

Collapse of Italian government

The decision of the Italian Prime Minister to resign rather than face a Confidence vote brings to an end a curious government experiment. 2 populist parties with very different programmes and outlooks tried to govern together. Both found the restrictions of the EU budget rules and Euro scheme difficult to live with. Lega were keen to cut taxes and 5 Star wanted to introduce a more generous basic income payment by the state. The PM, not elected for either governing party, sought to keep the government more in line with EU requirements and tried to keep co-operation between the two leaders of the two main parties in the coalition against a background of disagreements. Meanwhile the Italian economy stagnated, and fell into a shallow recession for the second half of last year.

There will be efforts for the pro EU New Democracy party to ally in government with 5 Star to avoid an election both of them might do badly in. They might be able to establish a temporary government. It would have to pass a budget that appears compliant with EU rules. If they do this Lega will look for any way to bring on an early election which they think would give them more seats and more clout in the Parliament. They will be looking to the new EU Commission to see if there is any scope to relax the current tight settlements, given the wish of many in Italy to spend more and be taxed less. They will also be hoping the new President of the European Central Bank follows an even more accommodating policy, and will expect Italy to continue as the number one borrower from that Bank under the Target 2 balances arrangements.

Italy is an interesting test of whether populist parties can govern in any way in the Euro area that keeps faith with what their electors want and what they promised. The Lega/5 Star coalition compromised with the EU to avoid a worse conflict in ways which prevented the implementation of much of their respective economic and financial programmes. Mr Salvini of Lega is hoping to bring about an election which he thinks he can win, when he would doubtless be less willing to compromise. This in turn raises bigger questions of Italian electors. Would they trust a committed populist government to challenge these EU orthodoxies? How far would they let such a government take their demands? When Syriza in Greece tried it they ended up backing down. Greece is a much smaller country that does not have the same weight as Italy financially and economically, so we would be in uncharted territory. Italy owes large sums to the ECB, which is Germany's problem as well as they have lent most of it.