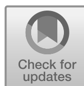

A Critical Exploration of the Reason Behind Italy's Economic Recession since 1999

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Abstract. Italy was a successful economy for forty years after the Second war and was one of the countries with rapid industrial development. But by the mid-1990s economic growth rates began to decline and continued to fall over time, which puts the economic growth of Italy in an undesirable position. This study will discuss the factors behind Italy's recession from three aspects by analyzing the impact of the European Union on the Italian economy as well as Italy's own economic policies in the context of the literature and some of the available data. This study firstly goes through history of Italy's economic development from 1950 to nowadays. Then the negative impacts of entering European Union on Italian economy is discussed. Thirdly, strict fiscal polices of the Italian market after 1990 are analyzed. Fourthly, social factors within Italy from North-South difference perspective.

Keywords: Italy economic recession, cultural divide, fiscal policy.

1 Introduction

The causes of the Italian recession has been a hot topic of academic debate both domestically and internationally. A growing number of analysts, political scientists and some economists believe that Italy's accession to the Eurozone since 1999 is the main cause for the almost zero growth of its economy in the last two decades. It is commonly expressed that the single currency policy of EU exacerbated Italy's recession. Some scholars believe that Italy's economic decline is a long-term historical problem, as the country's industrial structure began to crumble and worker productivity began to decline much before the currency union. This was due to the gradual replacement of the Italian textile industry by cheaper British and French textiles in the 17th century, which led to a significant loss of Italian textiles [1]. In addition, the high taxes imposed by the Italian government and the rise in the price of labour led to an increase in the cost of production of goods and ultimately to a reduction in profits, leading to a weak economy. This study will analyse the external and internal factors of the Italian economic recession and finally draw critical conclusions and use them to give some suggestions for the Italian economy to cope with the recession.

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2 History of Italy's economic development

At the end of the Second World War, from 1952-1963 Italy's economy experienced its first golden period. During this period, Italy deregulated its foreign trade and took an active part in regional economic integration [2]. In 1962, Italy's industrial output was seven times higher than it was before the First World War at an average annual growth rate of 5.8%, which led to an increase in national income [2]. Besides, Italy began to focus on export markets and, due to the favourable export environment, the traditional Italian textile and clothing industry and food processing took off rapidly, as did the new automobile manufacturing and tourism industries. However, the first oil shock in 1973 dealt a heavy blow to the capitalist world economy and caused the Italian economy to slow down again before the full recovery could be brought to a climax. Even the average annual growth rate of the Italian economy fell to 2.65% in the years 1974-1979 [3]. As can be seen from Figure 1, Italy's inflation rate was close to 21.06% in 1980, leading to a decline in economic growth [4]. In response to this hyperinflation the Italian government introduced a series of emergency measures aimed at reducing public borrowing, but Italy's public debt continued to grow through the 1980s [5]. In order to improve economic development, Italy undertook a monetary reform in the 1990s in order to comply with the EU monetary union criteria. As the Italian government believed that joining a democratic Europe would help Italy to leave communism more quickly and that countries joining the Common Monetary Union would be able to fully benefit from a single currency policy. Finally in 1999, Italy successfully joined the European Monetary Union (EMU) and began using the Euro. However, Italy's GDP growth rate after joining the Eurozone remained very low and from 2000 to 2008, growing by 0.2% per year [6]. In particular, the global economic crisis of 2008 led to a stagnation of the Italian economy, a fall in GDP and a sharp increase the unemployment rate of 10% [7].

By 2009, Italy's GDP had fallen by 5.28% and the Italian government attributed the recession to a general decline in the country's industrial production and exports stagnation following the economic crisis [3]. 2010 saw a recovery in Italy's economy, with GDP growing to 1.71%. However, this was followed by a downward trend in GDP from 2011 to 2012 at -2.98% [3[. It was not until 2014-2019 that Italy's economy almost recovered from the 2008 financial crisis, but GDP growth was still not as high as in other eurozone countries. 2020 saw a global pandemic disease outbreak and Italy was the first of the European countries to be affected. As a result of the embargo imposed on most of the country's economic activities in response to COVID-19, Italy's GDP growth rate fell to 9.03%, which hit the Italian economy seriously [3].

In 2021, however, Italy's economy begins to recover, with GDP growth at 6.5% in 2021, which is a new high since 1976 [3]. This indicates that Italy is growing in both industry and services in 2021, on account of the Italian government's aggressive anti-epidemic measures and the release of policies to support economic growth. For example, the Italian government has given more subsidies to the population and provided more incentives and financial support to companies in terms of taxation, finance and loans in order to stimulate consumption and restore economic growth [8]. However, although growth has now returned to a relatively good level in 2021, Italy's overall economic development has not been favorable over the past few decades.

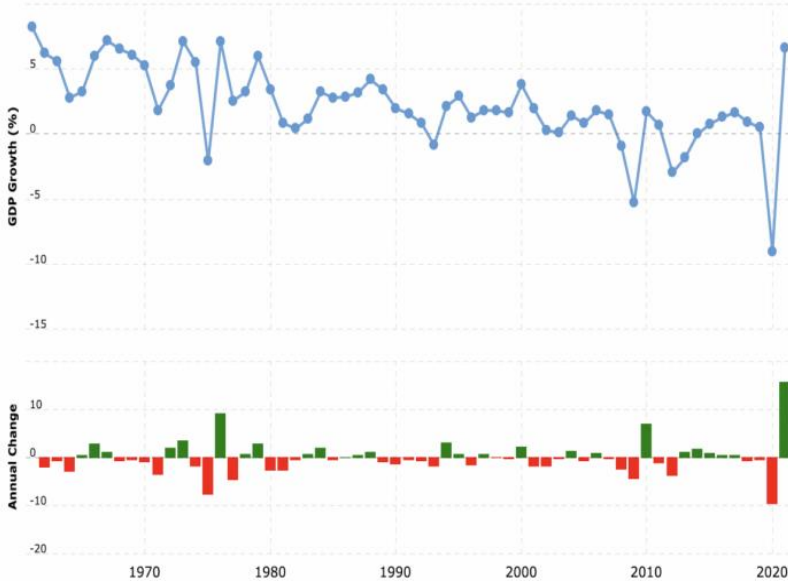

Fig. 1. GDP growth rate of Italy 1962-2020

(Source from: Macrotrends, 2022)

3 Impact of joining the European Union on Italy

The impact of the Eurozone on the Southern Economic Area member has been a subject of much debate, with some scholars arguing that Italy's economy was hit seriously by its accession to the EU in 1999. As can be seen in the graph above, Italy's GDP growth rate declined more frequently after 1999. However, Italy's per capita purchasing power surpassed that of the UK in 1969, but after the introduction of the euro, Italy's per capita income has been lower than that of the UK since 2000 [9]. For Italy, the introduction of the euro was intended to better develop the economy and control inflation but as the value of the euro reflects the average strength of all eurozone economies, the high euro exchange rate has had a negative impact on the Italian economy. In more detail, Italy's economic strategy prior to joining the Eurozone had been export oriented, exporting mainly traditional handicraft products, gaining a competitive advantage in the market due to the high quality and low prices of these products. However, due to a lack of capacity to coordinate workers' wages after joining the EMU, Italy has often relied on cyclical exchange rate devaluations and lower wages for workers to reduce the prices of its exports [10]. Meanwhile, the development of some emerging economies, such as China and Vietnam, which started to produce low-cost goods and took an increasing market share, led to a reduction in Italian exports and the loss of this economic adjustment capacity [10]. As exports were replaced, domestic demand became an important

part of the overall economic output. Domestic demand became higher and was accompanied by wage and price inflation. However, the ECB's one-size-fits-all monetary policy has not been very effective in curbing this inflation.

But some scholars argue that Italy's economic problems are not due to membership in the Eurozone, but to Italy's own problems. The replacement of Italy's low-cost exports by other new economies has led to a decline in the value of the Italian economy. But the fact is that regardless of the currency of the exchange rate used by Italy, due to globalization, developing countries have gained more market shares in the export of goods to Europe and elsewhere, which has inhibited Italy's exports to a greater extent [9]. In addition, Italy has chosen to lower the wages of its workers in order to be competitive in exporting goods [11]. However, only high-quality products and a high level of production skills can put goods in a favorable position, while Italy lack of this competitive strength, so even without joining the Eurozone, Italy would face these problems. Furthermore, if Italy were to leave the Eurozone, it could create an even greater crisis for Italy [12]. More precisely, leaving the euro could lead to higher costs of living for workers, who would therefore demand higher wages, and these would urge companies to raise wages to cover their costs. The consequences of this could lead to high inflation and social instability, which in this case would have a more negative impact on Italy's export market. The resulting social instability could weaken the country and the main beneficiaries could become the Italian mafia rather than the people. Thus, while joining EU has not influenced Italy positively, an exit of EU could lead to riskier consequences.

4 Fiscal policy of Structural reform of the Italian market

Italy adopted the Maastricht Treaty in 1992, which laid radical foundations for the introduction of the united European currency in 1999 [1]. The Treaty provides for the free movement of capital within the European Union, the true realization of a single market and a single currency, thereby establishing a European central banking system for the formulation and implementation of Community policies and the perfect coordination of economic policies. However, the macroeconomics in Italy after 1992 was marked by slow growth in Italian domestic and export demand. As shown in the economic data between 1960 and 1992, domestic demand per capita in Italy grew at a rate of 3.3%, faster than in Germany, France and other eurozone countries [13]. But in the period 1992-2018 domestic demand fell to 0.25%, lower than any other eurozone country [13].

This is because that Italy has implemented numerous market liberalization reforms as well as the fiscal austerity policies that in order to meet the requirements of the European Monetary Union. Italy adheres more strictly to EU policies than other eurozone members [6]. This has led to a prolonged decline in domestic aggregate demand in Italy, which has put significant pressure on domestic economic growth. Italy has maintained a budget surplus since 1992 as a way of reducing its debt ratios. However, due to Italy's large interest rate burden, slow demand growth has instead increased Italy's debt ratio by 23% [6]. Moreover, the fiscal austerity policy pursued by Italy posts negative effects

on domestic demand, as Italy's austerity policy is based on cutting public expenditure rather than raising taxes. Hence, Italy's public debt to GDP ratio is lower compared to that of France. On the other hand, France had a public debt to GDP ratio of 100% between 1992 and 2008. By stimulating the economy through government policy, France's total domestic demand reached at top of €461 billion in 2010, compared to Italy's €227 billion [13]. Thus, Italy's austerity policies, while reducing debt for a time, have led to a significant reduction in social spending per capita and a chronic shortage of domestic demand.

Besides, Italy had problems with inflation and high unemployment when the Maastricht Treaty was signed in 1992 [6]. The Italian government attributed inflation to the fact that wage increases outstripped labour productivity growth, resulting in a lower share of total profits. Therefore, the Italian government sought to curb the rising unemployment rate through labour market reforms, also known as structural reforms [14]. In more detail, Italy does not have a policy of setting a statutory minimum wage, nor does it have a system of unemployment benefits. The structural labour market reforms in Italy have therefore significantly reduced employment protection for temporary workers as well as regular employees. As can be seen from Figure 2, in 1991 the average wage of Italian workers was approximately 92% of that in France. However, from 1992 to 2008, the average wage in Italy began to fall to just 75% of the average French worker's wage [6]. This reflects the growing difference between the average worker's wage in Italy and that in France. It is also clear from the graph that the average worker's wage in Italy is also gradually declining compared to Germany and the other four Eurozone countries. This has led to an 8.5% increase in the total number of temporary workers employed in Italy from 1991 to 2007 and to the fact that 1.2 million fewer jobs were created in Italy than in France during this period [14].

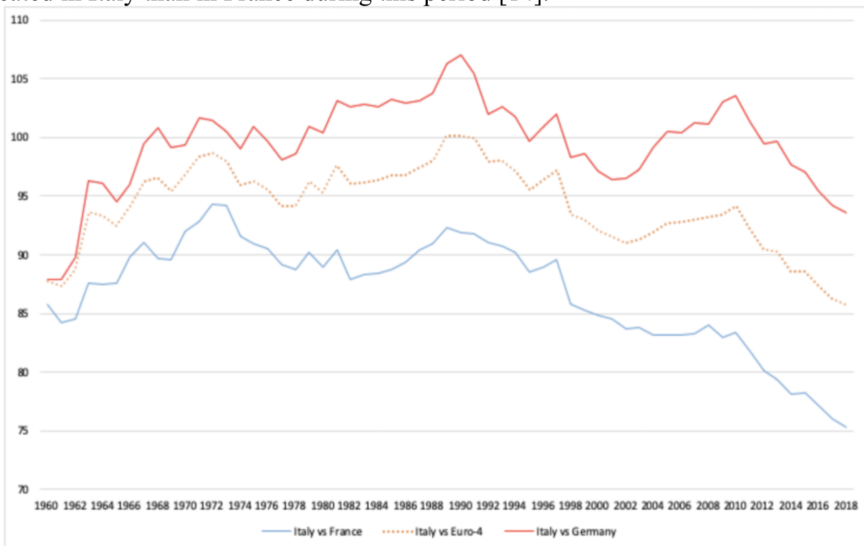

Fig. 2. Real wage per employee in Italy relative to France / Germany / Euro-4, 1960-2018

(Source from: Storm, 2019)

This suggests that wage moderation in Italy has led to a decline in job places, but did help to reduce inflation to some extent, evidently, Italy's inflation rate decreased from 5.27% in 1992 to 1.14% in 2018 [4]. In addition, Italy's unemployment rate was successfully reduced through labour market reforms from 8.9% in 1992 to 6.7% in 2008, which is lower than the unemployment rates in Germany and France [7]. The structural reforms introduced in Italy in 1992 have therefore been somewhat successful as they have led to a rising share of profits in Italy's GDP with inflation, unemployment, falling public debt and restrictions on workers' wages.

But the Italian government has failed to consider the extent to which fiscal austerity, as well as structural reforms, would hurt economic growth. As mentioned above, Italy's economic policies have created a chronic shortage of domestic demand in Italy, which has consequently affected productivity and ultimately had a negative impact on the country's profitability. Relative to German manufacturing, Italy's productivity fell significantly from 110% in 1995 to 63% in 2015 (Figure 3). Moreover, as a result of fiscal austerity, the ratio of investment to GDP in Italy was much lower than Eurozone counterparts such as France and Germany from 1990 onwards. This has also contributed in part to the low productivity of Italian industry, due to the reduction in investment in firms. Thus, the strategy of wage restraint and labour market reform in Italy did initially increase the share of profits, but at the same time it also reduced domestic aggregate demand and productivity, leading to lower levels of consumption and production and thus lowering the country's profitability.

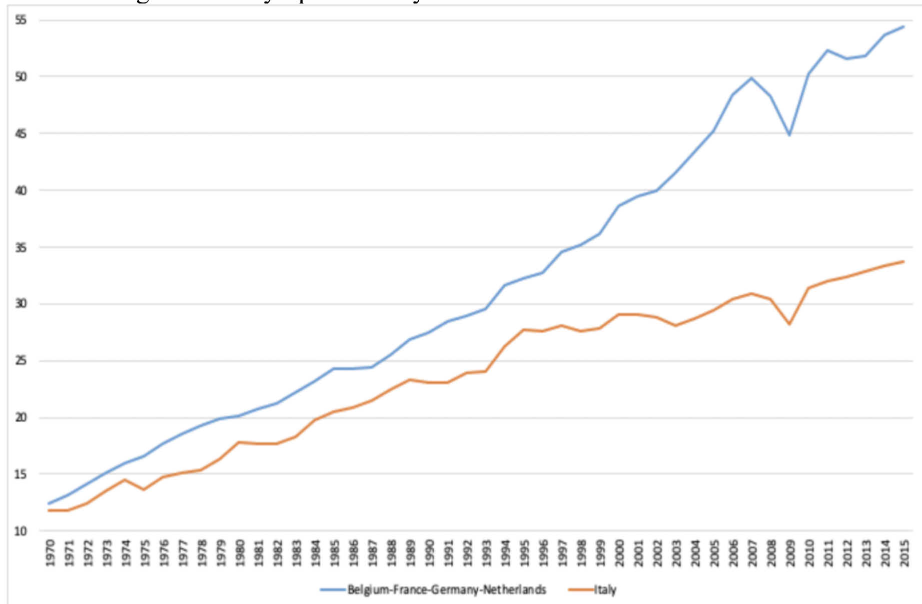

Fig. 3. Manufacturing labour productivity per hour of work: Italy versus the Euro-4 countries, 1970-2015.

(Source from: Storm, 2019)

In addition, Italy's manufacturing industry lacks technological strength [15]. Most Italian companies specialises in footwear, textiles and other more traditional and less technological product areas. Although there is a high level of quality in these products, Italy loses out in developing more technologically intensive products due to a lack of investment as well as low ability in technological innovation. Examples include communication equipment, automobiles, pharmaceuticals, etc. In contrast to Italy, German manufacturing which depends on increased innovation as well as productivity gains great market competitiveness [6]. At the same time, the competitiveness of Italian products relies largely on lower wages rather than on productivity performance [10]. Therefore, as mentioned above, the wages of Italian workers are lower than those of other eurozone countries, which has led to a decrease in their productivity.

5 Social factors within the country

For Europe, the growing relevance of regional economic inequalities is often seen as a major threat to economic progress and social cohesion [16]. The problem of regional inequality is more acute in Italy than in any other eurozone country. To be specific, Italy has a huge difference in development between the North and the South, reflected in basic economic indicators, such as income per capita, productivity, etc., and in the social system, such as quality of institutions, educational attainment per capita [17].

For the economic factors, the economic level of the north of Italy is on a par with other developed European countries. From the Figure 4, in 2019, it is noticeable that the top three richest regions are from the north, province of Bozen at €48,100, Lombardy at €39,700, and Aosta Valley at €38,800 [18]. More specifically, the north of Italy is the backbone of the Italian economy, with a strong industrial and commercial sector, the Milan-Turin-Genoa industrial triangle, many small and medium-sized enterprises in the centre and a strong tourism sector [19]. Hence, the north and the centre play a very important role in the economic development of Italy as a whole. But the south is one of the most underdeveloped regions in Europe. The economic level of the south continues to lag in socio-economic development compared to the economic level of the North. In 2019, the three poorest regions in Italy were Campania at €18,900, Sicily at€ 17,900, and Calabria at €17,300. They all come from the south of Italy, especially since Calabria's GDP is only 36% of that of the richest region, province of Bozen [18]. The problems of the south have long plagued Italy and have seriously hampered the development of its modern economy, even becoming a major source of political and social unrest on the territory [20].

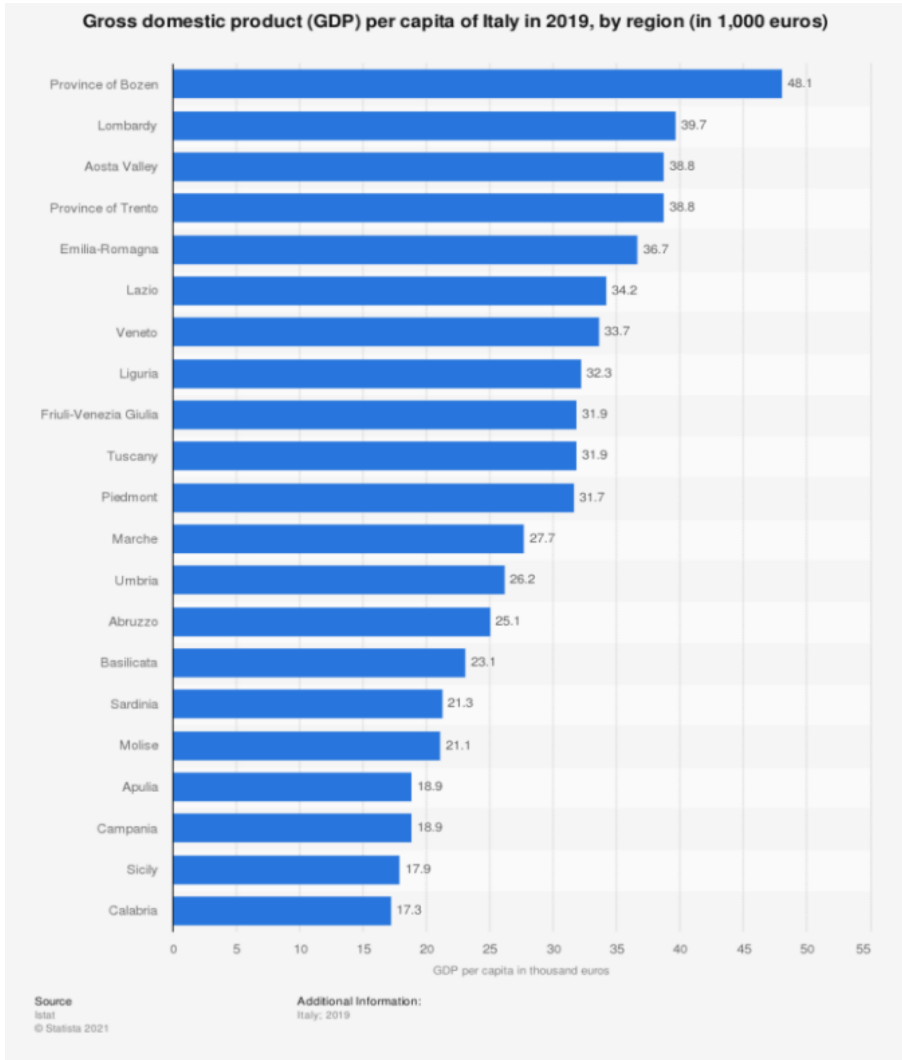

Fig. 4. Gross domestic product (GDP) per capita of Italy in 2019, by region

(Source from: Statista, 2020)

Meanwhile, there were some historical factors that contributed to the backwardness of the south. Italy had long been under feudal rule and many feudal remnants remained after unification. Influenced by other developed European countries, the north of Italy began to develop capitalist industry and commerce early on after unification, and industrialisation was relatively high [21]. However, the aristocracy in the south had no interest in investing in technology and was opposed to reforming agricultural contracts and modernising institutions, resulting in the south maintaining a backward agricultural business system and social structure [22]. As a result, the feudal forces in southern Italy

prevented the modernization of the south and the circulation of capital. Moreover, as the economy of southern Italy gradually deteriorated, it led to a high rate of poverty, which gave rise to many social problems [21]. The notorious mafia, which had a problem with crime and violence in the south dating back to the Middle Ages, further exacerbated the differences between northern and southern Italy.

Thirdly, The Italian government's gross underestimation of poverty in the south is also one of the reasons for the chronic poverty in the south [17]. The government's lack of knowledge of the true economic situation in the south after Italian unification led to a preference for free trade and laissez-faire economic policies, even to the point of having unrealistic illusions about the south's economic development and abandoning its intervention in the social transformation and economic development of the south. It is worth mentioning that the Italian government also gave way from time to time to the development of the south in order to strengthen the industrialization of the north and bring it up to the level of development of other large European countries [22]. The social resources of the south were sacrificed by government to accelerate the pace of industrialization in the north. As a result, the north of Italy received favorable development policies as well as significant investments, while the south had almost no specific favorable policies at the time, leading to a deteriorating economic development in the south.

Lastly, the financial crisis of 2008 exacerbated the differences between north and south. During this financial crisis, the economic decline in the South was much more severe than in the rest of Italy, not only in terms of GDP per capita, but also in terms of all basic economic parameters and the most important aspects of people's livelihoods [17]. This is particularly true of the unemployment rate, which in the aftermath of the crisis was approximately three times higher in the south than in the north. Even five years after the end of the financial crisis, the economy in the south of Italy was still far from recovering to its pre-crisis level and only improved in 2014 [17]. In addition, the pandemic of 2020 became one of the major factors accelerating the economic decline of the south. The economic recovery of the southern part of Italy was threatened by the impact of the pandemic, with all indicators of the Southern Economic Composite Index (GDP, exports, employment, etc.) falling, negatively affecting Italy's overall GDP [23]. This is due to the inability of the fragile southern health system to address social and health emergencies, resulting in a huge impact on the economic development of Italy as a whole. But COVID-19 has also opened up new opportunities for the economy of southern Italy. In more detail, the government has invested €25 billion to help the southern economy recover in response to the worse economic situation in the south as a result of COVID-19 [24]. In addition, more than one million people have migrated from the southern Italian states to the north in the last decade [25]. This has caused a serious brain drain. But starting in 2020, COVID-19 changes this trend, due to restrictions such as the epidemic embargo. The number of people leaving that southern Italy is reduced by more than a third compared to 2019 [25].

6 Conclusion

The Italian recession was significantly influenced by economic, political, and international factors. Therefore, in order to emerge from the economic weakness, Italy should deepen its political and economic reforms and eliminate all the negative factors limiting economic development. In addition, the government should develop favorable policies and regulations for Italian companies, such as incentives for innovation, tax breaks and export incentives, to provide an atmosphere for the development of Italian industry. Besides, the Italian government should pay attention to the disparities between the north and the south, as regional disparities not only affect the country's economic output, but also pose significant social problems. The Italian government should therefore strengthen the development of the south and reduce the disparities between the north and the south. Finally, Italy should encourage the development of technology-based industries and the innovation of national brands and should always be market-oriented and responsive to customer needs in order to increase its competitiveness in export markets.

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