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Political capital matters in the case for fiscal reform

Alberto Mingardi, director general of the Istituto Bruno Leoni in Milan and adjunct scholar with the Cato Institute, Washington, warns of moral hazard.

Though the concern is that governments may not manage their fiscal burdens with only a limited mutualisation of debt, I see the issue quite differently. My fear is that, with a deep mutualisation of debt, the reform process in member states will stop in its tracks.We know that successful federations feature regional bonds without bailout guarantees, as in the US, for example. The current crisis has its roots in irresponsible behaviour by European member states. The inordinate growth of public spending left some with too much public debt. Cutting spending is difficult in modern democracies but not impossible. Northern social democracies such as Finland and Sweden succeeded; Canada (now considered a country relatively resilient to the global crisis) did it in the 1990s; and Latvia and Estonia tightened their belts more recently.

A substantial mutualisation of debt would greatly diminish the incentives of member states to put their public finances in order. Political classes are short-termist almost by definition, and it will take tremendous leadership and commitment to restore public finances without the spur of market discipline.

German voters are sceptical of European “solidarity” because they sense that they will be handed the bill. However, a perhaps more substantial – and less subjective – worry on mutualisation is that it will lull the system into a false sense of security. Moral hazard is an important component of the current crisis.

Most Italians do understand that the crisis is the result of mismanaging our public finances and that public spending is huge: €800bn a year, including debt interest. Italians also appreciate they are paying Swedish rates for their public services, without Swedish standards. Stories about the government wasting money are daily media fare. There is no sense in the population that “this is just the Italian way”. Italians have known they need change since at least the early 1990s, when it became clear that extensive governmental intervention in the economy bred corruption.

However, what Italy most needs is political capital. It is one of those moments in history when a society can be amazingly honest in the diagnosis of its own ills but lacks the doctor to administer the cure.The eurocrisis may stoke populist extremism in Italy simply because the country seems unable to offer a different political response. Beppe Grillo, a comedian-turned-politician, has around 20 per cent of votes. Silvio Berlusconi, after a few months of benevolent silence, is now returning to the political arena and aiming to capitalise on uncertainty by promising a quick Italian exit from the euro.

The technocratic government led by Mario Monti was good at diagnosis but bad at treatment. Reforms were too slow and Italian taxpayers were squeezed like lemons in the belief that fiscal consolidation via tax increases was the quickest and the most practical avenue in the emergency.

The old Italian political class lacks legitimacy because of the scandals around Berlusconi and also because it navigated through the past 20 years without addressing structural problems. The technocrats in government lack legitimacy too – nobody elected them and they did not prove to be particularly efficient, or fair, in their government action.

Thus, Italians may vote for improbable, populist options even though they have a clearer view of the crisis than their voting preferences may suggest.

Alberto Mingardi