

Italy votes on constitutional reform but it may not be enough to save the economy

Written by Fabrizio Carmignani, Professor, Griffith Business School, Griffith University

On December 4, Italy will vote on constitutional reform designed by the incumbent government of Prime Minister Matteo Renzi. It aims to change the way government power is organised to make it easier to pass legislation, giving the government greater stability.

Those who oppose the reform argue that these arrangements would seriously limit voters' rights to choose their elected representatives and hence their government.

While polls suggest the result is likely [to be a "no"](#), markets and citizens alike are wondering what the implications of this referendum are going to be.

As is so often the case in today's globalised economy, what a few decades ago would have just been a matter of internal politics could now become an international economic shock.

What the reforms will do

In a nutshell, the proposed constitutional reform consists of two key parts.

One is the reform of regional governments to centralise more responsibilities in the national government. The other is a reform of the legislature.

Italy currently has two houses of government with exactly the same powers. The reform would break this balance of power by strengthening the lower house (*Camera dei Deputati*) and transforming the upper house (*Senato*) into a smaller chamber whose members are appointed by regional councils and assemblies.

In this new framework, the government would only need to obtain a vote of confidence in the lower house. Adding to this, most legislation (apart from constitutional bills and a few other exceptions) would be approved in the lower house and the upper house would only be able to suggest changes.

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Separate from the constitutional reform, but inevitably linked to it, is the project to introduce a new electoral law. This would give the winning party a guaranteed 54% share of representatives in the lower house, even if its actual share of popular votes were significantly smaller.

The purpose of the reform of the houses is twofold.

The first one is to strengthen governability. In the past, it has proven difficult to form and maintain the same majority in both houses, partly because of the heavy fragmentation of the Italian party system. This has resulted in short-lived governments.

In the new system, the government would only need a majority in the lower house, and the mechanics of the electoral law would guarantee the existence of this majority. This would increase stability in the sense of reducing the risk that a government loses a confidence vote in the middle of the legislature.

On the other hand, many argue that a single house elected with a system that artificially assigns a large majority of representatives to a party would not be representative of voters' preferences.

The second purpose of the reform is to reduce the risk of deadlocks in the making of legislation. The two houses have often ended up pushing laws back and forth in the attempt to find a mutually agreeable political compromise.

While this has not necessarily affected the quantity of laws produced, it has affected their quality.

Implications for the economy

The Italian economy faces considerable financial and structural problems.

Italian banks are saddled with bad loans and there's not much room for large-scale bail-out

operations, irrespective of the outcome of the referendum.

General government net debt is estimated [to peak close to 114% of GDP in 2017](#) and the Italian credit rating is already poor (BBB- from Standard and Poor's, Baa2 for Moodys, and BBB+ from Fitch).

The output gap, the difference between actual and potential gross domestic product (GDP), has been negative since [2009](#). This means the economy has been persistently in contraction (or even recession) for the last seven years.

Productivity growth is stagnating, as also shown by sluggish economic growth (0.3% a year since 2000 on average). [Unemployment](#), albeit in mild decline since 2013, remains well above 11%, with sharp geographical and demographic inequalities.

More durable and stable governments and fewer deadlocks in legislation would help in dealing with these challenges.

In the past, short-lived Italian governments have often focused on their immediate survival instead of tackling structural socio-economic problems.

Similarly, because of deadlocks, laws have often been designed to satisfy conflicting party demands rather than to address the core of the issues.

The constitutional reform in itself will not end Italian economic problems. However, it will create a conducive institutional framework to undertake other structural reforms that so many previous governments and parliaments have failed to approve.

What would happen if the reform is rejected

Here is a possible scenario if the result is a “no” to the changes.

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Matteo Renzi resigns and new elections have to be held some time in January or early February.

The uncertainty associated with the government crisis fosters concerns about the sustainability of the Italian debt. This triggers a further downgrade of Italy's credit rating and an increase in sovereign debt yields (thus making it more costly for the government to service its debt).

The resulting market turbulence coupled with capital outflows would hit the already shaky Italian banks, causing some to collapse. The shockwave propagates across the euro zone. Incidentally, the European Central Bank has already said [it would react](#) to any "economic shock" from the vote by easing monetary policy.

This scenario extends to the long term. The failure to approve the constitutional reform would slow down the implementation of other needed economic reforms.

Economic growth would thus continue to stagnate, eventually making debt unsustainable. Italy would then have to default, a condition that would be incompatible with permanence in the euro zone. Italy would then exit the euro and this would mark the end of the common currency.

Italy's exit could be accelerated if the "no" vote opens the way to a new government headed by the Five Star Movement, a fiercely anti-euro party created by comedian [Beppe Grillo](#).

Of course, not everyone would agree with this "end of the world" scenario. According to a recent [Reuters poll](#), several analysts are convinced that the outcome of the referendum will have only modest consequences.

Yet, this is a rare case where no change produces more uncertainty than change. Can the Italian economy handle any more uncertainty? Probably not.

Fabrizio Carmignani receives funding from the Australian Research Council for a project on the

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estimation of the piecewise linear continuous model and its applications in macroeconomics.

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