The 71st Public Policy Seminar

The Future of the Euro Zone seen from Italy

Political and Economic Dimensions

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1. Introductory remarks

On the **distinctive nature of the EU integration** process.
A project advancing by successive leaps, in a non-linear way

The need to reach consensus among 27 (28) Members States and to overcome initial inertia if not outright resistance to further integration.

A textbook case: the Euro, the common currency introduced to overcome the problem of competitive devaluation within the Single European Market

1991 - Maastricht Treaty

A common currency and monetary policy

Formal requirements for joining:

- Public deficit <3% of GDP
- Public debt <60% or approaching
- Inflation rate

but without effective mechanisms to cope with asymmetric shocks

- no system for fiscal transfer within the Euro zone
- small EU budget available (max 1.24% of GDP)
- limited intra-EU labour mobility
- major constraints on wage flexibility
- no common fiscal policy and taxation (allowing for opportunistic behaviours)

The current fiscal and banking crisis has clearly shown the flaws and the limits of the present arrangement.
How to cope? How to react in time?

2. The solutions envisaged and the measures implemented

A solution based on a policy mix based on:

- fiscal discipline
- deeper fiscal and banking union
- availability of funding programs - EFSF>>ESM - with sufficient firepower
- provision of sufficient liquidity by the ECB
- bank recapitalization
- systemic reforms (labour market, pension schemes, public administration, regulatory framework)

The measures adopted

In March 2012, **Fiscal Compact**, comprising:

- a mandatory balanced budget rule

- a benchmark for government debt reduction, if > 60% of GDP

(with UK and the Czech Republic not signing the agreement)

From this month the **European Stability Mechanism (ESM)** to be operational with some 500 billion euro of firepower

The ECB role
two LTRO (Long-term refinancing operation) at a low interest rate

Last week, EU leaders discussed and agreed to:

- *pan-European regulation of banks with an enhanced supervisory role by the ECB*
- *direct financing of insolvent banks*
- *use of EFSF/EMS funds to buy bonds of MSs that comply with country-specific recommendations*

Far-reaching systemic reforms in order to reduce public expenditures and, more important, increase competitiveness.

However, systemic reforms will produce results in the medium/long term.

In the short run, urgent need to promote economic growth in the Euro zone via investment in public infrastructure projects, research, education, …

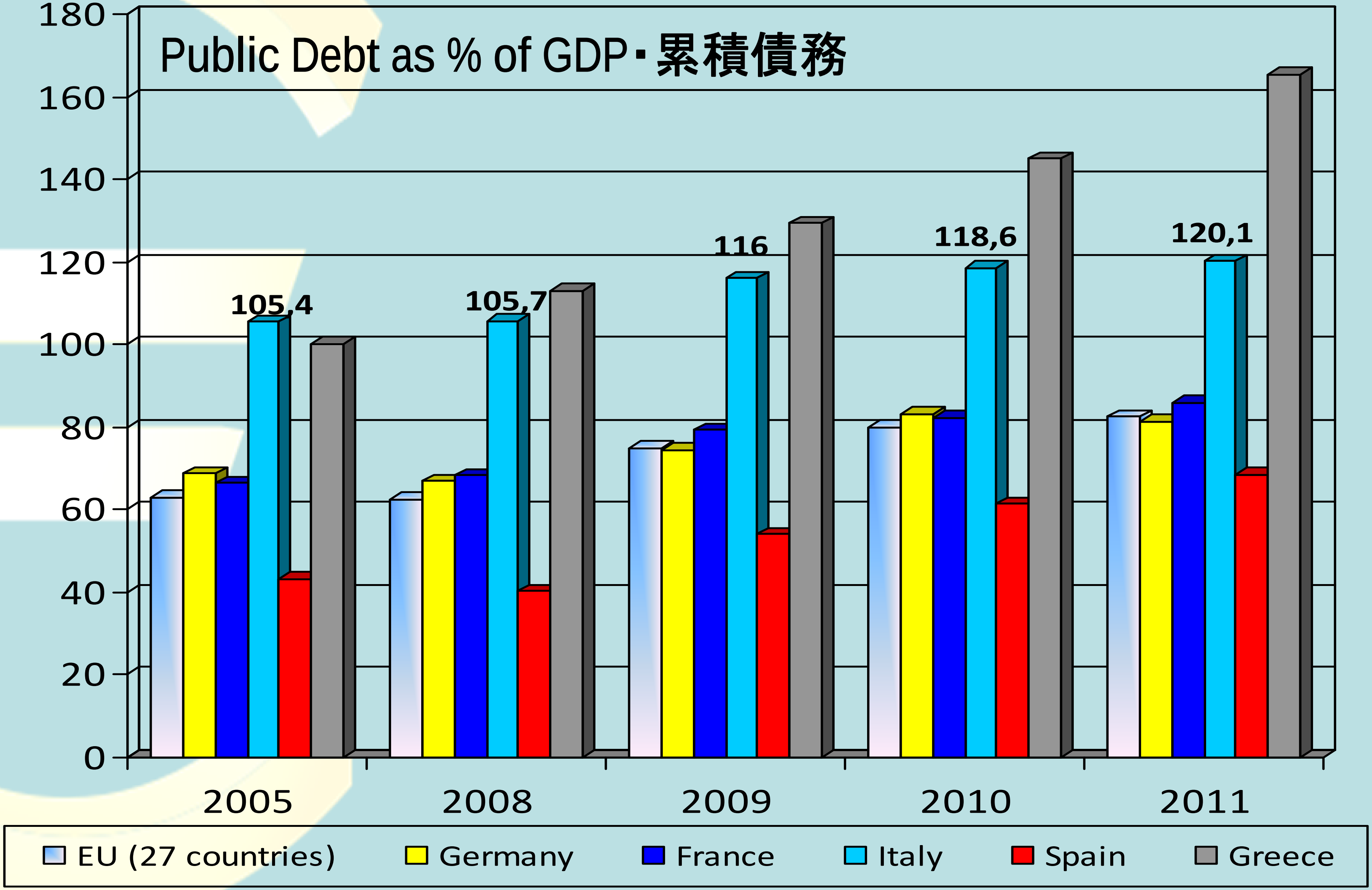
Economic growth will generate more fiscal revenues and positive expectations.

Unless economic growth is resumed any solution will not be stable, definitive.

3. The case of Italy

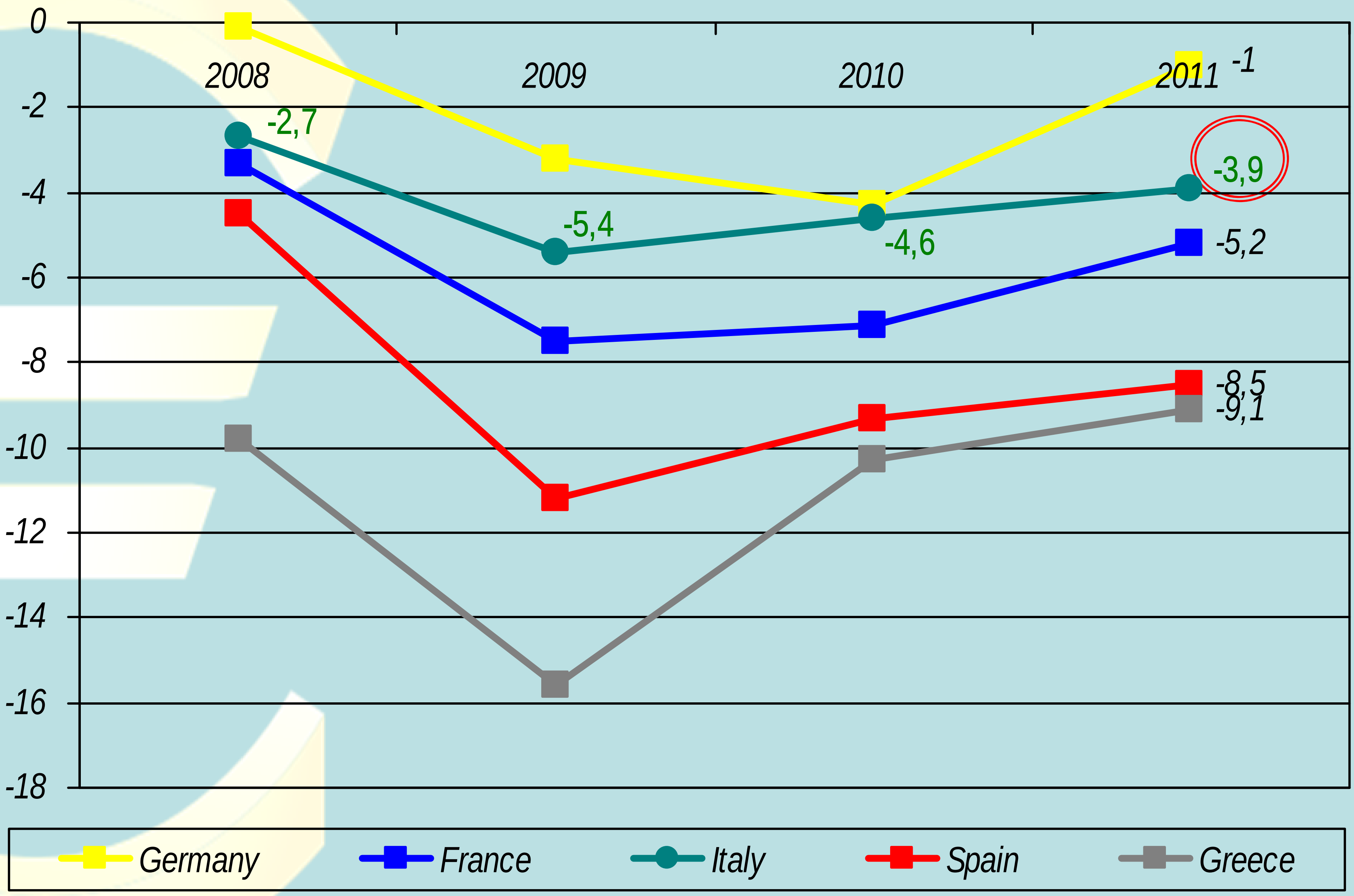
The less known reality of Italian economic fundamentals.

➢no major macroeconomic imbalances apart from high public debt



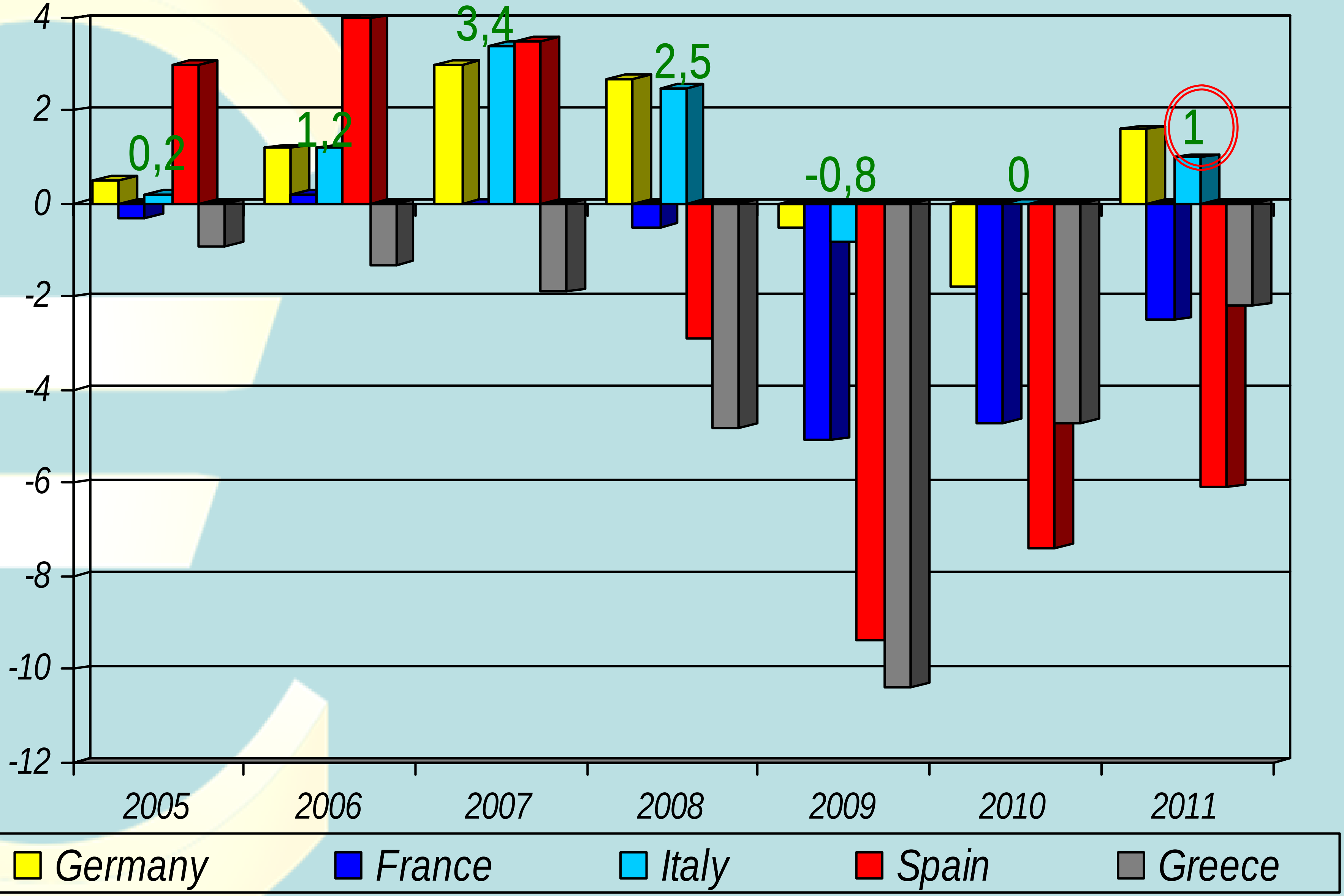
(Source: Eurostat)

Fiscal Deficit/GDP %　　財政赤字



(Source: Eurostat)

Primary Balance/GDP

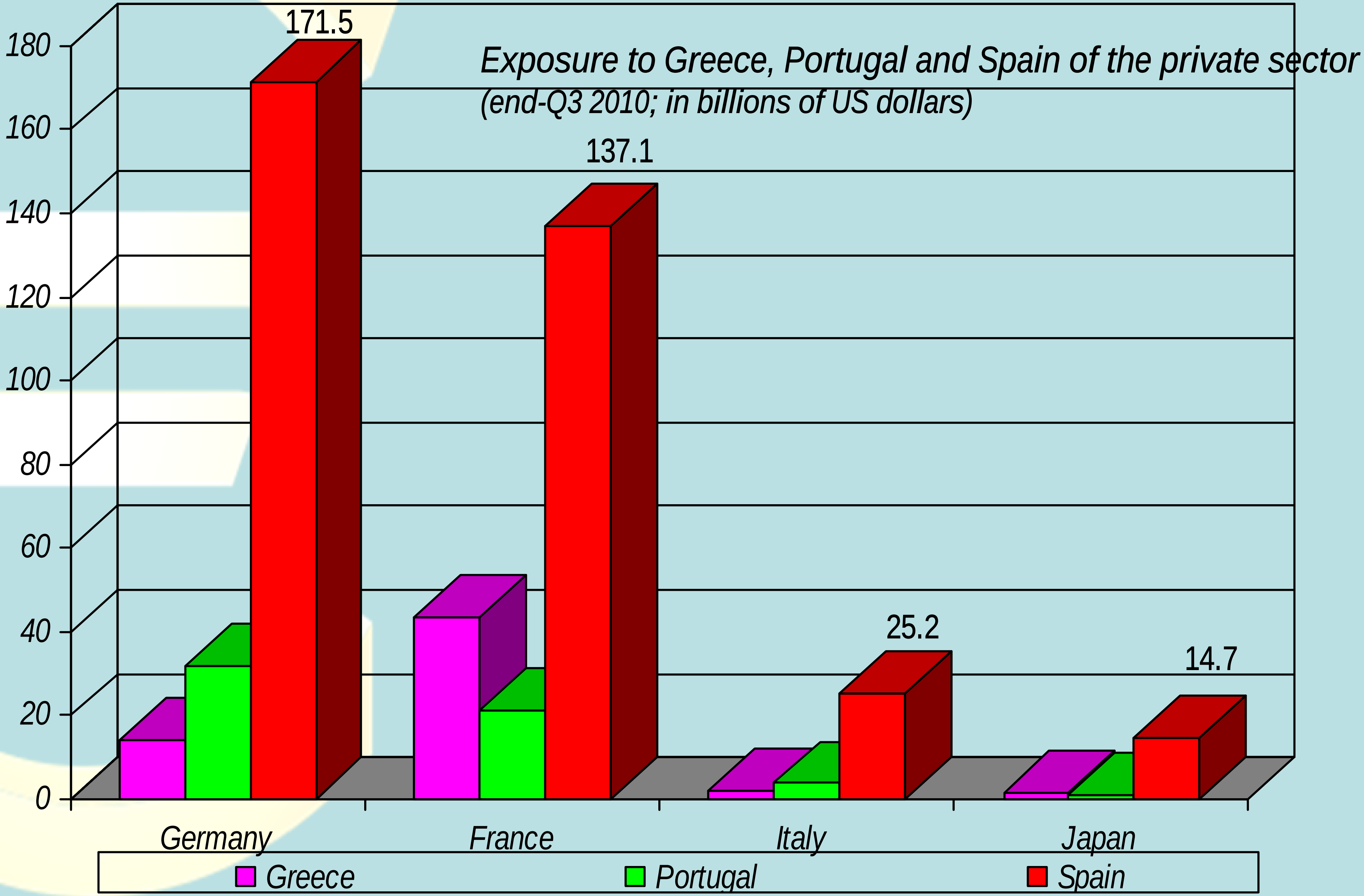


Source: European Central Bank

(Source: Bank for International Settlements (BIS))

Moreover, Italy can rely on:

- large financial reserves (household saving)
- sound banking system (no housing or financial bubble)
- limited exposures to indebted countries



Why was Italy attacked?

In 2011 the markets assumed that Italian virtuous fiscal policies were at risk because of local elections in 2012 and general election in 2013.

In summer 2011 restrictive fiscal measures were decided and approved effective from 2014
The markets were not convinced.

Italy’s spread (over German bonds) shot up to over 550 basic points.

On Nov 8, 2011 the government resigned.
Nov. 17, 2011 Mario Monti in charge.

PM Mario Monti, an economist and a former EU Commissioner.

The three-pronged policy approach:

- (fiscal) discipline
- growth promotion
- guaranteeing equity and fairness (across and intra generations)

Fiscal measures and pension reform
財政措置と年金制度改革

December 4, 2011 approval of:

A set of fiscal measures worth
€20.2bn in 2012, €21.3bn in 2013 and €21.4bn in 2014

On the revenue side:
- tax increases (VAT - 21% -, new tax levy on real estate, tax on luxury goods…)
- fight against tax evasion

On the spending site
- reduction of government expenditures and transfers to local governments

Pension reform >> large structural saving
- about €7.6bn total cumulative savings (net of taxation) in 2014, increasing to almost €22bn in 2020.
- linking retirement age and contributory periods to changes in life expectancy

Now based on solid foundations

January 20, 2012 - decree law to promote growth through deregulation and liberalization 規制緩和と自由化

- liberalisation of opening hours for retailers
- promotion of competition in professional services
- strengthening of the Antitrust Authority and of authorities in charge of consumer protection

June 27, 2012: approval of the labour market reform
労働市場改革

Reduction of rigidities in the labour market
but at the same time introducing a new modern social safety net

However, systemic reforms will produce results in the medium/long term.
Urgent need of fostering investment and growth

4. Conclusion

Toward a full fiscal and political union?

The different visions of different players.

Italy: a committed member from the very inception of European integration

The Euro area in 2011

- Population: 332,4 millions
- 14.2 % of world GDP
- 15.6 % of world export (excluding intra-euro)
- 25.4 % including intra-euro trade