THE INCOMPATIBILITY BETWEEN THE EURO AND DEMOCRACY: THE ITALIAN CASE

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July 2019

The Italian elections on 4th March 2018 have been a great setback for Europe. Italy, after all, was one of the founding members of the European Community and has always been a Europhile country with more than 80% of Italians traditionally endorsing the benefits of EU membership. All of this however has changed as the national electorate opted to register an emphatic protest vote. Last year's election result confirmed for the first time an en - masse political legitimisation for Eurosceptic parties with the Five Star Movement obtaining 32% of the overall vote, and the Lega Nord 17%. This has been compounded by the recent European election results which confirmed a resounding Eurosceptic result with the Northern League dominating Italy's European elections and tightening its grip on power in its first year in office, and, Mrs Meloni Fratelli d'Italia, entering for the first time the European Parliament, alongside the weakening Five Star Movement. For the Italian voters the defining elements were the ongoing unresolved economic stagnation and an unsustainable immigration regime evident in the ongoing immigration crisis in the Mediterranean. Since the Euro was formed in 1999, the Italian economy has barely grown at all with a ratio to government debt to GDP now at 132% and living standards stagnant. While the previous Italian government agreed to a deficit target of 0.8% of GDP in 2019, the current government budget had initially forseen a deficit of 2.4%. More importantly, even though unemployment has fallen by 3% since the late 2014, it is still at 10%, with youth unemployment over 30%. This tendency has been, for some time now, shaping the discussion about Italy's future in the Eurozone. An injection of economic growth in the near future, would - by all means - be very beneficial. However, the European Commission has disagreed with the optimistic assumptions of future growth and fears further slippage on account of the current predictions of a serious economic slowdown, apparently underway. This trend which almost began the process of opening a formal disciplinary procedure against Italy for "excessive deficit", and for breaking European fiscal rules on account of the country's excessive burden of public debt, has put Italy, for the first time, on a collision course with the European Commission. It is now a real possibility that, if European rules are not reformed, the choice for Italy could be between a political union or possibly, its withdrawal from the EU and at least the Euro. 2 It is very difficult, at the present time, to see how Italy can grow itself out of its debt while retaining its membership of the Eurozone under the current EU monetary and fiscal policy rules. Undoubtedly, for some time, Italy has been in need of a root and branch reform of both the economy and its political system, which the present government has started to undertake. Italy needs to undertake economic reforms to cut taxes, improve its public administration and justice system, and invest in productivity increasing technologies. These reforms however, even if implemented, and even if they turned out to be better than the proposals seen so far, can now only take place under different EU rules, if Italy is still to be part of the block. Admittedly, reforms had to be made in the 1990's, in a much more favourable global environment, and in compliance with the promises made by the Italian state at the time of the accession to the Euro - which clearly have not been maintained by the previous governments. Italy's position in the global economy has been a recurrent feature since the 1990's which by now is in the process of being urgently addressed by the present government, to make up for the little understanding of this context by the previous ruling elites. With the world changed in quite radical terms – first in the wake of globalisation up to 2007 - and in more recent years after the dramatic crisis of 2008-2009, Italy needs now to reposition itself in the world. At this juncture, EU reforms may be as dangerous as immobilism, since they can push the country off the cliff of further destabilisation. This is hardly surprising considering that reform proposals must originate from a vision of the future of the country, and which, within the present political cultural horizon of Italy, inextricably tied to inflexible EU rules, is essentially unviable. The digression towards increasingly abstract, legalistic formulations of the EU have reduced Italy to a sheer financial and fiscal balance sheet. What Italy needs in the immediate short term, is more aggregate demand, and to tackle its fiscal problem, which derives from a combination of a heavy weight of past debt and very sluggish economic growth, continuing into the present. Italy's economic underperformance in recent decades has been staggering. IMF data indicates that Italy's real GDP has been completely flat from 2002 to 2017, while Germany's has risen 20%. Hence, the new Eurosceptic government's pledge to rewrite EU rules rather than to follow them, with Mr Salvini declaring "Italy will need to renegotiate EU rules to stop Italy from suffocating" and the attempt by the Italian government to launch a parallel currency to rival the Euro after the Italian government approved in May a motion suggesting that mini BOTs - small denomination bonds to pay government debts to business -, should be considered, as in the words of the Lega Nord's Chief Economist Alberto Bagnai, "the goal to balance the budget has destroyed our economy". While Europe is certainly not the only culprit behind Italy's lamentable economic performance, it is definitely at fault and one of its main causes. In 1999, the ECB's 3 first President Wim Duisenberg hailed the arrival of the Euro promising financial stability, better employment prospects and higher living standards for almost 300 million people. Two lost decades later, Italy's economy has barely grown in real terms. As it were, the design of a common European currency contained major flaws, including a combination of rigid budget rules, a lack of automatic stabilizers and of a mechanism for prompt intervention to avoid panics in the sovereign bond markets. These are notorious and serious limits to the further expansion of the German controlled ECB operations that have never been addressed in the last twenty years, and worse still, these limits are now politically unsustainable. As pointed out recently by the Finnish Central bank chief, Mr Olly Rehn, the ECB will need to review how it conducts policy and rethink its policy framework given its failure to lift inflation back to target despite years of extraordinary stimulus. As the Italian case shows, not only is the ECB unable to protect countries from rising interest rates, but more often than not, European institutions actively and, presumably, contribute to exacerbate market tensions, as have the harsh pronouncements of Pierre Moscovici and Jean Claude Junker, among others, in the recent Italian stand-off. The ECB is a dysfunctional central bank as it intervenes on the sovereign bond markets of member states on the basis of fixed quotas, and not by setting the interest rates as a buyer of last resort; it cannot therefore boost its acquisitions of bonds for a specific country to quell market speculation. Specifically, it can do so via the Outright Monetary Transactions (OMT) programme whose "strict and effective" conditionality (such as the one imposed on Greece) would explain why no country has yet applied for an OMT programme. Furthermore, the ECB mandate is enshrined in international treaties, under which the signatories accepted a certain conception of the European common currency and its management, as part of the framework of a comprehensive political agreement. As the legal obligations currently stand, it can only be altered by means of a necessary, but difficult political agreement and treaty. This also indicates the predominant socio-economic European model of austerity or, the limited conception of conceiving economic models and paradigms as completely de-coupled from political questions. In this context, the recent Italian vote reflects a refusal by the majority of Italians to make heroic levels of economic and personal efforts for the concept of an ever closer union based on a continuation of a thus conceived undemocratic self- interested German run European superstate and, to a lesser extent, by a Franco- German identity of interests. It also reflects the more general problem of the inadequacy and social consequences of the predominant socio-economic European model of austerity which nevertheless, has prompted Matteo Salvini's neo Eurosceptic government to introduce the implementation of a 15% flat tax income which could cost the government large amounts of revenue and, with Mr Di Maio, who heads the Five Star movement, intent on protecting welfare spending. Balancing the very narrow space to try to get some fiscal space on one side, avoid going into recession and, at the same time, not trying to scare the markets too much, has been the biggest recent challenge facing the new Italian government. The impact of higher bond yields 4 spilling over Italy's banking system would reignite concerns over a slump in sovereign bonds which, in turn, would put pressure on domestic banks holding the debt, requiring a bailout which would only add to Italy's deficit. In the light of the recent deferral by the European Commission of the excessive deficit procedure against Italy, one might ask if the European Commission's inflexibility is justified, and raise questions about the seemingly irrational and deeply political nature of Europe's fiscal rules through the Fiscal Compact, but more importantly, about the fundamental incompatibility between democracy and the Euro. The fact that Italy has been running a primary fiscal surplus almost continuously for 25 years suggests that EU rules have not worked in terms of public debt, raising the question of whether the EU's criteria for its fiscal rules are deemed arbitrary and not sufficiently flexible, or, whether technical debates only serve to obfuscate what is really decided behind closed doors and ultimately, the political nature of the Commission's decisions. Any doubt that the Commission is acting in bad faith here is dispelled by its very different treatment of countries that have much larger deficits than Italy, - notably France and Spain. France has recently announced a temporary deficit increase to over 3% to respond to the persistent widespread Yellow Vests protests in the country, while Spain's deficit this year is now expected to hit 2.7%. Furthermore both countries have been running primary budget deficits for the past decade – the main factor accounting for their better economic performance, vis a vis Italy. More importantly, the Commission has been silent on Germany's ongoing and massive current account surplus, which reached 8.4%of GDP in 2017 – well above the 6% threshold allowed under the Eurozone's Macroeconomic Imbalances Procedure – and one of the main culprits for Europe's deep structural disequilibria. By these data, it is an incontrovertible fact that EU rules have always been applied in a selective manner, contingent upon the political clout of the transgressor and other deliberate consolidated power games: it is a wellknown fact that both France and Germany flouted Maastricht's fiscal rules in the early 2000, without incurring any consequence whatsoever. Therefore, in the light of these precedents, and the fact that Italy's economy is in urgent need to grow, it is very difficult to justify the Commission's recent ferocious attack on Italy's mildly supportive fiscal policies. The proposed budget was definitely not an expansionary budget, and it was less contractionary than the one drafted by the previous government. In fact, excluding payments on the existing stock of public debt (equal to around 3.5% of GDP), the government's fiscal plan foresaw a primary budget surplus of a little over 1% of GDP (which has now been raised to 1.5%).This continues a long-standing tradition in Italy: despite common misconceptions about Italy being a reckless spender, the country has been running a significant primary surplus for the past two decades - making it the most "virtuous " country, by mainstream standards, in the developed world. Therefore, the European Commission's insistence that the Italian government continue on the road of austerity to reduce its public debt, is completely unreasonable. Economic common 5 sense requires that a robust fiscal expansion is what Italy needs. Also, with over 70% of Italy's GDP accounted for by internal demand and that the rest of the Eurozone also experiencing a slowdown, it is inconceivable that Italy could rely only on exports to restore acceptable levels of employment and economic growth. Furthermore, financial markets, typically a more effective source of discipline, were largely unfazed by the Commission's report on Italy on June 5th, despite some investor's confidence being hurt. Within this context, it is also worth considering the technical rationale behind the Commission's evaluations and the perverse dynamics of public debt within the monetary union, considering that Italy's 2.4%deficit is well below the 3% ceiling set by the Maastricht Treaty. The answer lies in the fact that, in recent years, the EU has changed the way it assesses member states budgets, by taking into account the so called "structural budget balance" (that is, what the actual budget deficit would be in the absence of the so called cyclical component of the budget, or, the tendency of social expenditure to rise in economic downturns) instead of looking at the actual country's budget deficit. Therefore, the European Commission calculates the cyclical component of the deficit based on the so called "output gap" – the difference between the actual GDP and the potential GDP -, i.e, the maximum output an economy could achieve at full employment and full capital utilisation, without generating inflationary pressures. However, this is a manipulative method adopted by Brussels to estimate the so called "output gap", as it rests entirely on guesswork and dubious econometric models. In the light of this, it is imperative for the present Italian government to press for reforms of Europe's fiscal rules. The fact that the Commission has concluded that an Excessive Deficit Procedure is no longer warranted for Italy on 3rd July, will not exonerate Italy from the requirements of the Stability and Growth Pact in 2019. With a correction for 2019 amounting to Euro 7.6 billion or 0, 42% of GDP in nominal terms, the Italian government has agreed to adopt its mid-year budget for 2019, and as a result, Italy's headline deficit is expected to reach 2.04% of GDP in 2019, compared to the initial 2.5%, which was the target enshrined in the 2019 budget as adopted by the Italian Parliament. Fundamentally this points to the Italian government having had to cede, yet again, to the Commission's requirements to lower the Italian deficit for the second time in a year, despite a contraction in the economic growth, which will inevitably be reflected in its budget policy. The Commission will also, undoubtedly keep under surveillance the effective implementation of this package until a new revision takes place in the autumn with the presentation of the 2020 draft budgetary plan. In the light of its recent stand-off with the Italian government, and in consideration of the effects of Italy's GDP shrinking by a massive 6% in the last ten years, keeping at bay the increasing Eurosceptic forces in Italy may be the EU's main objective, but it will do so at its own peril. If the third biggest EU economy's requirements are not addressed by ensuring a better balance between stability and growth and between a reduction of risks and the sharing of risks within the Eurozone, Europe's non 6 justifiable and intransigent fiscal rules could lead to an eventual collapse of the Union, as it presently stands, regardless of Brexit. After all, the Italian government's idea of introducing mini BOT's are, from the EU's viewpoint, not just an instrument of fiscal irresponsibility, they are also perceived as a means towards dismantling the cohesion between member states, if they started to issue their own currency, and a means towards taking the confrontation between Rome and Brussels to a new EU dimension. Italy's priority, at the present moment, should be to reduce its public debt, but, as the ongoing economic data demonstrates, austerity is not the way to achieve that. Fiscal consolidation, due to its recessionary effects on GDP can have persistent and perverse effects on the debt-to-GDP ratio. The only way for Italy to stabilise its public debt is through a simple recipe of stronger nominal GDP growth, plain and simple. This smacks of a looming conflict on the way, and perhaps of a financial crisis. However, compared to the political crisis in 2011, where Mr Berlusconi was forced out of government in favour of a Euro technocrat, after losing its parliamentary majority, the current government has a large majority and, new elections, which, could be called as early as Autumn of this year, could confirm a landslide victory for Eurosceptic forces with, according to recent statistics, Salvini's Lega Nord at its helm. The Italian vote definitely betrays the EU's failure to provide the ultimate solution for Europe's post war economic question visible in the paradoxical situation whereby the question of leadership has been transferred to faceless bureaucrats and central bankers whose role is no longer regarded as that of mere technicians in charge of a smooth and mechanical functioning of monetary policies. Rather, there is now no clear indication of what policies can provide a better economic environment for a specific country, given the complexity of a global interconnected economy, and it is illusionary to think that EU authorities, and even the German government, have any better idea, nor any interest in what ought to be done for Italy. The EU's legendary tendency to kick the can down the road has left the Eurozone in an ongoing crisis situation where the Italian debt is less sustainable than in 2010 and Germany less willing to sustain the Eurozone. Undoubtedly, if an Italian vote could eventually lead to Italy's exit from the Euro, it would be an exit that France cannot afford. While the strong German economy could also thrive in a smaller and tighter monetary union with some Nordic countries, the same could not be said for France. An Italy with a devalued currency would subtract market share from many of France's most important sectors, from food and wine to cars, banking and fashion industries, with its expensive welfare system competing head- to- head with German firms. An Italian exit would probably be the biggest political gift to Mrs Marine's Le Pen party that could, in turn, have the potential to threaten to the stability of Mr Macron's Europhile government. Undoubtedly, the recent EU leadership will also have an effect on how the majority of the Italian electorate considers the EU, by reinforcing the idea of a technocratic empire committed to more harmonization, centralizing power and the shocking 7 disconnection between the people and the elites. Everything that the majority of Italian voters have voted against recently was yet again sharply on display: the confirmation of a self-serving Franco-German coalition, with the top EU nominations of Mrs Ursula von der Leyen as the new Head of the Commission, and Mrs Christine Lagarde taking over as new ECB Chief from Mr Mario Draghi; smaller states being brushed aside, especially Eastern European ones; and a useless European Parliament, which has prompted Mr David Maria Sassoli, the newly elected European Parliament President, to launch an immediate scathing attack on the bloc's leaders for ignoring democracy and transparency, after withering criticisms of the process enacted to replace Mr Jean-Claude Juncker as head of the Commission, and consequently urging EU leaders to consider holding a "special intergovernmental conference" after they ignored the Parliament's picks for the top jobs via the traditional role of a lead candidate system. Furthermore, just as the economic crisis has played an important role in Italy's recent elections, so did the unresolved ongoing immigration crisis in the Mediterranean. With the massive influx of immigrants from the Middle East and North Africa wanting to reach Europe through Italy, the EU's Dublin Regulation, which imposes the burden of immigration and all the costs of assistance to the country of arrival, has been a disaster. Despite the Italian government voluntarily signing the EU Dublin Regulation, Italy has been left alone in tackling its migration woes, as EU countries have consistently refused to take a lawful quota of immigrants, leaving Italy to shoulder most of the crisis on its state budget. To add insult to injury, the Italian immigration crisis is a European made disaster. The intervention that made Libya a failed state - one that promotes terrorism and illegal immigration - was advocated by then French President Nicolas Sarkozy who wanted to increase France's power abroad and possibly cover up the money he allegedly received from former leader Muammar al-Qaddafi for his election campaign. Contrary to the previous Italian government's attitude, and in line with most of the Italian public opinion, the present governing coalition has adopted a tougher stance on defending Italian territorial boarders in the Mediterranean by banning migrant ships docking at Italian ports. The government's decree passed in December 2018 will also undermine humanitarian protection for people not eligible for refugee status. Despite migration numbers having been contained, the problem of migration in the Mediterranean is still ongoing and not being addressed by the EU. In the latest episode of a breaching of Italian immigration laws, a German migrant rescue ship was charged for defying the ban and ignoring orders for not entering the country's Lampedusa port on the 29th June with forty rescued immigrants.

ITALY'S FOREIGN POLICY IN CONTEXT: LONG TERM ALLIANCES AND DOMESTIC FACTORS

The weakening of the transatlantic relationship and the lack of solidarity of many of Italy's European partners (particularly in the resolution of the civil war in Libya) 8 during the refugee crisis, are behind recent Italian attempts to strengthen cooperation with the US, Italy's traditionally staunchest ally. During his recent visit to Washington on June 17th, Mr Salvini stressed the common ground shared with the Trump administration "not only for economic and commercial interests, … but also for our common vision of the world , of values, of work, family and rights … controlled immigration, and the protection of the national economy". Defence issues and the need to continue US-Italy defence cooperation were also part of Mr Salvini's agenda, for issues relating in particular to the threat posed by China's predatory investments in key infrastructure and technology in the Mediterranean and Europe, and confronting regional security risks in Africa and the Middle East. It is understood that such external support would be forthcoming, conditional on the Lega Nord's splitting with the Five Star Movement in its present government's alliance, the latter having angered the US after spearheading Italy's signing of a memorandum of understanding with China to join the controversial Belt and Road project. Hence, Mr Salvini's visit to the White House which aims at positioning Italy as one of the main US interlocutors in Europe, at a time when Italy is more in line with the Trump administration than France and Germany. Mr Salvini's meeting with Secretary of State Mike Pompeo and Vice President Mike Pence also sought the US administration's endorsement for him to become the next Italian Prime Minister. That would bring a right wing government in power in Europe for the first time since WWII, with significant ramifications for European policies on immigration and economics. But, even without fresh elections, Mr Salvini is the one setting the agenda in Italy, and, to a certain extent in Europe, where he is to become a beacon for the Right. An admirer of Mr Trump, Mr Salvini has changed his party's motto to "Italians First", after taking over the leadership of the League in 2013. He has transformed it from a separatist party that wants more tax autonomy for the wealthier Italian north into a sovereignist party that has been conquering the centre and south of Italy with its message of lower taxes, and its promises to protect the country's borders from illegal immigration.

Italy's approach to international politics is also reflected in its traditionally friendly bilateral relationship with Russia with the view to tackle more effectively the complex, multilateral crisis that currently haunt its immediate neighbourhood. On account of the former US administration's and Western allies policy of disengagement from the Mediterranean region, Italian leaders have become increasingly keen towards reviving cooperation with Moscow and to compartmentalise the Ukraine crisis, so as not to carry confrontation to other geographical areas and policy contexts in its immediate Southern neighbourhood. In particular, Italian public opinion has increasingly seen Russia as a partner in the fight against terrorism, particularly as it successfully tilted the balance of forces in the Syrian civil war and side lined the West in the subsequent peace negotiations. None of the Italian political parties has taken an anti-Russian stance, with domestic public opinion in favour of this posture, particularly on issues as the fight against 9 terrorism. According to a survey published in October 2017, a majority of Italians tend to be sceptical about the current EU sanctions towards Russia: 53% of the interviewees believe they should either be softened or lifted. On the other hand, 77% believe that Italy should cooperate with Russia on fighting Islamic terrorism. Sofar, Italy's stance on Russia is reconciled with its Euro Atlantic orientation, by way of its attempt to facilitate a rapprochement between Moscow and the West. Despite occasional periods of tensions between these two aspects of its foreign policy, Italy has continued to stress, like at the onset of the Ukraine crisis, that this international crisis could only be resolved through dialogue rather than confrontation, despite having condemned Russia's annexation of Crimea and contributed to NATO's defence posture in Eastern Europe. It is reasonable to expect that, Italy's favourable stance towards Russia will continue, as demonstrated in the recent Russian state visit to Rome at the beginning of July, on account of it being an increasingly important energy, economic and trade partner. In the energy sector in particular, during the Saint Petersburg International Forum held in June 2017, ENI and Gazprom renewed cooperation on a range of issues including the modernization of gas supply agreements, potential partnerships in the liquefied natural gas (LNG) sector and the construction of a Russian gas corridor in Southern Europe. The present coalition government has stressed that "Russia is an increasingly important and economic trade partner" and advocates the lifting, or in the more cautious words of the Prime Minister, Mr Conte, the "revision", of EU sanctions. To have a chance of influencing the EU's stance on Russia and its sanctions policy after the annexation of Crimea, the Italian government would need to build coalitions with like-minded governments, such as Austria and Hungary, but such potential coalitions led by Italy are unlikely to achieve radical change in the present EU's Russian policy. In this present framework, Italy will most likely continue to build on its traditionally friendly bilateral relationship with Russia to enhance cooperation on regional crisis in the Mediterranean. Italy's interest in mediating and facilitating the de-escalation of tensions between Russia and the West have been functional to Rome's goal of reconciling its quest for cooperation with Moscow and its commitment to the EuroAtlantic community. However, the main drawback of this strategy is that neither the Western allies nor Russia seem to consider Italy's mediatory role as particularly desirable, and have continued to rely on their own bilateral channels. Hopefully, the new US administration will project its influence by reengaging in the strategic Mediterranean area and Africa, with Italy as its closest partner of choice in Southern Europe and, by strengthening US-Italy traditional and historical alliance, particularly in defence cooperation.

CONCLUSIONS

Italy's fateful participation in the Eurozone in 1999, under the leadership of Prime Minister Massimo D'Alema of the Democratic Left Party, is undoubtedly the main cause of the disappointing performance of the Italian economy. This, because it 10 entailed a complete loss of independent monetary policy, and, worse still, because Germany, by now the dominant economic power of the Eurozone, was gradually allowed to rule and dominate over the ensuing years. Germany is using the Euro to its benefit, while other countries are complying with Euro rules and German requirements obeying without resistance. The Eurozone today is driven by conflicting interests among member states, whereby the reconciliation of interests, in the era of the common currency, has proved to be impossible. Italy has now started to seriously consider leaving the Eurozone. The first decision by the coalition government of the Five Star Movement and the Lega to submit a 2019 budget with a deficit of 2.5% had pointed in the right direction. In this crisis, the Italian government's foremost obligation is to safeguard the prosperity and wellbeing of its people by strengthening domestic demand and not to follow Brussels' strict fiscal regulations that have been authored by Germany. However, if this trend persists, Italy must now cease to dance to Berlin's commands and return to the Lira, whereby the country will regain its political, economic and institutional sovereignty. With devaluation no longer an option, and banks beginning to be in deep trouble, Italy will not be able to kick start its economy because of the highly integrated nature of Europe and the global financial system, means that loose money management isn't an option. Despite its excessive debt mountain, ($2.7tr) and liabilities reaching $290 billion, about 15% of GDP, which is already far above the amount the European Commission will accept, it must be understood that Italy still has the second largest industrial capability after Germany in the Eurozone at 19% of GDP. Its export potential remains high, with the country producing aircraft, cars, weapons, electronic systems, perfumes shoes, and high end fashions. Italy would also be in a better position to take care of its energy needs through an independent foreign policy and alliances, by engaging directly with Libya, Gazprom and the US - sponsored TAP (Trans Adriatic Pipeline), giving Italy a strategic role in Europe, as a hub for the re-exportation of gas towards European countries via the Alps from Azerbaijan. Italian politicians have feared short-term negative effects if Italy left the Euro. Yet the cost of delaying Italy's exit from the Eurozone may ultimately prove to be far greater than the cost of rupture because of the nature of the EU and the imminent economic crisis. Italy has always proved that it can get its act together, but, if not, it won't be only Italy who will pay the price.