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The Italian Crisis: Grounds for Eurozone Policymakers to Reform Domestic Politics

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Italy's ongoing political crisis highlights the weakness of its political system and its inability to implement economic reforms. This instability is, however, built into Italian democracy and can hardly be a cause for surprise in other capitals. EU decision-makers, currently focused on improving governance mechanisms at the supranational level, should therefore counter the national deficiencies complicating governance in the southern eurozone. These countries will otherwise crystallise as a permanent weak link of the new eurozone architecture.

Failure of EU-Inspired Reform. During the more than 60 years of its existence, the Italian Republic has famously been ruled by 62 governments—a reflection of the strong polarisation between parties of the left and right. The fact that the two most stable and the long-lived cabinets in post-war Italy were both headed by Silvio Berlusconi (1,412 days in 2001–2005 and 1,287 in 2008–2011) also highlights the troubling allegiance to party centrality and strong, expressive leaders. Further sources of instability, as underlined by reformists, are found in Italy's electoral law (such as the multiple-winner method, closed lists, and majority bonus awarded to the winning coalition in case it fails to obtain a sufficient mandate) as well as in its perfect bicameralism, which assigns equal powers to both chambers. However, despite the urgent need to introduce changes to the electoral legislation before the judgment of the Italian Constitutional Court planned for 3 December, there seems to be no consensus among major political forces on its content. Hence, a more systemic reform of the Italian political system aimed at changing the role of the so called upper chamber might be a solution to the permanent political instability.

At a time of persistent eurozone fragility, each Italian political crisis darkens financial institutions' perception of the country, potentially destabilising the whole eurozone. Other Member States still have no proper response. A dispute between Berlusconi and his then Minister of Finance Giulio Tremonti in July 2011 caused nervousness EU-wide, and tensions in November of the same year eventually led to the resignation of Berlusconi and, under pressure from other EU governments, the appointment of Mario Monti as prime minister. The formation of this technocratic government was viewed as a precondition for the country's economic reform, and indeed the Monti reforms contained in the *Salva Italia* (Save Italy) decree were positively assessed by international financial institutions. In its report "Assessing the macroeconomic impact of structural reforms: the case of Italy," released in January this year, the IMF estimated that the continuation of the measures taken in 2012 would help the country achieve real GDP growth of 5.75% in the next five years and 10.5% in a long-term perspective.

And yet, it seems that this was not a very sustainable response. Measures such as raising the retirement age (to 66 years and 3 months for men, and 62 years and 3 months for women), the announcement of an increase in VAT from 21% to 23% and the introduction of a unified property tax have all met with stiff popular opposition. Tax increases were among the most unpopular reforms implemented by the government and resulted in low support for Monti's Scelta Civica (Civic Choice party) at February's parliamentary election. Furthermore, well-placed critics suggest that some of the reforms are actually having the opposite effect to that intended, such as those linked to the labour market. It has been estimated by the Italian General Confederation of Labour (CGIL) that more than 500,000 workers could lose their jobs due to stricter regulations that make it harder to give "junk contracts" to workers.

However, the failure of the technocratic government to undertake politically-sensitive structural reforms to reduce public expenditures, the budget deficit, and public debt is considered the greatest indictment of Monti's government.

Lack of Public Faith in Domestic Politics. The political crisis affecting the grand-coalition government of Prime Minister Enrico Letta, who rose to the position earlier this year, has renewed international concern. Moody's stated that although Italy had managed to avoid the EU infringement procedure by reducing its deficit from 5.5% of GDP in 2009 to 3% in 2012, in 2013 it most probably will miss the target required by the European Commission. Other alarming data are included in the latest report by the Italian treasury on 20 September. It estimates that public debt in 2014 will equal 132.2% of GDP, up from 129% in April this year. On top of these macroeconomic issues, the Letta government is struggling to find a solution to other urgent problems, such as an unemployment rate of 12.2%, the highest for 30 years. EU politicians, though, are still nervous about pushing for change in the domestic political system. It seems they have overlooked the fact that many Italian voters are looking to the EU rather than their own scandal-hit political class as a conduit for change.

Berlusconi remains the dominant force in Italian politics. In August, he was sentenced to four years for tax evasion, reduced to 10 months due to an amnesty decision (according to Italian law, the 77-year old cannot be imprisoned, and has been given the opportunity to serve out the sentence as social work). He has been banned from holding public office for two years, although the fate of his mandate in the Senate is still uncertain (the final decision will be taken during a vote by the whole Senate, tabled until November). Berlusconi also lost the position of uncontested leader of his own party when its national secretary, Angelino Alfano, publicly criticised Berlusconi's decision to quit the coalition. Although Berlusconi eventually backed Letta's government, the short crisis clearly showed the coalition's fragile foundations. It also caused a public backlash, further undermining trust in a political class seen as unable to compromise and introduce necessary reforms. This could be potentially harmful for mainstream political parties, especially if there are snap parliamentary elections.

Conclusions. All this underlines a broader problem concerning the foundations on which European economic integration is built. The current project to create a "genuine" Economic and Monetary Union is principally focused on closing the gaps in EU-level governance. Yet, the current discussions do not seem to sufficiently take into account the domestic governance problems of certain eurozone members. Even the national financial-adjustment programmes controlled by economic experts from the "troika" (IMF, European Commission, European Central Bank) neglect the broader context of domestic political and social deficiencies. And other crisis-born mechanisms available to the EU, such as the annual economic policy recommendations given by the Council (the European Semester) lack teeth.

Italy is an example of how an inefficient political system squanders economic advantages, failing to stabilise sovereign debt, which is cutting down fiscal manoeuvring room. It raises the question whether a future euro area, highly integrated and with considerable fiscal transfers in place, will be sustainable if national politics cannot deliver. This refers not only to Italy, the largest eurozone trouble-maker with a "too-big-to-fail" status but also other eurozone laggards, such as Greece, Spain, Cyprus and Slovenia. Experience shows that, sometimes, economic reforms must be preceded by changes in political systems. Thus, EU countries should attach importance not only to creating new EU-level or eurozone governance mechanisms but also to the proper functioning of basic economy-related institutions, the effective fight against corruption, and increasing the standing of civil society and the independence of media. Amidst valid concerns about the EU overstepping its competencies, an initial step would see the formation of an independent and respectable high-level "wise-man group" that would make non-binding country-specific recommendations.

The political instability in Italy and the other southern eurozone member countries could entail an economic contagion for all EU members, including Poland. This requires the latter to tighten up its own domestic governance. The slow increase in economic growth in Poland, expected for 2014, should be an occasion to clean up public finances, speed up structural reforms, and prepare for the proverbial rainy day.

As for its relationship to Rome, despite its size, Italy is a relatively weak player in Brussels. Nevertheless, in the past, it has proved to be a valuable ally for Warsaw on several issues. Monti, who enjoyed good relations with Angela Merkel, had sympathy for Poland's efforts to be included in eurozone decision-making, in preventing cuts in the new EU Multiannual Financial Framework 2014–2020, or in deepening the EU internal market. Despite the current government in Italy becoming increasingly introspective, ceding some place in Brussels to other players with more solid political standing at home, it is worth continuing close cooperation with the country, which is the third-largest eurozone economy.

Poland should also be aware of the Italian lesson and not lose political vigour in Brussels in its own electoral years in 2014 and 2015, when all of the domestic political forces, including numerous members of the European Parliament, will be focused on national politics. This time will be crucial for forming new powers in EU politics and for designing new institutions and mechanisms for the eurozone.