



## Market Jitters and Political Turmoil in Italy

*Nicolas Véron says the prospects for structural economic reform are uncertain in light of the surprising and confusing election results this week in Italy.*

*Transcript of interview recorded February 26, 2013. © Peterson Institute for International Economics.*

Steve Weisman: The financial markets have been unsettled by the Italian election results. There is a cloud of uncertainty over what government will take shape. Nicolas Veron of the Peterson Institute for International Economics and of Bruegel is here with me, Steve Weisman, to try and demystify some of that. Nicolas, what is the latest assessment of who won this election?

Nicolas Veron: It's pretty clear that nobody really won. [Former Prime Minister Silvio] Berlusconi had a big success in a way in preventing the center-left from having a clear victory. The center-left will have a majority in the lower house but not in the upper house (the senate), and it will make the formation of the government very complicated

The big winner – actually there is one – is Beppe Grillo and his new Five Star Movement, Movimento 5 Stelle, which is a completely new sort of force. Not unlike the pirate parties in Sweden or Germany. Very apolitical, very young, very connected through Twitter and all of those social media, Facebook, etc.

So that's the big news. I think this is what explains the market reaction. The success of the Five Star Movement will be seen as opening up a new era in European politics where all party systems are really put into question in a much clearer way than say in Spain or France or any other big country elections.

And in a way even more than in Greece because Syriza [the left-wing opposition] -- I think they're not taking that seriously in some ways – it [Syriza] is a Greek far left party – and the Five Star Movement is a new political force.

Steve Weisman: What is the ideological tint to the Five Star Movement? They are anti-establishment, but where do they fit in terms of what Italy is being asked to do by the international lenders?

Nicolas Veron: I think it's really an ideological mix. It's a very unorganized movement. It's not a party. It doesn't want to label itself a party. The leader of the movement, Beppe Grillo, is not a candidate; he's not elected, so he describes himself as a megaphone for the movement, but not a leader. The ideology is like the pirate parties in Sweden and Germany. They were these parties that were formed to protest legislation that curtails of freedom on the web and the freedom to download music and that sort of things. There are some points which they feel very strongly about, like transparency, Internet freedom and access and a number of things around that.

They are critical of austerity of course. Their rallying slogan is to criticize austerity. But this doesn't add up to a program. And even so, the Five Star Movement would say they do have elements of a program. Actually it's a blank slate. It's also a blank slate because frankly there is no party or organization.

So whether that will be discipline, a vote, from those very numerous new members of the Italian parliament, most of which are extremely young, the average age I think is a little more than 30 years. What's their voting discipline? What's their behavior as deputies? What sort of alliances will they will be part of individually or collectively? All this is unknown.

I think this is what explains most of the market reaction. It's really this feeling of uncertainty that we have a new political reality, a new political phenomenon here. We don't know how it works, more than the lack of a government or political instability in Italy per se.

Steve Weisman: But the center left did squeak ahead in the lower house right?

Nicolas Veron: Yes.

Steve Weisman: So they will be asked to form the government first?

Nicolas Veron: Yes, but in the Italian constitutional system, if you have a hung parliament, a different majority in the upper house from the lower house, you have a big problem of governability.

Steve Weisman: Is there any possibility of a coalition between elements of both?

Nicolas Veron: Yes. I think that this is why I'm less pessimistic than many observers in terms of how governable Italy will be after this election, because never underestimate the complexity of Italian politics. And I think a number of views can be made on the basis of almost any parliament in Italy, because national parties are weak. It's actually very much regional or local realities.

People say the center-right voters voted for Berlusconi but actually that's only part of the reality. A big part of the reality is just that they voted for local political establishments which happen to be affiliated with Berlusconi. And therefore I think there is a vast potential for wheeling and dealing in the next few days and weeks, and that makes the outcome unpredictable, but not necessarily as dire as some of the comments we've heard.

Steve Weisman: And the future of (A) austerity and (B) economic reform?

Nicolas Veron: Of course these are the big questions of substance for the euro zone. I think perhaps one welcome outcome of this election result is that it will put an end to the feeling of complacency that you could feel distinctly in Brussels since the end of last year, a "crisis is over" mentality. It's a bit sad to say, but I think this complacency will no longer be sustainable, which is a silver lining in a way.

But the truth is that it's fine to be against austerity. It's more difficult to see the remedies for countries like Italy, which are physically constrained. By the way, Italy has a sizable fiscal surplus, primary surplus, so it's not in the same situation as other periphery countries from a fiscal management perspective.

But I think that the big question is: can you replace austerity with some stimulus that comes from other parts of the euro zones. So if you think of stimulus just in Italy, I don't think it flies.

Steve Weisman: Reform could lead to growth, but what are the prospects for that finally?

Nicolas Veron: Exactly. Here the sad truth is that the multi-government hasn't achieved as much in terms of structural reform as it purported to do and it's not likely that the next few months, given this election result, will bring a lot more in terms of structural reform.

Beyond a few months I don't think we have any visibilities also. So I'm not going to venture any prediction. I think we're clearly in the phase of political and policy volatility in Italy, but I would say from a market judgment investor perspective, it's not like we had great structure reforms the past few months and it is suddenly stopped by this election result.

Actually Italy has not entered the path of structural reforms the same way as France has not entered the path of structural reform. This was already the case before the election.

Steve Weisman: Thank you Nicolas.

Nicolas Veron: Thank you Steve.



