PERSPECTIVE

A Progressive Growth Strategy for Italy

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Introduction

There must be a return to growth in the Italian economy, as only sustained growth will enable Italy to eliminate the high level of public debt steadily accumulated over the years (the 2013 figure is about 130 per cent of GDP). To achieve this, as we shall see below, important domestic reforms must be introduced to remove structural obstacles that have hampered the economy (more in Italy than in other European countries), preventing it from adjusting positively, from the late 1990s onwards, to new dynamic and revolutionary IT technologies and changes in global equilibrium caused by development in emerging countries.

There must also be a significant improvement in both the European and the international economic situation if Italy is to enhance its exports, traditionally a strong point of the country's growth pattern. Clearly, what is needed is an overall growth strategy for the entire euro zone; domestic measures and even important reforms introduced by individual countries are not sufficient in an area in which there is a high level of interdependence. Each state must take action to bring about economic reconstruction, but this alone will not be sufficient to produce economic recovery. Without a concerted effort towards growth, countries in difficulty will have no chance of effectively adjusting their economies, irrespective of the austerity imposed.

The Challenges Facing the Italian Economy

The onset of the euro-zone crisis that subsequently spiralled into a deeper economic downturn hit the Italian economy harder than most other countries in Europe. It was already ailing prior to the crisis, having lost ground in terms of growth compared to the more advanced countries, starting from the mid-1990s and in the following 15-year period. Even during the short-lived economic respite (2010–2011), recovery in Italy was slight, and below the European mean. The economy then fell into a period of economic recession that was more prolonged and severe than anything witnessed since the end of the Second World War. Proof of this can be seen in the constant stream of enterprises that have been forced to cease their activities, partly due to a powerful credit crunch that shows no signs of easing. The repercussions for employment have been particularly severe: the current unemployment rate exceeds 12 per cent, rising to around 40 per cent for the young.

However, all this must not prevent us from acknowledging the incisive action that has been taken to adjust fiscal issues since November 2011, when the financial crisis deepened. This intervention has led to a significant improvement in the structural deficit of public finance. Thanks to the positive results achieved, in June 2013 the procedure imposed on Italy for breaching the deficit level, which commenced immediately after the onset of the slump in 2008–2009, was lifted.

Of the numerous factors that contribute to the severe and lasting Italian recession, many are longstanding as they are linked to structural issues that have long afflicted the Italian economy. The most important of these include weaknesses in the production system and research, the lack of infrastructure, the inefficiency of the welfare system and public administration, and territorial rivalry between north and south. To some extent, all these weaknesses are reflected and summed up in one problem: the stagnation of productivity in Italy, particularly so-called total factor productivity. This highly significant and concise indicator sums up the capacity of an economy to efficiently combine overall capital and labour endowments and represents the prime ingredient for a nation's economic growth. In Italy, this indicator has shown a particularly negative trend, especially over the past decade. Although there has been only a small increase in nominal salaries, in the past decade, stagnating productivity has led to a widening gap in competitiveness, thus penalising the Italian economy. Although the export trade has suffered, compared to other European countries such as France and Spain, Italy has succeeded to some degree in maintaining its position by managing to contain deficits in the trade and current balance. The past two years have witnessed an initially limited inversion of the negative trend, with the trade balance once more registering a surplus, although this is largely due to the period of recession and subsequent reduction in domestic demand and imports that began at the end of 2011.

Remedies for Promoting Growth

There must be a return to growth in the Italian economy. Since there is (as we well know) a very close positive correlation between growth in productivity and GDP which, compared to the past decade, has become even stronger during these years of economic crisis, it follows that only a significant increase in Italian productivity over the next few years will enable the country to raise its future growth trend. Achieving this objective will depend on two factors: important domestic reforms to eliminate the aforementioned structural obstacles and a marked improvement in the European and international economic scene capable of enhancing exports, traditionally a strong point of Italy's growth pattern. On the domestic front, tough policies and intervention are needed to counter the current recessionary spiral and help the Italian economy to link up to an international recovery that could start to become visible at the end of the current year. In this respect, there are three fundamental macro-areas to be taken into consideration.

First, there is the question of public finance, an area where it is vital to keep public accounts under control. Italy is back among the virtuous countries as regards the deficit-GDP ratio, but it remains at the top of the list of countries with the largest debt. To avoid the sanctions envisaged under the new Fiscal Compact, the government must include in its budget policy a balanced medium-term path that avoids stifling the economy and gives more opportunity for public investment to return after years of heavy penalisation. Policies involving a spending review and the sale of publicly-owned assets must contribute to this process.

A global outlook is needed to counter the sharp reduction in domestic demand which, in the past two years, has more than offset the positive contribution made by growth in exports. In this case, the key problems are, on one hand, how to ensure greater liquidity and credit for businesses, the victims of the credit crunch, and on the other hand, how to significantly reduce the »tax wedge« (income tax and social security contributions) so as to benefit both workers and employers. As regards the latter, the main obstacle stems from restrictions on national expenditure, whereas for the former, there are two possible effective solutions: the first is the rapid payment not only of the sum already allocated, but also of all the arrears owed to enterprises by public administration, currently estimated at approximately 100–120 billion euros. This can be done through careful management of state insurance systems and the consequent increase in national debt. The second solution is to re-introduce loans to enterprises (and families) by reactivating banking channels and/or alternative means of financial support.

There is no time to lose. The country's industrial foundations are steadily crumbling. The third essential step is to prevent this erosion so that Italy can link up to economic recovery in Europe. Although many Italian enterprises have reacted well to the economic downturn by modernising and becoming more international, this number remains small and, at an optimistic estimate, represents no more than a quarter of the entire productive system. The remaining, or what amounts to the majority of enterprises, are still in great difficulty. In fact, since the beginning of the recession, Italy has lost 15 per cent of its manufacturing strength and 25 per cent of its industrial production. What is needed are far-reaching processes of reconversion and large-scale productive reorganisation. Clearly, there are numerous ways of promoting these changes, but it is essential to introduce industrial policies focused on production and research that help enterprises to group together, innovate and become more international.

The Need for a European Outlook

Although a return to economic growth means that Italy must pursue a reform path that will require a long-term effort, it is clear that positive domestic intervention will not suffice. In order to get back on a path of sustained and lasting economic growth, Italy must interact with Europe, and particularly the euro zone. This Europe will, however, be different from the one we have known in recent times: today's Europe is an area of deep economic crisis, increasingly divided between creditor countries and indebted nations, and where unemployment, inequality and poverty are on the increase.

Obviously the European crisis is part of a much broader, global crisis, but it is principally the result of the wrong remedy – austerity packages – introduced after an equally erroneous diagnosis – the fiscal irresponsibility of indebted nations. Principally on account of such policies, indebted countries, Italy included, have found themselves spiralling in a vicious circle, in which tax hikes and spending cuts depress income and prevent a reduction in the debt/GDP ratio. Growth is out of the question, and the most realistic prospect – assuming that the European Central Bank manages to avert a disastrous end to the euro – is a long period of stagnation, with an immediate effect on the Italian economy. If this situation continues, stagnation could last for most of the current decade.

Another scenario could emerge, although its creation is currently meeting strong political opposition. No one has a magic formula for producing economic growth, but what is clearly needed is a strategy that encompasses the whole of the euro zone.

A return to economic growth in Europe will depend not only on enhanced competitiveness and the full implementation of structural reforms in each individual country, but also on the capacity to exploit the European domestic market that must become a new hub for European development. The euro zone is not a small open economy; on a world scale, it is the second largest economic area in terms of income produced and wealth accumulation. Germany's export-led growth formula cannot therefore be extended to the whole European zone. In fact, foreign demand and exports to the rest of the world cannot compensate for a lasting weakness in the European domestic market which is too large and wealthy to be sustained by the American and/or Chinese consumer.

Achieving a return to growth will involve the use of made-to-measure methods and policies. Two of these are worth mentioning: symmetric adjustment mechanisms for indebted and creditor countries that, contrary to what has occurred thus far, oblige countries with a deficit as well as those with a surplus to adopt reciprocally compatible adjustment measures prescribed by the new European governance. Moreover, the domestic market must be promoted. This will mean liberalisations within Europe, the creation of a joint area of research and innovation and also European investment to jointly finance services and strategic areas (focusing on research, alternative forms of energy, eco-friendly technologies, education and communications).

Ensuring growth throughout the euro zone will make it easier to pursue a path of greater economic integration, a prerequisite for guaranteeing the stability of the single currency. Steps to be taken by European governments in this direction should include important measures such as banking union under the central control of the ECB. This would interrupt the vicious circle created by the banking sector and sovereign debt crises, a combination that has been largely responsible for fuelling the economic crisis over the past two years. Another step would be to take action to govern finance which must be used to support the real economy. Finally, intervention is needed to share debt risks and eventually build a fiscal Union entailing distribution of European debt and the emission of eurobonds.

New Growth Engines

The policies adopted in Europe by mainly centre-right governments, led by the German Chancellor Angela Merkel, are not working. These are the so-called structural reforms based on austerity and the restructuring of supply, and are designed to open up markets and make them more competitive. However, they are unable to trigger and promote a new lasting cycle of expansion on account of the vicious circle into which European countries have spiralled and from which they are unable to escape. What is needed are structural reforms in individual states accompanied by medium- and long-term public and private investment in all the above sectors that could become new growth engines.

For example, the golden rule could be applied to agreements on strict budgetary policies, such as the fiscal compact, and alterations could be made to European and international financial rules that oppress medium- and long-term investments but reward short-term financial speculation. Moreover, use could be made of policies to reorganise national budgets by restructuring public expenditure; this would mean a reduction in current spending and more capital expenditure.

These proposals involve the re-establishment of a correct and subtle balance between markets and the supply of collective goods, essential for the efficient functioning of a growth-oriented market economy. In the past few decades, this equilibrium has been lost due to a period of ideologically driven free trade and undisciplined globalisation that has given rise to increasing instability, inequality and an inordinate concentration of economic and financial power in the hands of an élite. It is important to restore this balance, not by returning to the government activism characteristic of the 1960s and 1970s, but by promoting new methods of intervention such as those mentioned earlier. Only by introducing these new strategies can we begin to reduce inequality and restore global growth and thus comply with the ever more stringent restrictions arising from the need to consolidate public debt.

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