



## Foundational Economy and the Italian case

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Among the firsts to present a set of proposals to reconstruct our economies after the Covid-19 crisis, there was the Foundational Economy. This name characterizes a collective of European academic researchers, who advocate for a new way of framing and conducting economic policy.

They acknowledge that the economy structure is composed by multiple layers, distinguished by different types of consumption expenditures, business models, sources of revenues, organizational forms and relation to public policy. However, starting from the 1980s, our political system has allowed the economic principles and laws governing the tradable, competitive economy to become the standards also for the rest of the economy, namely, the *foundational economy*. This residual part encompasses the daily essential goods and services for all households: infrastructures distributing water, electricity, gas, banking services and food, primary and secondary education, health and care, income maintenance. According to the Foundational Economy, building a social citizenship means guaranteeing access to these primary goods and services, recognizing that citizens' income may not guarantee provision. Hence, public policy should not aim only at economic and job growth, taking for granted that benefits will be equally distributed to workers, but it should also have an active role in guaranteeing that minimum levels of goods and services in these sectors are met for the entire population. Privatizations and outsourcings have distorted the functioning of foundational sectors, characterized by low risk, low returns and long-term horizon. Indeed, obtaining double digit rates of return requires cutting on other margins, labor being one obvious candidate. Such practice is not irrelevant, as the foundational economy employs a significant share of employment across European countries - 37% of the Italian workforce in 2017, according to [“Introducing the Foundational Economy”](#) .

The pandemic has shown the sectors that cannot be shut down and the identity of the essential workers. The Foundational Economy shared [ten guidelines](#) to reorganize the provision of these essential goods and services, although recognizing that they must respond to local needs, so there cannot be a universal method of implementation. The Covid-19 Report states that the priorities should be the health and care systems, by reinforcing investments in high-tech medical capacities, but also in community-based health and care services and preventive medicine, as well as housing and energy, promoting the expansion of social housing and public and community energy provision. The food sector should be reformed, by limiting the dominant retail positions of few supermarket chains, and long fragile supply chains in foundational commodities should be shortened. Profit and non-profit actors can be providers of foundational services, via agreement to legal social and environmental obligations. Capital intensive foundational activities should be financed by entities accepting low returns. The government should increase its ability to raise revenues through tax reforms on income, expenditure and wealth, in order not to cut funding to the foundational sectors for servicing the debt incurred to face the Covid-19 crisis. Furthermore, it should rebuild technical and administrative capacity at all levels. Finally, European countries should offer finance for the foundational systems in neighboring regions.

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Public policy should aim to strike balance between opposing incentives, in order to realize its goals. It is not our intention to question the incentive balance or the methodology of the various reforms proposed, because they are necessarily expressed as general principles, given the local nature of the foundational goods and services. We agree with the objectives, but the implementation is crucial too - the devil is in the details -, and it appears to differ and develop case by case. Hence, we rather prefer to offer some critical hints to stimulate discussion, leveraging on the case of Italy.

### **Public administration: from procedures to objectives**

The Covid-19 report acknowledges the fundamental role of public administration to invest in the foundational economy. Indeed, it is the public administration that will bear the ultimate responsibility of the implementation of such reforms. Such commitment requires rebuilding technical and administrative capacity, especially at the local level of government, where large cuts followed local budgets decreases, privatization and outsourcing. In Italy, this might just not be enough. The Italian public administration employs 56 workers per 1000 inhabitants, versus 85 in France, 79 in the UK, up to 138 in Sweden<sup>[1]</sup>. At the same time, employment in regional and local public administration has been cut by 25% in recent years, following a tendency towards centralization. Furthermore, Italy has the oldest public workforce among the OECD countries - 45.35% of public employees had more than 55 years of age in 2015, compared to 24.3% average OECD -, combined with one of the lowest percentages of graduates, disproportionately having a legalistic background, as opposed to an economical or technical one<sup>[2]</sup>. In fact, the Italian public administration is traditionally more focused on the procedure rather than on the objectives.

In the next three years, 450-500,000 public employees will retire, spurring the occasion for rebuilding technical and administrative capacity. However, such effort will be successful only if it addresses other peculiarities of the Italian PA, starting from the performance and administrative capacity divide between North and South, between regions, between urban and internal areas. But also, the higher perceived level of corruption with respect to other European countries; the low level of involvement of the public administration when defining government's actions (the Italian PA had a say in what the government does 10.1% of the times with respect to OECD average of 36.8% in 2016) and of the civil society when defining public policies; the small use of empirical evidence and pilot testing in the design and implementation phases, addressed only from a procedural point of view; the inadequate system of incentives connected to the evaluation of results; the small amount of time devoted to formation; the low level of digitalization. In particular, the foundational economy approach considers fundamental the involvement of citizens in defining public policy and requires technical expertise for its implementation, promoting local pilot experiments. Italy needs to reform the way it does public policy, contaminating legal methods with scientific knowledge, the "how" with the "what" approach, and connecting more the public administration to both government and society. Indeed, improving its capacity may not prove enough.

### **Public budget financing**

Foundational economy undoubtedly suggests an increase in the role of the state in the economy, particularly a direct intervention in non-traditional sectors such as supermarkets and a stricter control through all food value chain. Overall, almost none of the ten proposals provides for a reduction in public expenditure: on the contrary, the amount of services and



sometimes goods that should be provided by the state is dramatically enlarged. This poses a serious threat on public finances of highly indebted countries like Italy, whose fiscal space is already very limited. Indeed, even prior to the Covid-19 crisis and the foundational proposals, the need for a holistic fiscal reform has been bipartisan recognized in Italy in recent times, as bipartisan was its non-fulfillment. Surely, it is time to move from need recognition to proposals of practical solutions - a phase in which the foundational approach has the possibility to contribute practically to the actual debate. Particularly, attention should be focused on the level of wealth redistribution operated by fiscal policy and its ability to raise enough revenues. Crucial and challenging choices are whether or not to introduce a wealth tax or a higher inheritance tax (Tortuga already had the occasion to comment on an [alternative inheritance tax proposal](#)), and how to achieve the balance between taxing labor income, capital income and consumption, taking into account the well-known impacts of such choices on labor supply, capital mobility and production incentives.

De-financialization, as well as the notion of “fair return” leading to a 5% bond yield for long-term foundational-related investments, is something that deserves further analysis and declination. This financing approach presents similarities with social bonds, which may be a good mechanism to restart the economic growth engine, moving the well-known amount of Italian private wealth away from bank deposits. A similar role may be played by municipality bonds, emitted with precise foundational destinations. These instruments may provide for an investment-destination link that is clearly recognizable by the citizen-investor, with positive consequences on the accountability of local administrators. Nevertheless, the central control on emissions should be maintained, to prevent abuses that turn into financial distress. The current monetary policy of the ECB hit the zero-lower bound, creating a liquidity trap in which private investors prefer to divest their savings instead of getting very low bond yields or incurring losses in the stock market. Indeed, the distortions of the actual financial system, namely the gap between economic risks and market returns, has caused a paralysis on investments. However, a proposal for financial disintermediation, especially in the Italian context, must come along with an ambitious financial education plan fixing precise targets. Otherwise, this operation will probably incentivize more frauds and cause huge market failures.

### **Innovation and the Foundational Economy**

The last thought goes to the necessity for the foundational economy to reconcile incentives to innovation carried out by private enterprises in the foundational sectors, and preservation of the low risk, low return nature of such sectors. Take the health and care sector, for instance. In 2015, the UK’s National Health Service (NHS) launched a start-up accelerator program, trying to bridge the gap with the latest innovations developed by the healthcare start-up community. Indeed, national health care systems lack the private market competitive forces that allows for a greater innovation take-up, as in the US. An increasing number of healthcare technology companies in the UK are trying to partner with the public system and work with private companies. This might sound as the ideal solution for everybody: the private sector provides the incentives to innovate, this innovation is guaranteed to be applied in the public system, and the start-ups reap the benefits from both – higher profitability from the former, risk management and safety protections from the latter. However, as the Financial Times reports, such partnerships in practice transmit bad practices of the private sector healthcare innovation – unequal access to resources, lower standards of clinical evidence, loosely-regulated marketing – to the NHS. Innovation by private actors is growing as an important driver also for foundational sectors and cannot be left out from the picture, but it needs to be carefully thought of.



## Lagging areas

In a broad sense, the Foundational approach aims at providing an alternative to the current economic paradigm, focusing especially on its weak points: rent-seeking, market failures, macroeconomic imbalances. While under normal circumstances the actual paradigm seems to work well, in the Italian context one of the main emerging imbalances is related to the so-called “lagging areas”, defined as economically and geographically disadvantaged areas which can hardly reap the benefits of a perfectly competitive market, due to the impossibility of reaching minimum efficient scales. These rural contexts have therefore been disregarded by many private and public investments, including in the utility-public services field: the broadband connection infrastructure is an evident case. The main issue is the tendency of this geography-related competitiveness gap to turn into vicious cycles: the absence of a minimum service level, such as the broadband connection, reduces the possibilities for the development of many modern and high-value industrial sectors, halting the development process. Further consequences can be found in the labor market, characterized by internal high-skilled (thus high-wage) migration flows from lagging to leading areas, further depriving the former of valuable human capital. The resulting difference in income levels, heavily affected by the absence of foundational services, is not socially acceptable anymore.

In this context, given the level of inertia of policymakers, driven by the relatively scarce electoral importance of lagging areas (Tortuga analyzed the [electoral consequences](#) of a growing gap between central and internal areas), there may be a potential space for economic policy experiments in the foundational framework. An increased level of public intervention in the economy is required, with the aim of bridging the current gap in terms of different net paid prices or service levels. Indeed, these higher implicit prices are not just limited to healthcare or educational systems - think about the additional cost for off-site university students, coupled with more limited local employment perspectives -, but also to private consumption goods, due to higher transportation costs. Similar causes impair the supply side. Think about all competitiveness-enhancing services: the relative proximity to logistic hubs/infrastructures or the availability of broadband connections are sometimes real survival factors for rival firms. In this context, a simple and interesting experiment would be the extension of special economic zones, or “duty-free” zones: they are already present in Italy in very restricted contexts and their results were quite satisfactory.

## Conclusion

Given the points raised, the foundational perspective can undoubtedly constitute a good stimulus to enrich the actual debate. The “ten-points platform” constitutes a starting point for the subsequent declination of practicable foundational policies, to which we tried, hopefully, to provide discussion elements.

<sup>[1]</sup> <https://www.ilsole24ore.com/art/alla-pa-servono-risorse-non-un-altra-riforma-ACrQY6B>

<sup>[2]</sup> Public administration characteristics and performance in EU28: Italy; European Commission