



Italy's elections

Oxford Analytica Conference Call summary

Italy's elections may seem like an afterthought to those in the big EU member states last year: France, Germany and the United Kingdom. But whatever happens in the poll on March 4, it will pose Europe with its next big challenge. That is not just because Euroscepticism remains a force across Europe and will likely poll well in Italy, especially among the young, but also because the Italian elections will highlight the urgency of reforming the Eurozone and better managing migration.

Three main blocs are contesting this election: a centre-left coalition led by Matteo Renzi, a centre-right coalition led by Silvio Berlusconi (although he cannot be prime minister again because of a tax fraud conviction) and the anti-establishment Five Star Movement (M5S). The centre-right coalition leads in the polls at this point but perhaps by not enough to form a strong majority government.

What should we be looking for? Could any of the contenders win outright?

Two well-known facts about Italian politics and this election: the party landscape is highly fragmented, and it is a three-way contest between the centre-left but fiscally cautious Democratic Party (PD), the M5S, which is less fiscally cautious, and a coalition of smaller centre-right parties that represents the least fiscally cautious of the three groups. All three propose some form of fiscal expansion through a combination of tax loosening and higher spending. There is some difference in where the benefits would fall. The centre-left offers various forms of social credit spread across the electorate whereas the centre-right's most distinctive elements in terms of its fiscal loosening are additions and changes to pension regimes and tax loosening, particularly for small businesses. To anybody looking for a solution to Italy's poor growth performance or its accumulated debt pile, none of these sets of programmes represents anything that will do the trick. If there is to be a fundamental turnaround it will come from the non-fiscal elements and from changes at the European level.

Could any of these three contenders actually win and be in a position to implement their programmes? The answer is probably not. The centre-right is leading with 37-38% of the vote. It is not inconceivable that it might reach 40% and win the majority bonus given the way the single-seat contests could fall out, but it looks highly unlikely. Even if it won majorities in both chambers of parliament, it would mean a very thin majority for a coalition of four parties which, three times in recent Italian history, has fallen apart pretty quickly or shown itself to be divided over tax and spending issues.

Equally another grand coalition of the PD and Berlusconi's centre-right Forza Italia has become less and less likely. The two parties may not win a majority and, more fundamentally, Italy has almost certainly had enough of grand coalitions. It had a grand coalition for the last five years in one form or another. It would be very dangerous to Italian politics and a sub-optimum outcome to have Forza Italia and the PD back in government. It may well be just an interim measure before another election.

It is possible that another election will be held soon. President Sergio Mattarella would fight tooth and nail to avoid it but it is difficult to see how either of those scenarios -- a centre-right government or a grand coalition -- could work. The worst-case scenario is a fleeting alliance between the League and the M5S. However, it is unlikely that they get a majority, and even if they did they would struggle to form a coalition to stay in office long enough to pursue the anti-euro policies the M5S has proposed. The betting is on a short-term government and early elections.

Economic issues and the banks

The banks are in trouble, and the sources of their troubles are wider problems within the Italian economy which any incoming government will have to address: the collapse in house prices, fragmentation of the banking sector and inadequate regulation.

Unlike in the rest of the EU, house prices in Italy have not recovered. Prices are one-quarter lower than before the crisis and show little sign of rising. The nature of the market, with three-quarters of Italian households owning their own house, means that people are refusing to sell and the construction sector is stuck.

The second driving force in the bank crisis is another Italian characteristic: a large number of regional banks heavily embedded in the local economy, which is dominated by small and medium enterprises. It is interesting that Spain had the same problem and addressed it by setting up a state-owned bailout bank and concentrating the banking sector on two large private banks, allowing them to restructure the sector. However, this would involve forcing bankruptcy on the regional banks with enormous consequences for regional politicians. It would also pull out support for small and medium businesses with undesirable consequences for any political parties.

The third driver is the lack of adequate regulation. The regulators are captured by the banks and again an incoming government would have to tackle the independence of the bank regulators and allow them to clean up the banking sector, which would be difficult for a weak government or one depending heavily on regional and local leaders. The banking crisis goes beyond technical factors and is more about the way the Italian economy is organised both by sector and regionally.

What is the European dimension and will it push forward pressing issues in Brussels?

Brexit is not the first word on everyone's lips in other EU capitals. However, the fact that the United Kingdom is leaving does make Italy more important among the remaining EU-27. It will soon be the third-largest economy in the EU, so Italy's success or failure in returning to sustainable growth and solving the banking crisis is important to the union as a whole.

As Brexit will leave a vacancy at the top three table in the EU, quite a few countries will be hoping that if a stable Italian government emerges it could take the lead in ensuring that the EU does not become a Franco-German stitch-up. At the same time, if a grand coalition emerges in Germany, the prospect of a Franco-German stitch-up on euro-area reform will increase. Paris and Berlin have different agendas but they are both pro-European. If a Eurosceptic coalition emerges in Italy, Italy could emerge as the leader of a more sceptical group of countries wary of Franco-German plans.

The migration crisis has been a big issue in the Italian election, driving support for Eurosceptic parties. In 2017, roughly 120,000 people arrived in Italy by crossing the Mediterranean illegally. There is a strong feeling in Italy that the rest of Europe has not been listening to Italian concerns. There has been a lack of solidarity in sharing the burden. That, in turn, has led to support in Italy for the EU falling quite significantly. However, there is a shared EU-wide anxiety to avoid another flare-up of the migration issue in the run-up to the 2019 European elections.

Another issue is Russia, which for Eastern Europe is the biggest threat to stability within the EU. Italian parties are more pro-Russian than their counterparts in most other European countries. Berlusconi has close ties with Russian President Vladimir Putin. During the election campaign, the M5S has been critical of EU sanctions against Russia imposed after the annexation of Crimea. The League likes some of the rhetoric coming out of Moscow. There will be wariness in Brussels and some other capitals if any government emerges in Rome that is more disposed to mend fences with Russia and in particular to threaten the fragile unity within the EU in its approach to relations with Moscow.

Are the Italian elections likely to alter the EU plans put forward by Emmanuel Macron?

On euro-area reform, EU governments are divided between those that emphasise solidarity, such as French President Emmanuel Macron, and those that emphasise national self-responsibility, which is what the Germans called for until the start of the coalition negotiations. Italy emphasises the importance of solidarity, in the hope that a strong Italian voice in the reform process would tip the scales towards completing the common backstop for the single resolution fund and the European deposit insurance scheme.

If Italy's voice is weak in the months following the election, there is greater opportunity for those countries that want to emphasise national self-responsibility to do so. That would be detrimental to the long-term success of the reform process.

There is a sense among some that all that is needed to achieve successful reform is an agreement between France and Germany on a compromise position that can then be implemented with the passive acceptance of all other member states. However, if there is no Italian buy-in up front and if Italy is not seen as having a role in shaping the reform process, the political repercussions could be strong and the effectiveness of the reforms could be mitigated.

Italy's relationship with the EU has changed a lot in the past two decades, both in terms of popular and elite attitudes. The elites have fallen out of love with the EU. There is now a greater willingness to push back and Italian politicians are more likely to put their vision forward more assertively. The EU will have to accommodate this, even if the new government is not the most effective political entity for other European member states to interact with.

Is Italy starting to look more like Austria, Hungary or Poland in that regard?

The European issue has a very different salience across member states. Italy will prove to be a more problematic partner. All parties are running on fiscally expansionary platforms, but the Commission will expect the new government to reduce spending. There is going to be a lot of tension. When Italian politicians talk about the prospects for the German proposal to create a European monetary fund with significant responsibility for fiscal policy co-ordination, they react in horror at a European entity coming to dictate terms to them. That will not win votes for Europe, nor will it reinforce their domestic political position.

Do Paris and Berlin trust Rome to clean up the Italian banks?

Italy, unlike Greece or even Spain, represents a potential systemic risk to the European financial system. Whether they like it or not, European policymakers and the ECB have to be ready to backstop Italy under almost any circumstances. The Italians know that and it allows them to behave slightly more independently than they would otherwise do.

It is not just a question of Macron's reforms. The EU's budgetary cycle will end in 2020. The EU now has to draft a new budget with the obvious problem that the United Kingdom is not there to contribute to it. Extra funds have to be raised.

Growing inequality across regions means that demand for cohesion funds is increasing. One-third of the EU budget goes on agriculture and one-third on cohesion funds, so this will play into regional politics in Italy as much as anywhere else. It is difficult to see any Italian politician voting for a cut in agricultural subsidies or cohesion funds. It is one thing to criticise the euro-area and another to be prepared to do something about it.

Most businessmen would not want to go back to the lira. They trust their own politicians even less. Given a choice between the Bundesbank running the financial system or the Bank of Italy, most businessmen on the left, progressive or otherwise would support the former. Italy is therefore not likely to rock the boat very much on the main planks of regulatory reform and budgetary reform. It is not very enthusiastic about Macron's reform, but then nobody else is.

Can we trust opinion polls in Italy?

Even if opinion polls can be trusted, the outcome of the election remains uncertain for two reasons. One of them is the question of whether any coalition wins 40% of the vote and thereby the majority bonus. It is not likely that the centre-left or the M5S will get there, but the centre-right coalition could. It is polling at 37-38% and reliable polls normally have error margins of 3 percentage points. Small variations in support can therefore lead to big differences in final outcome.

The second reason is that it is unclear whether the League or Forza Italia will be the largest party in the centre-right coalition. They have broadly agreed that if they are to form a coalition, the party with the largest share of the vote will provide the prime minister. There is a huge difference between a centre-right coalition headed by League leader Matteo Salvini, who is a populist rabble-rouser, and a government led by a Forza Italia prime minister such as Gianni Letta, who was deputy prime minister to Berlusconi and is considered cautious and moderate, or Antonio Tajani, president of the European parliament. Forza Italia is leading in polls by only 2-3 percentage points.

Beyond that, the same questions are asked about polls worldwide: different techniques, such as carrying out surveys by telephone or computer, come into play. Some poll respondents do not tell the truth. In this particular election, there is the concern that support for the two most populist parties, M5S and the League, is underestimated because some respondents may be reluctant to confess that they intend to vote for them. There are also the issues of young versus old, and late swing voters.

Are there significant differences between the potential prime ministers from the centre-right coalition?

Yes. The main question is whether Forza Italia or the League is the largest party in that coalition. A Salvini government would trigger a crisis of confidence inside and outside Italy. The EU would also feel an immediate sense of crisis as the extent to which such a government would carry out the League's threats in relation to the euro would only become apparent over time. However, if a more reassuring figure like Letta were to become prime minister, there would be a stronger feeling that reason would prevail and that Italy's position within the euro would be safe. There will be a long-drawn-out process after March 4.

What impact does the election have on EU migration policy?

The EU's policy of relocating migrants across the bloc has been a failure. Governments in Central Europe and elsewhere have refused to take part. For German Chancellor Angela Merkel and others, it feels like migration has been contained. It does not feel like that for those in Lampedusa or off the coast of Sicily.

The EU-Turkey deal to reduce illegal migration has been a success in the sense that it has contained the sense of crisis, despite the fact that the EU's relationship with Turkey is still problematic. It does not address the flow of people to Italy, which has only gone down slightly from 2014.

A centre-right coalition would use a more aggressive tone in demanding EU solidarity. Whichever government comes in, migration has to be at the very top of the list of priorities.

There has been success in effectively relocating the border of southern Europe into the Middle East and North Africa. There are arrangements with governments of these countries to act as buffer states around the edge of Europe. To work in the future, this is going to require stronger institutions both on the security and aid fronts. Italy has played a key role in getting Brussels to articulate and implement a common southern defence and aid programme. If anything, more progress would require a stronger Brussels.

French-Italian relations

The Franco-Italian relation is important from an economic and migration perspective. The SBX shipyard deal was reneged on by the French. There was a Franco-Italian summit in September to clear the air. They agreed to disagree and to pursue more guardedly economic nationalist policies regarding foreign direct investment.

At the same time, Macron used his foreign policy influence in Africa to help shore up and reinforce the migration deal with Libya. While 120,000 migrants crossed the central Mediterranean border last year, the expectation up to July was that the number could be well over 200,000. The French played a critical role in ensuring that it did not take place. A real partnership has developed between France and Italy. It is likely that they will work more smoothly together in the future.

Is there any risk that Italy would leave the euro-area?

There is virtually no risk that Italy leaves the euro-area and the market for euro-denominated securities is not pricing it in. The euro has survived the crisis. There is the question of how much more progress can be made, particularly without the United Kingdom, in establishing the coherent regulatory system that the euro requires. Strengthening of bank regulation and a shift from ad hoc bailouts to a more regulated system -- which implies pressing ahead with bank reform -- would lead to the emergence of a smaller number of European banks that would work across the region. That would have profound political consequences in Italy given the regional structure of business and banking. The project of financial integration could be slowed down.

Foreign policy

On the issue of Russia, the big question is the extent to which unity can be maintained within the EU on the issue of sanctions. It has been difficult to keep the sanctions regime in place. A government emerging in Rome that was in any way more sympathetic to restoring ties with Moscow and forgiving and forgetting on Crimea would possibly tip the balance, making it impossible to get unanimous agreement on sanctions in the European Council.

Other foreign policy issues will be the relationship with North Africa and crisis management along the coast with Libya, which is difficult to deal with due to its shifting coalitions of warlords. There is also the longer-term policy of trying to build relationships with countries in Sub-Saharan Africa where many of the migrants originate, and to provide long-term policies for developing economies to make them places that people do not want to leave.

Who is Trump's candidate?

US President Donald Trump has not figured in this election. Trump would feel at home with Berlusconi in terms of personal style and relationships with Russia. The Pentagon would feel more at home with a continuation of Paolo Gentiloni's government, and continuity with the current state of affairs.

There is a worry that the League or the M5S might interfere with Italy's role in NATO. It could be used as a bargaining chip to get better terms on other issues. A government that is known to have some doubts about Italy's anchors and its NATO anchor, in particular, might be willing to use those more than the PD, which more generally from a US perspective would offer most stability and continuity. There has not been any mention of Russian 'meddling' in the election.

US presidents have never been restrained about weighing into Italian politics. As recently as 2006, the Bush administration played an important role in supporting Berlusconi in his attempt to remain prime minister. The president explained that it was confusing to learn new names. That lukewarm support did not work for Berlusconi as he had hoped. If the Trump administration were to weigh in, it would have the opposite effect. There are a lot of different actors that would prefer to see the United States stay out altogether.

Berlusconi can't be prime minister because of legal convictions; what role will he play?

Berlusconi is well in charge of his party at the moment, but that has not always been the case. After the middle of the last legislature, when Berlusconi parted company with the PD, the PD government was only propped up by defections of a significant number of Berlusconi's forces. He will not be prime minister because he is disqualified, he is old and it looks like he does not have the appetite. But he will be kingmaker behind the scenes.

Have we seen the high point of Euroscepticism?

There is no question that it has a considerable distance to go. There are clear divides emerging in Europe. In response to developments in Poland and Hungary, Macron has been emphasising that EU values should be non-negotiable. EU commissioner Frans Timmermans has become a hate figure in Poland because of EU demands over the rule of law when it comes to judicial and media independence. If the League were in government, it could raise questions about rule-of-law issues.

What signposts to look for?

The extent to which pre-electoral coalitions hold after the elections.

The appointment of a respected finance minister.

Whether M5S can consolidate as a party.

How far interest rates rise, which could change the context of Italy's debt servicing significantly.