

Friday, 27 May 2022 9.00-18.00

Workshop Industrial policy and Italy's National Recovery and
Resilience Plan

Faculty of Economics, Sapienza University of Rome

**The "new" European industrial policy and core-periphery
dynamics**

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Outline

- ❖ The war changed the world
- ❖ The asymmetric effects of the war
- ❖ At the root of dependence
- ❖ Industrial restructuring
- ❖ Implications for the EU policy
- ❖ Industrial policy and the RRF

Celi, Guarascio, Reljic, Simonazzi and Zezza, *The Asymmetric Impact of War: Resilience, Vulnerability and Implications for EU Policy*, Intereconomics, 2022

The asymmetric costs of sanctions

Survey of IGM Forum at Chicago Booth (March)

- an overwhelming majority of the experts: a deep recession in Russia;
- nearly four in five: reduction of global growth and rise of global inflation over the next year.
- A slightly smaller majority: a high risk of recession in European economies.

EU member countries: impact varies with

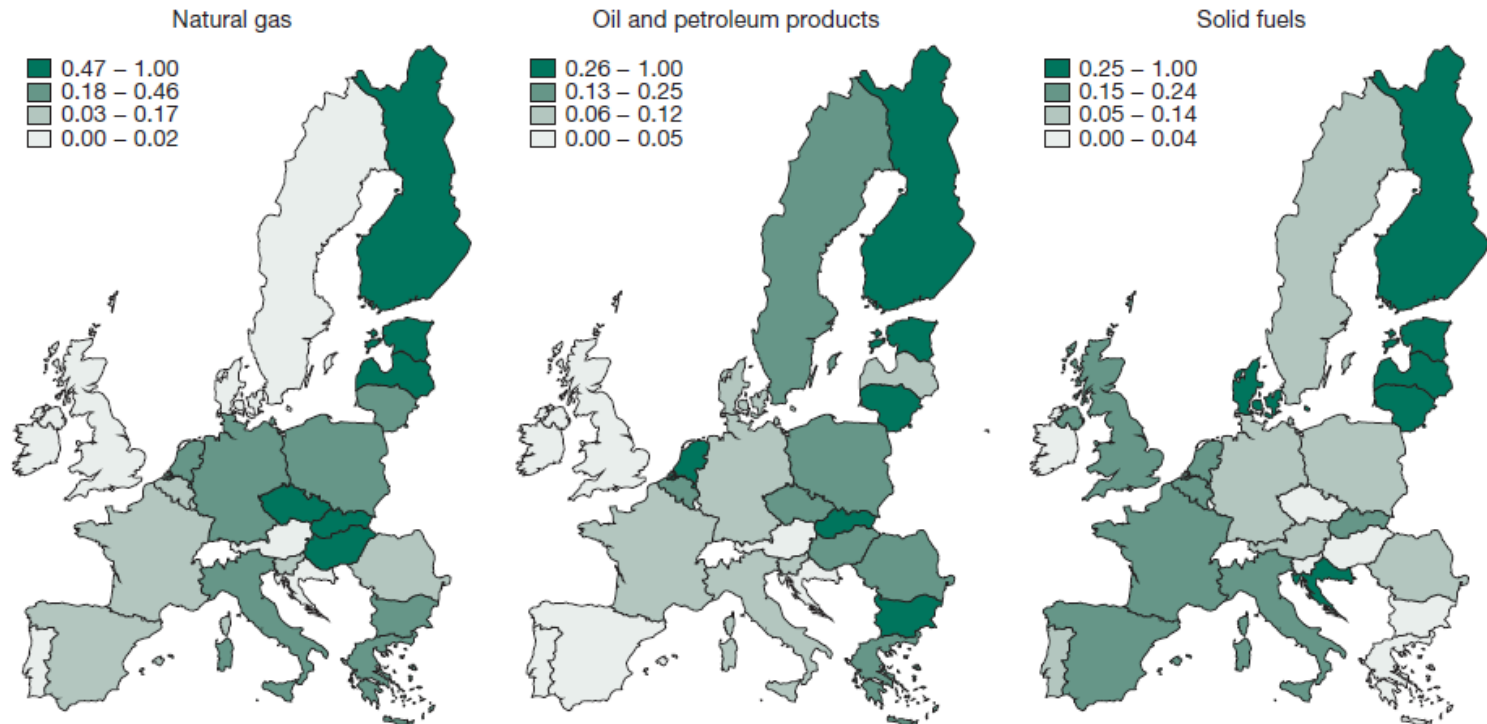
- The energy dependence from Russian fuel,
 - the degree of economic and financial integration with the Russian economy
 - the structure of the economy and the weight of energy intensive sectors
- and
- Resilience to secondary effects deriving from the EU's policy response to stagflation (ECB's monetary policy and public debt)

A new asymmetry

- European countries are affected differently but in ways that transcend the traditional core-periphery division. The German Manufacturing Core (made up of Germany and the Visegrad countries) and Italy in the southern periphery.
- Diversification of energy sources and composition, in particular renewables, will only work in the medium term.
- Equally serious is dependence on Russian and Ukrainian key raw materials and intermediate goods (e.g. iron, cereals, fertilisers)
- The risks of bottlenecks and supply restrictions feed sector-specific inflationary shocks, which are easily transmitted to the whole economy. (Difference in components of inflation between US and EU: energy, food, and other).

EU member states' dependency on energy imports from Russia, 2019

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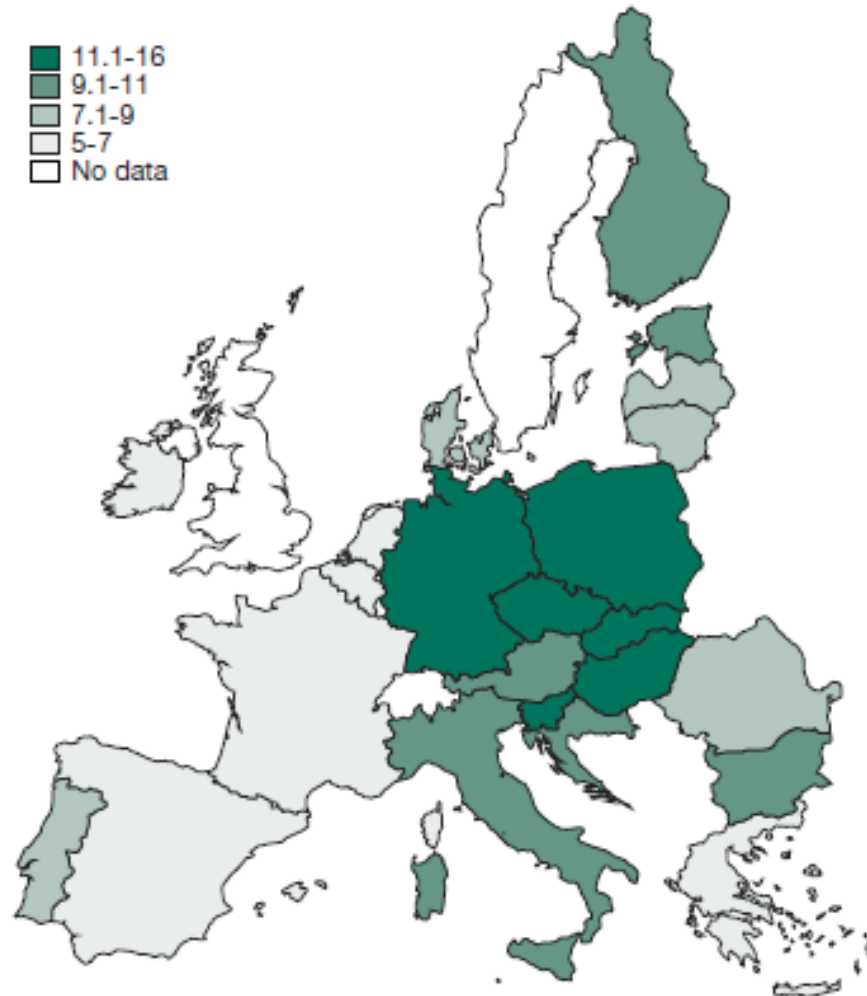


Celi, Guarascio, Reljic, Simonazzi and Zezza, The Asymmetric Impact of War: Resilience, Vulnerability and Implications for EU Policy, Intereconomics, 2022

The share of energy intensive industries

Employment in high and medium-high energy-intensive sectors in Europe, 2019

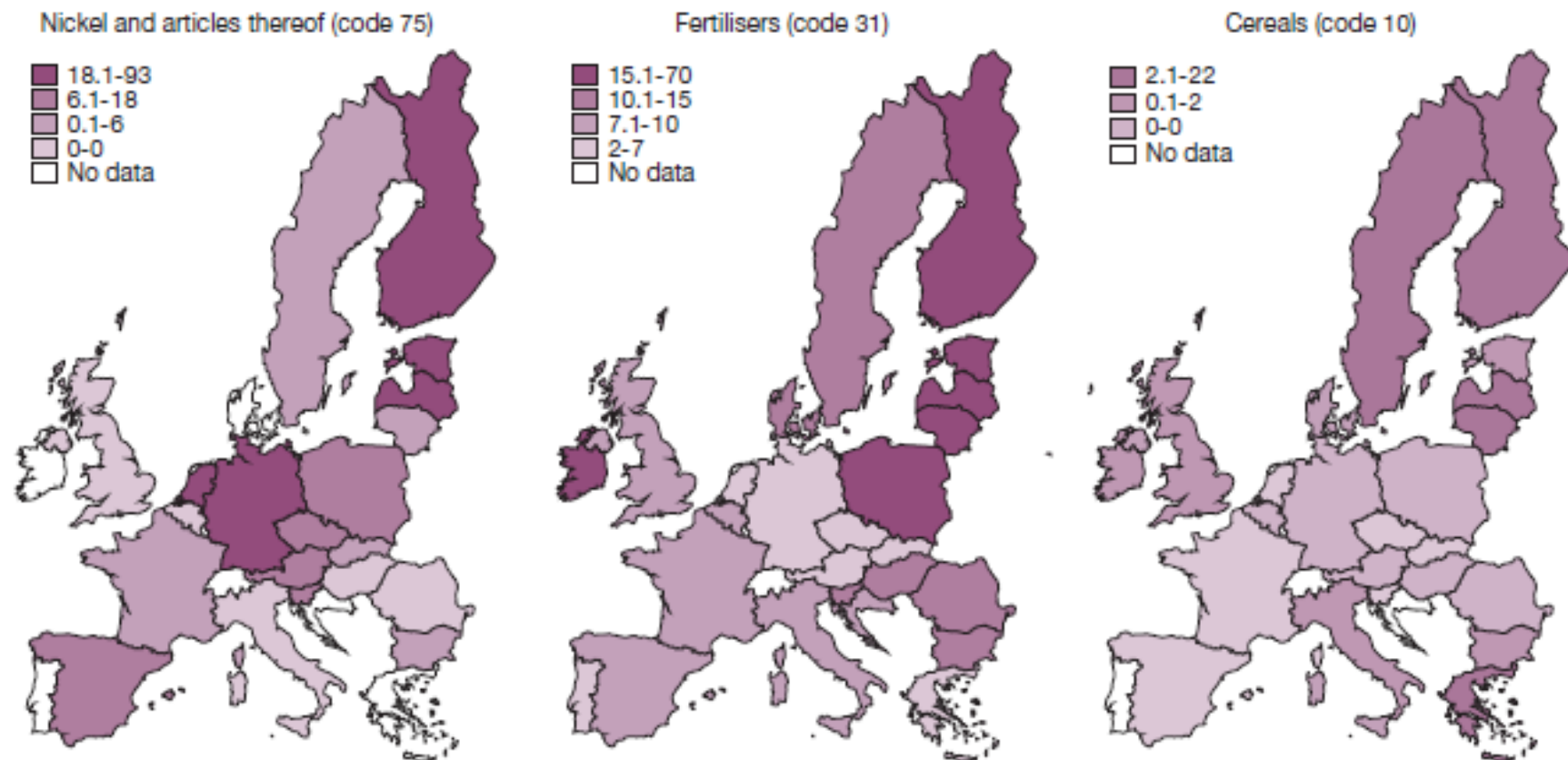
% of total employment



Not only fossil fuels

The share of imports from Russia in total imports, 2019 (top three products)

in %



Note: In the case of cereals, half of the countries do not import from Russia.

Source: Authors' elaboration on Comtrade data.

At the roots of dependence

- Economic interests, as well as the illusion behind the doux commerce doctrine (“Wandel durch Handel”, change through trade, in German), may explain the lack of diversification efforts as ties to the Russian energy sector grew stronger.
- Willy Brandt’s Ostpolitik has been first favoured, then opposed by the US
- In the 1990s, fall of the soviet empire opened a new phase of rapprochement:
 - relocation of German industry to the East and
 - German trade with Russia: Russian gas and German technology
- Similar arguments hold true for Italy

Industrial restructuring

Structural change in the EU economies no longer postponable: energy intensive industries at the basis of the export model.

- Disruptions and opportunities will not be evenly distributed across sectors and regions

China: from strategic partner to systemic competitor.

- Chinese leadership in production and export of renewables and control of raw materials sources in Africa, Asia and LA
- Risks of energy transition: from dependence on Russia for fuel to dependence on China for rare earth and other inputs for renewables

The German-Russian-Chinese road

- Germany's competitiveness is tied to Russian resources and Chinese markets, its politics and financial links are with the Atlantic alliance.
- It is doubtful that Germany will permanently subordinate its industry, technology, commerce to Washington, even for the sake of the high principles .
- True to its mercantilist principles, Germany's policy follows Lord Palmerston's rule: "We have no eternal allies, and we have no perpetual enemies. Our interests are eternal and perpetual, and those interests it is our duty to follow." (House of Commons, 1848).
- Germany is not the only nation to follow this rule.

Globalisation, reshoring, friendshoring

- The age of “politically naïve” globalisation is over
- German ambivalence and American conflicting aims: the US needs a strong Germany to lead a unified European front, but not too strong such as to jeopardize its foreign policy, especially with China
- The tension between economic and political forces may grow over time, vis-à-vis the US.
- Within the EU? (Nord stream 2)

Implications for EU policies

- Fiscal support for households and business: increase in deficits and debt.
- The war has only temporarily overshadowed debt and austerity.
- The growth of public debt – made worse by the commitment to increase military spending – may alarm creditor countries and convince them to resume austerity measures for the whole Union.
- Rising inflation confronts the ECB with a conundrum: interest-rate hikes, although inadequate to cope with price increases due to supply shocks, may be needed to strengthen ECB's credibility in moderating inflationary expectations
- The international context also matters: global tightening and the dollar (a new wave of developing countries' bankruptcies?)

Main CBs are reducing liquidity

Assets as % of GDP

	FED	ECB	B.of England	B. of Japan	B. of Canada
2021	37	70	46	133	20
End 2022 *	33	62	42	136	16

Source: Bank of America

Morya Longo, Sole 24 ore, 16-5-2022

A fiscal agenda for sustainability

- the EU needs a new contingent facility to finance the emergency spending that will be required,
- along with a commitment by the ECB to introduce a PEPP-like program, if necessary, to provide liquidity to the market and fight financial fragmentation.
- the ECB should consider flexibility in the geographical distribution of asset purchases and exercise a great deal of caution in withdrawing monetary support.
- the EU's monetary and fiscal authorities must coordinate and calibrate the instruments they use in responding to the crisis.
- The definition of the fiscal rules for the future is as important as the policy mix (fiscal, monetary and industrial policies) implemented in the current environment for the survival of the Union.
- European bonds and financing by BEI could complement national resources.

Industrial policy

- Disruptive innovations have spawned a range of transversal technologies, spreading horizontally across sectors. Europe's current approach no longer sustainable.
- needed an industrial policy at the European level, capable of anticipating economic change, not simply tracking, or reacting to, it.
- the many initiatives designed must be coordinated within a common vision.
- care for filling the divide between its member states. Next Generation EU, although it represents an undisputable change from the past,
 - does not yet respond to the urgency of ensuring a **European** response to the main challenges.
 - finances primarily national projects, ensuring little coordination or coherence.

Italy's PNRR: up to the task?

- The Plan: more demand activation tool than intervention aiming to structurally influence supply capacities.
- Public demand interventions (especially infrastructures) prevalent
- few measures targeted at influencing the development of the Italian production structure of advanced goods and services.
- No plan on how (and when) to help existing firms to find new business models and how to encourage the birth of new firms
- Transition 4.0: intervention of a horizontal nature, delegated to incentives, and devoid of any conditionality in terms of innovation, sustainability, employment and quality of work, contributes little to an expansion of the spectrum of our manufacturing capabilities
- The prospects for a serious redesign of long-term industrial policies and the definition of a development agenda worthy of the name appear weak in the current political context

Zeitenwende

- The war marks an “epochal turning point” for the global geopolitical order.
- Globalization, already affected by the US-China trade conflict and the disruption following the pandemic, could be in retreat, and we may see the formation of international economic blocs.
- If the engine of growth falters, distributional conflicts within and between societies intensify, fuelling a global trend towards protectionism.
- In such a world, there can no longer be any world champions in exporting. Germany and its fellows will have to rethink their export-oriented economic model.
- It is too early to say whether the changed international circumstances will be able to favour the long-desired reforms of European governance