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Mario Monti Was a 'Bubble'; Now He Can Lead Italy

By Francesco Giavazzi and Franco Debenedetti - Dec 21, 2012

A highly indebted country such as Italy depends on its reputation. Lose it and you fall into a “bad equilibrium,” in which high [interest rates](#) make the debt unsustainable and default becomes a self-fulfilling prophecy.

This is what happened to Italy in the summer of 2011, when then Prime Minister [Silvio Berlusconi](#) and his ministers lost what remained of their reputations and the cost of Italian debt soared, putting at risk both the future of Italy's economy and of the euro. The only way out was for Italy to appoint a prime minister who enjoyed a strong reputation in the eyes of the world and would therefore be able to repair Italy's.

Mario Monti was such a figure. His appointment, together with the [European Central Bank's](#) decision to [pump liquidity](#) into the euro-area banking system, saved Italy and the euro.

Not so fast, though. One way to think about what happened and the role that Monti played is through the parallel of a bubble -- an image that Financial Times columnist Wolfgang Muenchau used this month. Financial bubbles can have positive effects. Some are instrumental in jump-starting a young industry -- think of the dot-com bubble more than a decade ago, or of the railway-construction [bubble](#) in the U.S. at the end of the 19th century.

Monti's bubble was reputational. The prime minister's impeccable standing and the tough measures he adopted during the first month of his government were instrumental in getting [Italy](#) out of the bad equilibrium into which it had fallen. In the year since, however, none of Italy's deep-rooted problems has been solved. Today, Monti submitted his resignation, and a [national vote](#) for a new prime minister is expected in February.

Failure's Seeds

Monti's good reputation bore the seeds of his failure to reform Italy. Within a few months of his appointment -- and thanks also to the ECB's long-term refinancing operations -- the spread between Italian and German sovereign bonds halved, shrinking to 0.28 percentage point from 0.55 percentage point. These narrower spreads avoided the threat of default, but also reduced pressure on Italy's parliament to adopt the legislation that the government was proposing to make the economy more competitive. As a result, Monti's reform program was delayed and diluted.

The immense credit that Monti enjoyed and the favorable conditions within which, thanks to the ECB, his government operated weren't used to reform or to rein public spending, which in Italy exceeds 50 percent of the country's gross domestic product. Instead, Monti relied solely on a tax

increase, which eventually contributed to a deep recession.

Italy's problem is growth -- and not in the same sense as for most other countries. In Italy, as in [Japan](#), lack of growth has been a problem for almost 15 years. In the past 12 years, Italy expanded at an average rate of less than 0.2 percent annually, compared with the 1 percent a year achieved by the euro area as a whole.

During that period, Italy had 10 governments. Each of them acknowledged the growth problem and committed to solving it, but none succeeded. On one occasion failure was attributed to the power of unions; the next time it was the teachers; then came the students' parents, the judges, the notary publics and the taxi drivers. It can't be that Italy is unable to reform because of taxi drivers.

We Italians thought for a time that it all hinged on the way we elect our representatives in the parliament. So, in 1993, Italy replaced proportional representation with a first-past-the-post system. The result was, to be kind, meager. The problem is much more deeply rooted. It has to do with a country that for more than a century looked to the state to solve its problems, and whose constitution resulted from a compromise between Catholics and Communists.

State Dependence

As the central banker Tommaso Padoa-Schioppa once wrote, the Italian constitution could accommodate anything, even a Soviet republic. For a large fraction of Italians, words such as "competition," "merit" and even "private" still bear negative connotations.

These are the reasons for which, in Italy, reforms typically are introduced only under external constraints. So it was in 1992, after the crisis with the European exchange-rate mechanism, when Italy was forced to devalue and the government of Giuliano Amato started reforming pensions and loosening the grip of the state on banks and industries. So it was again in 1998, when the government of [Romano Prodi](#) sold a huge amount of state assets in order to meet the Maastricht Treaty's criteria on joining the euro. Similarly, rising borrowing costs drove Monti's government to overhaul pensions and (very timidly) [labor laws](#).

As usual, though, the scope of the most recent changes introduced was the minimum required to exit the crisis of the day. Monti's government reduced the [budget deficit](#) to less than 3 percent of GDP, by increasing the tax burden to the tune of 4 percent of GDP. Virtually no cuts to [government spending](#) were made.

Italy will change only when Italians have the will to do so. That, in turn, will happen only when they are convinced that change is in their interest and that to prosper in today's world they need a different set of rules, a different relationship between citizens and the state, and a different level of personal responsibility in taking care of their individual futures.

In a democratic society, this is the task of politics and elected politicians. Italy needs a politician such as [Charles de Gaulle](#), and Monti is no de Gaulle, not least because he has never been elected. A year ago, Monti was appointed prime minister. In 1995, he was sent to Brussels by then Prime

Minister Berlusconi to serve as European commissioner. He is a technocrat.

“Tecnico,” the name that Italians gave to Monti’s government, has two different meanings: One is “technocratic,” indicating that it is a government independent of the special- interest groups represented by political parties; the other meaning is “technical” and rests on the popular idea that difficult problems have technical solutions.

Technocrat Illusion

The widely held assumption was that to overcome deep-seated cultural hurdles and political obstacles, it would be enough to hand power to a technocratic government. This was an illusion.

Most of the changes Monti introduced, with the possible exception of the pension reform, have been timid. The legislation adopted was, more often than not, poorly written. In his government, neo-Keynesians coexisted with believers in state intervention and a few supply siders and free-market advocates. Privatization never made it onto his program. His government used [Cassa Depositi e Prestiti](#), a state-controlled off-balance- sheet vehicle, to “privatize” a bunch of state-owned companies: [Snam Rete Gas](#), Fintecna, [Fincantieri SpA](#), SACE SpA and Simest SpA.

“Tecnico” also has another meaning in Italian, one that refers to Plato’s “Republic” in opposing the (supposed) wisdom of philosophers to the common sense of the people. Monti’s “Republic” was too far from the common sense of the people to be able to influence their values. How can people’s values be changed, their interests put in a different perspective, their hopes set on a different outcome, if there is a distance between government and demos, between logic and concrete needs? The very confidence that helped create the Monti bubble proves to be its limit and the cause of its deflating.

[Mario Monti](#) has [now decided](#): In the coming general election, he will campaign at the head of a group that bears his name and adopts his program. He is now a fully fledged politician and can overcome the drawbacks of his “technical” government. If the group he supports wins the election, thanks to his skills and his recognized virtue, he will have a chance to transform Italy and accomplish what he hasn’t been able to do so far.

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