Salvini's Italy between Greek tragedy and Portuguese fado

Miguel Otero-Iglesias | Senior Analyst, Elcano Royal Institute | @miotei

The original version in Spanish was published by Agenda Pública.

Italy is the chronicle of a conflict foretold. It was evident the government of **Giuseppe Conte** –directed by his political patrons, **Luigi Di Maio** (of the Five Star Movement) and **Matteo Salvini** (leader of the Lega and, for many, Europe's strongest because most feared politician)– would clash with the European Commission over the deficit levels of the new Italian public budget. Di Maio and Salvini convinced (or more likely compelled) their Minister of Finance, Giovanni Tria, to allow the deficit for 2016 to rise from a planned 1.6% of GDP to 2.4%, which was received in Brussels like a slap in the face. In response, the Commission's President, Jean-Claude Juncker, was very firm: Italy cannot receive favoured treatment, for 'if everyone received it, that would be the end of the euro'.

I have just returned from a few days in Italy, where the tension was plain to see. I had the opportunity to attend a meeting of young US and Italian leaders from a variety of sectors, organised by the Italy-US Council. The level of concern amongst the Italian contingent was more than noticeable. Many feared that Salvini would over-estimate his own strength in his battle with Brussels and push the country into an even more acute crisis. The ghost of the Greek tragedy of 2015 was in the air. Nevertheless, many of these young Italian executives and entrepreneurs understand that their current government has a popular mandate. If the politicians who won the elections with such a broad majority have promised a basic subsidy for the long-term unemployed, a minimum pension of €780 and a tax cut for nearly a million workers, naturally the deficit will increase.

It is possible to feel a certain sympathy for **Italy's increased spending**. The country has been stagnating for decades and its public accounts are subject to the iron-fisted control of senior civil servants in the Treasury, who know that Italy's hefty public debt (over 130% of GDP and €2.3 trillion in volume) does not leave the state much elbow room. In a sense Salvini's government could do what Antonio Costa's did in Portugal. When the latter came to power –also on the back of an unprecedented coalition that generated as much mistrust in Brussels as in the markets– many commentators thought his anti-austerity measures reckless. Nearly three years later, however, Portugal is bringing down its debt –despite (or perhaps as a result of) raising the salaries of civil servants–, increasing pensions, cutting unemployment and recording over 2% growth.

> "Salvini has struck a heroic pose because he knows it arouses sympathy and attracts votes in Italy. Conversely, his pugnaciousness makes him many enemies in Brussels and elsewhere"

And this is precisely Giovanni Tria's vision. At the last Eurogroup meeting he apparently asked his colleagues for an opportunity: a chance to apply stimulus policies to conjure up the primeval spirit needed to re-launch the economy. If the experiment works, it might even bring down Italy's debt.

It sounds reasonable, but the snag is more the style than the substance. Were Salvini to go to Brussels singing a mellow Portuguse *fado* like Costa did, he would raise far greater sympathy. But, to the contrary, the Lega's leader seems to have chosen drama and Greek tragedy. He has sought confrontation and constantly provoked the Commission and the Union's northern members. Like **Varoufakis** in his day, Salvini has struck a heroic pose because he knows it arouses sympathy and attracts votes in Italy. Conversely, his pugnaciousness makes him many enemies in Brussels and elsewhere. The EU is based upon dialogue, alliances and mutual commitment and at present Italy has not a single ally in the **Eurogroup**, not even Malta. Salvini does not seem to grasp that today it is much more difficult to play the old 'two-level' game in the EU. In an ever more integrated and interconnected Europe, ranting at home is heard by the entire neighbourhood. By playing the tough guy in Italy, when in Brussels the legitimate representatives of the other European democracies will have to be tough too, precisely so as not to lose votes at home. That is how democracy works.

Italy is a club member that tends to be underestimated: certainly, it has a large public debt, but it also has a primary surplus and its debt stock has a relatively long average maturity. The country also has an almost structural current account surplus (my visit to Trentino and Alto Adige only confirmed my view of northern Italy's powerful export strength), while its net international investment position (ie, its net foreign debt) improved from -24% in 2014 to -8% in 2018. It can therefore stand its ground for a few rounds with Brussels (which the Commission knows). However, if confrontation continues unabated, the **markets** will start to get jittery, the risk premium will shoot up, Italy's banks will see their Italian public debt holdings lose market value and the country could swiftly descend into a vicious cycle like the one that overwhelmed Greece in 2015, particularly if Salvini starts to play the 'Italy might leave the euro' card. This seems unlikely at the moment, but it remains a powerful political weapon especially if Brussels appears before Italian public opinion as the implacable bureaucratic monster.

My advice to Salvini and Di Maio would be not to follow in Varoufakis' wake. They should choose the Portuguese *fado* (even if a melancholy acceptance that heroics are something of the past) over Greek tragedy (which always ends in tears). It might not be a bad idea to take the European Commission's most recent country report on Italy and implement some of the structural improvements it recommends. Commissioner Moscovici and the Eurogroup would then surely be more flexible and a more positive dynamic could be fostered, on balance benefitting Italy. In the final analysis, what Italy needs is more investment and higher productivity, and this cannot be achieved with higher consumption alone. In that too, Portugal can be an apt lesson on what to avoid: its productivity levels remain low.