Macroeconomics and the Italian Vote

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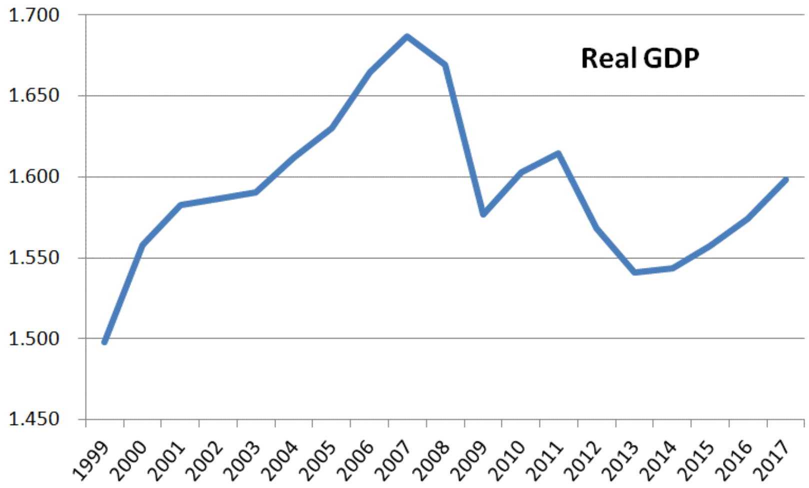
To understand the rise of the League and 5 Star Movement, look at economic indicators
Italy's 2018 elections results—with the success of the Five Star Movement, the relative importance gained by the Northern League, and the marked decline and ensuing disaggregation of the Democratic Party—have attracted much international attention and perhaps even caused some surprise. The anti-euro and anti-austerity character of much of the pre-electoral rhetoric of the two parties currently in power almost caused an institutional crisis in the country and generated the reaction, from miffed to arrogant, of various European leaders and commentators.
In this brief contribution we will not aim at a sociological and political analysis of the vote, for which we have no competence, but provide some data on the macroeconomic trends, and on inequality and income distribution in the last decade and some further information on what was going on before the 2008 crisis. We think these can help clear up some misconceptions and allow us to better understand why a majority of Italians voted clearly against "having more of the same"—even though it may be less clear what they voted for.
We will not touch on the very hot and complex issue of immigration, which is very important in the internal political debate in Italy and other European countries and at the same time so openly reveals European disunity and the inability to join efforts in facing it. Yet we think that the information below can indicate that even without immigration, economic and social problems are such that they might have affected Italian politics in much of the same direction and measure. In other words, we do not think that concern with immigration is necessarily the main reason for Italy's political turn. Rather, it suggests that in Italy, as in other European countries, austerity policies, labor market deregulation, and the increasing rate of poverty are not compatible with an environment allowing a civilized and orderly management and integration of immigration flows.

Italy's Double Dip and its Consequences

The 2008 crisis severely hit the Italian economy, as can be seen in Figure 1; yet the initial fall was not much larger than Germany's.

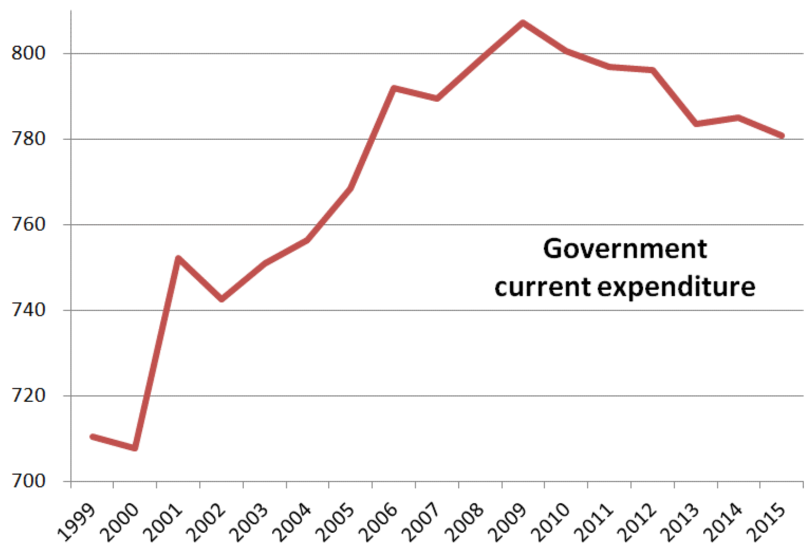
Figure 1. Italy's real GDP (billions of constant Euros)



Source: OECD Economic Outlook.

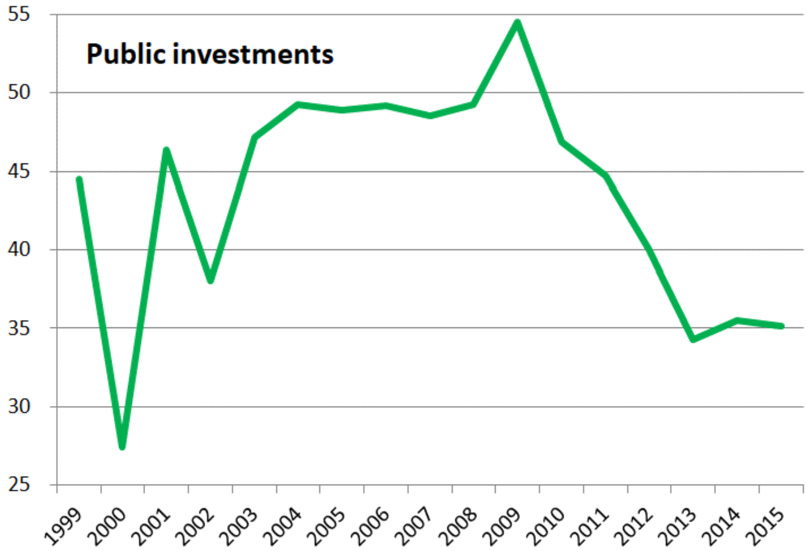
Both countries have a large manufacturing sector, which is known to be more sensitive to fluctuations than the service sector. After the crisis, a recovery had begun, but was interrupted by the European “spread crisis” (that is, falling prices and increasing interest rates on Italian and other ‘peripheral’ countries public bonds in the financial markets) and subsequent inception of more severe austerity policies, that caused a fall in current expenditure and public investment (as documented by Figures 2 to 5) and an increase in overall tax revenues of 18 billion euros in the period 2011-2013, mostly owing to an increase in indirect txation. As a consequence of such measures GDP fell sharply (-73 real billion euros, i.e., -4.5 percentage points), despite some recovery in exports. Industrial production fell much more than GDP: it dropped by one fourth between 2007 and 2009, then recovered 7 points in 2010-11, but fell again subsequently and in 2015 was still slightly below the 2009 level.

Figure 2. Italy’s government current expenditure, including interest payments (billions of constant Euros)



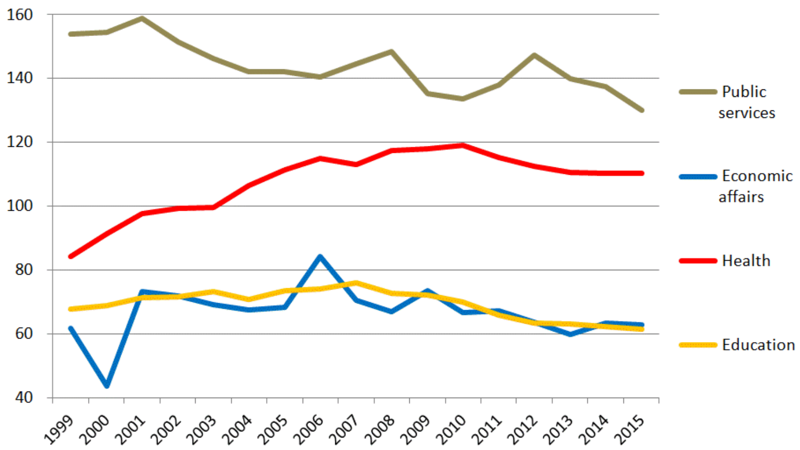
Source: OECD.Stat (COFOG).

Figure 3. Italy’s public investments (billions of constant Euros)

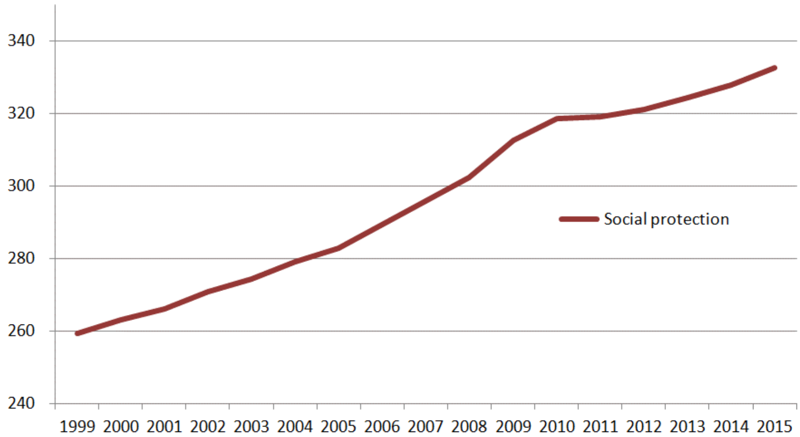


Source: OECD.Stat (COFOG)

Figure 4 and 5. Italy’s government current expenditure by function (billions constant Euros).



Source: OECD. Stat (COFOG).



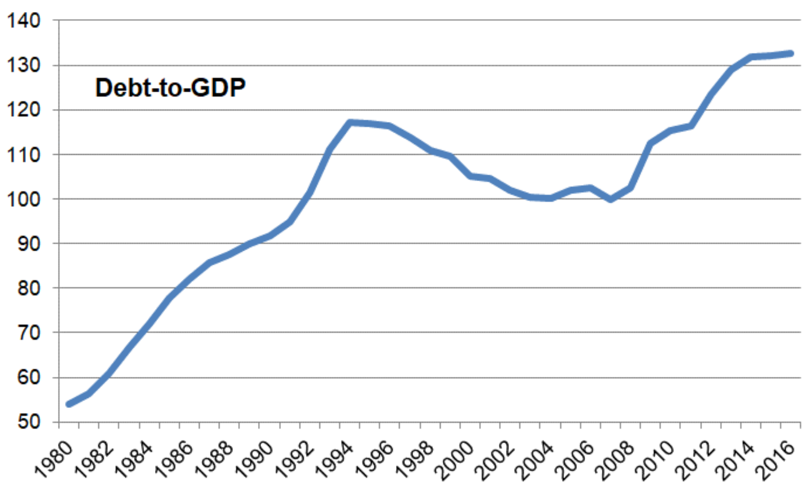
Source: OECD. Stat (COFOG).

Overall unemployment, that was at 6.2% in 2007, increased from the 8.4% reached in 2010 to 12.4% in 2013 and is currently just below 11%. Youth unemployment (those between 15 and 29 years old) increased by more than 10 points (Figure 6) in two years—between 2011 and 2013—owing to the combination of the fall in GDP and the pension reform. The latter, by postponing the retirement of employed workers, prevented the physiological turnover of the labor force, and hence sharply reduced the opportunities of younger workers to enter employment in substitution of the retiring elderly. The same reform has also caused increasing unemployment among elderly workers who have lost their jobs through the crisis. There are about 500,000 unemployed people over the age of 50 (most of whom have great difficulty in finding employment), more than three times as many as there were in 2006.

Not only did austerity policies increase unemployment and reduce GDP and household disposable income, but they also hit public services and the welfare state. In particular, the national health service and public education, which may be regarded as two main pillars of the Italian universal welfare system. The first underwent a cut of 7% in real terms between 2011 and 2013, and the second has witnessed a longer term process of diminishing resources, involving a real loss of 20% between 2007 and 2015. This has also involved, among many other things, huge cuts in the financial support granted to well-performing university students coming from low-income families, as well as great difficulties for highly qualified youth in obtaining jobs in the public education and research systems. And yet, both per capita and as a proportion of GDP, Italian public expenditure in these specific areas and also overall (including all services and social protection) currently is, and has always been, below that of other European countries of comparable size and development. Public investment also dropped sharply during the period of austerity, which also visibly reflected on the maintenance of public edifices and infrastructure.

But, one might argue, these measures were necessary in order to curb the high public debt-to-GDP ratio, which was said to be at the roots of the “spread crisis,” and indeed this is how they were sold to the public. On the contrary, as was in fact predictable, austerity policies caused an increase in the debt-to-GDP ratio (Figure 7), reducing national income (the denominator of that ratio) and, accordingly, tax revenues.

Figure 7. Italy’s public debt-to-GDP ratio.



Source: Ameco.

In other words, Italy is a living example of the fact, now widely recognized even by mainstream economists,[1] that fiscal consolidations can have persistent “perverse” effects on the debt-to-GDP ratio—especially when the economy is in a recession and fiscal multipliers are particularly high. According to other interpretations of the crisis, financial market expectations that the European Central Bank (ECB) could not intervene in the public bond market owing to its peculiar statute had a major role in the emerging of the spread crisis, and almost caused the breakdown of the euro owing to persisting inaction on the part of the ECB. At any rate, it was the change in ECB policies, not austerity, that put an end to the crisis.

Actually, austerity caused, and still causes, increasing fragility in the Italian economy, not only as a result of increasing the public debt-to-GDP ratio, but also of shrinking productive capacity in the manufacturing sector and difficulties in the banking sector (see Giacchè, 2017). Concerning the latter, the crisis of the real economy caused an increase in the load of non-performing loans in Italian banks. These in general have been less involved than German and French banks in risky financial market speculations, but more involved in providing credit to households and small and medium firms, which represent a very large share of Italian manufacturing sector. Households and firms have both suffered great losses from the two aforementioned crises—the first crisis due to the international financial breakdown, the second due to austerity policies. Thus, fragility of the banking sector, besides being a problem in itself, also tends to cause persisting difficulties in the access to credit on the part of households and, even more importantly, firms.

Despite some moderate recovery in the last three years, real GDP, employment (measured in standard labor units), and industrial production remain very much lower than their pre-crisis values (from 2007 to 2017, -5.25%; -4.63%; -24.39%, respectively).[2]

If we look at labor and income distribution, Italy has undergone since the 1990s a number of “reforms” concerning wage and labor contracts and labor market (de)regulation. The last of these, passed in 2015, has eliminated all remaining legal protection against unjustified (i.e., with no disciplinary or economic motivation) individual firings, except a relatively small monetary compensation. In addition to that, the continuum of reforms has allowed increasing use of “atypical” and short term contracts. The latter currently account for 16% of the stock of total employees, and 40% of employees between 15 and 29 years old, while involuntary part-timers amount to 2.6 million.

Real wages have been stagnating for a long time: according to OECD data, average gross earnings of employees in real terms are currently almost 1% below 2008 level and only 3% above what they were in 1990. Average gross annual earnings of employees in purchasing power parity are currently lower in Italy (equal to 36,700 dollars) than in France (43,800) and Germany (47,600), and are the lowest in the Eurozone except for Portugal and Greece. Absolute poverty has increased to five million people (8.3% of residents) in 2017; and relative poverty, which amounts to 15% of the population, spreads not only among the unemployed but also among the workers, particularly those who support two or more children. The combination of high unemployment, low pay, and precarious jobs has created, especially, but not only, among younger Italians uncertainty, lack of perspectives, and difficulty in realizing an independent individual and family life.

Read more at the website of the Institute for New Economic Thinking