

Economic note

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1. Economy and politics ...

Since the Second World War, Italy has experienced remarkable political instability, with the formation of almost as many governments (71) as there have been years since then (79). Since the beginning of the post-World War I First Republic, Italian governments have lasted an ephemeral average of 401 days: barely one year, one month and six days, a record among Western countries. In that time, a total of 31 Italian politicians have held the office of prime minister. In contrast, in the same period, Germany, for example, has had only ten chancellors and 24 governments. Silvio Berlusconi, during his second term as prime minister, holds the record for the longest tenure in office, spanning almost four years between 2001 and 2005. However, of the 71 governments Italy has had to date, as many as twelve have barely managed to stay in power for 3-6 months, while two governments did not even make it past 3 months in office.

The phenomenon of the "Italianisation of politics" describes a situation in which the country's politics and economy appear to follow divergent trajectories. Politics is characterised by unpredictability and volatility, while the economy continues on its course, experiencing growth, generating employment and allowing businesses and entrepreneurs to operate, albeit seemingly independently of politics. In this way, economics and politics are perceived as spheres that speak different languages and work independently of each other.

At this stage, however, it is undeniable that in the medium and long term politics and economics are intertwined. Italianisation' has profound political as well as economic implications, the most obvious of which is the inability to plan for the long term. When government cannot project itself towards a defined horizon, it lacks a clear vision and long-

term policies. This causes institutions to deteriorate and leads to business behaviour, which has a negative impact on investment and employment. In recent decades, Italy has been losing ground in terms of per capita income in Europe. Currently, the country faces a public debt close to 140% of GDP and closed 2023 with a worrying public deficit of 7.2% after having recorded 8.6% in 2022.

Despite the considerable political noise in our country, marked by a minority government, elections in Galicia, the Basque Country, Catalonia, and the European elections in June, as well as the discussion on the Amnesty Law and the absence of a budget for this year, the economy achieved a growth of 2.5% in 2023. This growth generated almost 800,000 jobs and reduced the unemployment rate by more than one percentage point to 11.8%, at the same time as the tourism sector reached historical records.

This is encouraging news and it seems that, for now, 2024 will be no different. Growth forecasts for this year continue to be revised upwards, approaching the 2% border from initial levels below 1.5%. In addition, employment continues to perform well, inflation is moderating and the European Central Bank could start a cycle of policy rate cuts as soon as June.

This is despite the fact that, as mentioned, the political situation has not allowed for the approval of a general state budget for 2024. Moreover, given the current composition of parliament, it will be difficult to achieve the approval of significant reforms in this legislature. We refer to reforms of some significance as those that inevitably have both positive and negative impacts, beyond those that simply imply an increase in public spending in the present and whose consequences only manifest themselves over time.

Moreover, even though the war in Ukraine continues and the situation in the Middle East continues to deteriorate - with Iran's recent attack on Israel in response to the latter's previous aggression - the Spanish economy, as mentioned above, continues to expand and seems to show few signs of slowing down in the short term.

2. Germany... the sick man of Europe?

In the rest of Europe, Germany stands out, whose projected growth for 2024 will be only slightly positive, estimated at 0.3% by the European Commission, and barely exceeding 1% in 2025. This is happening in a context in which the European Union's main economy has been particularly affected by the deterioration of two pillars that have supported it in recent decades. On the one hand, its model based on affordable energy, underpinned by what was considered a "privileged" relationship with Russia. On the other, its dependence on a significant demand for capital goods from China, which has sustained its high exports and given it a special status vis-à-vis the Asian giant.

The war in Ukraine has put an end to the first pillar. This is reflected not only in the effects on energy prices - gas in particular - but also in the loss of confidence in the reliability of Russian supplies. As a result, Germany is forced to abandon the model promoted by

Chancellor Schröder between 1998 and 2002 and strengthened by Angela Merkel in later years.

The second pillar is severely affected by the onset of "de-globalisation", a phenomenon that is also partly a result of the war, as well as by the progressive modernisation of the Chinese economy. For Germany, this means that its exports are becoming less relevant, especially in sectors such as technology and heavy machinery. Indeed, in some emerging areas, such as electric vehicles, Chinese capabilities appear to have far outstripped those of Europe.

The economic challenges facing Germany have revived the question posed in *The Economist's* iconic 1999 cover story, which asked whether Germany was "the sick man of Europe", just before the launch of the euro. At the time, all the weaknesses of the EU's leading economy were analysed. Today, at least in two crucial sectors for today's economy, such as electric mobility and artificial intelligence, and even technology in general, Germany seems to be lagging behind China and the United States. But now, as then, the resilience of its economy and institutions should not be underestimated.

What the situation of the German economy (and also, to a large extent, that of France, let alone Spain) does show is the need to tackle a series of reforms to return the European economy to the path of growth and productivity expansion. This is essential to maintain a level of growth that sustains the so-called European social model, and the new European Commission that emerges from next June's elections will have to commit itself to this task.

3. Draghi to the rescue... again

Several months ago, the European Commission commissioned Mario Draghi, former president of the European Central Bank, to prepare a report on how to improve European competitiveness. The figures are stark: the European Union is losing weight and influence in the global economy. It is now 65% of the size of the United States, compared to 91% three decades ago. In per capita terms, Europe's population (450 million) far exceeds that of the US (332 million). However, the EU's GDP growth rates since 1970 have been consistently lower than those of the US and the global economy. Even Japan, which was stagnant for a long time, has a higher average growth rate since 1970. The reasons are diverse and the possible strategies to reverse this situation are increasingly challenging, prompting the Commission to ask Draghi to analyse the levers to turn this situation around.

These include the comparatively high standard of living, prosperity and skills of its population, as well as a strong entrepreneurial fabric. In her September announcement of Draghi's mandate, Commission president Von der Leyen used words reminiscent of those uttered by the former ECB president in July 2012 to save the euro: "Europe will do whatever it takes to maintain its competitive edge".

Recently, Draghi met with finance ministers (the so-called ECOFIN) to communicate the first conclusions. He spoke about the need to mobilise public funds to address Europe's major challenges, mentioning a figure of 500 billion euros per year (excluding defence spending).

He pointed out that the EU is lagging behind in terms of productivity, growth and thus GDP per capita, compared to the US and other competitors. There was consensus on the urgent need for action at the European level to achieve lower energy prices, reduce the bureaucratic burden and strengthen the single market. However, when delving into the details of how to achieve this, differences and frictions between member states emerge.

Draghi's preliminary diagnosis presents some interesting elements, especially in terms of policy implications for the near future:

- i) Expectations about the benefits of globalisation have not fully materialised. Although poverty has been reduced in emerging countries, the globalising model suffers from a fundamental weakness: the lack of rules and institutions to ensure an equitable distribution of benefits in both developed and emerging countries.
- ii) Globalisation has generated trade imbalances that have led to excess savings that have not been matched by an equivalent increase in investment. This has led to extremely low interest rate conditions. While unconventional policies have sustained the economy, workers have lost bargaining power, with the result that part of the population has been left behind in this globalisation process.
- iii) As a consequence, people are demanding a more equitable distribution of the benefits of globalisation and greater economic security. At the same time, the urgency to address climate change has led to the implementation of initiatives such as the *Inflation Reduction Act* in the United States, which boosts public spending and has a clear focus on national interests. In Europe, a border carbon adjustment mechanism has been proposed, which would tax carbon emissions from goods produced in other countries and destined for the EU. While these measures prioritise climate objectives, they can also have distortionary effects on international trade.

Draghi points out that this situation requires a change in European strategy. There is a need for increased investment and financial regulation that supports the relocation of resources, as well as boosting innovation. Also, in an interesting twist with potentially big implications for the EU and its relationship with the US and China, the former ECB president suggests the need for a competition policy that facilitates state aid. In other words, he seems to advocate unreservedly for a pan-European policy of public support for the business sector. National state aid has been massive in recent years, especially in the aftermath of the pandemic, which poses the risk of undermining the single market and, in essence, being contrary to the EU Treaty if not approved by the European Commission. However, this pan-European dimension would, to some extent, justify the need for significant resources.

Draghi's vision will soon be complemented by the report also commissioned by the European Commission from another Italian, Enrico Letta. Interestingly, two Italians are defining the economic future of the Union. The former Italian prime minister is tasked with presenting his conclusions on how to strengthen the single market in the EU and is likely to point to similar conclusions as Draghi.

4. Politics and economics...

Looking ahead, Draghi argues that there will no longer be a global supplier of cheap and massive labour as China has been since it joined the World Trade Organisation in 2001. This is likely to generate more volatility in the global supply of goods, especially given the need to restructure supply chains. In addition, there will be *shocks* arising from the need to decarbonise economies and those related to geopolitical conflicts.

All this will translate, at least temporarily, into a reduction in the abundance of cheap goods and services of the last two decades. This will occur in a context where considerable investment will also be needed to replace polluting energy sources and some of the supply provided by globalisation. However, while the energy transition is being completed and productivity gains achieved, this pressure on resources could result in lower growth and higher inflation, due to transition costs and persistent fiscal deficits.

Draghi anticipates that, in the coming years, public spending will play a more important role in redistributing, investing and stabilising activity in the face of potential volatility in European economies. To ensure the sustainability of public finances, it will be necessary to establish a credible path that prioritises investment spending, as well as to develop a European fiscal capacity to issue its own debt and increase aggregate investment, thereby relieving pressures on national budgets.

In essence, it anticipates a framework in which the public will increase in relevance in the economy. However, if the future implies an increase in public intervention, it is hard not to think that politics and economics will meet again at some point...