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Comment

It is not about Berlusconi

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The center-right coalition of Silvio Berlusconi is on its last legs. His principal advisors are telling him that he cannot hold onto the votes. The crisis in Italy's sovereign debt markets has so far achieved what the opposition could not accomplish. Berlusconi may hold onto power a few days or weeks longer, but he has already received his economic vote of no confidence.

Unfortunately for Italy, the economic crisis does not end there. Even under the best of conditions – where Berlusconi leaves quickly and quietly so that power can shift from the center-right coalition to a broadly-based technocratic government – Italy remains hobbled by its endemic institutional indecisiveness. Worse, the bond markets are well aware of this fact, and so are the Italians themselves.

The loss of confidence in the bond markets was never only – or even principally – about Berlusconi. Italian bonds sold at reasonably high prices throughout nearly two years of scandal from April 2009 through June 2011. It was only in July 2011 that the markets started to turn against Italian bonds and it wasn't until the end of August that Italian bond yields moved decisively above those in Spain. Moreover, when first Standard & Poor's and then Moody's downgraded Italy's credit rating in September and October, they complained not only about the ineffectiveness of the government but about the profound rigidity of the public sector. These rigidities slowed decision-making and created unacceptable 'implementation risk' in the jargon of the agencies.

In making this claim, the ratings agencies confirmed what conscientious investors have long known to be the truth. Italy is only creditworthy so long as the Italians retain confidence in their state. The country has more than enough wealth and savings to cover what the government borrows. But should the Italians lose confidence in their political leadership, then the state's finances will collapse in the flight to safety. Italy's huge stockpiles of household wealth would quickly transform into a capital flight that would draw down on deposits in the domestic banking system and so send sovereign debt markets into a rout.

Italy's participation in the euro and its openness to international financial markets makes such a flight to safety ridiculously easy. Foreign banks like Deutsche Bank are available in every decent-sized city. The Deutsche Bank web site advertises 280 branches for routine business and another 109 for private banking. Inside, they have staff who are more than willing to help prospective Italian clients move their investments, savings and current accounts. You can also open a current account on-line. In this way, Italians can put their money abroad and still have it close to home.

Nothing could be simpler.

Hence the only way to stabilize Italy is to restore the confidence of the Italians in their public institutions. That will not be so easy so long as the prime minister denies there is a problem. The rumour that circulated on

2 November (subsequently vociferously denied by the government) that the state would charge each current account in the country a special tax in the neighbourhood of €300 makes things harder still. And the situation will not improve much even if the prime minister is replaced by a coalition of fractious and posturing party leaders, no matter how broad.

The Italian state will have to re-earn the confidence that it lost in the markets. And to do so, it will have to restore the faith of the Italian people. That will be difficult to accomplish. So while Berlusconi may go, this crisis still has some way to run.