Ministero dell'Economia e delle Finanze

Italy's economic outlook and policy challenges in the European context

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Washington 29 gennaio 2019

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Since last spring Italy has been a focus of attention in the financial markets and among policymakers, as a new and untested coalition took office and the economic recovery stalled.

There is no question that the past seven months have been challenging and that the outlook is not immune from risks. However, I believe we have achieved important results at the political and policy level, in particular with the recent enactment of the 2019 Budget and the agreement with the European Commission – and we can now focus our efforts on concrete actions to revitalize our economy and the process of European integration, and to improve social cohesion in our country.

As is well known, since the turn of the century Italy has suffered from unsatisfactory economic performance. The global financial crisis of 2008-2009 and the Euro area sovereign crisis of 2011-2012 dealt a further blow to our economy, which only slowly recovered in 2014-2018.

In this context the Italian government program aims to improve social cohesion and inclusive growth, within a path of debt reduction.

To this aim, increased resources are secured to stimulate private investment and to revitalize public investment, both in terms of financing and of technical and organizational resources.

In recent quarters Italy's real GDP growth slowed down because of the fall in the growth rate of trade and the concurrent weakness in the European business cycle.

In October, the economic conditions worsened, giving support to our thesis that the fiscal stance required to strictly fulfil European fiscal rules could have been excessively tight.

In December, the evolving national and international economic scenario made possible an agreement with the European authorities on the budgetary targets for 2019-2021.

According to this agreement, the nominal deficit target for 2019 has been set at 2.0 percent of GDP. We are also committed to lowering the deficit in 2020 and 2021, both in nominal and structural terms. The nominal targets are 1.8 percent of GDP for 2020 and 1.5 percent for 2021. These targets will ensure the decrease of the debt/Gdp ratio during the next three years.

Now, let me briefly describe the main policy measures adopted with the Budget Law.

Social inclusion policy

Regarding the policies for inclusive growth, the new 'Citizenship Income' measure aims to combines a universal income scheme and a labor-market activation mechanism.

The income scheme will provide a monthly payment to lift people's income above the relative poverty threshold. Eligibility is defined via a series of income and wealth indicators. The beneficiaries must enroll with employment centers and join a training program. But they lose the benefit if they turn down adequate job offers.

The new policy also envisages incentives for firms that hire workers currently enrolled in the program or for beneficiaries that start a new business or professional activity.

These norms are largely experimental with an envisaged start off according to a learning by doing process. Nevertheless, the measures are designed in a way that should be able to explore and exploit opportunities to expand employment by acting on both the demand and the supply side of the labor market. They include instruments that address the high level of present and predicted job mismatch, such as training and employment search, as well as incentives to employees and employers to search for and provide rewarding work.

Through these measures we try to address three crucial issues: the stock of poverty accumulated in the last ten years, current unemployment and the growing expected unemployment due to the technological transition.

The government policy program not only addresses Italy's gap on inclusion policies, it also focuses on enhancing the country's growth potential.

As far as taxation is concerned, the 2019 Budget broadens the eligibility of the existing simplified tax regime for low-income self-employed professionals and small businesses. The tax rate on net earnings is 15 percent for the self-employed with revenue of up to 65 thousand euros and 20 percent for professionals and small businesses with revenue of up to 100 thousand euros.

The statutory corporate income tax rate is reduced from 24 percent to 15 percent for companies that raise capital expenditure and increase employment.

Additional incentive measures for private investment in human and non human capital and innovation are also financed.

Most importantly, the government is committed to increase public investment, which has fallen from 3 percent of GDP in the ten years preceding the big crisis to an estimated 1.9 percent in 2018. The drop in public investment was not only due to fiscal austerity, but also to a gradual loss of planning and execution capacity, especially at the regional and local level.

Furthermore, the anti-corruption policy that was introduced in 2016 (Public Tender Code) based on a European Anti-Corruption Directive increased the complexity and unpredictability of the legal framework for public works.

Re-launching public investment is a key element of the government agenda, but also the greater long run challenge for the entire economy.

Not only public investment has been falling as a percentage of GDP, but also spending for maintaining existing public infrastructures has declined.

Many signs indicate that public capital is deteriorating alongside an even more worrisome fall of both the level and the quality of human capital. Because of the vertical fall in the quantity and quality of public investments, in fact, private investment intentions, in our country, increasingly face the prospect of settlements in backward areas, with scarce human capital and insufficient physical and civil infrastructure. Thus, the increase in public investment is needed not only to sustain domestic demand but mainly to increase the productivity and return of private capital.

What is lacking is not simply traditional public works, but an adequate response to the growing importance of technological progress and the systemic nature of modern infrastructures.
We need also more investment in social infrastructure, such as schools, universities, research centers for producing human capital, and fueling confidence and dynamism in a scenario dominated by uncertainties and worries about the unexplored future.

The crucial cause of the fall in public investment, on the other hand, is the deterioration of the ability of public administrations to manage investment projects, in their increasing complexity of the system, from the technical-

economic planning of works and maintenance to selection processes, evaluation and monitoring.
Beyond the financial resources, and in spite of potential and high returns, public capital tends to decrease because the ability to move from intentions to facts finds a prohibitive limit in the human and social resources available for the realization of quality investments.

These considerations are not new. What is new in the action of this government is however the attempt to run an ambitious new experiment of economic policy by allocating a critical mass of resources in reconstructing the administration's ability to plan, design and manage the infrastructures necessary for economic development.

To this end, in the budget law, the Government increases the funds available to public investments, but also allocates new and increasing resources to address the problem of substantial unspent appropriations that have accumulated due to the limited capacity of the administration to translate them into concrete achievements.

Long term challenges

Policies for social inclusion and private and public investment are also necessary to meet the long term challenges of the new technologies and the world-wide drive for their adoption which carry high long term risks and make them widespread.

This depends on intrinsic dangers in the commoditization of knowledge and on the diffusion process induced by hyper-connectivity. But it also relates to the new economic instability of the middle income class, disenfranchised and endangered by failure to adapt to new technologies and international factor movements.

These risks include threats to present jobs and rents and perceived rights of all sorts, magnified by the intrinsic fragilities of the wealth position of the middle class, highly dependent on economic growth and established order for the maintenance of its present and precarious well being.

The promise of technological progress, with menacing announcements of increased automation, higher factor mobility and lower border protection for nationally entrenched rights, therefore, goes hand in hand with a de-stabilizing trend. In turn this trend propagates and multiplies risks to all aspects of social living.

An additional structural factor for increased uncertainty is related to the Schumpeterian concept of creative destruction. A recent debate challenged the well-established idea that the contribution on GDP of the creative component of innovations, productivity and employment is much bigger of the effect of the destructive component, at least in the long run.

Although this idea has been confirmed by the history of the economic growth, we know that when and where the destruction occurs and when and where the creation occurs is relevant in the short and medium term. In other words, we have to consider the negative externalities due to the distribution of the destructive effects of innovations across productive sectors, firms, citizens and countries. This demands both a strengthening and reform of social protection for those left behind by the technological race.

This is also necessary because of the negative effect arising from the fact that the current globalization of the economy can increase the risk implicit in any innovation investment because of the increased speed of both technological change and of its diffusion around the world and, as a consequence, of technological obsolescence of previous innovations and investments.

That is to say that if the firms that invest in innovation and new technologies risk to never be able to reach the breakeven point in time for a business return, the destructive component of the Schumpeterian competition in this new context can have a growing negative impact also on the investments decision of potential innovator and investors.

In sum, investment and social inclusion are the pillars of our economic strategy not only from the short term perspective but also in response to a vision for long term challenges.

Thus, I trust that firms and financial market investors will realize that Italy's new policy framework is aimed to improve the investment climate and social cohesion, trying to combine financial and social stability.

The European dimension of economic policy and EMU deepening

Of course, for our economic policy plans to be fully realized we need a supportive and consistent European framework. There has been much noise about Italy's new coalition and its views about Europe. This noise is probably the main reason why our sovereign bonds are trading at yield levels that still look excessive vis-à-vis our country's fundamentals (trade and current account surplus, balanced net international investment position, high level of net financial wealth, continuing primary surplus since the beginning of the century, the second largest European manufacturing sector).

This explain why the high Italian debt, that is a legacy of the last century, even though it is a burden for the Italian economy, has been and is fully sustainable. This is particularly true in an environment characterized by historically low interest rate below growth level. Nevertheless, the Italian government is determined to reduce public debt, continuously and progressively.

I want to be also very clear on the relationship between Italy and Europe: our government wants to change Europe, but believes that Italy's position is and will remain in the EU and in the single currency.

However, we think that European economic policy needs a major boost in terms of deepening of the integration process, the governance of global processes and the taking charge of an ambitious and transformative program of Europe's macroeconomic and fiscal policy framework aimed to growth and to regional and social inclusion.

Some of the mechanisms of the currency union, including those that were introduced during the debt sovereign crisis, are intrinsically deflationary -- notably due to the asymmetric treatment of fiscal and current account surpluses and deficits.

This deflationary bias needs to be redressed as the model of export led growth and fiscal surpluses of some our European partners contributes to internal and external aggregate imbalances and is one of the causes of Europe aggregate low growth performance.

It also fuels divergence and fragmentation within the union and is ultimately unsustainable and self-defeating, given the trade tensions and the negative spillovers that it engenders.

Discussing all the facets of EMU reform would take an entire seminar. I would simply close by saying that we believe Europe's fiscal stance must be more supportive of growth and in particular of investment. Imbalances must be addressed not only via structural reforms, but also through a Euro area budget focused on rebalancing and competitiveness, and in particular on investment in modern infrastructure, research, innovation and sustainable development.

Thank you for your kind attention.