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Giorgia Meloni's electoral victory in September 2022 was largely interpreted as a new expression of the deep-seated and decades-old discontent of Italian citizens concerning the country's weak economy. Since the Parliamentary elections in 1994, government's parties have regularly been defeated at the polls and the new governments have often come to power to antagonize the European trade-off that allowed to stabilize the economy through tight EU fiscal rules only at the cost of constraining the governments' policy choices. Meloni campaigned differently: ensuring the respect of the fiscal rules while disputing Italy's traditional preference for European "shared sovereignty" versus "national sovereignty".

In this short brief, I analyze the coexistence of these objectives - financial orthodoxy and political autonomy - and see whether the risk of Italy's political isolation in Europe may materialize as a consequence of the government's European political strategy and of the country's financial fragility. I will conclude that to avoid that financial weakness morphs into political instability, Meloni will have to avoid political isolation, find an agreement with the European authorities and EU governments, and eventually tone down her nationalist rhetoric.

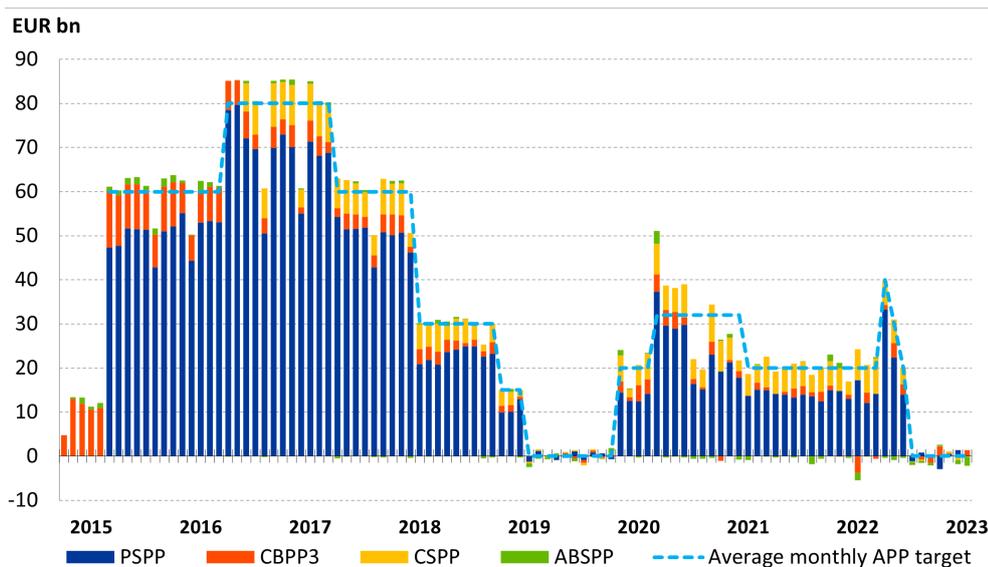
Italy's financial fragility persists

A pragmatic assessment by Meloni should consider that Italy's structural financial weakness is a conditioning factor of its policy towards Europe. Italy can hardly candidate to substitute Germany and France as an interlocutor, neither for countries that receive large financial provisions from the EU, nor for the Atlantic allies interested in engaging a strong partner. Moreover, Italy's financial fragility implies the risk of political instability of the government in office called foremost to ensure the sustainability of public debt, consistent with the rules of European economic governance. These rules will be revised over the next few months and will be influenced by the preferences of the largest countries, with Germany, France and Spain accounting for 60% of the euro area's gross domestic product.

That Italy's fragile conditions remain serious is evidenced by several factors. Last autumn, the UK's quasi-default showed that a less than careful fiscal policy can be severely sanctioned by the markets, with consequences on political stability. Italy is entering a new phase in which the normal roll-over of maturing government bonds is made more uncertain by the cessation of the European Central Bank's policy of

purchasing government bonds.¹ This policy will be made more fraught with consequences by the need to reduce² also the amount of securities accumulated in the ECB's balance sheet. Moreover, the issuance of Italian government bonds will become more expensive in view of the increase in policy rates by the world's largest central banks, including the ECB.

Fig. 1 Net asset purchases by program under APP



Source: ECB

The possibility of offsetting the ECB monetary tightening with a European fiscal policy is made unlikely because since 2020 the EU has already launched major fiscal expansion projects that have seen Italy as the largest beneficiary country³ and Rome seems to be struggling to fully use them, so much so that it requested a postponement of the program's deadline. Moreover, eventual new programs financed by the EU through a common sovereign fund⁴ would require the sharing of objectives - common security, industrial-technological policies, and geopolitical strategies related to energy supply - in which Italy is not always aligned with the other European countries.

Meloni is fully aware that Italy does not have fiscal margins. The budget launched by the government at the end of 2022 provides for a very restrictive fiscal policy with the reduction of the deficit from 5.6% of GDP in 2022 to 4.5% in 2023, 3.7% in 2024 and 3% in 2025. This is twice as much fiscal restraint as that of the period between 2010 and 2012, which was considered an episode of extreme austerity that significantly aggravated the recession after autumn 2011.

¹ <https://www.ecb.europa.eu/mopo/implement/app/html/index.en.html>

² <https://www.reuters.com/markets/europe/ecb-start-offloading-debt-fight-inflation-2022-12-02/>

³ [https://www.europarl.europa.eu/thinktank/en/document/EPRS_BRI\(2021\)698847](https://www.europarl.europa.eu/thinktank/en/document/EPRS_BRI(2021)698847)

⁴ https://ec.europa.eu/commission/presscorner/detail/en/STATEMENT_22_5543

In this context, even minor policy initiatives can be risky. The sudden (but overdue) scrapping of housing subsidies⁵ on February 20 was urged by an increase of the burden for the State and will cause more pain for the economy in the coming months. This impact adds to the inevitable exhaustion of savings that Italian households and businesses had involuntarily accumulated during the pandemic (and used to compensate for the increase in energy prices in 2022). Once those savings are exhausted, the “money illusion” effect that has so far reduced the impact of the increase in inflation on household consumption could peter out. The actual loss of income is much higher than perceived by Italian citizens. The real value of public spending alone, for example, fell by \$100 billion between 2022 and 2023. It will not take long before households feel the pain.

The macroeconomic conditions are such that it will be extremely challenging to reduce the deficit and public debt by next year when the procedures for prevention, correction and sanction of the European Stability Pact – the rules of European economic governance – are reactivated. The new rules proposed by the EU Commission⁶ single out Italy as the country with public debt in critical condition. This isolation is aggravated by the decision of the Italian government to be the only European government that will not ratify the ESM Treaty, which provides for financial assistance to member states in case of financial instability.

The risk of political isolation in Europe

In her autobiography⁷ Italian Prime Minister Giorgia Meloni spelled out her intentions to change Italy’s position in Europe: “Democratic sovereignty resides, first of all, in national states”. Giving “legislative initiative to unelected European bureaucrats ends up hurting democracy.” Four months after its inauguration, Meloni’s right-wing government has been pursuing a break with Italy’s pro-European federalist tradition. She wants the European Union to hand back powers to the nation states, changing Europe’s institutions. By doing this, however, Meloni is incurring a risk of isolation from Italy’s traditional partners: Germany, France and Spain, the other larger countries of the European Union.

There are at least three reasons for Meloni’s collision course. The first is that national sovereignty, a core constituent of the government’s ideological imprint, clashes with the principle of “shared sovereignty” that inspires Berlin, Paris and Madrid. The second is that Brothers of Italy, Meloni’s party, is forging alliances with the opposition parties in those countries, directly threatening the leaders in power. The third is that national autonomy is at loggerheads with the financial interdependence in the euro area that has granted economic stability to Italy so far. Meloni seems aware of the country’s fragilities, and she is treading carefully in domestic policy matters, however she may have underestimated the consequences of being isolated in Europe.

The war in Ukraine has accentuated Europe’s internal divisions in 2022. The Baltic and Eastern countries see Russia as a permanent enemy at the borders. France and Germany, instead, see Moscow as an inevitable interlocutor after the war. With the new year, efforts are being made to keep the larger countries united in the

⁵ <https://www.euractiv.com/section/energy/news/italy-overturns-superbonus-scheme-for-housing-renovation/>

⁶ https://ec.europa.eu/commission/presscorner/detail/en/ip_22_6562

⁷ Giorgia Meloni: “Io sono Giorgia. Le mie radici le mie idee” Rizzoli - May 2021

current challenging circumstances. In January, France and Germany tried to bridge the distances that had marred their bilateral relationship since the beginning of the war, celebrating the 60th anniversary of the Elysée Treaty⁸ and reinforcing the entente. In the same month, France and Spain signed a Cooperation Treaty⁹ with operational implications in defense and energy policies. In February 2023, the European Commission proposed industrial policy tools¹⁰ jointly inspired by Paris and Berlin in response to the US Inflation Reduction Act, with the support of a special European Council.¹¹

After criticizing¹² the Franco-German strategy on state-aid, on February 8, the Italian government opened a public rift¹³ with France and Germany on the occasion of the visit of Ukrainian Prime Minister Volodymyr Zelensky to Paris. Since she became Prime Minister, Meloni had repeatedly disapproved¹⁴ the initiatives of the French presidency and made no progress in bilateral dialogue with Germany.

Rome's distance from traditional partner countries has both strategic and ideological characters.¹⁵ The former emerges by Italy's lack of clarity in respect of Russia. The government belongs to neither the Baltic-Eastern camp, nor to the Franco-German one. Meloni is transparently on the side of the Atlantic strategy, but her allies – Silvio Berlusconi foremost – defend Vladimir Putin. As for the ideological character, it emerged on February 20, when Polish Prime Minister Mateusz Morawiecki illustrated the vision¹⁶ he shares with Meloni: "the vision of a Europe of homelands, of strong countries and not of utopian, federalist and centralist visions, with centralized power in Brussels."

The political cooperation between the leaders of Italy and Poland – whose parties in the European Parliament form the European Conservative Reformists group (ECR) chaired by Meloni herself – is part of an ambitious strategic framework aiming for an alliance between the ECR and the European People's Party (EPP).¹⁷ Meloni wants the ECR and the EPP to form a political majority in the European parliament after the 2024 European elections, unhinging the traditional centrist alternation between the People's Party and the Social Democrats. The new right-wing majority would aim to return to the nation states competences that are currently shared by the 27 member countries of the European Union.

This political design would be facilitated by the fact that in the second semester of 2024, the rotating presidency of the European Council will be held by the euro-skeptic Hungarian government. Moving the European integration clock backwards could also find support across the Atlantic if, in the same year, a

⁸ <https://www.auswaertiges-amt.de/en/aussenpolitik/laenderinformationen/frankreich-node/60-years-elysee-treaty/2574584>

⁹ <https://apnews.com/article/politics-spain-government-france-macron-afb99c21eeda6b62b1cccfad1c81a6b>

¹⁰ <https://www.politico.eu/article/eu-faces-up-to-us-green-subsidies-with-industrial-overhaul/>

¹¹ <https://www.consilium.europa.eu/en/meetings/european-council/2023/02/09/>

¹² <https://www.politico.eu/article/germany-olaf-scholz-placate-italy-giorgia-meloni-concerns-eu-state-aid-subsidies/>

¹³ https://www.ansa.it/english/news/world/2023/02/10/meloni-says-was-right-to-criticise-macron_74e23b36-7e3e-4987-92b0-e49620a540b2.html

¹⁴ <https://www.politico.eu/article/giorgia-meloni-emmanuel-macron-italy-france-clash-migrant-ship-ocean-viking/>

¹⁵ <https://www.politico.eu/article/veni-vedi-veto-giorgia-melonis-march-on-brussels/>

¹⁶ <https://www.governo.it/en/media/president-meloni-warsaw/21852>

¹⁷ <https://www.euractiv.com/section/politics/news/european-conservatives-right-wing-chiefs-meet-as-2024-eu-elections-loom/>

Republican candidate becomes president of the United States, backing the traditional vision of American conservatives opposed to a stronger European Union.

The plan puts Italy in direct contrast with the governments of Germany, France and Spain, not only for the different vision of European integration, but also in terms of the affinity of the largest Italian ruling party, Brothers of Italy, with parties that aim to undermine the governments in office in those countries: Vox in Spain, Rassemblement nationale in France, and a minority of the Christian Social Union (CSU), which is represented by the President of the EPP Manfred Weber, and which is tempted to appeal to the German far-right fringe electorate. The Italian government's support for radical opposition parties in traditional partner countries risks leading to an existential antagonism between Meloni and President Emmanuel Macron, Chancellor Olaf Scholz, and prime minister Pedro Sanchez.

The government's strategy has implications that can be assessed as non-pragmatic:

- 1) The lack of agreement with Germany, France and Spain prevents Rome from exploiting the unique opportunity to play a pivotal role in Europe, connecting that group of countries with the Baltic-Eastern group.
- 2) The chances of shifting the axis of the European People's Party towards a right-wing alliance with the ECR are rather limited as a result of the likely strong opposition of the German Christian Democratic Party (and of the majority of the CSU), which has always been the pillar of the EPP;
- 3) The attempts to begin a dialogue with the countries of Northern Europe, also inclined to reduce the centralization of competences, do not seem to be advancing, at least judging by the bilateral meeting between Meloni and Dutch Prime Minister Mark Rutte on the occasion of the extraordinary European Council of February 9, whose result mainly made clear the points of disagreement. Rutte, a putative leader of the so-called "frugal countries" also opposes¹⁸ Meloni's repeated requests for more European funds.
- 4) The hypothesis of an alliance with Poland and the countries of Eastern Europe, which are also jealous of their national sovereignty, is weakened by the fact that the Italian Government is unable to provide significant financial or military support for those countries to defend the Union's eastern borders. Italy's interests are also at odds with those of the Eastern European countries in matters of European security, migration, and cohesion policies.
- 5) Likewise, Italy's strategic ambiguity and limited financial capacity make it a non-central partner for the Atlantic alliance even in the hypothesis of a new American strategy after 2024.

¹⁸ <https://www.politico.eu/article/macron-rutte-agree-to-disagree-on-european-response-to-us-subsidies/>