

The 'no' vote in Italy's referendum triggers economic and political uncertainty

Written by The Conversation

Italian voters have rejected plans for constitutional reform supported by the government of Prime Minister Matteo Renzi. This result means more political and economic uncertainty for the time being.

The aim of the reform was to end Italian's "perfect bicameralism"; that is, the institutional arrangement whereby the house of representatives and senate have exactly the same powers and the government needs to receive a vote of confidence in both Houses. Perfect bicameralism was introduced in the first Republican Constitution, right after the end of Fascism, as a way to prevent the possible rise of a new dictator.

Over time, however, [this system also reduced](#) the efficiency and effectiveness of legislation while also increasing government instability. Matteo Renzi invested his entire political capital in the reform, to the point that the referendum itself was seen as a vote for or against the prime minister. Approximately 60% of Italians voted against the reform (and the prime minister).

Such a large defeat left Renzi with no other option but to announce his resignation, which will become formal on December 5. This opens the doors to a government crisis with uncertain economic consequences.

The political uncertainty

Upon receiving Renzi's resignation, the Italian President Sergio Mattarella will have two options. One is to end the legislature immediately and call for new elections. The other is to set up an interim government and eventually call for new elections if this attempt fails.

Several of the parties that campaigned against the reform are likely to favour immediate elections. The Five Star Movement, Italian's largest opposition party, argued for this in a press conference held right after the announcement of the results of the referendum.

However, this option is complicated by Italy's very confusing electoral law. This law was designed after the Constitutional Court ruled against the electoral law used in the last elections. [Many criticise](#)

the new law because it gives the winning party a guaranteed 54% share of representatives even if its actual share of votes were significantly smaller.

In addition to this, President Mattarella might want to avoid a vacuum of executive power in the aftermath of a referendum that is likely to cause some market turbulence. So it's likely he will look for a candidate who can form a new government rather than calling immediately for new elections.

In this case, Pier Carlo Padoan, the current Minister of the Economy and Finances, would be a possible candidate for the role of prime minister. He could form a new executive with the support of Renzi's Democratic Party and other smaller parties that have supported Renzi's government so far.

Note that in Italy there is no provision for the deputy prime minister to step up in case of resignation of the prime minister.

Silvio Berlusconi's Forza Italia, the leader of Italy's opposition party, might also support the appointment of Padoan in an attempt to gain some time to reorganise in preparation for the elections.

A possible, albeit unlikely, alternative would be a "Grand Coalition" with the Five Star Movement, the Democratic Party and Forza Italia. In this case, the Five Star Movement would probably want to nominate the Prime Minister. This could be either of two eminent jurists who have strongly opposed Renzi and his reform, Gustavo Zagrebelsky and Stefano Rodotà.

In any case, the new government would be short-lived. Its mandate would be limited to completing the budget law for the next fiscal year while the parliament designs a new, more broadly accepted electoral law. Italy would then go to elections in April or May 2017.

The economic uncertainty

The political uncertainty that results from the referendum result is not going to help the fragile

Italian economy.

The banking system in particular requires some immediate attention. A number of large banks are overloaded with bad loans and need some form of re-capitalisation or even bailout. The government crisis will likely reduce the financial and political space for this type of intervention.

At the same time, Italy remains vulnerable to changes in the yield on sovereign debt. With a stock of net debt that is now close to [114% of GDP](#) Italy's ability to serve this debt could be compromised by an increase in the yield, driven by this uncertainty. The repercussion of this financial turbulence would then be felt across the eurozone.

Moreover, the prospect of an electoral win of the Five Star Movement, either now or next year, raises concerns for the stability of the euro. The Five Star Movement is a strong opponent of the common currency. In the past, its representatives have indicated they would call for a popular referendum to decide whether or not Italy should stay in the monetary union. Other parties involved in pushing the "no" vote such as the Northern League, are also typically anti-euro.

Irrespective of whether the elections will take place immediately or next year, the future Italian government is likely to have strong opponents to the euro.

Given these economic scenarios, it is not surprising that the [euro has significantly weakened](#) in the hours following the referendum.

A weaker euro in itself is not necessarily a problem, given that inflation pressures are still subdued in Europe. However, it might mean that markets believe we are today a bit closer to an Italian exit from the euro than we were yesterday.

And if Italy really does exit, then the common currency will not survive, at least not in the shape and form we know today.

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Fabrizio Carmignani receives funding from the Australian Research Council for a project on the estimation of the piecewise linear continuous model and its applications in macroeconomics

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