

Italy to challenge Euro austerity

The new 5 Star/Lega government agrees about more than its critics thought it would. The two parties both think Italy has faced too much austerity from the EU and needs to spend more and tax less. They both think there are too many migrants entering their country, and want to see tougher controls over migration. They both think the Italian state debt is too high and some of it should be cancelled. Both want to put Italy first. Both challenge the German view of the Euro scheme, which refuses to transfer money from the rich parts of the zone including Germany to the poor parts of the zone. As a result we have had a series of Euro crises in stressed countries.

The worst of these crises so far were in Cyprus and Greece. In each case the commercial banks were unable to honour requests to withdraw Euro deposits, because the Central Bank refused them the cash they needed. In the case of Cyprus the Euro there was slashed in value if you held a deposit over a certain size. The Euro has been more stable and its value stronger more recently thanks to the Target 2 balances. Germany and the other surplus countries now deposit their surpluses at the Central Bank for zero interest with no repayment date. The ECB lends the money on to the stretched banking systems of the deficit countries for zero interest. The ECB also helps countries like Italy by buying up large quantities of their state debts to keep their costs of borrowing down.

Italy has now hinted that the ECB should write off the state debt Italy now owes it. The ECB disagrees. Italy thinks there should be some sharing system around the zone, allowing her to spend more and tax less. Germany disagrees.

It is likely Italy will set a budget which challenges the rules of the zone. The row may then lead on to doubts about the Target 2 system and the sustainability of this borrowing based model. Within the UK currency zone the rich parts send large amounts of money to the poorer parts. They pay more taxes, and the lower income areas get more in benefits, Council grants and general public spending per head. The Eurozone has no such mechanisms. Italy may be about to wobble the consensus which is based on extend and pretend. The ECB lends on surpluses from rich countries to poor countries, claiming it is temporary and will be repaid. It is best not to probe this too much.