Labour Costs and Employment in Italy and the EEC*

In 1960, the Statistical Office of the European Communities conducted the first survey of labour costs in the six member countries of the Community. The results were reported in *Social Statistics*, No. 3, 1962. An article published in the same year by this Review examined Italy's position with respect to labour costs in comparison with the other member countries.[1]

These were the early years of the integration of the European economies when there was still considerable anxiety regarding the effects of the complete abolition of customs barriers. There was therefore particular interest in comparing the first "harmonized" data on this important component of costs. Since then, fifteen years have gone by, and we are in a period of great uncertainty as regards international prospects and of profound disequilibria between different countries. Labour costs have again come to the fore as one of the crucial problems on the agenda. This is particularly the case for Italy. The present article examines the relative position of Italy in the following respects:

— labour costs per unit of output and their role at the national and international level in the formation of costs and prices;

— changes in exchange rates and their corrective effects on competitivity;

---

* The authors wish to thank Professors G. Fuà and E. Tarantelli for the comments and suggestions. Naturally all responsibility for the conclusions reached and errors committed rests with the authors.

1 C. VANNUTELLI, "Labour Cost in Italy" in this *Review*, No. 63, December 1962.

— domestic distribution of income in relation to levels of remuneration for wage and salary earners, to the total number of workers with employee status and to the level of per capita income; and

— links between wage trends, productivity trends and employment rates in Italy and in the other Community countries in relation to conditions in their domestic economies.

Labour Costs and Competitivity

The tendency of Italian labour costs to come into line with European levels was one of the most important developments of the 'sixties. In the 'seventies, the tendency was reversed. A comparison between the labour costs of wage-earners in the individual countries, expressed in a common unit of account (EUR) shows that, in 1976, Italy had markedly lower costs than most European countries. At current prices and rates of exchange,[2] the Italian figure was 27 per cent lower than the Community average and 50 per cent below the country with the highest labour costs — the Netherlands. Only Great Britain and Eire registered lower levels than Italy (column 1 of table 1). Even more significant differences emerge from a comparison with the levels of net earnings of European workers.

Even if we allow for problems of comparability, the differences are such as to call for a careful explanation which cannot be limited to considerations of changes in exchange rate parities.

Disturbances in international monetary equilibria in the last few years have certainly been of fundamental importance in causing these differences, but they provide a basis for a judgement of the effects rather than of the causes of the phenomenon. The origin of such marked divergences must be sought mainly in the evolution of the real, structural relations between the different economies which form the precondition of the changes in the rates of exchange. In particular — and abstracting from the delicate problems of statistical

2 A comparison in terms of EUR *at 1970 prices and rates of exchange* on the contrary brings out less striking gaps. For example, in 1976 the Italian level was 88 per cent of the EEC average and 64.4 per cent of the country with the highest cost — Luxembourg. But this comparison *per se* is of economic importance, since it refers to a system of prices and to an equilibrium between exchange rate parities which was seriously disturbed by the effects of the crisis. However, the comparison is useful as a benchmark for the evolution in real terms which has taken place since the reference period.

TABLE 1

AVERAGE LABOUR COSTS PER EMPLOYEE
AND GROSS PRODUCT PER EMPLOYED PERSON (p), IN 1976

Country	w	p	w : p as %	Index of domestic prices	w : p^{70} as %	Index of exchange rates	$w : p^{70}$ as %
Germany (Fed. Rep. of)	9,164	13,987	65.5	1.425	93.4	1.141	106.6
France	8,393	12,764	65.8	1.649	108.4	0.916	99.3
Italy	5,308	6,718	79.0	2.067	163.3	0.593	96.9
Netherlands	10,577	15,192	69.6	1.669	116.2	1.079	125.4
Belgium	9,394	13,794	68.1	1.636	111.4	1.028	114.5
Luxembourg	9,933	11,949	83.1	1.438	119.6	1.028	122.8
United Kingdom	4,883	6,976	70.0	2.136	149.5	0.590	88.3
Eire	4,821	6,043	79.8	2.261	180.4	0.590	106.4
Denmark	9,215	12,841	71.8	1.720	123.4	0.981	121.1
EUR 9	7,259	10,576	68.6	1.672	114.7	0.886	101.7
United States	9,491	14,253	66.6	1.463	97.4	0.787	76.7
Japan (*a*)	5,634	7,230	77.9	1.588	123.8	0.925	114.6
Differential: Italy/EUR 9	−26.9	−36.5	+15,2	+23.6	+42.4	−33.1	−4.7

Notes: The indices of domestic prices and exchange rates are on the basis of 1970=1.
w = labour costs per employee, in national currency at current prices.
w and p = labour costs per wage earner and gross product per person employed, in EUR, at current prices and exchange rates.
p^{70} = gross product per person employed in national currency at 1970 prices.
(*a*) The data for Japan relate to 1975.

Source: Calculations based on data in EUROSTAT, *National Accounts EAS, Aggregates, 1960-76*, Statistical Office of the European Communities, Luxembourg, 1977.

recording [3] — account must be taken of the fact that the data in question are expressed in *absolute values*, whose economic significance can be assessed only in relation to specific conditions in each country. For labour costs, the most pertinent reference point is productivity; for remuneration levels, the reference point could be the general standard of living expressed as per capita income.

The following analysis relates labour costs to average productivity,[4] taking into consideration, for 1976, the three central aggregates set out in table 1:

a) adjusted share of wages in national income;

3 In particular, the gaps in question refer to average values. It is therefore not possible to measure the extent of the dispersion and the characteristics of the distribution of the data. In the second place, the use of the official rates of exchange for the conversion of the national currencies into a common currency of account (in this case, EUR) is open to criticism since it takes no account of the differences in purchasing power of the currencies in the individual national markets. The consumer purchasing power equivalence rates calculated for the national capitals only and excluding important items affecting family expenditure, aim, in principle, at overcoming the difficulties of the comparison, but in fact are subject to limits which are by no means negligible. See EUROSTAT, *Survey of retail prices and equivalence rates of consumers' purchasing power* (Statistical Office of the European Communities, Luxembourg, 1975).

4 Within economic systems with very different *average productivity*, there can be productive units whose *specific level of productivity* is similar to that of the competing countries. In that case, a comparison between absolute monetary magnitudes of labour costs may be considered to be significant.

b) internal labour costs per unit of output;

c) external labour costs per unit of output.

a) The *adjusted share of wages in national income*[5] (see column 3 of table 1) brings out clearly the particular position of Italy when labour costs are related to current productivity. In 1976, this ratio (w:p) was 15 per cent higher for Italy than for the Community on average, and was in any case far higher than the levels of the major European countries.

The comparison of the data on labour costs (w) and the adjusted share of wages (columns 1 and 3 of table 1) brings out one of the basic contradictions which characterize the Italian situation. This is that, *in absolute terms, labour costs in Italy are among the lowest in the Community; in relative terms, that is, in relation to productivity, they are among the highest.* The differential with respect to the Community productivity average (−36 per cent), which is greater than that in labour costs (−27 per cent), indicates, on the one hand, an income distribution in Italy which is relatively more favourable to wage-earners and, on the other, is a synthetic indicator of a disequilibrium due to the fragility of Italian productive structures which are largely determined by the chronic dualisms (North/South, advanced/and backward sectors, and participation in/and exclusion from the labour market).[6]

Naturally, we cannot confine ourselves to a mere listing of cross national differences in the labour costs/productivity ratio; this survey

5 In the terminology of international economics, "the adjusted share of wages" is the ratio of labour costs per wage earner (w) to the gross output per person employed (p). The "share of wages" is derived from the comparison of total income from wage-earners (W) and domestic gross product (Y). This is "adjusted" for the effect of wage-earning employment on total employment ($E_d:E_t$). We thus obtain:

$(W:Y):(E_d:E_t)=(W:E_d):(Y:E_t)=w:p$

The adjusted share of wages in the study of income distribution a factor of homogeneization ($E_d:E_t$) permits valid comparisons over time and between different economic structures by reducing the phenomenon of heterogeneity.

6 These dualisms are brought out by the marked gaps in the levels of productivity (and in rates of employment) between areas, productive sectors and firms of different sizes. The correspondence between gaps in remuneration and gaps in productivity is fully documented, for example, in the ISTAT surveys of gross industrial output. (The most recent figures, for 1975, are published in supplement No. 4 of the *Bollettino mensile di statistica* for 1977.) On this point and on related economic policies, see V. Lutz, *Italy, A Study in Economic Development*, London, 1962, and G. Fuà, "Sviluppo ritardato e dualismo" in *Moneta e Credito*, Vol. XXX, No. 120, December 1977.

should be supplemented by a series of considerations regarding the character of the individual structures which the levels of productivity measure too succintly.[7] In the case of Italy, the relatively high level of the adjusted share of wages is also influenced not only by the low level of productivity, but also by other important structural characteristics of employment and income distribution to which reference will be made below.

b) *Internal labour costs per unit of output* are given by the ratio ($w:p^*$) of labour costs per wage or salary earner, expressed in terms of the national currency at a given point in time, and productivity in physical terms related to the prices in a base year (1976) necessary to obtain a unit of real resources expressed in base year (1970) prices.[8]

The choice of the base year is of fundamental importance in the determination of the level of the internal labour costs per unit of output. For the present study, we selected 1970, which was the year immediately preceding the world monetary (and subsequently economic) crisis, and is of particular interest for Italy, since it was in the "hot" autumn of 1969 that the profound changes in the balance between wages and productivity were to begin.

The analysis of the data in table 1 brings out the fact that *in 1976 internal labour costs per unit of output in Italy, on a 1970 basis, were 42 per cent higher than the Community average. Italy*

7 The productivity to which we refer is usually defined as "apparent", since it does not so much reflect potential productivity as the effective use of the productive capacity of labour and capital; it is an indicator which synthesizes real and monetary conditions on the one hand and structural and cyclical conditions on the other.

8 Reference is usually made to the *index* of the internal labour costs per unit of output and to its variations in order to express the change in the conditions of competitiveness in relation to the base year. Here on the contrary, we are considering the *level* of the internal costs. For the purposes of comparison, the index allows us to analyze the dynamic modifications (cyclical and/or structural). The level lends itself better to a study of the differences between various productive structures. Both the level and the index (and its relative variations) are the result of the combination of a static aspect, related to the period in question, and a dynamic one, related to the period between the base year selected for the evolution of the prices and the period examined. Unlike the adjusted share of wages in national income, the internal labour costs per unit of income are decisively influenced by the price trend which in turn they help to determine. Their level can also be calculated by starting from the adjusted share of wages in the national income, multiplied by the index of internal prices in relation to the base year (see columns 3, 4 and 5 of table 1).

had the highest level of all the Community countries with the exception of Eire.

The economic explanation of this very marked differential cannot be sought exclusively in the traditional conception according to which the internal labour costs per unit of output indicate the intensity of the cost push caused by a wage increase which is not adequately offset by increases in productivity. For, in a period of severe inflation, wage increases expressed in monetary terms include a high proportion of purely nominal increases in remuneration which merely help to make up the losses in purchasing power caused by inflation. In other words, in conditions such as those characterizing recent economic developments, the level of internal labour costs per unit of output is influenced to only a modest extent by real increases in remuneration, and is largely determined by a variety of inflationary pressures, especially those originating abroad and operating through import prices. In situations such as these, internal labour costs and their variations lose much of their significance as indicators of cost push, but are of decisive importance in revealing the intensity of the mechanisms for retransmitting prices to costs.

TABLE 2

EVOLUTION OF INTERNAL LABOUR COSTS PER UNIT OF OUTPUT IN 1976: PRINCIPAL FACTORS INVOLVED

	Italy	EUR 9	Italy/EUR 9
a) 1970 *adjusted share of wages* (w:p) . . . . 1970-76 (1970 indices=1)	70.8	64.8	1.093
b) *variation in the adjusted wage share* ($\dot{w}^*:\dot{p}^*$)	1.116	1.060	1.053
· variation in real labour costs ($\dot{w}^*$) . .	1.302	1.275	1.021
· variation in real productivity ($\dot{p}^*$) . .	1.167	1.203	0.970
c) *variation in internal prices*	2.067	1.672	1.236
· import prices	2.870	1.919	1.496
· coefficient of absorption of import prices	1.388	1.148	1.209
d) 1976 *internal labour costs per unit of output*, on 1970 basis . . . . . d = a×b×c	163.4	114.7	1.425

Note: Differential in internal labour costs per unit of output in 1976 (42.5 per cent) due to:
— initial disequilibrium (adjusted share of wages) (10.3 per cent);
— higher growth in Italy's adjusted share compared with that for Europe (6.9 per cent);
— higher growth of Italian domestic prices than that for Europe (26.3 per cent).

Sources: As for table 1.

As a first approximation, the crucial importance of components other than real increases in remuneration and productivity in price formation is indicated by the data in table. 2. The main point is that

the higher level of internal labour costs per unit of output in Italy in 1976 must in part be attributed to cyclical and structural factors, whether real or monetary, which, as early as 1970, had already pulled Italy's adjusted share of wages in the national income to 9 per cent above the Community average.[9] In addition, from 1970 to 1976, the Italian ratio registered a further increase, to which the slowing down of productivity may have contributed to a greater degree than did wage increases.[10] The latter factor explains — at least indirectly — a minor part of the differential between the labour costs per unit of output, even if the possibility should not be excluded that the higher increases registered by Italy in the adjusted share of wages may have contributed to the creation of indirect inflationary pressures. In any case, the higher level of Italian labour costs per unit of output in 1976 is strongly influenced by other components, especially the substantial differential between Italy and other countries with respect to the increase in import prices. The subsequent rise in living costs was in turn passed on in the form of increases in remuneration aimed at offsetting reductions in the workers' purchasing power. Even if we disregard other inflationary factors (for example, the huge expansion in Governments' financial requirements), there is no basis for the view that the excessive rise in internal labour costs per unit of output in Italy in the years 1970-76 is due exclusively or mainly to wage increases.

Whatever the pressures giving rise to, and forms of, internal adjustment between costs and prices, such a considerable gap in

---

9 Between 1960 and 1970, the adjusted Italian share of wages was always higher than the average European figure, with peaks in years of vigorous spurts of wage inflation (as in 1963) which were subsequently absorbed. In the 'sixties as a whole, labour costs in Italy increased in real terms by an average of 6.6 per cent a year compared with an increase of productivity in real terms of 6.0 per cent. In the Community as a whole (comprising nine countries), the average annual wage increase was 4.8 per cent, against an increase in productivity of 4.4 per cent. As a result, the increase of the adjusted share of wages in Italy's national income was much the same as that for the Community as a whole, since in Italy the larger increase in real wages was offset by a greater rise in productivity.

10 Between 1960 and 1975, Italy's adjusted share increased over the European one, even though the increase in labour costs slowed down more in Italy than in Europe. As regards real wages, on a yearly average, Italy went from 6.6 per cent in the 'sixties to 4.5 per cent in the years 1971-76, while the change in the EEC was from 4.8 to 4.5 per cent. The aggravation of the Italian situation is due to the decline in productivity. For the Community as a whole, the figure fell in the same periods from 4.4 to 3.2 per cent; in Italy, on the contrary, the percentage was more than halved — falling from 6.0 to 2.6 per cent a year. The decline in productivity may be attributed in the main to the fact that production fluctuated and on the average was at modest levels.

Italian internal labour costs per unit of output would have priced Italy out of the market had corrective mechanisms not come into play.

c) The *foreign labour costs per unit of output* take account of the labour costs in the form of changes in the rates of exchange (w:p*). By this mechanism the labour component of the price of a country's products is adjusted on the international market by an amount corresponding to the changes in exchange parities.

In 1976, Italy's foreign labour costs per unit of output, taking 1970 as base year, stood at 97, against 163 for the corresponding internal figure for labour costs; [11] the difference is to be attributed to devaluation which over the period totalled 69 per cent.[12]

In practice, repeated devaluations over the period 1970-76 allowed Italian products to regain competitivity, which had been lost in part as a result of the particularly rapid increase in domestic labour costs per unit of output. Such a mechanism may strengthen competitivity, but does not correct — it may even aggravate — through the increase in import prices the pressures on costs directly reflected in the internal labour costs per unit of output. That mechanism, moreover, does not modify the level of the adjusted share of wages in national income, and hence leaves unchanged the pattern of income distribution, which in Italy favours the expansion of consumption more than the financing of investments.

It should be noted that, but for the 1976 devaluation of the lira by 22 per cent, the external labour costs per unit of output (with 1970 as base year) would in that year have reached a level for Italy — about 118 — which would have seriously endangered the competitivity of the Italian economy. It is therefore only fair to credit devaluation with having sustained, albeit somewhat precariously, the productive recovery of 1976 which was largely export-oriented. At the same time is should be pointed out that this decline in the exchange rate of the lira, which was widely regarded as far

11 This means that in 1970, in order to obtain 100 units of output in Italy, 71 current lire had to be earmarked for labour costs, against an average of 65 in the Community. In 1976, to produce the same 100 units within the Italian economy, that is, disregarding variations in the rates of exchange, 163 current lire were needed, against 115 on average in the Community. If, however, we take account of variations in the rates of exchange, that is, of the real terms of international trade in 1976, the relative money costs fall to 97 current lire for Italy, against 102 for the Community, with a gap (in this case, in Italy's favour) of the order of 5 per cent.

12 The percentage rate of devaluation (68.6 per cent is the reciprocal of the index of variation of the rate of exchange given in table 1 (0.593).

from inevitable, after a very short interval refuelled the domestic fires of inflation, thus giving a further impetus to the rate of increase in internal labour costs per unit of output.

Remuneration and Distributive Aspects

As already observed, workers' net remuneration in Italy, compared with those in other countries, gives an even more unfavorable picture than that of labour costs. Average earnings in Italy, expressed in terms of current prices and rates of exchange, were in 1976 32 per cent below the Community average, while the corresponding differential for labour costs was 27 per cent. The difference can be explained if we take account of the fact that employers in Italy pay a greater proportion of total social security contributions.

TABLE 3

TAKE HOME PAY PER EMPLOYEE (r), GROSS PRODUCT PER INHABITANT (q) AND ADJUSTED DISTRIBUTIVE SHARE (r:q) FROM 1970 TO 1976

Country	r	q	r:q	r^{70}	q^{70}	Variation in prices and exchange rates: 1976 index (1970=1)	r	q	r:q
	in 1970, in EUR			Real domestic increases: 1976 index (1970=1)			in 1976, in EUR		
Germany (Fed. Rep. of)	3,348	3,058	1.095	1.216	1.144	1.626	6,617	5,690	1.163
France	2,931	2,775	1.056	1.285	1.233	1.510	5,687	5,168	1.100
Italy	2,264	1,727	1.311	1.285	1.134	1.226	3,568	2,401	1.486
Netherlands	3,052	2,429	1.256	1.156	1.171	1.801	6,355	5,122	1.241
Belgium	3,165	2,619	1.208	1.292	1.197	1.682	6,879	5,271	1.305
Luxembourg	3,569	3,129	1.141	1.411	1.071	1.478	7,441	4,952	1.503
United Kingdom	2,686	2,193	1.225	1.177	1.116	1.260	3,983	3,085	1.291
Eire	n.d.	1,322	n.d.	n.d.	1.122	1.334	3,857	1,978	1.950
Denmark	4,163	3,160	1.317	1.295	1.127	1.687	9,097	6,006	1.515
EUR 9	2,910(*a*)	2,458	1.184(*a*)	1.217(*a*)	1.159	1.481	5,246	4,219	1.243
United Stated	n.d.	4,789	n.d.	n.d.	1.151	1.130	n.d.	6,228	n.d.
Japan	n.d.	1,899	n.d.	n.d.	1.208(*b*)	1.469	n.d.	3,371(*c*)	n.d.
Differ. Italy/EUR 9	−22.2	−29.7	+10.7	+5.6	−2.2	−17.2	−32.0	−43.1	+19.6

Notes: Data for 1970 and 1976 in EUR at current prices and rates of exchange.
(*a*) excluding Eire; (*b*) 1970-75; (*c*) 1975.

Sources: As for table 1.

Naturally the comparisons between absolute earnings are subject to limits of statistical significance of the same kind as those encountered in comparisons of labour costs. In particular, the gap may not in fact represent a corresponding difference in the standard of living of Italian workers, since the purchasing power of the individual currencies is not the same as that expressed by the official

parities; [13] in any case this does not bring out the relation between the income levels of salary and wage-earners and general per capita standard of living in the individual countries.

In a more thorough examination of these aspects, adopting the same method used in the analysis of labour costs, we examine a) the adjusted distributive share and its recent evolution; b) the increase in net real remuneration (ṙ*); c) the share of the gross margin (m) allocated to different incomes.

a) The *adjusted distributive share* allows us to relate the average remuneration per wage or salary earner to the gross product per inhabitant (r:q).[14] As shown in table 3, the comparison between the the level of absolute remuneration (r) and the adjusted distributive share brings out the contrast already noted as regards costs. *In 1976, in absolute terms, average remuneration in Italy, expressed in terms of current prices and rates of exchange, was the lowest in the Community, while, in relative terms, related to per capita income, it was on the contrary near the top.*

The high adjusted distributive share for Italy is certainly not due to a high average remuneration, but rather to the modest level of per capita income, which is the best indicator available of the level of the country's economic development. As will be seen, per capita income is directly proportional to the productivity per person employed and to employment rate. Hence, the fact that in Italy the values of both variables are considerably below the Community averages emphasizes the crucial aspects of the weakness of the system within which the distributive mechanism functions.

In the Community as a whole, income distribution was modified between 1970 and 1976 in favour of salary and wage-earners; the adjusted distributive share increased from 1.184 to 1.243. This means that, as in the 'sixties, there was a general tendency for

[13] Differences in the needs, environmental conditions, consumption patterns and ways of life of the European peoples make it very difficult (and not very meaningful) to make comparisons on the basis of a single "basket" of goods and services. For these reasons, the results of the EEC's effort to estimate the consumer purchasing power equivalency rates have not so far been very encouraging. See note 3.

[14] Just as was seen in note 5 for w:p, r:q represents the share of national income going to wage earners (R:Y) adjusted for the proportion of these workers in the total population (E_d:N). For, since r=R:E_d and since q=Y:N, we have r:q=(R:Y):(E_d:N). It will be seen that the wage earners' average remuneration and the average citizen's income, when related by r:q, link the distributive process with the structure of employment.

remuneration to increase more than income per inhabitant. This phenomenon is relevant here because it took place during a period of international crisis; it involved a substantial increase in the wage and salary payments (from 39.9 to 41.3) as a percentage of the increase in GDP; it was matched by a reduction in the ratio of employee employment to total population (from 33.7 to 33.2 per cent).[15]

In this context, over the same period the adjusted distributive share showed a tendency to rise in Italy too to a greater extent than in European countries as a whole. The effects of this redistributive process are even more pronounced, if we allow for the fact that in Italy, as opposed to what happened in the Community as a whole, employee employment as a proportion of the total population increased (from 25.1 to 25.7 per cent), although remaining far below European levels. This more extensive redistributive process in favour of wage and salary-earners is clearly indicated by the comparison of changes in the adjusted distributive share — r:q (see table 3) and of changes in the adjusted share of wages in the national income — w:p (see table 1). It is important to note that the difference between these two shares is entirely explained by the rate of total employment — overlooking the differences in the fiscal and parafiscal system which in any case to some degree offset each other.[16] Moreover, between 1970 and 1976, the differential between Italy and EEC increased more for the adjusted distributive share than for the adjusted share of wages. All this points to a marked tendency in Italy to grant increases in the retribution of employed employee workers at the expense of an increase in job opportunities for those in search of employment.

[15] The average total increase for the Community of 5 per cent from 1970 to 1976 in the adjusted distributive share indicates the tendency to increase remuneration at the expense of employee employment (which fell by 1.5 per cent), with a real redistribution of income in favour of employed workers.

[16] If employers' social security contributions are expressed by s, then w=rs, and, if the rate of total employment (i.e. the ratio of total employment to the population) is expressed by e_t, then e_t=E_t:N. Since p=Y:E_t and q=Y:N, we can link the adjusted share of labour costs (w:p) with the adjusted distributive share (r:q) and

$$w:p=(r:q)\ e_t s$$

In international comparisons, if we eliminate the difference attributable to s, the differential between w:q and r:q is given by the total rate of employment, e_t. Employment enters not only in the adjusted forms of the two shares, but also in the expression which defines the value of Y=E_tp and in that which defines the value of q=Y:N=E_tp:N=e_tp.

We can obtain a more precise picture of this phenomenon by measuring the extent to which there has been an increase in Italy in the real earnings of salary and wage earners and by identifying those structural mechanisms through which this increase has influenced employment rates.

b) The *increase in real earnings* (i*) is from the point of view of the workers of greater interest than the comparative levels of remuneration. It enables us to assess real improvements in standards of living over time and between different countries and avoid the distortions inherent in tentative estimates of real purchasing power due to the use of official rates of exchange. *Between 1970 and 1976 the rate of increase in real take home pay*, corrected for variations in retail prices, *was much the same for Italy as for most other countries*, even if very slightly above the Community average (see table 3), that is, after the very marked reduction in the differential between Italian levels of remuneration and those of the Community in the 'sixties (see table 6), Italy was able in the 'seventies to maintain its relative position.

This confirms that the increase noted above in the ratio r:q between 1970 and 1976 is mainly due to the relative decline in per capita income (q) which in turn reflects the more serious difficulties encountered by the Italian economy in that period (see table 3). The bargaining power of wage-earners over the period as a whole enabled them to defend their levels of remuneration and increase them to the same extent as in other countries, despite unfavourable growth conditions and a more modest increase in per capita income (see table 3). In this way, the real increase in remuneration contributed, on the one hand — by increasing the differentials in earnings — to encouraging the move out of underpaid self-employment to employee status, and, on the other — by reducing the self-financing of investment — tended to severely reduce Italy's chances of attaining European levels of employee employment.

TABLE 4

GROSS MARGIN FOR EMPLOYED PERSON (m) AND OTHER GROSS INCOME PER SELF-EMPLOYED WORKER RELATED TO PRODUCTIVITY (p) AND TO LABOUR COSTS PER EMPLOYEE (w) - 1976

(absolute values in EUR at current prices and exchange rates)

Country	m	l	m:p	m:w	l:p	l:w
Germany (Fed. Rep. of)	4,823	40.9	34.5	52.6	2.92	4.46
France	4,371	32.8	34.2	52.1	2.57	3.91
Italy	1,410	10.3	21.0	26.6	1.53	1.94
Netherlands	4,614	41.9	30.4	43.6	2.76	3.96
Belgium	4,400	35.7	31.9	46.8	2.59	3.80
Luxembourg	2,016	21.7	16.9	20.3	1.82	2.18
United Kingdom	2,093	32.4	30.0	42.9	4.64	6.64
Eire	1,223	9.4	20.2	25.4	1.56	1.95
Denmark	3,626	29.4	28.2	39.3	2.29	3.19
EUR 9	3,317	27.2	31.4	45.7	2.57	3.75
Differential: Italy/EUR 9	−57.5	−62.1	−33.1	−41.8	−40.5	−48.3

Notes: m=p−w difference between productivity per employed person and labour costs per employee, in EUR at current prices and wage rates.
l=L:E_a, where L=Y−W is the difference between gross product and income from wages and E_a=E_t−E_d self-employed labour; 1 in 1,000 EUR at current prices and rates of exchange.
w=labour costs per employee at current prices and rates of exchange.

Sources: As for table 1.

c) The *proportion of gross margin* (m) allocated to incomes other than those of wage-earners throws light on another important fact of the structural weakness of the Italian economy as regards both productive capacity and the rate of employment. The level of the gross margin, which in the first column of table 4 is expressed in European Units of Account at current prices and rates of exchange, is defined in this article as the difference between productivity per person employed and labour costs per wage and salary-earner (p-w).[17] In 1976, *the Italian margin, both absolutely and relatively, was decidedly below that of other countries.* For activities using wage-earning labour, the margin had to cover overheads, meet fiscal and financial charges, pay for amortization, and provide a return to entrepreneurs and share holders. For those activities carried out by self-employed workers, the gross margin represents the return on management, which includes remuneration for labour services. Structural differences are fundamental in the determination of the low Italian

17 The gross margin, as used here, includes, in addition to the remuneration of other factors, the difference between the income of self-employed workers and of entrepreneurs and that of wage-earners. By subsequent transformations we obtain m=p-w; mE_t=Y-w(E_d+E_a); M=Y-W_d-W_a where m=margin per person employed; p=productivity per person employed; w=cost of labour per wage or salary-earner; Y=E_tp; E_t=E_d+E_a; W_d=cost of wage and salary-earners in total; W=the notional return attributed to self-employed workers and entrepreneurs, whose amount per unit is analogous to that of the labour costs of wage and salary earners; and M=total margin. M therefore expresses the residual share of total income (Y) after deduction of remuneration and social security costs of the workers (wage and salary earners, self-employed workers and entrepreneurs) in the given hypotheses. It follows that M corresponds to the earnings of the other productive factors of production, plus the difference between the real income of entrepreneurs and self-employed workers and the notional return attributed to them on the basis of the hypotheses set out.

gross margin. In particular, the large number of low income self-employed workers (especially the peasants in the mountainous areas and the other poor regions, particularly in the South) drag down the Italian average both for productivity and for per capita income.[18]

These distributive questions are important. But no less important is the question of production. The gross margin represents the main source of business savings and self-financing of productive investments. The low level of this margin in Italy is therefore a serious obstacle to the expansion of productive capacity and to job creation. To a certain extent, it explains both the tendency of firms to prefer capital intensive investments which save labour and the excessive slowness in the process of reconversion and diversification of the productive structure.

Remuneration Structure, Distributive Shares and Employment

For the Italian economy, the process of European integration falls into two sharply distinct periods:

— the 'sixties, when the main aspects of the Italian economy were converging more and more with the other European countries;

— the 'seventies, when the Italian economic system was tending to diverge from the economically stronger areas in terms of its structural characteristics.

The data confirm that this trend continues. The " trade unions switch " to a policy of moderation at the beginning of 1978 does not yet seem to be able to have produced results of any consequence. Between 1976 and 1977, the Italian situation suffered a further deterioration, registering an increase in labour costs of 21.8 per cent in monetary terms and an increase of 3.2 per cent in physical terms, which corresponds to an increase in productivity in physical terms of only 1.3 per cent. Domestic labour costs per unit of output have thus shown an increase of 19.7 per cent, while the foreign figure, despite the 13.75 per cent depreciation of the lira in terms of the other currencies, has increased by 5.2 per cent. As a result of the

[18] The considerations expounded for m are also valid for l. This indicator, reported in table 4, also registers the highest of all differentials measured in this study.

steps taken in 1977 (assumption by the State of part of social security contributions, for example) labour costs increased by less than gross remuneration (25.7 per cent), while the ratio of average remuneration per wage-earner to gross product per capita (r:q) rose by another 4 per cent, thus widening still further the distances between

TABLE 5

TOTAL EMPLOYMENT (E_t) AND EMPLOYEE EMPLOYMENT (E_d) RESULTING IN ITALY IN 1976 FROM THE HYPOTHESISED ALIGNMENT WITH DISTRIBUTIVE SHARES (ADJUSTED SHARE OF WAGES = w:p, ADJUSTED DISTRIBUTIVE SHARE = r:q) (1)

Magnitude	Real 1976 levels		Employment resulting from alignment at 1976 EEC levels of:	
	Italy	EUR 9	*w* and *r* (2)	w:p and r:q (3)
w	5,308	7,259	**7,259**	4,130
p	6,718	10,576	9,187	6,020
w:p	79.0%	68.6%	79.0%	**68.6%**
r	3,588	5,301	**5,301**	3,016
q	2,401	4,219	2,401 (1)	2,401 (1)
r:q	149.4%	125.6%	220.8%	**125.6%**
s	1.479	1.369	1.369	1.369
E_t	20,072		14,678	22,398
e_t	35.7	39.9	26.1	39.9
E_d	14,436		10,550	18,554
e_d	25.7	33.2	18.8	33.0

(1) The exercise presented above uses a gross product (Y = 134,844 million of EUR at current prices and exchange rates) and 1976 population (N = 56,169 thousand inhabitants); hence, q = Y:N remains unchanged (2,401 EUR, with differential of −43 per cent between it and Community average).

(2) If goal is alignment of w and r (and hence s) to the Community average and keeping share w:p unchanged, p = 9,178. It follows that $E_t = Y:p = 14,678$ thousand units. Where W = 76,626 million EUR, unchanged, $E_d = W:w = 10,550$ thousand. The ratio $E_d:E_t$ which results from these data is 71.9 per cent, that of real data for 1976. It will be recalled that this ratio is the adjustment factor which makes it possible to move from W:Y to w:p. The ratio r:p (since r is aligned to Europe and q is inevitably linked to Italian economic and demographic conditions, as observed in note 1, rises to an exorbitant degree — 220,8 per cent.

(3) If we wish to align to Community levels, shares w:p and r:q, we can start from q (unchanged) and caiculate r = 3,016. Since s = 1.369 at Community levels w = rs = 4,130. For w thus calculated and for w:p aligned, we can determine p = 6,020. Hence $E_t = Y:p = 22,398$ thousand. As we know W and w, it is possible to determine $E_d = W:w = 18,554$ thousand. The e_t ratio reaches European levels because $e_t = (w:p):(r:q):s$ in which all the terms of the right side of the equation are at a European level. On the contrary e_d — although very close — is not aligned because $e_d = e_t:w:p)\,(W:Y)$ where e_t and (w:p) are at European levels, but W:Y expresses the real 1976 Italian situation as regards total labour costs related to national income.

Sources: As for table 1 and for r and s, EUROSTAT, *National Accounts EAS, Analitical Tables*, Luxembourg, 1977.

workers in the productive system and those forced to remain outside it.

The relatively higher wage increases in real terms in Italy fuel a continuous process of distortion of income distribution. In addition by setting in motion mechanisms which constrain the propensity to produce and invest, such increases have direct repercussions on level of employment, thereby compromising any prospect of growth.

In these specific circumstances, the conclusion seems unavoidable that a higher level of employment can only be obtained by means

of a growth strategy which involves, *among other things*, a diminution in the rate of increase in wages. But the implementation of any such plan presupposes above all a vigorous drive to ensure the adaptation of Italian productive structures. It is not enough, to achieve this end, merely to return to higher margins of self-financing.

With the sole object of bringing out crudely the dimensions of the employment-labour costs dilemma, we conclude by suggesting alternative hypotheses developed on the basis of the comparative statics of the relationships examined above. The estimates in table 5 should help us in forming a judgement, even if only of an indicative nature, regarding the consequences on employment of two opposite strategies for economic policy:

— the first would seek to align the remuneration structures (labour costs, take home pay, employees' social security contributions)

TABLE 6

LABOUR COSTS PER EMPLOYEE (w), GROSS PRODUCT PER PERSON EMPLOYED (p), INCOME PER INHABITANT (q), IN EEC (NINE MEMBERS), 1960-76

Year	Labour costs per wage earner (w^{70}) in EUR at 1970 prices and exchange rates			Labour costs per wage earner (w) in EUR at current prices and exchange rates			Product per person employed (p^{70}) in EUR at 1970 prices and exchange rates			Income per head of population (q) in EUR at 1970 prices and exchange rates		
	Italy	EUR 9	Italy/ EUR 9	Italy	EUR 9	Italy/ EUR 9	Italy	EUR 9	Italy/ EUR 9	Italy	EUR 9	Italy/ EUR 9
1960	1,848	2,492	74.16	1,182	1,714	68.96	2,622	3,874	67.68	1,078	1,693	63.67
1961	1,941	2,618	74.14	1,280	1,884	67.94	2,831	4,040	70.07	1,158	1,764	65.65
1962	2,084	2,730	76.34	1,456	2,050	71.02	3,038	4,206	72.23	1,222	1,821	67.11
1963	2,301	2,844	80.91	1,744	2,227	78.31	3,256	4,373	74.46	1,281	1,877	68.25
1964	2,419	2,979	81.20	1,952	2,430	80.33	3,354	4,603	72.87	1,304	1,970	66.19
1965	2,508	3,099	80.93	2,111	2,629	80.30	3,528	4,789	73.67	1,335	2,035	65.60
1966	2,646	3,205	82.56	2,279	2,821	80.79	3,790	4,954	76.50	1,403	2,090	67.13
1967	2,791	3,308	84.37	2.473	2,975	83.13	4,010	5,156	77.77	1,492	2.143	69.62
1968	2,956	3,470	85.19	2.658	3,106	85.58	4,266	5,427	78.61	1,577	2,240	70.40
1969	3,054	3,620	84.36	2,861	3,376	84.75	4,487	5.689	78.87	1,656	2,356	70.29
1970	3,326	3,856	86.26	3,326	3,856	86.26	4.695	5.942	79.01	1,727	2,458	70.26
1971	3,514	4,033	87.13	3,765	4,335	86.85	4,775	6,155	77.58	1,743	2,524	69.06
1972	3,666	4,204	87.20	4.131	4,833	85.47	4,988	6,416	77.74	1,785	2,609	68.42
1973	3,925	4,436	88.48	4,277	5,309	80.56	5,297	6,708	78.97	1,891	2,740	69.01
1974	4,082	4,656	87.67	4,694	6,021	77.96	5,428	6,813	79.67	1,948	2,773	70.25
1975	4,212	4.770	88.30	5,352	6.899	77.58	5,234	6,794	77.04	1,865	2,722	68.52
1976	4,330	4.920	88.01	5,308	7,259	73.12	5,480	7,140	76.75	1,958	2,848	68.75

Source: EUROSTAT, *National Accounts EAS 1960-1976*, Luxembourg, 1977.

with European levels; while the second would try to align the distributive shares (adjusted share of wages and adjusted distributive share) with corresponding European levels.

In the first hypothesis, the alignment of labour costs and remuneration in absolute terms with average European levels would involve

an increase in the former of 36 per cent [19] and in the latter of 48 per cent, reducing the proportion of the employee social security contributions from 48 to 37 per cent. This modified remuneration structure would tend to cause the equilibrium of the system to move, through a readjustment process characterized by capital intensive investment, to much lower levels of total employment and of employment of wage-earners than those levels operating in 1976. The achievement of such higher levels of remuneration would imply a corresponding increase in productivity, which, at such levels of

TABLE 7

RATIO OF LABOUR COSTS PER EMPLOYEE (w) AND PRODUCTIVITY PER PERSON EMPLOYED IN ITALY AND IN THE EEC (NINE MEMBERS) 1960-76

Year	Adjusted wage share ($w:p$)			Domestic labour costs per unit of output ($w:p^{70}$)			Foreign labour costs per unit of output ($w:p^{70}$)			Devalutaion of lira/EUR (index: 1960 = 100)
	Italy	EUR 9	Italy/ EUR 9	Italy	EUR 9	Italy/ EUR 9	Italy	EUR 9	Italy/ EUR 9	
1960	70.44	64.82	108.7	45.08	44.24	101.9				100.00
1961	68.56	64.93	105.6	45.21	46.63	97.0				
1962	68.61	65.06	105.5	47.93	48.74	98.3				
1963	79.12	65.02	121.7	53.56	50.93	105.2				
1964	72.14	64.72	111.5	58.20	52.79	110.2				
1965	71.08	64.74	109.8	59.84	54.90	110.4				
1966	69.84	64.76	107.8	60.13	56.94	105.6				
1967	69.80	64.28	108.3	61.67	57.70	106.9				
1968	69.29	63.63	108.9	62.31	57.23	108.9				
1969	68.07	63.34	107.5	63.76	58.99	108.1				
1970	70.84	64.99	109.0	70.84	64.89	109.2	70.84	64.49	109.2	100.00
1971	73.59	65.21	112.9	78.87	70.43	112.0	78.85	70.02	112.6	99.97
1972	73.49	65.12	112.9	83.65	75.32	111.1	82.82	74.91	110.6	99.00
1973	73.14	65.37	111.9	94.19	79.14	119.0	80.74	78.86	102.4	85.73
1974	76.53	67.85	112.8	112.49	88.38	127.3	86.48	87.84	98.4	76.88
1975	80.46	69.95	115.0	141.20	101.55	139.0	102.25	101.55	100.7	72.42
1976	79.01	68.64	115.1	163.33	101.67	160.6	96.86	101.67	95.7	59.30
1977	79.93	—	—	195.51	—	—	101.91	—	—	52.13

For 1960-70, internal and external labour costs per unit of output are the same owing to the unchanged parity of the lira with the EUR (European unit of account).

Notes: w = labour costs per employee in current national currency (for EUR 9, at current prices and exchange rates).
p = gross product per person employed in current national currency (for EUR 9 at current prices and exchange rates).
w^{70} = labour costs per employee, in EUR at current prices and exchange rates.
p^{70} = gross product per person employed at 1970 prices (for EUR 9, at 1970 prices and exchange rates).

Source: Calculations based on data in EUROSTAT, *National Accounts EAS 1960-1976*, Luxembourg, 1977.

---

19 The alignment, envisaged for labour costs, is in fact already operative in certain sectors in absolute terms. Indeed, for some, for example, credit (see EUROSTAT, *General Statistics of the Community 1977*, table 114, p. 145) Italian levels of remuneration are considerably higher than those of other European countries. In particular, it should be noted that, as regards industry, a decisive influence is exerted on the Italian average by the greater role of the sectors with a low value added and by the greater quantitative importance of small firms (see EUROSTAT, *Social Statistics* 6/1975) whose economic survival, given their modest levels of productivity, is ensured by their lower pay scales. The larger productive units, register absolute levels of labour costs which are much closer to the Community average.

potential gross output, would be translated into a drastic reduction in employment. In other words, were the remuneration patterns to converge, in *absolute* terms, Italian labour market participation rates would tend to diverge still further from the average levels for the Community.

The second strategy envisaged is the alignment of labour costs and remuneration in *relative* terms. This would involve a 13 per cent reduction of the adjusted wage share (w:p) and one of 16 per cent for the adjusted distributive share (r:q). In this case, we have adopted as a supplementary hypothesis the reduction in the proportion of employer social security contributions to European levels. In such circumstances, the equilibrium of the system would tend to move, through a process of readjustment characterized by labour intensive investment, to higher employment levels. More generous margins of self-financing are a prerequisite, but not necessarily a guarantee for the growth of productive capacity, while the reduced pressure for labour substitution by capital could create considerable scope for employment. On the basis of the simulations in table 5, in the second hypothesis employment rates would reach the Community average (40 per cent for total employment; 33 per cent for employee employment). But the creation of the additional job opportunities would call for a profound restructuring of labour costs per unit of output which would necessarily involve all three components — remuneration, employer social security contributions and productivity.[20] To conclude it is obvious that, if the difficulties in securing an expansion of production persist — the employment objective will clash with that of levels of remuneration.

These results have, we repeat, a purely indicative significance and, in view of the simplified nature of the exercise, should be considered with caution. However, they are logically confirmed by the sign of the trend which would emerge if, assuming that the conditions set out above hold good, one or other of the mutually opposed

20 The average reduction of productivity which according to the simulation would be 10 per cent above the levels actually recorded in 1976 — should be realized in such a way as not to affect the propulsive sectors and in general the sectors exposed to international competition. The index of productivity which is important for competitive purposes is the one measured on an hourly basis. A reduction of productivity per wage worker linked to a lowering of the working hours, might not adversely affect the level of productivity per hour. In addition, it is obvious that a substantial expansion of employment involves the absorption of labour with a lower productivity, which lowers the average level of productivity per wage earner. An estimate of this is given in table 5.

strategies of economic policy were adopted. The indications which our analysis offers underline the structural character of the divergences noted and the impossibility of simultaneously attaining objectives which are mutually incompatible. The tendency to obtain real wage increases in excess of the foreseeable increases in productivity and per capita income, in addition to aggravating the already serious disequilibra shown by distributive patterns, also implies a refusal to establish higher levels of employment as a priority objective.[21]

Rome

F. Cavallari - G. Faustini

21 As P. Sylos Labini has shown (*Prezzi e distribuzione del reddito nell'industria manifatturiera*, Rome, Faculty of Statistical Sciences, 1977), in Italy's experience as in that of other countries, wage increases going beyond increases in productivity, reducing the profit margins, contribute to a reduction in the propensity to invest. This does not of course mean that it is sufficient to reduce labour costs in order to increase employment if then investment programmes which are indispensable for the reconversion of the productive system are lacking. On the contrary it means that, since $q = p\ e_t$, at every level of per capita income (q) there is in the short term a choice between productivity per person employed and rate of employment. In the medium term, the problem is more complex, but in this case too it should not be forgotten that a widening of the margins derived from an increase in productivity is a necessary but not sufficient condition for new investments aimed at creating new jobs.