested itself, particularly at the top of bourgeois society -- lusts wherein 'wealth derived from gambling naturally seeks its satisfaction, where pleasure becomes debauched, where money, filth, and blood commingle. The finance aristocracy, in its mode of acquisition as well as in its pleasures, is nothing but the rebirth of the lumpen proletariat on the heights of bourgeois society” (Marx, 1895, p.3).

> Capital, which has such "good reasons" for denying the sufferings of the legions of workers surrounding it, allows its actual movement to be determined as much and as little by the sight of the coming degradation and final depopulation of the human race, as by the probable fall of the earth into the sun. In every stock-jobbing swindle everyone knows that some time or other the crash must come, but everyone hopes that it may fall on the head of his neighbour, after he himself has caught the shower of gold and placed it in secure hands. Après moi le déluge! is the watchword of every capitalist and of every capitalist nation. Capital therefore takes no account of the health and the length of life of the worker, unless society forces it to do so. The answer to the outcry about the physical and mental degradation, the premature death, the torture of over-work, is this: Should that pain trouble us, since it increases our pleasure (profit) ? But looking at these things as a whole, it is evident that this does not depend on the will, either good or bad. of the individual capitalist. Under free competition, the immanent laws of capitalist production confront the individual capitalist as a coercive force external to him (Marx,1867, p. 381).

This is a case of lack of coordination, and a major contradiction of capitalist reproduction. The individual capitalist is forced to increase surplus value to stay competitive, while this strategy proves counterproductive once *all* capitalists behave this way. In other words, while on the microeconomic plane (and in the short-run) the lengthening of the working-day is expected to be a profitable device for the sake of increasing profits, on the macroeconomic plane (and in the long-run) this produces a decline of productivity and profits at the expense of firms as a whole. Note that, in this schema, labour productivity can decline also as a result of the reduction of investment and the consequent increasing obsolescence of fixed capital.

Marx stresses that taxes are, directly or indirectly, levied on labour, even if he does not provide a definite argument for this thesis. It the late 1970s this topic was resumed and clarified by James O' Connor (1976). According to him, the expanding public function requires a growing bureaucracy and the state must be able to gain more revenue: via privatizations, issuing state bonds, inflation and above all taxation[4]. The capitalist class always resists increasing taxation, and the fiscal burden mainly weighs on the working classes. The state plays conflicting roles: on the one hand the growing state role is necessary for the sustainability of the accumulation process, on the other hand the expansion of the state and the increase in public expenditure determine fiscal pressure that reduces the purchasing power of the working class and consequently consumption and effective demand (*fiscal expropriation*)[5].

This intrinsic contradiction leads to the fiscal crisis of the state, since the sustainability of state mediation in modern capitalist society is limited by working classes' ability to pay taxes and by its 'credibility' in the financial markets, i.e. its capability to reimburse the debt. After World War II, according to O'Connor, the instruments used by the state to guarantee the stability of capitalism were strongly inflationist, forcing the state to react with deflationary measures, controls on wages and prices, and stimulus to boost productivity. Although deflationary measures limit the bargaining

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[4] In Baran-Sweezy's approach the State has a positive function with its faculties to absorb the surplus, in O'Connor's view the State has only a fiscal dimension and its economic action determines budget crisis, fiscal and inflationist pressure.

[5] This opinion is in contrast with Sweezy's view on the greater equity of the fiscal system in modern capitalism: "Throughout the nineteenth century, the tax structure in all capitalist countries was highly regressive in its incidence, while transfer payments largely found their way into the hands of the wealthier sections of the population. Under these circumstances, there is little doubt that the State, through the mechanism of transfer payments, was acting as an engine of accumulation, siphoning purchasing power out of the pockets of consumers into the pockets of accumulators. In recent decades, however, the increasing use of corporation, income, and estate taxes and the growing volume of social-security payments have combined to shift the balance. That the transfer mechanism as a whole produces a net balance in favor of consumption is unlikely, but at any rate it is clear that it constitutes less of a drag on consumption than was formerly the case. We are therefore justified in saying that transfer payments have been evolving in a direction to offset the tendency to under-consumption (Sweezy, 1942: 233).

power of trade unions, they cause a contraction of the aggregate demand and increase unused production capacity and production costs. The rise in unemployment causes an increase in public spending on welfare, shrinks taxable income and lowers tax revenues. Vis-à-vis the fiscal crisis of the State, the stimulus to boost productivity is the only instrument, but at the cost of increasing unemployment and exploitation of the working classes.

3 – The Italian economic stagnation in a Marxian-Kaldorian approach

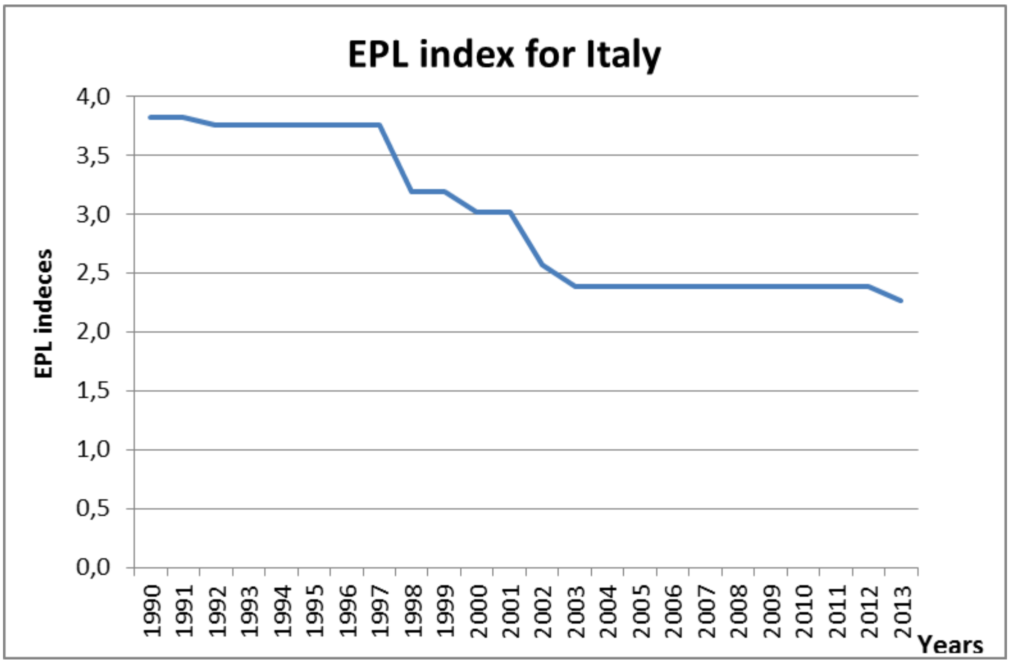
3.1 – The labour market

On the basis of the theoretical framework described above, this section will deal with Italian stagnation and particularly with the links existing between labour market deregulation policies and the recession. The subsequent section will tackle the effects of increasing public debt on economic growth.

In the last few decades, Italy has experienced a significant acceleration of policies of labour market deregulation. This distinguishes the Italian experience from that of most OECD countries, for two main reasons. First, labour flexibility policies were implemented somewhat later than in the main OECD countries (above all the Anglo-Saxon nations) but compared to those countries, they have been implemented with greater intensity (Tridico, 2017). Second, the beginning of this process of 'modernization' coincides with the beginning of the long recession that the Italian economy experienced starting from the 1990s (cf. Perri and Lampa, 2014), and some scholars imputed the Italian decline also to the acceleration of policies of labour flexibility (cf. Tridico, 2017).

Policies of labour market deregulation (also called 'labour flexibility') were introduced in Italy starting from the so-called Pacchetto Treu (Law 24 June 1997). These interventions were accentuated by the so-called Legge Biagi (Law 30/2003), the “Riforma Fornero” (Law 27 June 2012) and lastly by the Jobs Act, in 2014. Those reforms significantly reduced the costs of firing on the part of firms, and were presented to the Italian public as part of a wider political program of 'modernization'. The word 'reform' (which actually means structural reforms and hence labour flexibility), in the Italian political debate, became a synonym of progress, which would benefit the entire society, quite independently of its content.

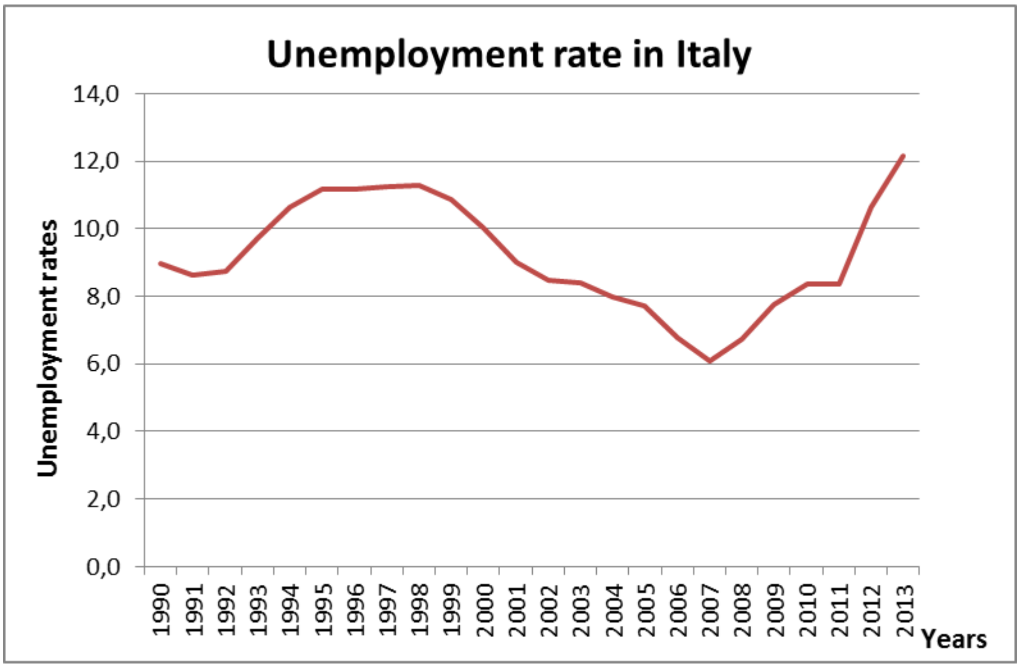
Evidence shows that worker protection – measured in a conventional way (i.e. the OECD EPL) – has declined dramatically in recent decades.



Source: Our elaboration from OCSE data

Figure 1. EPL index for Italy 1990-2013

The EPL index has declined considerably over the years, by 40.1% to be exact, going from 3.82 in 1990 to 2.26 in 2013, so it would seem easier to dismiss somebody today than in 1990. A sudden drastic drop occurred from 1997 to 1998, passing from 3.76 to 3.19, with a fall of over half a point, and from 2001 to 2003 when it went from 3.01 to 2.38 (in 2002 passing to 2.57) for a reduction of 26.5%.



Source: Our elaboration from Istat data

Figure 2: the path of Italy's unemployment rate

Although the EPL index has almost halved since 25 years ago, in 2013 the unemployment rate was over three points higher (3.17) than it was then (Cfr. Table 1 and Figure 2).
Importantly, Italy experienced a major decline in labour productivity combined with a massive reduction of the labour share, starting from the 1970s (see Figure 3).

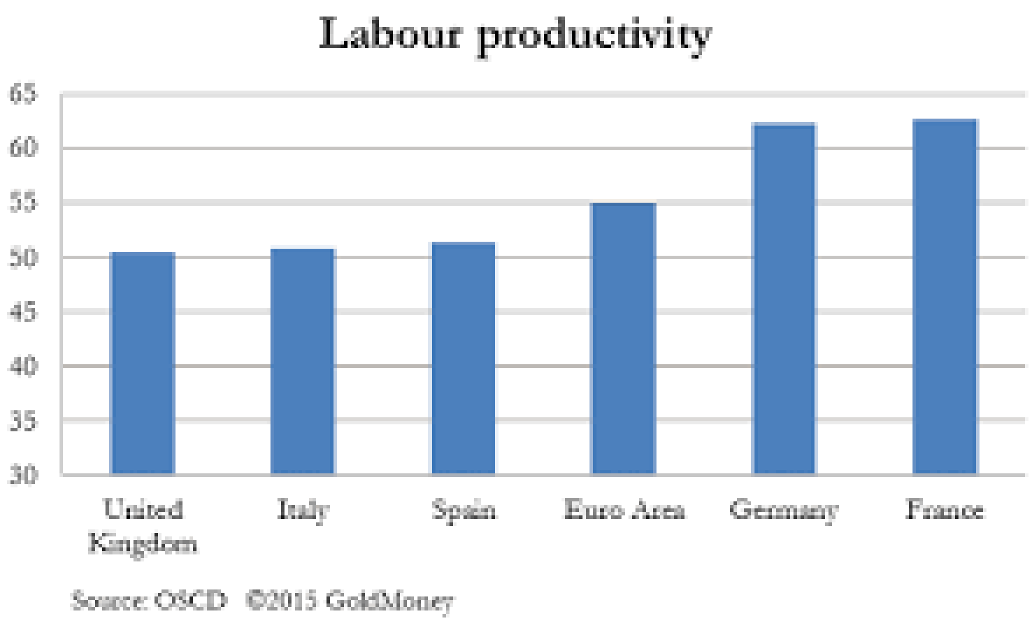


Figure 3: Labour productivity in the Euro Area

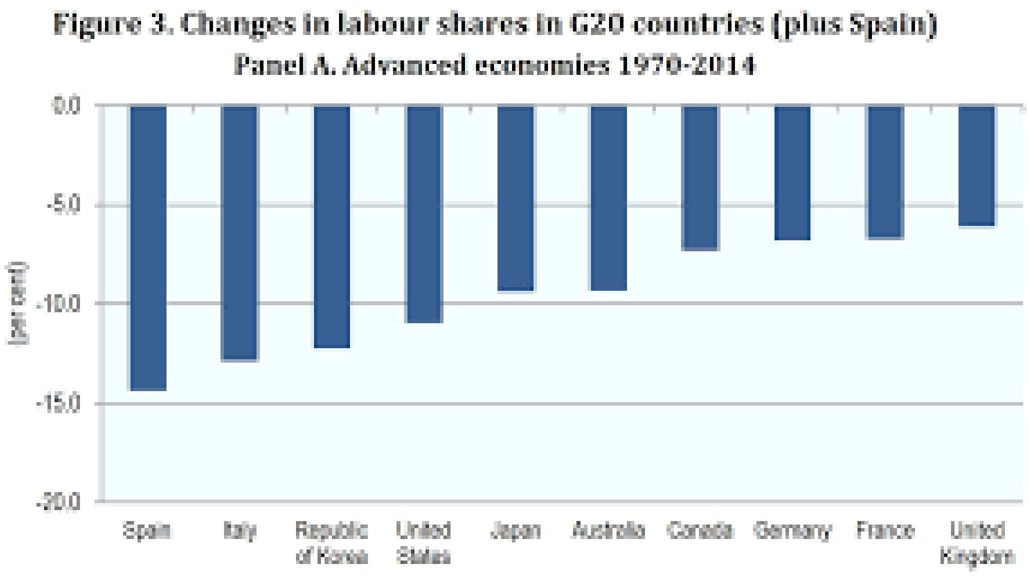


Figure 4: Changes in labour shares in advanced economies (source: OECD 2015)

On the theoretical ground, two main arguments are put forward to explain why policies of labour market deregulation reduce the growth rate. First, they disincentivate innovation, insofar as firms can stay competitive via wage reductions resulting from the decline of workers' bargaining power.

Second, labour flexibility negatively affects aggregate demand via the reduction of the propensity to consume. The rationale for this is based on the assumptions that *i)* workers aim at maintaining their consumption constant over time; *ii)* flexible labour contracts are expected to increase workers' effort (the so-called discipline effect); *iii)* flexible labour contracts increase workers' uncertainty[6]. On this basis, a fallacy of composition effect occurs. On the microeconomic plane, the individual firm finds it profitable to hire with flexible labour contracts, insofar as, due to the 'discipline effect', it expects that workers will increase their effort, with the consequent increase in labour productivity and profits. By contrast, on the macroeconomic plane, flexible labour contracts, insofar as they increase workers' uncertainty, push workers to increase their precautionary savings.

A further consideration is in order. Most Italian micro and small firms (mainly in Southern Italy) employ family members. Although this is a structural feature of the Italian economy, this phenomenon appears to have increased in the period of the crisis. This may be due to the increasing income inequality and the related stalling of social mobility. As a result, disguised unemployment has risen and this also contributes to the slowdown in productivity growth[7].

3.2 – Public debt, taxation and labour productivity

On the assumption that high levels of unemployment reduce workers' bargaining power not only in the labour market, but also in the political field, it follows that *the higher the unemployment rate, the lower the workers' bargaining power and the higher taxation on wages*[8]. As regards the tax system, in particular, one can argue that taxes cannot be levied either on banks or on capitalists. In the first case, this happens because since banks provide monetary resources to the State by purchasing State bonds, they have a higher bargaining power in the political arena than workers, who – with a unitary propensity to consume – do not buy State bonds[9]. In the second case, if big corporations find it *convenient* for the Government to reduce net public spending, they *can* achieve this result by exploiting their superior bargaining power with workers. In particular, in line with what is suggested by contemporary Institutional scholars (cf., among others, Bowles and Gintis, 1986), big firms can orient economic policy by means of the threat of delocalization – the so-called capital strike[10]. As a result, economic policy (and, particularly, the tax system) does not reflect any criterion of efficiency, but is solely designed on the basis of the bargaining of banks, capitalists and workers in the political sphere.

More generally, in line with O'Connor (1973), it is to be considered that the Government pursues two (potentially contrasting) aims: on the one hand it has to facilitate capitalist reproduction; on the

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[6] As Ramskogler (2007) points out *i)* in a capitalist economy, uncertainty is not evenly distributed among social classes and *ii)* workers, in particular, suffer from higher levels of uncertainty, due to job insecurity.

[7] Velucchi and Viviani (2011) find that labour productivity in Italian firms is mainly driven by innovativeness (number of patents), human capital and internationalization. They also find a robust correlation between leisure and productivity: as working hours decrease, work intensity increases. Note that this latter effect – although not empirically verified – was theorized, among others, by Francesco Saverio Nitti, an Italian economist and politician of the beginning of the 20th century.

[8] This issue has been clearly addressed by O'Connor (1984, pp.202 ff.): "the employment struggle [goes] along with demands for state intervention in the economy". He adds that "Keynesian theory was in part the unintentional *result* of the working class struggle, not only a doctrine used to legitimate working-class demands".

[9] One can add that workers' bargaining power in the political arena also reflects their bargaining power in the labour market, so that the higher the unemployment rate, the more the Government can tax wages.

[10] "The electoral prospects of an incumbent government depend on the general performance of the economy in the period preceding the election, particularly the level and growth of employment and personal income. The overall performance of the economy, in turn, depends on the level of investment. The level of investment in any given country depends on the anticipated domestic profit rate compared with expected returns in the rest of the world, and compared also with returns on non-investment uses of capital. Therefore the adoption of public policies that reduce the expected profit rate also tend to reduce the electoral prospects of the incumbent government" (Bowles and Gintis, 1986, p. 88).

other hand, it has to "legitimate" the existing social order. Considering that the "legitimation function" is in operation when wages and employment are at a level which prevents workers' discontent (Bohle, 2011), a continuous decline of wages (via increases of taxation on wages) is likely to produce the following effects.

1. Workers can react via social conflict and social conflict, in turn, is an undesired outcome for firms. However, although firms as a whole are interested in avoiding social conflict, a deregulated labour market tends to create the conditions for conflict to occur. This happens due to a "lack of composition" effect. While, under given circumstances, the individual firm finds it profitable to cut wages and employment, the resulting increase in worker discontent – if it translates into social conflict – damages firms as a whole. Moreover, while the individual firm expects its profits to increase as taxation on profits falls, this effect is nullified on the macroeconomic plane. This is because a reduction of taxation on profits, in an institutional setting which impedes expansionary fiscal policies, involves an increase in taxation on wages and, hence, a decline of demand and the consequent decline of aggregate money profits. Social conflict which can occur both inside (for instance, a voluntary reduction of labour intensity) and outside the firm (for instance, a general strike) produces a double effect: in the first case, social conflict involves an increase in the cost of surveillance for firms; in the second case, strikes or criminal acts entail an increase in taxation for paying unproductive labour – so-called guard labour (Bowles and Gintis, 2007). In a condition where wages cannot be further taxed, the tax burden is levied on capitalists with the consequent decrease of long-term profits.

2. Firms (at least partially) can translate taxation into prices increases (Graziani, 2003), which depends on the market structure where they operate, leading to the decline of real wages (even in the absence of a direct taxation on wages) and the decline of aggregate demand in the ensuing production periods.

3. More importantly, taxation on wages involves a *deterioration of the quality of the workforce*. In fact, a decline of the net real wage is associated with lower education and poorer nutrition, which, in a long-run perspective, reduce the rate of growth of labour productivity and, hence, profits. Accordingly, *in a long-term perspective taxing wages reduces profits more than taxing profits.*
These effects can be considered relevant by the Government when deciding the direction of economic policy and the size of possible variations in public spending. In other words, the Government intervenes to 'legitimate' the existing social order, preventing the social costs of capitalists' short-sightedness, to the benefit of long-term profits. If this is the case, it may happen that public expenditure increases as unemployment increases[11]. Moreover, insofar as social conflict involves an increase in unproductive public spending on repressing conflict, the Government may find it convenient to *prevent* more than *repress*, via a current increase in money transfers to workers in line with its legitimation function.

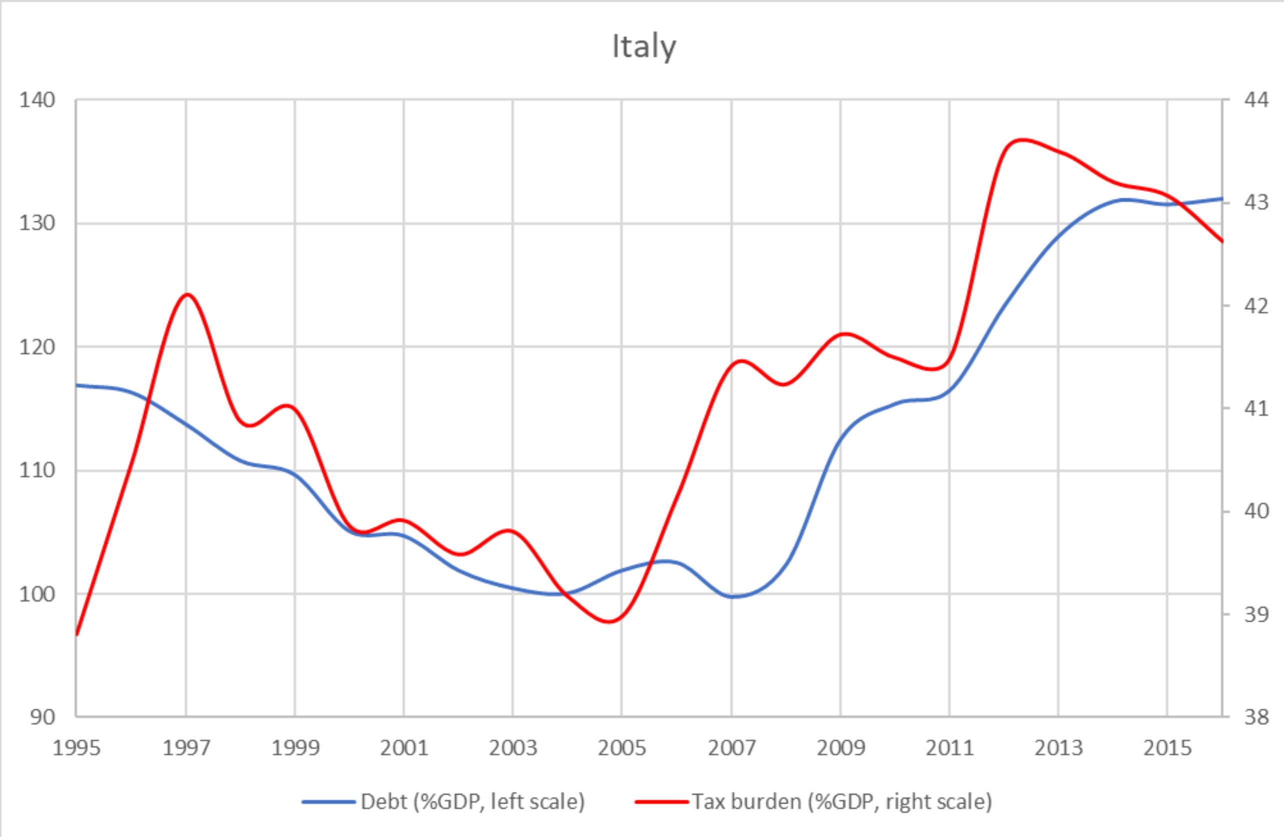
The conclusion one can draw from the argument of this section is that – following Marx and Kaldor – increasing public debt may have positive or negative effects on economic growth. The outcome basically depends on the *quality* of public spending, transfers and tax burden distribution (cf. Parguez, 2002; 2007). As stated by Rowthorn (1974), in a Marxian theoretical framework, higher

[11] As O'Connor (1984, p.201) remarks: "Keynesianism tries to legitimate this role by presenting itself as animated by the desire for 'improvement' and social reform". It is worth noticing that – in this theoretical context – there are no exogenous constraints on public debt. If constraints exist, they are imputed to *political* decisions. This is because, as Parguez (2011, pp.80-81) points out, "contrary to the widespread opinion, the state is not obliged to sell bonds to finance its deficit. Indeed, the sale of bonds is just an offsetting operation substituting bonds earning interest for excess reserve or liquidity earning no interest". Moreover, "the growth of public debt counteracts an increase in private net wealth", thus increasing aggregate demand, and "the state deficit accounts for tangible and intangible public investment" giving rise to a "public wealth effect".

public spending on welfare services boosts labour productivity, thus stimulating economic growth. Kaldor shared a very similar approach, arguing that redistributive economic policies increase aggregate demand because workers have a higher propensity to consume than capitalists. Combining these views, one reaches the conclusion that it is not increasing public spending in itself, but increasing public spending for redistributive purposes that drives economic growth.
In particular, policies of raising taxes on labour (following tax cutting on profits) reduce the growth rate, insofar as they have a negative effect on disposable income, thus depressing consumption, aggregate demand and, due to the operation of the Kaldor-Verdoorn Law, the rate of growth of labour productivity.

As regards the Italian case, figure 5 describes the dynamics of GDP, public debt and the tax burden (excluding social security contributions) over the period 1995-2016, in comparison with that of Germany (considered the best performing large country in the Eurozone). The two countries under scrutiny are characterized by the same fiscal rules, but the starting point is radically different. More specifically, the public debt to GDP ratio in Italy in 1996 was about 116%: this figure was twice as high as public debt in Germany and France. Italy substantially increased its tax burden in the mid '90s; this policy, combined with a favourable business cycle, allowed Italy to reduce its public debt.

As a result, until 2005 the tax burden was in a declining path after its initial peak. However, the Italian government soon reversed its policy by increasing the tax burden in the same years when public debt began increasing again. Clearly, this figure was affected by the Great Recession which hindered the fiscal effort to reduce public debt even if the tax burden increased. This graph shows that an increase in the tax burden can be completely ineffective in reducing public debt as it may reduce the tax base, making the recession dynamics more persistent. In the case of Germany, we observe a smoother path for both debt and tax burden. This is probably due to the considerably lower initial debt level that made it easier to follow a more countercyclical fiscal policy. After the Great Recession, public debt increased in both countries, especially in France, where the tax burden was substantially raised and in 2016 it was higher than in Italy.



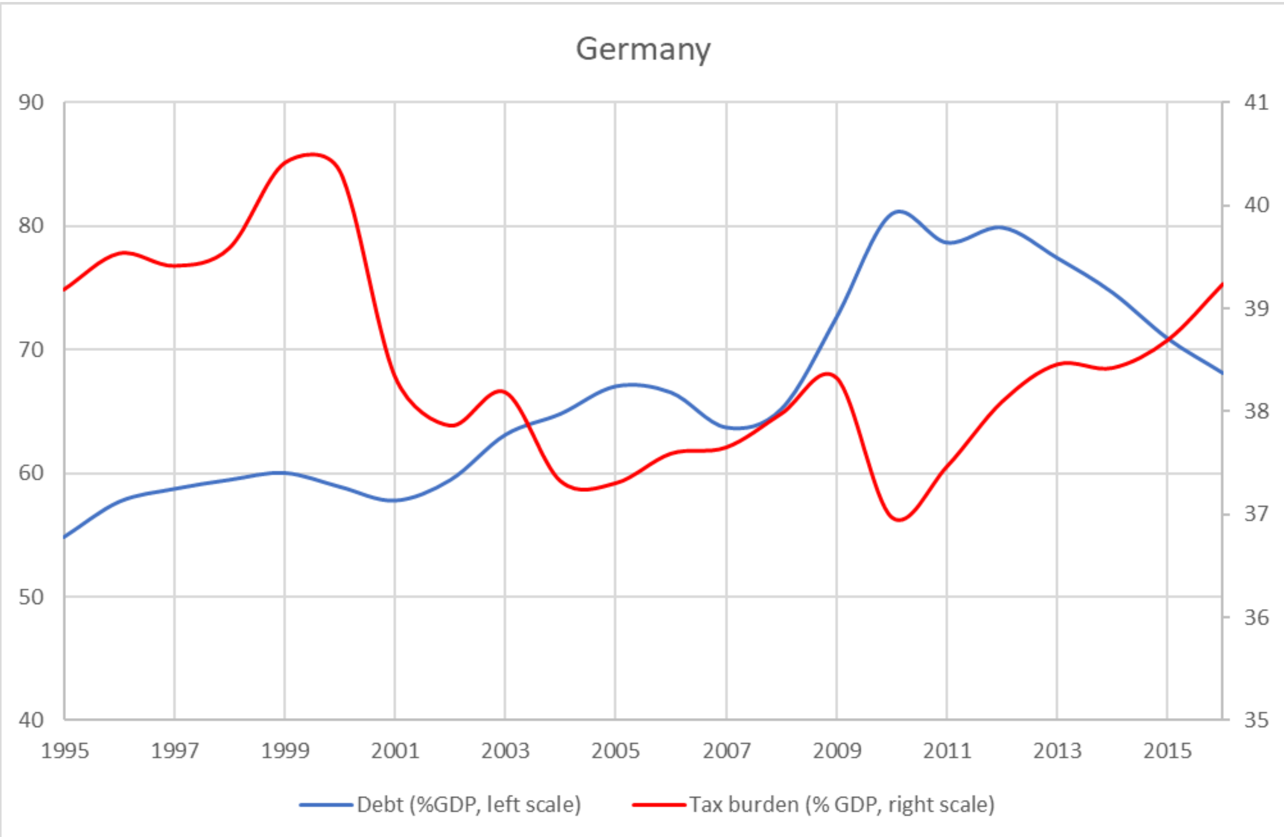


Figure 5: Public debt and taxation in Italy and Germany (source: our elaboration of OECD data)

These arguments are in line with Paolo Sylos Labini's view (1986) that the path of labour productivity depends on the wages to profits ratio (what he labels the Ricardo effect) and on aggregate demand (what he labels the Smith effect), i.e.

$$\pi=bY+c(W-pk) \qquad [1]$$

where π is labour productivity, b and c are the coefficient of acceleration (capturing the intensity of the reaction of firms and their induced investment in innovation as a response to increases in wages and demand), Y is aggregate demand, W is wage and pk is the price of capital goods. The extension proposed here refers to (i) the effects of labour market deregulation on both the propensity to consume and labour productivity; (ii) the effects of higher labour taxation on labour productivity. As a result, in formal terms, the labour productivity function is an augmented version of Sylos Labini's productivity function, i.e.:

$$\pi=bY(EPL)+c(W-T-pk),\ f'_{\pi/\mathrm{EPL}}>0;\ f'_{\pi/\mathrm{T}}<0 \qquad [2],$$

where T is labour taxation. Equation 2] establishes that labour productivity decreases in EPL and falls as taxation on labour increases. It provides a formal rationalization of the arguments proposed above. Moreover, in a CCC approach, an increase in wages can be both the cause and the effect of an increase in investment. An exogenous increase in investment boosts employment, which, in turn, due to the Marxian effect of the industrial reserve army, produces higher wages and, on the basis of equation 2], greater labour productivity.

A further vicious circle is generated by wage moderation. It contributes to generate deflation. Deflation, in turn, increases the real interest on State bonds, involving higher labour taxation and, in view of the argument proposed here, lower productivity growth and recession.

4 - Concluding remarks

This paper dealt with the Italian recession combining analytical issues deriving from Marx and Kaldor. It has been shown that the Italian recession started in the early 1990s and was accelerated by the adoption of a liberal agenda: mainly, labour market deregulation and taxation on labour with the aim of repaying the constantly rising public debt. These measures reduced domestic demand involving a reduction of the growth of labour productivity and of GDP growth. This, in in turn, increased the public debt/GDP ratio leading to increased taxation mainly at the expense of workers. Finally, the reduction of net wages made labour productivity grow even more slowly because of the deterioration of the quality of the workforce.

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