Reinvention of Europe Project

Italy: a country in receivership

By Marco De Andreis & Silvia Francescon

In November 2011 Mario Monti took over at the head of a technocratic Italian government in the absence of an obvious political solution – such as calling a snap general election – that could install in Rome an executive capable of dealing effectively with Italy's pressing problems. Monti's immediate challenges were a mounting national debt crisis and the need to lay foundations for reforms that would allow Italy to play a credible role within a changing European Union. But Monti's technocratic government is only a temporary solution for Italy, and his other challenge is to make his achievements sustainable in a country facing tough choices, continuing political dysfunctionality and less clear-cut support for the EU. This will be hard in a country that is shying away from serious debate about Italy's place in Europe.

Being run by an unelected technocrat is not unique to Italy, as recent Greek experience shows. What is unique to Italy, however, is that this is happening for the third time in the last twenty years. Before Monti there was Carlo Azelio Ciampi (1993-4) and Lamberto Dini (1995-6). All three were given the helm with the same mission of pulling the country back from the brink of financial default and keeping it within the grand scheme of European Monetary Union. Ciampi and Dini accomplished their respective missions, but failed to make their achievements sustainable. Will Monti succeed?

In receivership (again)

Almost all the major parties that existed before the fall of the Berlin wall, including the Communists, had disappeared by the mid-nineties. Since then the country has been convulsed by political upheaval, with new parties appearing and disappearing, merging, fusing, changing names and shifting their allegiances. The electoral system and constitution have changed repeatedly and are due to undergo another alteration. Silvio Berlusconi's leadership of the right (and often the country) has been the only element of political continuity over the last two decades.

Italy is a founding member of the European Community. Its spectacular post-war growth coincided with the development of European integration and the economic opportunities offered by free trade on a continental scale. Italy also had the strongest Communist Party in the western world: the collapse of communism in the Soviet empire also meant the end of a political consensus based on the exclusion of that party from government.

This turmoil has been accepted during fair economic weather, but when storms have blown in the political system has soon reached crisis point: hence Ciampi, Dini, and now Monti.

Italy's main economic problem is its huge debt (in 2010 it was 118.4% of GDP), which is rooted in deficit spending from the 1980s. In 1992 Italy came close to default, and in 1995 its public debt reached 120.9% of GDP. Throughout the nineties, Europe was the beacon that helped Italy navigate the storm of its public finances and economic difficulties. Italians saw monetary union (and jettisoning the lira) as the only hope of breaking the cycle that lay behind their economic troubles by limiting the profligacy of their political system (seeing Europe as a corrective to domestic problems has been a strong component of Italian pro-European sentiment). A one-off tax to bring the 2007 deficit below 3% (the threshold for joining monetary union) gained broad support.

Having joined the euro, the country aimed to bring down its public debt. The results were disappointing, and further hindered by both the global economic crisis from 2008 onwards, and a marked slowdown in Italian economic growth. By 2010 Italy's public debt relative to GDP was only 2.5% lower than in 1995 (although over the same period France's went from 55.5% to 82.3% and Germany's from 58.5% to 83.2%).

Slow growth has compounded the problems of Italy's public finances, making markets suspicious about the country's long-term solvency and vulnerability to contagion. This has further overshadowed the relative economic strengths that Italy does have: for instance, its share of world merchandise exports held up against the Asian onslaught of the last 40 years better than any other rich country but Japan[i]; its private sector has a low level of indebtedness. Household debt, in particular, is low (at 45% of GDP, Italian households are less indebted than Ireland, Japan, the UK, Spain, France, the US and Germany)[ii]. It can be argued that Italy's current challenges are ultimately more political than economic in nature.

Mario Monti's first 100 days or so have been encouraging. At his first press conference as Prime Minister on 13th November 2011, Monti said that "Italy must become an element of strength and not weakness of the European Union". By March 2012, The Economist's Charlemagne columnist was writing that "Italy's impressive prime minister has changed domestic and European politics"[iii]. Monti received a standing ovation in the European Parliament after laying out the government's economic legitimacy, and was warmly received by President Obama, who praised the US-Italian relationship while agreeing the broad goal of reconciling fiscal austerity with growth[iv]. After so long as a nation seemingly lost in Europe, Monti has achieved results in restoring Italy's international credibility.

Monti has also received a warm welcome from China. The "international voice" of the Chinese Communist Party, the People's Daily, broke its traditional prudence over other countries' affairs to signal relief in Italy's new course[v].

The rebuilding of Italy's international reputation has contributed to a substantial narrowing of the yield gap between Italian ten year bonds and those of Germany, which fell from over 500 basis points in November 2011 to below 300 in mid-March 2012 (the spread then rose once more, approaching 500 basis points by mid May – a sign of the persistence of market concerns).

This improvement, however relative and unsteady, was also greatly helped by the parliamentary approval of credible measures to arrive at a budget close to balance in 2013, and a sustained effort to have the legislature pass several structural reforms, including one concerning the labour market now being negotiated with trade unions. Two waves of quantitative easing à la ECB[vi] (cheap three year loans to banks) are also thought to have helped.

Monti has demonstrated that his appetite for reform extends beyond Italy to Europe as a whole. In February he signed a letter (along with 11 other European leaders) putting forward 'a plan for growth' to the Presidents of the European Commission and European Council[vii].

Crucially, this letter also reinforced the domestic message that growth could not be achieved through fiscal expansion. In the Italian Senate in January Monti said that "only die-hard believers in discredited policies can think growth can be pursued on the demand side through fiscal deficits or lax monetary policies". However, in Italy both the left and right not only *do* identify growth with public spending, but also show a strong aversion towards the market-opening measures Monti is struggling to get parliamentary approval for as a complement to fiscal consolidation.

Monti's reforms are contained in a document called the Programma Nazionale di Riforma from the Ministry of Economy and Finance (written every year within the framework of the 'Europe 2020'[viii] strategy), aimed at increasing European competitiveness. The first chapter is 'Italia 2020', and contains sections on austerity, growth and equity. Monti's preface makes it clear that the reforms are directed partly at stimulating public and political debate about the medium-to-long term future of both Italy and Europe. This represents an important attempt by Monti to position his programme as more than a short term fix for an immediate problem, but rather as building foundations that will be robust enough survive the period of receivership and the return of the politicians.

The 'plan for growth' letter that Monti co-signed also indicated a willingness to mend fences with the UK and co-author David Cameron, after the latter's stand against the new treaty on the fiscal compact. The eight areas of structural reforms indicated in the letter include further steps to make the internal market in services finally work, an official EU goal never truly shared by France and Germany, whose leaders did not sign the letter. There have been other signs of Monti wishing to balance between Britain and continental Europe, for instance when the Italian government reacted coldly to a German initiative to invite 9 foreign ministers[ix] to Berlin to discuss further European integration. On March 10th Foreign Minister Giulio Terzi said that "it would be extremely premature now to chart a course toward further integration".[x] When interviewed by the German newspaper *Die Welt* in January, Monti himself stated his clear conviction that "we will never have a United States of Europe".[xi] In the same interview Monti reiterated his admiration for the social market economy championed by Germany. As a fiscally-prudent and market-friendly economist engaged in restoring Italy's economic credibility, his faith in the market has had an impact on his country's foreign policy, in balancing the Franco-German axis with Britain (and the US). This also reflects the political need to rely upon support from the left (more diplomatically inclined towards Paris and Berlin) and a right that Silvio Berlusconi's years in power have made more attuned to London and Washington.

Despite attempts by the Italian government to distance itself from Germany, if it is successful in consolidating lasting economic reform then this will also be Angela Merkel's success. By resisting an early Italian rescue (for instance involving Eurobonds or allowing open-ended buying of Eurozone sovereign debt by the ECB), she contributed to Silvio Berlusconi's eventual resignation and Monti's coming to power. As such, Monti's government can be seen as the result of an informal fiscal compact in action, forcing a Eurozone country guilty of fiscal irresponsibility into receivership (a concept first used by Monti[xii] well before becoming Prime Minister as Berlusconi came under pressure over the economy).

What next?

Despite its apparent early successes there is still a chance that Monti's government may fail in its ultimate aim of tackling both the immediate financial crisis and laying the foundations for meaningful reform for Italy as a sustainable member of more resilient Eurozone (and EU). The challenges to these aims have both domestic and European dimensions.

Much of the domestic focus will be on the role of existing political parties. Monti has consistently excluded the possibility of running for office, and, as a subsequent election would be too soon to see a substantial change of personnel in the political parties it seems likely that any victorious parties would once again use their own members in government positions. The spoils of the probable post-Monti era are clearly there to be fought over, perhaps by new political entrepreneurs, particularly as parties see their support levels very low (although opinion polls are often unreliable, one on 22nd April found only 2% of respondents trusting political parties and 10% trusting Parliament). This also opens the possibility of a large party withdrawing support from Monti's government before the end of the current legislature a year from now, under pressure from special interest groups that feel threatened by the reforms.

Inter-party competition may also directly involve Europe. As noted above, Italy has tended to see Europe in a positive light, not least because of its association with rising prosperity and its role as a 'corrective' to problems within Italy itself. Both are now under threat. The wider euro crisis, compounded by domestic austerity and reform on the back of a decade of painfully low growth, has weakened any perceived link between Europe and prosperity, and larger Italian companies remain negative about the economic outlook.

This situation has partially undermined Italian faith in the EU. The last *Eurobarometer* poll suggests that 34% of Italians do not believe in the economic measures the EU has undertaken to overcome the current economic crisis: one of the highest shares of sceptics among Europe's member states.[xiii] Impositions from Brussels may no longer be viewed as being for the greater good, but as being dictated by the interests of individual nations (in particular Germany).

Although this describes the ground over which future political fights may take place, it does not suggest concrete trends as the environment is extremely fluid. The leader of the leftist Partito Democratico, Pier Luigi Bersani, has been notably active on the European scene, supporting the new French president François Hollande, during his campaign, and organising a conference of European socialist parties. Monti himself said recent elections in France, Greece and (at the local level) Italy would not change his agenda, but by underlining the importance of growth may make the logic of his reforms more compelling. Notably only the far left Sinistra Ecologia e Libertà of Nichi Vendola is calling for the fiscal compact to be revised or rejected.

There is also room for the emergence of a populist movement, as demonstrated by the recent electoral success of the 'Movimento 5 stelle' of activist and comedian Beppe Grillo, particularly with the corruption scandal currently engulfing the Lega Nord. Such an entrepreneur may profit from a eurosceptic position, perhaps framed as a rejection of a Europe driven by Germany rather than common interests.

However, the most telling observation about the political debate over Europe is that it is largely absent. Politicians from across the spectrum seem unwilling to discuss Italy's place in Europe to avoid either being seen to upset Monti's programme of reform or being associated with unpopular reforms that harm sectional interests that in turn may hurt them in future elections. This will undoubtedly change as elections draw near, but much depends on both the country's economic fortunes and the positioning of new political forces.

Monti also faces formidable technical challenges to success. He has already made major adjustments to pension reforms made by Giuliano Amato and Lamberto Dini. He still needs to bring this year's budget deficit down to around 2% of GDP (from 3.9% in 2011) and introduce several structural reforms, including, crucially, the labour market reform. Difficult reforms to both the judicial system and the electoral law will also be difficult to negotiate.

Externally there is the danger of market mistrust over Italian sovereign debt reigniting, or a marked slowdown of the world economy. This would make the pain of simultaneous fiscal consolidation and structural reforms, the *raison d'être* of the present government, unbearable. However, the accepted view among most stake holders is that such a failure would be a catastrophe, and worth strenuous efforts to avoid.

Avoiding immediate catastrophe would not represent a true success for Monti's receivership of Italy, given the more comprehensive reforming nature of his stated aims and the dangers that the return of the politicians may pose for Italy's future trajectory at home and within Europe. There are grounds for optimism, however, over the survival of Italy's traditionally pro-European stance. The faith Italians have in all things European is largely rooted in a long-standing distrust of their own politicians. They are therefore likely – even well after the Monti government – to see Europe and European integration as the broader solution to the problems that they and their politicians are liable to create for themselves. As a result, there remains significant support for a move towards a federal Europe with more powers ceded to Brussels. Despite some signs of increasing scepticism toward Europe, this will be limited by the absence of serious debate over Europe and this role as a corrective to domestic shortcomings.

In less than a year the general election to return power to politicians will be held. Whoever wins power will then confront the same tough economic agenda of fiscal consolidation and structural reforms – no matter how successful Monti will have been in the meantime. The coming year in Europe is likely to be tumultuous and there is time for the debate to change as the country's much maligned politicians once again jostle for power. However this is unlikely to upset Italy's usual trajectory as a committed, if troubled, EU member.

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[i] http://www.wto.org/english/res_e/statis_e/its2011_e/its11_world_trade_dev_e.pdf Table 1.6

[ii] McKinsey Global Institute, "Debt and deleveraging: Uneven progress on the path to growth", Report, January 2012.

[iii] http://www.economist.com/node/21549963

[iv] http://www.enewspf.com/latest-news/latest-national/30813-remarks-by-president-obama-and-prime-minister-monti-of-italy-after-bilateral-meeting.html

[v] http://www.liberoquotidiano.it/news/942392/Governo-ambasciatore-cinese-Wei-Monti-sta-facendo-lavoro-eccezionale.html

[vi] December 2011 and March 2012

[vii] The 12 leaders are the prime ministers of the United Kingdom, the Netherlands, Italy, Estonia, Latvia, Finland, the Czech Republic, Slovakia, Spain, Sweden, Poland, and the Taoiseach of Ireland.

[viii] http://ec.europa.eu/europe2020/index_en.htm

[ix] Austria, Belgium, Denmark, France, Italy, the Netherlands, Poland, Portugal, and Spain

[x] "UE: Terzi, Prematura prospettiva rilancio nuova costituzione" ANSA Press Agency,10 March 2012. These openings toward Britain were not helped by London's decision to attempt the liberation of two hostages held in Nigeria, a British and an Italian, by the local Jiahad, without consulting with Rome. The attempt failed and the hostages were killed on March 8, prompting strong domestic criticism of the Monti government conduct of foreign affairs.

[xi] "Warum Italien mehr wie Deutschland sein sollte", 11 January 2012.

[xii] http://www.corriere.it/editoriali/11_agosto_07/monti-podesta_1a5c6670-c0c4-11e0-a989-deff7adce857.shtml August 7th 2011

[xiii] See European Commission, "Standard Eurobarometer 76", December 2011.

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