

GLOBAL INSIGHT

ROME



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Italy's referendum holds key to survival of currency union

Europe's faultline runs through Italy. Such was the candid opinion of one participant in a conference held last weekend by Eliamep, an Athens-based think-tank. Few other participants dissented.

By "Europe" everyone understood, primarily, the 19-nation eurozone. For the question on the minds of European policymakers is where, and to what extent, political, financial and economic contagion may spread from Britain's June 23 vote to leave the EU.

The sharp falls in Italian banks' share prices since the British referendum indicate where financial markets smell the danger of contagion. But Italy is the focus of attention not only because of its undercapitalised banks, colossal public debt and miserable economic growth.

Rather, EU governments and the markets sense trouble ahead in the way that Italy's uncertain political outlook feeds into these problems, making them even harder to tackle. Their paramount concern is the referendum on far-reaching constitutional reforms that Matteo Renzi, Italy's centre-left prime minister, plans to hold in October.

If voters reject these reforms, Mr Renzi says he will resign. Naturally the ever inventive, insouciant premier is free to retract his promise. However, he has staked much on this referendum, having described the reforms as essential for Italy's reconstruction as a responsibly governed nation.

Defeat would damage Mr Renzi and risk driving Italy into prolonged political and economic instability. Confindustria, Italy's employers' group, predicts that defeat would cause the economy to shrink by 0.7 per cent in 2017 and 1.2 per cent in 2018.

Apart from putting Italian banks under more stress, such a recession would undo the good work of Mr Renzi's government since 2014 in restoring a modicum of economic growth and modestly reducing unemployment. In a country that has recorded almost no growth since it became a eurozone founder member in 1999, and whose public debt is more than 130 per cent of annual economic output, this would be a heavy blow. Equally important, defeat for Mr Renzi might

boost the fortunes of the anti-establishment Five Star Movement. This party, founded by blogger-comedian Beppe Grillo, opposes the constitutional reforms. It is wholly inexperienced in government at national level, but it showed its strength last month by winning mayoral elections in Rome and Turin.

At present, the movement is just a few percentage points behind Mr Renzi's Democratic party (PD) in opinion polls. Parliamentary elections are due in 2018 and only a rash forecaster would write off the Five Star Movement's chances. A referendum defeat for Mr Renzi may place the fate of Italy, a nation crucial to the survival of Europe's currency union, in the hands of an idiosyncratic party that merrily talks of pulling the country out of the eurozone.

Yet a referendum victory for Mr Renzi would not eliminate all risks. The essence of his reform proposals is that Italy should dismantle its bicameral legislature, established in the 1948 constitution, and concentrate power in the lower house. Meanwhile, an electoral law passed by his government guarantees an absolute parliamentary majority for the party that wins a national election.

Mr Renzi's advisers defend these reforms on the grounds they will cure Italy of its chronic governmental instability. More than 60 governments have come and gone since 1945, holding office, on average, for little more than a year each. Should the reforms take effect and lead to a PD victory in 2018, a five-year spell of strong government dedicated to economic reform might indeed ensue.

But if the Five Star Movement won, it would find itself — thanks to Mr Renzi's reforms — in firm control of a legislature reshaped to emasculate opposition to the ruling party.

Several banana skins lie in the EU's path over the next 12 months, from a potential victory for the far right in Austria's restaged presidential election in September to next year's Dutch legislative and French presidential elections. But Italy's referendum may be the most slippery banana skin of them all.

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