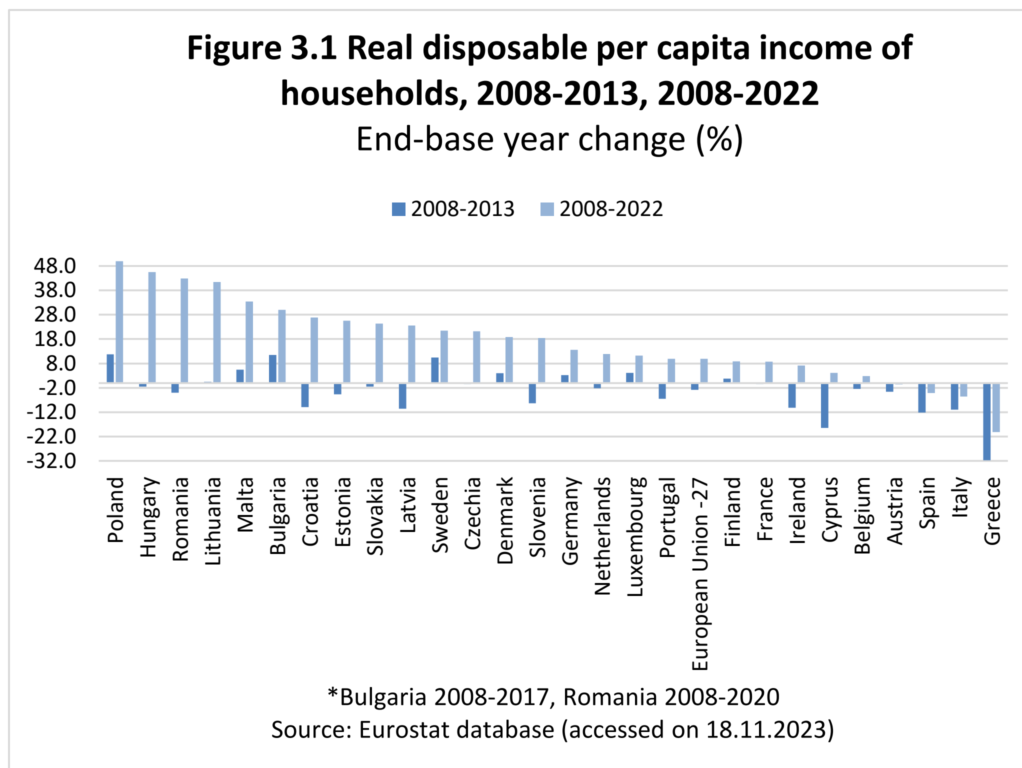
CHAPTER 3: Convergence/divergence between EU Member States since 2008

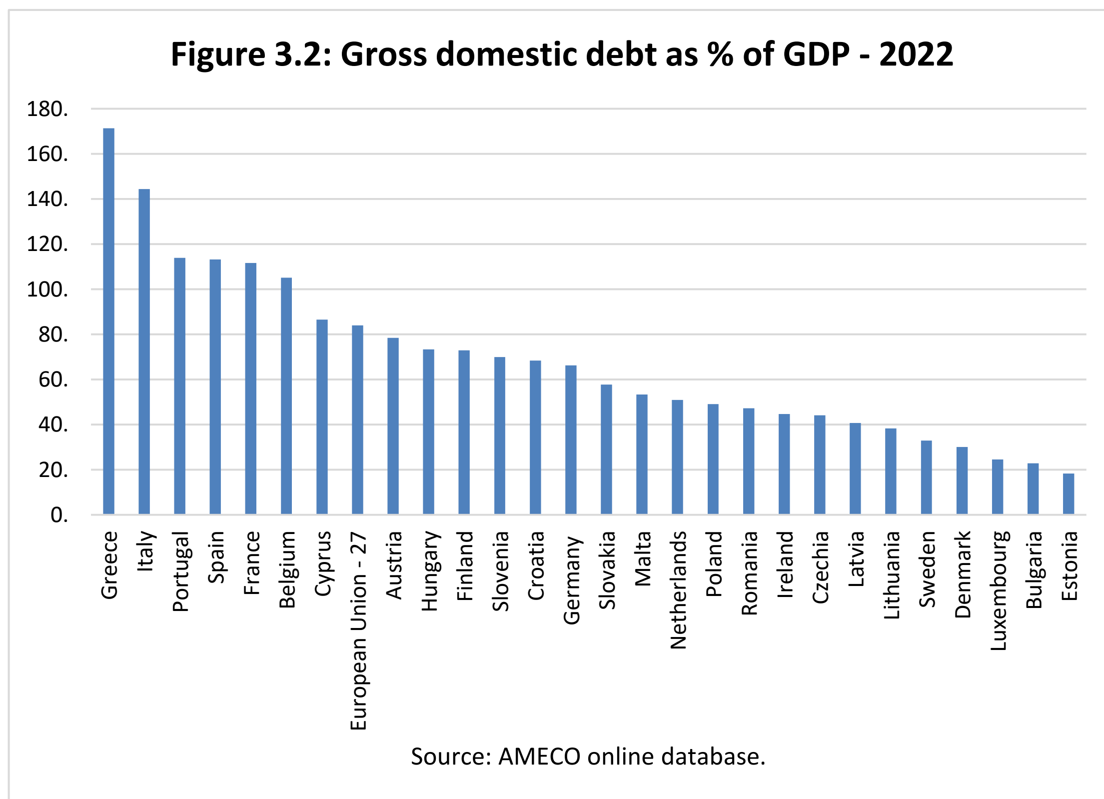
The global financial crisis, the Covid-19 pandemic and the ongoing cost-of-living crisis have significantly impaired the working and living conditions of households across Europe and are still affecting their wellbeing. Moreover, over the past fifteen years, economic and social divergences have increased both within and between EU member states undermining social cohesion and the legitimacy of the project of European integration. Rising inequalities have eroded social cohesion across the EU, including in the countries of its 'core', while economic and social divergences between member states have gone hand in hand, with contrasting trajectories in the old and new 'periphery' of the EU.

3.1. Contrasting trends of the old and new periphery

Between 2008 and 2022, the old southern periphery of the EU diverged from the countries of its core and the EU-average, while the new member states that joined the EU with the 2004, 2007 and 2013 enlargements - the new periphery - converged (Figure 3.1).

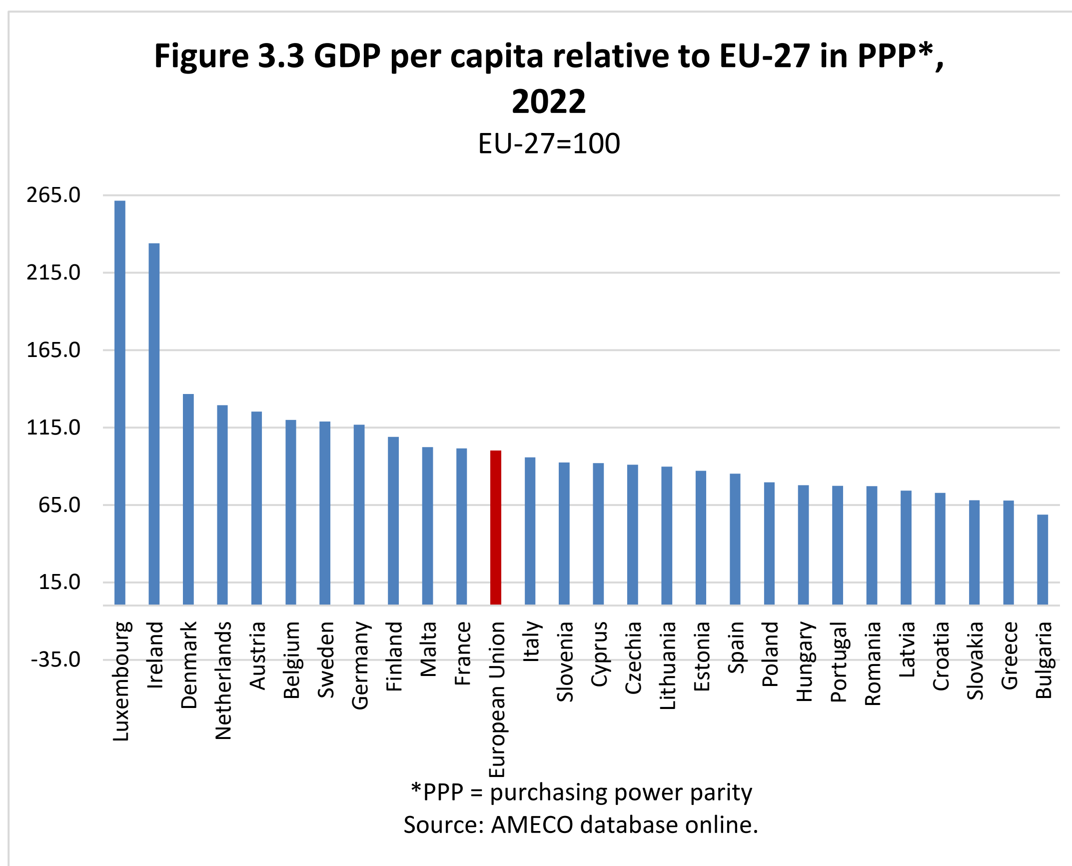


All new member states – except Poland, Bulgaria, Malta and Lithuania – were hit by the Great Recession between 2008 and 2013, some of them quite severely. Nevertheless, they were, on the whole, less affected than those of the southern EU periphery and experienced very strong economic growth between 2013 and 2022, which was only temporarily interrupted by the Covid-19 pandemic shock. By contrast, as a consequence of the sovereign debt crisis, Greece, Cyprus, Portugal, Spain and Italy implemented harsh austerity and internal devaluation programs that impoverished their populations, reduced wages and employee rights, weakened their welfare states and social cohesion, and impaired the productive capacity of their economies. Only Portugal and Cyprus managed to overcome the blow of the economic and sovereign debt crises 2013-2019 before the Covid-19 pandemic, while Greece, Spain and Italy have not yet recovered their pre-2008 productive performance and living standards. Having higher levels of public debt, the southern European member states lack the financial means to upgrade their industrial structures and welfare states or carry out a socio-ecological transformation of their economies (Figure 3.2).



Source: AMECO online database.

As for the new member states, despite economic and social convergence towards the EU average and their low sovereign debt-to-GDP ratio, the gap in GDP per capita between them and the ‘core’ EU member states is still very large, especially in the cases of Bulgaria, Slovakia, Croatia and Latvia (Figure 3.3).



3.2. The case of Italy

As is evident in Figure 3.1, Italy is an instructive case in this context, as an 'old', in fact founding member state and G7 member.

The stagnation of Italy's per capita income in PPP-terms can primarily be linked to low productivity over three decades. In the period from 1999 to 2022, while labour productivity in the EU-27 countries grew by 21.5% and real wages by 17.6%, Italy experienced a decline in both labour productivity and real wages. This decline was particularly notable during the years 2011-19. The gap in productivity compared to the EU-average has been attributed to factors such as productive specialization in low value-added sectors, labour market precarity, low investment in workforce-training, and a persistent North-South divide[1].

[1] Until 1980, Italy's productivity growth remained in line with other European economies. However, between 1980 and 2000, Italy began to lose ground compared to the European productivity frontier. Despite this setback, Italy continued to make improvements in productivity during that period. Since the year 2000, the country has entered a phase of slowing labor productivity growth. See: Cirillo, V., Reljic, J. (2024 forthcoming). The North-South Divide - A Structural Labor Market Perspective in Italy's fragmented Landscape. In U. Glassmann and C. Gräbner-Radkowitsch (Eds.), *The Political Economy of Italy and the Center-Periphery Perspective on Europe*. Metropolis Press.

The poor performance of the Italian economy is rooted in a combination of micro and macro factors. On the one hand, the fragmented industrial structure of Italian firms and the disappearance of some large state-owned enterprises, especially from the 1990s onwards, have impoverished the knowledge-base of the Italian productive sector leading to technological dependence, deindustrialization and a weakening of technological capabilities. The concentration of power in the hands of a few actors in key sectors – where competition is absent – together with the persistence of 99.9% of SMEs in the Italian economy, has resulted in Italy being the only European country in which average wages decreased over the 1990-2020 period (-2.9% when measured in USD constant prices, using 2016 as base year, and Purchasing Power Parities for private consumption of the same year). On the other hand, from a macro-perspective, several authors have highlighted the role played by stringent fiscal constraints imposed in the course of the EMU integration process,[2] resulting in austerity, wage moderation, lack of technological competitiveness, and a weakening of the capacity of Italian firms[3]. Industrial policy measures have been eliminated in response to EU competition rules.

The combination of counterproductive reforms, influenced by external constraints, demand compression, and labour market liberalisation, has resulted in a significant reduction in both public and private investment. Additionally, it has contributed to a rise in precarious and temporary employment.

The structural weaknesses of the Italian economy were aggravated by the 2008 financial crisis, the Covid-19 pandemic, and the Russia-Ukraine conflict. The surge in inflation has significantly impacted wages and the purchasing power of incomes, as Italian nominal wages have not kept up with inflation. At the end of June 2023 about thirty-one contracts covering about 6.7 million of employees were awaiting renewal. This can be attributed to the limitations of the Italian collective bargaining system in effectively addressing inflation[4]. But the rise in inflation has not affected all social groups equally; energy price shocks and mark-up shocks disproportionately impact the real income and consumption of low-skilled workers and individuals outside the labour force[5]. As a

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[2] Baccaro, L., Blyth, M., & Pontusson, J. (2022). *Diminishing returns: The new politics of growth and stagnation.* Oxford University Press.

[3] Storm, S. (2019). Lost in deflation: Why Italy's woes are a warning to the whole Eurozone. *International Journal of Political Economy*, 48(3), 195-237.

[4] Since 1992, Italy has moved away from wage indexation through the 'escalator' and adopted a regime of 'target inflation rate' for national-sectoral bargaining. Under this framework, wage indexation is replaced by the target inflation rate. From 2009 onwards, there has been a transition to using the *Harmonised Index of Consumer Prices* (HICP) net of imported energy prices as the primary benchmark for national-sectoral bargaining. This shift ensures that prices of imported energy goods are excluded from the calculation of planned inflation.

[5] As highlighted by ISTAT, households at the bottom of the income distribution allocate a significantly greater share of their income to the consumption of food and energy goods and are therefore more affected by inflation, in fact in Q4 of 2022, inflation, as measured by the HICP index, increased by 18.4% for the poorest quintile of households, while it increased by 9.9 % for the richest quintile. Moreover, the increase in the prices of products and services of which women are the biggest consumers, as well as the

consequence, it is of utmost importance to tackle structural weaknesses of the Italian labour market which represent the deep causes of the fall in real wages, the significantly expanded pool of working poor and of households that are living below the absolute and relative poverty line. Predictably, inflation has widened inequalities between social classes and within the labour force. Public mitigation measures (in the form of a monetary bonus and fiscal support), although substantial, have failed to curb the loss of purchasing power of lower and middle incomes and have not reversed the process of social polarisation that has been going on for decades.

Although the inflation rate is likely to decline in the coming months and years, this will probably not be sufficient for a recovery of the material conditions and the purchasing power for most of the working population. This is for several reasons. The most important of these are the weak and complex international macroeconomic framework, strong global geopolitical and economic tensions (see chapter 6); uncertainties over Italy's ability to fully exploit the resources made available through NextGeneration EU, and the return to restrictive monetary and fiscal austerity policies in the Euro area. More substantial actions are needed such as the renewal of collective agreements and the introduction of an inflation-indexed minimum wage. The latter, although not an exhaustive and comprehensive measure, could nonetheless help recover at least some of the purchasing power lost by those approximately three million employees who earn an hourly wage of below € 9 in Italy.

EU rules, especially those relating to wage moderation and flexibility, together with the reduction of the role of the state in industrial policy, have over the last decades supported Italian exports but have limited structural change in the economy. Especially the long-term strategy of wage moderation reduced the incentive for Italian firms to invest in and product innovation. As a result, Italian firms occupy a marginal and subordinate position in global and European value chains. Italian firms are increasingly dependent on parent companies in other EU countries, and are only moderately involved in high-technology and R&D-intensive activities. Hence, their marginality reflects that of the whole country in the current international division of labour: Italian industrial specialisation is weak and so is its future direction. The core-periphery industrial issue between the North and the South, that was an internal problem for Italy since its unification in 1861, has become a national problem. The last decades have seen the whole Italian economy declining from the centre to the periphery of the EU[6].

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concentration of women in sectors with low wages and where renegotiation of contracts is slower, had a huge impact on women, widening gender inequality.

[6] Guarascio, D., Heimberger, P., & Zezza, F. (2023). *The euro area's Achilles heel: Reassessing Italy's long decline in the context of European integration and globalisation* (No. 470). wiiw Research Report.

In political terms the role of Italy is more complex. Italian firms and institutions are relevant enough to represent the EU's Achilles' heel, exposed – as a result of high public debt and industrial crises[7] – to speculative attacks from global finance (as after 2008) and short-term takeovers, with technological assets being appropriated by foreign firms that are unwilling to commit to long-term investment in the country. This is connected also to the declining role of politics in Italy, due to several reasons, including corruption and the de-politicisation of society; but also to the declining role of trade unions, that is in turn linked to Italian de-industrialisation and the weaker shift of Italy's political economy to a knowledge society of technologically advanced services. After decades of an effective absence of an industrial policy, Italy is that much more in need of such policy. Without selectivity in public policy regarding the sectors and value chains where investment is more desirable, Italy will go on being dependent on the strategic decisions of global actors.

3.3. Reflection on policy developments in light of convergence and divergence

The EU has a historical record of promoting social convergence and cohesion between and within member states through its cohesion policy and the European Structural Funds. Income is redistributed through the EU budget between net contributors and net recipients. The Covid-19 pandemic crisis has been a catalyst for institutional innovation. The SURE program allowed member states to protect the jobs and incomes of workers and the self-employed, while EU cohesion policy was strengthened by a) the creation of the Just Transition Fund, to address or prevent social problems created in specific regions from the transition to climate neutrality and b) the NextGenerationEU which allocated resources in favour of the member states most affected by the Covid-19 pandemic crisis.

However, the efficacy of Cohesion Fund financing was diminished when the eastern enlargements were not accompanied by a larger EU budget; furthermore, the measures introduced during the Covid-19 pandemic appear to be temporary and exceptional. As illustrated in section 3.1, EU regional and social policy failed to prevent the deterioration of EU social cohesion between 2008 and 2022, mainly due to the economic and social divergence of southern Europe during the eurozone crisis. It is now clear that the green and digital transitions will exacerbate social inequalities in the absence of public funding not only to invest in up-/re-skilling and new jobs but also to provide income compensation to workers made redundant by the transition. Funding from

[7] Just to mention a few of them: ILVA in Taranto, the GKN subsidiary close to Florence and the Whirlpool one in Naples.

NextGenerationEU will be available until 2026 while that from the Just Transition Fund is clearly insufficient; thus, member states will shortly have to increase their own resources to prevent the deepening of social inequalities and protect social cohesion.

Also the reformed SGP (see chapter 1) will provide over-indebted member states, with very little additional fiscal room for maneuver, while remaining subject to even stricter EU-level controls of their compliance with the SGP and the European Semester. At the same time, these states will be adversely affected in their capacity to cope with ecological, technological and industrial transformation by the failure to render the NGEU permanent after 2026. The lack of national and European fiscal space is glaring at the current juncture, when member states are compelled to implement a restrictive fiscal policy in an international environment of higher interest rates.