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Inequality and Labor: A Comparison of the US and Italy

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Growth, Inequality, and the Role of Labor in the United States and Italy

How can the economy grow without producing massive inequality? This is one of the most important questions of the modern era. There are many competing theories about growth. Neoclassical economists argue that growth comes from reductions in regulation, taxes, and labor power, which in theory reduces the cost of doing business and increases supply and investment. Supply side growth occurs at the cost of greater inequality as corporations and the wealthy get a huge share of the income created. Certain post Keynesian economists such as Larry Summers would argue that high spending by the government and strong organized labor will grow the economy but drive inflation, so we should be careful and accept lower growth. This is also true in a way, but gives us a very short term frame of thinking. For these economists, inflation is the most dangerous economic disaster. Some left- Keynesians would argue that inflation is not something to worry about, and that growing the economy and keeping full employment is most important. While this argument may have had some merit in the past, at this point in the present it is clear that inflation is real and a real harm especially in the short term as rising costs primarily affect the middle and low income earners . What I and left- Keynesian economists would argue for now is a system that promotes growth, especially at times of economic recession through government spending and labor power. This is demand led growth. Keeping capital in line through regulation that preserves labor power and protection for consumers is vital according to this model, while both a long term investment strategy to increase supply and more progressive taxation would reduce inflation in the long run.

In this paper, I will examine two economies which, while similar in structure at a certain time, have diverged significantly: Italy and the United States. Each economy presents a set of major challenges: for the U.S. weak wage growth, inequality, and instability led by a large financial sector, and Italy, plagued with low productivity growth, high government debt, and overall economic stagnation. What paths they took, and their results, have informed my argument that left-Keynesian economic theory requires a major component of redistribution to avoid inflation.

Part One: The post-war period to the 1970s

Following the end of the second World War, Italy was in ruins. The Allies' campaign in Italy caused much destruction to physical infrastructure, and the removal of Mussolini and the Fascists party of Italy from power left a gaping political hole in government (Sassoon 1989). At the same time, the United States was growing economically, a result of both the wartime boom and the New Deal which together pulled the U.S. out of the Great Depression (Glyn 2007, EPI, Stiglitz 2010). At the same time the U.S. heavily invested in rebuilding Europe in order to ensure that the mistakes made in the aftermath of World War I were not repeated. Following the first World War, Germany was forced into paying reparations to the victors. The economic conditions that ensued led to the rise of the Nazi Party. Allied aid, especially through the Marshall Plan, was given to rebuild Italy and a new government was formed. Very quickly Italy was absorbed into the western capitalist world, and the far left was expelled from power. From here, Italy would take a somewhat similar trajectory to the United States, embracing a capitalist economy with a safety net (Sassoon 1989).

Both the U.S. and Italy saw high levels of growth in both productivity and wages throughout the postwar era, with both nations approaching full employment by the end of the 1960s. Over this time, both countries expanded their welfare states partially in response to relatively strong organized labor movements (Glyn 2007). Italy did not have the history of slavery and Jim Crow which had weakened the power of organized labor in the U.S. However, Italy did experience broad and severe regional inequality for many historical and political reasons, mainly that trade was centered in the North. Italy is natural resource poor making it much more reliant on imports than the U.S.. The position of Italy in its post war politics required that it engage in much more trade with its neighbors, because protectionist policies were associated with the fascist regime. However by the 70s, both countries faced economic circumstances that were very similar.

Full employment in both countries had strengthened labor power, which put pressure on profits and increased demand that supply could not keep up with. At the same time external political events, most famously the OPEC Oil Crisis led to supply shocks which raised prices of key goods. Finally, problems with how exchange rates were pegged wreaked havoc on the western financial system. For the entire capitalist system, this was the greatest economic crisis since the great depression (Glyn 2007). Inflation was high, profits were low, and real incomes were falling as a result of rising costs of living. How the U.S. and Italy reacted to this crisis was very different and crucial for understanding the economies of these two countries today.

Neoclassical economists who were most influential in the U.S. regarded inflation the biggest issue of the crisis; if they could get inflation under control then all of the other problems plaguing the economy, particularly low growth would be much easier to solve. To fight inflation the Fed raised rates to 18%, triggering a short but very intense recession (Klein 2022), which had the effect of both restraining wages and weakening the negotiating power of labor as unemployment soared. The crackdown on inflation ended the policy of full employment, an economic reality that weakened the bargaining power of labor. This allowed President Ronald Reagan to continue an anti- union crusade in the mold of the Thatcher government in England (Glyn 2007). Margaret Thatcher's government created policy which broke up unions. At the same time, Reagan began to institute a process of deregulation, especially of the financial sector. Deregulation would allow for new financial products which were very lucrative to banks while providing more credit to American consumers, raising demand. These new products were both highly risky and highly profitable. These products would have a dark side however, with many if not most poorly designed and failing to take actual ability to pay into account (Stiglitz 2010). At the same time, social programs were slashed and tax cuts for the rich were implemented. While wages stagnated as organized labor and the welfare state were dismantled, demand continued to grow as the financial sector became less and less connected to the real economy, giving credit to consumers who in the long run could not repay.

Italy was another story. In the Autumn of 1969, as much of the industrial North of Italy reached full employment, labor unrest began to mount. In what would be called the Hot Autumn, many workers, independent of unions, began to strike and protest for better wages and working conditions. In the political sphere the long ostracized Communist Party of Italy and their allies the Socialist party of Italy made major gains in the national parliament (Sassoon 1989). At this point employers in Italy, led by Fiat, had agreed to several union demands pushed by the CGIL, a communist labor union, including a scheme to index wages to inflation. At the government level, the long governing Christian Democrats were forced to make major concessions to the left. This included limits on deflationary measures, higher spending especially in the South of Italy, much stronger labor protections, and limits on how much the middle class could be taxed. While the Christian Democrats made good on some of these pledges, especially labor law reform, others, including the spending program in the South, were seen as lackluster or without teeth, as the program was not effective at reducing regional inequality. In the 1980s, some of the labor protections were repealed and the wage indexing scheme was weakened. At the same time, many unions agreed to at least some form of wage restraint to hold down inflation. However, labor remained much stronger in Italy than in the United States (Sassoon 1989). At the same time, wages and productivity were still growing hand in hand (OECD). This is not to say that there weren't issues, inflation was higher in Italy than most of the world, while the government debt was growing to unsustainable levels. However, by most measures income distribution in Italy would remain more equal than the U.S. (Glyn 2007).

Today we see the U.S. as an economic powerhouse while Italy is often seen as an economy that has lagged behind. However at the beginning of the 1990s, it was actually Italy's productivity that had grown more rapidly, indeed briefly surpassing the US when measured by GDP per hour worked. Here we see that the path of neoliberalism embraced by Reagan and the economic establishment at the time did indeed grow wealth, especially for the already wealthy and corporations, but did little to grow real wages for middle and working class families. Any increase in the standard of living was an illusion driven by expanded access to credit that was not sustainable. However we also see flaws in the Italian model, where a certain left- Keynesian approach was taken. Italian's wages and productivity were growing, but at the same time inflation and government debt was rising. Increased institutional problems resulted from this, the black market flourished and tax laws were not enforced which contributed to the spiral. Neither of these outcomes is desirable, but things were not yet at a breaking point for either country.

Part Two: Neoliberalism and the 90s

Both countries would continue the policies implemented in the 1980s until the turn of the century. In the 1990s the US and Italy were both seeing periods of productivity growth, yet wages were rising in Italy and stagnant in the U.S.. At the end of this period the productivity growth of both countries diverged, leaving Italy's economy to stagnate and the American economy to grow despite the fact that wages in the U.S. had been stagnant for years at this point, while the wages of Italians were still growing.What changed was the financialization of the American economy and the restrictions on economic policy mandated by the EU. The deregulation of the financial sector in the U.S. spurred rapid growth for capital with the stagnation of wages, while Italy's obligations under the Maastricht treaty required fiscal restraint.

In the U.S., Ronald Reagan's legacy of neoliberal policy continued under his successors, including welfare reform that cut benefits for many poor families (Glyn 2007), and several banking deregulations such as the repeal of the Glass-Stegal act (Stiglitz 2010). This led to a situation where consumption was going up even as wages stayed the same. Much of this growth came instead from the expansion of credit prompted by deregulation. Credit, especially mortgages, became more accessible to poor and middle class families not because they were making more money, but because banks had found a way to in theory limit the risk of a single default. Banks gave more and more loans to people who could not afford them, but using new financial innovations were able to package them in such a way that the risk was from investors. In this way, families could spend more money without making more money (Stiglitz 2008). The only thing that could undo this is if many different people across the country failed to repay mortgages at the same time, which was seen by some bankers as impossible at the time but would prove to be a destabilizing threat.

Italy faced a different set of circumstances. Much of Italian growth was driven by government spending. In the mid 1990s, Italians were almost as, if not more, productive than Americans (OECD). So what changed? In the late 1990s Italy began the process of joining the Eurozone. At this time, the left in Italy was in disarray, the Communist and Socialist parties effectively collapsing due to the fall of the Soviet Union. Therefore there was little in the way of left wing resistance to joining the Euro, which would require Italy to give up control of its monetary policy and restrict its fiscal policy in accordance with the Maastricht Treaty. Limits on government debt and deficits meant that the Italian government could not continue to spend as much on social services and other programs. The welfare state in Italy grew much slower in terms of total expenditures than the rest of the EU, meaning less money was going to Italians. This mainly came in reductions or limitations on pensions (Pavolini). At the same time, organized labor remained strong, able to push wage growth to continue. The consequence was declining productivity growth. The Italian economy was not sustainable before the introduction of the Euro, far too reliant on monetary policy and government deficits. However, switching to the Euro did not solve these problems, as the national debt would continue to accumulate.

In neither of these cases did the country in question make the sort of long term investments that would have brought about innovation and increases in productivity growth. The EU prevented Italy from doing so while many in the U.S. had a false sense of security brought by the growth of capital(Stiglitz 2010). Each economy was built on its own house of cards, so when a crisis hit, both countries were vulnerable. The U.S. had a financial sector less and less attached to the real economy, with massive growth in profits even as wages stagnated. Italy had unsustainable debt and restrictions on government spending. In the United States, allowing for more social spending and stronger labor to boost real incomes while restricting credit through regulation is the obvious answer, but when you look at the case of Italy you see a nation that spent its way to ruin. Perhaps if the government of Italy had been allowed to keep spending forever, productivity would not have stagnated, but even with restricted spending they faced a debt crisis. Neither of these countries found a sustainable model. Growth should not have come from overspending but by increasing incomes raised through worker power and a more redistributional tax and social service system. Productivity would grow in response to a growth in demand, creating a more sustainable cycle.

Part 3: Recession and Crisis: A Mismanaged Response

The growth of the financial sector in the U.S. had global repercussions. Many people across the world had invested in the U.S. real estate market, which had been fueled by giving out loans many were unable to pay among other financial scams. Growth in the U.S. in a globalized world meant growth for capital worldwide. Unfortunately, when problems arose, this also meant that a national recession would cause a global crisis.

In the U.S., the risky loans given out by many banks began to go into default as housing prices fell. This led many banks to raise rates on variable rate mortgages, which forced more people into default. A vicious cycle began of falling home prices leading to more defaults leading to more falling home prices. The housing bubble which had made up much of the growth of the past decades was bursting (Stiglitz 2010). The investments that other countries' citizens had acquired became toxic, and a global financial crisis began. The worst recession since the

Great Depression of the 1920s unfolded worldwide. Unemployment across the U.S. and Europe, among many other places soared. This put pressure on the debts of many countries, including Italy's, which without a strong economy was impossible to repay. As the devastation spread, a series of decisions were made in an attempt to slow the crisis and stop the bleeding, but these would be both inefficient and at worst counter productive.

The first response of the U.S. under President George W. Bush was to bail out the banks that caused the crisis. While he argued that this was necessary to avoid a credit squeeze that would prolong the crisis, this policy also sent a clear message to banks that their bad behavior would not only be tolerated but encouraged as official U.S. policy. This money, which was meant to revive the economy from the top down largely went instead to bonuses and profits for the very bankers that caused the crisis (Stiglitz 2010). When President Barack Obama came to power in 2008, he continued the policy of bailing out banks and denying prosecution to wrongdoers. He did also push for a new stimulus package that was meant to put money in the hands of working and middle class people, but this program was far too small and inefficient to revive the economy from the bottom up. Although some financial regulations were put in place, banks still enjoyed much of the same freedom that they had before the crisis to create dangerous new products while the bankers who had caused the crisis were not held accountable.

But if the situation was bad in the U.S. it was far worse in Italy. The EU and the financial organizations dedicated to preventing countries' economies from collapsing essentially decided that the debts owed, mostly to banks in London and New York, were to be repaid first, at the expense of the Italian people (Stiglitz 2010). A powerful new organ of the EU, the "Troika" created by the European Commission, European Central Bank and the International Monetary Fund, was formed to address the crisis faced by Italy and other European countries (Pavolini).

Unemployment rose to nearly double that of the U.S., poverty increased to more than a quarter of the population, and the economy was in tatters. Retrenchment of the Italian welfare state pushed by the Troika left many of these people with help. Again pensions were cut from very generous to less than the European average. At the same time, unions faced their first significant weakening since the 1980s (Pavolini). Worse still, two of Italy's most important sectors, tourism and shipping, were especially affected as they rely on the strength of the global economy in order to function.

In both Italy and the U.S., this economic crisis was met with insufficient response. The stimulus in the U.S. was far too small and there was nearly none given out in Italy. If there ever was a time to encourage spending on a government level, an economic crisis is it, but neither country rose to meet the challenge and were both faced with prolonged and painful recoveries. Of course Italy had a debt problem already, but extending the recession only made the problem more untenable in the long run while causing immense pain to people in the short run. I am not arguing that each country could continue spending forever, but that massive public spending during the crisis could have both prevented the worst for people and set both countries on a path to quick recovery, when more progressive taxation could have refunded those governments what they spent. If any good came from this crisis, it was teaching a lesson in what not to do, one that both the EU and U.S. remembered for the next crisis.

Part 4: The Pandemic, Crisis, and the Return of Social Democracy

The Covid-19 pandemic has been one of the, if not the most important economic events of recent times. From the virus' beginning in China, Italy became one of the first countries to be hit by the spread, which caused not just immense death and suffering on a social level, but a staunch lockdown across the country which halted most economic activity. About a month following the Italian outbreak, the first real spread of the virus in the U.S. began, to a mixed response. Some states announced strict lockdowns, others were far more relaxed. On the whole, however, the economy did face a major blow as millions were furloughed or otherwise dismissed from work. Both countries faced economic hardship alongside a public health crisis, and both had major responses.

The Italian government expanded the welfare state extensively with the full support of the EU which hoped that slowing the spread in Italy with lockdowns would protect their countries. Millions of employees were paid, if the lockdowns prevented them from working, from the government’s dole. lump sum transfer payments to self employed and essential workers, and a national suspension of mortgage payments were all directed at ensuring people would continue to have an income even if they couldn’t work. Still, economic hardship was widespread among Italians who in total lost around 20 billion euros worth of income (Figari 2020). The EU’s reversal on the subject of spending is explained by both the nature of the crisis, that is a public health crisis first and foremost and saving lives must come first, and the failures of the response in 2008. Indeed, the EU itself has given out major stimulus packages to countries which just a decade ago it was forcing austerity upon. The result was that for the first time since the 1990s, productivity actually increased despite the pandemic (OECD). Whether this model is continued and expanded in the future will be determined by the leadership of the EU, and the victories for the Social Democrats in Germany and Emmanuel Macron in France mean that the two strongest economies in Europe will have leadership sympathetic to deficit spending (Zinecker 2021).

The United States had an approach that was similar in theory: expand the welfare state for the duration of the pandemic. The GDP of the U.S. decreased 5% as the virus caused lockdowns and uncertainty. In response, the Trump administration with bipartisan support would implement the CARES act, a 2 trillion dollar stimulus program aimed at helping businesses and workers hurt by the pandemic. The effects of the crisis and stimulus had especially strong effects on low income Americans. Unemployment insurance was expanded and extended, the government gave direct aid to businesses and organizations and direct cash transfers in the form of stimulus checks to citizens below a certain income threshold. For many low income workers, the stimulus provided aid in excess of what they lost during the pandemic, and for the first time in years the rate poverty fell in the U.S. (Li 2021). More stimulus would follow, as would a new infrastructure package supported by President Biden (Klein 2022n 2022).

Both the U.S. and Italy had widely criticized responses to the actual public health crisis, with both countries facing higher disease and death rates than their peers. The economic responses have on the other hand been successful in many ways. To lower poverty or grow productivity in the midst of a pandemic which required a major reduction in economic activity is a major success, and speaks to the good use of public spending.

However, a clear dark side has emerged. For the first time since the 1970s in the U.S. and the 1990s in Italy, inflation has become a serious economic problem. At first, many dismissed inflation as a fact of a distorted economy rife with supply chain issues caused by the pandemic, and projected that as things returned to normal inflation would fade. The problem with this is that things did not return to normal, and inflation has continued to accelerate (Summers 2022) The Russian invasion of Ukraine and subsequent sanctions have caused even more severe supply shocks, and it does not seem like much of the world will return to “normal” for many years. The failure to both foresee this problem and address it has led to calls for the Federal Reserve and European Central bank to raise rates. This would probably slow inflation, and may be the only way to do so in the short term, but I argue that a more sustainable method that does not jeopardize the progress seen in both economies can be reached. First and foremost, the introduction of higher and more progressive taxes would have the impact of reducing demand without increasing costs for the most marginalized. Second, some loosening of protectionist policies and immigration law could ease both supply costs of goods and labor. Third, and most importantly, long term policy changes could create a more sustainable economy for all. Investments made today in renewable energy sources and public transportation mean lower costs when they are completed. A policy promoting denser zoning could lead to more housing nationally, easing pressure on one of the largest costs for families. And a widespread increase in childcare spending would allow more women to enter the workforce, which could reduce the effect of labor shortages. Seeing deficit and monetary hawkishness as the only way to end this crisis is both wrong and deeply shortsighted, and will only hurt the people who can least afford it, while reducing labor power when more is desperately needed.

Conclusion

No country has a perfect economic system which promotes growth and equality without conflict. Both the U.S. and Italy have faced incredible economic challenges in the past and present. By analyzing these very different economies we can see what works and what doesn't for economic goals. Austerity and monetary hawkishness almost always hurt poor and middle income people the most, and should be avoided. In the same vein, regulations, especially to constrain risky lending and to promote the rights of labor unions should remain strong both to protect the economy from collapse and give workers a strong seat at the table when it comes to making policy at the firm and national level. Taxes can be an especially useful tool when used progressively on the wealthy to reduce deficits, inflation, and inequality. We should look to expand our economy not through accounting tricks and financial scams as the U.S. did in the period leading up to 2008, but through real investment in long term policies that will boost aggregate demand, while avoiding the mess of deregulated policy. In a globalized world, the success of each country is dependent on a complex system of economics and finance, so an economic policy that ensures good outcomes in both our own country and the world must be pursued.

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