THE ITALIAN ECONOMY AFTER COVID-19

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Short-term Costs and Long-term Adjustments

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The COVID-19 crisis and Italy

by Pier Carlo Padoan

Twenty years from now, historians will look back at the COVID-19 crisis as a major turning point in the history of Italy, Europe, and the global system. How will they describe it? Certainly in terms of its breadth and depth (the most severe crisis after the Great Depression) but, also, in terms of its nature. Contrary to the Great Financial Crisis of 2008-10, COVID-19 is a "double crisis", impacting both public health and the economy. It is the interaction between these two components that has made COVID-19 an unprecedented event (at least in contemporary history). The interaction and tradeoffs have been such that improvements in public health meant a deterioration of economic conditions, and vice versa. This has necessarily led to prioritizing the lockdown measures and "accepting" the inevitable: negative demand and supply shocks. Only once public health had returned to "normal" – or was about to – could policy direct its efforts towards economic recovery. In the process, however, the economy has been affected, essentially, in all its components, as the contributions to this book demonstrate. This has led to huge costs, both short – and long-term. In some cases, the crisis has generated permanent changes in the structure of the economy, and in the behavior of companies, workers, households, and the State. Future historians will be in a much better position to assess such changes. From our vantage point, however, we can offer brief remarks on some of the longer-term changes, ignoring, for the sake of brevity, the short-term aspects (while recognizing that many short-term changes produce long-lasting scars). And with no ambition to present an exhaustive list.

The crisis has significantly accelerated, in Europe and elsewhere, the transition towards a digital economy, in terms of organization of (smart) work, as well as increasing demand for both digital skills and digital capital, much of which is intangible. At the same time, it has unveiled infrastructure gaps – including 5G networks – as well as skill gaps, and it has indicated a new reference framework for both private and public investments.

The crisis has, possibly, also accelerated the transition to a greener economy, aside from the fact that the recession reduces emissions, like it did during the Great Financial Crisis. The recovery will be a great opportunity to pursue a different, more sustainable, growth pattern. It will be a great opportunity to escape from the path dependency of past growth, production and consumption patterns.

The move towards the twin transition has inevitably activated strong adjustment pressures in labor markets and on welfare systems. The response has been markedly different across countries and regions.

The crisis has changed the relationship between the market and the State. Public intervention has been on restoring strong demand, adopting short-term, defensive measures, in the face of the huge drop in production and employment, but also longer-term measures, such as the State acquiring shares in companies affected by the crisis on a temporary basis to support the transition. It remains to be seen how soon and how fast the State will withdraw.

Europe has changed by adapting its long-term strategy – the green deal – to the challenges of the crisis. A number of new instruments have been introduced to implement the strategy, linking the emergency with the recovery, carrying significant financial resources (ESM, SURE, EIB guarantees, and especially Next Generation EU). While important in the short term, these resources will largely impact the long term. The challenge will be to boost growth while leading the European Union towards the twin transition: digital and green. The impact of such measures will also depend on how effectively national policies respond, especially on the structural front. In this respect, the exit from the COVID-19 crisis may well be the single most effective driver of structural reforms in decades.

Major changes will be seen in global economic and political relations, not necessarily all for the better.

Global value chains have been disrupted by the huge supply shocks and, as a consequence, regional rather than global investment and trade patterns may emerge. At the same time, the productive specialization of countries is undergoing significant changes driven by the new comparative advantage patterns shaped by the crisis. Not surprisingly, sectors less dependent on direct proximity provision (such as hospitality or tourism) have been rewarded by the crisis and will likely increase their market and profit shares. The opposite will hold for traditional services and transport industries.

Contrary to the response to the Great Financial Crisis, international cooperation has barely risen to the challenge. In 2008, major countries responded by establishing the G20 at Leaders' level to take on the role of primary forum for international economic governance. The policy response to COVID-19 has been similar in many countries but largely non-coordinated and, in some cases, characterized by beggar-thy-neighbor attitudes. Trade tensions have increased. The US administration has made it clear that the G7 should consider China as an adversary and Russia as an ally. In general, governments have failed to recognize the public good nature of security, including health security, and therefore the benefits of a coordinated response. International relations have deteriorated significantly, accelerating a pattern which was visible well before the pandemic. Bilateralism rather than multilateralism has characterized relations among key players.

This book focuses on the impact of the crisis in Italy, but many, if not all, the chapters highlight the relevance of the links between the domestic economy and the international system; not surprisingly, one might say, given the post-War history of the country. This has generally been a positive relationship. Only time will tell if Italy is able to take advantage of the COVID-19 crisis to accelerate the transformation it badly needs, while keeping to its traditional openness, support of multilateralism, and pro-European attitude.

Introduction[1]

by Giorgio Bellettini, Andrea Goldstein

The goal of this book is to shed light on what has happened in Italy during the COVID-19 outbreak, an exceedingly momentous time in national history, in a variety of ways: concerning what the response has revealed about the performance of the economy, the underlying policy forces, and the structural outlook. This volume is an instant book of sorts, in the sense that it is reaching bookstores only a few weeks after the lifting of most containment bans (although many social distancing measures remain in place) in Italy and elsewhere in Europe, signalling at least a temporary victory over COVID-19. Nonetheless, it is also meant to serve as a compass to help repair the immediate economic and social damage and kick-start the recovery, now that a modicum of normality has returned. At a juncture when a lot of dangerous noise surrounds discussions about public policies and endangers the very fabric of democracy, the contributions are scholarly, value-neutral, and evidence-based (with the unavoidable limitations of high levels of uncertainty surrounding the epidemiological horizons, insufficient and generally low-quality data, and relatively scarce clarity concerning the policy framework).

Questions range from the impact of the pandemic on short-term growth and social development, to the rules that will govern the reconstruction, from the role of Italy in Europe and its relationship with China, to the lessons learned in participating in global supply chains. Some topics could not fit into the book, but deserve long-term attention; in particular the future of retail, an industry that is the country's largest private-sector employer and like no

[1] The opinions expressed and arguments employed herein are those of the authors; in particular, they do not necessarily reflect the official views of the OECD or of the governments of its member countries.

other defines urban landscapes and the quality of life; and the implications of COVID-19 for territorial development, for Milan, and for southern Italy, the *Mezzogiorno*.

At the time of the writing, the virus had globally killed around 606,000 people and led to unprecedented job losses in OECD countries and emerging economies. In the OECD group of advanced economies, it will cause an estimated 13% drop in GDP in 2020, with a doubling of the unemployment rate from around 5% pre-crisis levels, despite emergency measures aimed at preserving employment levels in many countries. The economic impact is likely to be even larger in emerging economies and developing countries, leading to the first drop in their GDP in decades. At the same time, virtually all governments have deployed measures to deal with the shock on a scale and scope that was previously unimaginable. Overall, the fiscal cost of these measures is estimated to amount to around 19% of EU GDP and over 14% of US GDP, with a corresponding tenfold estimated increase in general government budget deficits in both the US and the Euro Area.

In terms of human lives and economic disruption, Italy was hit disproportionally hard by the COVID-19 outbreak of winter-spring 2020. By July 17, a total of 243,967 cases were registered, of which 35,058 died. At this point in time, only the United States, Brazil, the UK and Mexico had a higher number of cases; only Belgium, the UK, and Spain had experienced higher death rates. In March, two weeks after February 21, when Adriano Trevisan was the first victim of the pathogen in Vo' Euganeo, Italy held the daunting title of the country with the most deaths for 23 days. The population structure (in particular, the high number of elderly people, with 7.5% of the population older than 80 years old, second only to Japan) made the country particularly vulnerable to the spread of the novel coronavirus (Impicciatore, ch. 2) – although a definitive demographic history of the pandemic, globally and nationally, will require fully comparable and much better data than those currently available. In fact, data from death registries, from approximately 85% of Italian municipalities, suggest that the number of deaths directly and indirectly caused by the pandemic could be significantly higher than official reporting.

In Europe, Italy was also initially unique in the breadth of the reaction. While there were serious problems in terms of timing, communication, and implementation, authorities took early containment measures that could be considered draconian in a democracy. For the population at large, the lockdown was introduced on March 9 and extended to most non-essential business activities on March 21; these containment measures started to be lifted in phases from May 4 onwards. In mid-March, it was almost a cliché to criticize the Italian approach as alarmist and excessive; by early April, all other EU countries (except Sweden) and most US states had adopted similar, if not even more stringent, measures.

Overall, these measures have succeeded in containing the pandemic: the average number of new daily cases is currently down to around 200 (from a peak of 6,557 registered on March 21), despite a large increase in testing. As a result, the pressure on the health system has abated, with the number of COVID-related hospitalized patients dropping by more than 90% from its peak (of around 29,000) and patients in intensive care falling below 200 (from a peak of around 4,000 in early April).

It is too early to assess the damage that the pandemic has inflicted on the Italian economy, but some high-frequency data paint a damning picture. In April, new car sales were down 97.6%, electricity consumption 17%, and retail sales 26.3% with respect to April 2019. The loss to industrial production was of warlike proportions (19.1%), although some sectors, such as pharmaceuticals, food and beverages, and tobacco, have done better than others (Manzocchi, Romano, Traù, ch. 11). In the case of tourism, a sector that directly accounts for more than 5% of GDP, it is impossible to describe the consequences as anything short of dramatic. In March, the number of airline passengers plummeted by 85% relative to March 2019. For the year as a whole, inbound arrivals in Italy might fall between 60% and 80% with expected losses of between 1.5% and 2% of GDP, taking into account direct effects only. If domestic tourism is included, losses could reach 3.3% of GDP in the worst-case scenario (Mariotti, Figini, ch. 12).

The OECD forecast for 2020 GDP growth moved from 0.4% (November 2019 release), to 0% in March, to -11.3% or -14% in June (depending on whether or not there is a second hit in the fall). While in the short run the increase in unemployment was not as large as recorded in other countries, in April 2020 furloughing authorized hours (Cassa Integrazione Guadagni) were up by 2,900% relative to the same month of the previous year. The long-term implications for the labor market are likely to be devastating especially for low-educated and informal workers as well as young people and women (Garnero, Scarpetta, ch. 8), as will be the psychological sequels from the trauma of living under isolation, economic uncertainty and, for some people, the death of friends and loved ones (Dragone, ch. 6). Gender-based discrimination, and the ensuing underutilization of women in the workforce, were laid bare during the lockdown period, and the recent Family Act can only represent a first step to promote female employment and entrepreneurship (Profeta, ch. 9).

The Italian economy was already in a parlous state, having yet to recover from the sharp double-dip recession in 2009-10 and 2012-13 (Nicoletti, Pisu, ch. 1). Its public finances were under heavy pressure even before the pandemic; mounting a fiscal response to the decline in aggregate demand will create even greater strain, with public deficit and public debt over GDP expected to rise 7 and 20 percentage points respectively in 2020 (Manasse, Moramarco, ch. 4). The current recession has featured a surge in household savings that reflects growing fears for the future. There is therefore a serious and justifiable concern that the outbreak may have long-lasting and highly damaging consequences. To cite but one example, Italy was already performing poorly in international assessments of education outcomes and the school disruptions of 2020 will weigh heavily on any hope of a quick rebound (Gavosto, Romano, ch. 7). Banks that had painstakingly managed to clean up their assets and improve their ratings may fall back into crisis under the weight of huge non-performing loans (Brogi, Lagasio, ch. 10). The productivity sickness that has plagued Italy for the past quarter of a century risks worsening in the “new normal”, unless high-growth start-ups find a more favorable ground to flourish in (Fini, Sobrero, ch. 17).

The political economy of the pandemic has proven rather complex. COVID-19 has brought about an unprecedented concentration of powers in the hands of the executive and the prime minister in particular: not even during the worst moments of terrorism and Mafia attacks against the State in the 1970-90s were emergency measures so pervasive. The role of the state in the economy, as regulator, owner, and facilitator, has grown in a matter of weeks, sometimes reflecting broader European trends (Manzini, ch. 15), sometimes reflecting a deep-rooted suspicion towards market mechanisms (Pammolli, Stagnaro, ch. 16). There have also been calls for nationalizing so-called strategic industries and a multi-billion bail-out of Alitalia, twice the size of the funds earmarked for emergency education resources, which has generated considerable debate. To complicate things further, the model of imperfect federalism that Italy adopted two decades ago revealed its limits, as regions and even municipalities took uncoordinated actions in a variety of policy domains, including health (Pisano, Sadun, Zanini, ch. 5).

Last but not least, the crisis is also impacting Italy’s international positioning and in particular its relations with Europe (Jones, ch. 18) and China (Gabusi, Prodi, ch. 19). The initial reluctance of EU partners and institutions to succor Italy, some communication problems of ECB President Christine Lagarde, and the opposition of the so-called frugal nations to a €750 billion package of grants, loans, and guarantees to be partially financed by EU taxes, all combined to make an increasing share of public opinion wonder whether Italy could be better off without the Union (Coricelli, Lorenzoni, ch. 3). This sentiment was accentuated by gestures from China (and other countries such as Cuba and Russia) which offered humanitarian assistance and medical equipment to Italy. The relationships between Rome and its traditional European reference allies and the new power, China, are not only a curio for foreign policy wonks: they are fundamental questions for global governance given that Italy will chair the G20 in 2021, the last G7 country to do so before a string of emerging economies in 2022-25. Rowing against the tide of those who wish to roll back globalization and multilateralism, Italy can help to shape it better, especially in the realm of climate change (Galeotti, Lanza, ch. 14) and trade (Cotignano, Lanza, ch. 13), but also migration (Impicciatore, ch. 2).

May there yet be a silver lining in the current crisis, the severity of which is probably still a distant notion for many? Italians discovered some unexpected strengths in their country: the overwhelming majority of citizens immediately abided by the law, and the health system did not break down despite facing unprecedented challenges. Companies, households and individuals adopted innovative practices during the emergency period such as digital payments, telework, staff rotations and distance learning that may be common in other geographies, but could be considered a cultural revolution in Italy. In a country that has suffered from an acute brain drain in the past two decades, a Dutch cell biologist at Milan San Raffaele Hospital spearheaded an international consortium of scientists to explore an innovative approach in the search for the COVID-19 vaccine – to let the natural evolution of the coronavirus produce its own vaccine.

Many prestigious luxury brands, known globally for expensive cashmere suits and leather handbags, converted their production lines to contribute to the emergency efforts, in particular for personal protective equipment. In the nation's economic heartland, its celebrated pocket multinationals launched innovative products such as a handle that can be used with the elbow to prevent the spread of the virus (PBA of Tezze sul Brenta). The same happened with equally famous industrial districts such as Mirandola in Emilia-Romagna, specialized in biomedical equipment. In the area wrappedaround the medieval town, roughly 100 companies have been working flat out on coronavirus-related production such as filters and circuits to help supply oxygen, and disposable medical items to hook patients up to ventilators. In only 72 hours, a company launched the production of a prototype circuit developed by an Italian medical team allowing two patients to use the same ventilator – effectively doubling capacity at a stroke (Intersurgical). A start-up created by approximately 20 researchers to provide biotech research services switched to certifying the masks made by newly converted fashion plants (Tecnopolo).

At the end of May, the European Commission presented the Next Generation package which, if approved, will require Italy, and other Members, to elaborate a vision and a strategy. The European Recovery and Resilience Facility, which is justifiably creating so many expectations, is to be embedded in the European Semester and the National Reform Program. Governments have a chance to invest in reshaping economies, and none is more in need than Italy's. Over the longer-term a transformation strategy is crucial. This would mean accelerating the tortuous path of administrative reforms and simplications, building in resilience to infrastructure projects, investing in education, skills, and retraining, or supporting the green transformation. We hope that the analyses and proposals made in this book may prove useful in this regard – a simple return to business-as-usual, with its burden of inefficiencies, rents, and inequities would be to betray thousands of victims, hundreds of thousands of health and other workers who have been fighting on the frontline, and millions of people who are and will be suffering the economic consequences of the Monster.

This book would not have been possible without the enthusiasm of the friends to whom we wrote in mid-March to propose to join us in this adventure, with no budget, no publisher, no data. Authors have been incredibly generous with their scarce time and have forfeited their copyrights, that together with the proceeds from the sale of the book will be donated to the Sant'Orsola University Hospital Foundation in Bologna (specifically to the Più forti insieme initiative). In Bononia University Press we found a highly driven and versatile partner. In May we wrote again, to different, but equally busy, friends, requesting their help in reviewing the draft papers in a matter of days. Again, instead of well-justified disconcert, we met with professionalism and generosity: our thanks to Alissa Amico, Crispian Balmer, Giorgio Basevi, Bernardo Bortolotti, Matteo Bugamelli, Valentina Canalini, Jonathan Coppel, Riccardo de Bonis, Elsa Fornero, Roberto Galbiati, Giorgio Gomel, Fabrizio Guelpa, Jeff Israely, John Mathews, Sonia Lucarelli, Giulia Ajmone Marsan, George Papaconstantinou, Despina Pichnou, Lucrezia Poggiali, Andrea Presbitero, Louise Rosen, Paul-André Rosental, Michele Ruta, Barbara Stallings, Alessandra Venturini and Greg Viscusi.