Italy beware! MP Draghi has authored a toxic guide on how to restructure an economy

28 March 2021 | Mario Draghi has recently been put in charge of the Italian government without ever campaigning in a popular election. Have the parties who agreed to that done their due dilligence? Have they read Draghi's recent guide to „Reviving and restructuring the corporate sector". It boils down to: Let small companies go under, help private equity funds to strip the midsized ones of their assets and let the big ones take over.

Apart from being put at the head of the Italian government, Draghi has recently become a Senior Member of the G30, a group founded by the Rockefeller Foundation. It brings together high level representatives of global financial corporations, central bankers, academics and holders of other public offices. As recently as 2018 the EU Ombudsman ruled that it was improper for the President of the European Central Bank, Mario Draghi at the time, to be a member of such a mixed group, which discusses issues of public policy behind closed doors.

Draghi refused to leave at the time, but left the group as soon as he departed from the helm of the ECB. His successor, Christine Lagarde, did not become a member. But now, as head of a technocratic Italian government, he seems to think it is okay again, to take part in this group that puts out lobby-papers masquerading as objective public policy advice.

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His recent masterpiece, which seems to have qualified him for promotion to Senior Member was leading the working group - together with Raghuram Rajan - which produced the policy paper "Reviving and Restructuring the Corporate Sector Post-Covid. Designing Public Policy Interventions".

Since Draghi has been installed precisely to oversee the spending of the Corona-recovery-money, it is of particular interest which kind of recommendations his working group came up with.

Lest start with a quote from the summary (emphasis mine):

> Governments will increasingly need to move away from broad support to more targeted measures. This means **refraining from trying to preserve the pre-pandemic status quo**, and enabling the reallocation of resources needed for economies to emerge fitter and stronger. Further, **private sector capabilities should be relied on to prioritize and administer support** in jurisdictions with strong private financial institutions and deeper capital markets. Government intervention is best focused on addressing market failures, and to **managing the pace of the needed creative destruction**. Where they do act, policymakers should be willing to be creative in the tools they deploy."

If you should not see yet, whose interests are being promoted here, the acknowledgements of Draghi and Rajan are helpful. They thank „the many leaders in the financial community and the wider corporate sector who supported the study and agreed to be interviewed". They do not thank anybody else outside the G30 and the project team.

One of the big problems they identify is „excessive direct government decision-making and sub-optimal use of private sector expertise that could be used to better direct support". Politicians should have let the corporate world decide on how to distribute the money that the government gave. Interesting! Why? Well, because:

> Banks and private sector investors usually have substantially more expertise in evaluating viability, and they certainly face less political pressure as they make those decisions.“

Unless people do not trust commercial financial institutions to make these decisions. In this case Draghi recommends:

> „In those countries where there is greater mistrust of private sector capital, governments may need to explain the advantages of involving the private sector.“

„Those countries“ might well include Italy, as Italians are not stupid. Note: In the whole paper I have not found any mention of the fact that profit oriented financial institutions might have interests that diverge from the best interest of the country as a whole.

How would this be done? Well: Government is to pay financial corporations for the service of deciding who to give money to:

> When combining private and public sector expertise and resources, often the optimal solution will be to provide government incentives to encourage or channel private sector investment.“

There is also not a single mention of the potential problem that a government that knows so little about where help is needed and how help should best be given, will be taken advantage of in a severe way, if it tries to create the right incentives for the financial sector to do that work for it with large amounts of public money. The whole paper is a wish-list of the financial sector on how they would like to profit big-time from recovery money.

There are those cases, in which the private sector does not know much:

> It can be difficult to access timely, reliable information that equity investors typically require to make investment decisions, particularly for SMEs. Policymakers could consider creating a centralized data utility or encouraging a private sector initiative to fulfill the same function.“

Draghi‘s recommendation: Let the government find a way to procure the information and hand it over for free to the financial corporations, to allow them to pick and choose according to what is best for their bottom line.

> Governments should also „avoid an excessive focus on assigning blame or withholding support, as such an approach could cripple essential business support measures necessary for the sake of society as a whole.“

In other words: Give the billions to those tax-evading corporations and to all those who have depleted their capital by paying out large dividends or by spending the money on share buybacks. That should not matter. No one should be forced to bring home those monies from the carribian and commit to paying taxes in the future. At least, it is not mentioned.

Let small companies perish

The paper goes on with the battle-cry „kill those jobs“ or in their words:

> Governments should encourage necessary or desirable business transformations and adjustments in employment. This may require a certain amount of “creative destruction” as some firms shrink or close and new ones open.“

Here, there will be a job for governments, not for the private sector. The job is called „take the blame“:

> A key task will be to communicate these aims clearly, and manage the inevitable pushback against winding down broad, untargeted support programs and allowing some businesses to fail.“

Of course, the financial sector should be protected from any negative fallout:

> While this is primarily a crisis of non financial firms, government may need to intervene to protect or bolster the ability of the financial sector to support the economic recovery.“

Which are the companies that should be part of the creative destruction? Draghi has it explained under the headline „Zombi Firms: The Danger of the Walking Dead“. These are „companies that are unable to cover debt servicing costs from current profits and that depend on creditors for their continued existence.“

Wait a moment! They are zombies because they cannot service their debt? They can pay their wages and their suppliers. If (part of) their debt was cancelled, they would be viable. However, that would not be creative destruction. And it would hurt creditors. It is also bad for the corporate world since it has been shown - as the paper mentions - that failure to close down on production capacities and creating unemployment will result in lower prices, higher wages and lower profits. Lower prices, higher wages and lower profits would be bad. Lets do creative destruction instead, says Draghi.

Which type of company has the highest ratio of zombies? Draghi‘s papers says that its the small ones that should go under:

> A recent study found that the ratio of zombie firms increases as the company size decreases, raising concerns of a growing number of “invisible” walking dead among smaller firms.“

Help the locusts to buy up the mid-sized ones

Larger-companies are less zombie-infested and can be restructured, says the paper. Not by the government, though, since the government - as „virtually every serious analyst recognizes" - does not know how to do this. Rather it should be „partnering with the private sector to finance necessary balance sheet restructurings".

Sometimes, balance sheet restructuring can be a euphemism for asset stripping, at least if the ones doing it are private equity funds, formerly known as leveraged-buyout-firms, also going by the name "locusts". These are exactly the ones Draghi wants to rely on:

> Policymakers should identify where domestic pools of private capital reside to inform the design of interventions to channel private sector expertise and funds. (The) ability to mobilize foreign sources of private funding may be a disproportionately important source of financial resources for countries with less developed domestic private sources of funding. Governments’ attitude toward foreign take-overs of domestic firms will be important.“

Apart from letting it happen, governments should help those private equity funds and other asset managers - like the ones in his G30 working group - by guaranteeing bad assets of target companies and by „subsidizing equity investments in certain sizes of firm or sectors".

This might not be enough, though, since some of those investors might be of the more fearful type and shy away from the risk of losing money if things go wrong. These should get insurance from the government, such that overall, they can only win:

> Government intervention to protect extreme negative outcomes on investments across portfolios of investments resulting from extreme negative macroeconomic tail risks may be required to give private investors the confidence to invest."

In short, Draghi's advice for governments is: Draw up very large schemes of government subsidies. Hand them over to financial corporations and let them decide, how to make most money by allocating those subsidies to companies they lend to or buy and „restructure", while making sure that enough creative destruction happens to depress wages and keep product prices and corporate profits up.

Italians should keep a very close eye on what their prime minister is doing.

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German version of this blogpost

Dossier on Draghi and the G30