



Will Italy's Political Turmoil Slow Its Reform?

Angel Ubide says that Italian Prime Minister Monti's resignation may bring in a center-left government that will continue fiscal consolidation but slow down labor reforms.

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Steve Weisman: Prime Minister Mario Monti's decision to step down in Italy has stirred a reaction in the markets and on the political scene, raising questions about the future of reform in Italy. Angel Ubide of the Peterson Institute is here with me, Steve Weisman, to assess the situation. Angel, first, the prime minister's decision unsettled the markets. Why?

Angel Ubide: Because it increased the uncertainty. It was something that was supposed to happen. We knew there was going to be an election some time in the first half of next year. Now, he just made that a reality a month earlier than expected in an environment that wasn't expected. It was triggered by [former Prime Minister Silvio] Berlusconi's decision to remove support for Monti's government and present himself as a candidate.

Steve Weisman: That alarmed a lot of people. Is he [Berlusconi] going to run?

Angel Ubide: It's unclear. He's been sending mixed signals in the last few days, saying that yes, he's running but he would be willing to step down if Monti were to present himself as the leader of the center right. He's also been making noises that perhaps his so-called successor, at least the one that was supposed to be his successor, Angelino Alfano, could also be the candidate. It is quite unclear at this point what he's going to do at the end.

Steve Weisman: How much more does Italy have to do in fiscal consolidation and reforming its labor markets and regulations to gain the confidence of the markets and also to give confidence that its recovery is in the offing?

Angel Ubide: Italy has done a very impressive transformation in terms of fiscal policy. They reach in 2013 cyclically adjusted the deficit balance, which essentially means zero corrected for the cycle. They will still have about one and a half percent of GDP of deficit this year that they need to correct next year, but they have found an importantly positive primary surplus, which is going to have them contain the evolution of public debt.

So from now on really, what Italy needs to do is to grow. They can contain the numerator which is the level of debt. They need to make sure that that denominator doesn't shrink.

Steve Weisman: Do they need to reform to get that growth?

Angel Ubide: Yes, they need to do more reform. They have a public sector that is very big. They have a services sector, a domestic economy that is very much linked to that public sector and is reasonably inefficient. They need to make that part of the economy more productive. They have a manufacturing exporting sector which is quite effective on product but that's small.

It needs to grow and they need to restore growth in the rest of the economy. They need to restore flexibility in the labor market. They have a labor market that is very dual, very insider-outsider structure. The reforms of the last year or two have been going in the right direction. They probably can do more. I would expect that in the next couple of years they will do more.

Steve Weisman: Despite the current political uncertainty, you are optimistic they can do more?

Angel Ubide: I think they can. Now, the most likely outcomes of elections as of today, I would imagine, would be a government led by [Pier Luigi] Bersani, the leader of the center-left. The big question mark that we will have is that the center-left in Italy has traditionally been very reluctant to tackle the special interests in the real economy. And so, there could be a situation where they would be more willing to adopt more fiscal austerity if it's needed at the expense of doing less in terms of reform.

Steve Weisman: Your prognosis for both Mr. Monti and Mr. Berlusconi?

Angel Ubide: If I had to guess right now, I think Berlusconi will still be a member of Parliament. Mr. Monti would be the president of the republic some time during the course of next year and the prime minister will be Mr. Bersani.

Steve Weisman: Thank you Angel.

Angel Ubide: Thank you.

