Populism and the broken engine of the Italian economy

In Italy, the temptation to go back in time, or shut the door to Europe and globalisation is strong, especially after a quarter of a century of poor economic performance, argue **Lorenzo Codogno** *and* **Giampaolo Galli***. Anti-establishment parties, which gained an outright majority in Parliament in the country's recent elections, blame the past reform process, together with the threats arising from globalisation, European integration and immigration, instead of arguing for an even bolder reform agenda.*

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Italy is an anomalous case. It posted the lowest growth rates among the developed countries for about a quarter of a century. This anomaly can help to understand why the anti-establishment forces, which have also reaped successes almost everywhere in the Western world, gained a majority in the latest Italian elections. It also helps to understand the economic policy dilemma facing the country today.

Although the link between the economic crisis and the success of anti-establishment parties is not mechanical, it is evident that these same parties have denounced the many aspects of deteriorated social conditions and that this has been the key to their success.

The elections produced a good result for the Five Star Movement, a populist anti-establishment party that did not exist ten years ago and is now the first party in the Italian Parliament, with 32.7% of the popular vote and 35.2% of the seats in the Lower House. Another party scored particularly well, the League, which is an anti-immigrant anti-euro far-right grouping that used to be in favour of devolution for the North (Northern League) and now has ambitions for the whole country. It got 17.4% of popular votes and 19.8% of the seats in the Lower House. Together with other more moderate centre-right parties, it now commands 42.1% of the seats. The incumbent, the Democratic Party, collapsed to 18.7% of the votes and now, together with smaller groupings, controls only 19.4% of the seats in the Lower House. Bottom line: it is a stalemate. Over the next few weeks, the President of the Republic will try to broker a deal to form a new government, which looks a very challenging endeavour, to say the least.

As to the poor economic performance, Italy's per capita GDP stands at 106 if we put 1995 equal to 100, which means that Italy has barely grown over almost a quarter of a century. All the other OECD countries have done better, including the wretched Greece that stands at 116. The Eurozone without Italy stands at 135, which corresponds to average annual growth of 1.4% over 1995-2017, broadly the same growth recorded in the United States. Among the other major countries, Japan was second only to Italy, but it still managed to be at 119.

Thanks to a group of excellent companies, a strong export sector, and the policies introduced in recent years, the economy started to grow again in 2014, but Italy is one of the very few OECD countries that have not yet managed to recover to pre-crisis levels. To date, GDP per capita has contracted by 8.2% compared to 2007. Almost all other countries have largely exceeded pre-crisis levels. The Eurozone net of Italy stands at 5.0 percentage points above pre-crisis levels, the United States at 6.4 points. In each of the years between 2015 and 2017, Italy recorded GDP growth about one percentage point below the other Eurozone countries. Moreover, Italy's regional divide is huge and has not narrowed in recent years.

Most economists trace back such a poor performance to Italy's difficulty in adapting its productive structure and public administration to the challenges of globalisation, technological innovation and the single currency. Indeed, the facts do not support the idea that the harsh social conditions of Italy are the consequence of so-called 'neo-liberal' reforms that would have increased inequalities and favoured the 'usual suspects'. Instead, Italy is one of the few countries in which the Gini inequality index has remained almost unchanged in the last quarter of a century. Even more noteworthy is the fact that the share of labour on manufacturing value added, diminished in many countries, has increased in Italy during the crisis, and has returned to the record levels of the early seventies.

Here we come to the dilemma, which risks becoming a drama, for today's Italy. According to the majority of economists and international organisations, Italy suffers because the reforms of recent years have not been enough to restart the broken engine of the economy. This is because they have not managed to address the underlying issues forcefully and partly because of insufficient implementation and the typically delayed impact of structural reforms. However, the perception of voters — especially those who voted for anti-establishment parties — is precisely the opposite. According to them, the missing reforms are not at the origin of the troubles, but rather those already introduced, together with the threats arising from globalisation, technological innovation and immigration. Not surprisingly, they are proposing to roll back the recent labour market and pension reforms.

Probably the lack of feel-good factors and the sense of insecurity and uncertainty deserve more attention and different answers compared to the past. The problem is that Italy is in the middle of a ford: the economic and social costs of the reforms have, by and large, already been paid, but the results in terms of income growth, employment and the quality of work are still lagging. The temptation to go back, or shut the door to Europe and globalisation, is therefore strong. Nevertheless, by following this path, the economic recovery would derail, the social situation would get worse, and the state of the public finances would become even more precarious.

There are mainstream recipes to overcome the Italian anomaly and more innovative solutions. Even some new ideas by the populists can be considered. However, these new political forces should recognise that they cannot address Italy's broken engine of growth by rolling back reforms or worsening the already fragile state of the public finances.

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