The Economist

Italy’s troubled economy

In need of reform

Worrying signs of slippage in Europe’s slowest-growing economy

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NOT long ago, he was the belle of Europe’s disorderly ball. Of late, he has become everyone’s favourite target. The latest critic to line up for a shot at Italy’s prime minister, Mario Monti, is the European Commission. In the event, some of the stiffest criticisms in its annual economic report card were scrapped or diluted (eg, improving the recovery of unpaid taxes is no longer “still insufficient” but instead “a key challenge”). Yet the report still betrayed worries that Mr Monti’s non-party government is losing momentum.

Elena Carletti, professor of economics at the European University Institute in Florence, agrees that ministers have more to do. But she says that already “they have done much more than previous governments.” And she feels Brussels may have underestimated the psychological impact on consumer spending of the government’s efforts to stamp out tax evasion: “a perception among people that the government has cracked down and that they have to be more careful”.

Brussels is especially concerned about the effectiveness and efficiency of much of Italian public spending. It is not alone. On May 24th Giorgio

Squinzi, the new president of Confindustria, the bosses’ federation, said that his members could not understand “why the state cannot save and make cuts the way businesses do and the way households do”. One reason is that cuts aggravate recession. But another is that the trade unions are especially strong in the public sector. The biggest and most intractable of them has historic links with the centre-left Democratic Party (PD). And that makes bureaucratic reform and deregulation as much of a political hot potato as tax collection, which squeezes the disposable incomes of the self-employed from whose votes the other big party, Silvio Berlusconi’s People of Freedom (PdL), has long profited.

Last month Mr Monti ordered a spending review to identify cuts of €4.2 billion ($6.6 billion). He also named Francesco Giavazzi, an academic and critic of his policies, to advise on cutting subsidies to industry. The appointment did nothing to curb the professor’s tongue. Mr Giavazzi recently published an article in *Corriere della Sera* likening the spending review to a “timid mouse” and noting it would examine only a tenth of public spending. He and Alberto Alesina, a fellow academic, worry that Italy risks “twirling into a spiral of taxes, recession, deficit and yet higher taxes”.

In a sense, the country has been in peril for ten years, as taxes and public spending have both risen even as GDP has stood still (see chart). The commission is mildly optimistic on future growth (it expects a 0.4% increase in GDP next year). In an earlier report, the OECD was gloomier, forecasting that the economy would shrink by 0.4% in 2013, and that between 2012 and 2017 GDP would grow by an annual average of only 0.5%, the lowest rate among the 41 countries it surveys.

If Italy is to get out of these doldrums, the government must surely show more courage on reforms. It was put into office to pass the measures that the politicians had shrunk from. So far, there has been little sign that either big party is ready to topple the government and assume responsibility for pitching Italy into a new whirlpool. Yet in recent months, Mr Monti and his ministers have seemed to be paying more heed to the parties and, by implication, to the vested interests that lurk behind them. A decision this week to use confidence votes to ram through parliament the government's already-diluted labour reforms may be a sign that it is ready to take a firmer approach. It needs to.

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