LUISS SCHOOL OF EUROPEAN POLITICAL ECONOMY

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ITALY AND EUROPE - TIME TO RESTART THE DIALOGUE

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THE CURRENT RELATIONSHIP between Italy and the European Union is far from ideal. Even more worrisome is the widening distance between the national élites and the public opinion. Yet, there has been no shortage, at every level, of positive economic policy decisions that have contributed to the system's cohesion.

In Italy, Europe is portrayed as the severe budget inspector impeding the economy's recovery, the unjust punisher of banks, and the miserly dispenser of aid needed for managing the unstoppable flow of migrants—a problem that is now almost exclusively impacting Italy, the only European country through which migrants may still enter the EU, but from where they can no longer leave. It is now commonplace among leading industrialists and financiers to express doubts over whether Italy is capable of staying in the euro. Some have gone so far as to express support for leaving the common currency, without fully considering the consequences (on this matter, I would suggest consulting Greek Prime Minister Alexis Tsipras, who was forced to do a dramatic about-face when the end of liquidity support from the European Central Bank forced Greek banks to close). The departing Italian government's excessively and uselessly aggressive public rhetoric against Europe, employed in the vain hope of steeling consensus from populists Beppe Grillo and Matteo Salvini, have not helped matters. Not only did it garner no votes, it helped feed the hostile public opinion against Europe.

In reality, the European Union has been quite responsive to Italy's requests for budgetary flexibility. The recently expanded Juncker Plan allotments, of which Italy is revealing a large user, the Commission Communication on budgetary flexibility issued at the beginning of 2015, and the courageous Commission request for expansive fiscal measures amounting to 0.5% of Europe's GDP are prime examples. Additionally, the ECB aggressively expansionary monetary

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policy since the beginning of last year have led to a fall in long-term interest rates and significant depreciation of the euro, which is likely to slide toward parity with the dollar.

As to Monte dei Paschi di Siena (MPS), Frankfurt's supervisors did signal that after the failed private recapitalization, the bank would need up to €8.8 billion in fresh capital, but, as has been subsequently explained, this amount could be further reduced in light of the new industrial plan that the bank management must now elaborate. True, the decision could have been explained a bit better. Moreover, the ECB Supervisory Board also granted significant margins for flexibility by allowing access to the precautionary recapitalization regime, as envisaged by the BRR Directive, allowing Italy to avoid full application of bail in rules and to compensate retail investors for losses on junior bonds. The country's requests for greater burden sharing in the reception and management of migratory flows did not go without a response, even though the Commission's courageous decision to impose migration quotas, initially welcomed by the Council, collapsed under insurmountable resistance from certain member states. Documents attached to the last European Council Conclusions have documented a sharp fall in trans-Saharan migratory flows toward the Libyan coast, not least thanks to the European Union's efforts vis-à-vis origin countries.

Meanwhile, Italy's image as a shirker of budgetary discipline and European regulations on state aid is again steering strong opposition within the public opinion of 'core' EU countries. In truth, Italy has accomplished a near miracle, reining in and maintaining a public deficit below 3% of GDP from 2010 onwards, despite a more than 10% fall in per capita GDP (and 25% decrease in industrial production). In the meantime, it has launched structural reforms for the pension system, labor market, and banking sector.

A number of factors helped cement the negative image with which Italy is nonetheless stuck—the delay in confronting the acute issue of non-performing loans, due in no small part to the general paralysis of the Renzi government leading up to the referendum, and the stretching of common rules on the public budget, less so the decimal point overruns and more vitally the dubious distribution of money to attract voters—the two €500 bonuses to young Italians (and first-time voters) totaling over half a billion euros being the extreme example.

Moreover, the Eurogroup and the European Council have not forgiven Italy for blocking discussion on the reduction of banking risk, which subsequently led to the halting of all discussion regarding risk sharing in the Banking Union. The virulent attacks by many Italians on the bail in mechanism, which has worked without excessive trauma in other countries and was adopted with Italy's consent in 2013 (without, however, adequately informing savers of the change in risk profiles of bonds already in circulation or newly issued), has also been counterproductive.

In 2017, Italy will certainly have to face many difficulties vis-à-vis Europe, both on the budgetary policy front, where certain chickens will inevitably come home to roost, and with respect to the banking sector, where hesitations in the recent past will have to give way to radical decisions. However, the goal of a stronger and more stable system is within its grasp. As far as migration is concerned, there may be no alternative other than tightening the country's immigration policies, involving the EU to the extent possible, but also acting decisively on its own.

I would suggest that President Gentiloni, who will no doubt find full support from Finance Minister Padoan on this, dedicate every effort to healing wounds and re-opening a constructive dialogue with European institutions and partner countries, above all Germany. If our tones are

moderated and explanations clear, Italy's position is very defendable, especially if structural reforms blocked by the unfortunate pre-referendum phase are restarted.