

THE GOOD AND UNINTENDED CONSEQUENCES OF THE ITALIAN CONSTITUTIONAL REFERENDUM

Carlo Bastasin

ITALY'S CONSTITUTIONAL REFERENDUM is set to take place on December 4th in a climate of overheated tension. Prime Minister Renzi has framed the referendum as a vote on his personal standing and, consequently, on the destiny of the government, in a make-it-or-break-it quest for popular support. The gamble is proving reckless. Although most Italians agree with the substance of the reform, they are inclined to vote against the government. According to the latest polls, the risk of the referendum's rejection is high, with "no" leading by 8-10 points. In fact, I wonder if polls are accurately capturing the interests and veiled sentiments of the Italian electorate.

The big "unknown" is the vast number of silent and undecided voters, probably accounting for one third of the entire electorate. After seven years of an economic crisis deeper than the Great Depression, self-preservation could make Italians eager to shun a new phase of political instability. Paradoxically, anti-political sentiments could yield a "politicians-give-us-a-break" reaction, shunning a "no," fearing that it could scupper the fragile economic stability.

More substantively, the reforms proposed in the referendum, which would reduce the Senate's role and leave the confidence vote on the government to the sole mandate of the Chamber of Deputies, as well as change the electoral law to introduce a higher prize for the elected majority, are relevant for reducing Italy's persistent political instability. In the past 25 years, Italy went through 15 different governments. Of the seven latest legislatures, three underwent anticipatory interruption after less than two years, due to the Senate's thin

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majorities.¹ Whether one likes Renzi or not, a “yes” vote could be perceived by Italian voters as an important choice in favor of Italy's stability.

Political instability is exactly what a rejection of the referendum would bring. Renzi would resign, and he, or another member of his government, might later be reappointed to form a new executive since his party has an absolute parliamentary majority. Officially, not much would change. However, in real terms, the new government would be a lame duck, hostage to an unsettled and divided coalition, with pieces breaking off as the expiration date of the legislature in 2018 approaches.

Renzi was never elected, and this is one of the reasons why he wants to derive direct legitimacy from a popular consultation. But, if the referendum goes awry, the new Renzi government or surrogate would be the fourth in a row not resulting from a general election. It would be more than legitimate for the opposition parties to hoist the populist flag of a political elite detached from the people. Calling for new elections would be entirely understandable.

On paper, this could have the unsettling consequence of an untested political force with strong populist and anti-European tones, such as *Movimento 5 Stelle*, taking over the government. In reality, a new election does not necessarily mean that Italy will embrace a populist government, sparking a systemic crisis in the Eurozone and leading to Italy's exit. It is naïve to think that Italians, totally disenchanted with their national politicians, could make the kind of choices that led the Brits to follow a group of nationalists into Brexit. New elections must be predicated by a new electoral law that would eventually be designed by the current majority, which have a vested interest in minimizing the probability of a strong minority reaping the majoritarian prize and seizing the government. Eventually, the silent majority calling for economic stability over political change would get what it wants anyway: weak governments in keeping with a tradition of “stable instability”.

Italy's unique weakness stems from its historically high public debt, inherited from the Seventies and Eighties. Italy's public debt sustains one of the three largest bond markets in the world. More volatile than the other two (U.S. and Japanese), it presents a great opportunity for speculation. In fact, public debt sustainability is not a big concern, given the relatively slim difference between the debt financing cost (3.3% of GDP) and Italy's nominal growth (1.8%), a fraction of the levels reached in past years, particularly against the backdrop of growing private savings. Although financial markets see selling Italy's bonds as a one-way gamble before the vote, the bet will likely be called off after December 5th, whichever the outcome, since the European Central Bank is ready to stabilize a one-off source of instability relevant for the whole euro-area. In this sense, it is very significant that, for all the ups and downs of Italy's interest rate differentials, Italy's CDS (a financial instrument measuring the real credit merit of a bond issuer) has not budged at all in recent months.

However, government bond jitters and political instability are also relevant for Italy's banking weakness. Banking instability could emerge in the early weeks after an eventual victory of “no”. In particular, the troubles at Monte dei Paschi require a strong political counterpart to convince private investors to put capital in the bank. Without a reliable government, the recapitalization could fail or require forms of bondholder involvement in the losses. This would spell big trouble throughout the whole banking system. In order to be shored up, Italy's banks are estimated to require less than 30-40bn euro, a relatively meager sum. If push came to shove, a weak government, unable to find the necessary resources, could request funds from a European assistance program, as was the case with Spain in 2012. This would have

¹ Luigi Guiso. “Perchè serve la stabilità di governo.” lavoce.info

political consequences, but it could finally put the Italian economy and banks back on sound footing.

The vote on December 4th will send shivers down the spines of both Italy and Europe. But, whether or not Renzi prevails, the following months will provide the best opportunity to finally tackle the deep-seated problems that have kept Italy unstable for decades.