

The economic consequences of Italian political isolation

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In about two months' time, European citizens will be voting on their representatives in the European Parliament. The majority that will be created within Parliament will also determine the leaders of the common institutions, starting with the European Commission, whose president should be the exponent of the winning party or coalition. The Parliament will play a decisive role also in approving the appointment of other members of the Commission, candidates from the national governments, a process that may offer many surprises, in consideration of the anti-European positions of some governments and the majorities required in the common parliamentary decisions. Finally, the next president of the European Central Bank will have to appear in front of the European Parliament and obtain approval that, while not binding, determines the mandate of an institution that is vital to the resilience of the Monetary Union.

For Italy, where the government has chosen to distance itself from its traditional partners, the political indications that are taking shape before the vote allude to the risk that the country will be isolated and in difficulty concerning issues of fiscal stability that mark its weakness. In these pages I try to describe the political scenario that the Italian government could be faced with in the autumn at the launch of the new Commission and the new leader of the ECB, coinciding with the Italian government's difficult task of correcting the public accounts, which analysts consider to be decisive for the risk of financial instability linked to the increase of Italy's public debt.

According to the polls and voting estimates, the European People's party (EPP) should be the majority party also in this parliamentary term. However, to get the seats needed to form an absolute majority in Parliament, the EPP will need to form a coalition with more parties, in addition to the Social Democrats, the current partner. For this reason it is important to grasp the signs of the barycenter party leaning to the right or the left. The suspension of Fidesz, the political formation led by Hungarian leader Viktor Orbán, from the European People's Party in mid-March, for example, is only the tip of the political iceberg that will determine the future of Europe. The heart of the problem is the relationship that the center and center-right parties will choose to have with the sovereignist and anti-European formations. The terrain on which this historic battle will be fought is within the largest European party, the German Christian Democratic Union (CDU).

A recent document signed by the new leader of the Cdu, Annegrete Kramp-Karrenbauer (AKK), and published in the conservative newspaper "Die Welt" has reported a change of direction, unprecedented in Berlin, evoking the higher legitimacy of national policy compared to the European one. The message came as a rude and long-delayed response to the pro-European proposals of French President Emmanuel Macron. The signal of a clear distance between Berlin and Paris has been strengthened by the position assumed by the German Parliament a few days ago, which, in complete secrecy, refused to follow up on the commitment made in January at Aachen on the occasion of the signing of the new bilateral Elysée Treaty to vote jointly with the French Parliament, as had been agreed by the signatories of the agreement. Until a few weeks ago, the gap between the two countries was attributed to Macron's poor connection with Chancellor Merkel, which emerged in mid-February with the cancellation of Macron's participation in the Munich Security Conference. But the position of AKK broadens the problem beyond the individual personality and emphasizes the sense of loneliness that Berlin suffers when it observes the governments of its partner countries: not only the weakness in Paris and Madrid, but the farewell of London, the "betrayal" of the eleven countries of the Hanseatic League led by the Netherlands, the danger of the eastern European partners now reluctant to share the principles of liberal democracy, as well as the obvious Italian hostility. This break-up of past alliances, vital for a country that often considers itself "middle ground", comes after a brutal and unprecedented break-up of the relationship with the United States.

Kramp-Karrenbauer, however, is fighting essentially an internal battle. In December last year, she became the leader of CDU, voted by the one thousand party delegates, with a thin margin of only 17 votes over his challenger Friedrich Merz, a candidate supported by the president of the Bundestag, Wolfgang Schäuble. Today AKK is treated as if she were already chancellor, because for now it seems unlikely that the CDU would be defeated in the event of elections in the foreseeable future. However, Kramp-Karrenbauer has yet to affirm her own political line, distinct from that of Angela Merkel who had moved the party to the left, close to the Social Democrats (SPD) and the Greens coalition partners.

More than anything else, Kramp-Karrenbauer does not want to identify with Merkel's position on immigration. The chancellor believes that Germany should welcome millions of immigrants in the coming years, but the party is completely against this, especially in view of the threat posed by the far-right "Alternative for Germany" (AfD) party, which, although perhaps declining in the polls, is still destined to come out the winner from the next three regional elections in Brandenburg, Saxony and Thuringia, the vocation areas for the xenophobic party, between September and October. The panic of the CDU in the eastern Länder is such that it is considering any kind of alternative political alliance to AfD at local level, even the possibility of uniting with the extreme-left "Die Linke" party.

According to the party's conservative exponents, the voter base attributes the increased cost of housing (which, however, is an indirect effect of the crisis of the euro and of the excess of German savings that influences investment in real estate) to the policy of reception of immigrants, which became acute in September 2015 when the country welcomed refugees from Syria, and revealing fears an increase in traffic and pollution – indeed, powerful symbolic images – as a result of a potential overpopulation. The hypochondria in the conservative party – isolation on the part of the European partners and enemies inside Germany – is pushing AKK to the right. The party leader is intimidated by lack of internal trust in the CDU and is well aware of having in Wolfgang Schäuble, the most charismatic figure in German politics, a fearsome enemy.

CDU's shift provides an alibi and an opportunity to the Social Democrats, who are, in fact, recovering consensus moving more to the left, and side by side in the polls with the Greens (18%). As the CDU is leaving behind the Europeanist part of its own tradition, so the Spd is abandoning the liberal side and is moving towards the left by revoking some of the sweeping reforms introduced by Gerhard Schröder (Hartz IV), increasing social spending and offering a universal income. The Finance Minister, Olaf Scholz, is thus preparing his future candidacy for the chancellery, however unlikely that now seems.

After the regional elections in the autumn, the parties of the coalition government will open the debate on the coalition-contract that they had signed and this could be the occasion that SPD has been waiting for to leave the government.

At that moment, the CDU will experience its final internal clash, with Schäuble preparing to propose an alternative candidate to AKK in view of an early vote in the spring of 2020. At that point, Chancellor Merkel, who will choose to resign, will become the natural candidate to lead the European Commission.

Apparently, a scenario involving Angela Merkel at the presidency of the Commission may seem encouraging to those who fear for the fate of the Economic and Monetary Union. Recently, an interview with Schäuble in the Financial Times showed that Merkel has resisted, despite pressure from her Finance Minister an exclusion, even temporarily, of Greece from the euro since 2010 and not only, as it was known, since 2015. During the crisis, Merkel has indeed defended the euro-area integrity.

However, it must be noted in detail how the Christian Democratic Union will influence the European People's Party program on the Economic and Monetary Union. To this end it is necessary to consider the program for the European elections that has just been presented (March 25, 2019) by the CDU and its Bavarian ally, CSU.

The following is a translation of the main points, starting with the title of the chapter on the euro-area: "Euro: our Europe is a union of stability". The text defines the Economic and Monetary Union as the cornerstone of European integration. In detail, the definition of union of stability is explained as follows:

- Stability begins at home. The member states must therefore have as much autonomy and responsibility as possible, particularly as regards the budget and taxation. We therefore reject the appointment of a European finance minister.
- Risk and responsibility remain an inseparable couple. Each member state is responsible for its debts. We refuse to mutualize debts or risks. We want a real union of stability and not a union based on debt sharing and co-responsibility.
- Sound public finances guarantee a viable state and a strong and stable EU. The rules of the Stability and Growth Pact and the Fiscal Treaty must be strictly observed and applied. The violations of the stability criteria must have consequences. We therefore want to limit the discretionality in the procedure for excessive deficit and create more sanctions for our Europe. In case of an emergency, an insolvency procedure must be applied to the euro states.
- Also, the responsibility for social systems and for market policies must remain within the power of the member states. We reject a common unemployment insurance. Such insurance would lead

to the continuous disbursement of income transfers within the EU and would reduce the incentives for reducing structural unemployment.

- We want to further develop the Banking Union and the Capital Markets Union in terms of stability. Meanwhile, the existent risks of the banking system must be reduced. In particular, state bonds should no longer be considered devoid of risk and in view of this risk, adequate capital requirements should be established, similarly to what happens in other forms of investment. We reject bank bailouts using the states' fiscal resources. Any change at the European level must preserve the specificity of our three-pillared system of private banks, public banks and cooperative banks.
- We are committed to the independence of the European Central Bank (ECB) within the framework of its mandate. Because only a strong central bank that is not influenced by politics can guarantee an efficient monetary policy with the aim of monetary stability. Savers should not be victims. Monetary policies and fiscal policies should be strictly separate. Public finance is not the task of the ECB.
- We want to further develop the European Stability Mechanism (ESM). To this end, we support the creation of a European Monetary Fund so that our Europe's financial stability will not have to depend on the goodwill of other economic powers. The German Bundestag's control remains in effect.
- We want to better coordinate and jointly decide national economic policies. The specific recommendations for euro-area countries primarily concern structural reforms. Structural funds should be used in a more targeted manner to support processes of reform, innovation and development of economic competition.
- Cash is a form of freedom. Therefore, we reject its abolition.

Our Europe is synonymous with a healthy fiscal policy. We want to use budget resources in a responsible way. Common budget resources must be used for activities oriented towards the future, activities that create added value and benefit European citizens. We will regularly verify which expenses are indispensable and which can be omitted. Europe must act only if a uniform procedure in all of Europe brings real added value with respect to the accomplishment of the tasks of the national states. But it is also clear that we need an efficient European Union. For this we will give Europe significant, necessary and reasonable resources.”

Even at first glance, the CDU-CSU program manifests a position that is contrary to Italy's negotiating position. Increasing sanctions for deviations from budgetary policies is perhaps the most traditional bone of contention, though not the most important. More controversial is the reiterated request to formalize the insolvency procedure of the euro-area states. Furthermore, we see the return of the request to attribute risk coefficients to the various euro-area countries' state bonds, a possibility that would crystallize the lower credibility of Italy's debt, potentially affecting its whole economy for the foreseeable future. The first consequence would fall on the capital of

the national banking system and immediately afterwards, on the availability of credit for businesses. With the Italian economy being in a phase of recession, such requirements would have particularly serious repercussions.

The program should be considered an electoral document, aimed at draining the water in which German anti-European politicians have been swimming. We can thus imagine that these positions could change after the vote and particularly if, through Angela Merkel's personal engagement, the German chancellor would become the new president of the EU Commission. However, it is impossible not to notice how the German position towards European integration has backtracked in the last year. It is probable that CDU's "aggressive prudence" is related to the lack of collaboration on the part of Italy, a country that for the German voter remains the primary source of fiscal risks.