Opinion Corner*: Why distorted pictures of Italy are poison for European policy debates

BY PHILIPP HEIMBERGER AND NIKOLAUS KOWALL[1]

Current policy debates concerning the EU recovery fund and public debt strongly focus on Italy, the euro area's third-largest economy, which has been hard hit by the Corona crisis. The media and political discourse, however, make use of distorted pictures of the Italian economy, undermining attempts at a more nuanced and pragmatic debate. We discuss several key facts to counter prevailing narratives.

'A country cannot permanently live beyond its means. The Italian state must urgently tighten its belt!' Politicians and journalists have been repeating variations of this statement again and again when it comes to discussing Italy and its economy. Last year, we heard that Italy must stop being 'profligate' when the European Commission and political leaders of several EU member states were pushing for opening an excessive deficit procedure against Italy. Since the start of the Corona crisis, several political leaders have again lamented that Italy has allegedly failed to conduct proper 'structural reforms'. Politicians and the media have questioned whether Italy should receive any financial support.

But all of the above is based on distorted pictures of Italy. To see why, consider the following facts.

First, Italy has not been living *beyond* its means. Since 2012, Italy has consistently recorded export surpluses. In other words: the Italian economy consumes less than it produces – if anything, it lives *below* its means.

Second, high Italian public debt is primarily a legacy from the 1980s. Since then, Italy has been more 'frugal' than any other EU country. From 1992 onwards, the Italian state has consistently recorded primary budget surpluses, which exclude interest payments. Italy did more fiscal consolidation than Germany and the 'frugal four' (Austria, Denmark, the Netherlands, and Sweden).[2]

Italy's government debt of 135% of GDP is striking only because its economic growth has been so weak over the last twenty years. Rather than reducing the public-debt-to-GDP ratio, austere policies have contributed to economic stagnation so that the Italian state was unable to 'grow out' of the existing debt.[3]

Third, Italian governments have diligently followed European requirements for liberalising its labour market. In 2014, Matteo Renzi's government reduced workers' dismissal protection, which can be seen

* Disclaimer: The views expressed in the Opinion Corner section of the Monthly Report are exclusively those of the authors and do not necessarily represent the official view of wiiw.

[1] Nikolaus Kowall holds an endowed professorship for International Macroeconomics at the University of Applied Sciences for Economics, Management and Finance, Vienna.

[2] Heimberger, P. (2020): Italy is of systemic importance – European solutions are needed, wiiw website article (April 10th 2020), https://wiiw.ac.at/italy-is-of-systemic-importance--european-solutions-are-needed-n-438.html

[3] Paternesi Meloni, W., Stirati, A. (2018): Macroeconomics and the Italian vote, Brave New Europe (August 7th 2018), https://braveneweurope.com/walter-paternesi-meloni-and-antonella-stirati-macroeconomics-and-the-italian-vote

as a continuation of the process of labour market liberalisation that started in the 1990s.[4] These 'structural reforms' did not only reduce inflation and real wages. They also pushed down unemployment by generating temporary jobs: the unemployment rate in Italy was lower than in Germany and France when the financial crisis hit in 2008. However, cheap labour diminished incentives for Italian companies to make labour-saving investments – with negative effects on productivity, which is the basis for long-term growth.[5]

Fourth, Italy's average standard of living was virtually the same as in Germany twenty years ago. However, Italy has fallen behind since the introduction of the euro. By 2019, Italian per capita income was more than 20% below that of Germany. Nevertheless, Italy still records the second-largest share in the EU's industrial production behind Germany – and has been a net contributor to the EU budget.[6]

Recent developments in Italian political economy – including corruption and organised crime – should not be neglected. But it should also be remembered that Italy has never been a haven of political stability. In fact, the current government is the 66th cabinet since World War II. The mafia and corruption have always existed over the past decades. But this did not hinder the Italian economy from developing quite dynamically in the Post-World War II era running up to Italy's membership in the euro area.

Italy's persistent aggregate demand and productivity misery is also a consequence of the shortcomings of the institutions and rules in the euro area. While Italy has not been able to pursue a tailor-made monetary and exchange rate policy to support economic development since joining the euro, the restrictive austerity and reform requirements by the European Commission (and the ECB[7]) have also systematically tied the hands of national fiscal policymakers in the years before the Corona crisis. Decades of tight fiscal policy have deprived the Italian health sector of capacity to offer adequate protection for the Italian population during the COVID-19 crisis.[8]

European policy makers should avoid repeating the mistake of pushing the Italian government towards fiscal austerity and structural reforms from the market-liberal playbook. A more promising policy approach would be to go for an investment strategy and modern European industrial policies to provide a short and long run boost to economic activity.

The German government finally understands the urgent need for investment; it has been promoting a common 'recovery plan' with French president Macron. Have the Germans become altruistic? No, they just know that half of their exports go to the EU. They understand that the growth of the world economy has slowed down, and that we may soon see tendencies towards trade de-globalisation and so the importance of the EU's internal market can be expected to grow.

---

4 Cirillo, V., Fana, M., Guarascio, D. (2017): Labour market reforms in Italy: evaluating the effects of the Jobs Act, Economia Politica, 34, 211-232.

5 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.

6 Buchholz, K. (2020): Which countries are EU contributors and beneficiaries?, Statista (January 13th 2020), https://www.statista.com/chart/18794/net-contributors-to-eu-budget/

7 Rose, M. (2011): Trichet's letter to Rome published, urged cuts, Reuters (September 29th 2011), https://www.reuters.com/article/us-italy-ecb/trichets-letter-to-rome-published-urged-cuts-idUSTRE78S4MK20110929

8 Prante, F., Bramucci, A., Truger, A. (2020): Decades of tight fiscal policy have left the health care system in Italy ill-prepared to fight the COVID-19 outbreak, Intereconomics, 55(3), 147-152.

Alert minds also see the political dimension. Low levels of solidarity with Italy at the start of the COVID-19 pandemic were politically not very helpful: according to an April survey, almost half of Italians see Germany as an 'enemy country', followed by France (38%).[9] 'Friendly countries' in the eyes of the majority are now China (52%) and Russia (32%). Troll factories in the US and in Russia exacerbate such intra-European tensions. If policymakers fail to address rising discontent among the European population, the breeding ground for nationalist and anti-democratic tendencies will continue to flourish.

Upholding distorted pictures of the Italian economy would be poisonous and push into the hands of right-wing populists who want Italy to leave the European Union. If Italy were to seek an 'Italexit' after a possible right-wing populist election victory, the consequences would be fatal. Economically, the break-up of the euro area would above all strongly damage the industrial basis of export-dependent growth models in countries such as Germany, Austria and the Netherlands due to likely revaluations of their currencies. Politically, it would be the end of the decades-long process of European integration.

[9] Bechis, F. (2020): Polls show concerning effect of Chinese coronavirus charm offensive in Italy, Atlantic Council (April 17th 2020), https://www.atlanticcouncil.org/blogs/new-atlanticist/polls-show-concerning-effect-of-chinese-coronavirus-charm-offensive-in-italy/