The impact of the wage moderation policy on the labour productivity. The Italian case in a Kaleckian-Kaldorian perspective (1992-2013)

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This paper deals with the long economic Italian stagnation after the so-called "economic miracle". The aim of this study is to explain how the elimination of wage indexation, the set of a decentralised bargaining system and the labour market flexibilisation have contributed to the deterioration of the macroeconomic framework. The three above-mentioned directions, acted as the main components of an overall wage moderation policy that led to the collapse of labour productivity. Indeed, the hypothesis is based on the intuition that the Italian decline is characterised by multiple-causes, which interacted reciprocally among them and with fiscal consolidation policies. Italy is a relevant case study because its economy performed worse in the Eurozone and where wage moderation policy produced the worst outcomes within the EU. The wage share decrease and the flexibility increase have led to the aggregate demand drop, changes in the employment composition, the rise of unemployment, inequality and poverty, and finally, the reduction of workers and unions' power. We explore the consequences of these policies within a Kaleckian and Kaldorian framework, arguing that a new and stable economic growth path can be retaken through a wage growth and union's conflict.

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1. Introduction

Thanks to the sociologist Luciano Gallino, a long and intense debate on the Italian economic decline was started in 2003. His work exposed the disappearance of Italy's industrial sectors (Gallino, 2003) and paved the way to a fervent academic and public dispute. This sharp discussion, in which many scholars took part in, finished abruptly with the Great Recession in 2008 and it has re-emerged only recently.

This broad debate on the decline did not achieve any consensus, neither on the variables that indicated it or on its causes. There has been a tension between those scholars attributing the Italian decline mainly to some single cause and those emphasizing multiple causes.

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The author has been able to realise this paper despite the research cuts implemented without interruption since 2008 by all the Italian governments, which are responsible for the destruction of the Italian university and even more in the South of Italy.

Many scholars, indeed, tended to ascribe the Italian economic decline to the single currency adoption (Bagnai, 2016; Moro, 2018), or to the institutional weakness (Macchiati, 2016) or to the high public debt (Alesina and Giavazzi, 2018; Istituto Bruno Leoni, 2018). According to the first view, the adoption of Euro does not allow any devaluation of currency thus limit the chance to growth via the increase of exports. The second view supports the idea that the Italian government's duration is too short and this reduces the government's credibility amongst the international financial markets and does not allow for the implementation of structural reforms (such as labour marker deregulation, the reforms of the welfare system and the liberalisation of goods and services markets). The third one is based on the view that: (i) public debt increase is due to the wasteful public spending increase (such as wages for civil servants, excess of spending in welfare, etc); (ii) the increase of public debt reduces the rate of growth due to the operation on the standard crowding out effect and the Barro effect.

On the other side, other scholars highlighted the role of demographic, economic and social factors *(infra)*. Among the latter, there are scholars that pointed out the productivity dynamics as the main driver of the Italian economic decline. Two significant research paths were developed within this framework. The first one is based on supply-side factors: (i) the mismatch between labour demand and supply (depending on the educational system inefficiency); (ii) the high labour cost in comparison with European Union (EU) countries (due to higher taxation on labour payslips); (iii) the distortions in goods and services markets (Rossi and Giunta, 2017; Saltari and Travaglini, 2006). The second one is based on demand-side factors such as wage moderation, lack of both public and private investment, public spending contraction, fragility of the productive structure, and the poor performance on net export on GDP (Ciocca, 2003; Forges Davanzati et al., 2017; Lampa and Perri, 2014; Lucarelli et al., 2013; Lucarelli and Romano, 2015; Perri and Lampa, 2017; Pianta, 2012; Tronti, 2009). This latter problem is imputed to the small commercial openness of the Italian economy. In contrast to the mainstream view, the Post-Keynesian vision deems that the decline is not determined only by one cause but involves all the components of the aggregate demand. Moreover, the Italian Post-Keynesian scholars maintain that the fundamental indicator of the Italian economic decline is the continuous reduction of the rate of labour productivity growth.

This paper aims to expanding this approach taken here focusing on the effects on wage moderation on the path of labour productivity. We deem that (i) elimination of wage indexation, (ii) the promotion of a decentralised bargaining system and (iii) the labour market flexibilisation, acted

as the main components of an overall wage moderation policy that contributed to the deterioration of the macroeconomic framework (i.e. low rate of growth, increase unemployment, etc.).

These causes on the labour side interacted reciprocally as a mechanism of circular cumulative causation (Kaldor, 1966; Myrdal, 1944) among them and with the fiscal consolidation policies, and therefore made the aggregate demand collapse. In fact, the decline of wage share and the increase of precariousness in the labour market has affected labour productivity and has hardly changed the employment composition. Additionally, it has raised the unemployment rate, increased inequality and poverty and, finally, has reduced the workers and unions' power.

We explore the consequences of the wage moderation policy within a Kaleckian and Kaldorian framework. In this context, we facilitate the cross-fertilisation among the class nature of economic policy, the double role of wages in capitalism economy (it is a cost for individual firm but is component of aggregate demand via consumption), and the relationship between the rate of growth of labour productivity and the output growth rate. We draw from Kaldor the idea that productivity growth is positively linked with the output (or so called Kaldor-Verdoorn Law), and from Kalecki and the contemporany fiscal sociology (Streeck, 2005) we get the intuition that workers and capitalists bargaining power in the labour market reflects their bargaining power in the political field.

Indeed, we will deal with the latter vision, drawing from the Kaleckian theory of the issues about the class nature of economic policy (Kalecki, 1943) and the role of wages and trade unions in a capitalist economy (Bhaduri and Marglin, 1990; Hein, 2017; Kalecki, 1968, 1971). Furthermore, we get from Kaldorian theory the link between the rate of growth of labour productivity and the output growth rate, and the idea that the path of innovation is dependent on the dynamics of aggregate demand, according to the so-called *Verdoorn Law* (Verdoorn, 1949) or *Kaldor's second law* (Forges Davanzati, 2018; Kaldor, 1966; McCombie and Spreafico, 2016; Targetti, 1988).

This paper is organised as follows. Section 2 presents a historical framework about the period-considered (1992-2013). Section 3 shows the link between wage moderation and labour productivity. Section 4 discusses the Italian case on official data. Section 5 concludes.

2. The historical context (1992-2013)

The following analysis spans from 1992 until 2013. Regardless of the fact that Italy's economic problems have deep roots stretching back in time and they are linked to the late start of the Italian industrialisation process (Bianchi, 2013), we considered that at the beginning of '90s the Italian attitude on labour policies, and on fiscal policies, had drastically changed.

Many crucial events occurred in 1992-93 at the economic, political and monetary levels. It is worth mentioning here that pressure was placed on the economic and political systems through the Maastricht Treaty signing (February 7th, 1992) and the beginning of the judicial investigation of *Mani Pulite* (February 17th, 1992). A tripartite agreement - better known as *Amato Protocol* (July 31st, 1992) - promoted by then-Prime Minister Giuliano Amato, and signed by main employers and workers' organisations, cancelled out the wages indexation clause (*scala mobile*).

Later, a huge speculation attack against Italian Lira (₤) forced the government to devaluate the currency and leave the European Monetary System (EMS) on September 16th, 1992. After the ratification of the Maastricht Treaty, in October 29th 1992, the PM Amato implemented a hard fiscal adjustment implemented ever made in Italy. The same PM called it the "tears and blood" balancing plan: 93 thousand billion of Lira. This was the first tough austerity measure which was composed by cuts in government spending to the tune of 43.5 thousand billion of Lira, as well as tax increases in the region of 42.5, coupled with the privatisation of State-owned companies for 7 (Pesole, 2010).

This was followed by strong economic and political crises brought by the President of the Republic, Oscar Luigi Scalfaro, in appointing Carlo Azeglio Ciampi as Prime Minister on April 28th, 1993. Mr Ciampi, who served as President of the Bank of Italy until that moment, has been the first non-member-of-parliament to lead a cabinet in Italian history. His cabinet was composed of technocrats and politicians intended to reassure the EU's partners about the Italian respect of the Economic and Monetary Union (EMU) constraints – particularly inflation, debt-to-GDP ratio and budget deficit. On July 23rd 1993, Ciampi carried out another tripartite agreement with the cooperation of employers and workers' organisations. The so-called *Ciampi Protocol* aimed to reform the bargaining system in order to reduce inflation though wage moderation, income policy, investment and productivity increase.

Hence, from 1992 the room for budgetary manoeuvre became less and less possible for any Italian government, which aimed to reduce the public debt (Crouch, 2009; Streeck, 2013) and avoid the speculative attacks. In those years, and throughout the following two decades, the "economic

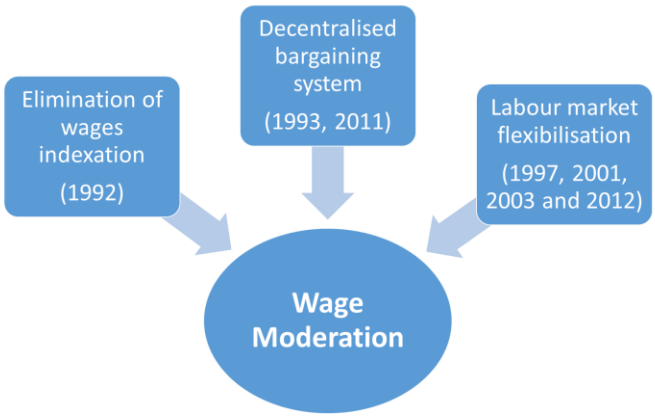
alarmism" describe by Federico Caffè (1972) became established. This strategy aimed to distort the economic situation, to inflate the negative aspects and to fabricate the impression of a continuous emergency about the economic conditions in which everything could be sacrificed in favour of public debt reduction and cuts in public spending. According to this approach, technocrats and/or non-MP's were preferred to politicians in leading cabinets such as Ciampi, Dini and Monti (Marangoni, 2012), or to serve as Ministry of Economy and Finances (Gasperin, 2018).

In 1993, after the tough austerity measures made by Amato I and Ciampi cabinets, a new voting system was approved with the aim being to renew the political system hit by a series of corruption scandals. This reform moved from a pure proportional representation - in force since 1946 - toward a mixed one with 75% first-past-the-post and 25% proportional one (*Legge Mattarella*), and it was used for three general elections (1994, 1996 and 2001). Later, in 2005, another voting system reform was approved which set a proportional representation with a majority bonus (*Legge Calderoli*). Unlike in the past (1946-1993) where the focus was the political representation, both voting system reforms approved in 1993 and 2005 aimed to create large party coalitions before the general elections – better known as centre-right and centre-left - in order to favour governability, hence credibility and the possibility to repay the public debt.

General elections	Parliament	Cabinets
5th and 6th April 1992	11th	Amato I Ciampi
27th and 28th March 1994	12th	Berlusconi I Dini
21st April 1996	13th	Prodi I D'Alema I D'Alema II Amato II
13th May 2001	14th	Berlusconi II Berlusconi III
9th and 10th April 2006	15th	Prodi II
13th and 14th April 2008	16th	Berlusconi IV Monti

Therefore, despite the political differences, we can assert that all the thirteen governments in power between 1992 and 2013 have had a common agenda about labour and economic policies. Indeed, the Italian governments have implemented a wage moderation policy through three main

directions: i) wages indexation elimination; ii) decentralised bargaining system promotion; and iii) labour market flexibilisation.



3. Wage moderation and labour productivity

Since the 80s, the debated revolved around the incentive to work and the role of unemployment. Among different opinions, it is important to mention the study of the threat of firing workers as a disciplinary device (Calvo, 1981). The mainstream approach in its different visions is based on the idea that the real wage and the level of employment are negatively correlated. Accordingly, the level of employment can increase only if the unitary real wage decreases[1].

In the last decades, this intensive economic debate has supported flexibility in the labour market in order to increase growth and employment and subsequently promoted the so-called structural labour-market reforms. Many OECD countries – specifically those in the European Union - have prevailed in the overall deregulation of their labour markets.

According to the dominant view, the deregulation of the labour market should be the way to allocate workers quickly to the firms' need. Moreover, the wage moderation should be the precondition to keep the price stable, in order to increase the workers' purchasing power and the firms' competitiveness, assuming a contextual labour market flexibilisation and liberalisation in

[1] Within the mainstream approach, the efficiency wage theory should be considered. This stresses that the labour productivity growth is driven by the individual effort being less relevant capital accumulation. Workers are considered as people who tend naturally to shirk and the unemployment benefit as a tool that attenuate the payoff menace. According to this view, the unemployment is the natural outcome of wages increases spontaneously given by firms to their employees in order to stimulate their effort. The macro result is involuntary unemployment confirming the inverse relationship between the real wage and the level of employment. In the terms of policy prescription, it is suggested to reduce welfare benefits in order to prevent workers shrink (Shapiro and Stiglitz, 1984).

goods and service markets. The final goal should have been to generate growth through the increase of exports (Blanchard and Giavazzi, 2003). Despite the fact that this mainstream economic model growth presents evident limitations (Ostry et al., 2016) it is still the reference within the EU. In another diametrically opposed view, the deregulation of the labour market generates the drop of labour productivity, which in turn leads to the collapse of aggregate demand.

According to Kalecki, entrepreneurs are against the full employment policy because the dismissal would cease to be a disciplinary measure. Indeed, in a full employment economy, the social strength of the business would be weakened by the workers' stronger bargaining power, which could allow them to call for strikes for higher wages and improvements in work conditions. In this framework, workers' class-consciousness would increase and it could cause deep social and economic changes, and more power in the political sphere. Hence, entrepreneurs prefer to keep the unemployment as mean to discipline workers' claims and instead welcome increased stability at the political level more so than higher profits, as clarified in his *Political aspects of full employment* (Kalecki, 1943).

In a capitalist economy, the role of trade unions is essential. Indeed, the union struggle can achieve wage increases, restrain the mark-up fixed by the firms and modify the income distribution from profits to wages, however only if there is an excess of capacity. Conversely, a wage drop tends to weaken the unions' bargaining power and lead to a fall in employment. Hence, the unions' bargaining activity can codetermine the distribution of national income. According to Kalecki, there are other forms of class struggle than wage bargaining, as explained in his *Class struggle and the distribution of national income* (1971). Indeed, another way to influence the income distribution and favour workers is the price control or, alternatively, the subsiding of the wage goods prices through the profits taxation (Kalecki, 1971).

According to Kaldor, the increase of wages can positively affect the labour productivity. Evidence shows that in countries where the wages are higher, the labour productivity is also higher (OECD, 2017). Since the union density within big firms in the manufacturing sector is higher than in smaller firms and other sectors (Kaldor, 1989), the bigger ones not only have higher internal availability but, also under the unions pressure, can pay higher wages to their employees. Big firms can pay higher wages to their workers not only because of the efficiency wage theory but also to gain good labour relations (Colacchio and Forges Davanzati, 2017).

Hence, in our Kaleckian-Kaldorian framework, the result of wage moderation combined with fiscal consolidation is the following. These policies trigger the reduction of aggregate demand via consumption (C) and public expenditure (G). This brought to the increase of unemployment (U), the reduction of wages (W), the further drop of consumption (C), the fall of profits' firms active in the domestic market and the public and private investments (I) downfall. In conclusion, the collapse of the labour productivity (Π) leads to low, or negative, growth rate, as following:

$$\hat{C} = f(\hat{G}, \widehat{W}), \quad f'_{C,G} > 0; \; f'_{C,W} > 0 \tag{1}$$

$$\widehat{\Pi} = f(\widehat{U}, \widehat{W}, \widehat{I}), \qquad f'_{\Pi/U} < 0, \; f'_{\Pi/W} > 0, \; f'_{\Pi/I} > 0 \tag{2}$$

The equation (2) can be regarded as an augmented version of the Paolo Sylos Labini productivity function where the productivity growth depends on the Smith effect (i.e. the increase of demand pushes the increase of productivity) and the Ricardo effect (i.e. the increase of wage rate on the profit rate ratio pushes the increase of productivity) (Sylos Labini, 1984). Indeed, the equation (2) expands the Sylos Labini function insofar as it provides a link between the rate of unemployment and productivity growth, where both are taken into account.

Hence, we can deem that higher union density (Ud) led to strong unions' conflict, which drives wage (W) increases and it, in turn, increase the labour productivity (Π), which boost the growth rate:

$$\widehat{\Pi} = f[\widehat{W}(Ud)], \qquad f'(\Pi/W) > 0, \qquad f'(\Pi/Ud) > 0 \tag{3}$$

Following this framework, the link between the labour share and the drop of labour productivity can be explained by the assumption that the introduction of wage moderation acts as a disincentive to invest in innovation (Kleinknecht, 2015). Indeed, when employment increases, firms finds hard to reduce wages and they are forced to innovate (Dutt, 2012)[2].

Kaleckianly speaking, we can deem the increase of unemployment and the decrease of the union density to lead to the reduction of the unions' bargaining power in the economic field, which

[2] Moreover, Perri and Lampa identified the income distribution deterioration as the cause of the economic crisis. According to their vision, the latter led to a reduction of aggregate demand and of innovative investments (Lampa and Perri, 2014) and the wage moderation acted also as a disincentive to invest, determining a labour productivity drop (Perri and Lampa, 2018).

brings less representation of workers' interests in the political field. This lead to the reduction of welfare public spending, which in turn increases unemployment and, consequently, reduces labour productivity as mechanism of circular cumulative causation, in the mode of Kaldor (1966).

4. The Italian case

In the Italian case, the wage moderation policy – that means all the measures that prevent workers to achieve higher wages - has been continuously implemented since 1992. Firstly, by the elimination of wages indexation (*Amato Protocol* in 1992). Secondly, by the decentralised bargaining system reform (*Ciampi Protocol* in 1993), which started to switch it from centralised collective bargaining to company or plant-level. Thirdly, by the main labour market reforms - such as *Treu Package* in 1997, *Fixed-term contract reform* in 2001, *Biagi Reform* in 2003 and *Fornero Riform* in 2012 – have increased the firms' freedom in hiring and firing workers. The result of these labour reforms has been the creation of many economic areas excluded from national collective bargaining. The claim of mainstream scholars that are still highlighting that labour productivity in Italy is lower in comparison with other EU countries because of the excessive protection of employment appears questionable. Italy has been reduced its Employment Protection Legislation (EPL) faster and deeper than other OECD countries (Forges Davanzati and Mongelli, 2017; Perri and Lampa, 2018).

The collapse of the EPT (protection of the temporary contracts) occurs after the reform of 1997 and 2001. The first reform created new temporary contracts; meanwhile the latter eliminated the justification required to the employers for opting for temporary contracts instead of permanent job.

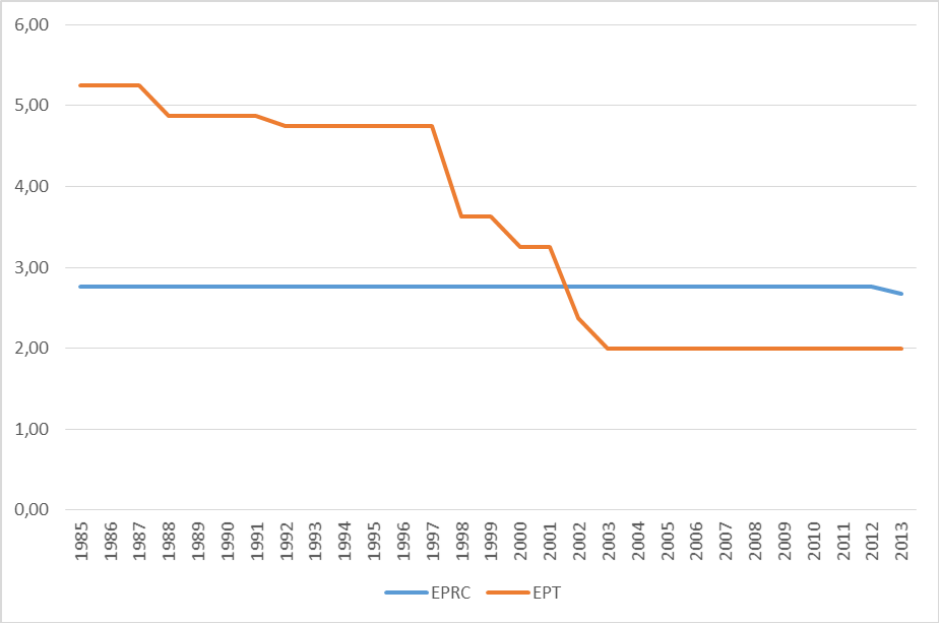


Fig. 1 - EPT and EPRC Index (1985-2013).
Source: own elaboration on OECD data

The drop of the EPL overall index is due to the collapse of the EPT (temporary) index. Indeed, as we can see, the EPRC (fig. 1) remains stable along all the period except after the 2012 reform.

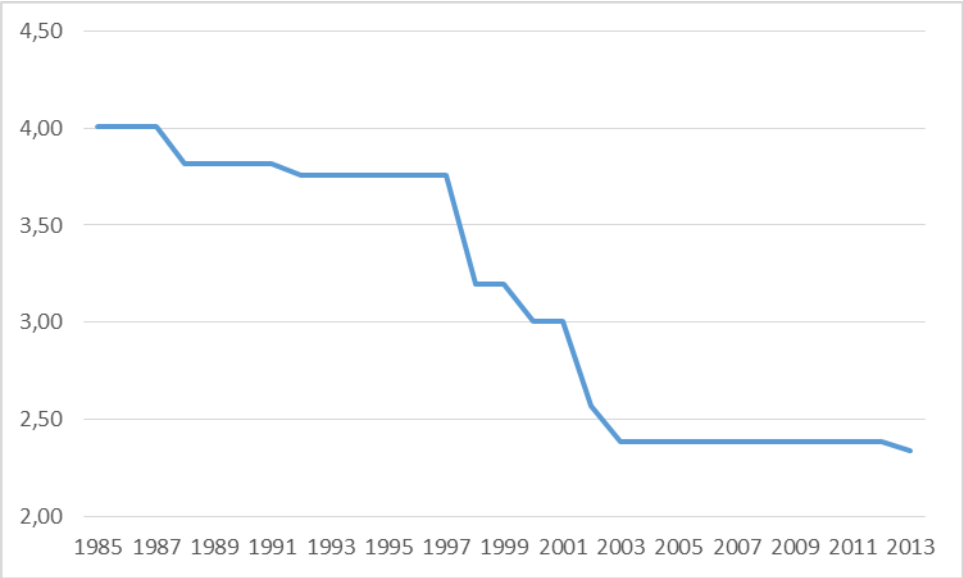


Fig. 2 - EPL overall Index (1985-2013).
Source: own elaboration on OECD data

As we can see, the workers' paid the cost of inflation reduction (Tridico, 2015b; Tronti, 2005). In particular, the implicit political exchange – i.e. wage reduction combined with the increase of private investments – occurred only to the detriment of their purchasing power insofar as firms did not react to wage decreases by investing more (which may be due to the deterioration of firms' expectations). Hence, this wage moderation policy has negatively affected the wages and workers' purchasing power because it was acting in a framework with a lack of private investments. It then led to the decrease of consumption and, consequently, of aggregate demand (Forges Davanzati et al., 2017; Tridico, 2015a; Tronti, 2009). Moreover, the drop has been even more significant because there was an incomplete reform of the social protection system (Leonardi, 2009) such as the unemployment benefits and its payees.

Firstly, the Italian lawmakers aim to respect the Maastricht[3] economic parameters thus reducing public spending in detriment of wages. Secondly, they have implemented only one side of the *flexicurity* model promoted by the EU with European Employment Strategy (1997) and later with the Lisbon Strategy (2000), following the Norther European best practises (Perri, 2018). Therefore, Italy has strongly accepted the *flexibility* into national employment legislation although it did not adopt the *security*, which had only some minor and occasional reforms. It appears contradictory to implement security plans in a context characterised by the fiscal consolidation. This contradiction can be explained as the result of the concomitant pressure to deregulate the labour market and to reduce the public spending on the welfare state (Baccaro and Tober, 2017). Indeed, according to fiscal sociology, the State must pursue two opposite aims: from one hand it has to favour capital accumulation and, on the other hand, it should preserve social cohesion (O'Connor, 1976).

The realisation of these measures have had a negative impact in Italy, above all because of the Italian productive structure and its productivity, especially in the *Mezzogiorno*. It should be pointed out that the Italian enterprises are small-sized, lack competitiveness, quite often family-owned, not exposed to the international competition and only active in the domestic market (ISTAT, 2014; Trésor-Economics, 2016). Moreover, most of the Italian enterprises have such a kind of productive specialisation in low-technology intensity sectors, above all in the *Mezzogiorno* (Bronzini et al., 2013).

[3] A clarification warning is in order. This is not to say that Maastrich Treaty *causes* wage moderation. Arguably, these policies were implemented in order to allow Italian firms to gain quickly competitiveness in the global market.

In the Italian case, the wage moderation did not contribute to the exports boost – as foreseen by the mainstream vision – mainly due to the fact that Italy's productive structure exports are not based on the price-competitiveness (Felettigh and Federico, 2011). Perhaps worse, the wage moderation contributes to a change in the consumption structure, which has increased, in turn, the import of all those goods no longer produced in the country.

Throughout the '90s, the technocratic and centre-left cabinets strongly adopted the idea of the "external constraint" elaborated by the economists Carlo Azeglio Ciampi and Beniamino Andreatta, and implemented a deep deregulation of labour market. The "external constraint" means that Italy is able to follow and respect an orthodox macroeconomic policy only if this is imposed by an external actor, such as the EU.

At the beginning of the 2000s and then in 2008, the II, III and IV Berlusconi Cabinets were strongly supported by a large parliamentary majority because of 2001 and 2008 General Elections. These governments led by Berlusconi promoted some structural reforms with the purpose of boosting growth, and with the clear backing of the CONFINDUSTRIA, the largest Italian industrial employers' confederation led by then-president Antonio D'Amato (2000-2004). The development model proposed by Berlusconi was essentially based on less fiscal pressure, more options for fixed-term contracts, the division of the three largest trade union organisations; the transformation of the Public Administration according to business parameters and, finally, a foreign policy based on the support of Italian exports.

In the 2006 General Elections, the centre-left coalition led by Romano Prodi – former Italian PM (1996-1998) and former President of the European Commission (1999-2004) – achieved the majority in the Chamber of Deputies and a draw in the Senate. Fausto Bertinotti and Franco Marini were elected speakers of the Lower House and of the Upper House, respectively. The first was the member of the national board of the CGIL – the largest Italian union confederation - and the latter was the general secretary of the CISL – the second one. Moreover, the Minister of Labour of the II Prodi cabinet was Cesare Damiano, former national vice-secretary of the CGIL's metal worker's union federation (FIOM). In this way, it seemed that the Government and the Parliament would have paid more attention to the worker's problems. The labour policy did not change despite the public statements of the Ministers' cabinet against the precariousness of jobs. We can highlight that in the II Prodi cabinet an Industrial Policy Plan was developed (*Industria 2015*) in which the

government came back to have a public role in the orientation of the production sectors in order to recover all the room lost in the international markets (Giangrande, 2016).

It worth highlighting that the above mentioned reforms – wages indexation elimination, promotion of the decentralised bargaining system and the labour market flexibilisation - have been negotiated in a tripartite way, or indirectly accepted by the largest trade union confederations – sometimes with the opposition of CGIL.

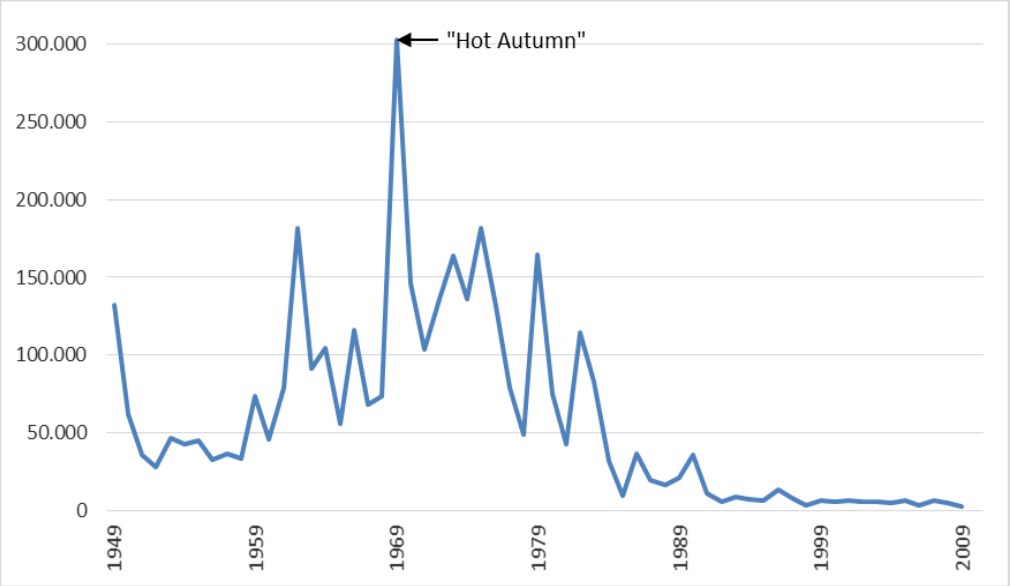


Fig. 3 - Non-worked hours due to conflict (1949-2009).
Source: elaboration on ISTAT data

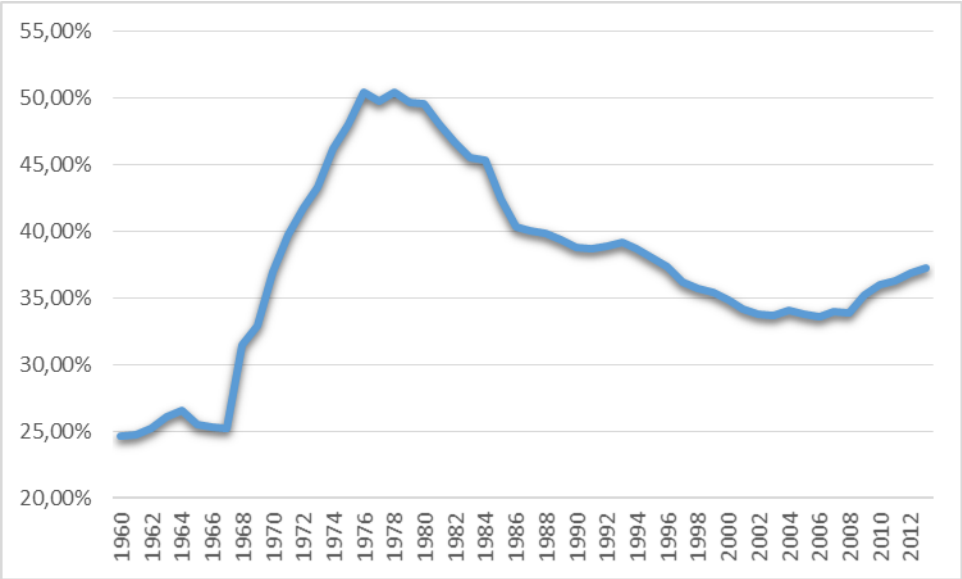


Fig. 4 - Union Density in Italy (1960-2015).
Source: our elaboration on OECD data

As we can see from the figures no. 3 and no. 4, there are peak points in the non-worked hour due a conflict and the union density in Italy that are in 1969 and in 1976, respectively. This shows the unions conflict and the following outcomes - in terms of higher wages and better welfare - that incentivise the unionisation. When the unions are defeatist and defensive – sometimes accepting laws against workers, they lose membership numbers and the result is a weak organisation which is not able to organise workers and support labour conflicts. Indeed, wages are not only a cost of manufacturing but also the main way to give purchasing power to workers and stimulate the demand. To achieve a strong unionisation, it would be necessary that a new conflict, which focuses on labour issues involves those workers excluded from national collective bargaining. In this way, it would be possible to conquer new spaces for worker's interests' and boost a wage increase that will restart the demand.

The figures no. 5, no. 6 and no. 7 show respectively the path of the GDP, the GDP per head of population and GDP per hour worked (France, Germany, Italy and United Kingdom).

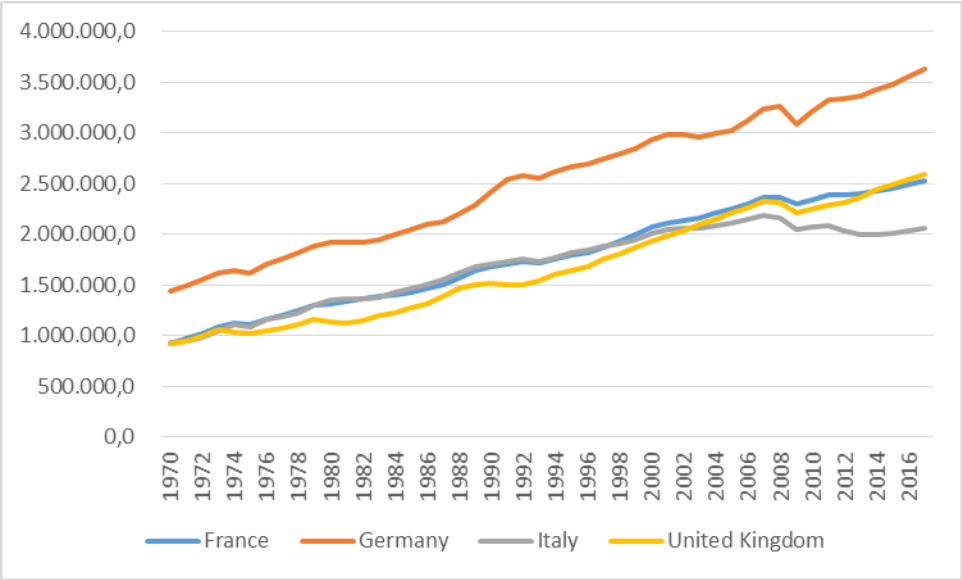


Fig. 5 - GDP (millions USD, constant prices, 2010 PPPs).
Source: elaboration on OECD data

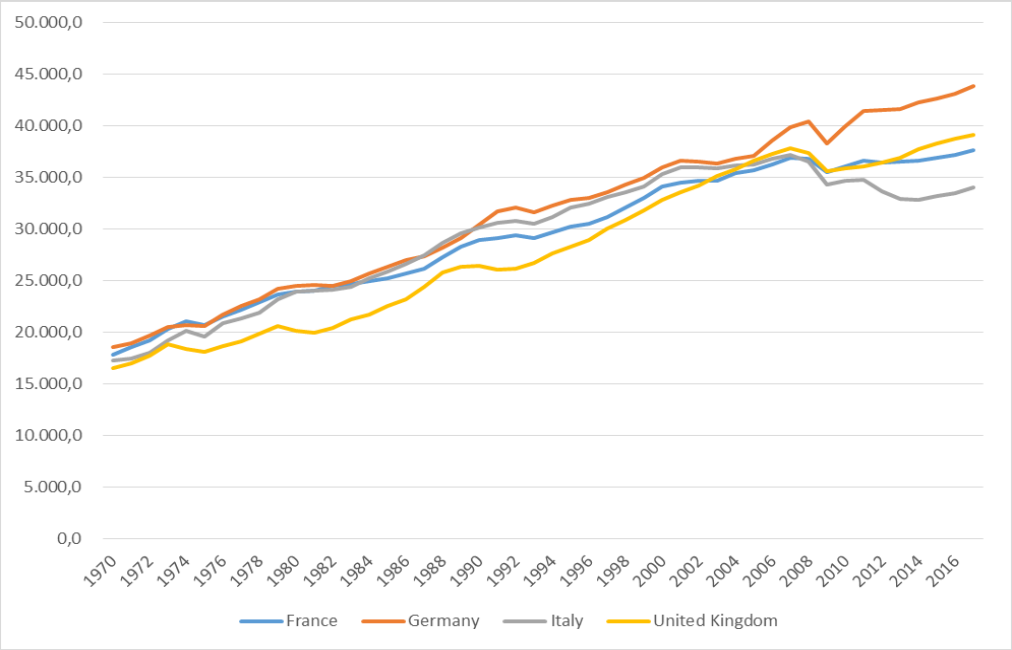


Fig. 6 - GDP per head of population (USD, constant prices, 2010 PPPs).
Source: elaboration on OECD data

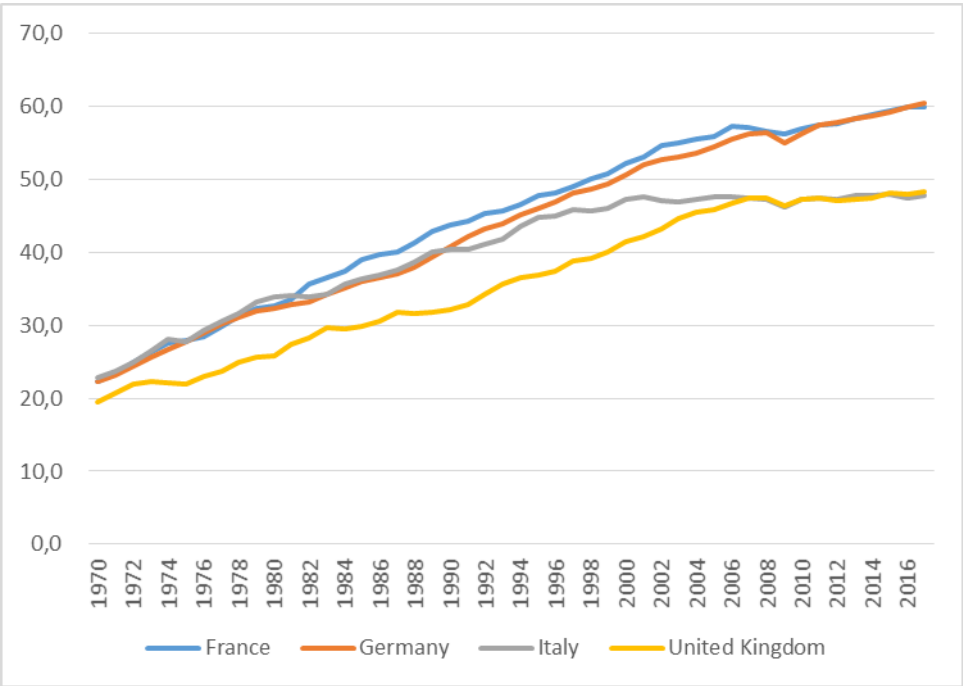


Fig. 7 - GDP per hour worked (USD, constant prices, 2010 PPPs).
Source: elaboration on OECD data

5. Conclusion remarks

In this paper, we have investigated the impact of the wage moderation policy on the labour productivity by analysing the Italian case in comparison with main EU countries throughout a historical period (1992-2013). After two decades, wages have been strongly reduced via wage moderation policies implemented by all the Italian governments from 1992 to 2013.

We explained the elimination of wage indexation, the promotion of the decentralised bargaining system and the contributions of labour market flexibilisation to the deterioration of the overall macroeconomic framework.

Moreover, we explored the consequences of these policies within a Kaleckian and Kaldorian framework, arguing that a new and stable economic growth path can be retaken through a unions' conflict and wage growth.

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