INTRODUCTION

The COVID-19 crisis has found in Italy a very frail patient and an ideal victim: aged and with serious pre-existing conditions. The country entered 2020 with a predicted annual GDP growth of around 0.2 per cent (below the already sluggish average since 2000 of 0.5 per cent). Productivity growth had been anemic since the early 1990s and the public debt had reached, by the end of 2019, a worrying 135 per cent of GDP.

The first outbreaks of the virus, in Lombardy and Veneto, hit the country’s industrial powerhouse and jeopardised fiscal revenues for the year 2020. Italy’s health-care system is organised on a regional basis. The responses of the regions differed. Veneto proved very effective in limiting the outbreak, through aggressive test and tracing. Lombardy did not, and paid a high price for it. Half of Italy’s COVID-19 related deaths are concentrated in this region.

The north of Italy, generally speaking, has a reputable network of hospitals. The south has not. This consideration has clearly influenced the strategy of a tight national lockdown, aiming to prevent the spread of the virus and the subsequent collapse of the health-care infrastructure in the south. The Italian lockdown meant that similar conditions to those of the Chinese province of Hubei were applied to the whole of Italy.

Predictably, the lockdown has severely impacted Italy’s economic activity, with industrial production shrinking by nearly 30 per cent between February and March 2020. Although ‘essential supply chains’ were kept active, lest groceries ran out of food, distinguishing what is essential from what is not proved to be an arbitrary exercise. The economic slowdown, in turn, had the effect of further impairing the country’s crumbling public finances. Without the economic policy measures taken between March and May 2020, the effects of COVID-19 would have caused Italy to experience a budget deficit larger by some 4 per cent of GDP and an increase of 15 per cent of GDP in its public debt-to-GDP ratio – nothing less than a dramatic change in its economic condition.

The International Monetary Fund (2020) predicts that Italy’s GDP will plunge by 9 per cent in 2020. It also estimates that measures taken by the government to counter the epidemic will cause a budget deficit of 8 per cent of GDP and that Italy’s debt-to-GDP ratio will rise from...
about 135 per cent today to 155 per cent by the end of the year. Can Italy sustain such a gargantuan public debt? Can it at least return to its pre-COVID-19 levels in, say, the next decade? Needless to say, this a much-debated issue. The simple public debt arithmetic suggests that, on the assumption that real interest rates will not be too far from zero in the next decade and that Italy will hold on to its already weak potential growth trajectory, yes, Italy would be able to go back to its pre-COVID-19 public debt levels in a decade if its primary balances could remain at 2 per cent of GDP and above in the next decade. No big deal, you might say.

But in the last quarter of a century, after allowing for the economic cycle, Italy was able to generate primary deficits of about 2 per cent of GDP in no more than eight years (and clearly it would have needed more than that). Moreover, in almost every single year in that period, Italy promised a primary balance 0.5–1 per cent of GDP larger than it eventually achieved. As economic historians know, public debt sustainability is not simply a question of arithmetic.

In short, in the run-up to the pandemic Italy was not just grey-haired and weakened by its pre-existing conditions, but also rather used to cheating on their actual severity. Against this background, on 21 February the first official diagnosis of an Italian COVID-19 patient was reported in a small town between Milan and Bologna.

2 | BEGGING EUROPE FOR MONEY

As has been widely argued,1 COVID-19 is neither a pure supply shock nor a pure demand shock in the sense that the initial supply shock may end up causing – as it actually did – a demand-driven slump (let alone another global financial crisis if something goes wrong in the near future). On the supply side, it endangered international supply chains. Moreover, social distancing – the key element in all governments’ strategies to confront the pandemic – by reducing economic exchanges contributed to further curtailing economic activity at large. It is likely that many Italians still wanted to have pizza in a proper pizzeria during the lockdowns; but they were prohibited from doing so. For once, rather than trying to stimulate activity in the wake of the pandemic, governments have been aiming to stop it. And at this task, governments performed splendidly.

This created the challenge for governments to provide forbearance – if not direct aid – to otherwise healthy businesses, which would not have gone out of business but for the lockdown itself. Frugal countries, with public finances well under control (from the Netherlands to Germany, from Denmark to Austria), did so with plenty of room for fiscal manoeuvre. Prodigal ones, like Italy, could not.

Right from the beginning, the Italian debate focused on the need for support from the European Union (EU).2 Certainly the EU has taken note of the novelty of these circumstances. Starting with a relaxation of the fiscal rules under the EU treaties, the EU helped to lighten the burden on Italy’s shoulders in a number of ways. Bond-buying by the European Central Bank, the European Commission’s programme of Support to mitigate Unemployment Risks in an Emergency (SURE), access to the European Stability Mechanism with no conditionality: all of this was vital in soothing the markets,3 and will be essential in helping Italy to borrow what it expects to need to refinance its outstanding debt and rescue its economy. As a result, the ‘free float’ of Italian debt to be absorbed by the market in 2020 could actually be less than in 2019.

Yet the country’s political class, beginning with the prime minister, has constantly downplayed European short-run support, seeking on the other hand long-term aid in the form of some sort of debt mutualisation by the member states of the eurozone, which ultimately resulted in the creation of a European Recovery Fund. While the Italian government insisted
on instruments to socialise part of Europe’s public debt, it is worth noting that it doesn’t seem particularly eager to enhance the EU’s fiscal capacity, or to adopt some kind of common fiscal institution, such as the EU common budget and finance ministry proposed by Wolfgang Schäuble, the German former finance minister and alleged fiscal hawk (Pearson, 2019).

We are afraid that this attitude is partly the result of Italy’s political cycle. With a general election due in 2023, and very possibly occurring well before then, the Italian governing majority wants to postpone the day of reckoning in terms of a programme of fiscal adjustment. The country has never returned to pre-2007 per capita income levels. In recent years, the lack of structural reform has put it on a path that diverges from that of other European nations. As the macroeconomic divergence index regularly published by the Istituto Bruno Leoni suggests, on the eve of the pandemic the Italian macroeconomic configuration was far from the eurozone or the EU average, even more so than it was in the run-up to the sovereign bond crisis of 2011 (Figure 1).

It is easy to see that Italy’s performance in the last 25 years, relative to its European peers, is one of divergence followed by short-lived convergence periods. More importantly, the oscillations shown by the macroeconomic divergence index tend to grow over time and to move around an upward trend.

FIGURE 1  Macroeconomic divergence index: Italy versus eurozone average, 1997–2021

Notes: The so-called Super Index published by Istituto Bruno Leoni is an ex-post performance indicator. It is based on the European Commission’s official economic database. It sums up in a single indicator the macroeconomic distance between every member country and the average of the EU or of the eurozone. Macroeconomic distance is defined in terms of five main indicators: (i) GDP growth rate in real terms, (ii) the unemployment rate, (iii) the government deficit to GDP ratio, (iv) the public debt to GDP ratio, and (v) the current account to GDP ratio. The index is equal to zero when a member country's macroeconomic performance coincides with the European average. It was first issued in 2015 and has since then duly mapped the diverging path of Italy, the ‘sick man of Europe’.

Sources: Istituto Bruno Leoni, http://www.brunoleoni.it/osservatorio-minghetti. Figures for 2020–21 are based on the European Commission’s official forecast as of November 2019.

3 | A NEW WAVE OF INTERVENTIONISM

The Italian economic response to COVID-19 displays four key features.

First, while made up of the same basic ingredients as those adopted by other EU member countries, Italy’s anti-COVID-19 economic policy differed substantially in its composition. An
immediate fiscal stimulus, much smaller than the eurozone average, was accompanied by larger-than-average deferrals and liquidity guarantees (Anderson et al., 2020), a textbook example of what limited fiscal elbow room allows when the rainy days come. Moreover, the fiscal impulse was distributed among an endless number of small bonuses, mostly targeted at a variety of different constituencies, thereby losing effectiveness and fairness.

Second, although announced as ‘powerful’ (poderoso) by Prime Minister Giuseppe Conte, the details of the government’s anti-COVID-19 economic plans took months to be defined. Because they are announced by instalments, Italian policies are still largely ineffective and partially unknown. We can think of very few comparable examples of such policy-induced uncertainty.

Third, all of the measures already undertaken, and those still being considered, point in the direction of a massive expansion of the state’s power to intrude into – if not to run outright – business and finance. This is a policy goal candidly advocated by a number of Italian government advisors.

Finally, as mentioned, the political debate has revolved around the need for European aid more than anything else. Possible supply-side, albeit partial, remedies for the country’s predicament have never been seriously considered. The implicit assumption is that only the state will be able to lift the country from its present condition, through a large programme of public spending in virtually all fields of economic activity.

In dealing with the health-care emergency, narrowly defined, the Italian regions seem to have increased their intensive care unit (ICU) capacity. The number of ICU beds was doubled in a month (Giglio, Citino, Depalo, Francese, & Petrella, 2020), thereby sowing the seeds of a more effective health response in the event of a second wave of the virus.

As for the economic response, apart from the money transfers we have mentioned, the first initiatives went in the direction of forbearance: public guarantees were extended to new loans and to refinancing existing ones, leveraging the resources of Mediocredito Centrale, a government-owned bank, and SACE, an insurance company. Following a well-known Italian habit, just writing something down was mistakenly confused with something actually happening. Eventually (and predictably), the banking system stuck narrowly to the old rules and thereby slowed down the entire liquidity flow towards firms and led the public to the (not entirely unfounded) belief that a heavily indebted guarantor could not be fully trusted.

Right from the beginning, part of the rescue package was hijacked for more debatable initiatives, such as nationalising the bankrupt airline Alitalia (EUobserver, 2020). Such a move was made possible by the weakening of EU state-aid discipline, which in normal times would have prevented it.

In a medium-term scenario, the government seems determined to use the crisis to expand its footprint in the Italian economy. Italy’s primary public spending reaching 51 per cent of GDP in 2020 is not a novelty: the country has a history of broad intervention in the productive sector, only partially reversed in the 1990s. Directly and through its holding company IRI (dissolved in 2002), the government used to control vast sections of the chemical, pharmaceutical, oil, food, automobile, energy, telecommunication, infrastructure, steel and building industries. Widespread government ownership of companies was supposed to be ended by EU rules on state aid; an agreement between then Foreign Affairs Minister Beniamino Andreatta and then EU Competition Commissioner Karel Van Miert was concluded in 1993. Until then, government guarantees had helped state-owned conglomerates to borrow money at artificially low interest rates in financial markets. A backstop plan was agreed to restructure government-owned companies’ debt, providing for a gradual reduction of the indebtedness of IRI, and the
privatisation of its various subsidiaries. A large portion of the Italian political class has ever since lamented the demise of the ‘entrepreneurial state’ and now looks forward to an opportunity to rebuild it, including by buying equity in private businesses. Not surprisingly, such a world view now justifies itself by appealing to the need for the ‘protection’ of Italy’s businesses.

Since the COVID-19 outbreak, the Italian stock market has lost something like 30 per cent of its value. In a familiar move, short selling was banned. Then the property rights of shareholders were further restricted by extending the ‘golden power’, the Italian version of the British ‘golden share’. These rules, aimed at dictating conditions around, or even banning, the purchase of shares by foreign parties, are now applied to insurers, to ‘critical infrastructure’, to nanotechnology and biotech companies, to artificial intelligence, robotics and cybersecurity, to companies that deal with ‘sensitive information’, including personal data, and to the food supply chain (at the government’s discretion).

So entrepreneurs’ property rights have been de facto curtailed – an implicit and barely noticed capital levy – as they are by a ban on firing employees, which will likely result in an explosion of unemployment as soon as the ban is lifted.

‘Flattening the curve’ took time: the lockdown was relaxed on 4 May, with 100,000 active infections, according to the official count, which is likely to be an underestimate.

4 | THE FUTURE OF ITALIAN BUSINESS

The Italian economy is a mosaic of small and medium-sized enterprises. Companies with annual revenues of less than 50m euros make up 92 per cent of Italian businesses. Though this fact has well-known downsides, it should in principle allow a certain flexibility for the Italian economy at large in a crisis such as the current one. Smaller businesses should have a more rapid and smoother transition, thereby facilitating a better allocation of resources.

Generally speaking, we expect an economy to exit a crisis with a rebound and a burst of economic dynamism. Marginal activities end up being shut down and new entrants fill the resulting void. This is not the case, however, with the Italian economy, whose economic dynamism – its ability and willingness to allocate resources efficiently – has been steadily declining in the last quarter of a century.

Istituto Bruno Leoni is currently working on an ambitious research programme, aiming to provide a panoramic view of business dynamism in Italy since the early 1900s. Examining the creation and destruction of companies can provide us with better evidence of what is going on in an economy below the surface of economic aggregates. Alas, we already seem to have rather conclusive evidence with respect to the topics discussed here (Figure 2). This should come as no surprise: Italy is increasingly hostile to change. Rather than just asking for protection when needed – looking to the state only when the market is unable to insure against a specific risk – Italians would like the frame of the movie to be frozen for ever. Failed businesses such as Alitalia should be kept alive irrespective of the facts. Redundancies should be denied instead of being duly recognised and transferred, via education and training, to healthy jobs. Obviously not all Italians share these views but opinion polls indicate that most of them certainly do. And Italian politics – whatever the party affiliations – far from leading, follows, ignoring the long-term effects of such attitudes.

It is reasonable to expect the economy to rebound in 2021, but it is unlikely that Italy will fully recover. The rigidity of its economy and the parlous state of its public finances are unlikely
to be offset by an explosion of entrepreneurial inventiveness and creativity. The fallout of the last crisis is a sad precedent. On New Year's Eve in 2019 Italy was the only country in the eurozone still not to have fully recovered from the global financial crisis of more than a decade ago. Its per capita income was between 5 per cent and 10 per cent smaller than that observed in 2007. What happened since 2007 simply made things worse in a number of respects. It is easy now to suggest that the Italian recovery after the pandemic will not be anything other than painful and slow, amidst a number of serious risks for Italy as well as for the eurozone.

It may well be that Italy has won the war against COVID-19 (or, at least, let us hope so), but it is quite likely the Italy will end up losing the peace. Will it be the only country in such a position?

NOTES

1The literature on the macroeconomic consequences of COVID-19 is itself of pandemic proportions. The review by the Bank for International Settlements (Boissy & Rungcharoenkitkul, 2020) and the International Monetary Fund’s Special Series on COVID-19 (https://www.imf.org/en/Publications/SPROLLs/covid19-special-notes) are obvious references.

2And, as expected, when cornered Italy did not refrain from raising its voice and stating that, if the European Union would not listen, Italy would go it alone. Nobody dared to explain how.

3It should be underlined that, if institutional differences are duly taken into account, the overall EU economic policy response to COVID-19 has not been different from that of the US.

4Interestingly, Giuseppe Conte, the current Italian prime minister now leading a centre-left parliamentary majority was the prime minister leading a centre-right parliamentary majority in 2018, when a budget law breaking all the EU fiscal rules was publicly celebrated. As Italians say: il tempo è galantuomo (‘time is a gentleman’).

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