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ITALY'S CREDIT CRISIS

Calling for Change

Madhusudan Pal Vedantatirtha

ITALY'S HAS BEEN THE THIRD largest economy in the European Union (EU) and the seventh largest economy in the world. Italy is a member of the Organization for Economic Co-operation and Development (OECD) as well as of Group of Eight (G-8) countries. Nowadays the G-8 countries almost determine the direction various economies of the world should follow to keep pace with global market economies. Italy has been a free market economy from the very beginning of the post second Great War. So Italy as a member of G-8 is a formidable economic force, yet it is a debtor country for decades. Politically, madness has been seething Italy's brain for a pretty long time. One Christian Democratic (DC) Party had almost monopoly of power since the reconstruction after the Second World War. Political paralysis, massive Government debt, extensive corruption in the highest echelon of power, organized crime's considerable political influence demanded political, economic and ethical reforms. In 1993, referendum took place. Majoritarian electoral system replaced the former proportional electoral system. Many political parties emerged, but none could give a stable government, partly because the same political class divided into various political parties and vied with competitor for hegemony, and the electorate never reposed faith in any one political formation. Italy had seen the chaos of electoral politics of fleeting, precarious and short-lived coalition governments in the nineties of the last century. In 1995, a coalition of parties, called *Freedom Pole* won narrowly and the media billionaire, Silvia Berlusconi became the Prime Minister for the first time. He reversed the electoral system back to proportional from the majority representation one, and thus Italy's apparent democracy was utilized to return to a kind of warlords' plutocracy. In 1996, however, S Berlusconi's government fell and Olive Tree coalition, a Centre-Left combination came to power with Lamberto Dini as the Prime Minister. Lambero Dini also did not consider it necessary to return to the electoral system established in the referendum of 1993. Socialists and Communists in Italy are theoretical, talkative and prone to writing discourses rather than lead the vast masses towards political emancipation. But in electoral politics, when united, can act as lever to Italy's struggle for power. They represent the Left force. For the first time Lamberto Dini's Centre-Left coalition ruled full term, that is, from 1996 to 2001. However, S Berlusconi returned to power in 2001 and served full term. In 2006, under Romano Prodi's leadership an 8-Party coalition, a successor of Olive Tree, won narrowly but fell subsequently paving way to Berlusconi's return to power in October 2007 election to which he held on till Italy's current credit crisis threw him out recently.

After the Second World War, Italy rapidly industrialized from an agriculture-based economy. Italy developed into an industrial state. But by 1980, Italy's economic growth rate stalled. Italy's GDP by the purchasing power parity (PPP) standard in 2010 stands at $1.77 trillion and per capita income by the same standard is $29,400. But Italy's crisis emanates from its foreign debt of over $2 trillion. Latest information for 2010 puts it at 119% of Italy's GDP. However, for a modern industrial economy, Italy has serious structural deficiency at its core. Italy's capital market is very weak for an OECD country. Italy still adheres to the old culture of family-owned businesses that are financed by banks instead of stock market. This practice has put a brake on building the scale they need to compete globally. Again, law discourages giant sized industrial units. Italy's economic strength resides in small and medium sized family-owned processing and manufacturing industrial units. Recently China has eroded the European market for Italian lower-end industrial product sector. Employment in these industries is predominantly under temporary contract with no job protections. Permanent jobs are scarce. On the macro side, Italy is net importer of food. There are no substantial deposits of iron, coal or oil. Proven gas reserves in the Po valley and in the Adriatic are not sufficient as revealed by the fact that more than 80% of the country's energy resources are imported. Persistent budget deficits, high public debt and increasing borrowing cost have made growth rate to crawl recently. Growth rate averaged 0.8% between 2001 and 2008. Two thirds of Italy's trade is confined to EU countries. About 30% of Italy's economy remains underground. All these and many other lacunae have made Italian economy a giant with feet of clay.

But Italy's credit crisis is different from Greece's. Keynes revolutionized economics by suggesting that internal savings, deposited in banks and through the banking system, transformed into investment can through the investment multiplier multiply production-income-employment in the long run. In the case of Greece, its high value savings as bank deposits in Greek banks fled to other EU countries, especially to Germany and France, leaving Greece dry of savings, making Greece's economy paralyzed and lame with little or no scope of the multiplier effect and no other option than dependence on credit from foreign countries and the ECB. Incidentally, the same event happened in the cases of Portugal, Ireland and Spain. But in Italy's case, its savings, that is, income less consumption expenditure did not flee to any other country. This savings is huge enough to sustain growth. So Italy's economy has that scope of regaining health and vitality which is not available in Greece, Portugal, Spain or Ireland. Secondly, Italy's underground economy is not like India's parallel economy run by tax-evaded Black Money. Unlike India, again, not a copper even of Italy's underground economy did ever clandestinely migrate to nameless accounts in foreign banks that can only be opened through encrypted passwords, known only to the offenders and closely guarded by the beneficiary banks' officials. Italy's fascist past and its hangover that has remained within its tax-laws allowed the underground economy remaining so and if Italy's tax laws are amended suitably, the underground part of the economy can be mopped up, government's tax revenue increased, budget deficit reduced, huge resources unearthed, savings rate and along with it the income multiplier increased, etc. What is needed for that to happen is strong political will which unfortunately is absent within Italy's political elite. Probably, the troika of IMF-ECB-EU has something similar to this in mind while negotiating with the government and the opposition parties in Parliament, forcing S Berlusconi to leave, replacing him now by ECB's own man, Mario Monti.

At this stage a brief discussion on ECB (European Central Bank) seems pertinent. One great Cultural Revolution of sorts that happened in Europe after the fall of the Berlin Wall is the working towards European integration, giving birth to the European Union. On the economic side, a European Central Bank was the off-shoot, established on 1 Jan. 1999. But it is neither like the Federal Reserve System of the United States nor like a country's Central Bank as, for example, the Reserve Bank of India. Another aspect of the ECB is that not all members of the EU are members of the ECB. Only 11 EU member countries—Austria, Belgium, Finland, France, Germany, Ireland, Italy, Luxembourg, Portugal, Spain and The Netherlands—formed the ECB. Greece joined in2001, Slovenia in 2007, Cyprus and Malta in 2008, Slovakia in 2009 and Estonia in 2011. Any EU member can join the ECB later. Those who join the ECB shall manage their economies with the single currency, the euro. Therefore till date the 17 EU member countries enumerated above constitute the euro zone. However, all members of the euro zone shall continue with their respective Central Banks, which, as before, shall perform all the customary functions of the Central Bank with respect to that state. These Central Banks are called National Central Banks (NCBs). In fact, all CBs of EU whether or not they are members are known as NCBs, which maintain their separate identities and independence. Now, the NCBs who form the ECB contribute to the paid up capital of the ECB, according to a formula set in the constitution of the ECB, which is a person in international law. The ECB's main task is maintenance of euro's purchasing power and thus price stability in the euro zone. On these two questions Italy failed. The representatives of the NCBs of euro zone meet twice a month with the ECB and transact business. There is a mechanism to intervene whenever an NCB deviates. A kind of warning is given to the delinquent NCB, often measures suggested for mending ways and in extreme cases bail out mechanisms are worked out. The ECB is not NCBs' bank. In the case of Italy, the ECB has sounded the alarm in so far as it considers Italy's profligate, reckless and mismanaged. Italy can and should mend. Banking, as it is known now, was born on the banco (It.banco>Fr.banque>Gmc.bank> Eng.bank, meaning bench), of Italy's 98 port cities at the genesis of the great European Renaissance and so Italy cannot be allowed to sink. Italy can and must find its own giant feet. □□□