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Why Italy’s stagnation could be the future for the entire eurozone

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Monetary reform alone can’t kickstart the European economy. It needs something more radical
'The European economy as a whole needs expansionary policies together with credit, industrial and regional policies. None of this is on the horizon.”

Photograph: Daniel Roland/AFP/Getty Images

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This summer Italy fell into a triple-dip recession. After the 2008/09 collapse, the economy stagnated, heading back into recession during 2011 and never really recovering. The philosophy of Giulio Tremonti, who was the economic minister at the time, was to wait and see, until speculation killed Berlusconi’s government. Prime ministers Mario Monti and Enrico Letta followed Brussels’ self-defeating diktat for fiscal rigour, but even with moderate deficits the public debt/GDP ratio soared.

The situation remained under control only thanks to the zero rate of interest and rhetoric by the European central bank president, Mario Draghi. Then came along Matteo Renzi, and Italian economic policy was all talk, talk, talk. While turning the screw of authoritarian parliamentary and electoral reforms, future lower taxes and liberalisations are promised to compensate for public cuts and to attract foreign investments. The €80 monthly tax break to lower-paid workers did not raise household consumption, and was instead spent on tariffs and local taxes.

Yet in the past few weeks the outlook has changed, with 2014 second-quarter data showing France flat and Germany experiencing negative growth. Greece, Spain and Portugal registered rosier figures only because they were recovering from severe austerity. The eurozone cannot but be driven by the three biggest economies alone. This is a continental crisis within an anaemic global economy. However, an old Gramscian truth about Italy must be remembered: the “backwardness” of its capitalism is paradigmatic. Europe’s exit from the crisis needs the same policies that Italy needs, and without them Italy’s stagnation is the future for the entire continent.

Many now think austerity has gone too far: upward elasticity on monetary or fiscal policy is essential. The suggestions go from quantitative easing (hopefully driving down the euro), and/or the ECB funding for lending, and/or a relieving of public finance constraints. Even Draghi’s speech at the US Federal Reserve conference in Jackson Hole, Wyoming, recognised this. This often goes together with a plea for supply-side structural reforms, such as labour flexibility and liberalisation. Others argue that trade imbalances are the main problem. Higher German internal demand, through fiscal stimulus and/or higher wages, would boost the GIIPS countries (Greece, Italy, Ireland, Portugal and Spain). A radical view is exiting the single currency to restore national economic sovereignty.

There is something sensible in all these propositions. Austerity is choking Europe. If the ECB buys assets it may improve state and firms’ balances. Higher liquidity could find its way to expenditure, and also revert the credit crunch plaguing small and medium firms. Trade imbalances, without counteracting policies, create regional disparities and social imbalances, leading to an explosive fragmentation. These policy outlooks, however, are wishful thinking, because in them the state is subsidiary to the private sector and the changes in the European landscape are ignored.

But monetary reform alone can’t kickstart the economy. Individual government deficits should be targeted by the ECB, providing the “big push” that private investment cannot give the biggest economies. Only in this atmosphere will the balance-sheet recession and the squeeze of private demand be overturned. If internal demand and production increase more than productivity, the consequent higher employment could ground consumption on income rather than on debt.

In the past 15-20 years, the European economy has gone through a deep financial and industrial transformation. Let us look at the financial side. Eurozone countries share the same payment system. There is nothing unusual per se in internal imbalances: they are absorbed by the banking system and do not lead to problems for the single currency. Balance sheets of banks and intermediaries are more integrated, and the public debt is managed on the bond market. On the industrial side, Germany spread its industrial and trade network so that increases in demand would be transmitted to a transnational value chain located in eastern and central Europe.

Demand reflation or wage increases do not guarantee enough exports for the periphery anymore, which may still need price-inelastic products from the centre. The exchange rate is a toothless weapon. From the financial side, exit countries need a stronger currency. A devaluation jeopardises the banking system and the management of public debt, and may not be so magical as hoped on the trade balance.

The European economy as a whole needs expansionary policies together with credit, industrial and regional policies. None of this is on the horizon. Changes must appear in continuity with the dominant consensus, as President François Hollande’s firing of the French economic minister this week shows all to well.

Draghi’s design to build Europe through a sort of “revolution from above” requires an ongoing crisis to weaken internal resistance within the capitalist class. An alternative social and democratic Europe “from below” meets the problem of the absence of a subject fighting for it. Though this is not good news, the euro may then actually end: not with a bang, but a whimper. But as the saying goes, “it ain’t over ‘til it’s over”.