Italian Debt Crisis Erupts: Is this a Greek Debt Crisis Writ Large?

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This past week, as the Italian populist party, '5-Star', began to form a government, suddenly the realities of the Italian debt (government and bank) and the 7 year stagnating Italian economy got the attention of media, investors and politicians. 5-Star and its parliamentary ally, the League, campaigned during the recent Italian election on a program to unilaterally stimulate the Italian economy by fiscal policy spending and tax cuts and, if necessary, to leave the Eurozone system in order to take back control of its own monetary policy. Under the Eurozone rules, Italy, like all Eurozone members, gave up independent control of its banking system to the European Central Bank and other pan-national European institutions like the European Commission. Under Eurozone rules, Italy was also limited to a tight cap on its fiscal spending.

With no independent monetary policy and strict limits on its fiscal policy, all Italy could do in a recession or financial crisis, such as 2008-2010, was borrow money from the ECB and the Euro Commission (with help from the IMF–together the three pan-European institutions called the 'Troika'). As it borrowed its government and private debt escalated. When the Eurozone slipped into a double digit recession in 2011-13, Italy's crisis deepened. It borrowed still more, to pay the interest on the debt it had previously borrowed–the interest payments going to the Troika, and from the Troika to the northern Europe banks (especially Germany) from which the Troika in turn raised funds with which to lend to Italy (and other economies during the debt crises in Europe 2010-2015).

By 2013 Italy's real economy had collapsed by 10% below 2008 GDP levels, and unemployment rose to near 20%. Italy government's debt to GDP has risen from 100% in 2008 to 130% by 2017, and its real economy has stagnated since 2013, today still at 5% below 2013. Italy thus has never recovered from the 2008-09 crash and subsequent 2011-13 double dip Europe recession.

To pay for the interest and principal on its rising debt load, Italy was required by the Troika to impose fiscal austerity on its populace. Successive Italian governments extracted the surplus with which to pay its rising debt, causing the Italian economy to stagnate. This vicious debt cycle since 2011 has locked Italy into a debt-imposed recession and stagnation–not unlike Greece and other Euro periphery economies.

Italy was not alone in this self-sustaining debt depression cycle. Greece, and indeed much of the rest of the European southern periphery, found itself in a similar situation. Greece was thrust into what is now a ten year economic depression, with severe austerity imposed on it by the Troika. That depression has still not ended, with Greece's GDP still 20%-22% below 2008 levels.

The Troika imposed austerity extracted income from Greek society to pay the interest on the debt owed to the Troika, to northern Europe banks, and to international bond investors. The first Greek debt crisis in 2010 was followed by a second in 2012, as more Troika debt was provided to 'roll over' and pay the old 2010 debt. The crisis erupted again in 2015, as still more debt was provided to pay for the 2012 debt. Throughout the period, Greek workers, small businesses and consumer households were squeezed to acquire the money capital to pay the Troika-investors-bankers. Today Greek debt as a percent of GDP is virtually the same as it was in 2012. And another round of debt and austerity is now on the agenda starting August 2018, as the 2015 debt deal expires. All that's changed is that private bankers and investors will now 'roll over' the debt this time and repay the Troika (contrasted to Troika debt roll over that repaid the private investors and assumed their debt in 2012). Austerity continues nonetheless; only who gets paid the interest and principal on the Greek debt will change. (For my book analyzing this history of the Greek debt crisis, see 'Looting Greece: A New Financial Imperialism Emerges', Clarity Press, October 2016), and my series of articles on this blog since 2015.)

What we're witnessing in Italy now is a repeat of the Greek debt crisis, with a populist government (5-Star) attempting to extricate itself from the economic vice-grip of the Eurozone and its pan-national institutions (European Commission, European Central Bank, IMF) that have served as the institutions for extracting payments to cover the debt it has provided Italy since 2010 to stay afloat (i.e. stagnate) economically. Austerity was imposed on Italy as well as Greece beginning in 2010. But being a larger economy, with more sophisticated pro-Eurozone capitalist parties, Italy was kept within the Euro fold and the Italian debt crisis was contained–but no longer. This changed with the election of the populist 5-Star movement and its attempt to assume control of government fiscal and monetary policy.

The case of Italy is more dangerous to the Eurozone than was (and is) Greece. Italy's government debt is 130% of GDP, but its private sector and bank debt is potentially more destabilizing for the Eurozone. No less than $500 billion in non-performing bank loans hang over the private economy in Italy (nearly $2 trillion still Europe wide). Europe never removed the bad debt from bank balance sheets after 2008. That's why its economy continually stagnates and is unable to recover fully from the 2008 crash. Recoveries are short and shallow and stagnation (and goods price deflation) is a perpetual problem.

The Euro periphery is even more severely impacted. The European Central Bank's 'QE" free money injections since 2015 have not gone into real investment, and especially not been directed the southern periphery where it is most needed. Most of the ECB free money has gone to German, French and other northern Europe banks that didn't need it, and they in turn have mostly loaned it to Euro financial investors who have sent a good part of it offshore to US markets. Europe stagnates as a consequence.

The crisis in Italy has just begun–and it is occurring as the Eurozone (and UK) economies are again beginning to stagnate, and possibly head for a 'triple dip' recession in 2019. The populist 5-Star party, should it be allowed to form a government, is declaring it will not abide by Eurozone rules limiting its fiscal stimulus spending; it is also raising the possibility of assuming independent control of its monetary policy. For the latter, however, it will have to leave the Euro and establish its own currency. Both these policy directions have the Troika and the northern Eurozone elites increasingly worried.

When the Greek populist party, Syriza, came to power in 2015 it also declared it would do the same as 5-Star is now advocating. Within six months, however, the Troika smashed Syriza. The ECB sabotaged Greek banks and drove the economy even deeper into depression by mid-2015 to put pressure on Syriza and get it to back off its policies. Syriza party leaders–Alex Tsipras and Yanis Varoufakis–caved in by the summer 2015. Varoufakis was sidelined in the Syriza by June and Tsipras ignored the Greek referendum he himself had called in July and cut a deal with the Troika to extend Greek debt and austerity measures in August 2015. Ever since August 2015, Syriza and Tsipras have gone along with whatever the Troika has demanded, as more and more austerity was proposed on Greek workers annually with every review of the Greek 2015 debt deal.

All the political parties in Greece have now lost legitimacy, including the once populist challenger, Syriza. Now Greeks are taking to the streets in widespread strikes and demonstrations, as another round of Troika-investor austerity and debt is coming up in August 2018.

The key question is whether the Italian populist party and challenger to the banker-Germany dominated Eurozone system will fall into the same trap as Syriza? The Eurozone elites will attempt to maneuver and put increasing pressure on 5-Star to bring it to heel; to drop its insistence on pursuing independent fiscal stimulus or moving toward re-establishing an independent Italian central bank (and private banking system) and eventual currency. With no fiscal of monetary independence, 5-Star and Italy are at the mercy of the Troika and Eurozone(Germany). What will be a 5-Star government's fiscal stimulus policy once it forms a government? Will it back off its program to assert independent central bank control–or to leave the Euro if necessary?

The Troika and Eurozone elite will have a harder time taming Italy than it had with Greece. Italy's private banking system is nearly insolvent. With a $500 billion nonperforming loan overhang, banks like Monte dei Pasche, Banco Populare, Banco BPM, and even Banco Intesa are fragile,if not technically insolvent (aka bankrupt). Efforts to pressure Italy's new government by withholding lending to Italy's central bank, and in turn private banks, will only exacerbate the crisis of the Italian banking system further. Moreover, northern Europe banks–especially French banks Credit Agricole and BNP Paribas–are deeply integrated and exposed to Italian banks. Contagion could easily spread from Italy to France and beyond. The Troika-Germany will therefore probably go softer with Italy than it did with Greece initially. It will likely allow Italy to exceed Eurozone fiscal spending caps, and the ECB will likely provide even more debt to Italy's government and private sector.

This response is not assured, however. It may try to apply its 'Greek Debt' strategy to Italy as well. Popular resistance could then spread throughout the Eurozone southern periphery. And that instability will further ensure the Eurozone economy will slip into triple dip recession in 2019–just as this writer is predicting the US economy will do the same.

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