Democracy, Italy and the euro cage

pera-goers streaming out of La Scala in Milan last Thursday night turned on their phones to discover that Italy finally seemed to have a new government.

The opera they had been watching, Aida, ends with the doomed lovers dying together, while locked in an underground prison. Some members of Italy’s new government might see that as an apt symbol of their country’s fate inside the European single currency. Paolo Savona, who will serve as Italy’s new Europe minister, has described the euro as a “German cage”.

However, Italy’s new administration has promised to stay inside the cage for now. In fact, the coalition between the League and the Five Star Movement was only accepted by Italy’s president once the europhobic Mr Savona was blocked from taking up the even more sensitive job of finance minister. In a further sign that the League is backing away from its longstanding flirtation with leaving the euro, a road sign proclaiming “Basta Euro” that stood outside the party’s headquarters was painted over last week.

For students of European politics, all this looks familiar. A populist government has once more been forced back into EU orthodoxy, by a combination of Brussels, Berlin and the markets. The only novelty is that this time it happened even before the new Italian government had sworn in.

The EU’s critics have long argued that this pattern illustrates that the bloc is, at heart, undemocratic. Mr Savona made this case in a recent book, claiming that the Italian government led by Silvio Berlusconi was brought down in 2011 by Franco-German pressure and that this was “an undemocratic act typical of the philosophy that dominates the EU’s actions”.

This argument has been made with increasing frequency in southern Europe, as the euro crisis has developed. Yanis Varoufakis, the former Greek finance minister, has likened the EU and the IMF’s pressure on the government of Cyprus in 2013 to a “coup”. In Mr Varoufakis’s mind, this was a rehearsal for the successful financial and economic pressure that was placed on Greece to reverse course after the country had voted to reject the terms of an EU bailout in 2015.

This debate over whether the EU is anti-democratic is bound to resurface in Italy. Even if the Italian government steers clear of any effort to leave the euro, it still seems likely to clash with the EU authorities over both fiscal policy and immigration. Matteo Salvini, the League’s leader and Italy’s new interior minister, has promised to speed up deportations and detentions of up to 500,000 illegal immigrants — which could cause angst in Berlin, as well as potentially violating EU law.

The League also wants a flat tax of 15 per cent on income. Five Star, its coalition partner, has argued for a universal basic income. Those policies together are a recipe for blowing up the EU’s 3 per cent limit on national budget deficits.

If the government in Rome ignores the EU’s fiscal rules, the reaction from Brussels and Berlin will be harsh. When Italy then finds itself under pressure from the bond markets, the likes of Mr Varoufakis and Mr Savona will return to the argument that the EU elite is conspiring against the will of the people.

The crude version of this argument does not make much sense. The biggest constraint on Italy’s freedom to cut
taxes and boost spending is the level of the country's debts rather than the EU’s rules. Italy’s debt stock is over 130 per cent of gross domestic product. In absolute terms, it is the third-largest in the world, after the US and Japan. Any sense that Italy is giving tip on fiscal discipline — or, even more dramatically, planning to return to the lira — would probably provoke an Italian debt crisis, regardless of the statements of the EU.

But there are other aspects of euro membership that really do restrict Italy’s freedom to run its own economy. By joining the euro, Italy lost the ability to devalue its currency to restore competitiveness; or to stoke inflation to erode the value of its debts.

Some would argue that these were bad habits that Italy needed to get rid of. But after a decade of weak economic growth, many Italians look back with nostalgia on the “bad old days” of inflation and devaluation.

However, those policies could only be returned to if Italy left the euro. And any effort to do that and return to the lira is likely to provoke capital flight from Italy — and a financial crisis. In that sense, the euro is a “cage”. But the cage is inherent in the original design of the currency. The EU’s fiscal rules are merely an additional feature.

What is more, the Germans are also locked in the cage alongside the Italians. While the German economy has clearly prospered mightily, compared with the economies of much of southern Europe, Germany’s future is inextricably bound up with that of its less fortunate neighbours. A financial crisis provoked by the break-up of the euro would not be contained to southern Europe. German banks and savers would swiftly find themselves at risk. The resulting economic conflagration might well destroy not just the single currency, but the EU itself — and with it more than 50 years of German foreign policy.

At that point, the appropriate opera would not be Verdi’s Aida, but Götterdämmerung by German chancellor Angela Merkel’s favourite composer, Richard Wagner.

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