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### OPINION

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# QuItaly is now a real possibility with new Italian Coalition government

by **Gabriele Gratton and Richard Holden**

Italy is about to embark upon a full-scale experiment in Eurosceptic populism. A Five Star-Northern League (Lega Nord) coalition government has been announced by Luigi Di Maio, the head of the Five Star Movement, and Matteo Salvini, who leads the League.

Populism may not be new in Europe – in the years since the global financial crisis Greece nearly left the European Union, and Britain is in the process of actually doing so. Both of those episodes were scary enough for the countries involved, and the world economy more broadly.

But Italy's new government [may usher in the biggest crisis of all](#). In many ways the fate of the [European experiment depends on its outcome](#).

Italy – a founding member of the European Community in 1957, cornerstone of the EU – is under withering political and economic pressure to abandon the common currency and leave the EU altogether. You know things are serious when there's a cute name for the prospect of a country leaving the EU (think Grexit and Brexit). In this case that prospect has been dubbed "QuItaly" by University of Chicago professor Luigi Zingales.

A little background – first, the economy. Italy was hammered by the global financial crisis. While in the US real gross domestic product fell by 4.2 per cent from the end of 2007 to the middle of 2009, in Italy, GDP fell by an annualised rate of as much as 7.2 per cent during the crisis, only returning to consistent positive territory in 2014. US GDP returned to pre-crisis levels by late 2011; in Italy real

GDP is still below its 2007 level. At around 1.5 per cent, Italy's annual GDP growth is the lowest in the whole euro area.

US unemployment shot up from 4.7 per cent to 10 per cent, but steadily declined back to 4.7 per cent by 2016 and is now close to 4 per cent. Italy's unemployment rate roughly doubled from close to 6 per cent to above 12 per cent. It is still at 10.9 per cent. Youth unemployment peaked at a staggering 42.7 per cent in 2014 and remains around 35 per cent.

The EU response to the crisis was too late and too little. Italian voters asked for fiscal relief. The EU replied with austerity policies.

Then comes immigration. Italy's geographical position made it the natural European entry point during the recent refugee crisis. The EU failed to reach a long-lasting agreement on how to distribute the costs of the crisis, leaving Italians with a disproportionate share of the burden.

It's no surprise, then, that at the March 4 Italian elections a majority of the Italian voters favoured Eurosceptic parties.

Almost one-fifth voted for the Northern League party of Matteo Salvini, a man who, referring to the recent refugee crisis, said that Italy needs "a mass cleaning – home by home, street by street, neighbourhood by neighbourhood". Even more shockingly, fully one-third of Italians voted for the Five Star Movement, a party founded by stand-up comedian Beppe Grillo, and whose animating call to action was the establishment of so-called "Vaffa Days" (translated to "f--- you" or "f--- off" days). That tells you what message Grillo and his supporters are trying to send to the Italian and EU political establishment.

Italy's gigantic public debt does not allow any room for internal fiscal relief. To boost demand, then, there remain two choices: fiscal spending underwritten by the EU itself or monetary policy. Both instruments are in the hands of EU institutions, dominated by Angela Merkel's German government.

But while Italy needs highly accommodative monetary policy, the European Central Bank seems to be moving to normalise it. ECB chief economist Peter Praet recently said: "Our monetary policy

measures are bearing fruit, and the growth outlook confirms our confidence", and Dutch central bank governor Klaas Knot who sits on the ECB's governing council opined: "The top priority is to normalise monetary policy and strengthen the economic and monetary union."

A larger EU budget, favoured by French President Emmanuel Macron, seems elusive. And there has been little progress by the EU on the refugee crisis.

Without a strong EU answer, the new Italian government may need to deliver on its promise to slash past pensions reforms, cut taxes, and introduce universal basic income. With markets weary of a possible Italian default and EU institutions blocking increases in public deficits, none of this may be possible without a referendum to leave the euro.

If Italy does leave the euro, however, it triggers an automatic exit from the European Union itself. That may well end the whole European project.

Unlike Greece, Italy is a huge economy. And while Britain is big, it was never part of the eurozone. Its political support for the European project was always tepid. Even when it entered in 1973 it did so reluctantly, and public support was never much above 60 per cent in subsequent decades. Italy, by contrast, had the founding treaty of Europe named after its capital, and enjoyed public support for European integration often above 80 per cent.

Not so any more.

Macron spoke last month of the risk of a "European civil war". Thankfully, that may never happen. But for the European project to survive, the EU must answer the questions posed by Italian voters soon. The EU would not survive Quitaly.

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***AFR Contributor***