Europe

Italy and reform

Renzi revisited

ROME

The Italian prime minister stakes his credibility on the passage of big reforms—but faces plenty of doubters

THE Sala Verde (green room) in the prime minister's official residence, Palazzo Chigi, in Rome has in the past been the scene of three-way talks between the government, the unions and employers that lasted for days. It was to this chamber that Matteo Renzi, the present prime minister, invited representatives of both sides on October 7th to discuss a revamped employment bill crucial to his government's credibility as a liberalising administration. He gave them each 60 minutes, starting at 8am. "Only once before has [such] an absence of social dialogue been seen in Europe," spluttered Susanna Camusso, leader of the biggest trade union federation. "With Thatcher."

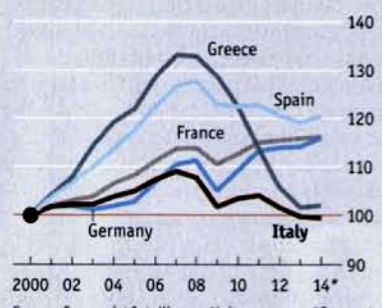
But in Italy, where "face" can be as important as it is in several East Asian countries, appearances are one thing and substance another. The employment bill, which passed its first test in the Senate a day later, is far from Thatcherite. It aims to give most new employees gradually increasing job security, potentially improving the lot of young Italians who now often work only on short-term contracts. But it leaves to enabling legislation the fate of Article 18, an emblematic provision in Italian labour law that makes it almost impossible for companies with more than 15 staff to dismiss workers on open-ended contracts (even if, in practice, most employees are willing to negotiate a settlement).

It is too early to assess the likely impact of the bill. It will be heavily conditioned by further legislation, some of it not due for approval until next year. But it is nevertheless Mr Renzi's first big structural economic reform, and as such it is a much-needed prize for the euro zone's austerity hawks. With Italy mired yet again in recession and GDP in real terms below its level in 2000, never mind 2008 (see chart), Mr Renzi is desperate for the hawks to take a more flexible view of his budget deficit so as to sustain demand. "Either we promote growth, or the euro is finished," he says.

This week the IMF reduced its forecast for Italian GDP growth this year to minus 0.2%, from plus 0.3% previously. Not even Italy's innately optimistic prime minister expects it to get above 1% in 2015. His country's public debt, already 135% of GDP, continues to grow despite relatively tight fiscal policy.

Bottom of the scuola

GDP, 2000=100



Source: Economist Intelligence Unit *Forecast

One reason for the brevity of Mr Renzi's talks with the unions and employers was that he wanted them out of the way before racing his employment bill into the Senate so as to coincide with a one-day European Union jobs summit that he was hosting in Milan on October 8th (Italy occupies the rotating EU presidency until the end of the year). To get the bill approved in the face of misgivings on the left of his Democratic Party (PD) and in other parties, Mr Renzi staked the fate of his government, turning the vote into one of confidence.

The result was a tumultuous session in the upper house. No fewer than 26 PD senators put their names to a document criticising the lack of detail in the bill. Beppe Grillo's Five Star Movement (M5S) also objected to the government's being given such wide powers to frame the enabling legislation. Some M5S senators threw coins at the government benches; their leader was expelled from the chamber. A lengthy break in the proceedings failed to calm the mood. At one point, a book was hurled at the speaker after he refused to postpone the vote. The bill eventually passed with 165 in favour and 111 against.

The passage of this and other reforms is vital if Mr Renzi is to convince Germany and other euro-zone austerians to cut him enough budgetary slack in order to boost growth. For the time being, and unlike France's leaders, he says he is prepared to stick to the euro zone's deficit ceiling of 3% of GDP: "An absolute must, for reasons of credibility," he insists. Yet Italy was originally meant to get the deficit this year down to 2.6%. It stands to lose some EU cofinancing if its deficit rises above 3%.

Mr Renzi does nothing to disguise his approval of France's decision to break the rules. "I prefer a France with 4.4% to Marine Le Pen as president next time," he says. The way that he now tells it, the employment bill passed by the Senate will be the first in a stream of structural reforms, all of them due to be approved by a new deadline: April 2nd 2015. After that, he is not giving any guarantees of what Angela Merkel, the German chancellor, and her fellow-hawks would doubtless consider good behaviour. "Over the next six months we want to conclude practically everything, and then we can start to speak frankly," Mr Renzi explains.

In the meantime, the signs are growing that his government is drafting an expansionary 2015 budget, with the attendant possibility that Italy's deficit could overshoot 3% long before next spring. A government document approved on September 30th suggested that spending cuts planned for next year had been whittled down from an initial €15 billion-16 billion ($19 billion-20 billion) to just €5 billion.

Mr Renzi ("I prefer arrogance to a lack of ambition") has never been short of self-confidence. "My ambition [for Italy]", he declares, "is not to do better than Greece but to do better than Germany." Yet his room for manoeuvre is cramped by the legacy of his predecessors' profligacy. Italy's public debt amounts to almost €2.2 trillion. Only the undertaking of a compatriot, Mario Draghi, the president of the European Central Bank, to do "whatever it takes" to save the euro has succeeded in containing Italy's borrowing costs. This week, its benchmark ten-year bonds were yielding a mere 2.34%, less than Britain's and America's.

At least two things could upset this delicate—indeed, somewhat improbable—balance. It remains to be seen how long investors will agree to accept such low interest rates on the debt of a country whose deficit is no longer shrinking. And Mr Renzi, in a rare admission of concern, admits to being worried by deflation, which is already discernible in the statistics for August. Deflation would automatically raise the burden of existing debt and also push up the real costs of borrowing. A recent study put the risks of deflation in the euro zone as a whole next year at around 12%, but in Italy alone at 35%*.

Not that the ebullient, boundlessly confident Mr Renzi stays concerned for long. "If I don't change the country," he says with a shrug, "I change jobs." ■

* "Italy slips towards deflation, but better news elsewhere". Oxford Economics