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ITALY'S CONSTITUTIONAL REFERENDUM: MAPPING POSSIBLE POLITICAL SCENARIOS

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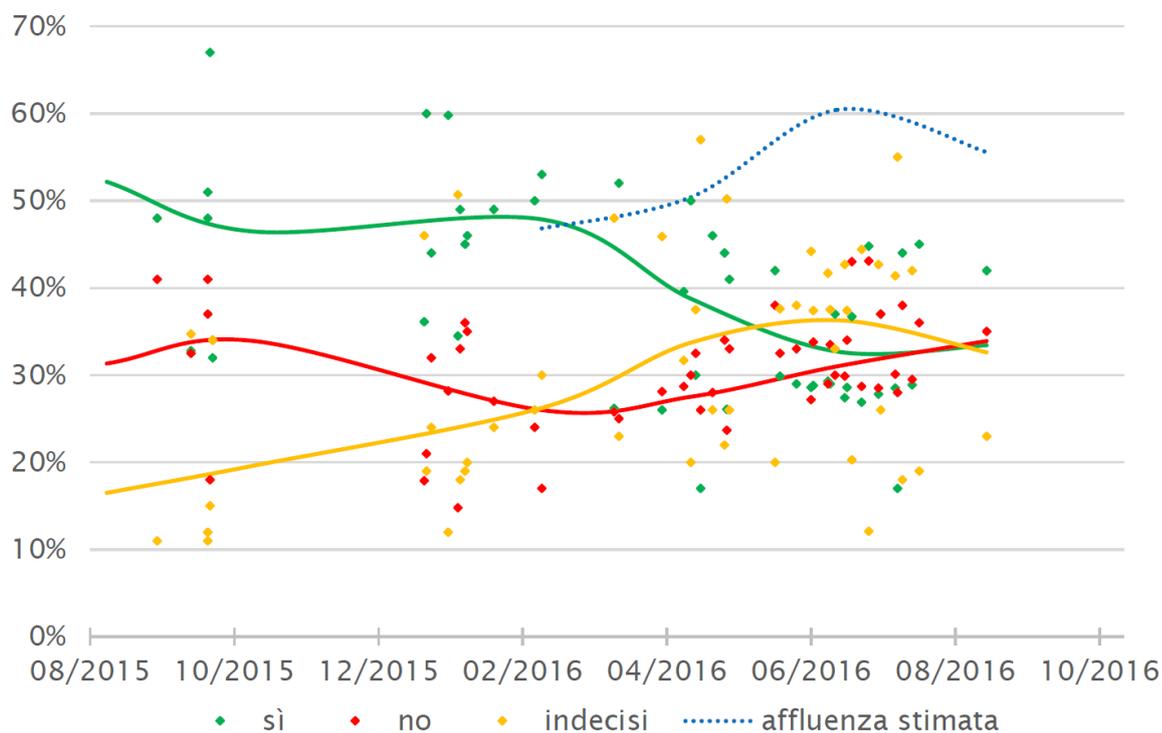
- The upcoming constitutional referendum is a key event for Italy's government and the political developments heading up to the general elections in Spring 2018. According to opinion polls, the outcome remains too close to call.
- The proposed constitutional reform has some flaws, but the bulk of it would be a significant positive step toward making (1) the legislative process more effective, (2) governments more stable, and (3) the relationship between central and local governments better functioning.
- In the event of a 'no' vote, the reform would have to return to the drawing board, which would mean a delay of at least 2-3 years.
- The two-pronged risks of (1) prolonged government instability and (2) the Five Star Movement rising to power remain low probability scenarios.

Crunch Time for Italy

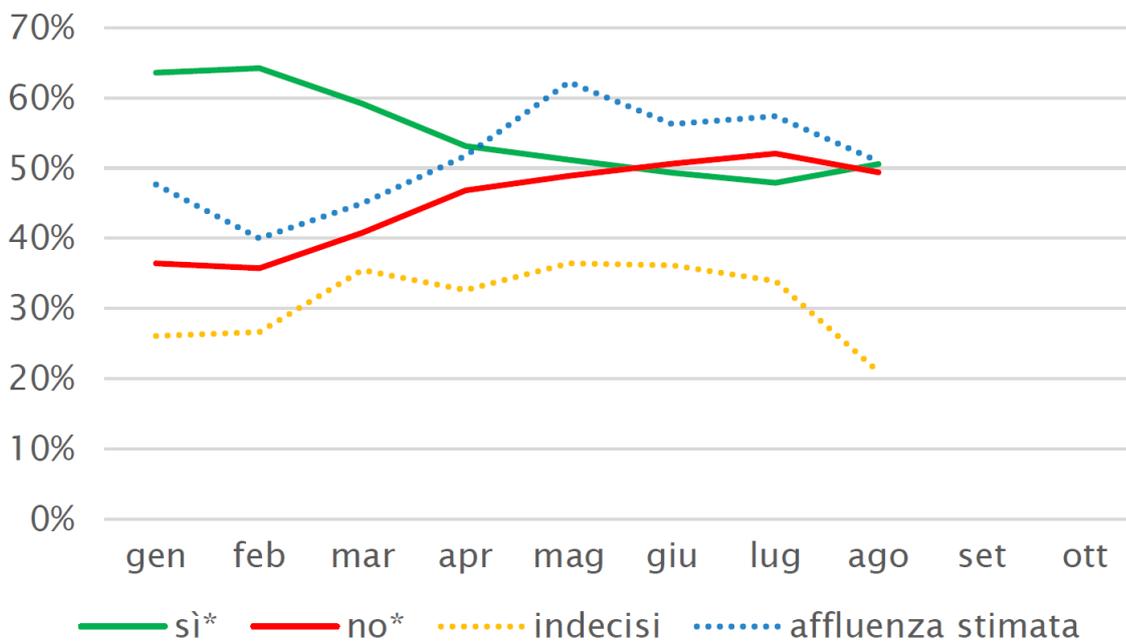
Italy's policymakers will try their best to avoid overcrowding an already heated autumn with a cluster of banking, political, and fiscal events. The referendum on constitutional reform will be the most crucial event by far, as it could have consequences for the survival of the current government, future political developments, and the timing of the next elections. Would a 'no' vote send Italy into a tailspin? What are the possible scenarios?

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Polling data on the 2016 Italian constitutional referendum ('yes', 'no', 'undecided,' and expected turnout)



Polling data on the 2016 Italian constitutional referendum ('yes' and 'no,' normalised to leave out undecided and abstentions).



Source: Wikipedia, Sondaggi politico elettorali, Italian government.

The Puzzle of the Referendum Date

There have been attempts to postpone the referendum by ‘unbundling’ the questions asked, as this would have required a new opinion by the Court of Cassation. However, this did not go through. Therefore, the referendum will definitely go ahead.

The procedure for deciding the date is complex. On 6 May, the Central Office for the referendum said the referendum complies with current regulations. On 8 August, it validated the five hundred thousand signatures submitted on 14 July by the Committee in favour of constitutional reform. Publication on the *Official Gazette* followed. The law requires the referendum to be called by decree of the President of the Republic upon deliberation by the Cabinet of Ministers within 60 days of publication. The Prime Minister stated on TV that the government would decide on the date on 27 September (Decree of Convocation). The referendum will then take place between the 50th and 70th day following the issuance of the Decree of Convocation, i.e., between 15 November and 5 December. This effectively makes 4 December the most likely date, but it could also be 27 November. The delay is due to the desire to vote on the 2017 budget in at least one of the two Houses prior to the referendum (thus, also making the final approval likely) and PM Renzi’s wish to have more time for a proper campaign.

Changing the Constitution is No Small Feat

There have been many attempts to reform the constitution in the past. One of the major attempts dates back to the ‘Commissione Bicamerale’ led by Massimo D’Alema in 1997, following another attempt a few years earlier in 1993. Both failed miserably. Since then, several laws of constitutional importance have been approved, most of them with a simple majority, lacking both 2/3 support in Parliament and a referendum. An exception was the referendum held on 7 October 2001. Participation was low, at 34.1%, and 64.2% of voters were in favour of the changes.

Thereafter, the Berlusconi government introduced major changes related to the form of government, the structure of Parliament, the shape of the State, the relations between the State and the twenty Italian regions, which was then submitted for popular vote. The second referendum took place on 25 and 26 June 2006. Participation was much higher, at 52.3%, but 61.3% of voters rejected the proposed constitutional changes. Needless to say, on both occasions, the referendums were very politically charged, akin to a vote of confidence on the government.

PM Renzi presented the current proposal to the Senate on 8 April 2014. Since then, it has been discussed and approved in the two Houses of Parliament, and the final vote took place on 11 January 2016. The government then submitted the reform for a popular vote (Art.138 of the Constitution).

What is at Stake?

In a nutshell, it is about three issues:

1. A major change in the perfectly symmetric nature of the Italian parliamentary system, i.e., both Houses effectively having the same powers. Currently, this makes laws bounce back and forth from one House to the other, thereby lengthening the legislative process. According to the proposal, the Lower House will remain the primary legislative body, while the Senate will become a House of Regions and Municipalities, with limited and specific legislative power and no veto. There would also be a sizeable reduction in the

number of MPs (from 315 to 100 in the Senate) and a streamlining of the legislative process.

2. A change in the relationship between central and local governments, especially by clarifying competencies and reducing overlapping. This will be a very significant change, as it would allow the government regain certain key responsibilities, which would make the public administration more effective, while allowing simultaneous devolution and control on other areas. It would also impact the privatisation of local utilities and various entities connected to the public administration.
3. A change in the principles governing elections. An ordinary law would introduce changes to the electoral law, in line with constitutional guidance. The new electoral system is called "Italicum".

PM Renzi has been keen to support an electoral system that gives a clear majority to the government (with a sizeable majority premium). The key feature of this electoral law is the strong majority premium it gives to the largest political party that receives more than 40% of the vote in the first round, automatically assigning it 55% of the seats. If no party gets more than 40% of the seats, as it looks likely now, then the two largest parties would go for a second ballot to gain the majority bonus. At least in theory, this system would ensure that a party controls 55% of the seats, a feature perceived to provide political stability.

However, such a scheme is designed for a bipolar political system. With the rise of the Five Star Movement, Italy has become tri-polar, and this may lead to unpredictable results. According to opinion polls, in a ballot between the PD and the Five Star Movement, centre-right voters are more likely to vote for the Five Star Movement, with a risk that the Five Star Movement gets into government. This message emerged from the local elections in June, which are held using the ballot system. The Five Star Movement won 19 ballots against 11 of the centre-left and 8 of the centre-right.

The opposition parties (and part of the PM's own party, the PD) claim that the system proposed in the referendum does not offer adequate checks and balances or enough representation to small parties. PM Renzi forced approval of the new electoral law in Parliament with a confidence vote, and, thus, he is unwilling to backtrack. Recently, however, he made some concessions to the opposition by saying that the government is open to constructive proposals to change the law, which are unlikely to be presented before the referendum. The electoral law is by far the most controversial component.

From the point of view of Italian politicians, the electoral law is the most important piece of legislation, far more important than constitutional changes. In fact, the law determines their survival, the alliances, the potential electoral outcome, etc.

Will the Constitutional Court Change the Outlook?

The electoral law is politically linked to the referendum, but it is de facto a different parliamentary process. The Constitutional Court will have to issue an opinion on the electoral law, which was supposed to happen on 4 October. However, on 19 September, it declared that any opinion will be postponed until after the referendum, both for technical reasons and to avoid any interference with the vote.

After the referendum, the Court may issue:

1. A flat-out rejection of the electoral law, i.e., the so-called “Italicum”. This would be a blow to PM Renzi. The Court may do it on the basis that it does not respect the principles of the Constitution.
2. An approval, which would be a big plus for Renzi but may upset many others. Renzi already said that he is open to making changes to the law in an effort to deflect PD internal and external opposition. If buoyed by the Court decision, he may be tempted to forge on with the current electoral law without changes.
3. A green light with modest changes would possibly be an even better outcome for Renzi, as it would give him an excuse to introduce some changes to the law to comply with the Constitutional Court and, at the same time, provide some sweeteners to the opposition parties and, more importantly, to internal opposition within the PD.

At any rate, the delay in the Court’s decision avoids any interference with the referendum. Following the referendum, it may provide useful input for a revision of the law.

It is widely expected that a possible revision would give the majority premium to coalitions rather than parties and that smaller parties may get some benefits in terms of representation. De facto, any such change would eliminate the outlying risk of an outright majority for the Five Star Movement, at the expense of a higher probability of coalition governments. Therefore, the widespread concern in financial markets that the Five Star Movement wins an outright majority in Parliament at the next political elections is grossly overstated.

The average of recent opinion polls on the next national election suggest 31.5% for the centre-left Democratic Party (PD), 28.4% for the Five Star Movement, 12.4% for the Northern League, and 11.8% for the centre-right Forza Italia. The Five Star Movement has recently suffered a blow from the rocky start of their local government in the municipality of Rome.

Will It, or Will It Not?

Much to my surprise, I discovered that there are hundreds of constitutional experts in Italy. Given that I now live in a country that happily survives without a constitution (or, I should say, without a codified constitution), I am a bit suspicious. Many of these experts have criticised the proposal on technical and substantive grounds. My personal take is that there may be some technical hitches with the current proposal, or even some real faults, but the bulk of the reform would represent a substantial improvement on the current situation, and the vote should thus be a no-brainer for Italian voters (but I am not here to campaign for it).

The opposition parties, some of which were originally in favour of the proposal, seized this opportunity to re-unite in an effort to knock Renzi out. Many Italians do not know what is at stake (even more so than in the case of the Brexit vote) and will likely vote in line with what their favourite leader tells them to do. De facto, it will be a referendum on Renzi’s government, as PM Renzi already clearly indicated that he would immediately resign if the ‘no’ camp wins.

Possible Outcomes

Opinion polls (see figures) are too close to call and the percentage of undecided voters is still very high. A victory of the ‘yes’ camp would give a boost to Renzi, and possibly increase his

electoral chances at the end of the current political term, i.e., Spring 2018. His government will hold power until the end of the political term.

A defeat would trigger Renzi's immediate resignation. In the latter case, there are three possible scenarios:

1. The President of the Republic rejects his resignation and immediately gives him a mandate to form a new government. Renzi accepts the mandate and is successful in forming a new government with small changes relative to the current one.
2. The President accepts Renzi's resignation and gives the mandate to form a new government to someone else. The most likely candidates, in my view, would be Pier Carlo Padoan, the current Finance Minister, or Enrico Letta, a more 'political' choice backed by the PD and the same coalition currently supporting the government, i.e., the centrist groups key to gaining a majority in the Senate. Other names could be Del Rio or Calenda. Any shift to the left would undermine the support of centrist groups in the Senate and, thus, the probability of this outcome is somewhat low.
3. Renzi ends up without a majority in the Senate, where he currently commands a razor-thin lead, courtesy of some centrist groups (Verdini's and Alfano's). These groups may decide to re-join forces with the centre-right. Thus, there would be no choice but to broaden the coalition to include Berlusconi's Forza Italia and other smaller groups, but not the Northern League or Brothers of Italy. Officially, Forza Italia is not seeking such an arrangement, but they are not ready for general elections and they may well take part in a coalition government, if asked. This would also give Berlusconi's party a much-needed fresh new role, which may stop the free fall of their consensus in opinion polls. In this case, the President would accept Renzi's resignation and give the mandate to a politician perceived capable of leading a grand coalition. This route would likely be possible only after the failure of the first two options. Candidates would probably be the same as above, with a preference for Enrico Letta, who already led a grand coalition between April 2013 and February 2014. The new government would have a limited mandate, i.e., to pass the Budget, prepare a new electoral law, and a few other bits and pieces. Then, there would be general elections. However, agreeing on an electoral law may take longer than people expect, and, thus, the government may very well complete the current political term, i.e., it may run until Spring 2018.
4. After many failed attempts to form a new government, there is no option but to call early elections (with the old electoral law). This seems a remote possibility as no party would agree to go to elections with the current system (as modified by various Court rulings). It has two very different schemes for the two Houses and would make a deadlocked parliament almost a certainty.

What are the Economic, Political, and Financial Implications of a 'No' Vote?

Let me make one thing clear—the sun will continue to rise and set even after a 'no' vote. As I said before, if the current coalition does not hold, there would almost inevitably be a grand coalition. It may initially be difficult to form a new government but, eventually, a grand coalition, which would be tasked to design a new electoral law and then call elections, would come together. In financial markets, this may trigger some volatility, but systemic consequences for the country are very unlikely.

The task of designing a new constitutional reform would likely be given to a new parliamentary commission or an ad hoc assembly. Many fear that a grand coalition would end up helping the Five Star Movement at the next elections, which is quite possible. However, it would also be an opportunity to re-design the electoral law in a way that effectively rules out the Five Star Movement getting a sizeable majority premium and, thus, an outright majority in Parliament. The huge mess in the municipality of Rome, led by the Five Star Movement, is also contributing to the reduction of this outlying risk.

As a result, the two outcomes perceived by financial markets as very dangerous, i.e., prolonged political instability and a country led by the Five Star Movement, appear a distant possibility for now.

So, only rosy pictures? Not really. A 'no' vote would effectively have negative political, economic, and financial consequences, and it would mean three things:

1. Protest and populist votes can lead to unpredictable outcomes even in Italy, which may become a danger as Italy approaches general elections in 2018 (not just for the Five Star Movement).
2. The reform of the Constitution, which took two and a half years to proceed through Parliament, would have to restart from scratch. It may very well take at least 2-3 years to produce a new proposal. This would highlight an institutional stalemate and the inability of Italy's lawmakers to reform the country. Inevitably, it would also slow the legislative process for all other reforms.
3. It is puzzling, to say the least, to see some MPs who voted for constitutional reform in Parliament now campaigning for a 'no' vote for purely political reasons. It suggests that the country is unable to reform itself due to parliamentary infighting and that elected representatives are unable to govern the country effectively. Not a nice feeling, given poor economic growth and high public debt.

Conclusions

A 'no' vote would not be a disaster, nor would it immediately lead to disastrous outcomes for Italy. However, it would deepen the country's sense of impotence and inability to move out of the political quicksand.