Democracy in Europe and the Italian crisis

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The last day of this January represented the sixty-fifth anniversary of the end of Allied occupation and the return to elected governments, placing the current Italian unelected "technocratic" government in its bitter historical context. It should be noted that the first major "reform" of the "technocratic" government was to award businesses a 2 billion subsidy in the guise of an employment incentive, to be soon followed by the commitment to a drastic reduction in job protection to facilitate companies firing their workers (details at http://www.istockanalyst.com/finance/story/5595183/weighing-italy-s-debt).

The overlords (and overladies) of the Euro Zone and their Italian allies brought in a non-elected government to solve a "crisis" of their own creation, misrepresented as provoked by decades of fiscal irresponsibility by successive Italian governments. In this *faux* narrative, the greatest transgression of the odious Silvio Berlusconi is his failure to be sufficiently reactionary in his policies towards Italian workers; i.e., did not carry out "labor market reforms".

Falsification of the deficit and the debt

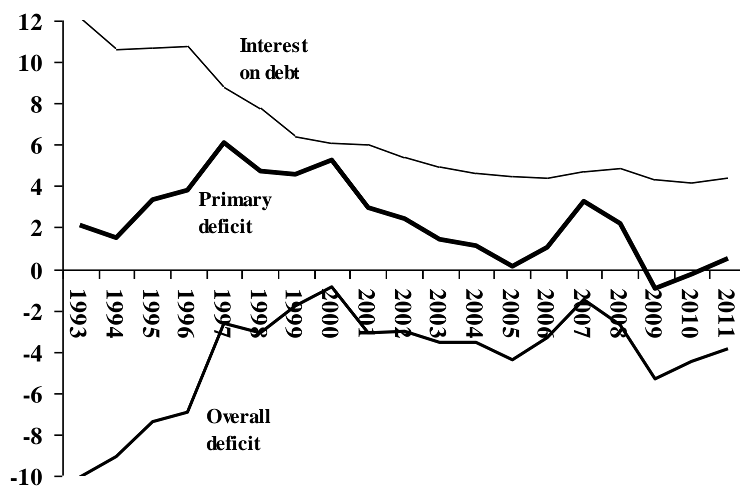
The crisis narrative to justify a non-elected Italian government and its reactionary policies goes as follows. As a result of excessive social spending, Italian governments generated an enormous public debt and unsustainable annual deficits. This fiscal irresponsibility contributed to a complementary problem, lack of export competitiveness, resulting from rigid labor markets, absurdly generous retirement policies and over-regulated, anti-competitive product markets. As a result of excessive public borrowing and trade deficits, "markets" lost faith in the government's ability to service its debt, driving up interest rates to crisis levels. To state it succinctly, excessive social spending led to dual deficits that drove up borrowing costs. The only solution is fiscal austerity combined with labor market "reform".

Not merely false, the narrative is the reverse of the truth. Far from recent, high interest rates are a long-standing characteristic of Italian public bonds, and are the reason for the public sector deficit. Far from being irresponsible

spend-thrifts, Italian governments for the last twenty years have consistently run a surplus by the deficit measure the IMF uses to set its conditionalities.

This measure, shown in Figure 1, is the primary deficit, the overall deficit less interest payments on the debt. An IMF research paper in 2010 concluded from the experience of thirty-one countries (including Italy) that it is the primary deficit that influences borrowing costs. During the nineteen calendar years, 1993-2008, in only one year (2009) did an Italian government have more non-interest spending than its revenue, with an average primary **surplus** of almost 2.5 percent of GDP. Only one country now in the Euro Zone had a larger primary surplus, Belgium. Germany's average was slightly negative. One of the many absurdities of the EU Stability and Growth Pact of 1997 is its irrational specification of the deficit rule to refer to the overall not the primary deficit. In an important and fundamental sense, the Italian debt crisis results from the unjustifiable specification of an inherently dysfunctional deficit rule.

Figure 1: Italy's overall and primary deficits and interest payments
shares of national income, 1993-2011

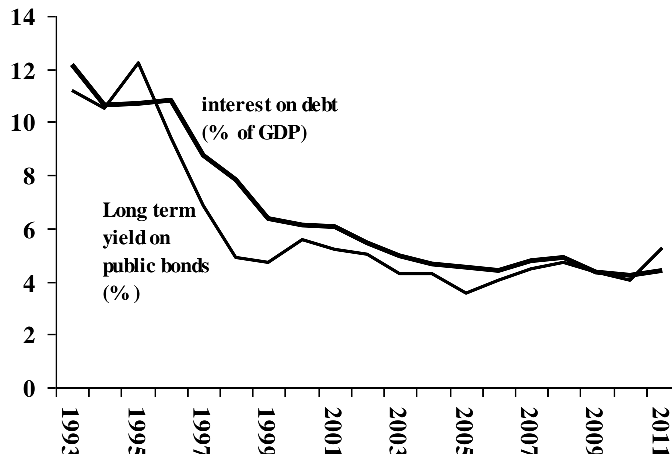


But a deficit is a deficit whatever its cause, is it not? It is not. An expenditure deficit and a debt service deficit have different economic and social implications. Figure 2 makes this obvious. In the 1980s and early 1990s, Italian governments borrowed at extraordinarily high interest rates, by comparison to which the recent "crisis rates" seem low. At the beginning of the 1990s, public borrowing was at double-digit rates, and continuously declined into the 2000s.

By any rational assessment, the public finances of Italy became more

manageable over the last twenty years, from seriously unsustainable to fundamentally stable. The *faux* crisis resulted not from the size of the Italian deficit, but from opportunistic speculation on short term public debt that came due in 2011 and 2012.

Figure 2: Interest rate on long term Italian public bonds and share of interest payments in GDP, 1993-2011

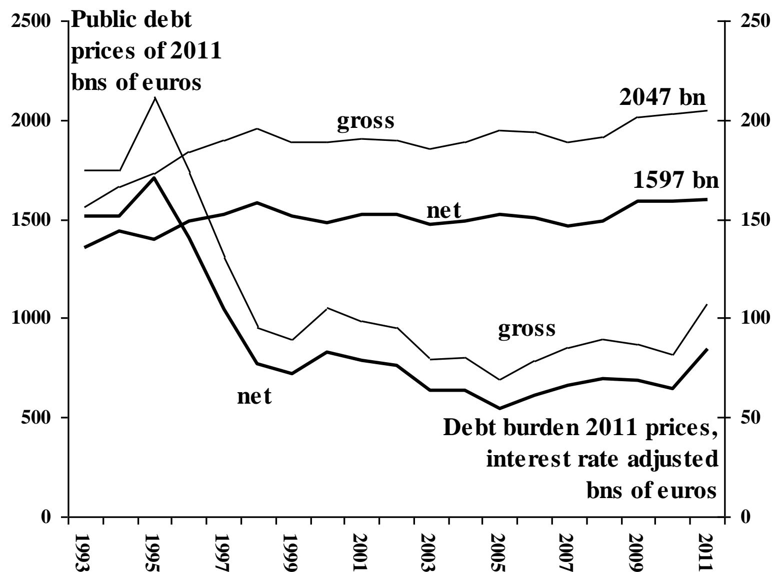


The masters and mistresses of the Euro Zone will say that the deficit is a side issue. The central problem is the massive Italian debt, over 100 percent of national income. Lies and distortions take many forms. In the Italian case these manifest themselves in facts we are never told. While it is true that the public debt of Italy is over 100 percent of GDP, it is also true that at the end of 2007, just before the financial crisis hit Europe, the Italian debt in constant prices was the *same* as it had been ten years earlier (see Figure 3).

Second, in another indefensible anomaly, the EU debt criterion is defined for gross liabilities, not net. By the EU definition, Norway in 2011 had a debt "burden" almost at the Stability Pact's limit of sixty percent of GDP. Due to its accumulated petroleum revenues, the public sector of Norway enjoys a *net worth of 160 percent* of national income. The absurdity of the gross debt criterion is equally obvious for the public sector of Finland, which exceeds the limit on the EU gross debt measure, yet has a net worth of sixty percent of national income.

For Italy, net debt at the end of 2007 was less than for the previous eleven years. Even after the financial crisis depressed public revenues during 2008-2011, the net public debt at the end of December in constant prices was less than five percent higher than it had been a decade before.

Figure 3: The Italian public debt in constant prices (2011)
and the interest-adjusted debt burden



Third, the burden of a debt depends on the interest rate. The cost of a 100,000 euro mortgage is considerably less at five percent than at twelve percent. This implies a simple "debt burden" calculation, the amount owed times the interest rate. As Figure 3 shows, by this commonsense measure, the "burden" of the Italian debt fell dramatically during the 1990s, then continued a gentle decline until the mid-2000s. Even at the end of 2011 the real burden stood far below its level two decades before.

Using the internationally accepted IMF measure, the Italian budget is in slight surplus and has been for the last two decades except for 2009. The public debt is sustainable. Measured in today's prices, the increase over the last twenty years was 1.5% annually for the gross debt and less than one percent for the net debt. By any rational assessment there is no debt problem (certainly compared to the 1990s), and no deficit problem.

So why is there feverish speculation on Italian public bonds? First is the obvious effect of unregulated financial markets gone rogue. These financial predators have an opening because of the unwise policy of contracting public debt with short term maturity (pay-back) dates. This is a problem easily solved, by selling Italian public bonds directly to the European Central Bank, as would be done domestically if Italy still operated with the *Lira*.

The habitually mendacious Berlusconi was close to the truth when, just before his fall, he complained that there was no crisis of Italian public

finances. The ongoing Italian "crisis" is the result of dysfunctional and unprofessional EU rules on deficits and debt, a badly designed European Central Bank and unregulated financial trading.

The Growth-Deregulation Argument

Even if the "experts" are wrong about the Italian debt (and they are), is it not a fact that the Italian economy has grown very slowly for two decades and has an unmanageable trade deficit? Don't those problems demonstrate the need to stimulate employment through subsidies and raise competitiveness by measures such as labor market "reform"? In this vein, one reads that in the 1990s the German Social Democrat Chancellor, Gerhard Schröder, introduced labor market “reforms” and corporate tax reductions that transformed an over-regulated, sluggish German economy into an internationally competitive export machine. Do the same in Italy is the advice.

Schröder did reduce some of the rights enjoyed by German workers and cut taxes on capital. Subsequently German exports grew rapidly, turning a small trade deficit in 2000 into a huge surplus today. As I have shown, the accumulating German surplus was the mirror of the growing trade deficits of Portugal, Italy, Greece and Spain (the “PIGS”, http://www.social-europe.eu/?s=the+lazy+pigs).

There is considerable reason to doubt that the German “deregulation” and its trade performance are related. The reversal for Italy was the most dramatic, from a surplus of €5 billion with Germany in 1994 to a 25 billion deficit in 2008. However, the OECD measure of labor market regulation for Italy, the “employment protection index”, declined compared to the Germany throughout this fifteen years.

Thus, in the judgment of the neoliberal OECD, the Italian labor market was *less* regulated than the German (see Figure 4, trade balance measured on the right, “employment protection” on the left). For product markets, where Italy stands accused of endemic anti-competitive regulations, the OECD measure of “market regulation” is almost the same for the two countries, 1.27 for Germany and 1.32 for Italy, compared to a US value less than .5. While these indices should not be taken too seriously, they show that not even the measures generated by supporters of “deregulation” dispel the stereotype of the Italian economy as uncompetitive.

Equally bogus are arguments that Italian export competitiveness suffers from excessive wage increases (Figure 5). From 1995 onward, annual real private sector wage changes for the two countries were almost the same, *lower* in Italy until 2009. The same calculation for labor productivity in manufacturing tells quite a different story, with German productivity rising substantially faster than in Italy (over two percent per year compared to less than one percent).

The absolute fall in the bilateral trade deficit with Germany tracks the relative decline in manufacturing productivity in Italy as if it were its shadow. As I have argued elsewhere, "labor" productivity is in practice "capital" productivity, because it is determined by the age and quality of machinery that workers operate.

Figure 4: The Italy-Germany bilateral trade balance and OECD index of employment protection (Italy/Germany ratio), 1994-2008

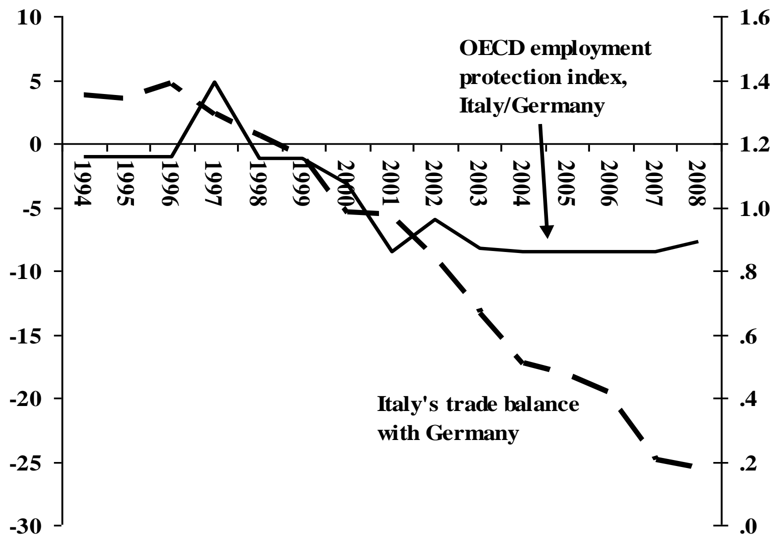
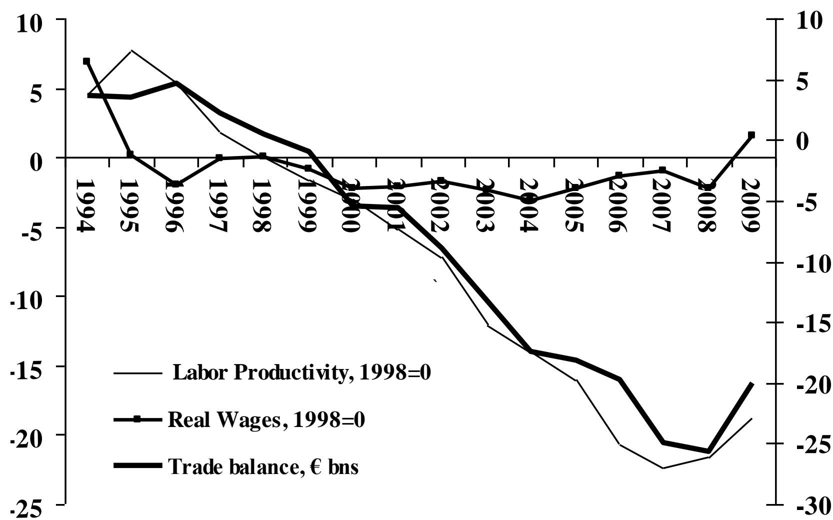


Figure 5: Italy-Germany: Wages, Productivity and bilateral trade balance, 1994-2009



Note: Productivity and real wages are calculated as changes from the base year 1998 with levels for the two countries arbitrarily set to zero for comparison.

A Clear Choice

Any problem of competitiveness of the Italian economy results from inadequate investment during two decades of slow economic growth. The bogus market "rigidity" and excessive wages arguments are invented to cover another obvious cause of the trade deficits of Italy and almost every other euro zone country. This is the neo-merchantilist policy of the German government. (for a detailed explanation, watch the video with Heiner Flassbeck, http://therealnews.com/t2/). In addition ot directly serving the interests of German exporters, these bogus arguments are part of a broad and increasingly successful campaign by financial interests to reduce social protection in the European Uion to a brutish minimum.

It is at one level a war waged against the principles and practice of social democracy and its more conservative cousin Christian democratic welfare provision. Inseparable from the war on social protection is the parallel battle against democracy itself. The first move in this battle was the imposition of non-elected "technocratic" governments with extra-parliamentary powers in Italy and Greece. The next step, already in process, is externally-imposed rules, strictly enforceable, on public deficits. Whether these rules require the blatantly authoritarian surrender of national fiscal decisions to the European Commission (see *Financial Times*, 27 January 2012, "Call for EU to Control

Greek budget"), EU imposed fines on miscreants, or national balanced budget clauses in constitutions, the effect is the same. They all remove economic policy from democratic accountability.

The fiscal austerity forced upon Italy and Greece through undemocratic means by the European Union under the unambiguous leadership of the German Chancellor leaves a clear choice for Italians and Greeks: the euro or democracy. When the euro was introduced on 1 January 1999, few would have predicted that a decade later the *Lira* and the *Drachma* would becomes symbols of democracy lost.