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The Italian economy: the outlook and the need for reform

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- The spread of the new coronavirus all over the world has led to an extremely serious public health emergency and an economic crisis without parallel in modern history. In order to contain the pandemic, in many countries it has been necessary to introduce measures to curtail people's movements and social interaction, to suspend teaching in schools and universities and to temporarily close down many productive activities. The repercussions on global growth are severe.

- Already in the first half of April, the International Monetary Fund estimated that global GDP would fall by 3 per cent in 2020, compared with an increase of the same amount forecast in January. At the start of this month, the World Bank estimated a decline of 5.2 per cent. Last week the OECD released scenarios indicating a fall of 6.0 per cent in the least unfavourable scenarios and of 7.6 per cent in the event of a second wave of contagion. It has been calculated that this year will see the most widespread fall in per capita income since 1870.

- On 5 June, we presented a scenario analysis for the Italian economy as part of the Eurosystem staff macroeconomic projections. The analysis was based on alternative hypotheses regarding the duration and extent of the epidemic, its impact on the global economy and the financial repercussions. The baseline scenario is for GDP to fall by 9.2 per cent; in a second scenario based on more pessimistic hypotheses, consistent, among other things, with the need to counter possible new outbreaks, GDP would fall by 13.1 per cent.

- All the scenarios indicate that the decline in GDP, both in Italy and worldwide, will be concentrated – and for the most part this has already occurred – in the first half of this year. However, a great deal of uncertainty surrounds the speed and intensity of the subsequent recovery and, in general, the outlook for the next two years. This is due to multiple factors.

  - First of all, what happens next depends on non-economic variables, such as the course of contagion in different countries, including the possible appearance of new outbreaks, and the duration of the lockdown measures. Put simply, there is uncertainty about how long it will take and by what means the pandemic will be defeated.

- Second, there is uncertainty about the ability of the support measures adopted in the various countries to influence household confidence and consumption as well as firms' expectations and investment. In other words, it is very difficult to foresee in this situation what resources will be required, how they will be employed, and how effective they will be.

- Finally, at a deeper level, we do not know how and how much this pandemic will end up shaping our behaviour, consumption patterns, and the allocation of potentially higher precautionary savings. We ask ourselves what new needs will emerge and what social mores will be definitively left behind. And we wonder about the possible consequences for how our society and productive activity is organized. It is very difficult to predict what shape these 'new equilibria' will take or what 'new normal' awaits us.

- However, this heightened uncertainty must not become an excuse for inertia. It is, on the contrary, another reason to act immediately to strengthen our economy and to press on with a comprehensive package of reforms whose course, for the most part, has already been charted. Two weeks ago, in the Concluding Remarks that accompanied the publication of the Bank of Italy's Annual Report, I recalled the words uttered by John Maynard Keynes 80 years ago, when he suggested ways of countering the economic difficulties of a great war. In a nutshell, Keynes's idea was that the best short-term strategy was to come up with a good plan for the medium-to-long term (the same Keynes who to those suggesting that natural market forces should be left to run their course famously responded 'in the long run, we are all dead').

- Only time will reveal the results of this endeavour, but a comprehensive plan makes the path ahead clearer, shapes expectations positively, and bolsters confidence. The impulse for reform can draw on a number of strengths that characterize our economy, which notwithstanding the last few difficult years have become increasingly apparent and which it is well to recall. Despite the delays and difficulties in many areas of the country, in recent months the network infrastructures have held up, enabling millions of workers and students to continue to work and study remotely during the most acute phase of the emergency. The manufacturing sector is flexible and, already since the sovereign debt crisis of 2011-12 has rapidly recovered competitiveness, bringing the balance of payments into surplus. Italy's net external debt is practically nil. The real and financial wealth of households is high overall and their level of indebtedness among the lowest in the advanced countries, while those of firms are below the European average. In the private sector as a whole, debt amounts to 110 per cent of GDP, even lower than that of Germany (114 per cent) and half the level recorded in countries such as France (215 per cent) or the Netherlands (258 per cent). The financial system has become stronger in recent years and, despite the very serious effects of the double-dip recession, is in better shape now than it was on the eve of the financial crisis.

- For more than 20 years now, our economy's biggest problem has been low growth, in turn due to very weak productivity growth.

  - It is well known that the demographic projections are not favourable: even taking account of the contribution of immigration (estimated by Eurostat to amount to more than 200,000 persons on average per year), the population aged between 15 and 64 will decline by more than 3 million in the next 15 years. Nevertheless, assuming that the trends of the last ten years continue in a similar vein, higher female labour market participation and the extension of working lives can enable employment to make a positive contribution to growth, of more than half a percentage point per year.

  - To restore GDP growth to at least 1.5 per cent, the average annual level recorded in the ten years leading up to the global financial crisis, will accordingly require an average increase in labour productivity of almost 1 percentage point per year.

- This objective is within our reach, but its achievement presupposes a break from the recent past; it calls for the resolution of those structural problems, which for too long now we have failed to address, and which have become increasingly pressing in a new technological context and a more integrated world.

- Productivity gaps cannot be bridged through expansionary monetary or fiscal policies. Indeed, these are macroeconomic stabilization measures that are essential to achieving adequate levels of aggregate demand, facilitating full employment and preserving price stability, but they cannot, in and of themselves, raise productivity in the long term.

- In this emergency phase, the measures in support of households and firms have been crucial to mitigating the economic and social costs of the crisis; they will continue to be so in the future, in order to support demand and thereby attenuate the impact of the transition by tackling social hardship and the rise of inequality. Now, however, it is essential to map out the path of reform that is best suited to raising growth potential, and to achieving the broadest possible consensus, being aware that, oftentimes, the costs of structural changes are immediate, while the benefits only develop gradually and not always rapidly.

- Resources must be channelled to where the social returns are highest. The accumulated lag in traditional infrastructure must be overcome by upgrading it and making it more efficient, but it is possible to identify three macro-areas in which it appears equally urgent to intervene.

- The first is the public administration, which must truly be at the service of citizens and firms. A substantial improvement in the quality and timeliness of public services is required: the oft-cited necessary simplification of procedures must be accompanied by the right allocation and mindful assumption of responsibilities on the part of civil servants, managers and officials, who need to be rewarded and motivated:

we need a good bureaucracy, not an absent bureaucracy. We also need to speed up the justice system to ensure full compliance with the rules. There are two variables that have a profound impact on the functioning of any firm: technology and human resources. As for the former, what we have learnt from this crisis has shown the way forward, demonstrating the need to fast track the digitalization of all working processes and to rethink their organization. Regarding the latter, we now have a unique opportunity: the heavy turnover expected in the public administration in the coming years will make it possible to hire young, highly skilled and motivated workers from a variety of backgrounds, whose enthusiasm we must nurture and whose skills we must foster; we must invest in them and in the training of staff.

- The second area is innovation; the measures to facilitate it can be plotted along three main axes.

  – First of all, the development of highly innovative infrastructure and sectors. For example, the fixed ultrafast broadband network still only reaches less than one fourth of Italian households, compared with 60 per cent on average in Europe, and is especially penalized in the South of the country. The European Commission ranks Italy nineteenth among the EU states for connectivity. The opportunities that will come from the inevitably faster transition to a more environmentally friendly economy with lower polluting gas emissions must be seized.

  – A second point is the need to improve the quality of human capital, by tackling the underlying problems of schools and universities. Italy ranks second last in the European Union on the proportion of young people aged between 25 and 34 with tertiary education; it is ranked first for the share of young people aged between 15 and 29 who neither study nor work. Teacher quality and motivational levels are of vital importance. In many cases, school and university buildings fall short on security; they should instead be comfortable and equipped with up-to-date technology. Moreover, it is necessary to understand that the problems related to education are not only on the supply side: households must also grasp the importance of investing in knowledge, not only in school but also as a lifelong pursuit.

  – Finally, it is necessary to invest in ensuring the high-quality of Italy's research. The State spends about €8 billion in its university system, half of what countries similar to Italy do, relative to GDP. Even just the reallocation of a modest portion of the government budget would lead to a marked improvement in the training of young researchers and in fostering innovation. This would strengthen Italy's ability to tap into the European resources allocated to research; it would also benefit the productive sector, which puts barely 0.9 per cent of GDP into research, compared with 1.7 per cent, on average, in OECD countries. The hiring of new researchers, envisaged in the decree issued on 19 May, marks a significant break with the past.

- The third area to consider concerns the preservation of Italy's natural, historic and artistic heritage, which constitutes this country's very identity. The crisis in the tourist sector has made its economic importance immediately apparent. This sector must be preserved and access to it made safe, increasing the use of new technologies so that, after the pandemic, it can once again contribute to growth, even more so than before.

- The public resources needed to finance these measures and to promote the productive use of private funds must come from a restructuring of the public budget, the recovery of the tax base, a reduction in the risk premium on government bonds, and the pragmatic and judicious use of European funds.

- Excluding interest payments, Italy's public expenditure is in line with the average for the euro area as a whole, even if the share of pension expenditure is higher and destined to increase further, driven by an ageing population, as in many other countries of the European Union. Tax revenues are also broadly aligned with the average of the other countries, even if the tax wedge on labour is higher. Where Italy differs most from the other advanced economies is in the extent of its underground and illegal economy and tax evasion, which translates into an excessive tax burden for those who always play by the rules. The resulting injustices and profound distortionary effects reverberate on the economy's ability to grow and firms' capacity to innovate; they generate rents that damage the efficiency of the productive system. A comprehensive rethinking of the tax system that also takes account of the changes in the social welfare system must adopt the objective of reducing the tax levy on the factors of production.

- The sustainability of the public debt is not in doubt, but its high ratio to GDP is being maintained by the low growth potential of the country and is, at the same time, an obstacle to economic growth. Economic growth and prudent fiscal policies to encourage investment should, instead, reinforce each other, in a virtuous circle that our country is capable of activating, favouring a reduction in the burden of debt servicing costs.

- Italy's difficulties are amplified in the South of Italy. First and foremost the business environment needs to improve in the southern regions, above all as regards guaranteeing legality. The technology gap is even greater, public policies are less effective: 75 per cent of unfinished works are located in these regions, of which only 30 per cent are public works. The South of Italy is fast becoming poorer, in part owing to the emigration of its youngest and most highly-educated people to the Centre and North of the country. It is a trend that has immediate social costs and negatively impacts growth prospects.

- There have been numerous attempts to deal with 'the Southern question' over the years, with interventions that have been as differently structured as the results have been disappointing. The development of the South is essential to the development of the country: about one third of the Italian population lives in the southern regions, producing almost a quarter of Italy's GDP. Measures to support growth in the regions that are lagging behind must not distort the incentives for firms and workers, preventing the employment of the most productive resources. It is necessary to act on the factors underlying the delays – it is not enough to try to compensate for them with monetary transfers. The effects on the southern economy of efforts to reform the public administration, schools and infrastructure can be extremely significant.

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- Lastly, allow me to express my most sincere wish that these national consultations may conclude with concrete actions that allow us to take the steps forward that the country needs, now more than ever before, making the most of the opportunities offered by the new European programmes that have already been approved or are now being drawn up.

- European funds can never be free of charge: the debt of the European Union is the debt of all the member countries and Italy will always make an important contribution to the funding of common initiatives, because it is the third largest economy in the EU. The benefits of European support measures should be valued not only because of the considerable financial advantage that characterize them, but also – and above all – for the opportunity to frame the national effort within a common development strategy. This is the only way to respond to the global challenges facing us, not only those of a geopolitical, technological and environmental nature but also, as we have learnt the hard way in recent months, to public health challenges.